Q1 2020 Earnings Call

Company Participants

- Carol B. Tome, Chief Financial Officer and Executive Vice President - Corporate Services
- Craig Menear, Chairman, Chief Executive Officer and President
- Isabel Janci, Vice President of Investor Relations and Treasurer
- Mark Holifield, Executive Vice President - Supply Chain & Product Development
- Ted Decker, Executive Vice President of Merchandising
- William Lennie, Executive Vice President - Outside Sales & Service

Other Participants

- Christopher Horvers, Analyst
- Chuck Grom, Analyst
- Elizabeth Suzuki, Analyst
- Michael Lasser, Analyst
- Peter Benedict, Analyst
- Scot Ciccarelli, Analyst
- Seth Sigman, Analyst
- Simeon Gutman, Analyst
- Zachary Fadem, Analyst

Presentation

Operator

Greetings and welcome to the Home Depot First Quarter 2019 Earnings Call. At this time all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. (Operator Instructions) As a reminder, this conference is being recorded. (Operator Instructions).

It is now my pleasure to introduce your host Isabel Janci. Please go ahead.

Isabel Janci {BIO 20990226 <GO>}

Thank you, and good morning everyone. Joining us on our call today are Craig Menear, Chairman, CEO and President; Ted Decker, Executive Vice President of Merchandising; and Carol Tome, Chief Financial Officer and Executive Vice President, Corporate Services. Following our prepared remarks, the call will be opened for questions. Questions will be limited to analysts and investors.

And as a reminder, please limit yourself to one question with one follow-up. If we are unable to get your question during the call, please call our Investor Relations Department at 770-384-2387.

Before I turn the call over to Craig, let me remind you that today's press release and the presentations made by our executives include forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These statements are subject to risks and uncertainties that could cause actual results to differ materially from our expectations and projections. These risks and uncertainties include but are not limited to, the factors identified in the release and in our filings with the Securities and Exchange Commission.

Today's presentation will also include certain non-GAAP measures, reconciliation of these measures is provided on our website.

Now let me turn the call over to Craig.

Craig Menear {BIO 15126612 <GO>}

Thank you, Isabel, and good morning everyone. Before I begin, let me take a moment if you would, personal privilege. As you've read at the end of April, we announced that Carol has decided to retire as our Chief Financial Officer and EVP of Corporate Services, effective August 31. After 24 years of service to the Home Depot. This month in fact marks for 18th anniversary as our CFO, making her one of the longest tenured CFOs in the Fortune 100.

And while I have more to say about Carol's numerous contributions to the Home Depot, as we get closer to her actual retirement. I did want to note on today's call, Carol's extraordinary financial stewardship of our Company. Richard McPhail who will become our CFO in September will indeed have big shoes to fill, and Carol I can't thank you enough for your service to our Company and to our shareholders.

Carol B. Tome {BIO 1907475 <GO>}

Thank you, Craig.

Craig Menear {BIO 15126612 <GO>}

Sales for the first quarter were $26.4 billion, up 5.7% from last year. Comp sales were up 2.5% from last year with U.S. comps of positive 3%. Diluted earnings per share were $2.27 in the first quarter. Our sales performance came in below our expectations in the quarter as a result of two factors. First, the month of February was the second wettest on record for the U.S. Second, lumber prices continue to decline in the quarter, resulting in a negative impact to sales growth of approximately $200 million.

Looking at our results geographically, all of our U.S. divisions posted positive comps. Two of our 19 U.S. regions posted mid-single digit negative comps as they faced difficult compares due to hurricane-related sales a year ago. Internationally, Mexico posted another quarter of positive comps in local currency, while Canada's comps were slightly negative. There is no doubt was a noisy quarter, but when you look through the noise to the core business, we are pleased with the underlying performance. We saw growth in both ticket and transactions in the quarter and 10 of our 14 merchandizing departments posted positive comps.

Ted, will provide additional details around departments that were negative in the quarter as Hurricane comparison price deflation impacted several categories. What I remain excited about is the progress we're making with regards to our strategic investment priorities. These investments enable us to continue to grow share in a highly fragmented $600 billion addressable market. We are making these investments from a position of strength, as the Number 1 retailer in home improvement.

Every investment was formed using the customer back approach to create a truly seamless, frictionless customer experience that will drive results, not just over the next several years but for the long-term. Our strategic efforts to drive an enhanced interconnected customer experience through investments in both the physical and digital worlds are yielding solid returns.

Online traffic growth was healthy, and first quarter online sales grew 23% from the first quarter of 2018. We continue to use our digital platforms to lean into adjacent categories like HD Home, pool and even workwear where the customers told us that we have the right to compete for an additional share of their wallet. For the consumer, we are investing in new category experiences that make it easier for a customer to shop their full project needs online. If a customer is redoing a bathroom and decides on a particular type and finish of faucets, chances are they probably want to see the full suite of matching bath faucets for vanity, shower and tub.

In order to take friction out of this process, we are now rolling the ability to shop a collection using minimal clicks. But we are investing to address the unique demands of the digital customer experience. We know that our customers continue to value the relevancy of our stores, as seen an increased number of customer transactions in the quarter. Additionally, approximately 54% of our online U.S. orders were picked up in our stores during the quarter, a testament to our interconnected strategy.

During the quarter, we continued to make progress, enhancing this interconnected customer experience by investing in our stores, to improve our front-end checkout experience, continuing to roll out automated lockers, streamlining our customer service desk and simplifying tools for our associates. This is translated to reduce wait times and increase customer satisfaction, as our customer service scores and checkout time satisfaction have increased over 500 basis points versus last year.

Not only do these front-end investments have customer service and productivity benefits, they're also helping us to optimize store layouts to maximize merchandising space productivity and high traffic event, in laid out areas. Another key focus area from an investment standpoint is our pro-customer, which once again outpace the DIY customer in the quarter. Pros tell us that they are busier than ever. This is why investing in our portfolio of offerings to help them manage their businesses efficiently and remove friction from their shopping experience, are critical.

Having the brands that Pros care about in-stock with job-like quantities is table stakes. You have to have that, to serve them. But the value proposition that we are creating for the Pro, through various investments over the next several years, as is, as we believe unique to the marketplace. We continue to onboard Pro customers through our new B2B website experience. Adding 35,000 customers in the quarter for a total of 135,000 customers that have been migrated to this experience so far. Our plan is to on-board over 1 million customers by the end of this year.

Though it is early days we are seeing increased engagement, which translates in the increased spend. We also continue to make traction with the investments in other capabilities like Terrell [ph] for example. We know that 90% of Pros, rent tools. But several years ago, only about 1 out of 10 Pros rented from us. Today that number has improved to 1 out of 4. Yet there remains opportunity for further growth as we continue to invest in our tool rental experience.

We know that when Pros rent tools from us, their spend increases. Again the theme here is about driving engagement. The more dimension of the relationship is with our Pro customers, the more they spend. This is a time of transformational change in the business as we execute our One Home Depot strategy. Our team continues to focus on what is most important, our customers. We hired 80,000 new associates for spring and thanks to our new in-aisle mobile training solution pocket guide. They had product knowledge at their fingertips, to help them get up to speed quickly. Our merchants store MET teams, supplier partners and supply chain teams did an outstanding job of delivering value and service to our customers throughout the quarter. I'd like to close by thanking them for their dedication, hard work and commitment to our customers.

And with that, let me turn the call over to Ted.

Ted Decker {BIO 16614891 <GO>}

Thanks, Craig, and good morning everyone. As Craig mentioned, when we worked through the noise of the first quarter, we were pleased with how the business performed. Looking at our departments, constant appliances, indoor garden, core tools, outdoor garden, building materials, plumbing and hardware, were about the Company average. Paint and kitchen and bath were positive, but below the company average, no work in flooring were slightly negative, in large part due to hurricane overlaps.

Our electrical lighting department reported a low-single digit negative comp due primarily to light bulbs. Commodity deflation grow high-single digit negative comps (technical difficulty). In the first quarter, comp average ticket increased 2% and comp transactions increased 5.5%. During the first quarter, we continue to see significant deflationary trends in lumber that began last year. Let me give you an example, the lumber prices peaked last year, we were selling a 4x8 sheet of OSB for approximately $17, and our units were negative.

At the end of the first quarter, the price for that same sheet of OSB had fallen over 58% to about $8. While we have seen nice unit productivities, prices have fallen, we have not overcome the top line headwind from this significant deflation. Without lumber price deflation, our average ticket growth would have been closer to 3%.

During the first quarter, big ticket comp transactions are those over $1,000, which represent approximately 20% of U.S. sales, were up 3.9%, reflecting in part the impact of last year's hurricane-related sales. Excluding hurricane-related markets, big ticket comps were up approximately 5.1%. Wet weather in February, also had a significant impact to our big ticket performance in the quarter. The big ticket comps were flat in the month of February and finally, lumber price deflation also had a negative impact.

We continue to see strong performance in big ticket categories like vinyl plank flooring, water heaters and appliances. And just to comment on appliances, as a result of our supply chain initiatives and working more closely with our partners, we are seeing improved customer satisfaction scores in appliance delivery. During the first quarter, we saw growth with both our Pro and Do-It-Yourself customers. Pros are complex customers. We are investing in a number of different initiatives and services to help our Pros get their jobs done. One of these services is our tool rental business. We have the largest number of tool rental centers in North America with approximately of 1,100 locations inside our conveniently located stores.

As Craig mentioned, we know that approximately 90% of Pros rent tools, and only one in four of our Pros rent tools from us. We also know that when Pros start running tools from us, we see a significant uptick in their overall Home Depot spend. As part of our multi-year investment plan, we are investing in more space, more tools and better technology to improve the customer experience, and continuing to grow this differentiated service offering.

In addition to our Pro investments, we continue to invest across our interconnected platforms. During the first quarter, we had record quarterly online visits that helped drive 23% growth in our online business. As we continue to invest in the online experience and reduce friction, we see higher traffic and improved conversion rates. In addition to enhanced site functionality, we are also expanding certain online assortments.

At our Investor Conference in 2017, we talked to you about HD Home, our expansion in home decor categories. We continue to lean into this category by offering a wide assortment and great values, and we are seeing strong growth. We are also expanding our online assortments in categories like auto, cool workwear, natural extensions to our in-store assortments. We are excited about the growth we are seeing from brands like Weather Guard, Hayward and Carhartt.

Now, let's turn our attention to the second quarter. We are thrilled to announce the launch of the DEWALT ATOMIC 20-volt compact series, exclusive to the Home Depot. These compact tools offer the same 20-volt cordless power as traditional 20-volt tools, in a smaller, more versatile platform. The DEWALT ATOMIC series complements our already successful lineup of compact and sub-compact power tools from Milwaukee and Makita.

The Milwaukee 12-volt program is a favorite for mechanical trades, while the sub-compact Makita 18-volt line up offers the most power and torque in its class. In the big box channel, these DEWALT, Milwaukee and Makita tools can only be found at the Home Depot.

We are excited about new product offerings across all of our categories in our upcoming events. During the second quarter, we will host our Memorial Day, Father's Day, and Fourth of July events, where we will be offering more of great values and special buys for our customers.

With that, I'd like to turn the call over to Carol.

Carol B. Tome {BIO 1907475 <GO>}

Thank you, Ted and good morning everyone. Before we discuss our first quarter results, I want to mention that at the beginning of fiscal 2019, we adopted ASU number 2016-02, which pertains to how we account for leases. The adoption of this standard impacted our balance sheet, but it did not materially impact our income statement or statement of cash flows. Under this new standard, operating lease right of use assets and liabilities are now reflected on our balance sheet.

With that, let's move on to our first quarter results. In the first quarter, total sales were $26.4 billion, a 5.7% increase from last year, versus last year, a stronger U.S. dollar negatively impacted total sales growth by approximately $76 million or 0.3%. Recall that for our first quarter comp calculation, we are comparing weeks one through 13 of fiscal 2019 against weeks two through 14 of fiscal 2018. Our total company comps were positive 2.5% for the quarter with negative comps of 2% in February, positive comps of 5.6% in March, and positive comps of 3.2% in April.

Comps in the U.S. were positive 3% for the quarter, with negative comps of 1.9% in February, positive comps of 6.1% in March, and positive comps of 4% in April. The cadence of our monthly comps was a bit distorted by the Easter shift this year. Adjusting for the timing of Easter, our U.S. comps were 4.5% in March and 5.3% in April. As you heard from Craig, our first quarter sales growth missed our expectations, driven primarily by two notable factors. First, weather had a negative impact on our February performance.

To put the February weather impact in two perspective, 17 of our 19 U.S. regions reported negative comps in February. By the end of the quarter, however, only two regions reported negative comps, and that was due to hurricane related overlaps. Second, versus last year, lumber price deflation hurt our sales growth by approximately $200 million. If you ignore the weather impact of February across our business and lumber price deflation, our total company comp would have been closer to 4.5%.

In the first quarter, our gross margin was 34.2%, a decrease of 36 basis points from last year. The year-over-year change in our gross margin reflects the following factors. First, the change in mix of products sold caused approximately 17 basis points of gross margin contraction. Second, higher shrink than one year ago resulted in 13 basis points of contraction. And finally, higher supply chain and fulfillment expense cost approximately 6 basis points of gross margin contraction.

In the first quarter, operating expense as a percent of sales decreased by 44 basis points to 20.5%. Our operating expense performance reflects the impact of our strategic investment plan and ongoing expense control. Specifically, expenses related to our strategic investment plan of $229 million, reflect a $50 million increase over last year, and approximately 15 basis points of operating expense deleverage. This deleverage was offset by productivity in BAU, or Business As Usual expenses, which drove 59 basis points of operating expense leverage.

Our operating margin for the first quarter was 13.6%, an increase of 8 basis points from last year. Interest and other expense for the first quarter grew by $34 million to $273 million, due primarily to higher long-term debt levels, than one year ago. In the first quarter, our effective tax rate was 24.4% compared to 23.5% in the first quarter of fiscal 2018. Our first quarter tax rate was higher than last year due to certain state tax settlements that did not repeat. For the year, we expect our effective tax rate to be approximately 25.5% in line with our guidance. Our diluted earnings per share for the first quarter was $2.27, an increase of 9.1% from last year.

Now, moving onto some additional highlights, during the quarter we opened two net new stores for an ending store count of 2,289. Selling square footage at the end of the quarter was 238 million square feet. Total sales per square foot for the first quarter were $435, up 5.6% from last year. At the end of the quarter, inventory turns were 4.7 times, down from 4.9 times last year, reflecting growth in inventory to accelerate merchandising resets, as well as an early load-in for spring sales. For the year, we expect our inventory turns to be flat to what we reported in fiscal 2018.

Moving on to capital allocation. In the first quarter, we repurchased $1.25 billion or approximately 6.5 million shares of outstanding stock. Computed on the average of beginning and ending long-term debt and equity for the trailing 12 months, return on invested capital was approximately 45.4%, 940 basis points higher than the first quarter of fiscal 2018.

Turning to the remainder of the year, our view on the U.S. economy and the drivers of home improvement spend are not fundamentally different from what we shared with you back in February. First quarter U.S. GDP growth was strong. Unemployment is the lowest, it has been in nearly six decades and wages are rising. The relevant housing metrics that drive home improvement spending, notably home price appreciation, existing home turnover, household formation and the age of the housing stock continue to be supportive of our outlook.

And as you've heard from Craig, as expected, we are seeing benefit from our strategic investments. The building blocks of our 2019 plan are in place. Nonetheless, two factors have changed, since we put our plan together. First, there was a recent announcements that certain tariffs are increasing to 25%. We are working through the impact of these tariffs, and as a result have not included them in today's guidance. Second, and more immediate, is the significant deflation we are seeing in lumber prices. You'll recall that our sales forecasting model does not include commodity price inflation or deflation.

If lumber prices remain at today's level, this could hamper our fiscal 2019 sales growth plan by as much as $800 million. But because we cannot predict what will happen to lumber prices, and because we are just one quarter into the year. At this point, we are not changing our sales or earnings per share guidance for fiscal 2019. With that in mind, today we are reaffirming the sales and earnings per share growth guidance that we laid out on our fourth quarter earnings call.

Remember that we guide off GAAP, so fiscal 2019 guidance will launch from our reported results for fiscal 2018, which includes sales and earnings associated with the 53rd week. When we report our quarterly comp sales results, we will compare weeks one through 52 in fiscal 2019, against weeks two through 53, in fiscal 2018. For fiscal 2019, we expect comp sales is calculated on a 52-week basis to increase by approximately 5%.

We expect sales to increase by approximately 3.3%, reflecting the compare of 53 weeks last year. For earnings per share, we expect fiscal 2019 diluted earnings per share to grow approximately 3.1% to $10.03. Our earnings per share guidance includes our plan to repurchase approximately $5 billion of outstanding shares during the year.

So we thank you for your participation in today's call, and we are now ready to take questions.

Questions And Answers

Operator

Thank you. We will now begin conducting a question-and-answer session. (Operator Instructions) Our first question comes from the line of Simeon Gutman with Morgan Stanley. Please proceed with your question.

Q - Simeon Gutman {BIO 7528320 <GO>}

Thanks, good morning. Can you hear me?

A - Craig Menear {BIO 15126612 <GO>}

Good morning. Yes.

A - Carol B. Tome {BIO 1907475 <GO>}

Yes, good morning.

Q - Simeon Gutman {BIO 7528320 <GO>}

Okay. Good morning. Sorry about that. Carol, congratulations and good luck. My first question is, I have it's two parts. So don't count this as my follow-up.

A - Carol B. Tome {BIO 1907475 <GO>}

We will.

Q - Simeon Gutman {BIO 7528320 <GO>}

I realized you don't give quarterly guidance. But for this context, I think it's helpful if you can share with us what the internal expectation for Q1 was, and how much it underperformed and I appreciate you made the 4.5% comment ex-weather, ex-lumber. Because, are you making up 50, 100 basis points for the year and I get, it sounds like lumber could end up being around a 70 basis point headwind. And then the second part of that is, if it is mostly weather, do we think about you making most of it up in the second quarter and a little in the third, but we leave the fourth quarter alone?

A - Carol B. Tome {BIO 1907475 <GO>}

Well, thank you for your question, Simeon. As you point out, we normally don't provide our quarterly plan, but I will tell you that our plan for the first quarter of 2019 with a comp of 4.5%. So if you look through the weather noise in February, as well as the lumber deflation, we were very pleased with our results. The other thing that I will remind you all of, is that we are comping this year $800 million of hurricane-related sales, $500 million of those hurricane-related sales took place in the first quarter of last year. So our compares get much easier as we look to the back half of the year.

Q - Simeon Gutman {BIO 7528320 <GO>}

Right. I guess (multiple speakers)

A - Carol B. Tome {BIO 1907475 <GO>}

(multiple speakers) about weather and we'll recover it. This is very different than what we saw a year ago in the first quarter, which was very much in April story that impacted our garden department. The weather in February impacted our business, 17 of 19 regions were negative. The majority of our selling departments were negative. Our transactions were negative 2.5% for the month of February alone.

Our big ticket was flat in the month of February, those sales are coming back as the weather improves. Part of those sales are related to our Pro customer and we understand from our pros, that they have backlogs that are in excess of 90 days. So those sales will come into the second quarter and continue into the third quarter, that's what gives us confidence to reaffirm the guidance of a 5% comp for the year, albeit there is lumber price deflation, and it continues into May, actually. If we look through lumber price deflation, our May results are performing as we expected, but we thought it was important to get that lumber price deflation number out there for you because we can't predict. Too early in the year to know what's going to happen to lumber prices, but we thought we should give you the number.

Q - Simeon Gutman {BIO 7528320 <GO>}

Great, that's helpful. And then maybe just to clarify and this will be the follow up, it -- so you've initially guided the back half, I think it was about 250 basis points stronger than the first half. And you've made the case right hurricane, I think you just said $800 million at least in the first half of this year, and then we have lumber. And so that doesn't I think if we do the math, that doesn't leave as much of a spike as far as other initiatives go, as far as the pickup that's required in the back half. Is that fair and maybe can you just quantify what is outside, what needs to happen from the business to get stronger outside from the lapping of weather and now unfortunately I guess lumber deflation?

A - Carol B. Tome {BIO 1907475 <GO>}

So, just as a point of clarification on the hurricanes, it's $800 million for the year, 500 million in the first half, 300 in the back half. So clearly the hurricane comparison is much easier in the back half. As we look at the shape of the year today, we would expect that the back half comps to be more than 2 times the first half comps, principally because of those hurricane compares, but more importantly, because of the initiatives that we are investing into, one of those initiatives being the B2B website that we've talked to you about. Greg, maybe you want to talk about what we're seeing or Bill, what we're seeing with the B2B website.

A - Craig Menear {BIO 15126612 <GO>}

Yeah, we're actually very pleased. I'll let Bill jump in here, we added 35,000 customers in the quarter and we expect to have 1 million customers up by the end of the year.

A - William Lennie {BIO 15126222 <GO>}

Yeah. Simeon we're migrating customers as new website capabilities come on-board. I'll give you just a few examples of it, the capabilities we added in Q1. We added an administrator and user hierarchy which allows administrators or account owners to add purchasers or users. We also now allow customers to easily link their purchases of QuickBooks and upload their purchase history. Then we also made localization much easier. Our Pro customers shop across multiple cities, multiple stores. This allows them to save their stores they shop and easily localize their purchases.

And then in Q2 next up, we'll enable the Pro purchase card, which is our legacy Interline customer shopping in Home Depot stores, be able to use that Pro purchase card online and they have their purchases attributed back to their account. We'll make it buy it again easier for them, it will be an auto-populated page based on their recent purchase history, both in-store and online. And then we have a redesigned homepage coming up, that's going to be based on our feedback from test and target on 1,500 customers, that just more personalizes that experience, makes it easier for them to transact.

So, it is early days, it's too early to comment on sales lift. But the experience that we're delivering is all about engagement like Craig said. And we know the more that we take friction out of the ability to transact the more customers engage. So, early days, but pleased with the capabilities, pleased with the results we're seeing from the customers that are active.

Q - Simeon Gutman {BIO 7528320 <GO>}

Great. Thank you.

Operator

Our next question comes from the line of Michael Lasser with UBS. Please proceed with your question.

Q - Michael Lasser {BIO 7266130 <GO>}

Good morning, thanks a lot for taking my questions. And Carol congratulations and best wishes. There is -- nice things we can say. Thank you, for everything. With sales coming in below your expectations in 1Q and some of the challenges lingering into 2Q, at what point in the year do you start to see downside risk to the full-year guidance, if sales do not improve? Is that window as soon as June or July or do you think, even if 2Q is softer than you expect you can maintain that full-year 5% comp expectation?

A - Craig Menear {BIO 15126612 <GO>}

Michael, we'll have to see how the second quarter actually plays out, as it relates to lumber. Clearly, when you look at the first quarter, the two big impacts were the situation in February, were really, it was pretty horrible across the country. And then lumber -- and if you think about lumber for a minute, I'll let Ted get into some of the feedback that we're hearing from our suppliers. But lumber has a lot of factors. And when you think about -- we won't know until we see what the environment is and what the storm situation may look like this year. It's predicted to be another potentially active year that could change a lot of things, but we're also hearing some information from our suppliers.

A - Ted Decker {BIO 16614891 <GO>}

Yeah, so on lumber the situation this year is really the exact opposite of last years growth. Last year the mills had a shortage of logs and we had some early housing activities, so lumber prices went to all-time highs. Those peaked at towards the end of May of 2018. This year the mills were able to harvest their logs, they had tremendous amount of inventory on the log decks. And at the same time with the wet February, we have the slowest start to housing. So this would be exact opposite year. And so, prices have fallen in some categories, I said OSB, as much as 50%. So what we're hearing now is, the mills are working through their backlog of logs.

The mills had not been able to curtail earlier in this year, because you've got to process the logs, as it get wet and soggy and start to roll. It worked through a lot of that backlog and we're starting to see some of the first curtailments. But again, it's very early days, we're going to need to see rebound in spring, in housing, construction, that's where lumber prices are set on the margin, in the distributor channel, not the retail channel. Our units are terrific, given our units, we'd be expecting to see lumber prices going up.

A - Carol B. Tome {BIO 1907475 <GO>}

Yes, exactly.

A - Ted Decker {BIO 16614891 <GO>}

But unfortunately the price is set at the margin through the wholesale distribution, which has a lot more to do with housing starts. So as weather clears up, mills curtail logs get worked. There is promise for the back of the year, so that's why again we -- we laid out the risk, but haven't called it.

Q - Michael Lasser {BIO 7266130 <GO>}

Okay. In recognizing and putting aside the lumber deflation and recognizing that your model is heavily influenced by overall GDP growth in the home price appreciation. If you look at any of your sales by category, are any of them showing a correlation to housing turnover? There is evidence that some of your specialty competitors in areas like flooring are exhibiting weakness in a pretty tight correlation to housing turnover. So if you're not seeing that, why do you think that is the case?

A - Craig Menear {BIO 15126612 <GO>}

If we look -- on a continual basis, we look at discretionary categories. And we don't see a direct correlation to any movement in discretionary categories. and matter of fact you think -- look at things like clause or organization, which is purely discretionary, and we feel good about those kind of businesses. There has clearly been a shift in the flooring business to vinyl, which has had some impact on some other categories. But we don't see anything right now, that would indicate the change.

Q - Michael Lasser {BIO 7266130 <GO>}

So Craig, even though housing turnover has been under a considerable amount of pressure over the last several months, it's not having an impact on any real category within your portfolio, despite the fact that in the past it's been a pretty influential driver of the overall business?

A - Carol B. Tome {BIO 1907475 <GO>}

Yes. Michael, you've just written a report on this, which was really helpful, that there is been a disconnect between housing turnover and sales performance. And we went back and try to correlate turnover to our departments, to see if there was any correlation and we couldn't see it. Now, our flooring department was one of our slower growing departments in the quarter, but that isn't correlated to housing turnover. We think we have some opportunities within the mix.

A - Ted Decker {BIO 16614891 <GO>}

Yeah. The dynamic in flooring and these things are trends and trends will reverse themselves. We saw a meaningful shift to hard surface flooring over the past several years, that went into tile, that then went into wood look tile with not rectangular or not square but more rectangular shape. And then in the last couple of years, luxury vinyl plank arrived on the scene.

And it's an incredibly innovative product, because you can put it below sub-floors, it's waterproof, it's unbelievably easy to lay, you don't obviously have to get tile set material, you don't have to level floors, it's so much faster for our Pros. So we've had unbelievable growth in the last three years, and it just continues. That all in is a lower price point, lower all-in basket, because you are not getting sub-materials growth et cetera. It's certainly less expensive for the Pro to lay. So that's part of the mix shift that Carol was talking about. That's not to say that there isn't still plenty of demand for soft surface in tile, in wood and laminate. And we need to do a better job responding on our mix in those categories, as you know, we put a lot of emphasis on the plank and we've got some work to do on mix in the other categories.

Q - Michael Lasser {BIO 7266130 <GO>}

That's very helpful, and Carol, congrats again.

A - Carol B. Tome {BIO 1907475 <GO>}

Thank you.

Operator

Our next question comes from the line of Christopher Horvers with J.P. Morgan. Please proceed with your question.

Q - Christopher Horvers {BIO 7499419 <GO>}

Thanks and good morning. And my congratulations to you as well, Carol. I think you're -- I started following your company in '03 and I think you're the last remaining C-suite person. So, congratulations and obviously just a tremendous career. My question -- my first question is, at the start of the year you mentioned that the first half would be 250 bps below on a comp basis. But the second half -- versus the second half -- on a stack basis relatively flat. You do lap a big May, a year ago on the seasonal shift. Should we think about 2Q on a two-year stack basis? Or do we do a little better considering that, the shift of the Pro that you talked about, out of February into later than year, presumably you had plan, May down given the compare?

A - Carol B. Tome {BIO 1907475 <GO>}

I think the easiest way to think about Q2, is that the comp rate should be higher than what we reported in the first quarter. If the stacking gets a little confusing because of the calendar shift. And if I could change the calendar shift, trust me, I would. Wish I could have done that before because it just confuses that kind of thing, but I would just think that's the easiest way to think about your model.

Q - Christopher Horvers {BIO 7499419 <GO>}

Okay. And do you have a sense of like shifting that two weeks -- two to 14 last year, obviously you flow that through the top line impact, but presumably the compare -- the comparison itself was harder than what you would -- what you reported last year. So is there -- have you been able to quantify or you looked at that in terms of what 1Q would have looked like a year ago, if you had to two to 14 in the comp base -- in the comp calendar?

A - Carol B. Tome {BIO 1907475 <GO>}

Yeah. If we hadn't shifted the calendar, our unshifted comps would have been 5.8%. And I can give that to you by month if you'd like. The unshifted comp for February, 2.6%, for March 5.5%, and for April, 8.1%.

Q - Christopher Horvers {BIO 7499419 <GO>}

Got it. And then as a follow-up on lumber deflation, that obviously impact sales, but do you maintain gross margin? This is margin rate sort of work in the opposite direction such that while you lose sales, our gross profit dollar is roughly the same. So in other words, if there is risk around deflation, it seems like, is that more of a top line risk, but not necessarily a bottom line risk?

A - Carol B. Tome {BIO 1907475 <GO>}

It's a top line risk, because margin is one of our lowest of lumber -- is one of our lowest margin category, a lower penetration of lower margin category is good for the gross margin. So while we called out the risk to the top line if lumber prices stay where they are today, we didn't call any risk to the bottom line, because there really isn't much risk to the bottom line.

Q - Christopher Horvers {BIO 7499419 <GO>}

Understood. Best of luck. Thank you.

A - Carol B. Tome {BIO 1907475 <GO>}

Thank you.

Operator

Our next question comes from the line of Peter Benedict with Baird. Please proceed with your question.

Q - Peter Benedict {BIO 3350921 <GO>}

Hey, guys. Carol, my congratulations as well, it's been great to work with you. So my first question is just looking back into the garden sales category, I think it was called out as being above. I think last year it was 200 plus basis point headwind. Can you maybe give us a sense of just how impactful garden was at least here in the first quarter and shifted or unshifted how we'd like to do it? That's my first question.

A - Ted Decker {BIO 16614891 <GO>}

Well, I would say in garden we've planned for, if there is such a thing, a more normal spring, it turned out, it wasn't as normal as we've liked. But what you saw and when we called out about the company comp, particularly in indoor garden., that was all driven by a consumer response to just fantastic innovative product. And we've talked about product innovation, consumer finding the value in the store, the Pro finding, the tool to help them save time and save money on their jobs. And we have just such terrific product in outdoor power equipment, particularly as worthless technology moves into that space with our new grills, with pellet grills led by Traeger, which is an exclusive to us by far the dominant player in pellet grills, new patio collections. So despite the not so great weather, the customer responded to the product in the values and that's what really drove the business. Live goods for example how has some room to make up, which we're looking forward to in Q2, and that's obviously weather driven and when we get great weather, our live goods are selling double digits and obviously when it's cold and rainy on a weekend, not so much. But really pleased with the garden business, again you wouldn't -- you wouldn't think it would be as strong, given the weather we've been talking about, it's really product and value.

Q - Peter Benedict {BIO 3350921 <GO>}

Okay, that's helpful. Thanks. And then just, I think you called it earlier, something around appliances that the customer service scores were up, I'm just curious if you guys can give us an update of where you guys are in terms of delivery, the DTC delivery capabilities same day, one day and just anything to call out there in terms of progress you're making on being more convenient for your customers? Thank you.

A - Craig Menear {BIO 15126612 <GO>}

Peter, I'll make a comment and I'll turn over to Mark. So 2018 was really the year that we put pilots in place and 2019 moving forward through to 2022 will be the rollout of those. So, Mark, if you want to provide an update?

A - Mark Holifield {BIO 5952851 <GO>}

Sure. Thanks, Craig and good morning, Peter. Yeah, we, first-off, in terms of next day or one day delivery coverage from our Home Depot Pro distribution centers, formerly Interline, we already have coverage today, via privately trucks for all our Home Depot Pro customers in all major metropolitan areas. When you look at parcel shipping capability from our direct fulfillment centers, with second day or faster delivery for over 90% of the population, were at next day for 36% of the population.

We've begun to retrofit our Hagerstown, Maryland direct fulfillment center for further parcel shipping. And because of its proximity to the population centers of the Northeast, that'll get us to the next day delivery, a parcel for 50% of the U.S. population by the end of this quarter. Will further improve our next day delivery capability with our new direct fulfillment centers under development in both Dallas and up in the Pacific Northwest near Seattle.

And then when it comes to stores, we delivered from stores everyday, as well, and we've talked in the past about our delivery partnerships with Deliv and Roadie for crowd sourced delivery via car and van and that's now available to 40% of the U.S. population for car, 70% for van. And what that means for customers is we've got same-day delivery available for orders placed by 2:00 PM and next day after that time. And by the end of Q2, we'll have the same day and next day capabilities for small parcel items from stores, moving from 40% to 50% of the population. So our delivery keeps getting faster and that's very important because our data shows that every time we take time out of the delivery lead time, we increased conversion.

We've got new data tools that are helping us to know what products to stock [ph] where and what delivery options to enable. Those tools can help us with understanding, hey, if we take a day out of power tools versus a day out of power tool accessories, which creates more value to our customers in terms of conversion. And we can tell that, across the departments and classes in the company.

Q - Peter Benedict {BIO 3350921 <GO>}

That's great color. Thanks, Mark, and good luck.

A - Carol B. Tome {BIO 1907475 <GO>}

Thank you.

Operator

Our next question comes from the line of Scot Ciccarelli with RBC. Please proceed with your question.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Good morning guys, Scot Ciccarelli. Actually another delivery question, I appreciate all the color there. But when you look specifically at your pro sales. I'm sure it depends on category, what percent of your pro sales today are delivered to a Pros job site? And then how do you think that evolves as you build out your supply chain and the delivery capabilities, you're just talking about?

A - Craig Menear {BIO 15126612 <GO>}

Yeah, Scott, for competitive reasons obviously, we're not sure the specific data on that, but we believe that delivery is important for the Pro and particular segments of the Pro customers. It's important to be able to get them what they need, when they need it. So they can depend on that service. And that's what we're working to do.

A - Mark Holifield {BIO 5952851 <GO>}

Yeah. And Craig, a little bit more color on that, we are definitely designing our delivery offerings around key Pro use cases. For instance we'll be opening our new flat-bed delivery center out of Dallas later this year. That's really a pro-oriented delivery with the flatbed trucks with the Moffitt on the back able to put it on the job site. Also we've implemented those two and four hour delivery windows that give our Pro reliability in terms of when a delivery will be there, so that they can count on their crews being kept busy by having very timely delivery.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

So let me assess presumably as you build out that capability, more and more people will windup taking advantage of it presumably, that's why you're making it. But what, how should we think about the margin implications as delivery to job site mix growth?

A - Craig Menear {BIO 15126612 <GO>}

It's an all-in calculation that we use obviously. And as you grow with the Pro that actually uses delivery, it gives us an opportunity to much more effectively compete against the distribution houses and the lumber and building material yards that provide the service. And we look at as an all-in cost of operation considering what we get on the trucks and what kind of gross margin dollars that actually provides.

A - Mark Holifield {BIO 5952851 <GO>}

Yeah, Craig. We've managed this as a portfolio, as you said and we have seen that when our Pros engaged with us in delivery they buy more across the portfolio. So it's an important portfolio management tool for us.

A - Ted Decker {BIO 16614891 <GO>}

When you get that blend with the Pro, the overall margin with the Pro on a blended basis is very comparable to the DIY customer.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Got it. All right. Thanks a lot guys.

Operator

Our next question comes from the line of Seth Sigman with Credit Suisse. Please proceed with your question.

Q - Seth Sigman {BIO 17751557 <GO>}

Hey guys, thanks for taking the question and Carol again congrats to you. A couple of points I wanted to follow-up on. First on the deflation, you talked about lumber being an 80 basis point headwind. Can you just give us a sense of the total commodity deflation impact comparable to sort of how you guys have disclosed it in the past? And then the second part of the question is around just sort of broader inflation that you're seeing across the store outside of the commodity categories sort of any trends that you're seeing, what you guys seeing from vendors and how are you trying to sort of manage through that from a retail price perspective? Thanks.

A - Carol B. Tome {BIO 1907475 <GO>}

Sure. If you look at the commodity business excluding lumber, we'd look at building materials and copper and there was actually slight inflation in the quarter, about 30 basis points of growth came from commodity inflation that was offset, obviously by the stronger U.S. dollar, because that was deflating. So it kind of worked its way out. And then in terms of just general inflation across the store...

A - Ted Decker {BIO 16614891 <GO>}

Yeah, I would say that has abated, so we track, working with our finance partners very closely, all request for cost changes from our supplier base, our own costs with our direct import product label, supporting private label products, that has ramped up meaningfully over 2018. And as we went into '19, I wouldn't say it's reversed, that we have tighter way of cost out opportunity. But the pressure has subsided. So this is all putting aside the new tariff, I would say we're in a neutral to slightly positive cost position, even excluding the lumber deflation. On the tariffs, so we increased the Phase 3 tariffs on all products shipped out of China, on from May 10, so nothing has landed yet, think of three odd weeks to cross the Pacific Ocean. So we're looking at the end of this month, the increase on the tariffs of $200 billion of product going from 10% to 25%. For us that's about, call it $1 billion so the tariffs we've already received through 2018. We've said it's manageable and it's of roughly $1 billion impact. Should these new tariffs hold, it would be an incremental $1 billion, so call it less than 1% of our total sales. So it will certainly be more acute in certain categories. But as we repeatedly say we run the businesses of portfolio and 1% in aggregate of sales little harder, but to manage, but still I would call the manageable category.

A - Carol B. Tome {BIO 1907475 <GO>}

So that just the math of it. That's just the math of it, we haven't gone vendor-by-vendor, product-by-product, we actually determine what the actions will be.

A - Craig Menear {BIO 15126612 <GO>}

Yeah, Seth, I would say there is one interesting thing to look at when we talk about the tariffs. So when you look at kind of what happened in laundry, because that's one where it went into play, it was pushed throughout the market and candidly moved forward into retail. In the initial stage of that, we saw no impact for the first several months, then we actually saw negative unit declines come into play. And now we've seen double-digit positive growth in last quarter in laundry. So it's, it will be interesting to see how this all plays through, both in terms of how we can -- we'll work our portfolio approach as Ted said, but then how that actually plays out of the market. So more to come on that.

A - Mark Holifield {BIO 5952851 <GO>}

Yeah, it's a great -- the laundry say it's been completely digested, and it was our strongest comping appliance category. As Craig said, in double digits, and that those tariffs have held and those go up to 50%.

Q - Seth Sigman {BIO 17751557 <GO>}

Okay, great. Thanks everybody for the color. I'll leave it there.

Operator

Our next question comes from the line of Chuck Grom with Gordon Haskett. Please proceed with your question.

Q - Chuck Grom {BIO 3937478 <GO>}

Hey, thanks, good morning and Carol congrats. Just on the macro front here, just wondering how sales are trending in some of the markets where we're starting to see some of the home prices start to slow down or in some cases compressed?

A - Carol B. Tome {BIO 1907475 <GO>}

Now let's take a market like L.A., there is been a lot of conversation about what's happening in home prices in L.A. Our comp in L.A. was considerably ahead of our Company for the first quarter. Let's take a market like New Jersey where people were very concerned about what would happen to sales, given the high -- state. And when we see New Jersey, it's actually outperforming the company average, too. So trust me, we're spending a lot of attention and looking at performance by markets, but we just can't see anything at this point in a negative way, pardon me, we see lots of things in a negative way.

Q - Chuck Grom {BIO 3937478 <GO>}

Okay. Good. I just wanted to see if you guys could clarify on that. And then just on the guide, I know you're keeping the sales and the earnings. Just wondering if you're still comfortable with the 34% gross margin and the -- I believe the 53% expense growth factor and overall operating margin of about 14.4%?

A - Carol B. Tome {BIO 1907475 <GO>}

Yes. Nothing has changed within the top and the bottom line of the P&L guide.

Q - Chuck Grom {BIO 3937478 <GO>}

Okay, great. Congrats again.

A - Carol B. Tome {BIO 1907475 <GO>}

Thank you.

Operator

Our next question comes from the line of Zach Fadem with Wells Fargo. Please proceed with your question.

Q - Zachary Fadem {BIO 18911015 <GO>}

Hey, good morning. First of all, Carol, also Richard congrats. First question from me, on the SG&A line, Q1 had the benefit of the calendar shift on the top line. Curious how that impacted margins here? And as we think about the cadence in the Q2 with the calendar shift reversing, should we anticipate incremental deleverage with comps presumably above total sales, could you just walk us through the moving parts here a little bit?

A - Carol B. Tome {BIO 1907475 <GO>}

Yeah, so first as it relates to the gross margin, the calendar shift doesn't impact the gross margin, because you have 13 weeks of sales against 13 weeks of sales. From an expense perspective, because we do have a difference in our comp rate and our total sales growth rate, it will have a more meaningful impact on our expenses, either as a percent of sales or from an expense growth factor perspective. So we are expecting in the second quarter that our comp will be higher than our sales growth, again, because of the calendar shift. So you would expect our expense growth factor to be higher in the second quarter than it was in the first quarter. Does that make sense? Hopefully, that makes sense for you.

Q - Zachary Fadem {BIO 18911015 <GO>}

Yeah, yeah, that makes sense. Appreciate that. And then second, just to follow-up again on the May 10 tariff, bigger inflation at the 10% level has abated a little bit. But perhaps you could comment on just the elasticity of demand in your categories, based on the data that you have as further price increases look a little bit more inevitable here?

A - Ted Decker {BIO 16614891 <GO>}

You broke up a little, but I think I got that, we look at the elasticity very carefully and that supports when we always say, we take a portfolio approach. We don't necessarily put dollar cost, it received into like dollar increase in retail. That's a super elastic item, we may hold if not even drop price in that category for trying to spur demand and manage the cost increases somewhere else in the portfolio. And yeah, we are very, very robust data and great again support with our finance partners and internal assortment planning and pricing teams that are working all those elasticities by category, by product, by market.

A - Carol B. Tome {BIO 1907475 <GO>}

These are sophisticated tools that we've built up over a number of years, that allows us to have this kind of responsiveness.

A - Ted Decker {BIO 16614891 <GO>}

Yeah, its going on 8 years.

A - Carol B. Tome {BIO 1907475 <GO>}

Yeah.

Q - Zachary Fadem {BIO 18911015 <GO>}

Got it. Appreciate the color.

A - Isabel Janci {BIO 20990226 <GO>}

Christine, we have time for one more question.

Operator

Thank you. Our final question will come from the line of Elizabeth Suzuki with Bank of America Merrill Lynch. Please proceed with your question.

FINAL

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Q - Elizabeth Suzuki {BIO 16142563 <GO>}

Great. Thank you. And maybe this was touched on already and I missed it. But just curious if you could comment on current petition from U.S. tile manufacturers or anti-dumping and countervailing duties against Chinese tile manufacturers. Do you source a meaningful percentage of your tile from China and what's the -- your current strategy as it pertains to duties, tariffs, et cetera on those imported products?

A - Craig Menear {BIO 15126612 <GO>}

We don't have a huge fight in the China tile import, fortunately, we're sourcing largely domestically in Mexico.

Q - Elizabeth Suzuki {BIO 16142563 <GO>}

Great. Thank you. That's helpful.

Operator

Thank you. We have reached the end of the question-and-answer session. I would now like to turn the floor back over to Ms. Janci for closing comments.

A - Isabel Janci {BIO 20990226 <GO>}

Thank you for joining us today. We look forward to speaking with you on our second quarter earnings call in August.

Operator

Ladies and gentlemen, this concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.
