Q2 2017 Earnings Call

Company Participants

- Bill Lennie, Executive Vice President-Outside Sales & Services
- Carol B. Tomé, Chief Financial Officer & Executive Vice President-Corporate Services
- Craig A. Menear, Chairman, President, Chief Executive Officer, Director
- Diane Dayhoff, Vice President-Investor Relations
- Edward P. Decker, Executive Vice President-Merchandising
- Mark Holifield, Executive Vice President-Supply Chain & Product Development

Other Participants

- Alan Rifkin, Analyst
- Brian Nagel, Analyst
- Christopher Horvers, Analyst
- Daniel Thomas Binder, Analyst
- Dennis Patrick McGill, Analyst
- Kate McShane, Analyst
- Keith Hughes, Analyst
- Matthew J. Fassler, Analyst
- Matthew McClintock, Analyst
- Michael Louis Lasser, Analyst
- Peter S. Benedict, Analyst
- Scot Ciccarelli, Analyst
- Scott A. Mushkin, Analyst
- Seth M. Basham, Analyst
- Simeon Ari Gutman, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good day, everyone, and welcome to The Home Depot Q2 2017 Earnings Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Ms. Diane Dayhoff, Vice President, Investor Relations. Diane, please go ahead.

Diane Dayhoff {BIO 15757035 <GO>}

Thank you, Debbie, and good morning to everyone. Joining us on our call today are Craig Menear, Chairman, CEO and President; Ted Decker, EVP of Merchandising; and Carol Tomé, Chief Financial Officer and Executive Vice President, Corporate Services.

Following our prepared remarks, the call will be open for analysts' questions. Questions will be limited to analysts and investors and as a reminder, we would appreciate it if the participants would limit themselves to one question with one follow up, please. If we are unable to get to your question during the call, please call our Investor Relations Department at 770-384-2387.

Now 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 presentations 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 A. Menear {BIO 15126612 <GO>}

Thank you, Diane, and good morning, everyone. We had strong quarter, achieving a milestone of the highest quarterly sales and net earnings results in the company history. Sales for the second quarter were $28.1 billion, up 6.2% from last year. Comp sales were up 6.3% from last year, and our U.S. stores had a positive comp of 6.6%. Diluted earnings per share were $2.25 in the second quarter, up 14.2% versus last year.

We continue to see broad based growth across the store and all geographies. In the U.S., all three of our divisions posted positive comps in the second quarter, as did all of our 19 regions and top 40 markets. Internationally, both Mexico and Canada posted another quarter of positive comps in local currency.

Our solid performance was driven by the outstanding execution of our store and merchant teams delivering value and service for our customers across multiple event, both in-store and online. As Ted will detail, both ticket and transactions grew in the quarter and all of our merchandising departments posted positive comps. We saw a healthy balance of growth from both our Pro and DIY categories, with Pro sales once again outpacing DIY sales in the quarter.

We believe that the work that we are doing to enhance the service capabilities for the unique needs of our Pro customers continues to resonate. We are focused on being a valued partner for our Pros by offering solutions both in store and at the jobsite that help them to more effectively manage their business. This includes enhancing our leadership position in tool rental. During the quarter, we closed on the acquisition of Compact Power Equipment, a leading national provider of equipment rental and maintenance services.

Compact Power has provided larger jobsite equipment rentals at more than 1,000 Home Depot stores since 2009. The acquisition is yet another investment to enhance our portfolio of service offerings for our Pro, and though we have worked closely with the Compact Power team for many years, we are delighted to officially welcome them to The Home Depot family.

Our investment in Interline and the MRO customer is another avenue to better serve the needs of our Pros. Use case one, the rollout of Interline's catalog of products to Home Depot stores is now implemented and we are pleased with the early results. We also continue to rollout use case two, which enables Interline customers to shop Home Depot stores using a swipe card linked to their Interline account. Though it is early days, we are seeing an incremental sales lift from accounts who have been given the swipe card.

Our deeper level of engagement with the Interline customers has helped to drive sales growth that outpaced the company average in the quarter, and we remain very excited about the MRO opportunity going forward.

Another growth engine for our businesses is our focus on interconnected retail. Our dot-com business represented 6.4% of sales and grew approximately 23% in the quarter. Our digital team continues to invest in content, site improvement and better mobile experiences to take the friction out of the interconnected experience online, while our operations team remains focused on improving the interconnected experience in-store. The result of these combined efforts is continued improvement in sales and customer satisfaction scores across both platforms. This is the power of interconnected retail.

As you know, we look at productivity as a virtuous cycle here at The Home Depot, and our efforts to connect our business end to end continue to pay dividends that enable us to reinvest in the customer experience. We are pleased with the productivity in the business during the quarter as the end to end initiatives to improve freight handling in the store continue to drive labor efficiency and optimize product flow from truck to shelf.

Beyond the four walls of our stores, we continue to drive productivity throughout our value chain with initiatives like Supply Chain Sync. Sync is live in all of our RDCs, but as you know, this is a multiyear, multiphase endeavor as we work to onboard each of our suppliers' flowing product through our RDCs. We continue to see great productivity from our supply chain as our investment over the past several years is having a positive impact on logistics costs, inventory productivity and service to our stores and customers.

Turning to the macro environment, we continue to see positive signs in the housing data which we believe serve as a tailwind for our business. As Carol will detail, because of our outperformance in the first half versus our plan, we are increasing our sales and earnings per share guidance for the year. We now expect fiscal 2017 sales growth of approximately 5.3% and diluted earnings per share of $7.29.

The success of our spring selling season is the direct result of our 400,000-plus associates and their passion for our customers that extend well beyond serving them in our aisles. For example, this year we celebrated the 20th anniversary of Home Depot's in-store kids workshops. Held in our stores on the first Saturday of every month, these workshops have become a source of empowerment, accomplishment and pride for millions of children and their families. We like to think that we're fostering the next generation of do-it-yourselfers with some of the most enthusiastic participants over the years, even trading in their mini aprons for larger ones by becoming associates in our stores themselves.

I want to close by thanking all of our associates for their hard work and continued dedication to our customers as they once again successfully navigated the increased demands associated with our busiest selling season. Based on the first half results, approximately 99% of our stores qualified for Success Sharing, our profit-sharing program for our hourly associates. We are very proud of their efforts.

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

Edward P. Decker {BIO 16614891 <GO>}

Thanks, Craig, and good morning everyone. We had a great second quarter driven by strength with both our Pro and do-it-yourself customers. In addition, our online business continued its momentum as online sales grew approximately 23% versus last year. We saw a broad-based growth across the store as all of our merchandising departments posted positive comps. Lumber, electrical, tools and flooring had double-digit comps in the quarter. Building materials, appliances, indoor garden and decor were above the company average. Plumbing, millwork, kitchen and bath, outdoor garden, hardware, paint and lighting were positive but below the company average.

In the second quarter, total comp transactions grew by 2.6% and comp average ticket increased 3.6%. Commodity price inflation in lumber, building materials and copper positively impacted average ticket growth by approximately 68 basis points. During the quarter, we held a Memorial Day, Father's Day, and Red, White and Blue events. These events drove excitement in our stores for both customers and associates, and we were very pleased with the results.

Looking at big ticket sales in the second quarter, transactions over $900 which represent approximately 22% of our U.S. sales, were up 12.4%. A few drivers behind the increase in big ticket purchases were appliances, flooring and certain Pro-heavy categories. Transactions for tickets under $50, which now make up approximately 16% of our U.S. sales, grew by 1.5% in the quarter, reflecting among other things the return of our outdoor garden business in certain parts of the country.

In the second quarter, Pro sales outpaced the company average, driven by both our high-spend and low-spend Pros. We saw strong comps across several lumber and building material categories, as well as categories like pipe and fittings, power tools and wire. Sales to our DIY customers also showed strength in the quarter with flooring, storage and organization, and patio, all outperforming the company average comp.

We strive to balance the art and science of retail as part of our core merchandising strategy. For example, we are using data to help our merchandising execution team, or

MET, execute more effectively. MET services the base in our stores with primary responsibility for planogram integrity and shelf presentation.

Currently, each base service is based on overall store volume. We're initiating unique service rotations based on category-specific sales and transactions. MET associates will receive individualized and optimized work assignments through their FIRST phones. This allows for the most efficient use of tasking ours and focuses base service where customers shop most. Looking ahead, we will continue to build capabilities and invest in people, process and technology in order to leverage our data to better serve our customers.

Now, let me turn our attention to the third quarter. We strive to be the product authority in home improvement by providing our customers with the best brands at the best value. Our assortment includes many exclusive brands, and we are excited to be expanding our launch of PPG branded products, a brand that has been trusted by Pros for over 100 years. This quarter, we are introducing PPG TIMELESS paint. This new product guarantees one coat coverage and is available in both interior and exterior paint. PPG's world-class coating technology improves durability, saving our customers time and money.

Product innovation is also at the forefront of our retail strategy. Flooring, both hard and soft, has been an excellent growth driver for our business this year and we continue to see great innovation within the category. New to our assortment is an improved vinyl plank flooring from LifeProof. This innovative product features a highly-engineered, closed-cell foamed PVC core that delivers rigidity and strength, yet is lightweight and easy to handle and install. It is also 100% waterproof and scratch resistant, and is available in over 40 patterns. This new LifeProof vinyl flooring is exclusive to The Home Depot.

We're excited about our upcoming Labor Day, Fall Cleanup and Halloween, Harvest events in the third quarter. As always, we will be offering a variety of special buys and values throughout the store and online to help kickoff the fall season.

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

Carol B. Tomé

Thank you, Ted, and good morning, everyone. In the second quarter, sales were $28.1 billion, a 6.2% increase from last year. Our total company comps or same-store sales were positive 6.3% for the quarter, with positive comps up 5.8% in May, 5.9% in June and 7.2% in July. Comps for U.S. stores were positive 6.6% for the quarter, with positive comps of 6.6% in May, 6.2% in June and 7% in July. Versus last year, a stronger U.S. dollar negatively impacted total sales growth by approximately $64 million or 0.2%.

In the second quarter, our gross margin was 33.7%, a decline of 6 basis points from last year. The year-over-year change in our gross margin is explained largely by the following factors. First, we had 9 basis points of gross margin expansion in our supply chain, driven primarily by increased productivity. Second, we had approximately 8 basis points of gross margin contraction due to a change in the mix of products sold. And finally, we had 7 basis points of gross margin contraction due to higher strength than one year ago.

In the second quarter, operating expense as a percent of sales decreased by 44 basis points to 17.8%. In the quarter, our expenses were $20 million over our plan, due primarily to a true-up of our bonus accrual. Even so, our operating expenses as a percent of sales were better than our plan due to our strong sales performance.

One last comment on expenses. As we told you last quarter, we expect our expense growth factor to vary by quarter giving year-over-year comparisons and the timing of investments. Looking ahead, we expect our expense growth factor to be lower in the back half of the year than it was in the first half.

Our operating margin for the second quarter was 15.9%, an increase of 38 basis points from last year. Interest and other expense for the second quarter grew by $21 million to $249 million, chiefly due to the impact of adding $4 billion to our outstanding long-term debt over the past year.

In the second quarter, our effective tax rate was 36.6% compared to 37% in the second quarter of fiscal 2016, reflecting the benefit of a new stock compensation accounting standard that we adopted at the beginning of the year. Our diluted earnings per share for the second quarter were $2.25, an increase of 14.2% from last year.

Moving on to some additional highlights, in the first six months of the year we opened four new stores, including three in the U.S. and one in Mexico. We have not opened a new store in the United States since 2013. Our New York stores still open void, and we are pleased with their initial sales performance. Total sales per square foot for the second quarter were $464, up 5.9% from last year.

Turning to the balance sheet. At the end of the quarter, merchandise inventories were $12.9 billion, up $545 million from last year, and inventory turn were 5.3 times, up one-tenth from last year. In the second quarter, we repurchased $2.6 billion, or approximately 17.3 million shares of outstanding stock, bringing our year-to-date share repurchases to approximately $3.9 billion.

Additionally, during the quarter, we took advantage of an attractive interest rate environment and raised $2 billion of incremental long-term debt. We will use the proceeds of this debt issuance to repurchase outstanding shares, increasing our 2017 share repurchase target from what had been $5 billion to now $7 billion.

Computed on the average of beginning and ending long-term debt and equity for the trailing 12 months, return on invested capital was approximately 32%, 300 basis points higher than the second quarter of fiscal 2016. Year-to-date, our sales and earnings per share have exceeded our expectations.

Turning to our outlook for the remainder of the year, we expect to see continued growth in the repair and remodel market as the U.S. has experienced solid wage growth, faster home price appreciation and the reemergence of first-time homebuyer. As a result, we are lifting our fiscal 2017 sales and earnings per share growth guidance to reflect our first half performance and are confident in the back half of the year.

In addition, as Craig mentioned, we recently completed the acquisition of Compact Power Equipment and are excited to welcome the Compact Power team to The Home Depot family. As we look to the back half of the year, Compact Power will not have a material impact to our sales or earnings per share forecast, but it will slightly affect our gross margins and expense structure.

We now expect fiscal 2017 sales to increase by approximately 5.3% with positive comps of 5.5%. While this suggests our second half comps will be slightly lower than our first half comps, our sales guidance is based on our planned foreign exchange rates for the back half of the year. Given the recent performance of the U.S. dollar, there could be some upside to our sales forecast.

At the beginning of the year, we expected our fiscal 2017 gross margin to decline by 15 basis points from what we reported in fiscal 2016. Reflecting the impact of Compact Power, we now expect our fiscal 2017 gross margin to decline by approximately 10 basis points.

For the year, also reflecting the impact of Compact Power, we now expect our expenses to grow at approximately 46% of the rate of our sales growth. Finally, for the year, we expect our effective tax rate to be approximately 36.3%. For earnings per share, remember that we guide off of GAAP. For fiscal 2017, we now expect diluted earnings per share to increase by approximately 13% to $7.29. Our updated earnings per share guidance reflects the points I just mentioned, as well as $7 billion of share repurchases for the year.

So we thank you for your participation in today's call. And, Debbie, we are now ready for questions.

Q&A

Operator

Thank you. We'll go first today with to Simeon Gutman with Morgan Stanley.

Q - Simeon Ari Gutman {BIO 7528320 <GO>}

Thanks. Good morning. Quick question, I guess, on the recovery. The longer the recovery persists, it's just natural, it seems like the market is getting some angst, that there is eventually going to be a shoe to drop. How do you get comfortable with the tenor of the recovery? Clearly the business is performing great, and if there are yellow flags, how do you know what you're you looking for?

A - Craig A. Menear {BIO 15126612 <GO>}

I mean, I'd say, Simeon, that we've had obviously a protracted recovery here, and it has been clearly driven from housing, which has been a steady but slow recovery in the market. We continually look at months of supply, there's 4.3 months of supply in the market of housing availability against the historical norm of six. That clearly is helping to drive improvement in home value appreciation.

But housing starts haven't returned to their norm yet, either. The only thing that is kind of running at historical averages is housing turnover. So we see this housing favorability continuing as we look forward. And I think the watch out for us is you wouldn't want to see affordability become an issue, but that, at this point, doesn't seem to be a concern for us at all.

A - Carol B. Tomé

Right. As we look at the affordable index, it stands at 153%. So long ways to go before that would be a watch out for us. And recovery is a difficult thing to put your arms around, but if you look at simply PFRI dollars, they've only recovered 70% of the loss. So if you put that into baseball terms, I guess that's about the sixth inning.

The other thing that's really interesting to us is the age of the housing stock. We've talked to you a lot about 66% of the housing stock being older than 30 years. Well did you know that 51% of the housing stock is older than 40? And as houses age, well they need more repair.

A - Edward P. Decker {BIO 16614891 <GO>}

It's more to spend.

Q - Simeon Ari Gutman {BIO 7528320 <GO>}

Okay. That's helpful. My follow up is on e-commerce, and I'm sure this will be topical. I just want ask one angle of it. So in using the power tool category as an analog for how to think of appliances, the pushback that we've been getting is that, look, Home Depot has done a great job on power tools, but they have a lot of exclusive brands and labels which is different than appliances. And ultimately, appliances will be harder to control given some of the large national brands. Can you share some thoughts on that comment?

A - Craig A. Menear {BIO 15126612 <GO>}

Look. What I would say is we have a lot of categories of goods in our stores, over 200-plus categories of goods, and we compete with lots of folks across all of those categories. And candidly, by category the strategy is different because the categories are different. And so our job is to create the strategies that allow us to be the customers' advocate for value across the categories and compete accordingly, and it varies by category what our approach is.

Operator

We'll go next to Michael Lasser with UBS.

Q - Michael Louis Lasser {BIO 7266130 <GO>}

Good morning. Thanks a lot for taking my question. I have two questions on market share. First, it looks like your total sales increased slightly less than the category according to the Census Bureau, so where do you think you might have lost some share to during the quarter? And then I have a follow-up on that.

A - Craig A. Menear {BIO 15126612 <GO>}

Actually, based on the NAICS 441, it actually looks that we gained share in the quarter. We don't believe we lost share the quarter.

A - Carol B. Tomé

No. We're up 20 basis points.

A - Craig A. Menear {BIO 15126612 <GO>}

Yeah, 20 basis points year-over-year.

Q - Michael Louis Lasser {BIO 7266130 <GO>}

So do you think other...

A - Edward P. Decker {BIO 16614891 <GO>}

20 bps to $28.12 billion.

A - Craig A. Menear {BIO 15126612 <GO>}

Right.

Q - Michael Louis Lasser {BIO 7266130 <GO>}

Okay. And then the second part of the question is on e-commerce. The e-commerce channel within home improvement overall, do you think that you're gaining share within that channel, within the category? And what rate of growth do you think the home improvement category is growing online?

A - Craig A. Menear {BIO 15126612 <GO>}

We actually have an interconnected retail approach, and our customers are blending the physical and the digital world together. And we look at share in totality as it relates to Home Depot's gain in the market against what the market is growing.

A - Carol B. Tomé

And we're pleased with the share gains. It's important to remember that over 43% of our online transactions are picked up inside of a store. This is one Home Depot, not an online or in-store business, but it's one Home Depot.

Q - Michael Louis Lasser {BIO 7266130 <GO>}

Okay. Thank you very much.

Operator

We'll go next to Dan Binder with Jefferies.

Q - Daniel Thomas Binder {BIO 1749900 <GO>}

Thank you. As you just mentioned, different strategies for different categories online. Obviously appliances have been in the news recently. I know you do some of your appliance business online. I was wondering if you could just talk a little bit about the complexity of that transaction, how the customer is shopping it in the store, even if they're ordering it online? And where you think your competitive advantages are if you started to see that category become more available online at other competitors?

A - Craig A. Menear {BIO 15126612 <GO>}

Dan, look, if you look at the interconnected experience, candidly for appliances, there are lots of other categories. In many, many categories, the shopping experience starts in the digital world even though it might finish in the physical world, or in some cases actually finish in the digital world as well.

It is truly a blended experience today where the customer at the front door of our store is no longer at the front door of our physical store for many, many product categories. The customer starts digitally looking at product, doing research, and then in many cases, particularly in large ticket, they come in and they actually want to talk to one of our associates before they make a purchase. But we clearly – in big ticket categories, we sell both in the physical and the digital world.

Q - Daniel Thomas Binder {BIO 1749900 <GO>}

And then if I could just ask one other question related to delivery, can you give us an update on how many of the stores are able to deliver to the Pro within two hours now?

A - Craig A. Menear {BIO 15126612 <GO>}

Yeah. We've actually rolled out the delivery program at the end of fiscal 2016. Mark Holifield is here. I'll let Mark.

A - Mark Holifield {BIO 5952851 <GO>}

Yes. Hey, Dan. Our Buy Online, Deliver From Store and our deliver from store capabilities were fully rolled out at the end of last year, and we offer the two and four-hour window options at all of them at this point.

A - Carol B. Tomé

And, Mark, it's true we've seen sequential growth in our delivery business every week in the quarter. So our customers are responding very well to this offer.

A - Mark Holifield {BIO 5952851 <GO>}

Very healthy growth.

Q - Daniel Thomas Binder {BIO 1749900 <GO>}

Great. Thanks.

Operator

We'll take our next question from Christopher Horvers with JPMorgan.

Q - Christopher Horvers {BIO 7499419 <GO>}

Thanks. Good morning. Can you talk about – Carol, last quarter, you talked about Pro being up 2 times DIY. Did that trend continue? And can you talk about the growth that you're seeing in the Pro versus DIY? What does that make you all think about what's going on in the market now and in terms of the duration of the growth going forward?

A - Carol B. Tomé

Sure. So, yes. Our Pros grew twice as fast than the DIY. It actually expanded that gap a bit in the second quarter. And, Chris, I can recall talking to you last August about our sales and our Pros going out on vacation. Well, based on what we're seeing in the stores today, our Pros are not on vacation. The stores are busy and our sales are quite good.

Q - Christopher Horvers {BIO 7499419 <GO>}

Nice. And then, I think one of the questions that was asked on our last visit I thought it was really interesting and wanted to put out there, you have companies like Wayfair spending a lot on advertising, and Amazon's reported to be more interested in the category. So, obviously, as you saw these companies get rewarded with sales growth and not necessarily profitability, clear in Amazon's last report. So, do you think that given this increased interest in greater advertising spend, do you need to flex some muscles here and maybe deleverage advertising a little bit to defend The Home Depot brand in the home-related categories?

A - Craig A. Menear {BIO 15126612 <GO>}

Chris, I'd say, one of the things I'm very proud of the team, they have worked really hard over the past several years to drive dramatic improvement in terms of the effectiveness of our marketing dollars to reach a customer in a space where they have a high level of interest. So, we have been on a path to balance our approach in terms of marketing, both in traditional media and in digital media, and the team has been able to drive incredibly effective returns on our marketing spend.

A - Carol B. Tomé

We spent more on digital in the second quarter than we did TV and radio combined. So the team's doing an awesome job of getting more eyeballs, higher return on that spend.

A - Edward P. Decker {BIO 16614891 <GO>}

Yeah. Our overall advertising spend is up lower-single digits. But as we've essentially made a more significant pivot to digital marketing, it's over half our marketing right now, that's a medium that you can get good insight on the return on your spend. And as Craig said, the team's just done a great job continuing to increase the return on that spend, so leveraging that low-single digit to a much more productive return on overall ad spend.

Q - Christopher Horvers {BIO 7499419 <GO>}

All right. I'm sure you do a lot of key search terms and so forth there. Is that becoming more expensive to you as Wayfair and Amazon focus more on the category?

A - Craig A. Menear {BIO 15126612 <GO>}

I mean it varies by category by day, candidly.

Q - Christopher Horvers {BIO 7499419 <GO>}

Understood. Thanks very much.

A - Craig A. Menear {BIO 15126612 <GO>}

Yes.

Operator

We'll go next to Brian Nagel with Oppenheimer.

Q - Brian Nagel {BIO 6638066 <GO>}

Hi. Good morning.

A - Craig A. Menear {BIO 15126612 <GO>}

Morning.

Q - Brian Nagel {BIO 6638066 <GO>}

Nice quarter.

A - Craig A. Menear {BIO 15126612 <GO>}

Thank you.

Q - Brian Nagel {BIO 6638066 <GO>}

So my first question, I guess, just follow-up on some of the other e-commerce type questions, but maybe to what exactly Chris was saying just a minute ago. The other e-tailers or online omnichannels, if it meet – at least indicates some interest gain in this category But from your vantage point, are you seeing anything suggest that anyone's coming out with a much, much more price-aggressive effort, and one that you would have to match or you're choosing to match?

A - Craig A. Menear {BIO 15126612 <GO>}

I mean, Brian, we've invested, obviously, in tools and capabilities to inform our merchants in terms of the overall competitive position in the marketplace, both in the digital and the physical world. And this, quite candidly, has been something that the company has been focused on since its inception in terms of making sure that we're driving value. Core belief that I have is as merchants, we are the customers' advocate for value, period. And that's the job of The Home Depot and The Home Depot merchandising team every single day. So we must stay focused on a competitive offering. And quite candidly, value is defined by what the customer is willing to pay for.

Q - Brian Nagel {BIO 6638066 <GO>}

Got it. Okay. My follow-up question, I mean, shifting gears a bit, flooring. I think you called that out as another bright spot. Again, from a competitive standpoint, there's other companies now that are pushing into the flooring from a specialty perspective. Overall, what are you seeing as far as – I guess how would you characterize the consumer demand of the category? And then, are you seeing anything from stepped up competitions you've had to react to?

A - Edward P. Decker {BIO 16614891 <GO>}

No, as Craig said, it's a great point. We competed over 220 categories, flooring is a very big category. And there are actually a lot of competitors have been and will be. We see consumer demand very strong and the consumer is responding to The Home Depot value proposition. So we have innovative product. We have exclusive product. We have new technology and exclusive launches at The Home Depot. And we've worked very hard on our in-store selling model and Ann and her team are just doing a great job communicating that value to the customer in both our hard and soft flooring, and they're both doing extremely well, as I called out, double-digit comps for the category.

Q - Brian Nagel {BIO 6638066 <GO>}

Thank you. Congrats again.

A - Craig A. Menear {BIO 15126612 <GO>}

Thanks.

Operator

We'll go next to Kate McShane with Citi Research.

Q - Kate McShane {BIO 7542899 <GO>}

Good morning. Thanks for taking my question.

A - Craig A. Menear {BIO 15126612 <GO>}

Morning.

Q - Kate McShane {BIO 7542899 <GO>}

I was curious about your comment with regard to the reemergence of the first-time homebuyers. Is this the first time you're seeing this? And if this were emerging, would this be enough to offset any slowing of price appreciation if there were to occur?

A - Carol B. Tomé

Well, it's really interesting to see what happens with the first-time homebuyers in the second quarter. The highest number of first-time homebuyers since 2005, about 424,000 first-time homebuyers making up 38% of all homebuyers and up 11% year on year. So that's good news. Why? Because first-time homebuyers tend to buy homes that need repair and remodel. So as we see and we anticipated this happening, with millennials coming into of age where they start to form families, children, or pets, or whatever their family unit might look like, they're moving into homes which bodes very well for us, and to your point, it extends the recovery.

Q - Kate McShane {BIO 7542899 <GO>}

That's great. Thank you. And then, Ted had mentioned that the three events you conducted during the quarter. Just wondered if that differed in any way versus last year and does that help explain some the acceleration into July?

A - Edward P. Decker {BIO 16614891 <GO>}

They were similar events in duration as last year, Kate.

Q - Kate McShane {BIO 7542899 <GO>}

Thank you.

Operator

We'll go next to Matt Fassler with Goldman Sachs.

Q - Matthew J. Fassler {BIO 1509751 <GO>}

Thanks a lot and good morning.

A - Craig A. Menear {BIO 15126612 <GO>}

Good morning.

Q - Matthew J. Fassler {BIO 1509751 <GO>}

My question relates to your discussion of sales trends by ticket. Can you just remind us whether that's store-only or whether that's inclusive of online? And then, I have a quick follow-up.

A - Craig A. Menear {BIO 15126612 <GO>}

Yeah, it's all in.

A - Carol B. Tomé

It's all in.

Q - Matthew J. Fassler {BIO 1509751 <GO>}

I guess, is there anything about the way consumers are shopping based on project or basket that would change the composition of that sales performance by ticket, just thinking about the outsized – extended outsized growth of the big ticket piece and the fact that the smaller ticket piece has been growing at a slower rate for kind of equally consistent period of time?

A - Craig A. Menear {BIO 15126612 <GO>}

The biggest driver behind that has been the recovery of our Pro customer and the growth that we've had in categories like appliances and flooring. Those are big ticket purchases in and of themselves. So appliances is clearly much larger than our average ticket. A flooring job is significantly larger than our average ticket. And our Pro customer spends dramatically more than the average DIY customer.

So, those have clearly helped to drive the growth in tickets above $900. And then we did see the recovery in the smaller ticket, Matt, as a result of the garden business coming back to a more normal state in the second quarter.

Q - Matthew J. Fassler {BIO 1509751 <GO>}

Great. Thank you so much, guys.

A - Craig A. Menear {BIO 15126612 <GO>}

Yes.

Operator

We'll go next to Dennis McGill with Zelmen & Associates.

Q - Dennis Patrick McGill {BIO 6299739 <GO>}

Hi. Good morning. Thanks.

A - Craig A. Menear {BIO 15126612 <GO>}

Good morning.

Q - Dennis Patrick McGill {BIO 6299739 <GO>}

One more question just going back to appliances online, I think you said 6% of sales are online now for the total store. Can you just maybe frame appliances relative to that number and just give a little bit more detail on how you mentioned, Craig, the buying experience in some cases starting digitally and ending digitally. What percentage of those big ticket transactions in appliances are executed online? Just to kind of give some frame a reference to the categories as a whole already being an online category.

A - Craig A. Menear {BIO 15126612 <GO>}

We don't break that data out. For competitive reasons, we would not share that data. Thanks.

Q - Dennis Patrick McGill {BIO 6299739 <GO>}

Okay. I won't count that as my question then. So my first question is – we'll shift to not online. When you look at outdoor garden, I guess, for the first half of the year it's a below-average category. So I guess with the weather comps year to year, it didn't really get the typical bathtub effect. Carol, when you look at the back half of the year, do you expect that some of that could come back? And the full year would balance out? Or is that lost demand at this point?

A - Carol B. Tomé

Some of the softness is relative because the category grew, soils and mulch. And Ted, I wouldn't think we'd get much of that back.

A - Edward P. Decker {BIO 16614891 <GO>}

No. I think some of the uptick we saw in July was that extended season. All in, it was a reasonably good season. I wouldn't say great, certainly colder and wetter early, and it was really wet into June. So some late garden, but I think we've seen that, and it just isn't that big until you get into fall. And then hopefully you'll get a seed season and some planting season.

Q - Dennis Patrick McGill {BIO 6299739 <GO>}

Okay. And then second question, just as it relates to inventory, Carol. How would you characterize inventory in the channel today when you adjust for same-store and the acquisitions and so worth as far as what a supplier might be facing with projects and so forth? Is there less inventory throughout the channel today? And if so, can you quantify that in any way?

A - Carol B. Tomé

We're growing inventory to support our self. We also want to drive productivity, as Craig called out in his remarks, and so we're always going to look to improve the velocity of our inventory turn. But my goodness gracious, as Craig always says, customer service starts with in stock. You've got to have what the customers want, and certainly we will do that working with our supplier partners.

Q - Dennis Patrick McGill {BIO 6299739 <GO>}

So the inventory turns that you had framed earlier being up little bit, is that a same-store representation?

A - Carol B. Tomé

That is a one Home Depot representation. It includes inventory in our stores and in our distribution centers.

A - Craig A. Menear {BIO 15126612 <GO>}

Yes. I mean total inventory is up $545 million in the quarter.

Q - Dennis Patrick McGill {BIO 6299739 <GO>}

Okay. Very good. Thank you, guys.

A - Craig A. Menear {BIO 15126612 <GO>}

Yes.

A - Carol B. Tomé

Thank you.

Operator

We'll go next to Alan Rifkin with BTIG Corporation.

Q - Alan Rifkin {BIO 1493714 <GO>}

Thank you very much for taking my question. Carol, you mentioned that the expense factor in the second half should be lower than in the first half. Given the fact that typically second half revenues in aggregate are less than the first half. And you said that you forecasted comps to be a little bit lower in the second half versus the first half, is the reason for a lower expense factor in the second half entirely due to Compact Power? Or are there other things going on there?

A - Carol B. Tomé

Let me give you little bit more color on our expenses, if I could, please. As you know, we stepped up our capital spending program this year, taking our total spending up to $2 billion including $350 million of capital to invest in our stores. And certain of our stores are getting new wayfinding packages, new flooring, new lighting, new restrooms, new break rooms, so on and so forth. That capital comes with an expense.

Now, we didn't plan for the activity over every quarter. And in fact, a lot of that activity took place in the second quarter. And so if I look at our expense performance in the second quarter, while it was planned, expenses related to our store investment, which would include, old write-offs of old fixtures and reset expense and that sort of thing, year-on-year it was up $19 million. So it was pretty lumpy in the second quarter. That won't be as lumpy in the back half of the year, and that's really the driver of the expense growth factor first half versus second half.

Q - Alan Rifkin {BIO 1493714 <GO>}

Okay. Thank you very much. I appreciate that. And as a follow up, with respect to Compact Power, either Craig or Carol, could you maybe just talk about the margin structure for that business? Would it be correct to assume that it's a lower gross margin as well as lower SG&A business? And what effect on a full-time basis to EBIT margins does the acquisition of Compact Power in and of itself have?

A - Carol B. Tomé

Yeah. Happy to talk about it. First, to Compact Power. The revenues for Compact Power are recognized on a net and not a gross basis, so you have gross margin associated with that business. It's highly margin accretive, and Alan, that's one reason why our gross margin guidance for the year has changed from what has been down 15 basis points to now down 10 basis points.

Because if the revenues are recognized on a net basis and because there are expenses in Compact Power, it put some pressure on our expense growth factor for the year. We had guided that expenses would grow at 43% of our sales growth. We're now suggesting 46% of our sales growth. That's because there are no revenues, we record on a net basis, but there are expenses. As you look at the EBIT of Compact Power, it's very accretive. In the back half of the year, this is a small business, strategically very important. But in the back of the year, Compact Power shifts contribute $0.01 of EPS accretion.

Q - Alan Rifkin {BIO 1493714 <GO>}

Okay. Thank you very much, Carol.

A - Carol B. Tomé

You're welcome.

Operator

We'll go next to Scot Ciccarelli with RBC Capital Markets.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Good morning, guys.

A - Craig A. Menear {BIO 15126612 <GO>}

Good morning.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Carol, you've already highlighted how the housing stock in the U.S. continues to age, and obviously that's been a pretty big theme for you over the last call it two years or so. Do you happen to – I know it's something you guys have been looking at for a while. Do you happen to have any analytics around the home improvement spending, maybe by vintage, or do you know if there's an average percentage spend relative to an average home price?

A - Carol B. Tomé

Yeah. A couple of data points. Homes built before 1980, the average annual home improvement spend is $3,500 a year. Homes built after 2000, the average annual home improvement spend is $1,500 a year. So there's a pretty nice delta as the homes age.

The other interesting data point, and we haven't proven this analytically in our own research, but I'll share it with you anyway, because I think it's very interesting. We look at John Burns Real Estate Consulting Group a lot, they've got some really interesting data in housing. And they say that for every percentage point of improvement in real wages, and real wages are up this year after inflation of 2.2%. They say for every percentage point increase there's a 1% increase in the repair and remodel spend. Interesting. We haven't proven that, but it stands to reason. If you got more money in your pocket, you're going to spend some more money on your home.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Yes, that makes a ton of sense. And then just a quick follow up. You also mentioned how first time home buying is finally starting to accelerate. And again, that should be good for duration, but just based on historical purchase patterns, would you expect that to impact your small ticket performance? Presumably there is a little – a lot more kind of nickel-and-dime type projects that are probably done, but I don't know if that's true or not?

A - Carol B. Tomé

We don't think so, no. Because when they're going into the homes, they need to repaint them, and paint is not just a bucket – a gallon of paint. But it's the tape and tarps and all the other stuff that goes with it, or re-floor.

A - Edward P. Decker {BIO 16614891 <GO>}

Yeah. I wouldn't think so, other than a trip for picture hanging or something like that would be under $50. But, yeah, your – which we like.

A - Carol B. Tomé

Which we like.

A - Edward P. Decker {BIO 16614891 <GO>}

It's older basket.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Right. So no real change in the cadence between big ticket and small ticket as you wind up getting more first time home buying?

A - Carol B. Tomé

We don't think so.

Q - Scot Ciccarelli {BIO 1495823 <GO>}

Okay. Great. Thank you.

Operator

We'll go next to Keith Hughes with SunTrust.

Q - Keith Hughes {BIO 2489171 <GO>}

Thank you. You mentioned several times earlier in the call that your Pro is up well in excess of the DIY. Can you give us any insight on product categories that did particularly well with the Pro in the quarter?

A - Edward P. Decker {BIO 16614891 <GO>}

Well, certainly our building material categories did very well. Our electrical did very well. Tools, consumers, consumers love our power tools, but the Pros are really the heavy users of that. Lumber is very strong, lumber prices are near or at all-time highs per unit productivity is – the commodity price as we know, will go up and down, and we watch the units very carefully in lumber and building materials. And those have been very strong as well.

Q - Keith Hughes {BIO 2489171 <GO>}

You had mentioned earlier on the call in the introduction about new Pro paint initiative. Is that an area? Does that rank among your tops in terms of growth with the Pro?

A - Edward P. Decker {BIO 16614891 <GO>}

Yeah. The Pro paint initiative that we have with each of BEHR and PPG has been very successful. I'd say overall, we are pleased with our growth in our paint business. I'd say we're holding share, if not gaining a little bit of share in paint. But our Pro paint initiative in particular is multiples higher growth than our DIY paint business.

Q - Keith Hughes {BIO 2489171 <GO>}

Okay. Thank you.

Operator

We'll go next to Scott Mushkin with Wolfe Research.

Q - Scott A. Mushkin {BIO 7138867 <GO>}

Hey, guys. Thanks for taking my questions. So I guess I wanted to take a step back and ask a broader question. A lot has been asked on the call. I mean, as you guys look at your business, because obviously just performing terrifically, and obviously a big tailwind from what's going on in macro, but also the great things you guys are doing. What do you worry about?

A - Craig A. Menear {BIO 15126612 <GO>}

So, I'd say there's two things that are up there on the list. And one is we're investing in the one Home Depot Experience. That's how the customer views us. Not exactly how we are built, so we have to do some things to get there completely. And you worry about the ability to execute on that fast enough and the change management that comes along with that.

Second worry, I'd say is the customer and the associate experience in our high-volume stores. Clearly, with the growth that we've had, that puts pressure on in those stores disproportionately. And so, we're going to have to invest to solve that situation, and we're working to put that in place, but those are certainly two worries that we have in the business.

Q - Scott A. Mushkin {BIO 7138867 <GO>}

All right. That's really good insight. But I was just wondering if you could talk about kind of how things are going so far this quarter. I mean, we have the retail sales numbers out today. They were good. And we've experienced sometimes a third quarter low because DIY is not as strong as Pro. I was just wondering any thoughts as we look into third quarter and anything we should consider.

A - Carol B. Tomé

Yes. Scott, as we mentioned just a little bit earlier, we are quite pleased with our sales in August thus far.

Q - Scott A. Mushkin {BIO 7138867 <GO>}

All right. Perfect, guys. Thanks very much.

A - Craig A. Menear {BIO 15126612 <GO>}

Thank you.

Operator

We'll take our next question from Matthew McClintock with Barclays.

Q - Matthew McClintock {BIO 16452505 <GO>}

Hi. Yes. Good morning, everyone.

A - Craig A. Menear {BIO 15126612 <GO>}

Good morning.

Q - Matthew McClintock {BIO 16452505 <GO>}

It's been a little over a quarter since you've now had access to Interline inventory and your stores. And I was wondering, conceptually, how should we think about the benefit from that access, building and having an impact on your sales? How do you build awareness of that? Is that really what we're waiting on to see an acceleration in the business from that, or – just how to think about that benefit layering in over the coming years? Thanks.

A - Craig A. Menear {BIO 15126612 <GO>}

I mean, I'll start and Bill is here, who runs our Pro and Services business. But as I call out my comments, we're actually very pleased with the use case one and use case two response from our customers. And with that, as well as the effort of the team at Interline, Interline actually grew above the company average growth in the quarter. So...

A - Bill Lennie {BIO 15126222 <GO>}

Yes. Just, Craig, thanks, a quick comment. We're not live in 1,958 stores, so we basically have finished the rollout. We have 1,500 stores that have access to Interline's products next day, and an additional 458 stores that are a two-day delivery. And we're seeing great activity on a broad base of goods, primarily servicing the trades from plumbing, electrical, hardware, also strength in the HVAC business. So it's doing a nice job of extending our product reach, giving us access to deeper inventories for Pros that are coming in and looking for project-based purchases. And then, overall, average ticket on par, ramping up sequentially week-over-week, I'm pleased with the progress in the MRO business.

Q - Matthew McClintock {BIO 16452505 <GO>}

And then, Carol, if I could have a follow-up, and I'm sorry if I missed this, but the 7 basis points of pressure from higher shrink. I have to ask about it because it almost offset the benefit from the supply chain. Could you just talk about what you're seeing there, what's driving that? Thanks.

A - Carol B. Tomé

Yes. As you know, there are many drivers of shrink, including higher staff and changes in operational processes, and new systems. We have a cross-functional team that is addressing this. We're hearing from other retailers that best is up across the board, but we're really focused on, well, what have we changed inside of our store that perhaps caused some of this. And in fact, the cross-functional team has identified a few defects that we are correcting and we will continue to work on this going forward.

Q - Matthew McClintock {BIO 16452505 <GO>}

Thank you very much for the color.

Operator

We'll go next to Peter Benedict with Robert Baird.

Q - Peter S. Benedict {BIO 3350921 <GO>}

Hey, guys. Thanks for taking the question. First was just on kind of labor market and wages and availability of workers. I mean, what are you guys seeing on that front, whether it be with the seasonal folks that you hire or some of the specialty or full-time folks? That's my first question.

A - Craig A. Menear {BIO 15126612 <GO>}

Sure. So, Peter, we hired seasonally this year over 90,000 people, and one of the great things that happened in this season was we enhanced our application process through an improved mobile experience. It actually doubled our applicant pool, so we're very pleased with that. It was a better experience for the applicants themselves and was pretty effective on our end as well.

We are certainly seeing wage pressure and that varies market by market, but that's something that we anticipated and planned for. And it's actually built into our guidance for 2017.

Q - Peter S. Benedict {BIO 3350921 <GO>}

Okay. Thank you. And then, Carol, just curious on the FX, just to make sure we understood you correctly. Your guidance right now still assumes – I think it was a $250 million headwind from FX for the year. Is that right?

A - Carol B. Tomé

Well, in the back half, it's actually $250 million. That's right. So if you were to add that back, you would calculate the comp to be about the same as what we reported in the first half.

Q - Peter S. Benedict {BIO 3350921 <GO>}

Okay. And then last one, if I could just sneak one in. The store refreshes that you alluded to, remind us how many you are getting done this year. How many you think you could maybe do in 2018? And, Craig, anything specific? I mean, you talked about trying to alleviate some of the customer experience and associates experience friction that may occur in these high-volume stores. Anything in particular that you're focused on that you're seeing some improvement from as you work to reengineer the stores a little bit. Thank you.

A - Craig A. Menear {BIO 15126612 <GO>}

Sure. The first part of the question in terms of how many this year, approximately 500 stores will get the updates that Carol referenced earlier as it relates to the signage, navigational signage, lighting, floor, break rooms, restroom and so on.

And then in the high-volume stores, we have to work to continue to improve to experience for the customer on the front end in particular and get the customer through the registers with greater speed. And then likewise, those stores feel more pressure from BOPUIS and BOSS pickup, and we're working to solve that for them as well. And that will be a different scenario by different type of stores, but those of the areas of focus.

A - Carol B. Tomé

And, Peter, we've got an investor conference in December, and so we'll lay out our plans for 2018 and beyond at that conference.

Q - Peter S. Benedict {BIO 3350921 <GO>}

Okay. Fair enough. Thanks so much, guys.

A - Craig A. Menear {BIO 15126612 <GO>}

Yes.

A - Diane Dayhoff {BIO 15757035 <GO>}

Debbie, we have time for one more question.

Operator

We'll take our last question today from Seth Basham with Wedbush Securities.

Q - Seth M. Basham {BIO 15235973 <GO>}

Great. Thanks for taking my question.

A - Craig A. Menear {BIO 15126612 <GO>}

Sure.

Q - Seth M. Basham {BIO 15235973 <GO>}

As we look at the trends in small ticket sales relative to big ticket sales, obviously they've been underperformed for some time. Do you think that you're still gaining market share in some of the small ticket categories?

A - Edward P. Decker {BIO 16614891 <GO>}

Yeah. I would. The small ticket is healthy. We talked about the transactions being up 1.5%, but that also comes with a strong positive comp associated with those transactions. And the mix of the business, we used to talk about under $50 being 20-odd percent and over $900 being 20-odd percent, and that dynamic shifted as the customer has responded, we think largely, to the product and the innovation in the store.

And again, we look at this every single week. Where are the sales coming from in the assortment? And we continue to see the customer respond to the innovation and buy up the continuum on the assortment. An example of that would be in soils and mulch this year. So we talked about Garden coming later, which it did, and we had a fine garden business in the second quarter. But we were a little less promotional on commodity mulch because what we find is the customer is buying heavily into the organics. We have a number of exclusives in organics with Kellogg's and DR. EARTH's and some of the Scotts Miracle-Gro product, and customers are happily trading up. And we're talking two and sometimes three and four times the cost for a bag of organic mulch over commodity mulch.

So we look at it very carefully because it's a natural and fair question, but we continue to be comfortable with what the dynamic is of the ticket growth. We look again that it's exclusively this year product mix and then the effect of commodity prices, lumber and building materials. There has been no price impact on our AUR.

Q - Seth M. Basham {BIO 15235973 <GO>}

That's helpful. And given that it's been a theme of this call, as we think about the e-commerce impact on some of these smaller ticket categories, do you feel like you guys are better or less well positioned to gain share in some of these smaller ticket categories as a result of what's happening with the online channel?

A - Craig A. Menear {BIO 15126612 <GO>}

We feel very comfortable that we compete across all segments of the line structure. Opening price point, mid-price point, upper price point across channels.

Q - Seth M. Basham {BIO 15235973 <GO>}

Excellent. Thanks a lot, guys.

A - Craig A. Menear {BIO 15126612 <GO>}

All right.

A - Diane Dayhoff {BIO 15757035 <GO>}

Well, thank you, everyone, for joining us today and we look forward to talking to you next quarter.

Operator

Ladies and gentlemen, thank you for your participation. This does conclude today's conference. You may now disconnect.
