Company Name: Home Depot
Company Ticker: HD US
Date: 2018-05-15
Event Description: Q1 2018 Earnings Call

Market Cap: 215,331.99
Current PX: 186.67
YTD Change($): -2.86
YTD Change(%): -1.509

Bloomberg Estimates - EPS
Current Quarter: 2.839
Current Year: 9.475
Bloomberg Estimates - Sales
Current Quarter: 29959.400
Current Year: 107977.613

Q1 2018 Earnings Call

Company Participants

- Isabel Janci
- Craig A. Menear
- Edward P. Decker
- Carol B. Tomé
- Mark Holifield
- William G. Lennie
- Kevin Hofmann

Other Participants

- Simeon Ari Gutman
- Michael Louis Lasser
- Zachary Fadem
- Steven Forbes
- Keith Hughes
- Tori K. Bertschy
- Seth I. Sigman
- Brian Nagel
- Elizabeth Lane Suzuki
- Seth M. Basham
- Dennis Patrick McGill
- Daniel Thomas Binder
- Charles Grom
- Matthew McClintock
- Peter S. Benedict
- John Allen Baugh
- Matthew J. Fassler
- Scot Ciccarelli
- Alvaro Lacayo

MANAGEMENT DISCUSSION SECTION

Isabel Janci

GAAP and Non-GAAP Financial Measures

Today's presentations will also include certain non-GAAP measures

Craig A. Menear

Q1 Highlights

Sales and EPS

- Sales for Q1 were $24.9B, up 4.4% from last year
- Comp sales were up 4.2% from last year, with U.S. comps of positive 3.9%
- Diluted EPS were $2.08 in Q1
- We are pleased with our performance in Q1 and the fundamentals of our business remain solid
- As Ted will detail, excluding weather-impacted categories, our pro and core interior projects business remained strong in the quarter and we saw healthy growth in maintenance and repair categories

Weather Impacts

- From a geographic perspective, weather impacts can be seen in the variability of performance across Canada, our three U.S. divisions, and 19 regions
- Our largest division is the Northern Division, which posted flat comps due to weakness in our seasonal categories
  - The Southern and Western Division saw relatively better weather trends and comped above the company average
- On the international front, Canada posted a slightly negative comp in local currency, while Mexico posted positive comps in local currency

Spring Breaks

Sales, Customer Demand, Investments and Deepening

- You've heard us talk about the bathtub effect based on when spring breaks, where weak seasonal sales in Q1 are counterbalanced by strength in Q2
- We expect that effect to be true this year
- And over the past few weeks as spring has finally arrived through the U.S. and Canada, we are seeing strong customer demand
- Part of the strength we saw in the business can be attributed to the health of our pro customer, as pro sales once again outpaced DIY sales in the quarter
- Investments and deepening our relationship with our pro customers are yielding increased engagement, which translates to incremental spend

Enhanced Associate Tools

- While still early, the combination of enhanced associate tools in the store and expanded delivery capabilities are gaining traction with the pros. In delivery, for example, we augmented our two-hour and four-hour delivery window options with same-day car and van delivery in select markets
  - These efforts helped drive double-digit delivered sales growth in the quarter

Interconnected Retail Strategy

Online Traffic Growth

- Our interconnected retail strategy continues to resonate with our customers
- Online traffic growth was healthy and our first quarter online sales grew approximately 20% from Q1 2017
- During the quarter, we began to launch the customer's ability to attach install services when they buy certain products online in select markets
- For example, in certain markets if you purchase a faucet online and want to include the installation of the faucet in your purchase, we now enable this experience
  - We continue to invest in interconnected shopping experience and see a positive response from our customers in the form of improved customer satisfaction scores, better conversion, and increased sales

Supply Chain

- As we continue to make the shopping experience more convenient for our customers, another area of focus and differentiation is our supply chain
- The flexibility of our supply chain is a competitive advantage, particularly when unpredictable weather results in spiky demand patterns
  - And stock levels are at record highs as our shelf shelves are fully stocked with products our customers need to get their projects done

Strategic Priorities and Initiatives

- Let me touch briefly on our long-term strategic priorities
- You will recall at our investor conference in December, we outlined our commitment to accelerated investment plan to create the One Home Depot experience for our customers
- I'm pleased to report that our key initiatives are on track
- We implemented our enhanced wayfinding sign and store refresh package in nearly 250 stores during the quarter and intend to pilot our first new supply chain facility starting this summer
  - It's still early days, but we remain very excited about the work and opportunities ahead as we focus on enhancing the customer experience by investing in our business and in our associates

Spring Selling Season

- Our associates consistently execute
- A delay in the spring selling season is not without its challenges
- But given the company-wide alignment and coordination of our store teams, merchants, vendor partners and supply chain, coupled with a favorable housing backdrop, we are poised to deliver a strong 2018
- I'd like to close by thanking our associates for their dedication, hard work, and commitment to our customers

Edward P. Decker

Highlights

Performance

- As you heard from Craig, we're pleased with our performance in the quarter
- Excluding our seasonal business, sales exceeded our expectations
- We saw significant strength in our pro business, interior projects, and maintenance and repair categories
- The extreme winter weather in the quarter had a negative impact on our garden categories, which historically represent around 15% to 20% of our first quarter sales
- Our garden departments had negative comps in the quarter, driven by softness in chemicals, fertilizer, mulch and live goods, just to name a few

Garden Departments

Comp Transaction Growth

- Looking at our departments, appliances, electrical, and lumber had double-digit comps in the quarter
- Lighting in our garden departments were negative, with the lighting comps reflection of LED price deflation
- All other merchandising departments were at or above the company average
- In Q1, comp average ticket increased 5.8% and comp transactions decreased 1.5%
  - If we exclude our garden business, we saw positive comp transaction growth

Commodity Price Inflation and Foreign Exchange Rates

- Commodity price inflation in lumber, building materials and copper, positively impacted average ticket growth by approximately 111BPS.
- Foreign exchange rates also positively impacted average ticket growth by approximately 41BPS.

Outdoor-Related Projects, Floor Maintenance and Repair Categories

- While cold and wet weather impacted some outdoor-related projects, this didn't prevent our customers from completing a variety of interior projects
- Categories like interior doors, bath fixtures, storage and organization, interior paint, door locks, ceiling fans and window treatments, all had comps above the company average
- Floor maintenance and repair categories also performed well during the quarter, with strong results in safety and security, water heaters, plumbing repair, pipe and fitting, and air circulation

Pro-Heavy Categories

- As you heard from Craig, in Q1, we saw continued traction with our pro
- Pro-heavy categories, like lumber, gypsum, insulation, pneumatics, wiring devices and flooring tools, all had comps above the company average
- In addition, we are building engagement and enabling our associates to target specific customers, which is driving expansion of categories and services sold

Interline Brands

- In Interline Brands alone, we saw sales growth ahead of the company average
- We also saw healthy customer appetite for big ticket projects
- Big ticket sales in Q1, or transactions over $900, were up 10%
    - The increase in big ticket sales was driven in part by vinyl plank flooring, appliances, and various lumber and building materials categories

Presidents' Day and Spring Black Friday Events

- In Q1, we hosted our Presidents' Day and Spring Black Friday events
- Our stores did a fantastic job executing these events and our customers responded
- During the event, we saw great results in several tool categories and cleaning

Core Strategies

- One of our core strategies as merchants is to balance the art and science of retail, both in-store and online
- Over the last year, we made several improvements to our interconnected shopping experience, including better product content, refreshed mobile experience, improved inventory visibility, and faster checkout
    - These investments have helped drive a more seamless, frictionless customer experience, and conversion rates in Q1 increased more than 10% y-over-y across all devices

Outlook

Outdoor Garden Category

- Now, let's turn our attention to Q2
- Just in time for the warmer weather, we are excited to introduce a fantastic new innovative product in our outdoor garden category
- We have partnered with Syngenta and Fernlea to bring our new Rio dipladenia plants to market
    - These plants are low maintenance, drought tolerant, and have reoccurring blooms throughout the growing season
- Rio is available in all of our U.S. stores and is a big box exclusive to The Home Depot

PPG Partnership

- In addition, we are very happy to announce the extension of our PPG partnership with the launch of Olympic exterior stains
- With this launch, Olympic brings 80 years of trust and brand recognition into our stores
    - This broadens our assortment in our paint department, providing customers choice with a strong lineup of products across the category

New Product Offerings

- We are also thrilled about new product offerings across all of our categories in our upcoming events
- During Q2, we will host our Memorial Day, Father's Day, and 4th of July events, where we will be offering more great values and special buys for our customers

Carol B. Tomé

Financial Highlights

Accounting Policy

- Before we discuss our first quarter results, I want to mention a change in our accounting policy
- During the quarter, we adopted ASU No. 2014-09, which pertains to revenue recognition
- This standard changes the way we account for certain items related to our private label credit card and gift card programs
  - While the new standard changes the geography of certain items on our income statement, it has no impact on operating profit

Gross Profits and Operating Expenses

- Looking at our first quarter results, the change in accounting caused $131mm increase to gross profit and a corresponding $131mm increase to operating expenses
- Note that the $131mm increase in gross profit was driven by $33mm net increase in sales and $98mm decrease in cost of goods sold
  - While we did not recast our historical financial statements to reflect to this accounting change, included in today's press release is a quarterly pro forma view that shows the impact to the accounting standard as if it had been in place during FY2017
- So with that, let's move on to our first quarter results

Sales

- In Q1, total sales were $24.9B, an increase of 4.4% from last year. vs. last year, a weaker U.S. dollar positively impacted total sales growth by approximately $104mm, or 0.4%
- Our total company comps were positive 4.2% for the quarter, with positive comps of 5.6% in February, 5.9% in March, and 2.2% in April
- Comps in the U.S. were positive 3.9% for the quarter, with positive comps of 5.1% in February, 5.5% in March, and 2% in April
  - As you may have personally experienced, April was one of the coldest and snowiest months in more than 20 years

Gross Margins

New Accounting Standard, Acquisitions and Transportation Costs

- In Q1, our gross margin was 34.5%, an increase of 40BPS from last year
- The increase in our gross margin y-over-y reflects the following factors
- First, we experienced $131mm, or 48BPS, of gross margin expansion due to the new accounting standard
- Second, we experienced 14BPS of gross margin expansion due to changes in mix and the gross margin benefit of recent acquisitions
- Finally, we experienced 22BPS of gross margin contraction due to higher shrink and higher transportation costs in our supply chain than what we experienced last year

Operating Expense Deleverage

- In Q1, operating expense as a percent of sales increased by 87BPS to 21%
- Our operating expense reflects the impact of the new accounting standard, the impact of the strategic investment plan we laid out at our December investor conference, and ongoing expense control
- Specifically, the new accounting standard resulted in $131mm increase in our operating expenses and caused 50BPS of operating expense deleverage
  - Expenses related to our strategic investment plan resulted in approximately 56BPS of operating expense deleverage

Expense Leverage, Operating Margins, Tax Rate and EPS

- Finally, we drove 19BPS of expense leverage due to ongoing productivity actions in the core business
- Our operating margin for Q1 was 13.6%, a decrease of 47BPS from last year
- For the quarter, interest and other expense decreased by $2mm to $239mm and our effective tax rate was 23.5% compared to 35.2% in Q1 FY2017
  - The decrease in our effective tax rate reflects, for the most part, the benefit of tax reform
- For the year, we expect our effective tax rate to be approximately 26%
- Our diluted EPS for Q1 were $2.08, an increase of 24.6% from last year

New Store

- Moving on to some additional highlights; during the quarter, we opened one new store in Stamford, Connecticut for an ending store count of 2,285
- Signed square footage at the end of the quarter was 238mm square feet
  - Total sales per square foot for Q1 were $412, up 4.5% from last year

Merchandise Inventories

- At the end of the quarter, merchandise inventories were $14.4B, up 6% from last year
- Inventory turns were 4.9 times, up slightly from last year

- While spring was a reluctive bride, she has arrived and our stores have the inventory necessary to meet demand, which is a good thing, as month to-date, for the company, our May comp sales are double-digit positive

Capital Allocation, Share Repurchasing and Debt

- Moving on to capital allocation, in Q1 we repurchased $1B, or approximately 4.7mm shares, of outstanding stock
- As of today, we are targeting $4B of share repurchases for FY2018
- Computed on the average of beginning and ending long-term debt and equity for the trailing 12 months, return on invested capital was approximately 36%, 370BPS higher than Q1 FY2017

Guidance

Housing Fundamentals

- As we look to the remainder of the year, we are encouraged by what we are seeing in housing and the broader economic environment
- The U.S. economy is strong and housing fundamentals continue to be supportive of our business
- Unemployment is the lowest it has been since 2000
- Wages are increasing
- Home prices are appreciating buoyed by housing shortage in the U.S.
- And while interest rates are rising, this is indicative of a strong economy
  - At these levels, we do not expect interest rates to lead to a slowdown in customer desires or demand

Sales and EPS Growth

- That's why today, we are reaffirming the sales and EPS growth guidance that we laid out at our fourth quarter earnings call, adjusting certain items solely for the change in accounting standard
- Remember that we guide off of GAAP.
- The new accounting standard will not affect our EPS guidance, but it will impact sales growth and the gross margin and expense growth factor guidance we gave at the beginning of the year
- Recall that FY2018 will include a 53rd week, so Q4 FY2018 will consist of 14 weeks
- For FY2018, we now expect sales to increase by approximately 6.7%, with positive comps, as calculated on a 52-week basis, of approximately 5%

New Accounting Standard

- Reflecting the new accounting standard, we now expect our 2018 gross margin to increase by approximately 45BPS.
- Also reflecting the new accounting standard, we now expect our 2018 operating expenses to grow at approximately 144% of our sales growth rate
- For EPS, we expect FY2018 diluted EPS to grow approximately 28% to $9.31

Sales Growth

- I also want to take a brief moment to comment on our long-term financial targets
- The new accounting standard does not change our sales growth or operating margin targets for FY2020
- Because the accounting change did affect the geography of certain items on the income statement, we have posted an update to our December investor conference materials on our website to assist you with your modeling

QUESTION AND ANSWER SECTION

<**Q - Simeon Ari Gutman**>: My first question, it's all about weather and it's got a couple parts. Can you clarify – you said garden was negative. Is April the largest month for garden? And then you also mentioned that Northern is your biggest division. If we assume it's, let's say, 40%, I think that would imply Southern and Western would be north of like 6%, 6.5%. Is that fair?

<**A - Craig A. Menear**>: In terms of garden, April is not necessarily the biggest month in garden generally. That is May. And we actually don't break out the divisional numbers, but Northern Division is our largest division.

<**Q - Simeon Ari Gutman**>: And maybe just a follow-up. The remaining divisions, I guess, Southern and Western, were those trajectory similar or was there a big discrepancy between them? And then have their quarter-to-date trends held up? I'm assuming Northern is the one that's breaking out, but has Southern and Western stayed the same or strengthened?

<**A - Craig A. Menear**>: Actually all areas are breaking out with the change in the weather.

<**A - Carol B. Tomé**>: We're so pleased with the performance across our geographies. And if you look at the performance in Q1, the Southern Division had a slightly higher comp than the Western Division. But remember, the Southern Division had some hurricane-related sales in it. So if you normalize for hurricanes, the divisions performed pretty much the way they should have performed. It was really in the north and it's come back and the whole business is coming back.

<**Q - Simeon Ari Gutman**>: And my follow-up question. I think the issue the market's contemplating here is the cycle question vs. what the weather is doing. And so I don't know how you look at it, but if there is something that's slowing that's more than weather, and it doesn't seem like that's the case, I guess, how obvious are these signals and how much lead time do you think you have to be able to see them?

<**A - Craig A. Menear**>: First of all, this clearly is really a garden story for us. The miss in terms of garden was significant against what we planned.

<**A - Carol B. Tomé**>: Maybe we could just quantify that for you. If you backed out the gardens, our comp for the quarter would have been 6.5%.

<**Q - Michael Louis Lasser**>: Of that 230 basis point impact from the weather, is that a net number, so that's net of the hurricane benefit? And what percentage of those sales do you expect to recoup in Q2?

<**A - Craig A. Menear**>: The storm-affected sales were roughly 135 basis point impact, and we actually expect to capture the majority of those sales and as we're seeing that happen in May.

<**Q - Michael Louis Lasser**>: And my second question is on the initiatives that you outlined. Both the 200 stores that you touched with the new signage package, what comp are you seeing those stores produce above and beyond the corporate average? And then as part of that, can you also touch on your pro delivery initiatives? Is that helping you more with existing customers or customers who really haven't done business with in the past?

<**A - Craig A. Menear**>: Let me – I'll touch on the store a minute here, and then Mark Holifield is here and can speak to the delivery. 250 stores that we implemented is signing and refresh packaging. We're, obviously, just completing those. We did that investment for our stores over a couple of year period, or doing that, because of the pilots that we ran

previous to that. So we've built that lift into our guidance, and that's something that we're rolling here over the next two years across all the stores.

<A - Mark Holifield>: On the new delivery that's out there, the car and van delivery, that's really driving sales across the range. We have a lot of Buy Online, Deliver From Store customers who are trying out the car and van delivery. And our pro customers, our existing pro customers and new customers are using the two and four-hour windows.

<A - Carol B. Tomé>: Our math isn't perfect, but our modeling would suggest that the majority of these delivered sales are incremental.

<Q - Michael Louis Lasser>: Incremental for customers that you're already doing business with or more so...

<A - Carol B. Tomé>: Both.

<Q - Michael Louis Lasser>: ...attracting customers who you – both, got it.

<Q - Zachary Fadem>: Could you talk a little bit about the competitive environment in the paint category? Have you started to see any step change there in terms of promotions? And any thoughts on what you think the key drivers are for you to maintain and win share in the category this year?

<A - Edward P. Decker>: I would say that the paint promotional environment is – certainly for us, it's the exact same y-over-y. We're not seeing any more promotion out of others in the marketplace either. We're very happy with our paint performance. Our comp was at the company average and we saw the strongest interior paint comp [ph] in gallon (26:13) performance we've seen in a long time. So we're happy with our brands. We have the best brand there in the marketplace. We're thrilled with our expansion of PPG, and Ann and team are doing a fantastic job of selling in the stores.

<Q - Zachary Fadem>: And to follow-up, is input cost for items like lumber and building materials continuing to grind higher. First of all, what are your expectations there for the year? And is there any concern in your mind on your ability to pass along the higher prices to customers in this environment?

<A - Edward P. Decker>: The two areas we've seen the largest cost request are in clear commodities, so looking at lumber and copper, for example. Those generally the market passes on. Most of those products are priced weekly in well-known pricing indexes and the market tends to follow that. So we've had no problem passing that on. I will say lumber and panel prices are at historic highs. We don't see that abating at all. We're up about 30% y-over-y. Certainly don't want it to go a whole lot higher, but for right now we've been able to pass on and not seeing degradation in units. The other area is in things like laundry, where you had a very specific tariff. The entire industry has accepted that cost increase based on the tariff and you're seeing retails in all competitors that have gone up more or less mirroring the impact from the tariff.

<Q - Steven Forbes>: You mentioned piloting the first new supply chain facility this summer. But can you help expand on that, what type of facility is it? And maybe just give us your updated plan for this year as far as how many and what type of facilities you plan on opening in 2018.

<A - Mark Holifield>: The facilities we're going to be doing first are market delivery operations, which are the hubs out there. These are stockless locations that will be delivery hubs for big and bulky product, like appliances and vanities and things like that. Later this year, we'll be testing our flatbed distribution capability and opening our first local direct fulfillment center.

<A - Carol B. Tomé>: I'd like you to remember that this is a five-year plan. We've committed $1.2B in our supply chain over the next five years. We will spend as much in year four and five as we do in year one through three, so it's definitely going to ramp up over time, isn't it, Mark?

<A - Mark Holifield>: Perhaps a way to think about this is, if you think back to our RDC rollout years ago, in the first year, 2007, we had exactly one RDC. In 2008, we did four; 2009, we did seven; 2010, we did seven. So you'll see a ramp somewhat similar to that across the five years of the supply chain transformation ahead.

<Q - Steven Forbes>: And then just a quick follow-up, on retail services, so I recognize the percentage of revenue here. But it's a topic I find interesting as you think about the opportunity to build brand awareness and share of wallet, right, with the DIY consumer here. So can you touch on how that business performed during the quarter?

<A - Craig A. Menear>: Our services business represents about 4% of our total sales and grew low single-digit, really driven by HVAC and window treatment.

<A - Craig A. Menear>: Wasn't much exterior business happening.

<Q - Keith Hughes>: I've another product question, specifically on flooring, you've done very well on flooring the last several years, particularly carpet, which is kind of a declining industry, but as you called out luxury vinyl plank, I assume you mean LVT there is growing well. Could you talk about your hard [ph] service (30:40) offering, how that's growing, and what you see for the future?

<A - Craig A. Menear>: Overall, flooring, again, we're very happy. Our comps in flooring were above the company average, for sure, led by the LVT. That product is just a fantastic product, solid or waterproof vinyl product that looks like tile and/or wood. The rest of the business is solid. I mean, lot of sales moving into that LVT product, but the rest of the business is sort of low single-digit comp.

<Q - Tori K. Bertschy>: From prior quarters, it would seem that pro is comping 10%. Is that fair? And can you talk about the performance of pro in Q1 and if you think that impacted the business?

<A - Craig A. Menear>: We certainly had a strong pro quarter and it outpaced the DIY business in total, largely due to the fact that the garden business was, obviously, down dramatically in the DIY space. But we're very pleased with our pro. And, Bill, I don't know if you want to add to that.

<A - William G. Lennie>: Just kind of a follow-up on engagement. Craig mentioned the tools that we're providing to our account managers in the store is our POSs. And as they get more engaged, we are seeing customers expand the number of categories that they purchase. We're seeing them start to utilize more services, like delivery. And then as a result, we're seeing accelerated growth in the accounts that are managed by our POSs. So, great strength in pro and top performing pro trades, where our renovator/remodeler, our property investors and property managers. So we're pleased with the progress and the trajectory of the business.

<Q - Tori K. Bertschy>: And as my follow-up, following up on the May commentary, can you talk about what you've seen from the acceleration from pro vs. DIY quarter-to-date?

<A - Craig A. Menear>: We're seeing both in May. The whole store is lifting.

<Q - Seth I. Sigman>: Couple of follow-up questions here. So first just on the delivery from the store, it's continued to grow at this double-digit rate pretty much since you guys have rolled it out. Can you help us understand how meaningful that is today in terms of the overall contribution, and also, the influence that it may be having in driving higher transaction size? Because it does seem to be a big differentiator for you. Thanks.

<A - Craig A. Menear>: We're pleased overall with what's happening on the delivery side of the business. We don't break out those numbers specifically, but we are seeing very nice growth. And as Mark said earlier, that is attracting both incremental business with current customers and new customers into the business.

<Q - Seth I. Sigman>: And then when you look at the online growth this quarter, up 20%, obviously, very strong again. Is it fair to assume there was really little weather impact there? And you discussed a couple things that may be helping. Any more insight into where the growth is coming from, the types of categories, and also from a profitability perspective, just the progress that you're making there in improving the margins in that business? Thank you.

<A - Craig A. Menear>: I'll answer the second part of that and I'll turn it over to Kevin Hofmann. From a profitability standpoint, we run this on a portfolio basis and it's an interconnected experience. So in many, many cases, the experience starts in the digital world. It may finish in the physical world. Over 45% of our orders, the customer chooses to pick up in one of our stores. So we manage the portfolio, if you will, on a profit basis across the channels.

<A - Kevin Hofmann>: And then, just from the health of the online business, so we were really pleased with the traffic growth we saw. Ted mentioned we had double-digit improvement in our conversion rates because of the experiential improvements we've been putting in place. But just super excited some of our fastest-growing sales are what we call those interconnected sales, where the customer is buying online, picking up in store; buying online, shipping to store, and that was some of our fastest growth. And really across the store, Flooring did great, Plumbing did great, Electrical did great, and we were very pleased.

<A - Craig A. Menear>: There actually is an impact from a seasonal standpoint in the online business. When it's snowing on the ground in April, people aren't really looking online for a patio furniture, for example.

<Q - Brian Nagel>: My first question just on ticket growth. Clearly a lot of discussion here on weather. If you look at the ticket growth, it tracked higher in the quarter and I think were the highest rates in a while. What's behind that? And how should we view the sustainability of that metric? And then I have a follow-up.

<A - Craig A. Menear>: I'm assuming you're referring to the $900 and above.

<A - Carol B. Tomé>: Or the average ticket of 5.8%.

<Q - Brian Nagel>: I was just talking more about the number in the press, the average ticket of 5.8%.

<A - Craig A. Menear>: If you look at the average ticket of 5.8%, think about the commodity impact plus the FX impact, and that gets you back to kind of where we've been running all of 2017 quarter-by-quarter.

<Q - Brian Nagel>: There really hasn't been much change besides [indiscernible] (36:42).

<Q - Brian Nagel>: Then the second question I have, I guess, from a bigger picture perspective. We talk a lot about – just you mentioned a lot just the ongoing strength of the macro environment. Clearly, looking at my screen right now, we do have rates rising, albeit off of historically low levels. The question I have is, what do you watch? You guys do a very good job of watching a lot of factors out there. What are you watching for maybe some potential early indications of an impact of higher rates upon your business?

<A - Carol B. Tomé>: There are number of things that we look at, obviously. During the recovery, we were always looking for green shoots and now we're looking for red flags. Luckily we're not seeing any of those, but here's what we're looking at. As you see, rates are going up. 30-year mortgage, I don't know what your screen is showing, the last time I looked it was about 4.6%., and it's on its way up projected to be up at least 5% by 2020.

Historical mortgages over the past, gosh, 50-some-odd years is 5.8%. So we are considerably under those historical mortgage rates. But we are super focused on the Affordability Index and what that means in terms of performance by market. So if you look at the Affordability Index for the country at large, it's 152%, which is still very good. The average over, again, decades is about 127%. So if the Affordability Index were to reach 127% or under, that would certainly be a red flag.

And then we look at rising home prices coupled with rising mortgage rates. You see in markets where you might argue there's a overheated housing market or at least certainly one that's on fire, is there anything happening to our business? So I will call out two markets, Denver, Colorado and Seattle, Washington. Both have had seen extraordinary expansion of home price appreciation. The business there is very good, and the reason is because the economy is very good. So you can't just look at housing prices and interest rates to say, oh, oh, you got to then look at what's happening to the economy.

So it's getting a bit more complicated than it has in the past, because there are all these influences of business. But certainly, if I stop talking and just tell you what we look at every day, we look at ticket and transactions, ticket and transactions. Because if you go back to the last recession, ignoring the housing downturn recession, but the last recession the United States had, 2001, our ticket was flat. So we're looking at that. And then, of course, transaction, because transactions could be an indicator of a few things, right? It could be an indicator of a slowdown in demand or an indicator that a competitor taking your customer away. So, hopefully, that's helpful, Brian.

<Q - Elizabeth Lane Suzuki>: You had expected before to experience a similar net sales impact from Harvey and Irma in 2018 as in 2017. Is that still the expectation. And will the benefit be limited to H1, or could there be some residual benefit in H2 as well?

<A - Carol B. Tomé>: Our expectation is that the sales will be the same year-on-year. The majority of the benefit will occur in H1. There may be some trailing benefit in the back half, because the issues in Puerto Rico are so dramatic, but it won't be material to the company.

<Q - Elizabeth Lane Suzuki>: And then shifting over to online, what are the product categories that are doing well online and which are more traditionally sold in-store and don't do very well online? And then how frequently are you able to adjust your online pricing to stay competitive?

<A - Craig A. Menear>: First of all, what I'd say is largely our business online is incremental sales. We're growing the categories in store at the same time that we're growing online. And I'll let Kevin speak to the categories.

<A - Kevin Hofmann>: As mentioned, so still strength in our core tools department, our plumbing department, our electrical department. Really the core of the store has been performing very nicely. We've got a great bath business online as well. In your question around pricing, it's just like how we think about it in the store of being priced competitively every day and making sure that we differentiate, not just on price, but on the full service offering to the customer, the experience, and all the things that we bring to the table. So very actively monitoring and managing the price situation online just like we do in the store.

<A - Craig A. Menear>: We can move prices, obviously, online instantaneously. We purposely, because of how it impacts the store environment, move the prices in the store at a different rate than we do online.

<A - Edward P. Decker>: And I don't want to forget the interconnected aspect of our online business as well, because things like the lumber department pages or building material pages are some of our most active pages, because the pros are looking at price and the inventory availability. So while they're not transacting as much online in those departments, we have great traffic on those pages.

<Q - Seth M. Basham>: Could you guys give us some color on the comp or the growth in comp transactions by ticket size?

<A - Carol B. Tomé>: We talked about big ticket already. I suspect you're wanting to know what happened with the smaller ticket?

<A - Carol B. Tomé>: As you would anticipate, for transactions with tickets of $50 or less, they were down year-on-year. That was because of our garden business. And I can make this really real for you. You can just think about penetration of tender and you may say, why? If you look at penetration of tender in the quarter, our private label credit card penetration increased by 50BPS, while at the same time our cash tender decreased by 50BPS. And that was all related to our garden business, which is a smaller ticket activity.

<Q - Seth M. Basham>: If you think about the transaction growth overall ex-garden, how positive was it and how does that compare to recent quarterly trends?

<A - Carol B. Tomé>: It was a positive 1.1% for the quarter and continues to be positive. As we said, May comps for the company are double-digit positive.

<Q - Dennis Patrick McGill>: First question just had to do with the pilot program on the delivery from car and van. Can you maybe elaborate a little bit there what you're seeing from that uptake and particularly at big category or customer level are you seeing pro vs. DIY being more heavy with that uptake?

<A - Craig A. Menear>: It's still early days and customers are choosing to purchase all sorts of things. It could be a pro on a jobsite needing something. But there's a lot also on the Buy Online, Deliver From Store front. So it's interesting to see where it goes. It's not taking a real pattern at this point.

<Q - Dennis Patrick McGill>: And then, Carol, can you elaborate, on the transportation costs increase that you experienced in the quarter the deleverage there, is that fuel alone? Are you seeing any issue with availability? And where do you see that trending for the year within guidance?

<A - Carol B. Tomé>: It wasn't fuel alone. We had 8BPS of gross margin contraction in transportation, of which 3BPS was fuel and 5BPS was the pressure in transportation. We're not alone. All companies are facing higher transportation cost. And as you know is our practice, we will figure out a way to work through this, but we've certainly got some challenges ahead.

<Q - Daniel Thomas Binder>: You mentioned a margin mix impact on gross margin. Was that primarily from the seasonal mix and how should we think about that for Q2? And then my second question was around credit. And just curious if I can get your thoughts on demand for credit, use of the credit lines that are out there, average spending on credit and delinquencies.

<A - Carol B. Tomé>: On the margin expansion that came from mix and acquisitions, that was 14BPS in total, of which 6BPS was mix and 8BPS came from our recent acquisitions, those acquisitions being The Company Store and Compact Power. As we look to Q2, obviously, with an increase in penetration of the garden business, which is a lower margin category, that's an impact to gross margins, but we're going to have benefit in other areas, too. So nothing comes to our attention that says we can't deliver the gross margin guidance that we just provided and updated with you today.

On our private label credit card, really pleased with the performance. As I mentioned, we saw 50 basis point improvement in penetration year-on-year. What we're seeing is a very healthy portfolio. The average net receivable, which obviously isn't underwritten by us, it's underwritten by a third-party, but it's over $12B. We had 1mm new accounts opened year-on-year and we're seeing pretty good utilization on those accounts. For the consumer, the utilization is around 29%. For the pro, the utilization is around 23%. And our approval rates are north of 70% for both the consumer and the pro.

Part of the change in accounting for us is moving all of the aspects of our private label credit card up to the revenue line. And included in the benefit that we removed out of our selling expenses and moved up to the revenue line was [ph] gain share. Gain share (46:56) is our profit-sharing program with Citi, who underwrites this card for us. The way the portfolio has gains is there's an EBIT threshold that must earn, and then anything over that EBIT threshold, we share in it. And that percentage of sharing changes over time. Embedded in that EBIT threshold, of course, is that you've got to make sure that the portfolio doesn't have high losses, because that could impact your gain share and our losses – this is a long winded answer to your question, but our losses are running at or below historical averages. So the portfolio is very healthy.

<Q - Charles Grom>: Just on the gross margin line, just a follow-up on the transportation costs. Just wondering if you could characterize how they came in relative to your original expectations. And then I have a follow-up.

<A - Carol B. Tomé>: We didn't anticipate deleveraging the supply chain in Q1 to the extent that we did. The team did an awesome job, though, of managing spiky demand, pressure coming from all kinds of areas, so managed through it.

<Q - Charles Grom>: You would expect that headwind to continue over the balance of the year?

<A - Carol B. Tomé>: There is definitely pressure coming at us for the balance of the year, but we'll manage through it.

<Q - Charles Grom>: And then just on the weather here, obviously, you guys have a lot of experience dealing with it. When you think about it, does the business get simply delayed here and you recover most of it, or do you lose some of it because the window just simply closes?

<A - Craig A. Menear>: We'll actually recover most of the business there. There may be a piece here and there that you miss, like part of pre-emergence, but even in that, we feel like we're getting most of that business right now, particularly in the north. So the majority of this business will be recovered.

<Q - Matthew McClintock>: I was wondering if we take the housing question from more of a generational perspective, it seems like a lot of the long-term optimism for the housing market to stay strong is driven by the millennial generation forming households. But can you talk about maybe trend changes that you're seeing in the other generations? And I only ask because it seems like a lot of the story of baby boomers maybe moving, downsizing their household seems to be kind of minimizing. Thanks.

<A - Carol B. Tomé>: As we look at mobility rates, we see mobility rates declining by all age cohorts, particularly baby boomers like me. And there's been some great research that came out of the Harvard Joint Center for Housing Studies that suggest the desire is to age out in your home. If you think about what that means for home improvement, there's nothing but opportunity. So, that's just one trend.

<Q - Matthew McClintock>: Can you maybe dig into some of how the opportunities do change for you and how you position yourself for some of those changes just a little bit more?

<A - Craig A. Menear>: If you think about flooring, for example, that's something that people look at as they age in their home. How do you make sure you eliminate trip hazards? You think about bath remodels and the ability to put in walk-in showers, for example, so that you don't have to step into a bathtub, where you have the potential to slip. You think about lighting around the home becomes an important factor, both inside and outside the home. You think about security. So there's lots of factors that go into how somebody thinks about changing their home if they're aging out in their home.

<Q - Peter S. Benedict>: Thanks for taking the question and appreciate the Stamford, Connecticut store.

<A - Carol B. Tomé>: It did $1mm the first week. It's an awesome store.

<Q - Peter S. Benedict>: There you go, well done. Given the traction online with categories like tools, electrical, bath, just can you remind us how you're rethinking the space allocation within the stores to take advantage of the opportunities across different categories? That's my first question.

<A - Craig A. Menear>: As I mentioned earlier, our online business, for all practical purposes, is incremental, so we actually haven't seen the need to make a lot of shifts in space. It's something that we look at on a continual basis, but we really haven't had to do that at all.

<A - Edward P. Decker>: The space that we're doing speaks more to the interconnected nature of our online business, where we're putting lockers in the front of our stores. We'll do about 1,000 lockers this year and we're also adding some bigger holding area for bulkier items near the front of the store. So space allocation is more for online pickup than any merchandising changes in the bay.

<A - Carol B. Tomé>: 46% of our online orders were picked up in a store in Q1.

<Q - Peter S. Benedict>: Back to kind of the red flags that you're keeping an eye on out there, how about what are you watching when you think about the leverage guardrail for the business? Interest rates are going up here. But is there a level or a point at which the 2.0 becomes something that you're not comfortable with or how should we think about that?

<A - Carol B. Tomé>: I'm really pleased with how we've managed our capital structure over the past several years. If you look at the amount of debt that we have outstanding, long-term debt, excluding current maturities, $24B, the average maturity of that debt is 13.6 years. The coupon is 3.7%. The latter maturities go out 40 years. So we really worked hard to not put any financial risk into the company. And with an adjusted debt-to-EBITDAR target of 2 times, that implies we could get the debt paid off in a very short period of time, so comfortable with that leverage. Always going to be mindful of not putting the company into financial distress, but real comfortable with where we are today.

<Q - John Allen Baugh>: Just quickly, since you're hyper-focused on the transactions and thanks for the 1.1% number in April ex-garden, I know you don't guide to that figure, but it sounds like May is well up. You've been running a 2-plus percent, I believe, fairly consistently. Is there any thought around that number for the year, in light of the start to

Q1? Thank you.

<A - Craig A. Menear>: The 1.1% was for the quarter ex our garden business. It wasn't for April. So that was for the total quarter. And we think about the balance between ticket and transactions being relatively even over time, and that's how we plan the year.

<Q - Matthew J. Fassler>: My first question is for Carol. You spelled out a 56 basis point impact on the expense ratio from your investment plan. Can you spell out here at the outset of that program where some of that money went and whether that's the kind of impact you would expect to see us through the year or whether with a better top line, that impact should dissipate a bit?

<A - Carol B. Tomé>: I talked about expense deleverage and leverage as a percent of sales. I didn't really talk about the expense growth factor. But let's use that nomenclature, because that's how we've guided for the year. So the expense growth factor in Q1 was 202% and the drivers of that were rev rec, which was 57%; investments in the business, 70%; and then what we call BAU, business as usual, 75%. And in that business as usual, there's about 12% of acquisition-related expenses, companies that we've acquired. So if we focus then on the guidance that we gave for the year, clearly, it's going to get better and it's going to get better for a couple of reasons.

First, we have $167mm of hurricane-related expenses in the back half that will not repeat. So you should model higher expense growth factor in H1 than in the back half. Secondly, and you've heard Ann-Marie talk about this, we have a new labor model, which more effectively allocates hours to our activity. That starts to kick in into June. So we should be driving more labor productivity than we saw in Q1.

Then if I focus simply on the investments in Q1, the dollar amount of investments, and I'm not going to call this out every quarter, but because we're just getting into this, I'll give you this color. The dollar amount of the investments were $144mm in the quarter. And those dollars were used for increased wages for our people; for increased advertising as we move to a more marketing technology platform; increases in display costs, you heard Craig call out what we're doing inside of the stores; and then increase in head count. We've got to have some people on board to help us do all of this investing. In fact, I believe we've hired 350 people alone in our IT organization. So these are investments that we're making to reach those sales and operating margin targets that we laid out for 2020.

<Q - Matthew J. Fassler>: If I could follow-up on a couple of disclosures you made on the monthly trends. Was there any weather impact on the first two months of the quarter on February and March? And then when you think about the bathtub effect, if April was really the only month that was impacted? Do you tend to recapture most of those lost sales in the month of May or does the bathtub effect push out towards June or July?

<A - Craig A. Menear>: There definitely was impact still in the other months as well. And the recovery of that, you'll get a significant piece in May, but it will actually flow into June and July as well.

<Q - Scot Ciccarelli>: Are you seeing a greater appetite for jobsite delivery from your pro customers?

<Q - Scot Ciccarelli>: Obviously, that is the case. Now, over time, do you think that happens to change your historical real estate advantage that you've had against some of your major competitors or maybe even open the door to higher levels of e-commerce competition, because then the physical location or physical structure of The Home Depot store maybe gets partly marginalized over time?

<A - Craig A. Menear>: When you think about our location and footprint, we'll actually leverage that as an advantage overall to our business, where we are well-positioned across markets, including urban markets and sit within 10 miles and 90% of the U.S. population. So, no, we actually see this as an advantage. And, Mark, I...

<A - Mark Holifield>: You'll recall from the investor conference, we outlined 40 flatbed distribution centers and we expect to open those to take some pressure off of the stores. But our stores are going to be in the delivery business in smaller markets for a good long time. They're still ideally located and a great place to originate those deliveries from. In urban markets, those flatbed distribution centers will take a lot of pressure off of those high volume stores.

<A - Craig A. Menear>: The other thing you have to think about is, actually not just the downstream portion of our supply chain network, but the advantage that we actually have as a result of the upstream portion of our supply chain moving goods from our suppliers to our stores and our distribution centers, it's those things working in combination that will create the fastest, most efficient delivery in home improvement.

<Q - Alvaro Lacayo>: Just one question on update on the capital allocation, Carol, last call you said you were going to provide us with an update later on, given that cash flow from operations was going to be a little bit higher than sort of what was guided on dividend and repurchases and just some commentary around if there's any updated thoughts there.

<A - Carol B. Tomé>: We've been working on how to best use the cash that's coming off the business through lower taxes. We aren't announcing anything today. We have a board meeting this week. So we will keep you apprised, expect a more thorough update at the end of Q2. But with that, let me just say that our principles aren't changing. The first uses of cash is to go back in support of the business and our strategic imperatives. The second is to pay our dividend, and anything that's leftover goes to share repurchases.