Company Name: Home Depot
Company Ticker: HD US
Date: 2017-05-16
Event Description: Q1 2017 Earnings Call

Market Cap: 190,097.00
Current PX: 158.26
YTD Change($): +24.18
YTD Change(%): +18.034

Bloomberg Estimates - EPS
Current Quarter: 2.215
Current Year: 7.213
Bloomberg Estimates - Sales
Current Quarter: 27807.818
Current Year: 99207.037

Q1 2017 Earnings Call

Company Participants

- Diane Dayhoff
- Craig A. Menear
- Edward P. Decker
- Carol B. Tomé
- Kevin Hofmann

Other Participants

- Simeon Ari Gutman
- Michael Louis Lasser
- Seth I. Sigman
- Keith Hughes
- Brian Nagel
- Christopher Michael Horvers
- Matthew J. Fassler
- Kate McShane
- Seth M. Basham
- Matthew McClintock
- Michael Baker
- Alan Rifkin
- Greg Melich
- John Baugh

MANAGEMENT DISCUSSION SECTION

Diane Dayhoff

Non-GAAP Financial Measures

Today's presentations also include certain non-GAAP measures

Reconciliation of these measures is provided on our website

Craig A. Menear

Business Highlights

Sales and Diluted EPS

- Sales for Q1 were $23.9B, up 4.9% from last year
- Comp sales were up 5.5% from last year, and our U.S. stores had a positive comp of 6%

- Diluted EPS were $1.67 in Q1
- We were pleased with the start of the year, as we executed within a more-normalized spring environment and navigated a tough weather comparison, with weather-driven demand that we saw in Q1 last year
- All three of our U.S. divisions posted positive comps led by our Southern division

International Performance

- On the international front, both Canada and Mexico posted another quarter of positive comps in local currency
- The power of our interconnected retail strategy continues to gain traction in our international businesses, as digital sites in both countries were recently updated, driving sales growth and positive response from our customers

U.S

- Turning back to the U.S., we saw a broad-based growth across our store, as both ticket and transactions grew in the quarter, and all merchandising departments posted positive comps
- Our commitment to new and innovative products continues to be a contributor of our ticket growth
- Our merchants collaborate with our supplier partners to bring innovative and exclusive items to market that deliver value for our customers by saving them time and money
- As Ted will detail, the extension of lithium-ion battery technology into the outdoor power category is an excellent example of our ongoing focus on innovation, and we continue to see great sales in this category

DIY Sales

- Another engine of growth for our business is the Pro customer, as Pro sales once again outpaced DIY sales in the quarter
- We recognize that Pro customers have needs that go beyond our traditional in-store offerings, and we believe that the work we are doing to strengthen our sales support, assortment, and fulfillment for this customer base continues to resonate
- For example, our in-store tool rental business helps our Pros more effectively run their business

Pro Referral Platform

- In many cases, a partnership with The Home Depot can translate into business for our Pros, as we can connect to them with our do-it-for-me customers through our Pro referral platform
- We continue to see significant opportunity to help our Pros manage and grow their business, while driving higher product pull-through and strengthening our relationship with our do-it-for-me customer

Pro Strategy

- Another component of our overall Pro strategy centers on Interline and the MRO customer
- Use case one, the rollout of Interline's catalog of products to Home Depot stores, is now live in over 1,500 U.S. stores

  - We continue to roll out use case two, which enables Interline customers to shop Home Depot stores using a swipe card that is linked to their Interline account
- Interline sales growth outpaced the company average in the quarter, and we remain very excited about the opportunity that Interline provides
- The power of interconnected retail creates growth opportunities for The Home Depot
- As we invest in this area, we are seeing a positive response from our customers in the form of improved customer satisfaction scores and increased sales

Online Traffic Growth

- In Q1, our online traffic growth was robust, and our online sales grew approximately 23%
- Our supply chain continues to be a source of strength for our business
- The flexibility and nimbleness of our supply chain is a competitive advantage
- This is particularly evident during our busy spring selling season, when regional weather conditions vary, resulting in spiky demand patterns
- Operationally, nimbleness and flexibility carries over into our stores
  - This spring, MET, our Merchandising Execution Team, helped us drive productivity by reducing merchandising set times by 25%

Sales

- In store, associates efficiently manage freight flow within the store, while remaining focused on providing strong customer service in the aisle
- And we hired over 85,000 new associates to ramp up for spring sales, with a simplified application process, reducing the time it takes to complete an application by up to 80%
- The success of our first quarter is a result of each and every one of our associates
- And I'd like to thank them for their hard work and dedication to our customers
- Looking forward, we plan to continue this momentum

Edward P. Decker

Q1 Highlights

Pro Business

- We had a great first quarter driven by continued strength across the store
- Our Pro business was particularly strong and outpaced the company average
- We also saw excellent growth in our online business, as online sales grew approximately 23%

Merchandising Departments

- All of our merchandising departments posted positive comps
- Appliances, lumber, and flooring had double-digit comps in the quarter
- Tools, electrical, plumbing, decor, and kitchen and bath were above the company average
  - Indoor garden was in line with the company average
- Building materials, millwork, hardware, lighting, paint, and outdoor garden were positive but below the company average

New Innovative Products

- In Q1, total comp transactions grew by 1.5% and comp average ticket increased 3.9%
- The increase in average ticket was positively impacted by a number of things, including customers trading up to new innovative products
- Commodity price inflation in lumber, building materials, and copper also positively impacted average ticket growth by approximately 75BPS

Sales

- Looking at big ticket sales in Q1, transactions over $900, which represent approximately 20% of our U.S. sales, were up 15.8%
- A few drivers behind the increase in big ticket purchases were appliances, flooring, and roofing

Pro Customer

- In Q1, sales with our Pro customers outpaced the company average, driven by both our high-spend and low-spend Pros. We saw strong comps in several lumber categories, wire, commercial and industrial lighting, and gypsum
- In addition, the core of the store performed well, and we saw strength in several maintenance and repair categories across the company
- Classes that outperformed the company average included several flooring categories, tool storage, power tools, and a number of bath categories

New and Innovative Products

  - As Craig mentioned earlier, our customers respond to new and innovative products
  - A perfect example is the customer response we are seeing with our new lithium-ion battery technology in outdoor power
  - We've partnered with the best suppliers to put together a lineup of tools that has the long-lasting power and runtime to get the job done without the hassle of gas and cords, even with a lawn mower

Assortment of EGO and Ryobi

- Our exclusive assortment of EGO and Ryobi cordless mowers can handle a standard-sized yard with just one charge

- In addition, for those customers that prefer gas power, we've got a powerful lineup led by Honda and Toro that includes 13 of the top 15 rated self-propelled gas mowers on the market
- And all of these are retail exclusives to The Home Depot
- Our spring Black Friday event was a success
- Our associates drove excitement around special buys in our stores and online, and our customers responded
  - We saw increased traffic both in-store and online, and strong comps in categories like mix-and-match patio, outdoor power tools, mowers, and chemicals

Interconnected Retail Strategy

- We strive to balance the art and science of retail
- With our interconnected retail strategy, we are continually improving the customer experience by striving to create frictionless shopping across all channels
- For example, our new simplified and expedited online checkout process reduces customers' checkout time by an average of 20%

Leveraging

- In addition, we are leveraging our digital assets and big data to better know our customers, and in turn, better meet their needs to targeted online offerings and localized online experiences
- For example, our refreshed mobile app personalizes the users' homepage based on location, customer segment, and shopping patterns
  - We are pleased with the customer engagement in response to these enhancements, and we are seeing increased conversion rates

New PPG TIMELESS

- Now, let me turn your attention to Q2
- We continuously introduce innovation and value to save our customers both time and money
- A great example of this is the new PPG TIMELESS exterior stain and sealant
  - This is the first PPG-branded product offered at The Home Depot, and it's their most advanced and durable line of wood care on the market
- With enhanced oil technology, improved resins, stronger UV absorbers, and better water repellency, this product provides outstanding outdoor protection from the elements
- PPG TIMELESS exterior stain and sealant is exclusive to The Home Depot

Ring Outdoor

- Another exciting new product is the Ring outdoor cam with motion-activated floodlight
- This is the first high-definition security camera, with built-in floodlights, two-way talk, automated recording, and a siren alarm

- The best part is that this product is easy to install and connects directly to your mobile device, so you can monitor your property anytime, anywhere
    - This product launched exclusively at The Home Depot

New Product Offerings

- In addition to all the new product offerings, we are gearing up for our upcoming events in Q2
- Be on the lookout for our Thrill of the Grill, Memorial Day, Father's Day and Fourth of July events, where we will be offering more great values and special buys for our customers

Carol B. Tomé

Financial Highlights

Sales Growth

- In Q1, sales were $23.9B, a 4.9% increase from last year
- Our total company comps or same-store sales were positive 5.5% for the quarter, with positive comps of 5.8% in February, 4.3% in March, and 6.2% in April
- Comps for U.S. stores were a positive 6% for the quarter, with positive comps of 6.3% in February, 4.6% in March, and 6.8% in April
- The cadence of our monthly comps was impacted a bit by weather and by the timing of Easter this year vs. last year
- Adjusting for Easter on a like-for-like basis, our U.S. comps were 2.9% in March and 8% in April
- Two more comments about our first quarter sales growth
    - First, for activity purposes, we record comp sales when tender is accepted
- And we record sales revenue when the transaction is completed
- The difference is known as deferred sales
    - Compared to last year, our deferred sales grew by $116mm
- As a result, our reported sales growth was less than our comp sales growth

Gross Margin

- Second, vs. last year, fluctuating foreign currency exchange rates negatively impacted total sales growth by approximately $71mm
- Our total company gross margin was 34.1% for the quarter, a decrease of 9BPS from last year
- As expected, the modest decline in our gross margin was primarily driven by a change in the mix of products sold

Operating Expenses

- For FY2017, we continue to expect our gross margin to decline by approximately 15BPS from what we reported in FY2016
- In Q1, operating expense as a percent of sales decreased by 59BPS to 20.1%
- Our expense leverage reflects the impact of positive comp sales growth, along with continued expense control
- In the quarter, our expenses were roughly $18mm under our plan, albeit some of the variance was due to timing
    - While our expenses grew at approximately 39% of our sales growth rate in Q1, for FY2017, we now expect our expenses to grow at approximately 43% of our sales growth rate

Operating Margin and Tax Rate

- Our operating margin for Q1 was 14%, an increase of 50BPS from last year
- Interest and other expense for Q1 was $241mm, up slightly from last year
- In Q1, our effective tax rate was 35.2% compared to 36.5% in Q1 FY2016
- The y-over-y change in our effective tax rate was driven largely by a new FASB stock compensation accounting standard that we adopted at the beginning of FY2017
- For the year, we expect our effective tax rate to be approximately 36.3%
- Our diluted EPS for Q1 were $1.67, an increase of 16% from last year

New Store Openings

- Now, moving to some additional highlights
- During Q1, we opened two new stores in the U.S. and one new store in Mexico, bringing our total store count to 2,281, and selling square footage to 238mm square feet
- Total sales per square foot for Q1 were $394, up 4.6% from last year

Balance Sheet Items

Inventory and Accounts Payable

- Turning to the balance sheet
- At the end of the quarter, merchandise inventories were $13.6B, up $390mm from last year
- And inventory turns were 4.8 times, flat to last year
- Accounts payable grew by $427mm y-over-y

Share Repurchasing

- In Q1, we repurchased $1.25B or approximately 8.5mm shares of outstanding stock
- For the remainder of the FY, we intend to repurchase approximately $3.75B of outstanding stock using excess cash, bringing total anticipated 2017 share repurchases to $5B.

- Computed on the average of beginning and ending long-term debt and equity for the trailing 12 months, return on invested capital was approximately 32.3%, 310BPS higher than Q1 FY2016

Sales and Earnings

- To wrap up the commentary on our first quarter financial results, we were pleased, as sales and earnings were better than we planned
- Looking ahead, while U.S. GDP forecasts are mixed, housing continues to be a growing asset class
- And our sales thus far in May have been very good
  - But relative to our plan, we do anticipate some foreign exchange pressure

EPS

- So, today, we are reaffirming the sales growth guidance we laid out on our fourth quarter earnings call
- For FY2017, we expect sales to increase by approximately 4.6%, with positive comps of approximately 4.6%
- For EPS, remember that we guide off of GAAP
- Given our first quarter expense performance, we are lifting our EPS growth guidance
- For FY2017, we now expect diluted EPS to increase by approximately 11% to $7.15

QUESTION AND ANSWER SECTION

<Q - Simeon Ari Gutman>: In looking in different markets across the country, can you tell us if you're seeing a broadening across markets, meaning if there were some of the laggards out there, are they speeding up? And then are you seeing any moderation in some of the faster improving markets?

<A - Craig A. Menear>: We actually look at the variability of our markets. And in the quarter, our variability narrowed about 40BPS y-over-y, which was pretty consistent with what we saw in Q4.

<Q - Simeon Ari Gutman>: And that narrowing, I guess, can you elaborate if that's a function of the fast getting slower, or some of the slower, improving and getting faster?

<A - Craig A. Menear>: No, it's really – we're not seeing a big change in the regional sales, other than where we have some weather impacts.

<Q - Simeon Ari Gutman>: Okay. And then my follow up on flow-through, which has been pretty strong and consistent. And it's a function of both the gross margin and the SG&A. We know the guidance for the rest of the year. Thinking really towards the end of this year into next year, anything sort of good guys or bad guys to think about that impacts it going forward? And we know, this year, gross margin a little weaker because of just mixed headwinds. But as you look out a little bit longer term, are there anything positive or negative we should think about?

<A - Carol B. Tomé>: Simeon, good morning. No, nothing at this point. And, as you know, we have an Investor Conference coming up in December. And we'll give you a lot more color about our point of view for FY2018, 2019, and 2020.

<Q - Michael Louis Lasser>: Deferred revenue was bigger this quarter than it's been in the past, recognize that next quarter. To what degree is that a leading indicator of the business, given the nature of the sales that are in that number?

<A - Carol B. Tomé>: Yeah. There were three big drivers of the deferred revenue growth year-on-year. One, you've heard commentary about our dot-com sales growth, up 23% year-on-year. Not all of those sales are completed at the time that we take the tender. Our dot-com sales now make up 6.6% of our total sales. We also saw growth in our services business. Our services business grew faster than our company average. And Ted called out flooring as an example. Those were the two biggest drivers of the deferred sales increase.

<**Q - Michael Louis Lasser**>: Is it a leading indicator for the next few quarters, given what's going into those numbers?

<**A - Carol B. Tomé**>: We would anticipate continued strong growth in those categories.

<**Q - Michael Louis Lasser**>: Okay. And then my follow-up question is on the e-comm business. Obviously, you're doing really well through that channel. To what extent is it validating that consumers increasingly want to buy the home improvement products through the online channel, and subsequently going to expose you to greater and greater levels of competition?

<**A - Craig A. Menear**>: I mean, I think the interesting thing for us is over 45% of our orders on homedepot.com, the customer is actually choosing to pick up into our store. So, they're finding it incredibly convenient to blend the channels and utilize all the assets that we have.

<**Q - Michael Louis Lasser**>: Is that percentage changing at all, Craig? I think you mentioned that it's 50%...

<**A - Craig A. Menear**>: It's been growing for the past 12 months.

<**Q - Seth I. Sigman**>: I had a follow-up question on big ticket comps in the quarter. It seems to be one of the key bright spots here, where it accelerated up 15.8%, I think you said. You mentioned a couple categories. Do you think that reflects an acceleration in market share and maybe some of the benefits from company-specific initiatives and the Pro focus, or how do you balance that with also maybe an acceleration in demand trends overall?

<**A - Craig A. Menear**>: I mean, I'll start and let Ted comment on this. I do think it's an acceleration of the customer's willingness to spend in big ticket projects. We're seeing strong remodel business with our Pro, but then it's also categories that we've invested in as well.

<**A - Edward P. Decker**>: Yeah. I'd add to that, that it's really all the above. The customers responding to the product and the innovation. Certainly, there are some very big ticket items like appliances where we had double-digit comps again. But across the whole portfolio, as I've mentioned before, we track the purchase patterns from OPP up the line structure. And we continue to see a willingness and a response from the consumer when we're showing great value on innovative products at higher price points. And then services is going quite well. Those obviously are bigger ticket items. And our Pro customer, which here, you get a much larger items per basket, where you're driving a project, and that's been very healthy as well.

<**Q - Seth I. Sigman**>: Okay. That's helpful. And then to follow up on gross margin, mix has been the primary driver of the slight decline. Can you maybe speak to some of the other underlying drivers that you've talked about in the past, whether it's the productivity and supply chain work, and then the partial offset from investments in price? Are you seeing a change in the pace for either of those items?

<**A - Carol B. Tomé**>: Well, let's talk about supply chain first. Supply chain did contribute 1 basis point to the gross margin expansion in Q1. That's after 3BPS of pressure coming from higher fuel cost. Again, spiky demand that we had Q1, we were very pleased with our supply chain performance in Q1. In fact, expenses were under plan. So, that was a good news story. And some of the other drivers, it's all part of the portfolio that Ted and the merchants run. And it's working just that way we want it.

<**A - Edward P. Decker**>: Yeah.

<**Q - Keith Hughes**>: Question on some of the categories, the double-digit categories, specifically, flooring. Could you just highlight what's – it appears to be well above the industry. Could you talk about what's working there, what's allowing it to gain share?

<A - Edward P. Decker>: Well, we have a nice mix there. The hard surface flooring had been much stronger over the past couple years. And we've done a lot of work in our showrooms with hard surface flooring, particularly, with tile and laminate. But recently, vinyl plank has been taking off. So, luxury vinyl plank manufacturers are now putting a solid core in the product, so you can get much greater use cases of that vinyl product. And the efficacy of it and the look is getting better and better, and that's selling very well. And then soft flooring, soft flooring is not dead. And we've simplified a go-to-market model.

<A - Carol B. Tomé>: Long live carpet.

<A - Edward P. Decker>: And we're seeing terrific strength with our soft flooring categories.

<Q - Keith Hughes>: And you're referring to the whole house installation price? Is that what you're referring to in soft flooring?

<A - Edward P. Decker>: Yeah. Yes.

<Q - Keith Hughes>: Okay. Second question regarding big ticket in general, as referred to, very good in the quarter. How much did the lumber inflation play into the big number you reported there?

<A - Edward P. Decker>: Lumber was a little more than half of that 75BPS.

<Q - Keith Hughes>: Okay, a little more than half. Okay. And that 75 points, is that on the full-year comp or just on the growth of the – or I guess it would be the same, actually, on the full-year comp or the growth of big ticket?

<A - Carol B. Tomé>: That was only on the average ticket growth for the company.

<A - Edward P. Decker>: Right.

<A - Carol B. Tomé>: In terms of the performance of big ticket categories, it was more driven by appliances…

<A - Edward P. Decker>: Flooring.

<A - Carol B. Tomé>: …and flooring.

<A - Edward P. Decker>: Yes.

<A - Carol B. Tomé>: And not so much lumber.

<Q - Brian Nagel>: So, couple questions here. First off, not to be nitpicky here, but if you – just a question on the cadence of comps in the quarter. So, Carol, you called out in the U.S. business, I guess, adjusted for Easter, March was 2.9%, and then April was 8%. So, as we think about that, I assume that 8% reflected picking up some of the business that may have been lost or didn't happen in March because of weather. And how should we think about then maybe a more normalized run rate there?

<A - Carol B. Tomé>: Right. So, Brian, it was a little choppy in terms of the cadence, and we do think that was weather. If you look at our transactions, our transactions in March were actually under 1% growth year-on-year, and it was all weather-related. And when the weather improved in April, the sales came back.

So, we always talk to you about the bathtub effect of H1. We had a bathtub effect in Q1. We did. And so, as we think now about H1, we would think that Q1 will be slightly stronger than Q2. And that the comps for H1 will be about the same as the comps for the back half.

<Q - Brian Nagel>: Got it. That's helpful. Then the second question I had, it's probably a follow-up to a prior question, but with regard to online sales, we have seen a nice tick up here. Craig, you called out, I think, you said 45% of the online sales now are buy online, pick-up in store.

<A - Craig A. Menear>: Right.

<Q - Brian Nagel>: The other point, so, I guess, the remaining 55%. Is there any color you can give on what people are actually buying online? Has it surprised you in any way? And maybe then there's a comment on the profitability of those sales vs. in-store sales. Thanks.

<A - Craig A. Menear>: Well, let me address the last part, and then Kevin Hofmann is here, who runs our online business. I'll let him comment on the sales patterns. When it comes to the profitability, it's actually – this whole customer engagement is becoming a blended element between online and in-store. And the customer is choosing, in some cases, to start the shopping experience online, they finish in-store, or they might vice versa, start in the store and actually finish online. And so, with 45% of the orders being picked up, it is truly a blended effort. And we look at it that way. And our merchants manage it as a total portfolio. So, they see an entire blended mix of sales for the business. And that's actually how we run the business. So, we don't focus on it individually by itself.

<A - Kevin Hofmann>: And then, Brian, from just a sales perspective, certainly, we see strength across the store. Our bath business has been doing very well. Our flooring business has been doing very well. Plumbing, power tools, all doing very well. And not to ignore the core building materials products. We see great [ph] visit traction (30:37) of Pros shopping online, looking for inventory levels, looking at pricing. And that's been working very, very well for us as well.

<Q - Christopher Michael Horvers>: Following up on just how you think about guidance. So, there was this swoon in the late summer last year. I was curious if you had any retrospect on what drove that? And as you just think about modeling the business, is the growth in the market the growth rate, and so, compares don't necessarily matter, or do you think maybe as we lap through that pause, like it seemed to happen in the late summer, where you would expect to pick up some extra this year as we approach that?

<A - Carol B. Tomé>: I think we've all kind of talked this out a lot. We think the Pros went on vacation, and good for them. They were busy, they got more work than they know what to do with, and they took some time off, and then they came back hard at work. And to your point, should we ignore compares? I don't think you should ever ignore a compare but, clearly, there's demand that's being created by this housing market that is very strong. Home prices up year-on-year over 5%, housing turnover over 4%, and aging housing stock, household formation. We see growth in private fixed residential investment every quarter. It's still a long way to go to reach back to the mean or 4.5% of GDP. So, a lot of good momentum in our business.

<Q - Christopher Michael Horvers>: So, I guess, then, playing devil's advocate on it, I mean, the compares do ease. You talked about a pretty normal spring. It doesn't sound like there was any pull-forward into Q1 out of Q2 on the spring business. So, why isn't this a 5% to 6% growth business through the balance of the year?

<A - Carol B. Tomé>: So, a few things. First, as I mentioned, we've got some currency pressure coming our way. We estimate that currency pressure to be $250mm. Second, it is the middle of May. And it's a little early to start thinking about listing for the full year. But as I said, sales, so far, in May has been very good.

<A - Craig A. Menear>: I think one other comment would be, Chris, that while we had a great indoor garden business with power equipment, the outdoor garden business in Q1 really hadn't come alive. And you saw that in the flatness of our ticket, $50 and under. There were parts of the country where it was pretty wet for people to be out preparing their landscape for planting, and so, I think that was a factor as well.

<Q - Christopher Michael Horvers>: And then my follow up is, if there's anything to – as you think about different cycles that you've all seen in this business, the traffic number for this quarter, ticket continues to lead, which is very encouraging, but at the same time traffic matters. How are you thinking about that in the context of the cycle? Thank you.

<A - Carol B. Tomé>: Ted's got some really great data on traffic. You might want to share that.

<A - Edward P. Decker>: Yeah. So, we look at the contributors to our transactions by obviously all the different price breaks. And as Craig just said, it is an outdoor garden story on the transactions, so to why we'd be a little conservative. You obviously have to get some good weather into Q2 to drive that outdoor business. Q1 wasn't particularly good or bad, it was a more normal spring. We are not concerned that there was much, if anything, pulled forward, so we are expecting that business to come in outdoor garden.

And when you talk about the bigger trends, and we've often mentioned the 40 classes that we track from the prior peak in 2006, that we still have 12 of those 40 top classes of goods that have not recovered to the peak. So, those tend to be the much bigger projects, involving a lot of millwork and building materials. So, while we're seeing a lot of strength in that business and very robust, I called out roofing as a double-digit driver, but that whole portfolio you're generally looking at adding square footage to get the big project-driven projects, and we're looking forward to that coming.

<A - Carol B. Tomé>: That sales opportunity, by the way, is $1.3B.

<Q - Matthew J. Fassler>: So, your online business seemed to reaccelerate from the trend that you saw all of last year. I'm interested in what you think drove that business, whether it was the tilt towards big ticket or changes that you made. And also, for the past couple of years, online growth has been strongest in Q1. It seems almost like the seasonality is changing. And if you could talk about if there's any rhyme or reason to that, it'd be helpful to understand that.

<A - Craig A. Menear>: I mean, Matt, as you know, this is an area that we've been investing in. And so, I think the investments that we're making is improving the customer experience. And I'll let Kevin talk about the specifics.

<A - Kevin Hofmann>: Yeah, Matt, we've been very focused on improving the experience across the whole shopping funnel. And we made a really large site redesign last fall. We upgraded our mobile app substantially, and those have paid nice dividends for us. From a seasonality perspective, I just think you're seeing core categories that we tend to be strong in online penetrate well in Q1, and that's what's driving the growth.

<A - Carol B. Tomé>: Matt, if I could add a couple of numbers.

<Q - Matthew J. Fassler>: Yes.

<A - Carol B. Tomé>: The business were up 15% year-on-year. Our conversion rate increased 13BPS year-on-year. So, if your business are up, and your conversion is up, your sales are going to grow. And a lot of that is because of the site experience improvements that Kevin and team have made.

<Q - Matthew J. Fassler>: That's terrific. If we think about that, I'm sure you have data on customer aging. You can probably tell from the kind of products that they're purchasing and the kind of products they're engaging in. If we think about online transactions, is there a sign that the millennial customer is disproportionately patronizing the enterprise online, or is it more evenly distributed across age groups?

<A - Craig A. Menear>: We actually see it more evenly distributed.

<Q - Matthew J. Fassler>: Got it. Thank you so much. And then just one piece of cleanup, if I could. You gave the comp growth for the biggest ticket basket. Can you give us the comp growth for the small ticket basket, the $50 and under please?

<A - Craig A. Menear>: It was flat.

<Q - Kate McShane>: My question is centered around any potential bankruptcies in the space. And if a bankruptcy were to happen, how does that play out for your business? And how would it change what you're already experiencing in appliances, if anything?

<A - Craig A. Menear>: I mean, we clearly have invested to disproportionately take share in categories that we overlap with key competitors, who have been having their challenges. And we're going to continue to focus on trying to capture as much business as we can. It's in categories like appliances, it's tools, hand tools, storage. There's multiple categories that we overlap in businesses, where we think we can continue to grow share.

<A - Carol B. Tomé>: There's an appliance retailer that recently announced store closing…

<A - Edward P. Decker>: Right.

<A - Carol B. Tomé>: …and basically going out of business. And we're seeing sales coming our way in an environment where they're liquidating the store. It's very interesting.

<A - Edward P. Decker>: That's really interesting, actually.

<A - Carol B. Tomé>: Yeah, very interesting.

<Q - Kate McShane>: Thank you. And then if I could just follow up, a bit granular. But I know you've highlighted that millwork is an opportunity but it's still trending below the company comp average. What is holding that category back? And do you have any expectations on when that comp could accelerate, and what could drive it?

<A - Edward P. Decker>: As I mentioned, these are much larger projects. You can replace an exterior door to refresh your look or wear and tear. But if you're going to be getting into a number of interior doors, add windows, et cetera, to your house, you're generally doing a much larger remodel, and one that would likely add square footage to the house. And we're confident, while that business hasn't come roaring back just yet, it's healthy. But with the price appreciation Carol mentioned in housing, this is where people are going to be much more confident to invest in their home, with the confidence that, that investment will be rewarded with a higher home value. So, I mean, very bullish on the state of housing and the likelihood of these much larger projects getting underway.

<A - Carol B. Tomé>: Guys, this is really a fascinating, to me, anyway. There are 76mm owned households in the United States, and of those, there are only 3.2mm that have negative equity in their home. And you go back to 2011, 11mm of those households had negative equity in their home. So, as the analysis shows, that since 2011 homeowners have enjoyed 113% increase in wealth, if you will, coming from home price appreciation, so on average $50,000 per household. So, you can imagine at some point, to Ted's point, they'll take that value out and do a bigger [indiscernible] (41:06) total remodel.

<A - Craig A. Menear>: And I think the other part is where there's 3.8 months of supply of inventory and housing on the market compared to historical norm of 6 months. I think that actually leans into people thinking about remodel vs. move as well.

<Q - Seth M. Basham>: My question's around the Pro business. Maybe you could provide some color on the degree of outperformance relative to DIY this quarter relative to recent quarters. That would be helpful.

<A - Carol B. Tomé>: Should I jump in?

<A - Craig A. Menear>: Sure.

<A - Carol B. Tomé>: I'll be happy to jump in. So, our Pro business grew twice as fast as our DIY customer in Q1.

<A - Craig A. Menear>: It was pretty balanced between our big ticket Pro and our small-spend Pro as well.

<Q - Seth M. Basham>: That's helpful. As it relates to Interline, specifically, you talked about some improvements with the use cases, and those starting to roll out and get some traction. As you anticipate the balance of the year from those use cases and the others you're working on, would you expect a further acceleration at Interline growth?

<A - Craig A. Menear>: We are very pleased with the growth that we're seeing in Interline. And in use case one, for example, I mentioned that we're at 1,500-plus U.S. stores now and actually seeing sales ahead of what we anticipated with that. So, yeah, we're excited about the opportunity with Interline, as we go forward.

<A - Carol B. Tomé>: The sales growth rate was higher than the company average in Q1. It's less than 2% of our sales, so you can't see it in the top line yet, but we will see it as these use cases gain traction.

<Q - Matthew McClintock>: I was wondering if we could talk about the power of innovation at driving both ticket and total sales. What product categories would you say over-index on innovation, or what you would call, the benefit of innovation, to those product categories?

<A - Edward P. Decker>: Well, there's actually a ton. I'll call out maybe some of the most exciting and technologically savvy. But when you look across the entire store – we've got to distribute a monthly report of all the great new innovative product. And it's fascinating to go through. This is a 200, 300-page report of product every month that's calling out. It could be lightweight drywall, it could be something as simple as cutting plywood into 4x4 panels to have that precut item for a project.

But, certainly, on the more techy innovative side, the lithium-ion battery technology has to be one of the largest. We have a full riding tractor, a Ryobi tractor, available for sale that – I've ridden it. You can cut your lawn on a battery-powered tractor. Craig mentioned the outdoor power. We have the power and the runtime of gas on blowers, and trimmers, and hedge trimmers. We've seen it in portable power for many years now, and it's now accelerating in outdoor power.

And then the second one is LED lighting technology, and not just the individual A-line bulbs, but you're now seeing integrated LED in your ceiling fans, in your light fixtures. And that's really what's driving our commercial and industrial lighting that I called out, as having such strong comps. Because now, you're getting that integrated fixture. You're getting all sorts of really attractive design elements powered by that incredibly thin lighting form factor. But it goes on. Our life-proof carpet and our pet-proof carpet, where technology enables us to offer lifetime stain guarantees on the product. So, really across the whole store, just super exciting, great innovative product that customers are responding to.

<Q - Matthew McClintock>: Thanks for that. And, Carol, if I could ask one follow-up. Just inventory turns for the quarter were flattish y-over-y. How should we think about inventory as we progress through the remainder of the year? Thanks.

<A - Carol B. Tomé>: Yes. Well, on an unrounded basis, inventory turns were slightly better than last year. And for the full year, we're expecting inventory turns to be up year-on-year, a few tenths.

<Q - Michael Baker>: Just one more e-commerce question. Have you guys ever – I'm sure you have, and it's probably been asked. Just to go over it again, what percent – what categories in your store do you think lend themselves best to online? And in particular, I'm curious about how the appliance business does online. Is that something that you think can work through that channel? Thanks.

<A - Craig A. Menear>: So, yeah, I think we shared a number of years back that we looked at all of our categories and had segments of the business that we felt would lean more towards the digital world. Those things would be products that were smaller cube, more dense, higher value, would lend themselves to that type of business. And so, things like faucets and power tools, for example.

What's interesting is that we've been in a position to be able to not only grow that business online, but we've also been able to grow those categories in-store at the same time. And so, that's something that we see as a real advantage in our business. And then other categories that maybe the customer actually starts online, but they may finish in the physical world would be things like flooring and kitchens. And so, the research is done there, but many times the customer still wants to come in and talk to one of our associates and maybe go through some product and questions that they may have about the process. So, it's really something that we've been watching carefully. But we've been incredibly fortunate that we've been able to grow both channels really across categories that we think lend themselves to the online business. [indiscernible] (48:01) customers look a lot online before they actually come into the store and shop.

<Q - Michael Baker>: So, just a follow-up there. Do people actually transact for appliances online? And then the second follow-up is have you ever quantified, like x percent of your products are in that first bucket of lend themselves well to online?

<A - Craig A. Menear>: No, I mean, customers do go online, and some customers buy online, just like some customers buy patio online. They're comfortable doing that without living in it. But, again, the majority of our business in those kind of categories are in-store. And we haven't spent a lot of time trying to quantify.

<Q - Alan Rifkin>: You said that your average ticket growth of 3.9% was boosted in part by new product introduction. Curious, like for a given product, what is the duration of like that that can help contribute to average ticket? And what does the pipeline look like for new products in the future? Then I do have a follow-up.

<A - Craig A. Menear>: I mean, it really varies by category on what the cycle is in terms of product innovation. Historically, you could think about a product in a 36-month kind of timeframe. Today, there's categories that that cycle's way shorter than that. So, it varies quite a bit.

<Q - Alan Rifkin>: Okay. Thank you. And then, certainly, you got very solid expense growth in Q1, which led you to take the full-year ratio from 49% down to 43% after getting 39% expense growth in Q1, which is one of your lower revenue quarters. If you take that together with the fact that comps ease going forward, it would appear that the expense leverage in the following three quarters could even be better than what we saw in Q1, which would maybe lead to a number that's even below 43%. Is that a correct line of thinking on my part?

<A - Carol B. Tomé>: Alan, as you know, we put out guidance based on our point of view on the business, and we always try to do better. If I look at the next three quarters, I would say, the expense growth factor will be slightly higher in Q2, and then lower in the third and fourth quarter, principally because of y-over-y comparisons. But we do like to put out numbers that we can beat.

<Q - Greg Melich>: I had a couple questions, kind of follow ups. Carol, you mentioned that May was very, very good, right?

<A - Carol B. Tomé>: Yes.

<Q - Greg Melich>: I know, last May, there were some, I think, it was Memorial Day shift that meant you were doing sort of a 3% or 4% depending on how you look at it. When you say very good, is that a two-year or three-year stack? How should we think about that in terms of very good and exit rate? Is very good better than April?

<A - Carol B. Tomé>: I just look at our performance vs. our plan.

<Q - Greg Melich>: Always vs. the plan.

<A - Carol B. Tomé>: Always vs. plan.

<A - Craig A. Menear>: Correct.

<Q - Greg Melich>: And then the second question, maybe sort of a follow up broader speaking, there is a lot going on in the industry, a lot of change. And, Craig, I think you answered being positioned to help the customer and take that share. Could you talk a little bit maybe about the positioning in terms of how you work with vendors? It seems like you're getting a lot of innovation in product, maybe from some of those vendors that might be thinking differently about there are other ways of getting product to market. Could you help us understand that side of the equation, maybe Ted as well, especially given online growth, et cetera, as to how the vendors are working with you?

<A - Craig A. Menear>: I mean, I'll start with a comment and turn it over to Ted. I mean, this is an area that we have focused hard on for the past eight to nine years. During the downturn, one of the things that we clearly saw was that if the customer was going to spend money in 2008, 2009, 2010, it was going to be largely around new and innovative product. And if that product could help them save time or money, they would definitely step in, even in those tough economic times. So, this has been a focus that Ted and the merchants have had in a big way.

<A - Edward P. Decker>: We have a huge focus on collaboration with our supplier partners, and we appreciate that we have to win together. And two things we always want our partners to know is that when they're looking for volume, there's no better place than The Home Depot. No one is going to drive their volume and their productivity at their production facilities like The Home Depot. And the second thing, and you notice all the exclusives I called out in my prepared remarks, no one can launch a product like The Home Depot. And we want to continue working and collaborating with our partners, driving their volume, and introducing their innovation.

<Q - Greg Melich>: Right. And then, Carol, I have one follow up, bit of housekeeping. What was private label credit penetration in the quarter? And you talked a lot about strength, consumer from housing, I'm just curious how the credit dynamics are looking to you guys?

<A - Carol B. Tomé>: Yes. We were very pleased with our performance in our private label credit card. The penetration grew y-over-y by 20BPS, now stands at 22.6%. And we see that the sales on our private label card for our Pro, the growth rate was faster than the company average.

<Q - John Baugh>: Most of my questions are answered, but I was curious on the Southern division comment being the strongest. Is that due to weather compare, or demographics, or both?

<A - Craig A. Menear>: Well, the Southern division did have the benefit of the $70mm in storm sales y-over-y in Louisiana. There's still some recovery benefit going on there, so that was part of the driver of the Southern division's outperformance.

<Q - John Baugh>: And any calendar issues to be aware of, Carol, for the coming quarter or the year? Thank you.

<A - Carol B. Tomé>: No. No. Not that I can think of. The timing of Memorial Day may be off year-on-year. We may [ph] have to fit this into a (55:04) different fiscal month. I can't think that it does, but we'll clarify that…

<A - Craig A. Menear>: No quarter-to-quarter.

<A - Carol B. Tomé>: …at the end of Q2, but no quarter-to-quarter differences, no.