

Company Name: Home Depot
 Company Ticker: HD US
 Date: 2019-02-26
 Event Description: Q4 2018 Earnings Call

Market Cap: 212,690.08
 Current PX: 188.30
 YTD Change(\$): +16.48
 YTD Change(%): +9.591

Bloomberg Estimates - EPS
 Current Quarter: 2.191
 Current Year: 10.307
 Bloomberg Estimates - Sales
 Current Quarter: 26221.889
 Current Year: 111769.000

Q4 2018 Earnings Call

Company Participants

- Isabel Janci
- Craig A. Menear
- Edward P. Decker
- Carol B. Tomé
- Mark Holifield

Other Participants

- Simeon Ari Gutman
- Michael Lasser
- Scot Ciccarelli
- Charles Grom
- Christopher Horvers
- Steven Forbes
- Zachary Fadem
- Seth I. Sigman

MANAGEMENT DISCUSSION SECTION

Isabel Janci

Non-GAAP Financial Measures

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

Craig A. Menear

Business Highlights

Sales and Net Earnings

- FY2018 was another record year for our business, as we achieved the highest sales and net earnings in company history
- FY2018 sales grew \$7.3B to \$108.2B, an increase of 7.2% from FY2017, while diluted EPS grew 33.5% to \$9.73
- And although FY2018 was a record year for our business, our fourth quarter comp sales were slightly below our expectations, as the quarter experienced some unfavorable weather
- Sales for Q4 were \$26.5B, up 10.9% from last year
- Comp sales were up 3.2% from last year, and our U.S. comps were positive 3.7%
 - Diluted EPS were \$2.09 in Q4

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- Internationally, Mexico posted another quarter of positive comps in local currency, while Canada was essentially flat

Hurricane-Related Sales

- As we mentioned on last quarter's call, our fourth quarter faced tough comparisons given the prior year's approximately \$400mm in hurricane-related sales that would not repeat, and we planned for this in our outlook
- But as Carol will detail, what we did not plan for was the extent of the unfavorable weather we experienced in all regions throughout the quarter
 - It was cold, it was snowy, and perhaps worst of all, it was wet
- Wet weather delays projects, and this was evidenced in our sales performance in the quarter
- In fact, as Carol will detail, ex-weather, our business performed in line with our expectations

Pro and DIY

- And as Ted will discuss, both ticket and transactions grew in the quarter, and we saw growth in both Pro and DIY categories
- Pro sales once again outpaced DIY sales in the quarter, and the work that we're doing to enhance the service capabilities for our pros continues to resonate

Accomplishments

- I am very proud of our associates for continuing to do what they do best, serving our customers
- Our merchants, store teams, supplier partners, and supply chain teams did an outstanding job of delivering value and service to our customers throughout the quarter, both in stores and online
- In fact, several key accomplishments took place during the quarter
 - We set record performances on Black Friday and during Cyber Week
- Our holiday décor offering and gift center events set new all-time highs
- And during the quarter, we reached a new watermark of approximately 2B annual visits on homedepot.com, with many of these visitors indicating that their next stop is a Home Depot store

One Home Depot Investment Plan

- In FY2018, we made progress with regard to the One Home Depot investment plan, but we are still in the early days of our journey
- Our strategic effort to drive an enhanced interconnected customer experience through investments in both the physical and digital worlds are yielding solid returns
- We also continue to focus on productivity as a virtuous cycle by leveraging technology and improving processes throughout the value chain end of our business
- FY2018 provided a lot of great learnings and momentum that we will continue to build on in 2019

New B2B Website Experience

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- I'm particularly excited about the investments we're making for our pros. In the quarter, we announced a consolidated go-to-market approach for our pro customers under the banner Home Depot Pro, and we continue to invest in a more personalized offering for our Pro customers with a new B2B website experience
- We have now onboarded over 100,000 Pro customers, and the reception has been positive
- Our plan is for continuous enhancements with new features and capabilities
- For example, in response to customer feedback, we are adding the ability for businesses to enhance account management and ordering capabilities with improved tools
- Our intent to is roll out this new Pro online experience to over 1mm pros in 2019

B2B Personalization

- Beyond B2B personalization, we continue to make great strides in driving our digital experience
- This year we invested in our website and mobile applications, improving search capabilities, site functionality, and product content
- This ongoing investment in our digital properties has increased traffic and conversion. vs. prior year on a like-for-like basis, online sales grew 22.7% in Q4 and 24.1% in FY2018, now representing 7.9% of our total sales

Online Sales

- While we are seeing significant growth in our online sales, these online shoppers see the relevance of our stores, as approximately 50% of our online U.S. orders are picked up in our stores, a testament to the power of our interconnected retail strategy
- We continue to roll out automated lockers in our stores to make picking up an online order easier and more convenient
- To date, approximately 1,000 stores have lockers, with more to come in 2019
- Customer response to the lockers has been very positive, as almost 94% of customers rated their locker pickup experience a 5 out of 5 stars

Investment Program

- We fundamentally believe that when a customer comes to one of our stores, it has to be a great experience
- With our investment program, approximately 40% of our U.S. stores now have a new look and feel, and customer response has been very positive
- The store investments are not just about the customer response, as we are also seeing increased associate engagement and higher productivity

New Share Repurchase Program

- Another key component of a best-in-class interconnected shopping experience centers on enhanced delivery and fulfillment options
- FY2018 was the year of the pilot, as we kicked off our \$1.2B investment journey to create the fastest, most efficient delivery network for home improvement goods

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- We are now live with a number of these pilot facilities
- We look to FY2019 as the year to take what we have learned in pilot and begin the rollout that we expect to complete by 2022
- As a demonstration of the confidence in the business going forward, today our board announced a 32% increase in our quarterly dividend to \$1.36 per share
- The board also authorized a new share repurchase program of \$15B, replacing our existing authorization
 - We remain committed to maintaining disciplined capital allocation to create value for our shareholders

Sales Growth

- Turning to 2019 and beyond, I'm excited about the opportunities that are ahead of us
- Carol will take you through the details, but we expect 2019 to be another year of growth, with sales growth of approximately 3.3%, comp sales of 5%, and diluted EPS of approximately \$10.03
- Our strong performance in FY2018 also positions us well with respect to our 2020 financial targets, and today we are reaffirming those targets

One Home Depot Experience

- It's an exciting time to be part of The Home Depot, and we look forward to the work ahead as we continue our journey to create the One Home Depot experience
- There's a great deal of change being introduced throughout the business
- But as they always do, our associates are rising to the occasion, meeting new challenges head-on, without losing the passion to serve our customers that has made The Home Depot what it is today
- I want to close by thanking our associates for their hard work and dedication to our customers in Q4 and throughout the year
- For H2, 100% of our stores will receive Success Sharing, our bonus program for our hourly associates
 - We look forward to continuing our momentum in 2019

Edward P. Decker

Q4 Highlights

Performance

- When we look through the unfavorable weather we experienced in Q4, we were pleased with how the business performed
- Looking at our departments, comps in tools, appliances, décor, indoor garden, building materials, outdoor garden, hardware, and paint were above the company average
- Electrical, plumbing, flooring, millwork, and kitchen and bath were positive but below the company average, due primarily to price deflation
- Lighting and lumber reported low to mid-single-digit negative comps

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- In Q4, comp average ticket increased 2.3% and comp transactions increased 0.9%

Commodity Markets

- Q4 finished what was a volatile year in many commodity markets, particularly lumber
- For example, during Q2, we saw lumber prices that were more than 40% higher than they were in the year prior
- These prices fell significantly during the third and fourth quarter and now sit approximately 25% below last year's prices
 - While this deflation pressures sales, we have seen strong unit growth, as prices have come down, and this unit productivity drives activity across the store

Ticket Growth

- During Q4, deflation in lumber negatively impacted average ticket growth by approximately 41BPS.
- However, this deflation was largely offset by inflation in other core commodity categories, for a net impact to average ticket from core commodities of negative 8BPS.

U.S

- During Q4, big ticket comp transactions, or those over \$1,000, which represent approximately 20% of U.S. sales, were up 4.8%
- A number of factors served as headwinds to big ticket sales in Q4, notably, unexpected wet weather across the U.S. and lapping last year's hurricane-related sales
- Excluding hurricane-affected markets, we see that January's big-ticket comp was up almost double digits, in line with what we saw throughout 2018
- Big ticket categories like vinyl plank flooring, roofing, and appliances all had comps above the company average in Q4

Pro and Do-It-Yourself

- We saw growth with both our Pro and Do-It-Yourself customers in Q4, with Pro sales growing faster than the company's average comp
- We continue to see strong performance in Pro-heavy categories like power tools, water heaters, and commercial and industrial lighting
- Sales to our DIY customers grew y-over-y, as our customers completed a variety of interior projects
- Categories like hard window coverings, safety and security, and cleaning all posted strong growth in the quarter
- We also saw record performance with our annual gift center and holiday sets
 - Additionally, the combination of outstanding values from our suppliers, great assortments from our merchants, and phenomenal execution in our stores led to the single highest sales day in our company's history on Black Friday

One Home Depot Experience

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- As part of our journey to enhance the One Home Depot experience, we are significantly investing in our digital assets to provide a frictionless interconnected shopping experience
- Earlier this year, we formed approximately 50 cross-functional squads focused on agile development to improve our online customer experience
 - These teams have accomplished a great deal in a short period and are driving results

Ongoing Efforts

- In 2018, we hit a milestone of approximately 2B online visits, and our ongoing efforts to improve the interconnected customer experience have led to a consistent improvement in our conversion rates throughout the year
- However, our work is not done
- In 2019, we will continue to roll out enhancements across our digital assets
- As you heard from Craig, we are excited to be rolling out a new B2B online experience for our Pro customers to provide a more tailored personalized offering
- And for consumers, we will continue to focus on improving the way we bring our assortments to life in the digital world
- As we look to 2019, we are excited to build on our momentum
 - We are the number one retailer for product authority in home improvement
- And together with our supplier partners, we will work to offer the best products at the best value for our customers every day

Paint Business

- A great example of our strong partnerships is in our Paint business
- Our exclusive partners, Behr and PPG, bring the two highest-rated consumer paint and stain brands to The Home Depot
 - These strong brands along with the great execution in our stores helped drive paint comps above the company average in Q4
- We are particularly pleased with our sales to our Pro painters, as our investment and initiatives are gaining traction

New Color Solutions Center

- In addition to having the best products, we are investing to improve the in-store paint experience for our customers
- In 2019, we plan to roll out a new Color Solutions Center to all stores and will do a full reset in exterior stains
- We are thrilled with the results we are driving in our Paint business and look forward to building on our momentum in 2019

Product Innovation

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- Product innovation is resonating with our customers as we see them trade up to new features and innovation across the store
- One example we are seeing this is with Traeger in our grill category
- Traeger is one of the fastest-growing brands in the grilling category with their innovative Pellet Grills
- Traeger offers the versatility and convenience of being able to grill, smoke, bake, roast, braise, or barbecue, all on the same grill
- Given the strong sales, we are introducing Traeger's new lineup of WiFIRE grills
 - This technology connects the grill directly to your smartphone, so you can monitor your grill or adjust the temperature remotely
- We are excited to be Traeger's exclusive partner in the big-box home improvement channel

Pro-Heavy Roofing Category

- Another example of innovation is in our Pro-heavy roofing category
- Over the last several years, we have seen both residential and commercial roofers trade up for innovative products that save them time and money
- In the residential space, we have seen a significant shift from strip shingles to laminate architectural shingles
 - These laminate shingles last longer, have a lifetime warranty, are easier to install, and offer dramatic color contrast and dimension, which is important from a decorative perspective

Commercial Segment

- In the commercial segment, the trend has shifted from asphalt and aluminum roof coatings to elastomeric roof coatings that are more water and dirt resistant
- A great example of this is Henry Tropicool Silicone, an exclusive to The Home Depot in the home improvement channel
- No primer coat is needed, so the one coat application saves time and money
 - We are excited about the year ahead, particularly with the spring selling season right around the corner
- Our investments in localized assortments and innovative product at an everyday low price will continue to position us as the product authority in home improvement

Carol B. Tomé

Financial Highlights

Sales

- In Q4, total sales were \$26.5B, a 10.9% increase from last year
- And for the year, our sales totaled a record \$108.2B, a 7.2% increase from last year
- FY2018 included a 53rd week, which added approximately \$1.7B in sales to Q4 and the year

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- The extra week is not included in our comp sales calculation

New Revenue Recognition

- Our fourth quarter results also include the impact of a new revenue recognition standard that we adopted at the beginning of the year
- In Q4, the change in revenue recognition positively affected sales growth by \$86mm
- Our total company comps were positive 3.2% for the quarter, with positive comps of 3.1% in November, 3.1% in December, and 3.3% in January
- Comps in the U.S. were positive 3.7% for the quarter, with positive comps of 3.4% in November, 3.5% in December, and 4.1% in January

Comp Performance

- There were a few notable factors that affected our comp performance in the quarter
 - First, a stronger U.S. dollar negatively impacted total company comp sales growth in the quarter by approximately \$96mm, or 0.4%
 - Second, the commodity price inflation we experienced in the first three quarters of the year disappeared in Q4
 - Finally, as you know, we were up against nearly \$400mm of hurricane-related sales
- We expected that, but we did not expect such a wet winter
- Sometimes weather-driven demand can help sales growth, sometimes hurt
- Relative to our expectations, we estimate weather-driven demand negatively impacted fourth quarter comp sales by roughly 85BPS

Gross Margin

- In Q4, our gross margin was 34.1%, an increase of 19BPS from last year
- The y-over-y change in our gross margin reflects the following factors
 - First, the new accounting standard drove \$168mm of gross profit, or 53BPS of gross margin expansion
 - Second, higher supply chain and fulfillment expense caused approximately 19BPS of gross margin contraction
 - Third, higher shrink than one year ago resulted in 10BPS of contraction
 - And finally, changes in the mix of products sold drove 5BPS of contraction
- For the year, we experienced 29BPS of gross margin expansion

Operating Expenses

- In Q4, operating expense as a percent of sales increased by 79BPS to 21.3%, due to the following factors
- First, we experienced 152BPS of expense leverage in BAU, or business as usual, expenses
- The strong leverage in the core of our business was driven by solid expense control, but also reflects certain expense items that did not repeat this year, most notably, a one-time bonus of \$117mm that was granted to our

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hourly associates last year

BAU Expense Leverage

- Our BAU expense leverage was offset by the following
 - First, as we called out in our press release, as we move forward with our B2B experience, we recognized an impairment loss of \$247mm, or 93BPS of expense deleverage, related to the write-off of several trade names associated with Interline Brands
 - Second, the new accounting standard resulted in \$168mm increase to our operating expenses and caused 63BPS of operating expense deleverage
 - And third, expenses related to our strategic investment plan of roughly \$198mm resulted in approximately 75BPS of operating expense deleverage

Expense Performance

- FY2018 operating expense as a percent of sales was 20%, an increase of 49BPS from last year
- Our FY2018 expense performance was better than our initial expectations, driven by productivity in BAU
- For the year, we incurred almost \$700mm of expenses related to our strategic initiatives, in line with our plans
- Our operating margin for Q4 was 12.8% and for the year was 14.4%
- Interest and other expense for Q4 grew by \$19mm to \$265mm, reflecting for the most part a loss on the sale of a non-strategic asset

Effective Tax Rate

- In Q4, our effective tax rate was 24.7% and for FY2018 was 23.6%
- Our effective tax rate for the quarter and the year reflects the closeout of the provisional charge we took last year related to tax reform and certain positive audit settlements
- Our diluted EPS for Q4 were \$2.09, an increase of 37.5% from last year
- For the year, diluted EPS were \$9.73, an increase of 33.5% compared to FY2017

Impairment Charge

- Our fourth quarter and FY2018 diluted EPS were negatively impacted by approximately \$0.16 due to the impairment charge recorded in Q4
- Now moving on to some additional highlights, during the year we opened three new stores, including one in the U.S. and two in Mexico, for an ending store count of 2,287
- Selling square footage at the end of the year was 238mm square feet
- For the FY, total sales per square foot increased 7.2% to \$447, the highest in our company history

Merchandise Inventory

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- At the end of the quarter, merchandise inventories grew \$1.2B to \$13.9B, and inventory turns were 5.1 times, flat with last year
- The growth in our inventory vs. last year reflects the investments we are making to accelerate merchandising resets and higher in-stock levels than we had one year ago

Capital Allocation

- Moving on to capital allocation, in FY2018 we generated approximately \$13.3B of cash from the business, and used that cash as well as the proceeds from \$2.2B of net debt issuances and cash on hand to invest in the business, pay dividends to our shareholders, and repurchase our shares
- During the year we invested approximately \$2.4B back into the business through CapExs
- Further, we paid \$4.7B in dividends to our shareholders

Share Repurchasing

- And finally, during the year we repurchased approximately \$10B, or about 54.3mm of our outstanding shares, including roughly \$4.5B or 25.7mm shares in Q4
- Computed on the average of beginning and ending long-term debt and equity for the trailing 12 months, return on invested capital was approximately 44.8%, 1,060BPS higher than the end of FY2017
- Today's press release includes our guidance for FY2019, and I want to take a few moments to comment on the main points
- Remember that we guide off GAAP

Comp Sales Results

- So FY2019 guidance will launch from our reported results for FY2018, which include sales and earnings associated with the 53rd week
- When we report our quarterly comp sales results, we will compare weeks 1 through 52 in FY2019 against weeks 2 through 53 in FY2018
- So with that, turning to our sales growth projections, as you know, we use a directionally correct but imperfect model to project our sales growth
- It starts with GDP
 - While we are in the 10th year of economic recovery, U.S. GDP is expected to grow in 2019
- And for our model, we are using 2.6% GDP growth

GDP

- To GDP, we add the expected spending impact from key housing metrics, including home price appreciation, housing turnover, household formation, and the age of the housing stock
- As we look to 2019, most housing metrics are trending positive, albeit heading towards stability
- Two of these metrics worth highlighting are home equity, which is a function of home price appreciation, and the age of the housing stock

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- Home equity has more than doubled since 2011 and 52% of the homes in the U.S. are greater than 40 years old

Strategic Investments

- And you will recall that the three-year sales target we established in 2017 started with a base comp of 4%
- The sales forecasting model that we built for 2019 doesn't move us materially off that base
- For 2019, we are planning a 5% comp, which includes our base model plus growth emanating from our strategic investments
- For FY2019, we expect total sales growth of approximately 3.3%, reflecting the compare to 53 weeks last year

Sales Growth Rate

- Two more comments for your models, first, when you're thinking about the shape of the year, we would expect the comp for H1 2019 to be about 250BPS lower than H2 because of the hurricane-related sales overlap
- On a two-year stacked basis, we expect that our H1 and H2 comps will be relatively similar
- Second, because of the shift in the year and the seasonality of our business, our 2019 comp sales will not match our sales growth rates in three of four quarters

New Store Openings

- During the year, we plan to open five net new stores, four in the U.S. and one in Mexico
- For FY2019, we are projecting our gross margin rate to be approximately 34%, in line with the 2020 target we set forth during our December 2017 investor conference
- At this time, we are not expecting further gross margin contraction in FY2020

Operating Expenses

- We expect our FY2019 operating expenses to grow at approximately 53%, the rate of our sales growth
- On a 52-to-52-week basis and ignoring the impairment charge we recorded in Q4 FY2018, we expect our FY2019 operating expenses to grow at approximately 90% of the rate of our sales growth

Operating Margin and EPS

- For the year, we expect that our operating margin will be essentially flat with what we reported in FY2018
- For FY2019, we estimate our effective tax rate to be approximately 25.5%
- We expect FY2019 diluted EPS to grow approximately 3.1% to \$10.03
- Our EPS guidance includes our plan to repurchase approximately \$5B of outstanding shares during the year
- For the year, we project cash flow from the business of roughly \$14B.
- We will invest \$2.7B of this cash back into the business in support of our strategic initiatives
 - We also plan to use this cash to pay \$6B of dividends

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Dividend

- As Craig mentioned, we just announced a 32% increase in our quarterly dividend, which equates to an annual dividend of \$5.44, in line with our targeted dividend payout ratio of 55% of earnings
- Finally, we plan to repurchase \$5B of outstanding shares using excess cash

Strategy

- At our last investor conference in December 2017, we shared with you our long-term financial targets and our strategy to create the One Home Depot
- By the end of FY2020, we are aiming to grow our sales to a range of \$115B to \$120B, with an operating margin range of 14.4% to 15% and return on invested capital of more than 40%
- As evidenced by our FY2018 results and our guidance for 2019, today we are reaffirming our long-term targets

QUESTION AND ANSWER SECTION

<Q - Simeon Ari Gutman>: My first question is two parts on gross margin. So getting to the 34% level in 2019, was that always part of your plan and the Street maybe just looked like it was mis-modeling, or is something changing on your investment cadence?

And then the second part of that gross margin question is can you split it looks like about 30BPS of contraction into fixed vs. variable cost? And how much would gross margin flex if comps are better or worse than 100BPS of your forecast?

<A - Craig A. Menear>: Simeon, I think the first comment I'd have is as it relates to the margin rate, was it different than what we anticipated, a little bit more sustained pressure in supply chain maybe than what we initially anticipated in 2017.

<A - Carol B. Tomé>: And as we look at our model, both for 2019 and 2020, let me break apart the gross margin performance for you and our expectations. First, as you know, productivity is a virtuous cycle at The Home Depot, and we have productivity in our cost of goods, and we project productivity into 2019 and 2020.

Offsetting the productivity in 2019 is some pressure that Craig mentioned in supply chain as well as our supply chain rollout. There's a little bit of shrink pressure in 2019, but we're going to cover that off with productivity. And then there's the mix pressure, mix that was always in our plan as we see relative outperformance of growth in lower-margin categories. So as we look through 2019 to 2020, nothing comes to our attention at this point that the margin will contract further because productivity will continue into 2020.

On your second part of your question in terms of fixed and variable nature of our gross margin or of our cost of goods, we actually don't look at it through that lens. But I will tell you within the performance in Q4, there were a few surprises relative to the guidance that we gave at the end of Q3. First, the supply chain contraction of 19BPS was a bit higher than we had anticipated. We had 3BPS of fuel pressure come through and about 5BPS of higher fees related to third-party delivery agents. And then we had a bit higher shrink than we anticipated. Hopefully that's helpful.

<Q - Simeon Ari Gutman>: Yes, that's helpful. My follow-up is on the demand side. Can you tell us if there were any markets that were "normal," not meaning ex-weather? Did they perform in line or did they perform better than you thought? And then you've told us in the past where housing turnover markets have been soft, you've called out that the business has been solid. Just checking if that's still the case.

<A - Carol B. Tomé>: Yes, we saw great performance in areas that had good weather. I must say the weather was across the country, but you can find pockets of relative outperformance.

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And if you look at the housing-related markets, let's take Seattle as an example. Seattle is talked about a lot as a place where there's been huge home price appreciation. The comp in Seattle for fourth quarter was at 6.3%.

Let's take Dallas. Dallas is another area of the country where home prices have seen significant home price appreciation. The comp in Dallas was in line with the company average. So we're not seeing any impact to our performance in a negative way because of the housing environment.

<A - Craig A. Menear>: If you looked at a market like L.A., when the weather shifted we've seen 1,400 basis point swing week to week based on weather. So when the weather was positive, it would lift 1,400BPS.

<Q - Michael Lasser>: You noted that your comp guidance is based on 4% growth from underlying economic conditions in housing. Is there a way that you could size the potential downside if GDP doesn't meet 2.6% and we see a continued deceleration in some of the key housing metrics?

<A - Carol B. Tomé>: Clearly, our base model starts with GDP, and the forecast for GDP next year, there's a wide range. We landed on 2.6%. We think that's the right number to use. We added to that about a point coming from the various housing metrics that we look at. So that takes our base comp to 3.6%. And candidly, we rounded it up to 4% because we're just not that good at it.

We really wanted to call out two things that are important in our model, and one is home equity. There's \$15.4 trillion of home equity out there. Home equity has more than doubled since 2011. And if you look at the home equity per owner-occupied household, that equity is \$193,000 and has not been extracted. So we think that bodes well. It's a wealth effect, but that bodes well into 2019.

The other aspect of the housing market is just the age of the housing market. 52% of the homes older than 40 years, we know that spend for homes that are 40 years and older is 30% greater than spend on homes less than 10 years.

<Q - Michael Lasser>: My follow-up question is on the contribution from your initiative. Shouldn't we expect that the contribution, which you sized at 100BPS, shouldn't we expect that that's going to build over the course of the year as you've had more time to benefit from what you've put in place over the last 12 to 18 months? And what's the upside risk from those initiatives driving more than 100BPS of contribution to your comp?

<A - Craig A. Menear>: Michael, it will build as we go forward. You're thinking about that the right way. And so we definitely – we see it building throughout 2019 and then beyond.

<A - Carol B. Tomé>: Michael, I mentioned that the back half comp would be greater than H1 comp. Part of that is due to the hurricane overlap, but part of it is due to the build.

<Q - Michael Lasser>: And what leading indicators are you looking at within the business that give you confidence that it's going to contribute the 100BPS that you're expecting?

<A - Craig A. Menear>: When we look at the initiatives that we've begun to put in place, whether that is the amount of store refreshes that we have done, whether it is the interconnected experience with the automated lockers that we've put in place, which is driving obviously a great response from the customers, these are things that we tested, we piloted, and as we rolled we've begun to see benefit as a result, and feel comfortable that those are going to be the driver behind that point of initiative growth.

<A - Carol B. Tomé>: We're also seeing outsized growth in our Pro business. And as we continue to add pros to our website, to our new Pro experience, if you will, we are adding over 1mm customers this year, we see spend with those customers increasing.

<Q - Scot Ciccarelli>: So can you help us understand maybe the investment pace a little bit better? It sounds like there may be some shifts between your original expectations between 2019 and 2020 just from a timing perspective, number one. Number two, could we end up facing a scenario where the absolute investment amounts, what you're doing with the supply chain and in the stores, et cetera, maybe exceed your prior view since almost every company out there, their investment plan seems to be a moving target?

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 Date: 2019-02-26
 Event Description: Q4 2018 Earnings Call

Market Cap: 212,690.08
 Current PX: 188.30
 YTD Change(\$): +16.48
 YTD Change(%): +9.591

Bloomberg Estimates - EPS
 Current Quarter: 2.191
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<A - Carol B. Tomé>: I'm happy to take you back to December of 2017 when we laid out our investment plan. As you'll recall, we announced an \$11.1B investment plan, which was \$5.4B over what we would have spent in a BAU basis. And this is the cash look of the investment, so it's both expense and capital. Then we shared with you a chart back in 2017 that broke that spending down by year. We said we would spend \$1.4B in 2018, \$1.9B in 2019, and \$2.1B in 2020.

If we look at what we spent in 2018, we spent \$1.4B, about \$550mm in expense and \$800mm in capital. Now on the expenses, we also had some depreciation, but that wasn't on the chart that we shared with you. If you add the depreciation related to our investments in 2018, it was more like \$700mm.

As we look to 2019, we are projecting and in our guidance that we will spend \$1.7B, \$550mm in expense and about \$1.1B in capital. That's roughly \$200mm under what we shared with you in 2017. That spending is being pushed to 2020, and it might push out a little past 2020. The reason for this is because we're just getting smarter about how we spend our dollars and have had to change the prioritization of some of our activity to deal with some of our legacy IT systems. As we look at it today, our estimate is we won't exceed our spend. In fact, we may be able to deliver this under the target. But we've got to face this the appropriate way so that we don't actually deliver an initiative that the foundation can't serve, so hopefully that's helpful.

<Q - Scot Ciccarelli>: It is, thanks.

<A - Craig A. Menear>: Scot, this year was a learning year as it related to the investments, and we found that some things we could actually accelerate and other things are going to take us a little bit longer, as Carol mentioned, because of the legacy systems that we have to fix.

<Q - Charles Grom>: Carol, just on the macro again, I'm just trying to connect the dots between your 5% guide and the [ph] LEARS (44:23) view for 2019, particularly if the expectation of net gains in renovation spending slows as the year progresses, which is counter to what you're speaking to.

And just also on a follow-up to the comp, with the shift coming from weeks 1 to 52 to weeks 2 to 53, I know for some the department stores that tends to throw things off a lot. Is there anything that we should think about in terms of the quarterly cadence because of that?

<A - Carol B. Tomé>: So let me address the latter part of your question first, and then we'll get back to the macro. So the shift in the calendar wouldn't be such a big deal if we weren't such a seasonal business, but we are a very seasonal business. So this year, let's take Q1. We'll be comparing weeks 1 through 13 in 2019 against weeks 2 to 14 in 2018, and that shift will have an impact.

So you would expect the comp in Q1 to actually be lower than the actual sales growth that we report. That reverses in Q2. In Q2, we would expect the comp to be higher than the sales growth we report. In Q3, it will be about the same, and then in Q4 the comp will be higher than the sales growth that we report, principally because we're up against 14 weeks vs. 13 weeks that we will share.

I will tell you that the first week difference is about \$1.5B sales. So we're dropping off the compare on \$1.5B and we're gaining a compare of over \$2B. So hopefully that helps you model what that first quarter impact will be.

Now going back to the macro questions, we use this directionally correct but imperfect model, and it's worked for us pretty well since we implemented it. And if you've been following us for a while, you'll recall that we set forth stages of housing recovery and the impact it would have on our comps. And we had three stages of housing recovery. There was sharp, there was moderate, and then there was stability.

And if you look through that document, I think it's on our website, if not, we can get it to you, you could see in the stability area, which is where we think we are trending, our model suggests it's GDP plus 1% to 2%. We conservatively say GDP plus 1%. So if you use a 2.6% GDP and you add 100BPS to that, you get to 3.6%. We rounded up a bit to 4%. And then, as you heard from Craig, we added 1 point relative to our strategic investments.

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There are lots of forces and economic prognoses that you can use. One thing we used to support our point view is what the Harvard Joint Center says for remodeling activity, and their forecast for remodeling activity in 2019 is a 5% growth.

<Q - Charles Grom>: Okay, great. Thanks very much, and then one more for you, Carol. On Q3 call, you gave some helpful color on tax refunds and the timing impact. I'm just curious if your views on that front have changed at all. It looks like February refunds are down a lot, which is expected. I'm just wondering if that's impacted your business any thus far in February.

<A - Carol B. Tomé>: We wouldn't say there's an impact to our business from tax in February. And as you pointed out, we wouldn't expect the real benefits coming from tax reform to come in later, as those filers who have an earned income credit or a child credit, they actually haven't filed. Those returns get filed and processed later.

<Q - Christopher Horvers>: So there's a lot of noise in 2018, hurricane, inflation in H1, a titch in Q4 deflation. Can you just – it would be helpful to think about 2018. If we backed out weather on an annual basis and we backed out the net benefit from inflation in the first three quarters, what is that underlying rate and how does that compare to the 5% guide that you're putting out for 2019, and does that guide include any benefit or headwind from inflation/deflation?

<A - Craig A. Menear>: We've looked at that. We backed those noise levels out. It gets you somewhere in the area of a 5.5% to a 5.7% as a normalized run rate. If you think about taking out the storms, you take out the weather, you take out the inflation, that's where we rounded it to.

<A - Carol B. Tomé>: And as you know, when we build our plans, we are commodity inflation neutral. We don't really know how to plan for that. Based on where commodity prices are, there may be a little bit of pressure in H1, but we planned for that.

<Q - Christopher Horvers>: Understood. So just to summarize there, so you're basically saying, precise basis points, but 70 – 80BPS of moderation in the underlying driven comp from 2018 to 2019, understood.

<A - Carol B. Tomé>: Which in February, you would expect that's where we are in the housing recovery. You would expect that.

<Q - Christopher Horvers>: Got it. And then in terms of the shift from pricing – turnover net and then pricing and now home equity and age, does that express itself in any way in terms of traffic vs. ticket growth? Do you expect ticket continue to lead? Does ticket growth actually become more of a factor vs. the traffic growth? How are you thinking about that?

<A - Craig A. Menear>: It would in fact continue to support ticket growth for sure. And if you think about the formations estimated to be increasing in 2019, while turnover is more flatish to where it was in 2018, that would definitely drive project business.

<Q - Christopher Horvers>: Okay, and then one quick – go ahead. Sorry, go ahead.

<A - Edward P. Decker>: Sorry, Chris. I would just add on the ticket. The thing that's really encouraging about ticket, the reasons we called out the innovative product and more premium roofing and a grill like a Traeger grill, we look at a number of signals very closely. One is the line structure, where sales are coming from OPP through good-better-best. We continue to see stronger productivity as you move up price points, and we break that out.

The second data point we look at very closely is where is ticket growth coming from. And we include commodity, we include tariff, we include new items, et cetera. By far, our largest ticket growth is coming from the introduction of new innovative items. It's actually much more significant than either inflation or tariff.

<Q - Christopher Horvers>: Got it. And then just to sneak one last one in, Carol, anything, any particular cadence around gross margin and SG&A vs. sales growth? Obviously, in Q4, you lap the extra week, but anything else to call out on a quarterly basis in margins?

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<A - Carol B. Tomé>: Yes, we have a seasonal business, as you know. And we try to predict when spring will break, and we use five-year historical averages and forecasts from Planalytics, and we try to predict when it will break. We're usually wrong, but we try.

Now, based on the way that we built our plan, we think that spring is going to break – it hasn't yet, but we think that spring is going to break in Q1. So because many of our seasonal categories are lower margin, you would expect the margin decline to be the greatest in Q1. So that's an important thing to get out there as you're building your models. Chris, as you know, we're not really good at this, but that's what our model – that's how we're planning.

Then from an expense growth factor, the real noise will be I guess in Q4, but I think we've given you enough color there that you can model to that. So there's really nothing too goofy on the expense side.

<Q - Steven Forbes>: I wanted to focus on the enhanced delivery and fulfillment option rollout that you mentioned for 2019. So maybe just comment on the number and type of facilities slated to open in 2019 and I guess how you're moving along relative to the original plan.

<A - Craig A. Menear>: Steve, we're excited about the pilots that we've put in place in 2018 and the learning that we have. And Mark is here, I'll let him address that. But I also would say that we're excited about the options that we provided for our customers during the year as well on same-day delivery for car and van service on products out of our stores.

<A - Mark Holifield>: Just as a reminder, we have our five direct fulfillment centers already up providing one and two-day service to over 90% of the population. We've got our Interline Brands facilities, now Home Depot Pro, that give us near national coverage with next-day delivery via 700 private fleet trucks. We've opened three market delivery operations and we have openings planned and ground-breakings planned through the year on the various new platforms, market delivery operations, flatbed delivery centers, et cetera. So we're looking forward to that. And of course, we have our car delivery and van delivery fast options there with 40% coverage of the U.S. population for low-cost car delivery and 70% with van coverage.

<Q - Steven Forbes>: And then just a quick follow-up, maybe more of a modeling question as relates to D&A specifically. Because I think if you walk back to the Analyst Day in 2017, there was I guess an average three-year D&A run rate that was called out. Can you just update us on what we should be building in as we look out to 2020?

<A - Carol B. Tomé>: So I think in our guidance we gave you a D&A number of -what did we say – \$2.3B. Some of that flows through cost of goods sold. So on the expense line, you could plan about \$2B of D&A on the expense line and the remaining \$300mm would be up in the cost of goods sold.

<Q - Steven Forbes>: Any comment as we look out to 2020 relative to the three-year plan you laid out during the Analyst Day for D&A?

<A - Carol B. Tomé>: Just keep it at about that rate.

<Q - Zachary Fadem>: You talked about some of the dynamics around the transition to the spring selling season. With the later spring last year, is there anything that gives you confidence this year from either a weather to date or product perspective? And then just given the calendar shift, you gave some helpful color, but I'm curious whether you anticipate Q1 comp to be above or below the full-year comp growth, just given the full...

<A - Craig A. Menear>: I'd start with what Carol said earlier, and that is we do use a multiyear average model in terms of planning. And when you look at that model, it suggests that we'll actually see spring break in Q1.

<A - Carol B. Tomé>: We don't provide quarterly guidance, as you know. So I'd like to go back to the half. It's the easiest way to think about our business. I would expect H1 comp to be lower than the full-year comp.

<Q - Zachary Fadem>: Okay, fair enough. And could you comment on how some of the external factors in 2019, like lower gas prices and mortgage rates for the consumer, are incorporated in the 2019 outlook? And then second, what are you assuming around the tariff environment?

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<A - Craig A. Menear>: We for years have tried to correlate gas prices to our business. We've never been able to draw a correlation on that. And so there's nothing built in for that whatsoever. And then we've assumed nothing beyond what is in place today on tariffs. We don't try to plan for something that hasn't happened.

<A - Edward P. Decker>: As we said with tariffs, that's been manageable. Good news obviously Sunday, and it looks like negotiations are continuing. But all the tariffs that have been put in place to date, we have managed through that without any issue.

<Q - Seth I. Sigman>: So regarding the weather impact and the impact on exterior projects, you gave us the 85 basis point impact. I'm curious. During these types of periods, do you actually see an offsetting benefit on indoor projects? And then just narrowing in on the exterior projects, to what extent are you already starting to see those come back or expect to see those come back in that H1 outlook? Thank you.

<A - Craig A. Menear>: Generally, as Ted mentioned, we felt very positive about our Paint business, and so customers have a tendency to focus inside when they can't do work outside, and that is something that happens in the business overall. So we felt good about the interior side of the business.

<A - Edward P. Decker>: I would say every cycle we have had bad weather, Craig mentioned the huge swings in a market like Los Angeles. We've seen that consistently across all our markets. Last spring, for example, we were delayed, and as soon as the weather broke, our business just exploded. And we see that across markets now weekend to weekend. So full expectation that when spring comes, we're ready for it. We've got great innovative products. We're in stock and ready to go for our customers.

<Q - Seth I. Sigman>: Got you, okay, and then just one follow-up on the pricing environment. You talked a lot about commodity prices. Can you just talk a little about price changes that's you're seeing in non-commodity categories and if you're embedding anything in the guidance? Thanks.

<A - Craig A. Menear>: There's nothing in the guidance for sure, across the board, not just with tariffs, but we've seen through 2018 an increased cost expectation from our suppliers, just whether it's wages or transportation, supply chain, fuel, things that they've experienced. But we've digested all of that and run that across portfolio basis, and we don't see any increased pressure going into 2019. If anything, as you mentioned, things like fuel and transportation capacity and hopefully the tariff outlook, all those pressures should be abating a bit.

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