# HD – Q3'23 Home Depot Earnings Call
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**PRESENTATION**

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***Operator***

Greetings, and welcome to The Home Depot Third Quarter 2023 Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

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

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**Isabel Janci *- The Home Depot, Inc. - VP, IR & Treasurer***

Thank you, Christine, and good morning, everyone. Welcome to Home Depot's third quarter 2023 earnings call. Joining us on our call today are: Ted Decker, Chair, President and CEO; Ann-Marie Campbell, Senior Executive Vice President; Billy Bastek, Executive Vice President of Merchandising; and Richard McPhail, Executive Vice President and Chief Financial Officer.

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

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

Today's presentations will also include certain non-GAAP measures. Reconciliation of these measures is provided on our website.

Now, let me turn the call over to Ted.

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**Ted Decker *- The Home Depot, Inc. - President & CEO***

Thank you, Isabel, and good morning everyone.

Sales for the third quarter were $37.7 billion, down 3.0 percent from the same period last year. Comp sales declined 3.1 percent from the same period last year, and our U.S. stores had negative comps of 3.5 percent. Diluted earnings per share were $3.81 in the third quarter compared to $4.24 in the third quarter last year. The third quarter was in line with our expectations. Similar to the second quarter, we saw continued customer engagement with smaller projects, and experienced pressure in certain big-ticket, discretionary categories. In addition, lumber and copper wire deflation and storm related overlaps negatively impacted results in the quarter. Billy will discuss these and other business trends shortly.

During the third quarter, our Pro customer outperformed our DIY customer. While internal and external surveys suggest that Pro backlogs are lower than they were a year ago, they are still healthy and elevated relative to historical norms.

With only one quarter left in the year, we believe the endpoints of our previous guidance range are no longer likely outcomes. As a result, and as we announced in this morning's press release, we narrowed our guidance range for fiscal 2023. Richard will take you through the details in a moment.

As we've discussed, this year reflects a period of moderation. However, we are confident in our ability to navigate through this unique environment. We remain very excited about our strategic initiatives and are committed to investing in the business to deliver the best interconnected shopping experience, capture wallet share with the Pro, and grow our store footprint.

As we discussed at the investor conference in June, we continue to invest and focus on creating a frictionless interconnected shopping experience for our customers. We are pleased with the progress we are making. HomeDepot.com is one of the largest retail websites in the United States, and our digital app is one of the most highly rated in all of retail. And yet, we believe there is still opportunity to reduce pain points across the shopping journey. Our teams are identifying areas of improvement, like better communication throughout the shopping journey, an easier returns process, and the ability to seamlessly and intuitively make changes to an order once placed.

For our Pros, we are investing in a multitude of initiatives. We remain focused on building out our unique ecosystem of products and services. As a result, we are evolving our organizational structure and recently elevated Ann Marie Campbell to Senior Executive Vice President, better aligning our outside sales and service business and the global store organization. Pro is one of our biggest growth opportunities, and this organizational change will allow us to better serve them by leveraging our full ecosystem of expertise, product assortment, fulfillment, and operations.

Our merchants, store and MET teams, supplier partners, and supply chain teams did an outstanding job delivering value and service to our customers throughout the quarter, and I'd like to close by thanking them for their dedication and hard work. In addition, the Home Depot is proud to have tens of thousands of veterans, service members and military spouses in orange aprons. Last week, we announced that the Home Depot Foundation surpassed the goal of $500 million invested in Veteran causes and also increased the total commitment to $750 million by 2030.

And with that, I'd like to turn the call over to Ann.

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**Ann-Marie Campbell - *The Home Depot, Inc. – Senior EVP***

Thanks Ted and good morning everyone.

Let me start by saying that I'm very excited about my new role and the alignment it will create between the outside sales and services business and the global store organization. As you heard at our investor conference in June, capturing a greater share of the Pro's wallet is one of our largest growth opportunities. It represents a roughly 475 billion dollar addressable market, and today we have relatively little share.

The beauty of the Home Depot is that we have unique competitive advantages – our convenient stores, our leading brands, our engaged associates, our expansive fulfillment options – that are unmatched and that can be leveraged for the benefit of our customers. And that's exactly what we aim to do.

To do that, our new organizational structure will create stronger momentum with our teams to drive success with the Pro. Hector Padilla will focus on improving the experience for Pros shopping our stores. His 29-year tenure and knowledge of our store operations and new Pro capabilities will be instrumental in achieving our goals. And Chip Devine, our Head of Outside Sales, brings nearly 30 years of distribution experience. He will work on building out capabilities to better serve more complex project needs. Ultimately, we must focus on removing friction within our operations, so our customers have a great experience every single time…no matter how they choose to shop with us… whether in the aisles of our stores, picking up product at the store, receiving product at their job site, with a sales associate, or digitally.

We know that most of our Pros use many of these capabilities across our ecosystem when shopping with us. For us, we are building trust, and a partnership that lasts for decades and across generations. This means we have to work hard to deliver a great experience, regardless of their point of interaction.

As you know, we've identified additional growth opportunities with the Pro which requires us to invest in new capabilities and functionalities across the business. Think about the initiative we are undertaking with the Complex Pro. This customer interacts differently. They are accustomed to interacting with their suppliers in a different way than our traditional business model. Pros working on complex projects want to reserve product, use trade credit, and have product delivered to their jobsite in a staged manner. While these capabilities exist in the market today, we are incorporating them into our full ecosystem to serve Pro customers in a way no one else can. I could not be more excited about the opportunity that lies ahead.

And for the in-store experience, over the last several years, we've talked about the importance of in-stock and ultimately, on shelf availability or "OSA". Having the right products in-stock, in the right quantity and on the shelf available for purchase is critical. And we've implemented several initiatives to help us do this more effectively and efficiently. In the past, we've talked to you about GSR, or "get stores right". GSR drives productivity by using our proprietary space allocation model, coupled with our tenured field merchandising teams, to determine which categories to invest in on a store-by-store basis.

More recently, we've talked to you about our roll out of Sidekick and Computer Vision. Using machine learning technology, Computer Vision helps our associates quickly find depalletized product in the overhead and Sidekick helps direct associates to key bays where OSA is low or outs exist. Today, these tools have been deployed across all U.S. stores. And while early days, they have driven meaningful improvement in our on shelf availability.

The beauty of these initiatives is that they also drive productivity. They make it easier for our associates to restock product, have greater depth of high velocity product, and ensure we remain in stock with more product on the shelf and available for sale. As a result, we enable our associates to focus on the most important tasks and allocate more time to deliver a better shopping experience.

These are just a few examples of the many different types of initiatives that can drive significant value for our customers, our associates, and our shareholders.

Despite a challenging year, our amazing associates have remained engaged and ready to serve our customers. I want to thank them for all they do.

With that, let me turn the call over to Billy.

**Billy Bastek - *The Home Depot, Inc. – EVP, Merchandising***

Thank you Ann and good morning everyone.

I want to start by also thanking all of our associates and supplier partners for their ongoing commitment to serving our customers and communities. As you heard from Ted, during the third quarter, our sales were in line with our expectations, however we did have some unfavorable impacts from core commodity deflation and storm related overlaps. We saw a continuation of a trend that we have been observing throughout the year, with softness in certain big ticket, discretionary type purchases. Instead of engaging in larger projects, customers continue to take on smaller projects.

Turning to our department comp performance for the third quarter… our building materials department posted a positive comp and 7 of our remaining 13 merchandising departments posted comps above the company average including plumbing, appliances, hardware, outdoor garden, millwork, tools, and paint.

During the third quarter, our comp transactions decreased 2.7 percent and comp average ticket decreased 0.3 percent. Excluding deflation from core commodities, we experienced comp average ticket growth primarily driven by demand for new and innovative products.

Deflation from core commodity categories negatively impacted our average ticket growth by approximately 60 basis points during the third quarter, driven by deflation in lumber and copper. During the third quarter we continued to see a decline in lumber prices relative to a year ago. As an example, on average, framing lumber was approximately $420 dollars per thousand board feet compared to approximately $545 dollars in the third quarter of 2022, representing a decrease of over 20 percent.

Big-ticket comp transactions, or those over $1,000, were down 5.2 percent compared to the third quarter of last year. We continue to see softer engagement in big ticket discretionary categories like flooring, countertops and cabinets. However, we saw big-ticket strength in Pro heavy categories like roofing, insulation, and portable power.

Turning to total company online sales, sales leveraging our digital platforms increased approximately 5 percent compared to the third quarter of last year. We continued to invest in the digital experience across our website and app and released a variety of enhancements in the third quarter. These range from simple improvements to help customers track orders to more complex things like updating our search and recommendation algorithms. For those customers that transacted with us online during the third quarter, nearly half of our online orders were fulfilled through our stores.

During the third quarter, we hosted our annual Labor Day Appliance and Halloween events and were pleased with the results. In Appliances, we were encouraged with the customer's engagement during the event. And 2023 was another record sales year for our Halloween program both in-store and online as our customers continue to add to their collection with our unique and exclusive product assortment.

As we turn our attention to the fourth quarter, we intend to continue this momentum with our annual holiday, Black Friday, and Gift Center events. In our Gift Center we continue to lean into brands that matter most for our customers with our assortment of Milwaukee, Ryobi, Makita, DeWalt, Ridgid, Husky and more. We will have something for everyone whether it is our wide assortment of cordless Ryobi tools, DeWalt Atomic Drill and Impact Kit, or our new Milwaukee M18 FORGE batteries. These new M18 FORGE batteries will be a game changer for our Pro customer providing the most powerful, fastest charging, and longest life of any battery on the Milwaukee M18 platform.

This quarter, I am also excited to announce the addition of Wago to our powerhouse assortment of Pro brands including Milwaukee, USG, Custom Building Products, Leviton, and QEP to name a few. It is these strategic vendor relationships that make us the product authority in Home Improvement and the addition of Wago will help extend our position. Wago is one of the top requested, most innovative Pro brands in the wire connector segment that features a releasable, level lock wire connector that speeds up installation and saves space in tight applications. We recently launched a number of skus in our stores, which are exclusive to The Home Depot in the national big box retail channel.

Our merchandising organization remains focused on being our customers' advocate for value. This means continuing to provide a broad assortment of best-in-class products that are in-stock and available for our customers when they need it. We will also continue to lean into products that simplify the project, saving our customers time and money. That's why I'm so excited about the innovation we continue to bring to the market.

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

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**Richard McPhail - *The Home Depot, Inc. - EVP & CFO***

Thank you Billy and good morning everyone.

In the third quarter, total sales were $37.7 billion dollars, a decrease of approximately $1.2 billion dollars, or 3.0 percent from last year.

During the third quarter, our total company comps were negative 3.1 percent, with comps of negative 2.1 percent in August, negative 3.4 percent in September, and negative 3.7 percent in October. Comps in the U.S. were negative 3.5 percent for the quarter, with comps of negative 2.5 percent in August, negative 3.8 percent in September, and negative 4.1 percent in October. In local currency, Mexico and Canada posted comps above the company average. It is important to note that adjusting for storm related overlaps and some seasonal shift, monthly comps were relatively consistent across the quarter.

In the third quarter, our gross margin was 33.8 percent, a decrease of approximately 20 basis points from the third quarter last year, which was in line with our expectations.

During the third quarter, operating expense as a percent of sales increased approximately 120 basis points to 19.4 percent compared to the third quarter of 2022. Our operating expense performance during the third quarter reflects our previously executed compensation increases for hourly associates as well as deleverage from our topline results.

Our operating margin for the third quarter was 14.3 percent, compared to 15.8 percent in the third quarter of 2022.

Interest and other expense for the third quarter increased by approximately $30 million dollars to $438 million dollars.

In the third quarter, our effective tax rate was 23.3 percent, down from 24.4 percent in the third quarter of fiscal 2022.

Our diluted earnings per share for the third quarter were $3.81, a decrease of 10.1 percent compared to the third quarter of 2022.

During the third quarter, we opened 7 new stores bringing our total store count to 2,333. Retail selling square footage was approximately 242 million square feet.

At the end of the quarter, merchandise inventories were $22.8 billion dollars, down $2.9 billion dollars, or 11 percent, compared to the third quarter of 2022, and inventory turns were 4.3 times, flat to one year ago.

Turning to capital allocation…after investing in our business and paying our dividend, it is our intent to return excess cash to shareholders in the form of share repurchases.

- During the quarter, we invested approximately $670 million dollars back into our business in the form of capital expenditures.
- And during the quarter, we paid approximately $2.1 billion dollars in dividends to our shareholders and we returned approximately $1.5 billion dollars to shareholders in the form of share repurchases.

Computed on the average of beginning and ending long-term debt and equity for the trailing twelve months, return on invested capital was approximately 38.7 percent, down from 43.3 percent in the third quarter of fiscal 2022.

Now I will comment on our guidance for fiscal 2023.

As you heard from Ted, with one quarter remaining in Fiscal 2023, we no longer expect the endpoints of our previous guidance range as likely outcomes and therefore, we are narrowing our guidance for 2023.

- We expect fiscal 2023 sales and comp sales to decline between 3 and 4 percent
- We are targeting an operating margin between 14.2 and 14.1 percent for the year
- Our effective tax rate is targeted at approximately 24.5 percent
- We expect interest expense of approximately $1.8 billion dollars
- And we are anticipating between a 9 and 11 percent decline in diluted earnings per share compared to fiscal 2022

In addition, as you heard from Ann, we continue to focus on driving productivity in the business. We have taken a number of actions that will help us realize the previously announced $500 million dollars in annualized cost savings in 2024, and are fully confident that we will deliver on this commitment.

We also remain focused on meeting the needs of our customers with our leading product authority in home improvement, strong in-stock levels, and knowledgeable associates. We will continue to prudently invest to strengthen our competitive position, and leverage our scale and low-cost position to outperform our market and deliver shareholder value.

Thank you for your participation in today's call, and Christine, we are now ready for questions.

## QUESTION AND ANSWER

***Operator***

[Operator Instructions] Our first question comes from the line of Simeon Gutman with Morgan Stanley. Please proceed with your question.

**Simeon Gutman - *Morgan Stanley, Analyst***

Hey. Good morning, everyone. In thinking about inflections and when we might see one, looking at the spread maybe between DIY and Pro, is the story of this quarter that maybe DIY is stabilized but the Pro is getting a little bit worse? And then, if that's right, and feel free to correct if that's wrong, would that mean that it could take a little longer then for the Pro sort of normalizing to play out and actually the overall comp could get a little worse before it gets better?

**Ted Decker** - ***The Home Depot, Inc. - President & CEO***

Morning, Simeon. Thanks for the question. I would say Pro and consumer, it had the narrowest performance gap in some time. So they both performed reasonably well. If you step back and look at the quarter, we feel really good about the third quarter and we narrowed our comp guidance for the year because of that. And, in fact, if you look at the performance of the business overall this year, if you look at the seasonality of Q1 and Q2, we're pretty smooth in that minus 3% comp through the first three quarters of this year. And that's normalized for weather and storms and commodity price deflation. And then our regional businesses are also pretty consistent. We've seen the least variability in regions. And as I said, the narrowest gap between Pro and consumer. We had really good seasonal sell-through. And as prices have settled with abating deflation, we feel pretty good about that.

And our operations are increasingly getting back to normal. The supply chain is operating very well. Our inventory positions are better. Our in-stock rates are much better, as Ann took you through all the things we're doing in the store to improve on-shelf availability. Our value propositions, as Billy mentioned, are in great shape, and product innovation is better than it's ever been. And the wage investments are paying off. Our attrition is way down. And with that attrition being down, our associates have had more time in the store. Their ability to serve customers has improved. So all of that really is what delivered that consistent comp throughout the year.

But to answer your specific question, as we sit here feeling really good about the operations, the share shift of PCE from pre-COVID to today has not completely reverted. And we're still not exactly sure where that reverts to. The asset class for home improvement is worth 15-odd trillion dollars more than it was pre-pandemic. And we know now that the Fed definitely has a higher for longer monetary posture, and that's going to continue to pressure durable goods and financing or motivation for larger home improvement projects.

So as we said, we see great engagement, engagement in seasonal goods, engagement with smaller projects. It's that the larger projects are a bit down at the moment. So that's what we're watching. We're not obviously talking about 2024 today. But lots of good news in the operations of the business. Great news with still a very resilient customer. We just came off a 4.9% GDP in Q3 driven by the consumer. But as you know, we're looking at it this year, this period of moderation, for home improvement spend. But couldn't feel better about the business in our operations overall.

**Simeon Gutman** - ***Morgan Stanley, Analyst***

Thanks for that. And then maybe the follow up you mentioned GDP. Given that home prices seem to be pretty sticky, even with pretty weak turnover and may not get any better, how should we – should we think about GDP, should we revert to GDP as maybe a better proxy for how the business could do?

**Richard McPhail** - ***The Home Depot, Inc. - EVP & CFO***

Simeon, this is Richard. We have tried to take the most thoughtful approach possible in over the last few years of what the drivers of the business are, and those things that indicate to us how we have settled back out of the pandemic period. And that's why we focused on share of PCE. Like Ted said, we're not going to talk about 2024 today. There is an underlying kind of layer of economic activity that supports the business. But as Ted pointed out, number one, we still haven't reverted all the way back to 2019 levels of PCE share. And the Fed stance of higher for longer has had and could have increasing pressure on the outlook for durables and housing-related spend. So like Ted said, that's what we're watching at the moment. And we will talk about 2024 when we get to our call next quarter.

**Simeon Gutman** - ***Morgan Stanley, Analyst***

Thank you.

***Operator***

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

**Zack Fadem** - ***Wells Fargo, Analyst***

Hey. Good morning. Richard, considering all the ins and outs of your cost base this year, with wage investments, you've got the legal settlement in Q1, plus the cost save next year. Is it fair for us to assume your operating margins can expand in 2024 or is there a certain level of comp that you will need to see to hold this 14%-plus margin?

**Richard McPhail** - ***The Home Depot, Inc. - EVP & CFO***

Morning, Zack. Thanks for that question. Margin expansion is largely a function of top line growth. There is a point there in the low positive comp digits where you see expense turn from deleverage to leverage. We're not going to take on 2024 guidance today. What we have done is we have put in place measures and, in fact, now have essentially completed actions that will provide us with a $500 million cost buffer heading into 2024. And so regardless of the outlook, that provides some buffer in margin.

**Zack Fadem** - ***Wells Fargo, Analyst***

Got it. And then you mentioned that you would reinvest the legal settlement gain from Q1. So first of all, any color on what this reinvestment actually is or what it would look like? And then, is it fair to say the investment will be largely in Q4, or was there part of that in Q3?

**Richard McPhail** - ***The Home Depot, Inc. - EVP & CFO***

We've had part of that spent throughout the year. I think it is still a correct assumption that that favorability will be fully offset by the end of the year. And so I really point you to our guidance as the best jumping off point for your modeling.

**Zack Fadem** - ***Wells Fargo, Analyst***

Got it. Thanks for the time.

***Operator***

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

**Scot Ciccarelli** - ***Truist, Analyst***

Good morning, everyone. So in some other retail verticals – or a lot of other retail verticals, we're seeing a return to pre-COVID purchasing patterns, where you probably see more activity, purchasing activity, on weekends and around holidays and events, with, frankly, bigger lulls in-between. So the questions are, one, are you seeing a similar general pattern? And, two, assuming that is the case, are there ways for you guys to take advantage of that pattern from an operational standpoint to improve productivity? Thanks.

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**Billy Bastek - *The Home Depot, Inc. – EVP, Merchandising***

Yeah, thanks for the question, Scot. It's Billy. Listen, as it relates to different fluctuations in customer patterns and so forth, we haven't seen that. It's been very consistent throughout the quarter and, as Ted mentioned in his prepared remarks, really throughout the year, when you account for some of the weather and some of the bathtub effect we saw in the first half. So we haven't seen that.

Listen, as it relates to promotional activity, whatsoever, we have events in our stores that we love to execute and drive excitement for our customers. But from a promotional activity standpoint, it's really reverted back to pre-COVID times. Our pricing has certainly, as Ted mentioned, settled over the last several months. The environment has certainly stabilized. So we operate in a very rational market and promotional environment, as we said. This has returned to kind of pre-pandemic times.

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**Ted Decker - *The Home Depot, Inc. - President & CEO***

And we will always, Scot, we will always focus on EDLP. I mean, we have events during certain seasons that they're a lot of fun, they're engaging for the associate, they're engaging for our customers, but day-in and day-out, 12 months a year, we strive to be an EDLP retailer with great values every day.

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**Scot Ciccarelli - *Truist, Analyst***

Got it. Thanks. And then, just a quick follow up, on the big-ticket discretionary, is there any specific areas where you're actually seeing a positive inflection or are they all still trending, call it, mid-single-digit negative?

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**Billy Bastek - *The Home Depot, Inc. – EVP, Merchandising***

No, we called out in my prepared remarks categories like portable power and so forth where we have seen great engagement. And candidly we're thrilled with the innovation that we continue to partner with our supplier base on, that we bring to the market. And where we continue to see innovation, we continue to see great engagement with both the Pro and the consumer.

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**Scot Ciccarelli - *Truist, Analyst***

Got it. Thanks, guys.

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***Operator***

Our next question comes from the line of Chris Horvers with JP Morgan. Please proceed with your question.

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**Chris Horvers – *JP Morgan, Analyst***

Thanks. Good morning, everybody. So a couple follow ups to prior questions. My first one is with the gross margin decline in the third quarter, can you talk a little bit about what drove that? You were lapping storm-related demand and you had some commodity deflation. So I would have thought that those would be positive. So is that fair, and what were the offsets to that drove it lower?

**Richard McPhail** - ***The Home Depot, Inc. - EVP & CFO***

Thanks for the question, Chris. I'll go back to Billy's comments and Ted mentioned this as well. I think the most important observation we've made is that the worst of the inflationary environment is behind us. And as a result, as Billy said, retail prices are settling in the market. Some prices are settling at levels higher than 2022. Others are settling lower. But we're seeing some stabilization there that Billy can talk about.

Specific to the quarter and gross margin, there are some timing differences as some prices settle ahead of anticipated product and transportation cost benefits that will come through as we turn through our inventory. But those are – I'd really sort of consider those timing. For the full year, our view on gross margin hasn't changed. And we expect to see slight pressure year-over-year. But, Billy, maybe just talk about kind of the settling of prices.

**Billy Bastek** - ***The Home Depot, Inc. – EVP, Merchandising***

Yeah, as you mentioned, the inflation environment seems to be behind us. Prices absolutely settled in. And, again, I'd reiterate what I said, work in a very rational market. The other thing I'd add is this is no different than any other timeframe, frankly. We have a portfolio approach to how we take on, whether it's lumber deflation that we've talked a lot about throughout the year, or other ins and outs as it relates to the P&L. So very normalized environment, rational and really a stabilization that we've seen across the board as it relates to pricing.

**Chris Horvers** – ***JP Morgan, Analyst***

Got it. Got it. Got it. Got it. So that makes sense. And then on the variable cost side, you talked about a low single-digit leverage point historically and the $500 million of cost savings next year. You've had – at the same time, you've had negative transactions for quite some time now. So can you talk about where we are in terms of how labor can maybe become – how it becomes less variable over time maybe in the context of the percentage of stores on minimum staffing levels? And if there is negative comps in 2024 or over the next six months, is the flexibility that you get from the $500 million offset by the fact that you'll be – you could be having still negative transactions and less flexibility?

**Richard McPhail** - ***The Home Depot, Inc. - EVP & CFO***

Chris, thanks for the question. There's a lot of kind of 2024 conjecture built into that answer. [indiscernible]. So I think when you're talking about changes in the nature of our labor model, the degree of change in transactions really isn't material enough to say that changes the nature of our labor model.

**Chris Horvers** – ***JP Morgan, Analyst***

Got it. Sounds good. Thanks very much.

***Operator***

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

**Michael Lasser** - ***UBS, Analyst***

Good morning. Thank you so much for taking my question. You talked about the promotional environment is counting being very rational. If the cycle or the downturn for home improvement remains protracted and extended, under what conditions would you expect that discounting will be more intense than it was in 2019 across the industry? And if that were to be the case, would Home Depot choose to remain true to the everyday low price and the portfolio approach that it has, or would it look to protect market share and participate in some of that activity?

**Ted Decker** - ***The Home Depot, Inc. - President & CEO***

Morning, Michael. Yes, we will stay committed to EDLP. And our promotional cadences, as we said earlier, the Black Friday, appliances and Gift Center and some spring events for seasonal garden items to get traffic in stores, those have been the playbook for years and years, right, Billy?

**Billy Bastek** - ***The Home Depot, Inc. – EVP, Merchandising***

That’s right.

**Ted Decker** - ***The Home Depot, Inc. - President & CEO***

And we don't see us going away from that. In fact, we've stayed truer to reductions of promotions, when you think of categories like: ceiling fans, that I remember would constantly on and off, 10% and 20% off; paint, which was a promotional category, where 5% and 10s, and then it went to 10% and 20s. We've backed off all of that.

And on the margin, we prefer to be even less promotional than we are today. If you had a protracted downturn in the market, for sure, we're going to be competitive. And for sure, we are going to protect our share, but when you think of the nature of a large home improvement project, certainly one done by a Pro, the labor component is such a big piece of that job. Just take paint, for example. If you're painting your living room for $500, the paint in that job is going to be less than $100. And it's your labor bill, either your opportunity cost as a consumer or the Pro doing the job for you. So being super aggressive to take $10 off the $100 component of a $500 job, I don't think really moves the needle. And that's why our bias or starting position would be, no, we wouldn't chase a lot of price in that dynamic.

**Michael Lasser** - ***UBS, Analyst***

Got you. Very helpful. My follow-up question is historically Home Depot has under-promised and over-delivered in just about all facets. Is it realistic to think that you took the same approach when building this $500 million of net cost savings for next year, such that there could be upside to that number?

**Richard McPhail** - ***The Home Depot, Inc. - EVP & CFO***

Well, that cost number was really more a function of having built capacity to handle the explosion in our volume during COVID. And then the sort of other side of that hill where we pulled capacity in many forms back. And so it was the right thing to do regardless of the environment. It does happen to provide a buffer for our operating margin as we move into 2024.

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**Michael Lasser - *UBS, Analyst***

Okay. Thank you very much and have a great holiday.

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**Operator**

Our next question comes from the line of Steve Zaccone with Citi. Please proceed with your question.

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**Steve Zaccone – *Citi, Analyst***

Hey. Good morning, everyone. Thanks for taking my question. Congrats, Ann, on the new role. I wanted to focus on the Pro side of the business. So the commentary about growing with the complex Pro, in the past, there's been a focus on the flatbed distribution centers and the rollout on a regional basis. Is that still very much the strategy for the next couple years? And as you zoom out and think about the opportunity with the complex Pro, what are the top priorities within those next one to two years?

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**Ann-Marie Campbell - *The Home Depot, Inc. – Senior EVP***

Steven, thank you. Thank you so much for the kind words there. Chip is in the room, and he has been intimately knowledgeable about that. And so I'm going to throw it over to Chip and he'll talk a little bit about some of the capabilities that we continue to leverage and some of the functionalities and capabilities that we'll continue to build.

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**Chip Devine - *The Home Depot, Inc. – SVP, Outside Sales***

Yeah, thank you, Steven. We are going to continue certainly our march down to the expansion of outside sales teams and continue to grow the complex Pro. as it was mentioned in the earlier remarks. The connectivity into the store is an important part of this asset build as well. Our Pros shop in our stores every single day. And connecting that ecosystem to our flatbed delivery systems is part of that. So as we look and expand into different markets as we move forward from where we currently are, we will continue to evaluate the best opportunity to expand those distribution assets as well to support our growth in Pro.

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**Steve Zaccone – *Citi, Analyst***

Okay. Thanks. I wanted to revisit Simeon's question about inflection, because I know it's a challenging backdrop to predict. But I guess as you think about the business, what are the key building blocks to take the business from this period of moderation to a more stable market backdrop, when you talked about low single-digit market growth? I'm curious if you could opine on is it really the PCE shift, is it rates, just any help you provide would be helpful. Thank you.

**Ted Decker -** ***The Home Depot, Inc. - President & CEO***

Yeah, Steven, for that we're always looking at a balance between ticket and transactions. And what was interesting during the COVID period, we had inflation, so we had AUR up and we had ticket up, also driven by basket size. But the engagement was so high, you really didn't have elasticities. You had driving ticket and transactions and that's what led to the 25% comp. As inflation has abated in primarily commodities and those prices have come down, you've seen a falloff in ticket. And you didn't get the elasticity initially that you'd expect, and that was because people were still powering through projects. And now, it's a mix of what's the level of response from pricing versus pull forward versus the Fed stance and higher interest rates. So that's all the dynamic that's muddying the traditional ticket and transaction dynamic.

But what's healthy for us is a solid comp equally balanced between ticket and transactions. And that's what we'd be looking for. Now, as we said, prices have essentially levelled. Our ticket was down modestly. And if you take out commodity, our ticket would have been up for the quarter. And then transactions are still working through a bit of that PCE shift, pull forward, whatever that dynamic might be. But we'd be looking for growth in each in a nice balance going forward.

**Steve Zaccone –** ***Citi, Analyst***

Very helpful. Thanks, guys.

***Operator***

Our next question comes from the line of Brian Nagel with Oppenheimer. Please proceed with your question.

**Brian Nagel -** ***Oppenheimer, Analyst***

Hi. Good morning. Thanks for taking my question. The question I have – I think Michael may have asked previously just about price actions. But I guess maybe to expand that a bit further, so we've been discussing now this trend in weakness in bigger ticket for a while. Obviously, a very unique demand backdrop, but again, from your perspective, particularly as you look towards 2024, are there levers that Home Depot could pull to potentially spur better demand within big-ticket, other than price?

**Ted Decker -** ***The Home Depot, Inc. - President & CEO***

Well, the number one way that we're focused to drive demand is with the complex Pro. So it's – that is our key strategy, and that's what we're focused on. It's a $200 billion space, as we've defined the $950 billion, split evenly Pro and consumer, and at the $475 billion that's Pro there's $200 billion that is larger Pros, more complex spend that we're building out the capabilities to serve that demand. And that, Brian, is what we're very, very focused on and think for years and years, that is going to be a driver of our business as we take share in that sort of $200 billion white space.

**Brian Nagel -** ***Oppenheimer, Analyst***

Thanks, Ted, got it. And then, my second, my follow up, much quicker, you narrowed your guidance for the balance of the year. You talked about trends in the fiscal third quarter. But any commentary on sales trends early here in fiscal Q4?

**Richard McPhail -** ***The Home Depot, Inc. - EVP & CFO***

Our performance in the first two weeks is on track to achieve our full-year 2023 guidance.

**Brian Nagel -** ***Oppenheimer, Analyst***

Very good. Well, I appreciate it. Congrats again.

**Operator**

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

**Peter Benedict –** ***Baird, Analyst***

Oh, hey, guys. Thank you for taking the question. Another one on average ticket here. So pre-COVID average ticket around $67. I think now it's kind of trending closer to $90, so up 35%. Richard, just wonder if you have any perspective on kind of a like-for-like SKU inflation component there versus the big-ticket mix. It sounds like like-for-like inflation seems to be stabilizing. I know there's innovation that can make things not like-for-like. But just curious as you think about the big-ticket exposure there and what could potentially play out there, how big of a deal is that. Thank you.

**Richard McPhail -** ***The Home Depot, Inc. - EVP & CFO***

Thank you for the question. I think there are a few answers to that. First of all, we have seen inflation abate and really kind of settle on a like-for-like basis across the portfolio. I think it's interesting. You see some – we've seen different dynamics in big-ticket over the years, as we've had lumber inflation and deflation in particular skewing those results in big-ticket. But, Billy, maybe you talk a little bit about trends there.

**Billy Bastek -** ***The Home Depot, Inc. – EVP, Merchandising***

Yeah, I mean, and I'll just, Ted's response back to Brian on you know you see categories like: drywall, where we have capabilities; roofing; insulation; portable power, where we've added innovation. We continue to see great both Pro and consumer reaction to just the innovation and things we're seeing. As it relates to big-ticket, obviously, you've seen some deferral and so forth, as we talked about, and certainly the pull forward is probably still playing a part in that as we continue to get further away from the pandemic. So we'll watch that closely. We don't see anything. As we mentioned, stabilized pricing, a rational environment and we don't see anything differing from what we've seen over the last multiple months now.

**Peter Benedict –** ***Baird, Analyst***

Okay. Thanks for that, guys. And the, I guess turning to maybe the leverage and the pace of buyback, if we stay in this environment of, let's call it, moderation in demand, how do you think about just maybe balancing your buyback approach leverage? I mean, you're still operating below the 2 times. Is there anything that prevents you from kind of moving up that 2 times or just kind of curious your latest thoughts around those topics. Thank you.

**Richard McPhail - *The Home Depot, Inc. - EVP & CFO***

Thank you. We've maintained a position very close to that 2 times debt to EBITDAR leverage ratio and we intend to do so in the foreseeable future. We will also really maintain consistency with respect to capital allocation. We invest in the business first. We pay our dividend. And then, as we determine excess cash, we flow that to our shareholders in the form of repurchases. To your point, to-date, we've repurchased $6.5 billion. There's really no change in our stance. And so, I think that's the important takeaway there.

**Peter Benedict – *Baird, Analyst***

Okay. Thanks so much. Good luck.

**Operator**

Our next question comes from the line of Mike Baker with DA Davidson. Please proceed with your question.

**Mike Baker - *DA Davidson, Analyst***

Okay. Thanks. Just thinking about the fourth quarter, if we take the midpoint of the implied guidance, it does suggest a little bit of a deceleration, yet it does seem like your business has been consistent. Is that just a function of – am I reading too much into that or do we expect a deceleration? And maybe a second part of that is you said Halloween was really strong. Historically [indiscernible] trim a tree or your holiday decorating business. I think it's like in 10 of the last 14 years, your fourth quarter comp has been better than the third quarter. Why should this year be different than that? Thanks.

**Richard McPhail - *The Home Depot, Inc. - EVP & CFO***

Thanks for the question. The narrowing of the range is truly what it is. We saw the extreme points of that range become less likely and so we felt it would be helpful for our investors for us to narrow that range. There has been an assumption all year, from the beginning of the year, that our guidance reflected a reversion of our share of PCE from the pandemic time period back to 2019 levels. Our prior guidance range assumes that that share would continue to revert throughout the year. We've seen that reversion gradually and steadily. And our current range still has an assumption built in for Q4. We're largely reverted, but not all the way back. So there is some notion of that in our guide.

**Mike Baker - *DA Davidson, Analyst***

Okay. So sounds like it's, like you said, it's just a function of getting to the middle of the range. If I could ask one other question. You talked a little bit about storms and seasonality. I think a lot of retailers have said it's been a warm fall. How does that impact you? Do you need it to get cold as we go through the fourth quarter to drive your business? How should we think about that? Thanks.

**Billy Bastek -** ***The Home Depot, Inc. – EVP, Merchandising***

It's been a little warmer obviously, but not a big impact. We started to see where the weather is normalized. We started to see some of that fall cleanup and fall business really take off. Haven't seen obviously snow and so forth. So it's kind of right in line with what we'd say is a little more normalized year. Ad where you see the weather act a little more fall-ish, you've seen the categories and businesses that you'd expect to trend up trend in that positive direction.

**Mike Baker -** ***DA Davidson, Analyst***

Appreciate it. Thanks for taking the time.

***Operator***

Our next question comes from the line of Steven Forbes with Guggenheim. Please proceed with your question.

**Steven Forbes -** ***Guggenheim, Analyst***

Good morning. Ted, or maybe for Ann, just a follow up on Pro sales really focusing on the Dallas market versus the chain average. Can you update us on how that market is performing? And then, maybe just comment on any behavioral differences that you're noting between Pro markets based on the maturity of your strategic initiatives focused on the complex Pro. I mean, are you seeing and being able to analyze very like predictable behavioral changes?

**Ann-Marie Campbell -** ***The Home Depot, Inc. – Senior EVP***

Yeah, I'll start off by just saying that the capabilities and functionalities that Hector and Chip have been working on over the last several years are certainly going to help us engineer a great deal of momentum and success with the Pro. And, Chip, I'll throw it over to you again because of how intimately you are knowledgeable about that. But there is – it's just the Pro ecosystem is what we are focused on. And not in-store side or not only the in-store side, but the complex Pro. And as we build out these capabilities and we've seen the effectiveness of these capabilities, we're going to continue to leverage those.

And, Chip, I'll throw it over to you to kind of give you a little bit more details on Dallas.

**Chip Devine -** ***The Home Depot, Inc. – SVP, Outside Sales***

Yeah, thanks, Ann. And, Steven, yes, absolutely where we built capabilities inclusive of assets, distribution assets, and where we've expanded our sales force, we've seen meaningful impact in growth. Our outside sales team is the best performing cohort of all Pros. So we're going to continue, as I mentioned before, to invest in that and then add assets where necessary in the appropriate markets.

**Steven Forbes -** ***Guggenheim, Analyst***

Thank you. Maybe just a quick follow up for Richard or Billy. All the ticket conversations here, any way to just sum up how the quarter for big-ticket progressed relative to the expectations? It sounds like it performed better than expected. You have sort of stabilization in multiyear big-ticket comp trends. I would imagine that wasn't the expectation. But any way to help us frame on how the quarter progressed for big-ticket versus internal plan?

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**Billy Bastek - *The Home Depot, Inc. – EVP, Merchandising***

Yeah, I think, listen, it was largely how we planned it. I called out some great interaction from our consumers as it related to appliances. Having said that, we were in a better inventory position there. So we saw some tailwind from just our better inventory position as it related to that. But it largely played out exactly how we had thought it would. Really again back to the prior comments, a very balanced year across the board when you account for some of the weather shifts early on and then what we were lapping with the hurricane, very balanced across the board and across the regions.

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**Richard McPhail - *The Home Depot, Inc. - EVP & CFO***

I think it's important, though, thematically just to sort of repeat the point, this stance by the Fed of higher for longer is sort of coming across in surveys. There is a deferral of larger projects. And so if you just want to zoom all the way back to the true macro here and the forces on ticket that we're watching, that's probably the largest macro force.

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**Steven Forbes - *Guggenheim, Analyst***

Thank you.

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**Isabel Janci - *The Home Depot, Inc. - VP, IR & Treasurer***

Christine, we have time for one more question.

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**Operator**

Thank you. Our final question comes from the line of Dean Rosenblum with Bernstein. Please proceed with your question.

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**Dean Rosenblum – *Bernstein, Analyst***

Hey, guys. Thanks so much for taking my call, my question. My question is about the Pro and really just understanding the performance of the Pro relative to the comp overall and then splitting that out between store sales to Pro versus complex project sales to Pro. So just make sure I'm understanding. You put up, call it, a negative 3% comp. DIY and Pro very close to one another. US slightly worse than Canada and Mexico. So I'm assuming US Pro, call it, down 2%, 2.5%. And then, can you just either verify or correct that? And then can you characterize Pro sales in the store relative to Pro sales outside of the store through the outside sales force and FDCs, Thanks.

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**Richard McPhail - *The Home Depot, Inc. - EVP & CFO***

Well, taking your last part first, it's an ecosystem, like Ann said. We're actually not – we don't have goals or targets with respect to the separation of store and delivered sales. The point is actually lifting all sales, and that's what we've seen consistently in every market where we've rolled out capabilities. Originally, we worried. Okay. Are delivered sales going to begin to cannibalize the store? The opposite has proven true.

And so we are progressing in a way that we're pleased. With respect to your first question, factually the Pro did outperform the consumer in Q3, albeit at the narrowest margin we've seen in quite some time. If you actually normalize for commodity impact, the Pro was essentially flat for the quarter.

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**Dean Rosenblum – *Bernstein, Analyst***

Okay. Great. Thanks. And I guess my follow up would be when you guys measure big project versus small project, can you just clarify for us how you're determining what constitutes a big project versus a small? Is it like transaction size over $1,000? And if you could clarify that for us, that would be great.

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**Richard McPhail - *The Home Depot, Inc. - EVP & CFO***

We infer from category sales and from class sales. When you look at categories that are more likely to sell at higher volumes and larger projects, kitchens, flooring, millwork to an extent, we are doing some inference. We also ask our customers what they're seeing and what kind of projects they're working on. We use external survey data that tells us that the nature of projects is kind of shifting from larger to smaller. And so it's a triangulation.

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**Dean Rosenblum – *Bernstein, Analyst***

That's great. That's super helpful. Thank you so much, guys. Good luck in the fourth quarter.

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***Operator***

Ms. Janci, I would now like to turn the floor back over to you for closing comments.

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**Isabel Janci - *The Home Depot, Inc. - VP, IR & Treasurer***

Thank you, Christine, and thank you everyone for joining us today. We look forward to speaking with you on our fourth quarter earnings call in February.

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***Operator***

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