HD – Q1'24 Home Depot Earnings Call
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PRESENTATION

Operator

Greetings, and welcome to The Home Depot First Quarter 2024 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.

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

Thank you, Christina, and good morning, everyone. Welcome to Home Depot's first quarter 2024 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 presentation 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.

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

Thank you, Isabel, and good morning everyone.

Sales for the first quarter were $36.4 billion, down 2.3 percent from the same period last year. Comp sales declined 2.8 percent from the same period last year, and our U.S. stores had negative comps of 3.2 percent. Diluted earnings per share were $3.63 in the first quarter, compared to $3.82 in the first quarter last year.

The team executed at a high level in the quarter and we continued to grow market share. While the quarter was impacted by a delayed start to spring and continued softness in certain larger discretionary projects, we feel great about our store readiness, product assortment, and associate engagement. Our associates are energized and ready to serve our customers, as spring breaks across the country. As you will hear from Billy, where weather was favorable, we saw good customer engagement and strength in outdoor projects.

In addition, our focus remains on creating the best interconnected experience, growing Pro wallet share through a differentiated set of capabilities, and building new stores.

Driving sales growth with Pro customers remains one of our top focus areas. Remember, we operate in a $45 trillion asset class, which represents the installed base of homes in the United States. And we serve a highly fragmented addressable market of approximately $1 trillion. Within that TAM, the greatest growth opportunity is with the residential Pro contractor who shops across many categories of home improvement products, while working on complex projects. We've defined that specific opportunity as an approximately $250 billion TAM, of which we have relatively little share today.

We also know that to effectively serve this TAM, we need an expanded set of capabilities and services that we refer to as our Pro Ecosystem. And while the store remains the center of that Ecosystem, we are developing more fulfillment options, a dedicated salesforce, specific digital assets, trade credit, and order management capabilities geared at the residential Pro who shops across categories.

As we've shared with you before, our more mature markets with this Pro Ecosystem have seen great success, so we're expanding to other markets. As you heard last quarter, we'll have the foundational elements of our Ecosystem in 17 markets by the end of the fiscal year. And while these 17 markets are currently at different maturity levels, they are outperforming our other large Pro markets in aggregate.

Earlier this quarter we announced our intent to acquire SRS, a residential, specialty trade distributor with a leading position in three large, highly fragmented, specialty trade verticals serving the roofer, the pool contractor, and the landscape professional. SRS is complementary to the Ecosystem we've been building, giving us another avenue to more effectively serve the complex project occasion. They also give us the right to win with the specialty trade Pro customer. SRS does an exceptional job serving the specialty trade Pro, who typically only shops one category and needs specialized capabilities to complete their project.

In addition, SRS is an exceptionally well-run business with a world-class management team. As we build out our own Ecosystem, we can leverage their expertise and deep product catalog in the verticals in which they operate.

We have significant growth opportunities in front of us, and we are very happy with the high level of execution in our core business. And despite pressure in the market, we continue to invest in our business.

We are gaining share of wallet with our customers, whether they are shopping in our stores, on our digital assets, or through our Pro Ecosystem. Our merchants, store and MET teams, supplier partners, and supply chain teams are always ready to serve in any environment. They 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.
With that, let me turn the call over to Ann.

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

Thanks Ted and good morning everyone.

As we head into our biggest selling season, our associates continue to be engaged, excited and ready to serve our customers.

As Ted mentioned, growing share of wallet with the Pro and winning with Pros working on complex projects continues to be our largest growth opportunity. We know that delivering the best shopping experience for any purchase occasion is critical to our success. That's why we continue to invest in our Pro sales teams and capabilities. We have developed new capabilities within our Pro Intelligence Tool which feeds our CRM platform and leverages data science to bring better insight to our sales teams. These tools are helping us to both assist in identifying the optimal pro targets in a market as well as the highest value cross selling opportunities to drive action and sales.

Another critical component of the shopping experience is being in-stock with the right products and ensuring those products are OSA - on-shelf and available for sale. We've talked to you before about Sidekick and Computer Vision and are thrilled with the results we've seen so far. This year, we will continue to lean in to improve our OSA and drive productivity by creating consistent, actionable, and directed tasks for our associates. What's really exciting is how we are also now leveraging Computer Vision for other applications across the store.

For example, Computer Vision helps us maintain the integrity of our bays by ensuring that the product on the shelf meets our quality standards. Maintaining high quality, damage free product is a key component of delivering on the customer experience. Additionally, we have also deployed this technology in our self checkout corral to help us mitigate shrink. Computer vision can identify complex carts or high value carts and signal a cashier to help the customer with their basket to ensure all products are scanned and accounted for. While we will continue to improve upon all of these technology enabled applications, we are thrilled with the early results we are seeing.

Last quarter we talked with you about one of our areas of opportunity within our post-sale experience, specifically within our returns process. I'm excited to update you that over 70% of online orders are now able to self-service returns through their MyAccount profile on our website. Now, our customers can create their own return of an online order and drop it off at UPS with the scan of a barcode. Later this year, we will enable job-site pickup for returns back to the FDC, which will be a gamechanger for our Pro's shopping experience. This enhancement will allow our customers, primarily the residential Pro, to initiate a return from their jobsite versus having to return big-and-bulky items to the store. This is a massive win, not only for our Pros, but also for our associates and our stores and will drive better customer satisfaction and greater store productivity.

These initiatives are just a few examples of the different ways we are improving the shopping experience for our customers and our associates. I am so excited about all we are doing to drive sales in our stores and I look forward to the opportunity ahead of us. None of this would be possible without our amazing associates and I want to thank them for all they do to take care of our customers.

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 first quarter, our sales were impacted by a delayed start to spring and continued softness in certain larger discretionary projects. However, where weather was favorable, we saw good customer engagement and strength in outdoor projects.

Before providing commentary on our comp performance, it is important to note that we made some merchandising department changes, to more closely reflect how our customers shop our categories and better align with our merchandising growth efforts. We now have 16 departments, up from 14 previously, and have separated electrical and lighting and kitchen and bath. Additionally, we have renamed our tools department to power, and included outdoor power equipment to capture synergies and maximize the strength of our battery powered platforms.

Turning to our department comp performance for the first quarter… our building materials and power departments posted positive comps while outdoor garden, paint, lumber, plumbing, and hardware were all above the company average.

During the first quarter, our comp transactions decreased 1.5 percent, and comp average ticket decreased 1.3 percent. However, we continue to see our customers trading up for new and innovative products.

Big-ticket comp transactions, or those over $1,000 dollars, were down 6.5 percent compared to the first quarter of last year. We continued to see softer engagement in larger discretionary projects where customers typically use financing to fund the project such as kitchen and bath remodels.

Turning to total company online sales, sales leveraging our digital platforms increased 3.3 percent compared to the first quarter of last year. For those customers that chose to transact with us online during the first quarter, nearly half of our online orders were fulfilled through our stores.

We are incredibly focused on removing friction for our customers to create an excellent interconnected shopping experience. We continue to work on improving our online search functionality and serving the most relevant product offerings to our customers. To do this, we rolled out an intent based search engine that combines keywords, behaviors, and intent to deliver more targeted results. And we enhanced our filtering capabilities, improving the customer's ability to find exactly what they are looking for. All of these initiatives work together to drive strong results in our online business.

Pro and DIY customers performance was relatively in line with one another, but both were negative for the quarter. While Pro backlogs remain relatively stable, we hear from our pros that homeowners continue to take on smaller projects. The investments we are making are resonating with our pros as we see increased engagement. For example, we have made significant progress with the pro who paints and continue to see share gains with this customer. Our partnerships with Behr and PPG, as well as enhanced capabilities around our in-store service and jobsite delivery capabilities are helping to remove friction from their experience.

During the end of the first quarter, we hosted our annual Spring Black Friday and Spring Gift Center events and saw strong performance across both events. Our merchants did a fantastic job curating the best products, and we saw strong engagement with our customers throughout the events. We are pleased with the results we saw, particularly in categories like riding lawn mowers and outdoor power equipment where we had experienced some discretionary pull forward over the last couple of years.

The trend away from gas to battery powered products is continuing and we are well positioned with our assortment. We have the brands our customers are looking for whether its Ryobi, Milwaukee, DeWalt, Makita or Rigid. We estimate that there are nearly 500 million batteries in the market today and our assortment covers the vast majority of these batteries. In fact, more than 70 percent of batteries are with brands that are exclusive to The Home Depot in the big box channel. With hundreds of products across each of the platforms, this is one of the best loyalty programs that keeps customers coming back to The Home Depot.

And our live goods category looks incredible….We are ready for Spring with everything from shrubs, to a variety of flowers, herbs and vegetables for every type of gardener. We are excited about spring breaking across the country and we remain ready to help our customers with all of their outdoor projects and outdoor living needs.

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

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

Thank you Billy and good morning everyone.

In the first quarter, total sales were $36.4 billion dollars, a decrease of approximately 2.3 percent from last year.

During the first quarter, our total company comps were negative 2.8 percent, with comps of negative 4.0 percent in February, negative 0.8 percent in March, and negative 3.3 percent in April. Comps in the U.S. were negative 3.2 percent for the quarter, with comps of negative 4.8 percent in February, negative 1.3 percent in March, and negative 3.6 percent in April. For the quarter, Mexico posted positive comps whereas Canada was slightly below the company average.

In the first quarter, our gross margin was 34.1 percent, an increase of approximately 45 basis points from the first quarter last year, primarily driven by benefits from lower transportation cost and shrink.

During the first quarter, operating expense as a percent of sales increased approximately 140 basis points to 20.2 percent compared to the first quarter of 2023. The increase was primarily driven by a benefit from a legal settlement that we are overlapping from the first quarter of fiscal 2023 as well as deleverage from our topline results. Our operating expense performance was in line with our expectations.

Our operating margin for the first quarter was 13.9 percent, compared to 14.9 percent in the first quarter of 2023.

Interest and other expense for the first quarter decreased by $13 million dollars to $428 million dollars.

In the first quarter, our effective tax rate was 22.6 percent, compared to 24.2 percent in the first quarter of fiscal 2023.

Our diluted earnings per share for the first quarter were $3.63, a decrease of 5 percent compared to the first quarter of 2023.

During the first quarter, we opened two new stores bringing our total store count to 2,337. Retail selling square footage was approximately 242 million square feet.

At the end of the quarter, merchandise inventories were $22.4 billion dollars, down approximately $3.0 billion dollars, or 12%, compared to the first quarter of 2023, and inventory turns were 4.5 times, up from 3.9 times last year.

Turning to capital allocation…

- During the first quarter, we invested approximately $850 million dollars back into our business in the form of capital expenditures.
- And during the quarter, we paid approximately $2.2 billion dollars in dividends to our shareholders and we returned approximately $600 million dollars to shareholders in the form of share repurchases. As a reminder, in March we announced our intent to acquire SRS Distribution and as a result we paused share repurchases.

As you've heard us say many times, we maintain a disciplined approach to capital allocation and that is not changing…first and foremost, we will invest in the business and expect capital expenditures of approximately 2 percent of sales on an annual basis. After investing in the business, we plan to pay the dividend and it is our intent to return any excess cash to shareholders in the form of share repurchases. From time to time, we will also invest in the business through acquisitions to enhance our capabilities and to accelerate our strategic objectives.

Computed on the average of beginning and ending long-term debt and equity for the trailing twelve months, return on invested capital was 37.1 percent, down from 43.6 percent in the first quarter of fiscal 2023.

Now I will comment on our guidance for fiscal 2024.

Today we are reaffirming our guidance for 2024. As a reminder, our guidance does not currently reflect any impacts from the announced acquisition of SRS. The acquisition is currently under regulatory review and we expect it to close by the end of fiscal 2024.

- We expect total sales growth to outpace sales comp, with sales growth of approximately positive 1% percent and comp sales of approximately negative 1% percent.
- Total sales growth will benefit from a 53rd week, and we expect the 53rd week will contribute approximately $2.3 billion dollars in sales.
- Our Gross Margin is expected to be approximately 33.9% percent, an increase of approximately 50 basis points compared to fiscal 2023.
- We expect operating margin of approximately 14.1% percent.
- Our effective tax rate is targeted at approximately 24.5% percent.
- We expect net interest expense of approximately $1.8 billion dollars.
- Our diluted earnings per share percent growth is targeted to be approximately 1% percent compared to fiscal 2023.

It is our intent to update guidance as appropriate once the SRS transaction closes.

We believe that we have positioned ourselves to meet the needs of our customers in any environment. The investments we've made in our business have enabled agility in our operating model. As we look forward, we will continue to invest to strengthen our position with our customers, leverage our scale and low-cost position to drive growth faster than the 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 Chris Horvers with J.P Morgan. Please proceed with your question.

Chris Horvers – *JP Morgan, Analyst*

Thanks. Good morning, everybody. Can you talk about how you think the bathtub effect could play out? Do you have a sense of how much maybe the weather was a net headwind year-over-year, understanding that last spring was also wonky?

And related to that, Billy mentioned being pleased with spring where the weather was good and some positive commentary and some early COVID-winning categories, so where there was normal weather did you see comps maybe get flat or maybe up around the spring business? Thanks.

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

Hey. Good morning, Chris. Wonky is a great word to describe this spring. We can't really point to one geography that has had consistently good weather, but yes, certain markets, particularly in some of the northern-most markets where we've had some good weekends, business was just incredible and that's really what powered the positive comp in our power business. A lot of that is driven by outdoor power equipment, going to talk a lot about the battery platforms and the brands we have and customers are really responding to that category but we just haven't had the consistent weather across the country.

We're looking for much-improved western division this year, given how bad weather was last year in the West, but that really didn't happen, so the bathtub is in effect but we still have a long way to go. Our biggest selling weeks are ahead of us and certainly hope for some dryer weather and sunnier days, but Billy maybe you can add some commentary.

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

Yeah, no, thanks for the question, Chris. And as Ted mentioned, I mean, if you go back and we knew that there was pull forward in a lot of discretionary categories, single-item purchases if you will, and we're really pleased to see some of those businesses more normalized to the cyclical cycle of what you would typically see and there's no question that that was – had been an impact certainly last year and so really pleased we're seeing some of that.

Yes, where the weather's been great, which hasn't been, or consistent I should say, we've seen great customer engagement. I mentioned our spring Black Friday event, our spring Gift Center event. We've seen great consumer, customer engagement there, and there's still the continued pressure that we see in financed big projects as they called out in kitchen and bath specifically in the kind of remodeling finance projects, but really pleased with some of the customer engagement in some of those pull forward categories so far.

Chris Horvers – *JP Morgan, Analyst*

And just to dig in on that a little bit. On the big-ticket sort of two sides of the coin, the big-ticket finance project business, did it get worse because rates spiked and on the other side, categories like garden equipment and grills and patio, are you seeing any emergence of replacement cycle where you could see maybe those categories start to get back to flat if not up?

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

Chris, this is Richard. So just from a year-over-year perspective, we saw big-ticket pressure last Q1 which was more of the item purchase, as customers deferred those sort of item purchases. We saw big-ticket pressure this Q1 as well and yet the dynamic had changed and the dynamic really that we began to see towards the back half of last year was this deferral of large projects like Billy called out, so the pressure in those categories has actually increased. It's a different story of Q1 2023 versus 2024 and maybe Billy you talk about particular categories.

Billy Bastek - *The Home Depot, Inc. – EVP, Merchandising*
Yeah, again, the kitchen and bath remodel project, cabinets and so forth, I mean, anything that's financed we continue to see even a little bit more pressure conversely, and you just mentioned, Chris, some of the categories more item-buying I mean, a category like riding mower is well-over $1,000 purchase and we're seeing just in a few categories like that, terrific customer engagement. Again, we had pull forward, but we're really pleased with some of those specific item purchases even the ones that are over $1,000 as I mentioned. Riding mowers and some other categories where we've seen really back to that cyclical customer engagement, so we're really pleased with some of those pieces that we're seeing in the business.

Chris Horvers – *JP Morgan, Analyst*

Thanks very much. Have a great rest of spring.

Operator

Our next question comes from the line of Simeon Gutman with Morgan Stanley. Please proceed with your question.

Simeon Gutman - *Morgan Stanley, Analyst*

Hi. Good morning, everyone. My first is a macro and then I'm going to follow-up with a micro. I want to ask your opinion on lock-in effect versus turnover. If it's clear that we need turnover now for stronger demand?

And if you can talk about demand in regions of the country where pricing is more noticeably going up than others seeing if there is a real lock-in effect that can happen and the contingency is if we don't get rate decreases, what sort of normal could look like?

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

So, Simeon, I think you have to think about this short-term and longer term. So if we think about lock-in effect and the impact of housing turnover, clearly, we've seen two years of significant decrease in housing turnover to the point where we're really sort of at historical lows, and most folks think that that can't get much lower. When you're thinking about current performance, obviously, that puts pressure on our business. When a customer buys or sells a home they spend more in that year than any year when they don't, and so, there's no doubt that we're missing some of that project demand and that's what's weighing on our sales, as we had anticipated.

Then you have to ask yourself though, the lock-in effect, interest rate environment, at this point, a lot is subject to the macro. I think the question is at what point current interest rates become sort of the new normal. This is not something that we're making a prediction on. It's just thinking about behavior, at some point spend on housing shifts from discretionary to something that you simply must do. We know that there's pent-up demand for household formation. And so, again, I'd say, short-term, it is having an impact on our customer's mindset and it's not just housing turnover-related spend, it's really all large project.

As Billy said, sort of debt finance spend where we are seeing interest rates sort of weigh on the mind of customers and look, we're not immune to this. If you look at the national figures on what's really driving the consumer right now, it's services. Goods are underperforming services and durable goods are seeing the most pressure and in particular, home-related categories. So, this is not surprising, and this is baked into our expectations for the year. The question will be how it evolves over time.

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

Thanks. Yeah, that's helpful, Richard. My follow up, transaction is still negative but on a stacked, it looks like they're getting a little better if we're not over-reading it and that's despite the spring weather not breaking it. So, if you look at your transactions, on an improving trend line, is that industry bottoming getting better or is that Home Depot taking share?

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

Well, those are challenging to tease out. I would say our sense is we are taking share. That's from third-party reporting on 4441. But transactions, we have two dynamics going on and they relate to your prior question, Simeon. We talked about the COVID and the lap of the COVID is sort of like the giant storm in the hurricane. And for a couple years after you've pulled so much demand forward, you suffer from lower sales in those categories. And that's what we were talking about last year and what Billy was just reviewing this item buying. There was no doubt, grills and riders and patio sets and these big-ticket items were pulled forward.

We're seeing now that sort of naturally lap, sort of like that hurricane effect lapping. What is newer, and we chatted about this before, is the housing turnover which while historically not a huge driver of demand, it's steady state demand is housing turnover is fairly steady. But in the last 18-odd months is that has dropped from over 6 million units a year, I think at some run rates in certain months it was even under 4 million.

That dramatic decrease in housing activity is sort of the newer hurricane, if you will. And we don't see that going much lower. It's hard to predict. But as Richard said, tough to call the macro but at some point, people will start to lap the interest rates and the lock-in effect. We've already seen percentages of houses with mortgages and all the various interest rate strata, the percentage that we're in that under 3.5% is past-peak so you're already starting to see a bit of an unlock there. But all of that then leads to your transaction question.

So, we are starting to see some increase in transaction as we're lapping more of the COVID pull forward. Some newer pressure with the housing turnover dynamic but net-net we like the trend of transactions in units per basket were also up. And we like seeing that trend as well. So, not unexpected as Richard said and all baked into our guidance for 2024.

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

And just to add to that, you think about how we're performing in spite of large projects having seen the pressure. If you just look at debt financing, and you look at some of the statistics around where we're sitting, HELOC withdrawals or HELOC borrowing is down 23% year-over-year. That's a Q4 statistic but I think we're in the same territory in Q1.

In dollars, that's dropping somewhere from $70 billion-ish a quarter to $50 billion-ish a quarter. And you look at cash-out refinancing it's down 14% year-over-year and dollars, this peaked around $80 billion and there were $17 billion last quarter and so you've just got a significant drop more than 75% from peak to where we are today. And so that's, to us, interesting context for the fact that transactions have actually begun to recover on a sequential basis. So we're punching through the environment, but in some respects, as Ted said, the macro has been against us for a little while now. And you could almost say those statistics are stabilizing at least on the bottom.

Simeon Gutman - Morgan Stanley, Analyst

Thanks. Good luck.

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, and thank you. I want to start with a clarification on the outlook. You've got 1% EPS growth. I just want to confirm that this incorporates the buyback pause post-Q1. And then second, transaction growth stepping in the right direction. Curious if this was more Pro or DIY-driven or both and any color on the health of small- and mid-sized Pros versus larger Pros.

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

Great. So, Zach, I'll take the first part. It's Richard. So look, as we have reiterated guidance and see no reason to do anything but that. And when you think about the pause in share repurchases, think about the fact that we're also accumulating cash. As we accumulate cash, we earn interest on that cash. You'll see in our balance sheet we have over $4 billion in cash right now, which is around $3 billion higher than last year. So, given where short-term interest rates are, that interest income is a really strong offset to the impact from paused share repurchases. And therefore the net of it wouldn't change our guidance.

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

And on the Pro DIY, each were negative for the quarter, more or less the same rate. And within Pro, the larger Pro continues to outperform, particularly those engaging in the ecosystem. I'll let Chip comment some more about our performance there.

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

Yeah, thanks, Zach. Where we've expanded our capabilities around our supply chain capabilities and the expansion of our Outside sales teams, we've seen noticeable outperformance in those markets, and positive comps. So, very pleased with that march of expansion and as we move into this next nine months, we'll expand it another three FTC markets that we've mentioned, one in LA, one in Detroit and one in San Antonio. So we're very pleased with the progress.

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

Got it. Appreciate the color. And then, Richard, quickly. It looks like your SG&A on a per store basis was about flat year-over-year when you exclude the legal impact. And I'm curious if this is the right way to think about productivity this year or if you have any other levers at your disposal through the year.

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

Well, look, again I would encourage you to look at our full year guidance, because operating expense management can vary quarter-to-quarter. Obviously, we wanted to make sure that we were fully staffed in our stores. And as we said, we had a little bit later start to spring than we would have liked. And so, but we wanted to make sure that we were right there in front of our customer.

We had other favorability, I mean, hats off to all our teams, driving productivity throughout the portfolio. But in that particular point, operating expenses controlled by our operations team, just did a fantastic job landing the quarter. And that's all baked into the reaffirmation of guidance.

Zack Fadem - *Wells Fargo, Analyst*

Thanks so much 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, guys, and the scope of the answer here might be a little beyond this conversation. But in general, can you talk about how you plan to utilize SRS and their discrete set of Pro relationships to potentially leverage your broader complex Pro initiative?

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

Sure, Scot. First and foremost, SRS is just a great company operating in three large highly fragmented markets. So we talked about our TAM being $950 billion at the Investor Conference. With SRS and their market of roofing, specialty trade, pool and landscape, that opens up $50 billion increased TAM where they're a strong number two in each of those segments, so just a well-run company in three great growth markets where they have strong share positions. So, first and foremost, you get capability that lets you engage and win in a completely new TAM.

How it's complementary to what we're doing, all the things that we are building, they have as a distributor. We've been a retailer for 45 years and we're building wholesale capability, things like trade credit, things like much more robust, on-time and complete delivery to job sites, things like order management, things like incentivized field sales forces. So these are all things that they've done for years and we look forward to being able to engage with them and learn from them.

But then they can also serve our customers. I mean, our customers will benefit from their deep, broad catalogs in those verticals. And we can cross sell their product into our residential-focused Pro customer. So, we look at this as just a great opportunity to expand market, to expand capabilities and to better service our customers.

Scot Ciccarelli - *Truist, Analyst*

Very helpful. And then just hopefully a quickie. You talked about being in 17 markets by end of year for the complex Pro capabilities. How many markets do you ultimately see that capability rolled out to, it's 17 going to x?

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

I mean, we would expect over time to be in, we often talk about the top 40 kind of 80/20 rule of demand in our space, and that would be the expectation.

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. In light of the start to the year, did you give any internal discussions to moderating your expectation around the way the rest of the year could unfold? Especially in light of what's likely to be now fewer rate cuts than was expected 90 days ago which may mean that the overall rate of home improvement, the market may see less of an acceleration from here?

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

Yeah, Michael. We're not fed watchers here necessarily, and we said at the beginning of this year that we had a neutral stance on housing. We weren't going to take a bet on cuts or how many cuts. And that hasn't changed. What we are focused on and what our internal discussions do evolve around is our level of execution in the core business. And as I said, we couldn't be happier with how engaged this team is and how well we executed during the quarter. And if I can just take a minute to rattle off a few of these telltales.

When you think what Hector has done in the stores in terms of shrink and leveraging our wage investments, to getting attrition way down, which is helping with safety instances, what we're doing with technology and process in the store that Ann mentioned in her remarks, about not just the better in-stock but the supply chains delivering, with the actual on-shelf availability that all our tools are delivering, our supply chain and merchant teams, what an incredible job in the face of negative comps. They took out $3 billion of inventory at cost, increased our turnover 60 basis points to 4.5 times, and increased in-stock and on-shelf availability levels. I mean, that is just incredible performance.

And then add our price position. We talked about prices having settled in the marketplace. We're not anymore promotional this year but our overall price position with that rollercoaster that we experienced during the COVID years, we're as well-positioned on price and value and innovative products as we've been in some time, And then productivity in general remains a flywheel to Home Depot and a lot of that SG&A leverage that you noticed and we delivered was the efficiency in the model in having executed that $500 million in cost-out that we signaled at the end of last year.

So, Michael, that's what we focus on internally is controlling what we can control. And that's why I'm just so pleased with this team and their high level of execution in the quarter.

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

Thank you for that. And my follow up is, there is a school of thought out there that the SRS acquisition could be a sign that Home Depot's efforts to address the complex Pro segment of the market has just proved to be a little bit more difficult than what was originally expected. How would you respond to that?

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

Well, I'd respond to say what we are doing to capture Pro share of wallet with wholesale distribution capabilities is challenging, which is why no one's done it before, but we are doing it and we are succeeding in it, and we like what we see and that's why we continue to rollout to additional markets.

We also know it's a journey. This isn't open up a DC. Building a physical DC is about the simplest thing for us to do in our whole ecosystem that we're building, but it is putting together all the pieces of the ecosystem and introducing our customers to those capabilities and as we've said before, as we introduce customers to the capabilities, it is a linear relationship between increased comp and increased engagement with those capabilities, so we're still optimistic and green and progressing on our organic efforts.

SRS really is a completely different discussion in that a terrific asset and management team was brought to our attention that opened up a specialty distribution TAM that they have just a terrific position in. So at the end of the day, we keep reminding ourselves that we service a $45 trillion asset class with a $1 trillion TAM with The Home Depot at only about $150 billion in sales.

We have so much share to gain with our consumers, in-store, online shopping with our existing Pros who largely shop our stores, with this complex purchase occasion with larger Pros that we're building out the ecosystem and now SRS gives us whole new white space to go play in three other verticals to take even more share, so very, very different propositions.

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

Thank you very much and good luck.

Operator

Our next question comes from the line of Chuck Grom with Gordon Haskett. Please proceed with your question.

Chuck Grom - ***Gordon Haskett, Analyst***

Hey. Good morning, thanks a lot. Curious on the DIY side. Have you seen any changes in spending between income cohorts? And as a follow up you spoke to the delayed start to spring, curious a few weeks here into the month of May, maybe you could frame out how business is tracking relative to the first quarter or April.

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

So, on the income cohorts, it's actually really more about project size than it is about income cohort right now, and as I've said, as we said, the majority of the demand pressure is in those larger projects and that really sort of spreads itself across cohorts. You could even say that that almost tends to show as pressure in higher income cohorts.

As we said before though, this seems to be as it's not the inability to fund projects. It's a deferral mindset. You have this odd irony of every sound bite you read, while interest rates are going – they're coming down soon. Our customers tell us, hey, with that in mind, with that on the horizon, we're just going to wait, and so that's really the most important dynamic from an income perspective.

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

Yeah, and then, Chuck, just on the first couple of weeks of May. I mean, it really has been the same story where weather's been favorable. We've seen great customer engagement. Strength in outdoor projects, really pleased with what we've seen, the weather's been favorable which is – in my prepared remarks the same kind of dynamic we saw through especially later in the quarter as the weather got a little bit better in certain parts of the country.

Chuck Grom - ***Gordon Haskett, Analyst***

Okay. Thanks very much. And then Richard one for you. Just you spoke to confirming the 33.9% gross margin rate for the year. Is there anything today that makes you feel better or maybe worse about the underlying assumptions that got you there 90 days ago in terms of shrink, transportation, mix?

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

I think we're – so we're executing on all cylinders, and from a transportation perspective, from the merchant's managing retail and cost to one of the most volatile periods last year in our history, fantastic results. And then just to add to it, look, with respect to shrink, shrink is a problem for retail. Organized retail crime is not going away. It's a problem for all of us. The external environment is only getting tougher.

As a result, we've done a tremendous amount of work. It is amazing, the effort put forth by our teams in making investments that pay off with significant return on investment and so when we look at our shrink performance, I hate to say this, but the external environment is not helping. Our teams are succeeding in blunting the impact.

It's still a problem. It's still a pressure in our P&L. We want to keep attacking it, but we know that we've got the best in the business facing it, and it's not only return on investment in terms of financial performance. It's a return on investment from a customer and associate safety perspective and so we're really happy about that.

I think that there's one dynamic. You asked about margin. There's a dynamic here that I think it's worth calling out when you think about the shape of the year, and so I'll just go there. It is not insignificant when you think about the price dynamic last year, and how we saw retail settle in the market during the first half of 2023 and then essentially become what we would call settled during the second half of 2023, which has continued into Q1 and Q2 of this year.

So when you think about the AUR pressure within ticket, we reported ticket in spite of AUR pressure that is in essence about 2 percentage points this quarter year-over-year, and what I want to remind you of is, that's a year-over-year comparison, so we had kind of the height of – well, let's put it a different way. We had a lot of retail and cost settling during the first half of the year, so that 2% pressure is an artifact of a year-over-year measurement. It is not an observation on what prices are doing today and they are relatively steady.

As we move through the year, that pressure has from Q1 to Q2, so you'll have about one percentage point of pressure in Q2. It'll half again in Q3 and in essence be gone in Q4. So you asked the question about margin, I think that is a point with respect to the shape of the year that is important to put out there.

Chuck Grom - *Gordon Haskett, Analyst*

Great. Thanks very much, Richard.

Operator

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

Steve Zaccone – *Citi, Analyst*

Great. Good morning. Thanks very much for taking my question. I wanted to follow up on Michael Lasser's question. Can you just help us understand what drives the second half improvement in same-store sales, just given the fact that the first half has been a little bit softer here with this delayed start to spring?

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

Well, the primary factor is actually AUR, which we just outlined. So if you think about pressure going from the beginning of the year in Q1 of 2 percentage points sort of falling to 0 by the end of the year, that's really the majority of the arithmetic with respect to the year.

Steve Zaccone – *Citi, Analyst*

Okay. And then to follow up on gross margin, maybe it's a question for Billy. Spring Black Friday did well. We did notice there was a new spring sale from an online-only competitor. Do you think the promotional environments changing at all? I guess especially on the DIY side of the business as you try to compete for that customer?

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

Yeah, so I'll speak to the promotional piece and thanks for the question. Listen, we're in a very rational market and it's important to note that when we do events, we do events to drive excitement, to drive foot traffic at certain times of the year, no different than most folks do a Black Friday event, but we're doing that to drive excitement, bring value to the marketplace.

We're not putting stuff, housing stuff on sale. The promotional business as it stands today in 2024 looks exactly like it did pre-COVID, and before. It's no different. In fact, we've talked about appliances a little bit, but the environment really is normalized to what it was pre-COVID and I think it's again important to note that we do that to drive excitement footsteps and absolutely try to bring value to our customers at these key times of the selling year.

Steve Zaccone – *Citi, Analyst*

Okay. Thanks for the detail.

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 questions. So my first question, and I apologize, I know this can be a bit repetitive at least to a couple of the prior questions, so I'll maybe ask it a little bit different way. As you look – today you reiterated guidance for 2024. As you think about what we see what would transpire so to say in Q1, we talked a lot through the call about the macro pressures, the macro disruptions still impacting Home Depot, so the question I have – to get to that guidance, the guidance you reiterated today, do you need some type of change, some type of solidification in the macro environment from what you're seeing today?

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

No, Brian. Really the only impact here was a delayed spring and we managed this business in halves and no matter when spring comes, it always comes, and it never impacts our annual results or guidance. So that's why we reaffirmed today.

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

Got it. That's helpful. And then my second question, with some of the macro guidance there, and there's more chatter out there about a potential re-emergence, if you will, of inflationary pressures. So, I guess the question I have for you is, within your business particularly maybe more of the commodity side of this, are you starting to see this, a; and then, b, as you think about to the extent that we are seeing some type – potentially some type of re-emergence in inflation, how do you view at this juncture the ability of Home Depot to pass those type of costs along to consumers as it has in the past?

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

If you look at the national statistics, you can actually parse inflation. Inflation is being driven into the goods space – sorry, the services space, not in the goods space and particularly not in normally categories that Billy maybe just talked about, observations.

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

Yeah. And from a commodity standpoint, Brian, we've seen no impact. Obviously, we talked a lot in the last year about not only lumber but copper and we're pleased with the fact that there's no impact on commodities at this point and see a very stable environment.

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

Very helpful. I appreciate it. Thank you.

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

Christine, we have time for one more question.

Operator

Thank you. Our final question comes from the line of Steven Forbes with Guggenheim. Please proceed with your question.

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

Good morning, everyone. I was hoping maybe to just expand on the weakness in certain discretionary projects such as kitchen and bath. Any way to help us better understand if there's line of sight to stabilization in the project size headwind this year and/or pressure rolling off? Meaning is it cycling compare still or are you still seeing project size moderate, right, relative to some baseline, whether it's a year ago or sort of from peak levels?

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

Yeah, for sure, the single-biggest pressure outside of the AUR that Richard went through was from discretionary, larger, decor-oriented projects and as we've said, last year it was more of an item story. This year it's more of a discretionary generally finance story. If you take something like kitchen cabinets and countertops, those are probably the only categories where we've seen not just some fall-off in projects and size of projects, but actually a little bit of trading down.

So it's focused on those categories. It's the only place we've seen it and are seeing it. That too will pass. I mean, I think that is now going through, we've always had the idea that if turnover would drop, people would improve in place.

I think we're still seeing a fallout from the turnover being down so dramatically. It was just six months ago that interest rates hit their peak in October of 2023, mortgage rates, so those are the type of projects. You move into a new house, you update your kitchen, you update a master bathroom, et cetera, and then if you are going to stay in place, and take on those type of projects, outside of a move, you're generally going to finance, and as we've seen the rates tick up and the impact of rates ticking up, it's impacting that demand.

So right now, you would see a lap of that dynamic. We don't see housing turnover going lower and then the question is interest rates. What does happen to interest rates in higher for longer, what does that mean? You guys know as much as we do on that score.

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

And then maybe I have a quick follow up. I think it was Chip's comments earlier about the Pro comp, right, being positive. I believe he said within those markets that are servicing the complex Pro, so maybe just clarifying if that's what he said and does that imply that you've seen a widening in the performance gap between those markets where you're servicing the complex Pro versus the company average and maybe relative to what you guys stated at the Analyst Day last year?

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

Yeah, just reaffirming what I said, we have seen positive comps in those markets where we've invested in sales professionals and our FTC markets.

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

Great. Thank you.

Operator

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

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 second quarter earnings call in August.

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.