# The Home Depot, Inc. (HD) CEO Craig Menear on Q3 2019 Results - Earnings Call Transcript

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FQ3: 11-19-19 Earnings Summary

*Press Release* SEC *10-Q*

EPS of $2.53 beats by $0.00 | Revenue of $27.22B (3.50% Y/Y) misses by $-291.03M

## Earning Call Audio

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The Home Depot, Inc. (NYSE:HD) Q3 2019 Earnings Conference Call November 19, 2019 9:00 AM ET

**Company Participants**

Isabel Janci - VP, IR

Craig Menear - Chairman, President and CEO

Ted Decker - EVP, Merchandising

Richard McPhail - SVP, Finance Control & Administration

Ann Marie Campbell - EVP, U.S. Stores

Bill Lennie - EVP, Outside sale & Service

**Conference Call Participants**

Simeon Gutman - Morgan Stanley

Michael Lasser - UBS

Scot Ciccarelli - RBC

Steve Forbes - Guggenheim

Christopher Horvers - JP Morgan

Michael Baker - Nomura

Karen Short - Barclays

Zach Fadem - Wells Fargo

Peter Benedict - Baird

Seth Sigman - Credit Suisse

Kate McShane - Goldman Sachs

**Operator**

Greetings. And welcome to The Home Depot Third Quarter 2019 Earnings 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**

Thank you, Christine, and good morning, everyone. Joining us on our call today are Craig Menear, Chairman, CEO and President; Ted Decker, 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 Craig, 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 Craig.

**Craig Menear**

Thank you, Isabel, and good morning, everyone. First, let me start by welcoming Richard to his first earnings call. Sales for the third quarter were $27.2 billion, an increase of 3.5% versus last year. Comp sales were up 3.6% from last year. And our U.S. comps were positive 3.8%. Diluted earnings per share were $2.53 in the third quarter.

From a geographic perspective, all of our U.S. divisions posted positive comps. Internationally, both Canada and Mexico posted positive comps. Overall, we continue to see strong and engage customers. As Ted will detail both ticket and transactions grew in the quarter with the exception of lumber and electrical, all of our merchandising departments posted positive comps. We saw a healthy balance of growth between both our Pro and DIY customers with pro sales outpacing DIY sales in the U.S.

While our third quarter results largely demonstrate broad-based growth across geographies and merchandising departments our sales performance was below our expectations, driven primarily by the timing of certain benefits associated with our strategic initiatives. At the beginning of the year, we shared with you our expectation that these initiatives would collectively contribute approximately a 100 basis points to our comp performance in 2019. As the years evolve, we have learned a great deal and have shared with you that some of these initiatives have progressed more quickly while others are taking more time.

These investments are significant and long-term in nature. And we expect that the momentum we've seen will continue to build. Our rollout is largely on track and we're realizing benefits. It's just taking a little longer than our original assumptions. In a moment Richard will walk you through the implications this has for our 2019 guidance, but let me first provide more contexts. We've foundational IT work stream supporting many of our strategic initiatives that will significantly enhance our ability to serve our customers in an interconnected way.

Much of this IT work requires unwinding our legacy systems. And that has proven to be more complex than originally anticipated. Take the B2B website experience for example. Our investments in a personalized B2B website experience is a significant component of the unique value proposition we're creating for our pros. As you would expect, the most engaged customer cohort is a 135,000 pros that we on-boarded at the beginning of the year. And we're seeing meaningful lift in spend as these customers become more familiar with the new experience.

The rollout of the B2B site experience itself is on track. But underlying IT work must be completed before turning on additional elements of personalization and functionality for our larger Pro customers. Other investments are yielding results in line with or in some cases above our expectations. For example, HomeDepot.com continues to be a source of strength. Online traffic growth was healthy. Conversion is up and third quarter online sales grew approximately 22% from the third quarter of 2018.

Customers continue to respond to the ongoing investments and enhancements we're making to drive a frictionless, interconnected experience, including faster fulfillment options. We also continued to leverage our digital platforms to drive incremental growth from adjacent categories like HD Home, Cool and Workwear and are seeing good traction across all of these categories. We're seeing healthy growth in our online sales and online shoppers continue to see the relevance of our stores as more than 50% of our online US orders were picked up in our stores, a testament to the power of our interconnected retail strategy.

We continued to rollout automated lockers in our stores to make pickup of online orders easier and more convenient. To date, approximately 1,300 stores have lockers. And we've been very pleased with the customer response. As approximately 95% of customers rating their locker experience pickup give us a five out of five stars. We fundamentally believe that when a customer comes to one of our stores it has to be a great experience. Over 60% of our US stores have a new look and feel and customer response has been very positive. Customer service scores in the category of neat and clean have increased to 120 basis points versus last year. While scores for check-out times satisfaction have increased over 280 basis points versus last year.

As we approach the end of the second year of our transformative One Home Depot investments, we have even more conviction today that we're making the right, long-term investments for the business to extend our competitive advantage in the marketplace. As with any transformation, the work we're doing is complex and I'm proud of the way our team is consistently up for the challenge. Our associates continue to focus on what's most important in our business, our customers. And I want to close by thanking them for their hard work and dedication.

And with that let me turn the call over to Ted.

**Ted Decker**

Thanks Craig, and good morning, everyone. During the third quarter, we saw strength across most of our departments, driven by growth with both our Pro and DIY customers. Comps in appliances, Indoor Garden, Décor and Storage, Hardware, Tools, Outdoor Garden, Paint and Plumbing were above the company average. All other departments with the exception of electrical and lumber were positive but below the company average. Electrical was essentially flat due to light bulbs and deflation in copper. While lumber reported low single-digit negative comp due to continued commodity price deflation, we saw strong unit comp growth.

During the third quarter, we saw balanced growth with both transactions and ticket. Comp transactions increased 1.8% during the third quarter, acceleration from what we saw in the first half of 2019. The strength in our comp transactions was driven in part by the strategic store investments geared at improving the customer experience and extended outdoor season and traffic growth in a number of core categories. We also saw solid performance from big ticket transactions. During the third quarter, big ticket comp transactions are those over $1,000 which represent approximately 20% of U.S. sales, were up 4.8%. Excluding hurricane-related markets, big ticket comp transactions were up 5.5%.

In the third quarter, comp average ticket also increased 1.8%. We remain pleased with the performance of our ticket growth despite significant lumber price deflation. The increase in our comp average ticket continues to be positively impacted by our customers trading up to new and innovative items. During the third quarter, commodity deflation in lumber and copper negatively impacted our average ticket growth by approximately 80 basis points.

Let me take a moment to comment on tariffs. As expected, during the third quarter we saw increased cost rising from tariffs. Our merchants, finance and data analytics teams are doing an incredible job mitigating cost impacts and helping us evaluate our elasticities. While still early days, we continue to believe we can effectively manage tariffs. However, we remain cautious on how tariffs could impact the consumer more broadly. Going forward, we will use our tools and analytics to help us continue to focus on being the customers advocate for value. During the third quarter, we saw growth in both our Pro and DIY customers. Sales for our Pro customers which we estimate represent approximately 45% of overall sales continue to outpace DIY sales in the U.S. We're investing in resets services and a suite of tools to drive a better customer experience and save our Pros time and money. In the third quarter, we saw strong growth in Pro-heavy categories like fasteners, pneumatics, concrete and installation.

Turning to our DIY customer, as summer started to wind down, we saw customers take advantage of the extended outdoor season. During the third quarter, categories like Patio Furniture, Exterior Stains and Paint, Soils and Live Goods, all had comps well above the company average. Our digital investments in interconnected strategy are working. As you heard from Craig, we're enhancing features, functionality and category presentations on our website. We continue to see growth in online traffic, conversion and average ticket.

In fact, during the third quarter, we saw double-digit online growth in nearly all of our departments. And given the project nature of our business more than 50% of these online U.S. orders were picked up in our stores.

Let's look at Patio Furniture as an example, the category we know our customers shop both online and in our stores. Recently, we rolled out a new online category presentation in Patio that allows our customers to easily see the entire collection, different colors and styles, as well as various fulfillment options, all on one page. These new enhancements helped drive our strongest patio comp in the last 10 years.

And now let's turn our attention to the fourth quarter. Last quarter, we talked about the incredible response we're seeing from our customers to our industry-leading lineup of exclusive cordless outdoor power equipment from RYOBI, Milwaukee to Walt and EGO. We're excited to add Makita's new line of 18-volt outdoor tools to our assortment. Makita's 18-volt platform has over 225 tools in over 30 million batteries in the U.S. market. During the fourth quarter, we will add a powerful trimmer, lower hedge trimmer and chainsaw to that assortment. All compatible with Makita's award winning portable power platform.

We're proud to be Makita's exclusive big box partner. In addition, we're thrilled about the upcoming holiday season. Our merchants have worked hard to establish The Home Depot as the holiday shopping destination. We have worked tirelessly with our supplier partners to put together a broad assortment of product offerings and the best value for the holidays. As in previous years, we will have a number of special buys for Black Friday along with an in-store gift center showcasing great offers from our exclusive brands.

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

**Richard McPhail**

Thank you, Ted. And good morning, everyone. In the third quarter, total sales were $27.2 billion, an increase of 3.5% or $921 million versus the third quarter of fiscal 2018. Our total company comps were positive 3.6% for the quarter with positive comps of 4.1% in August, 3.7% in September and 3.1% in October. Comps in the U.S. were positive 3.8% for the quarter, with positive comps of 4.4% in August, 3.9% in September, and 3.3% in October versus last year, a stronger US dollar negatively impacted comp sales growth by approximately $41 million or 0.2%. As you will recall, fiscal 2018 had a 53rd week which shifted our fiscal 2019 calendar. As a result of this shift, our comp in October was negatively impacted due to the timing of our Black Friday event last year versus this year. This shift in timing --in event timing negatively impacted our US October comp by approximately 100 basis points.

US comps for the quarter were negatively impacted by approximately 35 basis points. As you just heard from Ted, during the third quarter, lumber prices remain depressed versus last year as lumber price deflation negatively impacted our comp sales growth by approximately $175 million, or over 65 basis points. In the third quarter, our gross margin was 34.5%, a decrease of 31 basis points from last year. The change in our gross margin was primarily driven by higher shrink and the mix of products sold compared to last year.

In the third quarter, operating expense as a percent of sales decreased by 10 basis points versus last year to 20%. Our operating expense performance reflects strong expense control and continued productivity in the business, as well as continued investments in our strategic initiatives, specifically expenses related to our strategic investment plan of $277 million increased by approximately $44 million from last year and resulted in approximately 13 basis points of operating expense deleverage. This deleverage was offset by productivity and BAU or Business As Usual expenses which drove 23 basis points of operating expense leverage.

Our operating margin for the third quarter was 14.5%, a decrease of 21 basis points from last year. Interest and other expense for the third quarter grew by $56 million to $280 million due primarily to higher long -term debt levels than one year ago. In the third quarter, our effective tax rate was 24.5% compared to 21.4% in the third quarter of fiscal 2018. For the year, we now expect our effective tax rate will be slightly lower than 25%. Our diluted earnings per share for the third quarter were $2.53, an increase of 0.8% from last year. In October, a devastating round of storms and tornados impacted the Dallas area. During these storms, tornados destroyed one of our stores in Dallas. And our thoughts continued to be with that community and are impacted associates.

At the end of third quarter, we had an ending store count of 2,290 and total sales per square foot were $449, up 3.5% from last year. At the end of the quarter, inventory turns were 5x down from 5.2x last year, reflecting a load-in of inventory in support of our strategic initiatives.

Moving on to capital allocation. In the third quarter, we repurchased $1.25 billion or approximately 5.2 million shares of outstanding stock. This included repurchases of approximately 2.0 million shares on the open market and approximately 3.2 million shares through an accelerated share repurchase or ASR program. Note that for the shares repurchased under the ASR, it is an initial calculation. Final number of shares repurchased in the third quarter will be determined in the fourth quarter when the ASR terminates. Computed on the average of beginning and ending long-term debt and equity for the trailing 12 -months, return on invested capital was approximately 45.1% or 290 basis points higher than the third quarter of fiscal 2018.

Turning to our outlook for the remainder of the year. As we approached the end of the second year of investment geared at achieving our One Home Depot vision. We're confident that we're making the right investments for the business to extend our competitive advantage over the long term. As Craig said, these initiatives are gaining momentum and are contributing to our sales growth. But some of the benefits anticipated for fiscal 2019 will take longer to realize than our initial assumptions. As a result, today we are updating our fiscal 2019 sales guidance. Remember that we guide off of GAAP. The fiscal 2019 guidance will launch from our reported results for fiscal 2018, which includes sales and earnings associated with a 53rd week.

For fiscal 2019, we now expect comp sales as calculated on a 52-week basis to increase by approximately 3.5%. And we now expect sales reflecting the compare of 53-weeks last year to increase by approximately 1.8%. We're also reaffirming our earnings-per-share guidance for fiscal 2019. We expect fiscal 2019 diluted earnings-per-share to grow approximately 3.1% to $10.03. We look forward to talking with you at our Investor Conference on December 11th in New York where we will give you an update on our key strategic initiatives, as well as some initial thoughts around fiscal. 2020. Thank you for your participation in today's call. And Christine we're now ready for questions.

## Question-and-Answer Session

**Operator**

[Operator Instructions]

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

**SimeonGutman**

Thanks. Good morning. My first question is what gives you confidence in these initiatives hitting? And then what gives you proof that it's the initiatives that are taking longer to realize and not something slowing in the macro. And then I have one follow-up.

**CraigMenear**

So let me start with the initiatives. First of all, we're seeing benefits from the initiatives. It's just not at the rate of our original plan. And when we look at the investments that we're making in this business, as we shared with you back in December of 2017, we're doing this for the long-term health of the business and to position ourselves to win competitively in the long term. This is such a big opportunity that we're going to do this right and continue to make sure that we are delivering an experience that our customers are accustomed to getting from the Home Depot.

And so we think we're getting about half of the investment benefit in 2019. And as we continue to add additional features and benefits as we unwind some of the complexities of our legacy systems, we'll see that continue to grow. And as it relates to how do we know it's not something else? We continue to see broad-based growth in our business. As Ted called out, we had great strength in ticket transactions. We had strength in big ticket. We saw our pro business accelerate during the quarter. And when we look at what happens in discretionary spend categories particularly that are high ticket discretionary spend we don't see anything there that concerns us at this point.

**SimeonGutman**

Okay and my follow-up is if you look at the construct of the existing three-year plan and you start from today where 2019 margins are going to land looks like around 14.4. It would call for flattish margins next year to up as much as 60, if you take the original plan. If the macro is not any different than you plan which it sounds like it's not, what would cause that to change? This range of flat to up 60.

**TedDecker**

Hi, there, Simeon. So what I would say is, first of all, we're focused on delivering on the guidance for the year and look forward to talking about 2020 at our Investor December conference. Clearly, there has been pressure to our margin from shrink which was the highest contributor to the decrease year-over-year within those 31 basis points. And so that is an unplanned pressure and we're taking steps and have many initiatives in place to address that.

**Operator**

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

**MichaelLasser**

Good morning. Thanks a lot for taking my question. You mentioned that you're getting about 50 basis points of lift from the return on investments rather than anticipated 100 basis points that you previously expected. Is there any reason why we shouldn't just take that delta the incremental 50 basis points and just tack it on to what we're modeling for next year? That speaks to both the nature of the return and the timing associated with the return.

**CraigMenear**

Michael, I think as we look at the investments that we're making, we expect that through the balance of 2019 as we move into 2020, we will continue to see the momentum build off the investments that we're making. I don't know that we see it as a straight line, but it certainly will continue to ramp. As we shared in my opening comments, for example on the B2B website experience, the first 135,000 customers that we put on early in the year, we're seeing very nice results. As we onboard more and we on-boarded a number recently at the end of the quarter, as we continue to see them engaged they get more familiar with the experience we see lift.

So we're definitely confident that we will continue to see some momentum build through the investments that we're making.

**RichardMcPhail**

And it's also if you think, Michael, about the investments we've made in our store environment and Ted and Ann may want to comment a little bit about that. We know that the changes we're making are resonating with our customer and we're seeing positive lift from that.

**AnnMarieCampbell**

Yes, no. Thank you, Richard. Couple of things that Craig called out. First of all, when you think about our sales growth and our online sales growth and what we've seen in the stores that 50% that's picked up in the stores as we continue to make that easy for customers, we're seeing just incredible repeat as we think about transactions. So we're going to continue to lean into things that really simplify the experience for more customers. We're also continuing to add delivery capabilities outside of the stores as well with our car and Van delivery which really benefits to our pro customer. And we see that accelerated through the quarter. And when you think about our VOC scores, Craig called it out, as we think about all lockers and but we're also seeing increased VOC scores on our checkout process on the front end as well.

So you think about the investments we're making and we think about the fourth quarter coming up we're going to see increased traffic or customers, another time of introducing all these investments to our customers which we believe is just going to drive tremendous loyalty.

**MichaelLasser**

That's helpful. And my follow-up question is you're guiding to a 5% comp that's implied for the fourth quarter. And that would be higher than what you've done throughout the course of this year. So what's driving your more optimistic expectation? Is it that you're going to see this accelerating return from the investments or are there other factors that you can outline that can help bridge to that 5% you're guiding to for the fourth-quarter? Thank you.

**RichardMcPhail**

Michael, thanks for the question. We're very comfortable with our guide based on the momentum Ted called out. And while our guidance does imply acceleration, that acceleration is mostly caused by the absence or reversal of pressures we saw in Q3 as we walked to Q4. From lumber deflation, from FX and from an event timing shifts that we saw in Q3. So you can look at it a couple of ways to normalize Q3. If you take the quarterly comp of 3.6% and you add back 60 basis points from a much lower level of pressure from lumber, we'll see in Q4 versus Q3. And you add back 35 basis points from the impact of event timing to Q3 where basically our Q3 comped over the first week of Black Friday from last year's Q4 due to the calendar shifts and then you add back 30 basis points from favorable FX compares. You'll see Q4 is actually right in line with a normalized Q3. You can look at it another way. You could take our October comp of 3.1% as an exit rate. You'd add back a 100 basis points from that event timing impact. Lumber of 60% and FX of 30. And again you will see why we have confidence in the progression from Q3 to Q4.

**Operator**

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

**ScotCiccarelli**

Good morning, guys. Two follow-ups. First, so when we think about the impact of both the Black Friday event and lumber pricing. When we're thinking about a net impact kind of negative 25 basis points. Is that right, Richard?

**RichardMcPhail**

From lumber, yes.

**ScotCiccarelli**

Okay, got it.

**RichardMcPhail**

[Multiple Speaker] your questions.

**AnnMarieCampbell**

Can you repeat the question?

**RichardMcPhail**

Repeat the question.

**ScotCiccarelli**

Yes. Just the net impact, right. You had some of the Black Friday event kind of fall into fourth quarter this year versus 3Q last year, plus you had the lumber pricing. I guess I'm trying to figure out what's the net impact? The comments you've made suggests it's about 25 basis points on a net basis.

**RichardMcPhail**

No, they actually both go the same way. So 35 basis points of negative pressure to Q3 and 60 basis points of negative pressure, sorry 35 basis points from event timing and 60 basis points from lumber pressure. So they add to about 95 basis points really sort of alleviation of those pressures as we walk from Q3 to Q4. And then if you're looking at total company comp where there was a 20 basis point differential between total company and US in the third quarter. And then you bring FX into play and we will have about a 30 basis point favorable compare in the fourth quarter. Does that make sense?

**ScotCiccarelli**

I think so. And then a follow-up question on your shrink comment. Has the pressure from shrink continued to increase? Or/and related to that, do you have any feel for if it's being driven more by internal? Let's call it, test or issues or if it's more external? Thanks.

**CraigMenear**

Scott, it is continuing to increase. We've seen the pressure. But we have a number of initiatives underway.

**AnnMarieCampbell**

Yes. I'll add certainly in the departments that we are seeing increased pressure; they are more what we considered kind of malicious. And we've had initiatives underway and have implemented in our high-risk store. Some of the things we've done in the past to make sure that we secure all products. But in addition to that, we are working through initiatives from a technology perspective as well. Because we want to make sure that we have a long-term solution to mitigate this risk as well. So while we're doing certain things in the short-term to release some of this pressure, we're also working on the initiatives in the long term.

**ScotCiccarelli**

And so when would you expect that trend, if you will, to start to reverse?

**AnnMarieCampbell**

We have an expectation in the stores that we have implemented. Some of the initiatives that will start to bend the curve. But as I said, we've done that in our high risk stores first. And we want to make sure that as we protect the top-line; we're mitigating and really created a good experience for customers. So we're going to continue to monitor. But some of the things we've seen in the short-term have been really positive in these high-risk stores that we've implemented.

**Operator**

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

**SteveForbes**

Good morning I wanted to follow up on the investment plan for this year. So I think you called out $44 million or yes, $44 million of pressure, right, from higher spend this year. But can you just remind us what the plan is for the whole year relative to 2018? Because I thought I guess, both in absolute dollars, because I thought the P&L pressure was going to be similar, right, same dollar impact 2019 versus 2018. So should we expect a reversal or a benefit in the fourth quarter?

**CraigMenear**

The investment plan actually ramp through

**RichardMcPhail**

Yes. The investment plan ramps actually from a total -- and remember I'm calling out capital and expense here. But a total investment plan of about $3.3 billion last year ramping to an investment plan of about $3.6 billion this year. And so and that's in line with the plan that we set back in 2017. And so the expense year-over-year is really sort of in line with that lift as well because expenses generally lift with the capital.

**SteveForbes**

So just a follow-up on that. So can you help us break that down between capital and expenses? Or is it really just the incremental, is the $300 million spread between those two numbers?

**RichardMcPhail**

It's actually, so the breakdown for 2019 is about $2.6 billion in capital and about $1 billion in expense which is higher than last year's levels. But it really is just that increment of ramping up to $1 billion in expense that you see in the P&L. And the cadence of those investments quarter-to-quarter over the year are relatively steady ramping up through the year and peaking in Q4. As you would expect, as we continue to ramp investment off and investment will be higher in 2020 than it was in 2019.

**Operator**

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

**ChristopherHorvers**

Thanks. Good morning. The market growth has moderated in 2019 relative to the past couple of years. Was that your expectation coming in? And do you think that lower mortgage rates allow the market growth rate to reaccelerate from here? So I think there's sort of a base case 4% market growth rate was a three-year plan or do you think that maybe that market growth rate moderates a bit further given where we're later into the cycle?

**CraigMenear**

And what we shared at the beginning of this year, we didn't expect that the market growth will be slightly less than it was in the previous year. And so that was part of our overall expectations. I mean when we look at the market in total, however, we play in a $600 billion market that we own about 17% of. And if you look at third-party data, it would indicate that we took significant share in Q3. And so we look at this as an opportunity going forward. We always talked to the merchants about the fact that we don't own enough share to worry about how that market growth itself. We just need to stay focused on the customer and continuing to drive the business.

**RichardMcPhail**

I think there's another point to that, Chris, which is really just looking at the headline of 4% market growth. And what we experienced in 2019 from a lumber deflation perspective. As we shared with you earlier in the year that's going to be about $800 million of pressure to us, but it will be pressure in the market in general. And so when you sort of round that out, you're looking at market growth or sort of our base case assumption of 4% lower down to around 3%. And, in fact, the fact that we're guiding 3, 5 today shows that we think we're getting about 0.5 from initiatives.

**ChristopherHorvers**

And so do you expect, so I guess the puts and takes as you look forward, as you've got the benefits from initiatives which I think back to the three-year plan you had expected that to ramp or I guess even over the five year plan. But then on the other side you have sort of the rate factors. So do you think that rates allow the underlying market growth rate to reaccelerate and maybe get some back --get back some of the deflation. So the underlying growth rate actually could be better as you look forward?

**RichardMcPhail**

What I would say is the macro and housing environment have played out right in line with our expectations. And the description we would use is housing is healthy and stable. There's no doubt that recent movements in the rate environment are going to create support for that stability. But as we've said for many years, we expected that we would see that from 2012 a period of moderate housing recovery and a period of sharp housing recovery. And then a period of stability in housing and that has played out. And so I would say again housing is healthy and stable. The rate environment certainly provides support to that.

**ChristopherHorvers**

That's very helpful. So my follow-up is on the extended season that was an impressive traffic number. Do you think that extended season was weather understand you lapped hurricane last year, but was just extended season additive to comp for this quarter?

**TedDecker**

Hey, Chris. It's Ted. Yes and no. I'd say certainly the extended season we did well in things like exterior stains and paint and some garden projects. But then in the Southeast in particular we had heavy drought as well. So there's some give and take with that. I think on the margin, we did do better with the extended season. I would say those are fundamental drivers of the business is the bigger story. When we think about this balance of ticket and transaction growth, we always start the year planning and expecting a balance of ticket and transaction that really plays out that way, but to see 1.8% growth in ticket, 1.8% growth in transactions. Real underlying stories also unit growth. We saw our strongest units as Craig called out in a year and a few adjust for as we've always called it the bathtub effector spring or if you have a weak Q1, you have a stronger Q2 depending on weather hits. When you normalize for the bathtub effect, this was our strongest units in two years across the entire business. As Craig said, it's across geographies. And it's actually across the store where we're seeing this unit productivity.

**Operator**

Your next question comes from the line of Michael Baker with Nomura. Please proceed with your question.

**MichaelBaker**

Thanks. A couple of follow-ups on the gross margin. First, what are you seeing competitively in terms of pricing? And if you could touch on the paint category in particular? And then secondly, as it relates to tariffs, you said you were-- you think you can manage tariffs. What has managed tariffs mean? Does that mean it has an impact on gross margins, but you can offset it elsewhere or basically what a tariffs doing to the gross margins? Thanks.

**CraigMenear**

So from a competitive standpoint to begin with, we see a continued escalated promotional environment in the marketplace. That would include the categories of paint. That doesn't seem to be abating whatsoever. Ted and the merchant team are sticking to our strategy of delivering great everyday value to our customers. We know that that's for long-term right approach for the business and has played well for us over time. So that is absolutely. Ted, I don’t know if you want comment on tariff.

**TedDecker**

Yes, on tariffs. Since this started, we said we believe it's manageable. And when I say that our finance teams merchants and data analytics teams have really drilled into the overall impact of the business. We know down to the SKU level the point of origin, the classification of the tariff, the potential impact. And from there we start working with our supplier partners to mitigate that tariff impact. We all know that on the margin, all goods have elasticities. And if you don't have to put price through, you are going to retard unit productivity. So each of Home Depot and our supplier partners are laser-focused on maintaining unit growth in this business. So we will work on mitigating the tariff impact to change country of origin, to change makeup of the product itself to add other features and benefits that can add value to the consumer.

With all that being said, we have offset from what would be not theoretical, the actual SKU level buildup of tariff impacts. We have offset well over half. So out of the gate there is no impact on well over half of the potential tariff impact to our business, again working closely with our supplier partners and with the balance of the impact that is a manageable set of actions we're taking across the portfolio not necessarily in the tariff SKU itself, but we have moved on some retails and that's implied. When I said we're measuring the various elasticities and where we've had to move and where we've acted in a portfolio fashion.

We've maintained unit productivity as I said, whether effective, this is our best units last quarter in over two years. So I would sum all that up to the content that we believe it's managing.

**MichaelBaker**

That's a lot of color. And very helpful. One more just a follow-up to a previous question, just on the housing in the macro. I get that you're talking about it being stable, but if we just look at it simply, simple measures of existing home sales. They have picked up as of late really six to nine months ago. And historically that does lead to better comps for you guys. So I guess are you surprised that comps aren't accelerating on the back of housing or should we expect that maybe early next year?

**CraigMenear**

I go back right to the base kind of comp that, Richard, walk through with you as we look forward. And the underlying health of the business is very solid. Great transaction growth, great unit growth, broad-based across the business. If you candidly look at where we thought this year would play out to where we are today. I mean 70-plus percent of the variance to the current year-to-date performance is lumber deflation, plain and simple. So we feel good about the environment.

**Operator**

Our next question comes from the line of Karen Short with Barclays. Please proceed with your question.

**KarenShort**

Hi, thanks very much. And just a question on housekeeping, last quarter you gave big ticket growth by month. I was wondering if you would be willing to provide that this quarter. And then I had a bigger picture question.

**CraigMenear**

I don't think we have that with us here right now. We can provide that. If you want to call in the Investor Relations department.

**KarenShort**

Okay. And then switching to the 20-20 investment comments. So you commented that the 20-20 investment would be higher versus 2019. So I guess the question is does that comments apply to both expense and capital? And then within the expense, is that still more skewed to D&A versus SG&A?

**CraigMenear**

Look, we've got our Investor Conference in a couple of weeks and we will provide all the color around this at that time. Right now we're laser-focused on delivering the balance of this year.

**Operator**

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

**ZachFadem**

Hey, good morning. So following up on the SG&A investment question for this year. You spent $277 million in the quarter that gets me to about $820 million in operating expenses so far this year, if my math is right. So how much of this would you categorize as strategic versus business as usual investment? And then I just want to confirm you don't expect these strategic investments to step down in Q4 to get to that $1 billion for the year that you've talked about.

**RichardMcPhail**

So all of the investments that we call out are strategic investment of $277 million in Q3. We've guided to planned number of around a $1 billion and we'll be north of $1 billion this year, right in line with expectations. As we set them out at the beginning of the year.

**ZachFadem**

Okay. And then on the 100 basis point calendar headwind in October, could you expand on that just a little bit more? I just want to confirm that this will be a similar benefit to November. And then when you think about the moving parts lumber deflation in Q4 and then the hurricane headwind perhaps subsiding. Why do you think the implied 5 percent-ish comp in Q4 is the right place to land? And are there any other moving parts that we should keep in mind?

**TedDecker**

I'll speak to the events. So from a merchandizing calendar, it's very heavy this time of year. So we set our pro Black Friday. We're bringing great values for our Pro. We bring in appliance Black Friday which is a very, very large appliance event. And then we set our gift center which is a lot of power tools, power tool accessories, hand tools, gifting items. All of those initiatives kicked off on the calendar a week late relative to comp. In that we're quite confident that's the number of 100 basis points. And we see that flowing into Q4. In some of that actually will go into December on the end. So it doesn't all get in November, this will hit throughout November and December.

**Operator**

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

**PeterBenedict**

So my question is just around the Pro B2B sign-up cadence. You've talked about a 135,000 or so that were signed up early in the year. Are you guys still expecting a million by the end of the year or have you kind of slowed the sign-ups because of some of the tech issues that you were talking?

**CraigMenear**

No. We still expect to onboard about a million customers during the year. And we on-boarded a number of them at the tail end of Q3 right, Bill?

**BillLennie**

Yes. Peter, we finished Q3 just above 780,000 pros that have been migrated onto the website. And we continue to add new capabilities as we go through the quarter. We now except the pro purchase card with our legacy interline customers so they can buy on HomeDepot.com. We've done things like introduced Buy It Again functionality. And we've made new user registration automatic. So as we have new customers signing up onto our Pro extra platform, we can get those customers at the time of sign-up and we can automatically migrate them to the B2B website. So we're on track with the customer migration and on-track with all the capabilities.

**PeterBenedict**

So that million target, what --roughly what percent of your pros does that represent? And I guess what kind of penetration you guys think you can get longer-term?

**RichardMcPhail**

Well, if you look at it, we think we can get all of our pros, our verified pro customers migrated onto the website over the long term. So that would represent about 30%.

**RichardMcPhail**

Yes, about 30% of the total right now. And as we continue to build the base of capabilities then we will obviously do more as we had originally planned to then make that knowledgeable to our pros and market to them accordingly.

**PeterBenedict**

Okay, great. And just my one follow-up would be just getting back to a question a little bit earlier, just around trade down. I know you mentioned some things around how you're trying to manage the elasticities and what not, but I am just, even absent of tariff. So have you seen any sign of trade down either within certain categories or what not or maybe some of the pros are opting for more middle line product as opposed to higher-end, I was curious if you're seeing anything there?

**TedDecker**

No. We're not. So a couple points of observation there. Appliances for example, we continue to see trade up across just great innovation in clients business, we've introduced Fosh, which is approaching the higher, highest end of the category and picking up lots of net new business there. And then the phenomenon with the cordless power tools now going in outdoor power equipment, we're seeing great pickup and these are all higher price points with the innovation of technology and outdoor power equipment.

**Operator**

Our next question comes from line of Seth Sigman with Credit Suisse. Please proceed with your question.

**SethSigman**

Hey, guys. Good morning. I did want to follow up on that last point. So when we look at your average ticket on a comp basis up 1.8 pretty similar to last quarter where it was 2%. I guess I'm surprised it's not accelerating more. Sound like you had a little bit less commodity deflation this quarter, big-ticket trends seem pretty healthy, maybe had a little bit of inflation on the back of tariffs. So I'm just curious is there something else that's holding back the ticket growth? Maybe is that the shift related to Black Friday where you have a lot of big ticket categories or something else maybe?

**TedDecker**

Yes. That's exactly the big Delta would be the events for the holiday promotion. So think of appliances, your average ticket on appliance, gifting portable power tools, combo kits et cetera, so that 100 basis point isn't, that shifted isn't entirely ticket but much more so than transactions.

**RichardMcPhail**

And I just say, Seth, that again when we think about the big ticket in this quarter over a $1,000 at 4.8 hurricane adjusted markets at 5.5 that is right in line with our expectations.

**SethSigman**

Yes. Okay, that makes sense. And then just to follow back up on tariffs. It sounds like you guys have managed that really well and have found some offsets. How do we think about the same SKU inflation that is --that you're seeing in the business and how it may be impacting comps? And then just the second part of that, there have been some exclusions announced recently in certain categories that you do playing. And I'm just curious if that's meaningful at all for you guys. Thanks.

**TedDecker**

Sure. I would I would say on the contribution of tariffs to that ticket growth, it's actually a very nominal amount. It's by far lower than for example the introduction of sales of new innovative higher price AUR items, is a far bigger driver of that 1.8% in any price moves we would have made associated with tariffs. And on the exclusions, we're working through that, it was last Friday we had a number of exclusions announced. A number in the flooring category that we are working our way through, very optimistic about what that is going to mean for Vinyl Plank. We believe most of our portfolio, the Luxury Vinyl Plank which has been our fastest-growing category and number of those items is seemingly going to be on the exclusion list.

Again, we're working through the detailed, but we're very encouraged.

**Operator**

Our final question will come from the line of Kate McShane with Goldman Sachs. Please proceed with your question.

**KateMcShane**

Hi. Thanks so much for taking my question. I just wanted to, you mentioned that the pro was still outpacing DIY. I just wondered if you had seen any changes in the Delta between the pro and DIY trends.

**RichardMcPhail**

I think if we look at the last few quarters, the Delta hasn't changed dramatically, but we did see the pro strengthen some in this quarter. So both strengthen. But and then the one comment I would make about the pro business is we're seeing, Ted talked a little bit about the unit comps, which are very encouraging but the growth in Pro was primarily through transactions versus ticket. So just good broad base strength on the business.

**KateMcShane**

Okay. Thank you for that color. I just had one follow-up question unrelated just with regards to the macro environment. If you could talk about any differential between the performance in different areas of affordability from a geographic standpoint.

**RichardMcPhail**

We actually look at the regional variability every single quarter. And in the third quarter, it was actually the narrowest we've seen in quite some time. And that includes all states whether there are high salt states or not. So we are very pleased with the narrow variability that existed.

End of Q&A

**Operator**

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

**Isabel Janci**

Thank you for joining us today. We look forward to seeing many of you at our Investor Conference in December.

**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.