Fitch Rates The Home Depot, Inc.'s $2.5 Billion Senior Unsecured Notes 'A'
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Fitch Ratings has assigned an 'A' rating to The Home Depot Inc.'s (Home Depot) $2.5 billion issue of seven-year and 30-year senior unsecured notes. The proceeds from the issues will be used for general corporate purposes, including share buybacks. A full list of ratings follows at the end of this release.

KEY RATING DRIVERS

The ratings reflects the strong improvement in Home Depot's comparable store sales (comps), operating margins and free cash flow (FCF) over the past five years, and Fitch's expectation that the company will be able to sustain this performance going forward. Compared with its nearest competitor, Home Depot has generated superior operating margins (400 basis-point gap) and consistently stronger comps over the past five years.

The ratings further consider Home Depot's leading position in the home improvement retail sector in North America and steady adjusted debt/EBITDAR at or under 2x. In addition, the ratings consider the cyclical nature of home improvement retailing and the challenges posed by a slow economic recovery.

Home Depot is the world's largest home improvement retailer with a 25% market share in the $312 billion U.S. home improvement market using the U.S. Census Bureau's NAICS codes. Lowe's has a 17% share, and Menards has sizable presence in the Midwest. Defining the market more broadly to include wholesalers, mass merchants, and online sellers suggests that Home Depot and Lowe's have a combined 20% of the market.

Home Depot has been able to generate strong operating momentum in the midst of a home improvement industry that has seen consumers focus on repair and maintenance projects.

Home Depot's comparable store sales (comps) have been positive since 2010. Faster growth of seasonal and big ticket items helped to drive healthy 5.3% comp growth in 2014. Comp sales are expected to grow at 3%-5% over the next two years, supported by a continued recovery in the housing market and the company's investments in its multi-channel activities. Online sales represented 5.1% of Home Depot's total sales in the first quarter of 2015, and grew over 36% in 2014, adding ~2% to top-line growth.

There has been no discernible impact on sales from Home Depot's September 2014 announcement of a data breach in which 56 million credit card numbers and 53 million emails were stolen. Fitch believes that the ultimate cash costs from this breach to cover fraud reimbursement and credit card reissuance, among other things, can be covered by FCF, although it would reduce the amount available for share repurchases.

Home Depot has produced a strong margin recovery on expense leverage, with EBIT margins (excluding non-cash stock based comp) improving to 12.9% in 2014, from 11.9% in 2013 and 10.9% in 2012. The company targets a 13% operating margin (including non-cash stock based comp) and a 27% ROIC in 2015 (from 12.6% and 24.9%, respectively, in 2014). Fitch believes this is achievable, and sees moderate margin upside longer-term from fixed expense leverage and the investments the company is making in technology and its supply chain.

Financial leverage (adjusted debt/EBITDAR) was 1.8x as of May 2015, in-line with year-end 2014. Fitch expects FCF and some incremental borrowings to be directed to share repurchases, as the company manages its financial leverage at or under 2x.

KEY ASSUMPTIONS

--Fitch expects comp sales to grow at 3%-5% over the next two years, supported by a continued recovery in the housing market and the company's investments in its multi-channel activities;

--Fitch expects FCF after dividends to track more than $4 billion annually going forward;

--Fitch expects FCF and some incremental borrowings to be directed to share repurchases, as the company manages its financial leverage at or under 2x.

RATING SENSITIVITIES

Weaker operating trends or a move by management to more shareholder-friendly policies that cause adjusted leverage to increase to the low 2x range on a sustained basis could lead to a negative rating action.

Continued positive operating trends together with a sustained reduction in adjusted leverage to below 1.5x could lead to a positive rating action.

LIQUIDITY

Home Depot has a solid liquidity position supported by a cash balance of $2.8 billion at May 3, 2015, together with an undrawn $2 billion credit facility. The company also benefits from owning 90% of its stores.

Home Depot is maintaining a very slow pace of new-store expansion, with plans to build only six new stores in 2015, focused primarily in Mexico. Low levels of capital expenditures (less than 2% of sales) have resulted in strong FCF after dividends, which is expected to track more than $4 billion annually going forward. Fitch expects Home Depot would remain FCF positive in an economic downturn, as it did through the last recession.

FULL LIST OF RATING ACTIONS

Fitch currently rates Home Depot as follows:

--Long-term Issuer Default Rating (IDR) 'A';

--Senior unsecured notes 'A';

--Bank credit facilities 'A';

--Short-term IDR 'F1';

--Commercial paper 'F1.'

The Rating Outlook is Stable.

Additional information is available on 'www.fitchratings.com.'

Applicable Criteria

Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage (pub. 28 May 2014)

https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=749393

Additional Disclosures

Solicitation Status

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