Fitch Upgrades The Home Depot to 'A'; Outlook Stable
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Fitch Ratings has upgraded its long-term Issuer Default Rating (IDR) on The Home Depot, Inc. to 'A' from 'A-', and its short-term IDR to 'F1' from 'F2'. The Rating Outlook is Stable. Home Depot had $16.7 billion of debt outstanding as of Nov. 2, 2014. A full rating list is shown below.

Key Rating Drivers

The upgrade 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 4.6% comp growth in the first nine months of 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 4.4% of Home Depot's total sales in the third quarter of 2014, but grew almost 40% in the quarter and the nine months, adding 1.7% 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 improving to 12.6% in the 12 months ending Nov. 2, 2014, from 11.9% in 2013 and 10.9% in 2012. The company targets a 13% operating margin and a 27% ROIC by 2015 (from 11.9% and 20.9%, respectively, in 2013). 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.

Home Depot is maintaining a very slow pace of new-store expansion, with plans to build only six new stores in 2014, 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 around $4 billion annually going forward. Fitch expects Home Depot would remain FCF positive in an economic downturn, as it did through the last recession.

Financial leverage (adjusted debt/EBITDAR) was 1.8x as of November 2014, in-line with year-end 2013. Fitch expects FCF and some incremental borrowings to be directed to share repurchases, as the company manages its financial leverage at or under 2x.

Home Depot has a solid liquidity position supported by a cash balance of $2.2 billion at Nov. 2, 2014, together with an undrawn $2 billion credit facility. The company also benefits from owning 90% of its stores.

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.

Fitch has upgraded Home Depot as follows:

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

--Senior unsecured notes to 'A' from 'A-';

--Bank credit facilities to 'A' from 'A-';

--Short-term IDR to 'F1' from 'F2';

--Commercial paper to 'F1' from 'F2'.

The Rating Outlook is Stable.

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

Applicable Criteria and Related Research:

--'Corporate Rating Methodology', May 28, 2014

Applicable Criteria and Related Research:

Corporate Rating Methodology - Including Short-Term Ratings and Parent and Subsidiary Linkage

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

Additional Disclosure

Solicitation Status

http://www.fitchratings.com/gws/en/disclosure/solicitation?pr_id=943236

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