Nicholas Galvani

Table of Contents

What is Home Depot?

The Home Depot, Inc. is a home improvement retailer. The Company offers its customers an assortment of building materials, home improvement products, lawn and garden products, decor products and provide a number of services, including home improvement installation services and tool and equipment rental.

It operates approximately 2,291 The Home Depot stores located throughout the United States. Home Depot is also located in Puerto Rico and the territories of the U.S. Virgin Islands and Guam. They have also expanded to Canada, Mexico, China and India.

The Company serves two primary customer groups: are the DIY (do-it-yourself) customers and the professional customers. DIY Customers include homeowners who purchase products and complete their own projects and installations. Professional Customers are renovators/remodelers, general contractors, handymen, property managers, building service contractors and specialty tradesmen. Specialty tradesman are electricians, plumbers and painters.

Home Depot is the fifth largest private employer in the US. The Home Depot had acquired many other businesses since its opening in 1978. They had expanded across the united states and even into Mexico and Canada. They had a sub-chain that was of higher end products and household materials called The Expo. During the great recession in 2008, Home Depot had to close more than 20 stores across the US and the entire chain line of The Expo. They also laid off thousands of workers and closed their higher end gardening stores made for professional landscapers. Today, Home Depot has 2000 stores. In comparison, their largest competitor, Lowes, has just a little over 2300 stores. The difference between Home Depot and Lowes is the size of the stores as Lowes stores tend to be smaller than Home Depot stores.

Home depot has many brands that only they carry such as DeWalt. They work with the company TTI which has many brands underneath it such as Milwaukee, RYOBI, HART, Hoover and Oreck. They also have their own house brands like Husky and HDX., which are both budget brands. Their target market is the professional contractors, and their grade of home products are “contractor grade” which is not always the highest quality but meant to be bought in bulk. Whereas Lowes’ target market is the DIY and weekend project type of people. They want the homeowner to be able to find custom fixtures and products for the individual’s home.

Current News

Home Depot has been relatively liquid, and its available cash continues to grow. As of November 16th, Home Depot acquired HD Supply for $8 Billion. HD Supply has a customer base of over 500 thousand, which should generate more than $6 Billion annually. HD supply is a North American distributor that supplies for the professionals involved in maintenance, repair, operations, infrastructure, power and specialty construction segments. This should help Home

Depot own more of the industry and add to its overall size and market share. The sale is expected to be finalized by early 2021 through the use of cash on hand and new debt.

Most businesses have been affected by COVID-19. Some have had positive turnarounds, while others, mainly small businesses and businesses that were already struggling before COVID-19, have had to close permanently. Since Home Depot is one of the essential businesses that have stayed open during the pandemic, they have had to make several changes, especially involving their employees. They have added extensions to time off and implementation of a temporary weekly bonus program. Home Depot is now transitioning to invest in permanent compensation enhancements for their hourly associates. This will result in approximately $1 billion of incremental compensation on an annualized basis.

Home Depot is expanding on their Foundation's $50 million trades training commitment. This was initially announced in 2018, and Home Depot is now adding a new education and job placement program, which has been tilted *Path to Pro*. “The program aims to address the skilled labor gap by educating more people in the skilled trades, connecting skilled tradespeople with jobs and careers, and generating interest in trade professions through educational campaigns (Home Depot).” This is very important program, and it will train people that are novice to even the more advanced, giving certifications upon completion. These skill positions are becoming more and more uncommon as they are not being taught in high schools, nor most colleges. Home Depot is aiming to close the gap that has been growing, where the newest generations have not been learning home improvement related skills.

SWOT Analysis

Strengths

Largest Retailer- Home Depot is the largest home improvement store. They have thousands of locations. They have the more benefits from the economies of scale because they have such a large market share compared to the competition, including Lowes.

High Profitability- Home Depot is notorious for being a good investment when it comes to purchasing stocks. They annually have positive profits, which is used for improvements, R&D, and expansions.

Value- Home Depot takes pride in offering the best deals, this starts with their *Price match policy.* This means they offer the lowest prices in their competition or they will match it to equal the lowest. Price matching is also important that it helps retain customers. They also offer tool repair, discount bins, and can save on bulk orders.

Variety- Home Depot has a huge range of products offered and brands. They have budget friendly products, or they have the pricier professional products. They also have anything from a screw/nail to roofing shingles and tools.

Online ordering- Home Depot has *BOPIS (buy-online-pickup-in-store).* This accounts for nearly 40% of their online orders. If you need something same day or next day, you can check your local store, and order it so it is still available before someone else purchases it before you can get there and also have it ready by the time you arrive.

Customer Service – Home Depot has well educated employees. Home depot strives to enhance the customer service, which starts with the employees. They are very knowledgeable in their specific areas and have some knowledge of all their products.

Weakness

Geographical Diversification- Most of Home Depot's stores are here in the states, with the spread to Canada and Mexico. The stores in Mexico tend to be more updated, but not always as stable and marketable as the ones in the U.S and Canada. They have spread to China and India. They should try to keep spreading to become more global.

Infrastructure- The Home Depot system has started to age, and they are aware of it. They had a new project set forth to try and revamp their system to a more digital world, but it has hit some bumps in the road and has not fully taken affect. They have improved their app and other online related things to improve the customer experience.

Ecommerce implementation- As mentioned above regarding infrastructure, they were late to the Ecommerce adoption and are lagging behind. They have lost money and opportunities, but they have started to catch up, specifically in 2020, which was a prime time since COVID-19 and a lot or home improvements have occurred since everyone is home.

Opportunities

Expansion- They need to keep expanding globally and not have their main major market solely in the North America area. This a weakness that they have already started to work on and if they keep progressing to make more sustainable growth and opportuneness. This can also bring in new brands that might only be accessible in other countries.

Online- They need to keep progressing in the online implementation. They started their big project to using online and apps for the customers. Their online sales are about 6% of their overall sales, which is lower than the competition.

Décor- They can merge or acquire other brands in the home décor and furniture areas. Bed, Bath & Beyond is not doing that well, so that can be a starting point. The problem with them, is they just sell home products and bedding, not too much furniture per say, and also most of those products are offered on Amazon. They would have to take this a step further, and maybe go the route like they had with Expo or a become an Ikea competitor with affordable modular furniture.

Threats

Competition- There are several other companies that can be taking major market shares like Lowes and Amazon. There are also smaller threats like Harbor Freight and Walmart. If Walmart were to acquire Harbor Freight and make their own tool and home improvement stores, it would be very detrimental to both Home Depot and Lowes.

Economy- This business can be heavy effected by the economy, specifically a recession. With COVID-19, the economy is not at its best. The government has been working to help keep it afloat, but many people are still unemployed. This can cause issues for spending money on home improvement, which might be deem necessary. There is a big example of this back in 2008 as an extreme example, where Home Depot took huge financial hits and had to close store and layoff many employees.

Deflation- Some materials and products are having price drops. One major product is the cost of lumbar, which has dropped over the past few years, and this accounts for 18% of Home Depo’s total revenue. The cost of other things like tech, lightbulbs and tools are having price drops.

Industry

Industry Rivalry

There is huge competition in the home improvement market. Their main competition is Lowes. There is low switching cost, which is definitely a problem for Home Depot. A customer can choose to go to Home Depot one day and Lowes the next. The catch of this is it effects both companies equally. Home Depot has a such a high number of stores, so this is a huge edge against the competition. There is a moderate exit barrier, which means the competing companies such as Lowes, is not very likely to close and exit the market, making it an ongoing and long-term competition.

Bargaining Power of Home Depot's Buyers

There is moderate bargaining power of the buyers due to the low switching costs. The customers have a slight edge over the stores since they can go to Home Depot or Lowes to purchase substitute goods. There are even other substitutes, like higher profession contractors or using local small hardware stores. Even though these are all options for the customers, there are such a large base of customers, that it doesn't have a large effect on Home Depot as a whole.

Bargaining Power of Home Depot's Suppliers

Home Depot has a large group of suppliers, especially when they are in different countries, such as Canada and Mexico. Home Depot and Lowes have exclusive suppliers, but they also have semi-exclusive. Some of the suppliers work with both companies or they work with just one of them. This results in not a huge impact to Home Depot and that they can always find another supplier since they are such a large company, its more of a loss for the supplier.

Threat of Substitutes

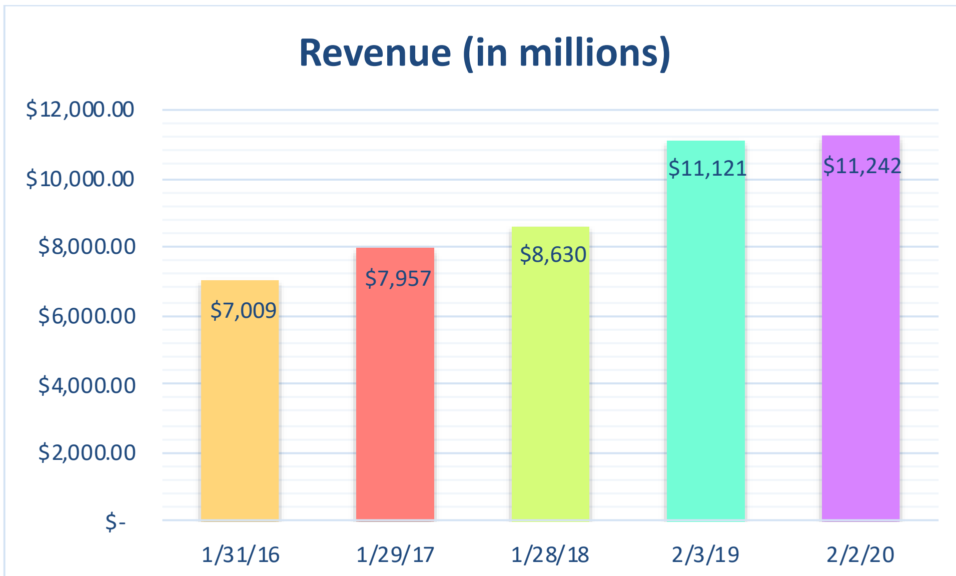
This is the biggest threat to Home Depot. There are a wide range of substitutes, such as large retail stores, small local stores and even ones in between. Lowes is the biggest competition as it is the most similar. There are also stores like Ace Hardware and True Value. While other, not obvious threats are Walmart and Amazon. They both sell a variety of products and also include hardware and home improvement sections and items. The switching cost are extremely low, especially with the internet allowing direct access to these stores. There is also a high satisfaction rate of switching, a lot to do with availability and pricing.

Threat of New Entrants

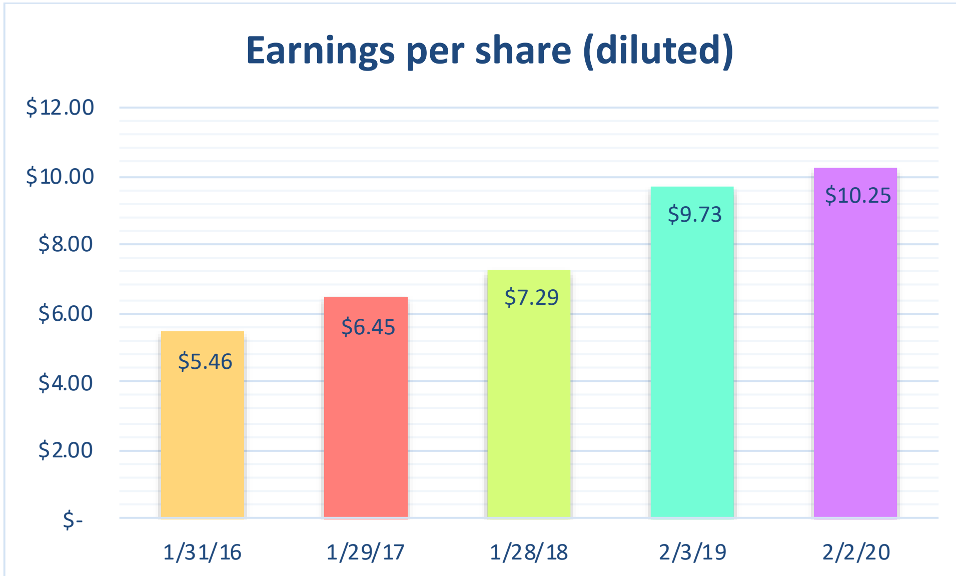
New entrants can be a threat to Home Depot. Part of this lies within the low switching cost. An example being Amazon, they can easily start adding more and more home improvement supplies, and that alongside the expedited shipping, causes a huge threat to Home Depot. This is not something that would happen overnight, and that would mean that Home Depot still has the edge, since they already have the products and suppliers. Home Depot just needs to keep up with the technology and improve their online presence and increase their ability to ship quickly with low costs.

Financial Statement Analysis

Income Statement



Home Depot is the world's largest home improvement store. They sell everything needed for the DIY person to the pro contractor. Their top selling categories are tools, lumber, outdoor garden, building maters, plumbing, and kitchen and bathroom. The chart above shows constant growth from fiscal 2016 to fiscal 2020. There was a jump from fiscal 2018 to fiscal 2019, where it was maintained into fiscal 2020. There has been a 60.39% growth in revenue during this time. Each year there has been a constant gross profit 34% over these fiscal years.



The chart above shows a constant growth in the Home Depot's earnings per share from the fiscal year 2016 to fiscal 2020. There is an extremely impressive growth of 87% growth during this time. This coincides with the huge 60.23% revenue growth. The growth percentage is a bit higher than the revenue growth, which suggest that the business is doing well in executing.

Profitability Ratios

$ in Millions	**1/31/16**	**1/29/17**	**1/28/18**	**2/3/19**	**2/2/20**
PROFITABILITY Ratios	***Are we generating enough returns on revenues and investments ?***				
Return on Equity (ROE)	111.0%	149.4%	298.3%	-5245.8%	-450.2%
Return on Assets (ROA)	16.7%	18.7%	19.7%	25.1%	23.6%
PROFITABILITY					
Gross Profit Rate (GP Margin)	34.19%	34.16%	34.05%	34.34%	34.09%
Operating Expense Margin	20.89%	19.97%	19.50%	19.99%	19.71%
Operating Margin	13.30%	14.19%	14.55%	14.35%	14.37%
Net Profit Margin, also known as Return on Sales (ROS)	7.92%	8.41%	8.55%	10.28%	10.20%

The chart above shows that from fiscal 2016 to fiscal 2018, there was a steady increase of ROE, from 111.0% to 298.3%. In fiscal 2019, there is a huge dip, which is shown in many different charts, because their equity becomes negative when they repurchase stocks. In fiscal 2020, it starts to climb back up, but it was so negative in 2019, that it is still negative in 2020. Home Depot's ROA has been on a steady increase over this entire period, with a slight dip in 2020. The GPM has been steady around 34% throughout this entire period, with the expense margin hovering around 20% and the operating margin hovering around 14%. The NPM has been steady around 8% from fiscal 2016 to fiscal 2018, and then started to hit above 10% in 2019 and again in 2020.

DuPont Analysis of ROE = <u>ROS</u> x <u>Asset turnover</u> = ROA x <u>Financial LEVerage</u> = ROE					
Return on Sales (ROS), also known as Net profit margin	7.92%	8.41%	8.55%	10.28%	10.20%
Asset Turnover	2.11	2.23	2.31	2.44	2.31
ROA (ROS X Asset Turnover)	16.7%	18.7%	19.7%	25.1%	23.6%
Financial LEVerage (FL)	6.65	7.98	15.12	(208.80)	(19.07)
ROE (ROA X FL)	111.0%	149.4%	298.3%	-5245.8%	-450.2%

Looking at the Dupont Analysis you can see that the ROS has steadily increased from 7.92% in fiscal 2016 to 10.20% in fiscal 2020. There is a huge change in Financial Leverage specially in the fiscal year 2019. The big change has slightly spilled into fiscal 2020, which is resulting from the decrease in the equity in which they use the cash flows to buyback stocks and put them in treasury. You can see the asset turnover remains pretty consistent throughout this period hovering now around 2.31.

Liquidity

$ in Millions	1/31/16	1/29/17	1/28/18	2/3/19	2/2/20
LIQUIDITY	***Are we meeting our current obligations ?***				
Working Capital	$ 3,960	$ 3,591	$ 2,739	$ 1,813	$ 1,435
Current Ratio	1.32	1.25	1.17	1.11	1.08
Quick Ratio	0.33	0.32	0.34	0.22	0.23

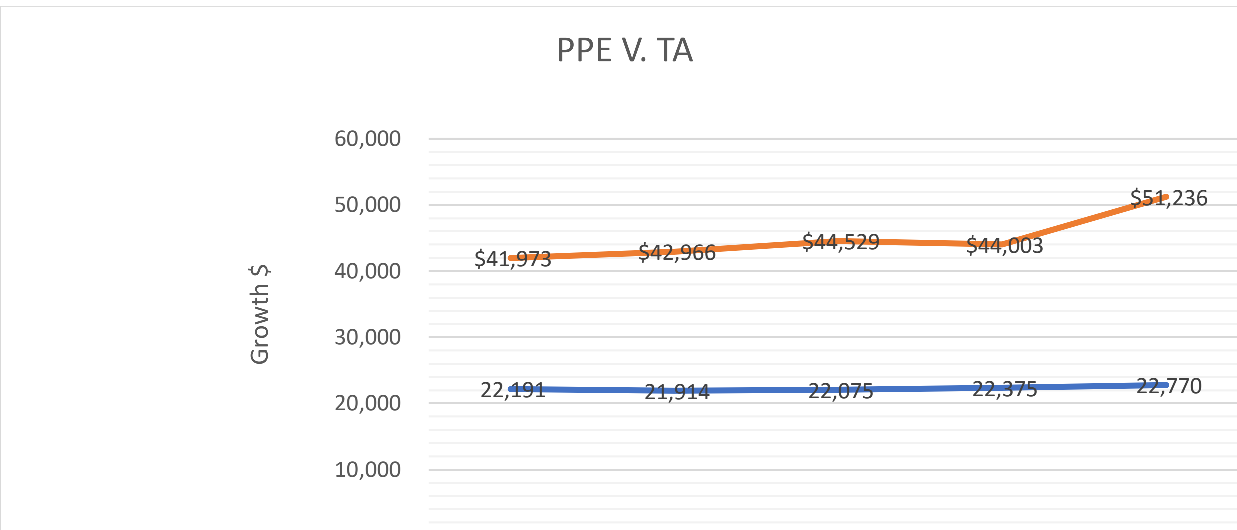
From the chart above, you can see that Home Depot's working capital has been in a decline over the period starting fiscal 2016 to the current fiscal 2020. This is the difference from their total assets from their total liabilities. Part of this is from that they buyback a lot of stocks over this period starting at 33,194 in 2016 to now 65,196 in 2020. This causes a similar effect in their current rations which is a measure of their liquidity, or ability to have cash quickly to pay of short-term debts. This is the ratio of the total assets against total liabilities.

Solvency

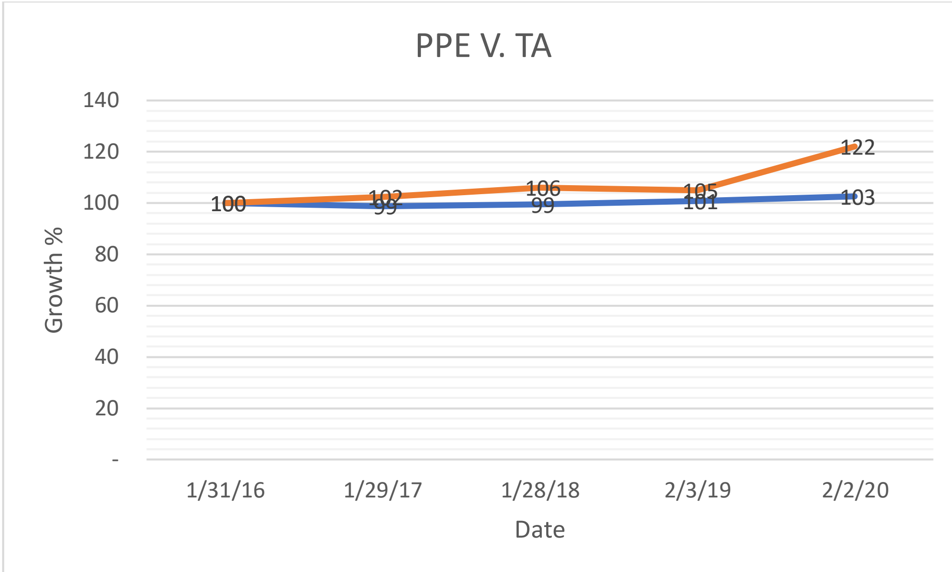
SOLVENCY	***Are we handling debt appropriately ?***				
Debt-to-Assets ratio (Debt ratio)	85.0%	89.9%	96.7%	104.3%	106.1%
Times Interest Earned	12.99	13.85	13.96	14.85	13.25

The chart above shows that the debt to assets ratio has steadily been increasing for Home Depot from fiscal 2016 to fiscal 2020. This Is mainly due to their equity decreasing over the same time period. This means that they are highly leveraged, but in this industry and the company being as large as they are, it is not necessarily a bad thing. Companies of this stature tend to want to have more debt, because it can save them money since it can be less costly when compared to equity due to tax deductibility of interest payments. When you see the operating income has also increased over the years, and is now above 15x, this means that there is plenty of cushion to be able to pay off the debts, without causing any major concerns.

Balance Sheet

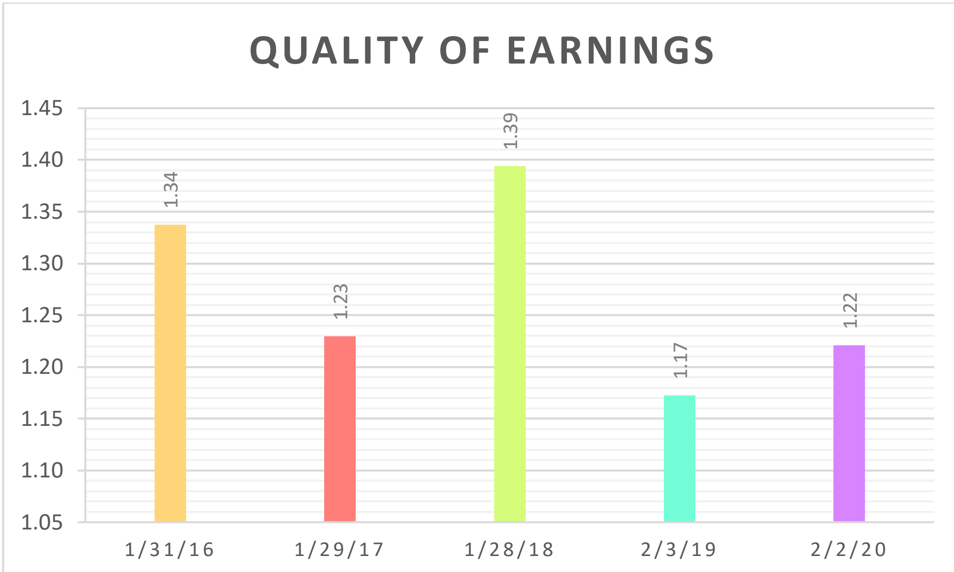


	1/31/16	1/29/17	1/28/18	2/3/19	2/2/20
Property, plant, and equipment, net	22,191	21,914	22,075	22,375	22,770
Total assets	$41,973	$42,966	$44,529	$44,003	$51,236



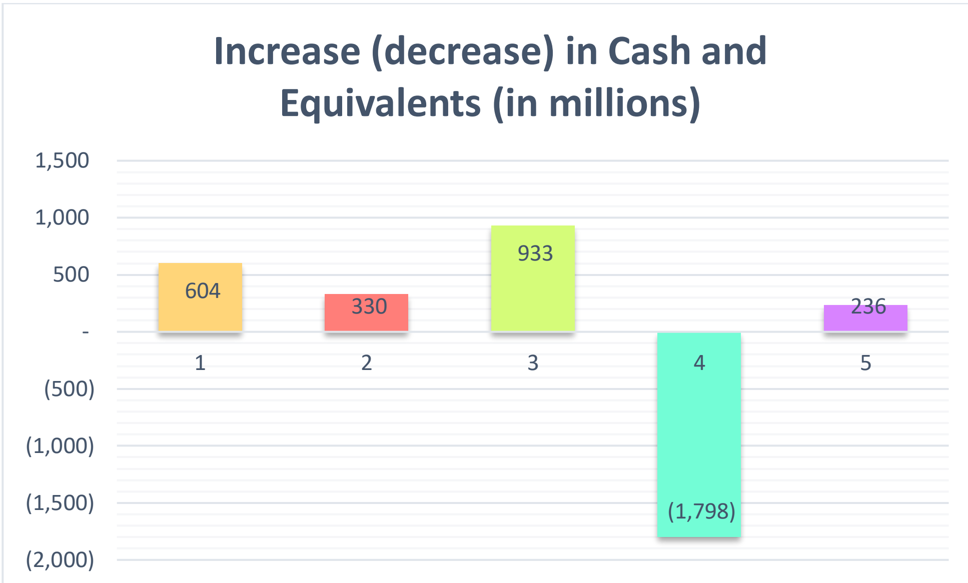
Home Depot's assets have continued to grow from the fiscal 2016 to fiscal 2020, with a spike from fiscal 2019 to fiscal 2020. The total assets have been relatively steady over the periods. The PPE has been steady over the periods with the spike being from 2019 to 2020. There has been a 22% growth in total assets from fiscal 2016 to fiscal 2020. There has been only a 3% increase in PPE over the same time period. During this time period the liabilities have continued to grow at a rate of 52.43%, which is more than the growth in total assets. In fiscal 2016 the liabilities were 35,657, then in fiscal 2020 they were 54,352. The equity has decreased from 15% in fiscal 2016 to -6% in fiscal 2020. This is due to the huge amount of treasury stock, which is 65,196 in fiscal 2020. Home Depot buys back a lot of their stock because they have consistently had high cash flows.

Retained Earnings



The chart above shows the cash that Home Depot has been earning from operating activates for every dollar of net income. This is a ration of the net cash from operation activities against their net income for the same period. So, that means that for fiscal 2016 they made $1.34 for every $1. Throughout the entire period they have always been profitable, with a peak in fiscal 2018 at 1.39. Now for fiscal 2019 and fiscal 2020, they see to have had less per dollar, but they have actually had an increase in both bet cash from operating activities and net income over these two years. Since COVID-19, they have had to spend more on their employees and customers to help ensure their safety and security, which could play some effect during these times.

Statement of Cash Flows



Home Depot cash has had some ups and downs in the fiscal years from 2016 to 2018. There is a huge dip in the cash in fiscal 2019, which we have seen in other analyses that it was due to huge purchases of stocks to put into treasury. They started to even out that purchase going into fiscal 2020.

Competitors

Year-End		
$ in Millions	**HOME DEPOT (HD)**	**LOWES (LOW)**
Assets	$ 51,236	$ 39,471
Liabilities	$ 54,352	$ 37,499
SEquity	$ (3,116)	$ 1,972
Revenue	$ 110,225	$ 72,148
Net Income	$ 11,242	$ 4,281

When comparing Home Depot to Lowes, Home Depot has higher assets, higher liabilities, higher revenue and higher net income. The stockholder's equity is much lower compared to Lowes, which is part of why the due to the use of the cash and buying back stocks, which was mentioned above in the balance sheet analysis.

ROS	10.2%	5.9%
Asset Turnover	2.31	1.95
ROA	23.6%	11.6%
Financial LEVerage	-19.07	13.17
ROE	-450.2%	152.5%

When comparing some of the ratios, you can see that Home Depot is nearly double in the ROS at a 10.2% compared to Lowes at 5.9%. They are slightly faster in Asset turnover. The ROA is higher for Home Depot as well since they have a higher net income. The same reoccurring problem with Home Depot is anything with regards to their equity. Their equity is negative, which causes the financial leverage to be negative along with the ROE. Their ROS, Asset turnover and ROA are above the industry average, which is 7.6%, 2.21, and 16.9% respectively.

COVID-19 Impact?

During the start of COVID-19, the majority of businesses were forced to shut down. The only stores that were allowed to stay open were the essential businesses. Businesses that are deemed essential are grocery stores, pharmacies, medical supply stores, convenience stores, pet stores, hardware stores, office supply stores and liquor stores. Home depot is considered a hardware store; thus, it has been allowed to stay open when most businesses closed.

Since Home Depot has stayed open during the shutdown and the pandemic, this has led to higher sales, driven in part by strong growth online. Rather than a drop in traffic, amid lockdowns and social distancing, customers began flocking to its physical stores. People decided to start spending their savings and the government stimulus checks on home-improvement projects. There was a huge spike in DIY projects as people finally had the time to work on their home.

All these sales did not directly translate into net profit because there has also be an increase in expenses as the company took steps to support its employees. They have had to hire more employees to compensate, not just in the store fronts, but along the supply chain to meet the demand. The added employee benefits—which included weekly bonuses and expanded paid time off.

Home Depot has added many safety measures such as closing stores earlier to allow for cleaning, limiting the amount of people in the stores, enforcing face coverings, enforcing the social distancing. They expanded on their curbside pickup, with interlocks with the app to allow speedy pickups. They extended their return policy form 90 days to 180 days. They extended time paid off to all employees and even more to those who are 65 and older, who are deemed high risk.

Investment Decision

When determining if a company is worth investing, there are many things to look at such as annual profits, the free cash flow versus the debt, the causes of debt and if they have enough liquidity to pay off their debts both short and long term. Is the company growing? Does the company have leverage? And if so, is it too leveraged where they may be a high risk?

Home Depot's EPS is now sitting at just over $10. Their NPM is sitting slightly above 10%. The company's revenue has been steadily increasing over the years, and they are working on expansion, both by acquiring other companies, but also expanding globally and internally. They have moved outside the U.S. to Mexico and Canada, but to other places like India and China. I expect they will continue to grow as the years progress. They have also taken on the fast-growing world of the internet and smartphones. They have acknowledged their lag, but with COVID-19, this basically forced them to step it up in a fast manor, to have a working app and to have online orders coincide with curbside pickup. They still have work to-do, especially if you try and compare them to the logistics and delivery system Amazon has in place.

So, the question remains, should you invest?

I would say yes you should. Home Depot is one of the biggest companies in the world and certainly the biggest in its sector. They have been growing financially, physically and digitally over the past few years. They have been making efforts to give back to their employees and to make sure they are treated properly, especially during these difficult and uncertain times.

One main concern is that the debt ratio is high. It is a bit concerning, but after careful analysis, you can see that they have enough cash on hand to more than cover it. Furthermore, Home Depot has ratios that are better than the leading competitor (Lowes) and above the industry average in all cases except when dealing with equity. This is due to the use of cash, and how they are trying to acquire other companies and the repurchasing of their stocks.

Work Cited

https://bstrategyhub.com/home-depot-swot-analysis/

https://corporate.homedepot.com/newsroom/covid-19-update-how-home-depot-preparing-and-responding

http://panmore.com/home-depot-five-forces-analysis-porters-model

https://www.fool.com/investing/2019/12/26/what-investors-should-understand-about-home-depots.aspx

https://finance.yahoo.com/news/investors-know-home-depot-inc-135349658.html

https://www.fool.com/investing/2020/11/16/home-depot-is-spending-8-billion-to-acquire-hd-sup/

https://ir.homedepot.com/news-releases/2020