The Home Depot's CEO Discusses Q2 2013 Results - Earnings Call Transcript

Executives

Diane Dayhoff - Vice President, Investor Relations

Frank Blake - Chairman of the Board, Chief Executive Officer

Craig Menear - Executive Vice President - Merchandising

Carol Tome - Chief Financial Officer, Executive Vice President - Corporate Services

Marvin Ellison - Executive Vice President - U.S. Stores

Analysts

Gary Balter - Credit Suisse

Dan Binder - Jefferies

Christopher Horvers - JPMorgan

Peter Benedict - Robert Baird

Michael Lasser - UBS

Matthew Fassler - Goldman Sachs

Greg Melich - ISI Group

Budd Bugatch - Raymond James

Dennis McGill - Zelman & Associates

Brian Nagel - Oppenheimer

Kate McShane - Citigroup

Michael Baker - Deutsche Bank

The Home Depot, Inc. (HD) Q2 2013 Earnings Call August 20, 2013 9:00 AM ET

Operator

Good day, everyone, and welcome to today's Home Depot second quarter 2013 earnings conference call. Today's conference is being recorded. (Operator Instructions).

Beginning today's discussion is Ms. Diane Dayhoff, Vice President of Investor Relations. Please go ahead, ma'am.

Diane Dayhoff

Thank you, and good morning to everyone. Joining us on our call today are Frank Blake, Chairman and CEO of The

Home Depot, Craig Menear, Executive Vice President, Merchandising and Carol Tome, Chief Financial Officer and Executive Vice President, Corporate Services.

Following our prepared remarks, the call will be opened for analysts' questions. Questions will be limited to analysts and investors and as a reminder, we would appreciate it if the participants would limit themselves to one question with one follow-up please. If we are unable to get to your question during the call, please call Investor Relations Department at 770-384-2387.

Before I turn the call over to Frank, 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 those factors identified in the release and in our filings with the Securities and Exchange Commission. Today's presentations may also include certain non-GAAP measurements. Reconciliation of these measurements is provided on our website.

Now, let me turn the call over to Frank Blake.

Frank Blake

Thanks you, Diane, and good morning, everyone. Sales for the second quarter were $22.5 billion, up 9.5% from last year. Comp sales were positive 10.7% and our diluted earnings per share were $1.24 per. Our U.S. stores had a positive comp of 11.4%. We expected the second quarter to be our strongest comping quarter of the year. The results exceeded our expectations. We grew sales by almost $2 billion in the quarter, posted the first double-digit positive comp in our business since 1999, and had the highest quarterly transaction count in the company's history.

From a geographic perspective, sales were strong across the U.S. Two-thirds of our regions posted double-digit comps. All of our top-40 markets posted positive comps and 98% of all of our markets were positive. So, the strength in the business was broad-based geographically. This was also true across our merchandising categories. Every one of our merchandising departments exceeded plan for the quarter. As Craig will detail, we saw particular strength in our spring seasonal categories.

As you know, we had a weaker than expected selling season for outdoor categories in the first quarter because of the late spring, but that was counterbalanced by strength in this quarter as the weather turned more favorable. The core categories in our store remained strong and we were pleased with the growth in our appliance business where we have added key brands and with the growth in the core categories like soft flooring, vanities and special order cabinets.

With respect to our customer base, we continued to see strength in our pro-business. In the first quarter, our pro customer growth outpaced our consumer growth. For the second quarter, the growth rates were comparable. This reflects less of slowdown in pro than a pickup in our consumer sales. And as in the first quarter, our larger pros were our fastest growing customer group, but we also saw continued improvement in our smaller lower spending pros.

On the international front, our Mexican business positively comped for the quarter making it 39 quarters in a row of positive comps. And, our Canadian business, had positive comps for the seventh quarter in a row. This quarter tested our ability to react and be flexible significant outperformance to plan obviously presents some interesting operational and merchandising challenges.

On the operational front, Marvin and his team were able to adjust store staffing and handle unexpected volume and transaction growth while maintaining customer satisfaction levels. Earlier in the year, Marvin introduced project Simple into store operations, dramatically reducing the administrative tasking within the stores. This played an important role in freeing up our store leadership to respond to changed circumstances.

On the merchandising side, many of the improvements that Craig, our merchants, Mark Holifield and supply chain team have made in our forecasting and replenishment systems that helped business react to and recover from sales pipes while keeping inventory under control.

On interconnected retail, we are at the point where almost one out of every three online orders are completed in the store either through Buy Online Pickup in Store, or buy online ship to store. This is important to us, because we believe our more than 2,000 store locations throughout North America are valuable convenience for customers and can and should be a competitive advantage for us. Of course customers have the opportunity to buy additional items when they come into our store and return or pickup a product as today one out of five customers do.

We are also pleased with the improvements we are making to the customer experience in our services business as we develop new project and communication tools online. In the second quarter, we continued the rollout of a functionality we call MyInstall, that will provide customer-specific installation information, dynamic tracking to keep them informed on the status of the installation, e-mail notifications for appointments and a point of contact to process order changes and alike. This provides both, a better customer experience and a better foundation for us to manage the business that is growing at a double-digit pace.

As we look towards the back half of the year, consensus GDP forecast continue to call for only modest growth. Housing data however are encouraged, private fixed residential investment or PFRI as a percent of GDP improved to 3.1% in the second quarter, but it's worth remembering that prior to the housing crash, this would have been below the previous 60-year low for PFRI.

As Carol will detail, we are raising our sales and earnings guidance for the year. The housing recovery should be a positive for our market, but we have difficult sales comparisons in the back half of the year as we anniversary hurricane events from 2012 and 2011, and very strong holiday seasons in both of those years.

Let me close by thanking our associates for their hard work and dedication. It is easy to talk about a flexible business model but the execution of that requires people willing to adjust to changed circumstances and deal with business challenges while putting the customer first. Our associates did that. Based on this facts results 100% of our U.S. stores qualified for Success Sharing, our profit-sharing program for our hourly associates and we will have our highest ever Success Sharing payout. We are very proud of that result.

With that let me turn the call over to Craig.

Craig Menear

Thanks, Frank, and good morning, everyone. We are pleased with our performance in the second quarter, posting positive comps in all departments. There were four key factors that drove our performance, strong summer events, a recovering seasonal business, commodity inflation and strength across the remainder of the store. The departments that had double-digit positive comps were kitchens, indoor garden, lumber, outdoor garden, lighting, tools, electrical and flooring. Bath, plumbing, decor, building materials, paint, hardware and millwork performed positively but were below the company average.

Our seasonal business exceeded our plan, as Frank finally kicked into gear in the second quarter. We were able to recover all the lost sales we projected from exterior project categories in the first quarter and then some. In indoor and outdoor garden, our second quarter success resulted in positive comps in both departments for the first half of the year.

The core of the store delivered solid sales growth throughout the second quarter. In maintenance and repair categories, we saw continued comp performance in light bulbs, wiring devices, cleaning, plumbing repair, fasteners, builder’s hardware, caulk and adhesives. We also saw traction in decor categories where comps above the company average in special order carpets, special order cabinets, floor tile and lighting as well as strong comps in faucets.

Our store associates did a great job executing our summer events and creating an excitement. Our Memorial Day, Father's Day and Fourth of July special buys and great values were well received by our customers and drove double-digit comps in categories like appliances and riding mowers. Our results were achieved through a coordinated effort between our supply chain, our merchants, our stores and our vendors. The investments we have made over the past several years gave us the flexibility and capability to respond quickly and meet spikes in demand.

Total comp transactions rebounded from the first quarter and grew by 5.7% for the second quarter driven by traffic related to our seasonal business. Transactions for tickets under $50, representing approximately 20% of U.S. sales, were up 3.8% for the second quarter, principally due to our garden business. Transactions for tickets over $900 also representing approximately 20% of our U.S. sales were up 15.5% in the second quarter driven by the strength in appliances, riding mowers, flooring as well as continued improvement from our pro business.

Average ticket increased 4.3% in the second quarter. Our average ticket increase was impacted by commodity price inflation mainly from lumber and copper which contributed approximately 70 basis points to comp.

As Frank mentioned, we had one of the best quarters in our recent history. As we look forward to the back half of the year, we are projecting solid sales growth but we do have several factors to overcome. First, we will face tough sales comparisons resulting from impacts of consecutive years of autumn storms. Second, commodity inflation is on track to no longer be tailwind as lumber and copper prices have begun to moderate. Third, we have began to the lap excellent response to our rollout of our expanded appliance business. As we get to the fourth quarter, the holiday shopping season, would be a week shorter due to the date on which Thanksgiving falls this year.

Now let me talk specifically about the third quarter. We continue to focus on innovation as a key part our leadership strategy. In stores now, Behr Premium DeckOver wood and concrete coatings brings new life to old wood and concrete surfaces. This 100% acrylic formula available in 54 colors conceals splinters and cracks and creates a slip resistant finish.

We continue to be innovative in lighting technology. As an example, we are introducing an LED 90-watt equivalent floodlight from Cree, now giving us a full range of assortment for the top-three most popular bulbs at market-leading values.

For our pro customers, we are introducing DAP SMARTBOND adhesive foam gel that is faster and easier to use than traditional cartridge adhesives helping our pro customers to be more efficient. One cartridge of SMARTBOND provides eight times the coverage of traditional adhesives. Also, new to homedepot.com for our pro customers, we are offering a line of fully welded steel cabinets from Husky, which feature a variety of door and interior configurations. This allows the customer to customize their cabinets exactly the way they want.

For our Labor Day and events we have an extensive lineup of great values and special buys. These events along with our superior execution in-store will generate a lot of excitement in the third quarter.

With that, I would like to turn the call over to Carol.

Carol Tome

Thank you, Craig. Hello, everyone. In the quarter, sales were $22.5 billion. On a like-for-like basis comps or same-store sales were positive 10.7% for the quarter with positive comps of 10.2% in May, 11.5% in June and 10.5% in July. Comps for US stores were positive 11.4% for the quarter with positive comps of 11.5% in May, 11.7% in June and 11% in July.

Total sales grew 9.5% from last year reflecting the impact of the calendar shift. As you will recall, fiscal 2012 had a 53rd week, which shifted our fiscal 2013 calendar. By starting fiscal 2013, one week later than last year, we had one less week of spring sales in the second quarter when compared to the same period in 2012, which negatively impacted total sales growth by approximately $249 million or 120 basis points.

As Frank and Craig mentioned, our second quarter sales performance exceeded our expectations due in part to strong demand for appliances and recovery in our garden department. Further, sales related to hurricane Sandy were approximately $47 million in the second quarter. We expect to see some benefit from storm related sales in the second half of the year, but the year-over-year benefit will diminish as we begin lapping hurricane sales in the third quarter.

Our total company gross margin was 34.3% for the quarter, an increase of 12 basis points from last year of which 13 basis points came from our US business. We saw a considerable amount of movement in our gross margin during the quarter as explained by the following. First, we experienced approximately 22 basis points of gross margin expansion due to the impact of gross margin accretive businesses that were acquired in the back half of last year.

Second, we had 13 basis points of gross margin expansion due to expense leverage within our supply chain. Third, our shrink efforts continued to gain traction as we realized 10 basis points of gross margin expansion due to better shrink performance than one year ago. Finally, we experienced approximately 32 basis points of gross margin contraction due primarily to a change in mix of products sold.

To put this contraction into perspective, over 50% or 19 basis points came from a higher penetration of appliance sales than one year ago. For the first six months of the year, our gross margin grew by 16 basis points. As we look to the last six months of the year, we would expect our gross margin expansion to be about half of what we experienced in the first six months, so for the year expect moderate gross margin expansion.

In the second quarter, operating expense as a percent of sales decreased by 79 basis points to 20.9%. In the second quarter, our operating expenses grew at 58% of our sales growth, better than our expectations for the quarter due to strong sales performance. For the year, we are expecting our expenses to grow at approximately 30% of our sales growth on a 52-week basis.

But note, like what we experienced in the second quarter, there will be quarterly distortion to that rule of thumb, given year-over-year comparisons and certain expense items like Success Sharing. For example, in the second quarter of 2013, over 300 stores were in higher Success Sharing payout tiers than one year ago. This caused 14 basis points of expense deleverage in the quarter.

Interest and other expense for the second quarter was $172 million, a 13.9% increase from last year, reflecting increased interest expense associated with $2 billion of incremental debt issued in April of this year. Our income tax provision rate was 36.9% in the second quarter and we expect our income tax rate to be approximately 37% for the year. Diluted earnings per share for the second quarter were $1.24, an increase of 22.8% from last year.

Moving to our operational metrics. During the second quarter, we opened one new store in Puerto Rico for an ending store count of 2,258. At the end of the second quarter, selling square footage was 235 million and total sales per square foot were $383.

Now turning to the balance sheet. At the end of the quarter, inventory was $11.1 billion and inventory turns were 4.9 times, up from 4.7 times last year. We ended the quarter with $42.2 billion in assets including $3.4 billion in cash.

Moving to our share repurchase program. In the second quarter, we received 2.1 million share related to the true up of an accelerated share repurchase or ASR program we initiated in the first quarter. Additionally, in the second quarter we repurchased $2.15 billion or 25.4 million of our outstanding share. This included 5.8 million shares repurchased in the open market and 19.6 million shares repurchased through an ASR program. For the shares repurchased under the second quarter ASR program, this is an initial calculation and we expect to receive an additional 2.4 million shares in August.

Computed on the average of beginning and ending long-term debt and equity for the trailing four quarters, return on invested capital was 19.1%, 310 basis points higher than the second quarter of fiscal 2012. We had solid first half, as evidenced by strong performance across our store. As we look to the back half, we believe we will continue to report solid sales gains and that sales will be higher than we originally planned.

So today, we are lifting our 2013 sales and EPS growth guidance reflecting our first half performance and our forecast for the second half of the year. We now expect fiscal 2013 sales to increase by approximately 4.5% with positive comps on a 52 week like-for-like basis of approximately 6%. We expect the rate of comp growth for the back half of the year to be about 50% of the rate of comp growth we have experienced in the first half of the year. Our second half forecast is based on our view that we are in the early stages of housing recovery, that GDP will grow less than 2% for the year and reflects back half challenges that Craig detailed.

Finally, we, like others, are watching the interest rate environment as consumer spending and mortgage availability could be negatively impacted if interest rates were to rise. In the absence of rising interest rate however, if there is a bias in our second half forecast today we would say there is more upside opportunity than downside risk. For earnings per share, remember that we guide off of GAAP. We now project fiscal 2013 diluted earnings per share to increase approximately 20% to $3.60. This earnings per share guidance includes the $4.3 billion of share repurchases completed in the first half of the year and our intent to repurchase an additional $2.2 billion in shares during the second half of the year.

So we thank you for your participation in today's call and Marquita, we are now ready for questions.

Question-and-Answer Session

Operator

(Operator Instructions). We will take our first question from Gary Balter with Credit Suisse.

Gary Balter - Credit Suisse

Carol, just following up on your comments near the end, you sounded more confident. Obviously the results should cause that confidence, but what causes that confidence going forward and what do you think competitively in terms of pricing or anything along those lines, because gross margin looks solid given this shift in mix.

Carol Tome

Thank you, Gary. We look at the number of factors both, internal and external to why that point of view as to how our sales will perform in the back half of the year coming off obviously a very strong first half of the year. The best thing we can look at our current trends and I will tell you the current trend of the business is good. Sales are quite brisk. Now, competitively, Craig, you might want to comment.

Craig Menear

Gary, from a competitive standpoint, we saw the last quarter that we just exited pretty comparable. Most folks went hard after the seasonal business given the late start of the business and certainly and big ticket appears we still need to stimulate the customer to buy, but not a radical change and kind of we would expect that going forward.

Gary Balter - Credit Suisse

There has been a lot of talk our a lot of talk, and I will get off the phone, there has been a lot of talk about interest rates rising and the impact that could have on housing and you guys et, cetera. What are your thoughts on where we are?

Carol Tome

Well, as you know through the year, mortgage rates are up. They are at the highest rate that they have been since October of 2011 at about 4.4%. The affordability index is still at historical high, Gary. So if rates were to move up, it would peak that affordability index, but we have got a long way to go before it should have a dramatic impact we believe mortgage availability or the attractiveness for the consumer or homeowner to take out a mortgage. All that being said, however we are watching it.

Gary Balter - Credit Suisse

Thank you.

Operator

We will take our next question from Dan Binder with Jefferies.

Dan Binder - Jefferies

Hi. Good morning. I was wondering if you could comment on two things. One, on sort of the bigger ticket project business what you are seeing, kitchen and bath in particular and then also if you could comment on credit availability. I know you guys had started doing that program. Any color around that?

Craig Menear

Dan, on the big ticket, we did see very nice strength in tickets above $900 growing at 15.5% in the quarter. That was largely driven with appliances things like riding mowers which were strong throughout the quarter. We saw flooring projects as well as our kitchen business, all contributed to that. Then certainly the continued strength of our pro business which carries a higher average ticket overall help that as well.

Carol Tome

On the credit front, during the quarter we opened 1.4 million new private-label credit card accounts, so we were very pleased with that. The penetration of our private label card room 41 basis points in the quarter now outstanding at 22.6%, so that's the good news too. We also saw an increasing bank card, so it appears that consumers are willing to use our bank cards, our bank card penetration up 30 basis points year-on-year.

If you look at what's going on within our private label portfolio, we see consumer approval rate hovering around 68%. That's good news too. because as you know, they were dropping as a result of some of the changes coming out Durbin, but now we see it hovering around 58%, the average line approved is $5,800. That's up $200 year-on-year at a FICO at about $716.

On the commercial front, the average approval rate there is 70%. The line approved is $6,800. That also was $200 a year-on-year. We are coming behind our pro customers, because they are still very important (Inaudible) programs or we work with the underwriter to extend credit lines on a case-by-case basis. So, credit obviously is an important part. It's not the entire story here, but it is certainly part of the story.

Operator

We will take our next question from Christopher Horvers with JPMorgan.

Christopher Horvers - JPMorgan

Thanks and good morning. Can you talk about very consistent comps throughout the quarter, is there a way to think about what the seasonal business actually lifted perhaps July which was later in the quarter, but obviously have these record moistures levels out there and your mowing and cutting bushes and so forth, so is there a way to sort of peel that back and think about what July is ex-seasonal?

Craig Menear

Yes. Chris, the seasonal business obviously carried strong throughout the quarter. We saw, for example in sales of things like power equipment remain very throughout the quarter including July, as you mentioned, due to the fact that we had a moist July that obviously kept the grass growing as well. When we look at the seasonal business in total, one of the risk factors coming off of the first quarter was whether or now you would be able to recover the whole live goods and fertilizer business and because of the moisture we actually were able to get all that business back and carrying through June and July and then actually some went above what we thought.

Carol Tome

July was our easiest compare. So that's another way to parse it out, if you think about it that recovery of garden evened out but mostly performance.

Christopher Horvers - JPMorgan

Okay. So, I guess you would say, like obviously guiding about 4% comp in back half of August is very strong but maybe the ex-seasonal or core underlying growth rate in the business is somewhere between that 4% and the 10% that you posted in July.

Carol Tome

Well, just the way I would like you to think about the back half of the year, and I will walk you down from what we posted in the first half to the second half, and around. So in the first half, our comp was 8%-ish. I am rounding down. I am going to walk you down to the guidance that we are giving you which is about 4%-ish. First, we are up against some very tough hurricane sales and I would like you to think about this really on a two-year basis.

We forget sometimes that we had a hurricane in 2011, Hurricane Irene. We had $360 million of hurricane related sales in 2011. Then if you move to 2012, we all know we had Hurricane Sandy but we also had Hurricane Isaac. So when you add up those sales, that's about $377 million of hurricane sales. So on a two-year basis, we were up against more than $730 million of sales coming off of hurricane.

So one of the walk downs, obviously, would be, we are not anticipating hurricanes now. If we get a hurricane, it's a different story but right now we are not anticipating a hurricane. So not maybe a 1.5 point off of just hurricane related sales.

Then, as Craig pointed out, commodity prices are starting to moderate. If you remember, the back half of last year, our structural planning pricing took off. Its now coming down. So we would knock off maybe a point, call it a 130 basis points for commodity price inflation. Then while we will have growth in categories like appliances, we don't anticipate the explosive growth that we had in the first half, just because we are anniversarying new brands. So knock off another 120 basis points, something like that and you get to the 4%.

Christopher Horvers - JPMorgan

Understood, and then, one last question. Can you talk about what the SG&A impact in this quarter was, from a leverage perspective? How much the fact that it was driven by traffic versus ticket impacted leverage overall? Thank you.

Carol Tome

Yes, well, first let me say, Marvin and our operations team have done a fantastic of managing payroll in our stores given the sight that we saw in our sales growth. We leveraged hourly payroll in the quarter. We leveraged hourly payroll by 38 basis points. So really excellent work there.

There is just some year-over-year comparisons, Chris, that are distorting the performance in the second quarter and let me just give you some of that color. It might help you better understand the shape of the year.

First of all, if you recall last year, we had a good guide coming from workers' comp in the amount of about $42 million. This was an actuarial reserve adjustment that we had last year. That did not repeat this year. Though it gave us some pressure on a year-over-year basis.

Secondly, I called out the gross margin benefit of our newly acquired businesses. Well, they come with expenses too. So, on a year-over-year basis, we had $37 million of expenses from our newly acquired businesses that we didn't have one year ago. Now we will start to anniversary the acquisitions, if you will, towards the back half of the year. So our expenses become much more in line with the guidance that I have given you.

The other thing I would like to call out, because are just so really excited about this for our store associates. As Frank pointed out, we will be paying record Success Sharing checks for our store associates. The year-over-year increase is $46 million and in fact is twice as much of what we paid in 2011.

Chris?

Operator

We will take our next question from Peter Benedict with Robert Baird.

Peter Benedict - Robert Baird

Carol, quickly just on D&A. It is flat to down over the last few years but it's up, I think about 5%, year-over-year in the first half, so just a modeling question. What's driving that and how should we be thinking about the growth in D&A going forward.

Carol Tome

Well, it's really a change in the mix of our capital spending. We spent a lot of our capital on new store that had long lives. We are now shifting our capital to sort of assts including IT. This year, we will spend about $435 million in IT the longest life we have got there is six years, so it's dragging off over three.

Peter Benedict - Robert Baird

Okay. If we think about the 6% comp that you guys have for this year, and let us assume that persists of the next couple of years going forward, is the OpEx growing 30% of sales, is that kind of a good benchmark to use or does it start to evolve as we lookout again assuming kind of a 6%-type comp?

Carol Tome

Well, for modeling purposes, I think 30 basis points expense growth is the right number.

Peter Benedict - Robert Baird

Okay. Perfect. Then just for Craig. You talked about some of the core categories. Can you maybe talk about some of the real remodel categories and things like windows and things like that, are you starting to see kind of evidence of that kind of activity starting to pick up in the stores?

Craig Menear

Yes. We are. We are starting to see, for example, in lumber not only that we have some inflation year-over-year, it was about 70 basis points of our comp coming as a result of that, but we also saw unit productivity which is our pro customer starting to comeback. Solid growth and things like fasteners and pneumatics all those are heavy pro-dominated categories.

Operator

We will go next to Michael Lasser with UBS.

Michael Lasser - UBS

Thanks a lot for taking my question. First, within the product mix are you seeing any shift around from opening price points to better and best price points? Then I have a follow-up question.

Craig Menear

Not a lot of change, Michael, in the line structure. The only thing I would point out on that is, we have had some really nice innovation and things like LED, which carry a higher ticket, certainly within the light bulb category we are seeing customer step-up, the [bear premium deck over] is a great product, so we are seeing customers willing to spend really in every segment of the category within a category whether that'd be opening price point, mid or high.

Michael Lasser - UBS

Is it that because you are seeing customers across all price points come back, which maybe obscuring some of the trade up or is there just not really that willingness to trade up at this point?

Craig Menear

No. Again, I think the innovation in many categories is what is driving the trade up, so customers are willing to step up and spend money when they see great innovation that either makes a project easier and/or like in the case of LEDs, saves them energy cost around the home. They are definitely willing to step up.

Michael Lasser - UBS

Got it. Sorry. I was confused. The second question I had is, if you look on a like-for-like basis within product, and I recognize that you got 70 basis points inflation from commodity price increases, but how are prices trending on like-for-like non-commodity oriented products if you look back say a year ago.

Craig Menear

I would say that our focus is relentless focus on driving value for the customer, wee are always looking to provide a better value, so we are working hard to drive unnecessary cost out whether that be working with our suppliers on how we can drive our cost. Obviously, supply chain is allowing us to leverage cost and we are looking to bring better value to our customer and reduce prices wherever we can.

Carol Tome

If I could just jump in, because Craig mentioned this, I just want to reemphasize the point. We saw an increase in items in the basket this quarter. It contributed 20 basis points of growth to our ticket in the quarter. It has been a drag since the housing crisis, so we can't overstate the importance of what that means in terms of recovery both, for our pros of course, but as well as our DIY customers.

Operator

We will go next to Matthew Fassler with Goldman Sachs.

Matthew Fassler - Goldman Sachs

My primary question and then I have quick follow-up, just if you could talk about the evolution of your expanded appliance assortment. Talk about the pace of the rollout just to put in context and compare the rollout in-store to the rollout and penetration online? How far along do you think you are in realizing the benefits of this rollout process? Thanks.

Craig Menear

Okay, Matt, at the end of the last year, we had rolled out about 120 stores with an extended appliance program. We added brands in the fall season. We added Samsung around the December time frame which got us to the full offering of brands that we have right now. We are in the process right now of expanding another 120 stores for, you know, an expanded showroom experience. All of those brands are available on homedepot.com and have been since last December. We are seeing very nice response from the customer.

Matthew Fassler - Goldman Sachs

So to the extent that you guys cited this is a headwind for the year, it sounds like the roll out is not yet done. So do you think there could be some ongoing gains from incremental penetration to offset the fact that you had this in the year ago?

Craig Menear

Well. I think we went at 120 stores last fall. Obviously, we are overlapping that. We started with some of our best stores where we felt we had the greatest opportunity. So we will see how that plays out.

Matthew Fassler - Goldman Sachs

Got it, and then my second question, I think, we have come at this maybe a couple of different ways. Is it possible to sort of put a number on the comp benefit that you think you captured just in terms of the shift in volume from Q1 to Q2?

Carol Tome

Yes, we outperformed the guidance that we gave you by about $800 million and as we look at that outperformance, the combination of appliances and gardens made up 50% of that. Garden would have been $200 million of that.

Matthew Fassler - Goldman Sachs

Carol, when you talk comps, do you talk about for the first half of the year or for the second quarter, per se?

Carol Tome

For the second quarter.

Operator

We will go next to Greg Melich with ISI Group.

Greg Melich - ISI Group

Carol, I wanted to ask on the SG&A to make sure I got this right.

Carol Tome

Okay.

Greg Melich - ISI Group

The second quarter, you grew out expenses over a 50% of sales.

Carol Tome

Yes.

Greg Melich - ISI Group

But you still expect for the year that it will grow to 30% or do you think in the second half it will get back to that 30% level? So that the full year you are still running above?

Carol Tome

Our guidance is that the full year expenses will grow at 30% of our sales growth rate. Now, let's just think about it on a quarterly basis so we can get our models right. We guided off of GAAP. In the third quarter of last year, we had expenses associated with our China store closing. So in the third quarter of this year, our expenses will be under last year. Then in the fourth quarter, it will return to more normal. It could be more in 30% range. So, when you add it up for the year, it will be 30%.

Greg Melich - ISI Group

Right, that's helpful. Thanks. Then a bigger picture question. Frank, it was in your prepared comments, you talked about getting one of every three online orders now down through the stores and one out of five by something else. Could you give us some benchmark of where that was a year ago and where you would like it to be or where you expect it to trend over the next year or two if we do things right.

Frank Blake

So, Greg, we have just started this year with the rollout of buy online ship to store. Last year we had buy online pick up in store. So there has been a substantial increase in the penetration because of the addition of buy online ship to store and the improvement of buy online pickup in store. I would say, we don't have a specific target on what we would like to see. The customers are going to tell us but we think, as I said, that we want our stores to be a competitive advantage and we want the convenience of our stores to be something that our customers see as a value and we are seeing that now. We are really pleased with it. It puts a lot of pressure on Marvin and his team because we have got new product rolling into the stores that they have to be able to respond quickly to the customer desire to pick it up, but that's really one of our long-term sustaining competitive advantages we believe.

Greg Melich - ISI Group

If I could, if Marvin is there, just of the added labor hours, if you are kind of having to put in this quarter, was it all just related to just overall sales or was this a particular driver there?

Marvin Ellison

Overall sales, but we have a very detailed analysis that we conducted at the beginning of the year trying to understand where Craig was investing in new merchandising categories, innovation and new products, as well as when we are forecasting sales, so to be specific we made labor investment in pro in two areas. Speed of check out, so we invested in our cash area. We also invested in loading. Pros want to get in and out buyer, so we made investments there.

We made investments obviously in garden, because of just the overall sales trend and believe or not we made other investments just in a lot, because the transactions were at a record pace and we wanted to just provide assistance with loading and other departments throughout the store, so the overall business drove a lot of the investment but also just a penetration of businesses like pro allowed us to make incremental investments over and above just the overall business trends.

Operator

We will go next to Budd Bugatch with Raymond James.

Budd Bugatch - Raymond James

My question, Carol, for you is kind help us walk through the third and fourth quarter sales guidance or how you would look at that? I know you walked us through the second half, but maybe you could go and parse some of those hurdles that you were facing by quarter during the second half?

Carol Tome

I would be happy to. On the sales front, you should expect our comps to be in a fairly narrow range, so as regarding to let's say 4% for the back half of the year, that gives you an idea. They are going to be in a fairly narrow range. I have already talked about the expenses. Expenses should be lower in the third quarter and then trending more at our guidance of 30% of sales growth in the fourth quarter.

I do want to pause and make sure everyone remembers that we had that extra week, so we got to axe that extra week out, (Inaudible) guidance here. The other thing I should comment on is, our gross margin performance. As we have looked out our gross margin rate up 16 basis points before the half and I guided that for the back half of the year it would be about half of that rate, or call it 8 basis points which translates to 12 basis points for the year.

That's actually slightly under what we had planned at the beginning of the year, but it's purely a reflection of what our consumers are buying in our stores. We are doing a great job of managing what we control supply chain leverage, shrink leverage, cost out, but when a customer comes in and buys a lower margin product, we are going to take that sale all day long and it impacts our rate performance.

Budd Bugatch - Raymond James

Okay. My follow-up question goes to kind of a appliances and cabinets. Do you have a market share number now for appliances that you could share with us? I know kitchen was up double digits as were appliances. I don't know if I heard cabinets in that.

Frank Blake

Yes. Budd, on the appliance side as reported by independent third parties on a rolling-12, we are at about 11.8% in the industry, so we are still a [distant] and that's versus about 10 last year, Craig. Is that what I recall?

Craig Menear

10 unchanged.

Frank Blake

Yes.

Budd Bugatch - Raymond James

So, up slightly?

Budd Bugatch - Raymond James

Cabinets, how are they performing?

Craig Menear

Cabinets continue to do well. We had strong growth in our overall kitchen business, we offer a wide variety of options for our customers whether that would be in-stock cabinets, semi-custom, fully assembled and we did well on the quarter.

Budd Bugatch - Raymond James

Okay. If I could just sneak one other quick one in, supply chain, Carol, you noticed that as a benefit. We haven't talked about that as much in recent quarters. What do you see going forward for that?

Carol Tome

We expect to drive continued leverage in our supply chain. Mark Holifield and team continue to drive productivity improvements, our RDC network is becoming a mature network, but it doesn't stop there. As you know, we are investing in direct fulfillment facilities, the transportation play it will help lower our transportation cost, not because cost of the supply chain transportation. Everything that Mark and team are doing, not just running better facilities, but managing the optimization of transportation should help us grow. As you know when we set out our roadmap to the 12% operating margin by 2015, supply chain was in that roadmap looking at a 20 basis points benefit.

Budd Bugatch - Raymond James

It seem to be though outperforming that now.

Carol Tome

Well. With a double-digit positive comp.

Craig Menear

But in 2012, we have picked up three of that, so there is about 17 to go between now and 2015.

Budd Bugatch - Raymond James

Congratulations again. Thank you for taking my questions.

Operator

We will go next to Dennis McGill with Zelman & Associates.

Dennis McGill - Zelman & Associates

Hi. Thank you. Carol, could you just detail what the appliance benefit was to comp both, in the quarter and the first half of the year?

Carol Tome

Well, the appliance benefit to the quarter was 80 basis point. Year-on-year, plenty of that number, I know that appliances are up $307 million year-on-year for the half, but I don't know what the comp is.

Craig Menear

Yes.

Carol Tome

We will look back into it.

Dennis McGill - Zelman & Associates

Yes, okay, got it. Then Frank, I guess just big picture, when you see double-digit comps come to the store and even if you think about 8% for the first half of the year, being much stronger than probably what it was a year ago, does it change the way that you think about the recovery and what the stores can handle on what this recovery could look like if the housing markets keeps unfolding?

Frank Blake

I split that into two parts. First what our stores can handle and then second, the broader comment on the market recovery. In terms of what our stores can handle, as I said in my comments, really an extraordinary job done by our store associates, our supply chain team, our merchants and our vendors to respond to a much sharper increase in sales than we expected and as I said again in my comments, it's easy to say you have a flexible business model. That puts a lot of pressure on you and when you just look at the inventory performance, the leverage and payroll as well as the sales, we are really pleased with our ability to respond flexibly.

In terms of the overall market recovery, as Carol said, in terms of what's underneath our guidance for the year is the housing market is clearly an assist to us. That was something we saw in the second quarter. We saw through the first half. We expect that to continue in the back half. There are some things we are watchful of, but we expect it to continue. Then we have some specific things within our business that moderate that and both Carol and Craig detailed those.

Dennis McGill - Zelman & Associates

On the part of that, as far as how the business responded to the strong comps? Would you say that's better than you expected to be or met your expectation?

Frank Blake

Yes, better. I would welcome my colleagues here to speak because I think it was a difficult quarter. It's kind of the difficulty that you want to have. You want to be challenged by sales but it required a lot of flexibility and responsiveness.

Carol Tome

Well, some of us were here last time we did a double-digit positive comp and our execution wasn't like it was today.

Marvin Ellison

Dennis, this is Marvin, and Frank said it well, would just remind people, we don’t increased dock doors or receiving space. We had record transactions and the associates, the merchants, the supply chain deserves a lot of credit. Managing payroll and environment was tricky but we have a new payroll system that Matt Carey and IT team helped us design about 18 months ago and it worked perfectly. So we are very proud. We kept our net promoters score year-over-year relatively flat over 70, which any other time wouldn't be pleased we were flat but in a record transaction quarter, we feel pretty good about the service levels for all of the transactions and customers and freight that we had to deal with. So are very pleased.

Craig Menear

That's all I would like to add to. I will be remiss if I didn't call up the fact that between our inventory plan and replenishment team, our merchants working with our suppliers, our suppliers did an awesome job of working with us to make sure that product was flowing and be able to take care of the demand spikes. We couldn't have done it without them.

Dennis McGill - Zelman & Associates

So can you handle a 20% comp?

Craig Menear

We would like to try.

Frank Blake

Yes, we would like to give it a shot.

Carol Tome

Absolutely.

Operator

We will go next to Brian Nagel with Oppenheimer.

Brian Nagel - Oppenheimer

A big picture question. Carol, I want to go back. You commented at the end of your prepared remarks that interest rates is a fact that you are watching. So I think now in the retail community, higher interest rates is the latest Boogeyman which could derail spending here. So the question I have for you is, as you think of Home Depot where, if interest rates start to have an impact on the business, where would you see it? Then, as a follow up to that is, and just to be clear, with interest rates having really ticked up a bit here, have you seen any indications thus far of the skittishness on the part of your consumers as a result of that?

Carol Tome

So let me ask or answer the latter part of your question first. As we look at the health in drivers that impact our business, really looking at turnover and home prices, and as you have known, we have seen a nice increase year-on-year in both of those. We think, based on forecast for both housing and turnover, that that will drive about 250 basis points of our overall growth this year.

Now, how do interest rates come into play for prices or turn over? Well, if you can't get financing then you can't get things to move so it could have an impact. We certainly haven't seen that to-date, so we have tried to do a lot of modeling and correlations to say well what would happen if rates went up another 100 basis points and another 200 basis points. We are not seeing anything that we can point out to as aha it is was a big learning, but just our intuition would tell us consumer psyche can change in a higher interest rate environment, so we want to be cautious.

Brian Nagel - Oppenheimer

Is there any historical pressure if you look at Home Depot through various interest rate cycles as to what point higher interest rates could actually impact the business?

Carol Tomé

If you go back through time in higher interest rate cycles, we are often time powered through those cycles, so. No.

Operator

We will go next to Kate McShane with Citigroup.

Kate McShane - Citigroup

Good morning. A lot of questions have been answered, so this is a little bit more smaller question, but I wondered if you could go into a little bit more detail about what you are seeing from the smaller pro customer. You highlighted you have seen an improvement, but have we seen an inflection with this group and are they comping positively?

Craig Menear

First, Kate, I will turn it to Marvin to respond more fully, but yes they are positively comping and the rate of growth is improving. It's not at the same rate of growth as our larger spending pros, but that is actually consistent with how we thought this would develop, but, yes, it's positive and strong.

Marvin Ellison

Kate, the point I will add to that is, when we dissect the data understanding why the larger pro is growing at a more robust rate, a lot of times it comes down to liquidity and just access the capital. These smaller pros are remaining same, we were very pleased with their performance in the quarter and just pleased with all the partnership with the merchants in getting the products in the prices that they want. As I mentioned earlier, we made payroll investments on that side of the building, because they told us for years they want to get in and out fast, they want to us to help them grow their business and we think because of the investment in payroll from a loading, from a service and some of the customer service initiatives we put in place and things as simple as dedicated parking, which doesn't appear to be important with your customer, where time is money, those things are very critical. We are pleased with the growth and we hope that we continue to see it.

Diane Dayhoff

Marquita, we have time for one more question.

Operator

We will take our last question from Mike Baker with Deutsche Bank.

Michael Baker - Deutsche Bank

Thanks. Two questions. One, following up on the appliances you had 120 stores and you said you are doing another 120. That's still only putting in little more than 10% of the store base is. Is that the right number longer-term, or is it something that you continue to put that jumbo set in more and more stores over time?

Craig Menear

I mean, our intent will be to continue to evaluate the opportunity as we go forward.

Michael Baker - Deutsche Bank

I assume these are just better stores, but is there something specific about these 240 or so stores that make the appliance work there that wouldn't work elsewhere?

Carol Tomé

No. As you can appreciate, when we went into this, we looked at some of our highest volume stores and those two were close clients competitor. As we look ahead, we want to make sure that any incremental investment that we make will be value create.

Michael Baker - Deutsche Bank

One more just on leverage and where you are right now, I think you are just under your benchmark of 2.0 times. Earlier in the year, you talked about potentially taking on more leverage. I think you had said it in December if memory serves or later in the year. Where do you stand right now with your outlook on debt?

Carol Tomé

Our adjusted debt to EBITDA ratio stands at 1.7 times against cap, if you will, at two times. That gives us about $3.4 billion of borrowing capacity as we stand today. We do have $1 billion in a quarter that comes due in December, and so we will take a look at whether or not we want to raise incremental financing at that time.

Michael Baker - Deutsche Bank

Above and beyond what's due?

Carol Tomé

Yes.

Diane Dayhoff

Well, thank you to everyone who has joined us today. We look forward to talking to your next quarter.

Operator

That does conclude today's conference. We appreciate your participation. You may now disconnect.

Executives

Diane Dayhoff - Vice President, Investor Relations

Frank Blake - Chairman of the Board, Chief Executive Officer

Craig Menear - Executive Vice President - Merchandising

Carol Tome - Chief Financial Officer, Executive Vice President - Corporate Services

Marvin Ellison - Executive Vice President - U.S. Stores

Analysts

Gary Balter - Credit Suisse

Dan Binder - Jefferies

Christopher Horvers - JPMorgan

Peter Benedict - Robert Baird

Michael Lasser - UBS

Matthew Fassler - Goldman Sachs

Greg Melich - ISI Group

Budd Bugatch - Raymond James

Dennis McGill - Zelman & Associates

Brian Nagel - Oppenheimer

Kate McShane - Citigroup

Michael Baker - Deutsche Bank

The Home Depot, Inc. (HD) Q2 2013 Earnings Call August 20, 2013 9:00 AM ET

Operator

Good day, everyone, and welcome to today's Home Depot second quarter 2013 earnings conference call. Today's conference is being recorded. (Operator Instructions).

Beginning today's discussion is Ms. Diane Dayhoff, Vice President of Investor Relations. Please go ahead, ma'am.

Diane Dayhoff - Vice President, Investor Relations

Thank you, and good morning to everyone. Joining us on our call today are Frank Blake, Chairman and CEO of The Home Depot, Craig Menear, Executive Vice President, Merchandising and Carol Tome, Chief Financial Officer and Executive Vice President, Corporate Services.

Following our prepared remarks, the call will be opened for analysts' questions. Questions will be limited to analysts and investors and as a reminder, we would appreciate it if the participants would limit themselves to one question with one follow-up please. If we are unable to get to your question during the call, please call Investor Relations Department at 770-384-2387.

Before I turn the call over to Frank, 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 those factors identified in the release and in our filings with the Securities and Exchange Commission. Today's presentations may also include certain non-GAAP measurements. Reconciliation of these measurements is provided on our website.

Now, let me turn the call over to Frank Blake.

Frank Blake - Chairman of the Board, Chief Executive Officer

Thanks you, Diane, and good morning, everyone. Sales for the second quarter were $22.5 billion, up 9.5% from last year. Comp sales were positive 10.7% and our diluted earnings per share were $1.24 per. Our U.S. stores had a positive comp of 11.4%. We expected the second quarter to be our strongest comping quarter of the year. The results exceeded our expectations. We grew sales by almost $2 billion in the quarter, posted the first double-digit positive comp in our business since 1999, and had the highest quarterly transaction count in the company's history.

From a geographic perspective, sales were strong across the U.S. Two-thirds of our regions posted double-digit comps. All of our top-40 markets posted positive comps and 98% of all of our markets were positive. So, the strength in the business was broad-based geographically. This was also true across our merchandising categories. Every one of our merchandising departments exceeded plan for the quarter. As Craig will detail, we saw particular strength in our spring seasonal categories.

As you know, we had a weaker than expected selling season for outdoor categories in the first quarter because of the late spring, but that was counterbalanced by strength in this quarter as the weather turned more favorable. The core categories in our store remained strong and we were pleased with the growth in our appliance business where we have added key brands and with the growth in the core categories like soft flooring, vanities and special order cabinets.

With respect to our customer base, we continued to see strength in our pro-business. In the first quarter, our pro customer growth outpaced our consumer growth. For the second quarter, the growth rates were comparable. This reflects less of slowdown in pro than a pickup in our consumer sales. And as in the first quarter, our larger pros were our fastest growing customer group, but we also saw continued improvement in our smaller lower spending pros.

On the international front, our Mexican business positively comped for the quarter making it 39 quarters in a row of positive comps. And, our Canadian business, had positive comps for the seventh quarter in a row. This quarter tested our ability to react and be flexible significant outperformance to plan obviously presents some interesting operational and merchandising challenges.

On the operational front, Marvin and his team were able to adjust store staffing and handle unexpected volume and transaction growth while maintaining customer satisfaction levels. Earlier in the year, Marvin introduced project Simple into store operations, dramatically reducing the administrative tasking within the stores. This played an important role in freeing up our store leadership to respond to changed circumstances.

On the merchandising side, many of the improvements that Craig, our merchants, Mark Holifield and supply chain team have made in our forecasting and replenishment systems that helped business react to and recover from sales pipes while keeping inventory under control.

On interconnected retail, we are at the point where almost one out of every three online orders are completed in the store either through Buy Online Pickup in Store, or buy online ship to store. This is important to us, because we believe our more than 2,000 store locations throughout North America are valuable convenience for customers and can and should be a competitive advantage for us. Of course customers have the opportunity to buy additional items when they come into our store and return or pickup a product as today one out of five customers do.

We are also pleased with the improvements we are making to the customer experience in our services business as we develop new project and communication tools online. In the second quarter, we continued the rollout of a functionality we call MyInstall, that will provide customer-specific installation information, dynamic tracking to keep them informed on the status of the installation, e-mail notifications for appointments and a point of contact to process order changes and alike. This provides both, a better customer experience and a better foundation for us to manage the business that is growing at a double-digit pace.

As we look towards the back half of the year, consensus GDP forecast continue to call for only modest growth. Housing data however are encouraged, private fixed residential investment or PFRI as a percent of GDP improved to 3.1% in the second quarter, but it's worth remembering that prior to the housing crash, this would have been below the previous 60-year low for PFRI.

As Carol will detail, we are raising our sales and earnings guidance for the year. The housing recovery should be a positive for our market, but we have difficult sales comparisons in the back half of the year as we anniversary hurricane events from 2012 and 2011, and very strong holiday seasons in both of those years.

Let me close by thanking our associates for their hard work and dedication. It is easy to talk about a flexible business model but the execution of that requires people willing to adjust to changed circumstances and deal with business challenges while putting the customer first. Our associates did that. Based on this facts results 100% of our U.S. stores qualified for Success Sharing, our profit-sharing program for our hourly associates and we will have our highest ever Success Sharing payout. We are very proud of that result.

With that let me turn the call over to Craig.

Craig Menear - Executive Vice President

Thanks, Frank, and good morning, everyone. We are pleased with our performance in the second quarter, posting positive comps in all departments. There were four key factors that drove our performance, strong summer events, a recovering seasonal business, commodity inflation and strength across the remainder of the store. The departments that had double-digit positive comps were kitchens, indoor garden, lumber, outdoor garden, lighting, tools, electrical and flooring. Bath, plumbing, decor, building materials, paint, hardware and millwork performed positively but were below the company average.

Our seasonal business exceeded our plan, as Frank finally kicked into gear in the second quarter. We were able to recover all the lost sales we projected from exterior project categories in the first quarter and then some. In indoor and outdoor garden, our second quarter success resulted in positive comps in both departments for the first half of the year.

The core of the store delivered solid sales growth throughout the second quarter. In maintenance and repair categories, we saw continued comp performance in light bulbs, wiring devices, cleaning, plumbing repair, fasteners, builder's hardware, caulk and adhesives. We also saw traction in decor categories where comps above the company average in special order carpets, special order cabinets, floor tile and lighting as well as strong comps in faucets.

Our store associates did a great job executing our summer events and creating an excitement. Our Memorial Day, Father's Day and Fourth of July special buys and great values were well received by our customers and drove double-digit comps in categories like appliances and riding mowers. Our results were achieved through a coordinated effort between our supply chain, our merchants, our stores and our vendors. The investments we have made over the past several years gave us the flexibility and capability to respond quickly and meet spikes in demand.

Total comp transactions rebounded from the first quarter and grew by 5.7% for the second quarter driven by traffic related to our seasonal business. Transactions for tickets under $50, representing approximately 20% of U.S. sales, were up 3.8% for the second quarter, principally due to our garden business. Transactions for tickets over $900 also representing approximately 20% of our U.S. sales were up 15.5% in the second quarter driven by the strength in appliances, riding mowers, flooring as well as continued improvement from our pro business.

Average ticket increased 4.3% in the second quarter. Our average ticket increase was impacted by commodity price inflation mainly from lumber and copper which contributed approximately 70 basis points to comp.

As Frank mentioned, we had one of the best quarters in our recent history. As we look forward to the back half of the year, we are projecting solid sales growth but we do have several factors to overcome. First, we will face tough sales comparisons resulting from impacts of consecutive years of autumn storms. Second, commodity inflation is on track to no longer be tailwind as lumber and copper prices have begun to moderate. Third, we have began to the lap excellent response to our rollout of our expanded appliance business. As we get to the fourth quarter, the holiday shopping season, would be a week shorter due to the date on which Thanksgiving falls this year.

Now let me talk specifically about the third quarter. We continue to focus on innovation as a key part our leadership strategy. In stores now, Behr Premium DeckOver wood and concrete coatings brings new life to old wood and concrete surfaces. This 100% acrylic formula available in 54 colors conceals splinters and cracks and creates a slip resistant finish.

We continue to be innovative in lighting technology. As an example, we are introducing an LED 90-watt equivalent floodlight from Cree, now giving us a full range of assortment for the top-three most popular bulbs at market-leading values.

For our pro customers, we are introducing DAP SMARTBOND adhesive foam gel that is faster and easier to use than traditional cartridge adhesives helping our pro customers to be more efficient. One cartridge of SMARTBOND provides eight times the coverage of traditional adhesives. Also, new to homedepot.com for our pro customers, we are offering a line of fully welded steel cabinets from Husky, which feature a variety of door and interior configurations. This allows the customer to customize their cabinets exactly the way they want.

For our Labor Day and events we have an extensive lineup of great values and special buys. These events along with our superior execution in-store will generate a lot of excitement in the third quarter.

With that, I would like to turn the call over to Carol.

Carol Tome - Chief Financial Officer, Executive Vice President

Thank you, Craig. Hello, everyone. In the quarter, sales were $22.5 billion. On a like-for-like basis comps or same-store sales were positive 10.7% for the quarter with positive comps of 10.2% in May, 11.5% in June and 10.5% in July. Comps for US stores were positive 11.4% for the quarter with positive comps of 11.5% in May, 11.7% in June and 11% in July.

Total sales grew 9.5% from last year reflecting the impact of the calendar shift. As you will recall, fiscal 2012 had a 53rd week, which shifted our fiscal 2013 calendar. By starting fiscal 2013, one week later than last year, we had one less week of spring sales in the second quarter when compared to the same period in 2012, which negatively impacted total sales growth by approximately $249 million or 120 basis points.

As Frank and Craig mentioned, our second quarter sales performance exceeded our expectations due in part to strong demand for appliances and recovery in our garden department. Further, sales related to hurricane Sandy were approximately $47 million in the second quarter. We expect to see some benefit from storm related sales in the second half of the year, but the year-over-year benefit will diminish as we begin lapping hurricane sales in the third quarter.

Our total company gross margin was 34.3% for the quarter, an increase of 12 basis points from last year of which 13 basis points came from our US business. We saw a considerable amount of movement in our gross margin during the quarter as explained by the following. First, we experienced approximately 22 basis points of gross margin expansion due to the impact of gross margin accretive businesses that were acquired in the back half of last year.

Second, we had 13 basis points of gross margin expansion due to expense leverage within our supply chain. Third, our shrink efforts continued to gain traction as we realized 10 basis points of gross margin expansion due to better shrink performance than one year ago. Finally, we experienced approximately 32 basis points of gross margin contraction due primarily to a change in mix of products sold.

To put this contraction into perspective, over 50% or 19 basis points came from a higher penetration of appliance sales than one year ago. For the first six months of the year, our gross margin grew by 16 basis points. As we look to the last six months of the year, we would expect our gross margin expansion to be about half of what we experienced in the first six months, so for the year expect moderate gross margin expansion.

In the second quarter, operating expense as a percent of sales decreased by 79 basis points to 20.9%. In the second quarter, our operating expenses grew at 58% of our sales growth, better than our expectations for the quarter due to strong sales performance. For the year, we are expecting our expenses to grow at approximately 30% of our sales growth on a 52-week basis.

But note, like what we experienced in the second quarter, there will be quarterly distortion to that rule of thumb, given year-over-year comparisons and certain expense items like Success Sharing. For example, in the second quarter of 2013, over 300 stores were in higher Success Sharing payout tiers than one year ago. This caused 14 basis points of expense deleverage in the quarter.

Interest and other expense for the second quarter was $172 million, a 13.9% increase from last year, reflecting increased interest expense associated with $2 billion of incremental debt issued in April of this year. Our income tax provision rate was 36.9% in the second quarter and we expect our income tax rate to be approximately 37% for the year. Diluted earnings per share for the second quarter were $1.24, an increase of 22.8% from last year.

Moving to our operational metrics. During the second quarter, we opened one new store in Puerto Rico for an ending store count of 2,258. At the end of the second quarter, selling square footage was 235 million and total sales per square foot were $383.

Now turning to the balance sheet. At the end of the quarter, inventory was $11.1 billion and inventory turns were 4.9 times, up from 4.7 times last year. We ended the quarter with $42.2 billion in assets including $3.4 billion in cash.

Moving to our share repurchase program. In the second quarter, we received 2.1 million share related to the true up of an accelerated share repurchase or ASR program we initiated in the first quarter. Additionally, in the second quarter we repurchased $2.15 billion or 25.4 million of our outstanding share. This included 5.8 million shares repurchased in the open market and 19.6 million shares repurchased through an ASR program. For the shares repurchased under the second quarter ASR program, this is an initial calculation and we expect to receive an additional 2.4 million shares in August.

Computed on the average of beginning and ending long-term debt and equity for the trailing four quarters, return on invested capital was 19.1%, 310 basis points higher than the second quarter of fiscal 2012. We had solid first half, as evidenced by strong performance across our store. As we look to the back half, we believe we will continue to report solid sales gains and that sales will be higher than we originally planned.

So today, we are lifting our 2013 sales and EPS growth guidance reflecting our first half performance and our forecast for the second half of the year. We now expect fiscal 2013 sales to increase by approximately 4.5% with positive comps on a 52 week like-for-like basis of approximately 6%. We expect the rate of comp growth for the back half of the year to be about 50% of the rate of comp growth we have experienced in the first half of the year. Our second half forecast is based on our view that we are in the early stages of housing recovery, that GDP will grow less than 2% for the year and reflects back half challenges that Craig detailed.

Finally, we, like others, are watching the interest rate environment as consumer spending and mortgage availability could be negatively impacted if interest rates were to rise. In the absence of rising interest rate however, if there is a bias in our second half forecast today we would say there is more upside opportunity than downside risk. For earnings per share, remember that we guide off of GAAP. We now project fiscal 2013 diluted earnings per share to increase approximately 20% to $3.60. This earnings per share guidance includes the $4.3 billion of share repurchases completed in the first half of the year and our intent to repurchase an additional $2.2 billion in shares during the second half of the year.

So we thank you for your participation in today's call and Marquita, we are now ready for questions.

Question-and-Answer Session

Operator

(Operator Instructions). We will take our first question from Gary Balter with Credit Suisse.

Gary Balter - Credit Suisse

Carol, just following up on your comments near the end, you sounded more confident. Obviously the results should cause that confidence, but what causes that confidence going forward and what do you think competitively in terms of pricing or anything along those lines, because gross margin looks solid given this shift in mix.

Carol Tome - Chief Financial Officer, Executive Vice President

Thank you, Gary. We look at the number of factors both, internal and external to why that point of view as to how our sales will perform in the back half of the year coming off obviously a very strong first half of the year. The best thing we can look at our current trends and I will tell you the current trend of the business is good. Sales are quite brisk. Now, competitively, Craig, you might want to comment.

Craig Menear - Executive Vice President

Gary, from a competitive standpoint, we saw the last quarter that we just exited pretty comparable. Most folks went hard after the seasonal business given the late start of the business and certainly and big ticket appears we still need to stimulate the customer to buy, but not a radical change and kind of we would expect that going forward.

Gary Balter - Credit Suisse

There has been a lot of talk our a lot of talk, and I will get off the phone, there has been a lot of talk about interest rates rising and the impact that could have on housing and you guys et, cetera. What are your thoughts on where we are?

Carol Tome - Chief Financial Officer, Executive Vice President

Well, as you know through the year, mortgage rates are up. They are at the highest rate that they have been since October of 2011 at about 4.4%. The affordability index is still at historical high, Gary. So if rates were to move up, it would peak that affordability index, but we have got a long way to go before it should have a dramatic impact we believe mortgage availability or the attractiveness for the consumer or homeowner to take out a mortgage. All that being said, however we are watching it.

Gary Balter - Credit Suisse

Thank you.

Operator

We will take our next question from Dan Binder with Jefferies.

Dan Binder - Jefferies

Hi. Good morning. I was wondering if you could comment on two things. One, on sort of the bigger ticket project business what you are seeing, kitchen and bath in particular and then also if you could comment on credit availability. I know you guys had started doing that program. Any color around that?

Craig Menear - Executive Vice President

Dan, on the big ticket, we did see very nice strength in tickets above $900 growing at 15.5% in the quarter. That was largely driven with appliances things like riding mowers which were strong throughout the quarter. We saw flooring projects as well as our kitchen business, all contributed to that. Then certainly the continued strength of our pro business which carries a higher average ticket overall help that as well.

Carol Tome - Chief Financial Officer, Executive Vice President

On the credit front, during the quarter we opened 1.4 million new private-label credit card accounts, so we were very pleased with that. The penetration of our private label card room 41 basis points in the quarter now outstanding at 22.6%, so that's the good news too. We also saw an increasing bank card, so it appears that consumers are willing to use our bank cards, our bank card penetration up 30 basis points year-on-year.

If you look at what's going on within our private label portfolio, we see consumer approval rate hovering around 68%. That's good news too. because as you know, they were dropping as a result of some of the changes coming out Durbin, but now we see it hovering around 58%, the average line approved is $5,800. That's up $200 year-on-year at a FICO at about $716.

On the commercial front, the average approval rate there is 70%. The line approved is $6,800. That also was $200 a year-on-year. We are coming behind our pro customers, because they are still very important (Inaudible) programs or we work with the underwriter to extend credit lines on a case-by-case basis. So, credit obviously is an important part. It's not the entire story here, but it is certainly part of the story.

Operator

We will take our next question from Christopher Horvers with JPMorgan.

Christopher Horvers - JPMorgan

Thanks and good morning. Can you talk about very consistent comps throughout the quarter, is there a way to think about what the seasonal business actually lifted perhaps July which was later in the quarter, but obviously have these record moistures levels out there and your mowing and cutting bushes and so forth, so is there a way to sort of peel that back and think about what July is ex-seasonal?

Craig Menear - Executive Vice President

Yes. Chris, the seasonal business obviously carried strong throughout the quarter. We saw, for example in sales of things like power equipment remain very throughout the quarter including July, as you mentioned, due to the fact that we had a moist July that obviously kept the grass growing as well. When we look at the seasonal business in total, one of the risk factors coming off of the first quarter was whether or now you would be able to recover the whole live goods and fertilizer business and because of the moisture we actually were able to get all that business back and carrying through June and July and then actually some went above what we thought.

Carol Tome - Chief Financial Officer, Executive Vice President

July was our easiest compare. So that's another way to parse it out, if you think about it that recovery of garden evened out but mostly performance.

Christopher Horvers - JPMorgan

Okay. So, I guess you would say, like obviously guiding about 4% comp in back half of August is very strong but maybe the ex-seasonal or core underlying growth rate in the business is somewhere between that 4% and the 10% that you posted in July.

Carol Tome - Chief Financial Officer, Executive Vice President

Well, just the way I would like you to think about the back half of the year, and I will walk you down from what we posted in the first half to the second half, and around. So in the first half, our comp was 8%-ish. I am rounding down. I am going to walk you down to the guidance that we are giving you which is about 4%-ish. First, we are up against some very tough hurricane sales and I would like you to think about this really on a two-year basis.

We forget sometimes that we had a hurricane in 2011, Hurricane Irene. We had $360 million of hurricane related sales in 2011. Then if you move to 2012, we all know we had Hurricane Sandy but we also had Hurricane Isaac. So when you add up those sales, that's about $377 million of hurricane sales. So on a two-year basis, we were up against more than $730 million of sales coming off of hurricane.

So one of the walk downs, obviously, would be, we are not anticipating hurricanes now. If we get a hurricane, it's a different story but right now we are not anticipating a hurricane. So not maybe a 1.5 point off of just hurricane related sales.

Then, as Craig pointed out, commodity prices are starting to moderate. If you remember, the back half of last year, our structural planning pricing took off. Its now coming down. So we would knock off maybe a point, call it a 130 basis points for commodity price inflation. Then while we will have growth in categories like appliances, we don't anticipate the explosive growth that we had in the first half, just because we are anniversarying new brands. So knock off another 120 basis points, something like that and you get to the 4%.

Christopher Horvers - JPMorgan

Understood, and then, one last question. Can you talk about what the SG&A impact in this quarter was, from a leverage perspective? How much the fact that it was driven by traffic versus ticket impacted leverage overall? Thank you.

Carol Tome - Chief Financial Officer, Executive Vice President

Yes, well, first let me say, Marvin and our operations team have done a fantastic of managing payroll in our stores given the sight that we saw in our sales growth. We leveraged hourly payroll in the quarter. We leveraged hourly payroll by 38 basis points. So really excellent work there.

There is just some year-over-year comparisons, Chris, that are distorting the performance in the second quarter and let me just give you some of that color. It might help you better understand the shape of the year.

First of all, if you recall last year, we had a good guide coming from workers' comp in the amount of about $42 million. This was an actuarial reserve adjustment that we had last year. That did not repeat this year. Though it gave us some pressure on a year-over-year basis.

Secondly, I called out the gross margin benefit of our newly acquired businesses. Well, they come with expenses too. So, on a year-over-year basis, we had $37 million of expenses from our newly acquired businesses that we didn't have one year ago. Now we will start to anniversary the acquisitions, if you will, towards the back half of the year. So our expenses become much more in line with the guidance that I have given you.

The other thing I would like to call out, because are just so really excited about this for our store associates. As Frank pointed out, we will be paying record Success Sharing checks for our store associates. The year-over-year increase is $46 million and in fact is twice as much of what we paid in 2011.

Chris?

Operator

We will take our next question from Peter Benedict with Robert Baird.

Peter Benedict - Robert Baird

Carol, quickly just on D&A. It is flat to down over the last few years but it's up, I think about 5%, year-over-year in the first half, so just a modeling question. What's driving that and how should we be thinking about the growth in D&A going forward.

Carol Tome - Chief Financial Officer, Executive Vice President

Well, it's really a change in the mix of our capital spending. We spent a lot of our capital on new store that had long lives. We are now shifting our capital to sort of assts including IT. This year, we will spend about $435 million in IT the longest life we have got there is six years, so it's dragging off over three.

Peter Benedict - Robert Baird

Okay. If we think about the 6% comp that you guys have for this year, and let us assume that persists of the next couple of years going forward, is the OpEx growing 30% of sales, is that kind of a good benchmark to use or does it start to evolve as we lookout again assuming kind of a 6%-type comp?

Carol Tome - Chief Financial Officer, Executive Vice President

Well, for modeling purposes, I think 30 basis points expense growth is the right number.

Peter Benedict - Robert Baird

Okay. Perfect. Then just for Craig. You talked about some of the core categories. Can you maybe talk about some of the real remodel categories and things like windows and things like that, are you starting to see kind of evidence of that kind of activity starting to pick up in the stores?

Craig Menear - Executive Vice President

Yes. We are. We are starting to see, for example, in lumber not only that we have some inflation year-over-year, it was about 70 basis points of our comp coming as a result of that, but we also saw unit productivity which is our pro customer starting to comeback. Solid growth and things like fasteners and pneumatics all those are heavy pro-dominated categories.

Operator

We will go next to Michael Lasser with UBS.

Michael Lasser - UBS

Thanks a lot for taking my question. First, within the product mix are you seeing any shift around from opening price points to better and best price points? Then I have a follow-up question.

Craig Menear - Executive Vice President

Not a lot of change, Michael, in the line structure. The only thing I would point out on that is, we have had some really nice innovation and things like LED, which carry a higher ticket, certainly within the light bulb category we are seeing customer step-up, the [bear premium deck over] is a great product, so we are seeing customers willing to spend really in every segment of the category within a category whether that'd be opening price point, mid or high.

Michael Lasser - UBS

Is it that because you are seeing customers across all price points come back, which maybe obscuring some of the trade up or is there just not really that willingness to trade up at this point?

Craig Menear - Executive Vice President

No. Again, I think the innovation in many categories is what is driving the trade up, so customers are willing to step up and spend money when they see great innovation that either makes a project easier and/or like in the case of LEDs, saves them energy cost around the home. They are definitely willing to step up.

Michael Lasser - UBS

Got it. Sorry. I was confused. The second question I had is, if you look on a like-for-like basis within product, and I recognize that you got 70 basis points inflation from commodity price increases, but how are prices trending on like-for-like non-commodity oriented products if you look back say a year ago.

Craig Menear - Executive Vice President

I would say that our focus is relentless focus on driving value for the customer, wee are always looking to provide a better value, so we are working hard to drive unnecessary cost out whether that be working with our suppliers on how we can drive our cost. Obviously, supply chain is allowing us to leverage cost and we are looking to bring better value to our customer and reduce prices wherever we can.

Carol Tome - Chief Financial Officer, Executive Vice President

If I could just jump in, because Craig mentioned this, I just want to reemphasize the point. We saw an increase in items in the basket this quarter. It contributed 20 basis points of growth to our ticket in the quarter. It has been a drag since the housing crisis, so we can't overstate the importance of what that means in terms of recovery both, for our pros of course, but as well as our DIY customers.

Operator

We will go next to Matthew Fassler with Goldman Sachs.

Matthew Fassler - Goldman Sachs

My primary question and then I have quick follow-up, just if you could talk about the evolution of your expanded appliance assortment. Talk about the pace of the rollout just to put in context and compare the rollout in-store to the rollout and penetration online? How far along do you think you are in realizing the benefits of this rollout process? Thanks.

Craig Menear - Executive Vice President

Okay, Matt, at the end of the last year, we had rolled out about 120 stores with an extended appliance program. We added brands in the fall season. We added Samsung around the December time frame which got us to the full offering of brands that we have right now. We are in the process right now of expanding another 120 stores for, you know, an expanded showroom experience. All of those brands are available on homedepot.com and have been since last December. We are seeing very nice response from the customer.

Matthew Fassler - Goldman Sachs

So to the extent that you guys cited this is a headwind for the year, it sounds like the roll out is not yet done. So do you think there could be some ongoing gains from incremental penetration to offset the fact that you had this in the year ago?

Craig Menear - Executive Vice President

Well. I think we went at 120 stores last fall. Obviously, we are overlapping that. We started with some of our best stores where we felt we had the greatest opportunity. So we will see how that plays out.

Matthew Fassler - Goldman Sachs

Got it, and then my second question, I think, we have come at this maybe a couple of different ways. Is it possible to sort of put a number on the comp benefit that you think you captured just in terms of the shift in volume from Q1 to Q2?

Carol Tome - Chief Financial Officer, Executive Vice President

Yes, we outperformed the guidance that we gave you by about $800 million and as we look at that outperformance, the combination of appliances and gardens made up 50% of that. Garden would have been $200 million of that.

Matthew Fassler - Goldman Sachs

Carol, when you talk comps, do you talk about for the first half of the year or for the second quarter, per se?

Carol Tome - Chief Financial Officer, Executive Vice President

For the second quarter.

Operator

We will go next to Greg Melich with ISI Group.

Greg Melich - ISI Group

Carol, I wanted to ask on the SG&A to make sure I got this right.

Carol Tome - Chief Financial Officer, Executive Vice President

Okay.

Greg Melich - ISI Group

The second quarter, you grew out expenses over a 50% of sales.

Carol Tome - Chief Financial Officer, Executive Vice President

Yes.

Greg Melich - ISI Group

But you still expect for the year that it will grow to 30% or do you think in the second half it will get back to that 30% level? So that the full year you are still running above?

Carol Tome - Chief Financial Officer, Executive Vice President

Our guidance is that the full year expenses will grow at 30% of our sales growth rate. Now, let's just think about it on a quarterly basis so we can get our models right. We guided off of GAAP. In the third quarter of last year, we had expenses associated with our China store closing. So in the third quarter of this year, our expenses will be under last year. Then in the fourth quarter, it will return to more normal. It could be more in 30% range. So, when you add it up for the year, it will be 30%.

Greg Melich - ISI Group

Right, that's helpful. Thanks. Then a bigger picture question. Frank, it was in your prepared comments, you talked about getting one of every three online orders now down through the stores and one out of five by something else. Could you give us some benchmark of where that was a year ago and where you would like it to be or where you expect it to trend over the next year or two if we do things right.

Frank Blake - Chairman of the Board, Chief Executive Officer

So, Greg, we have just started this year with the rollout of buy online ship to store. Last year we had buy online pick up in store. So there has been a substantial increase in the penetration because of the addition of buy online ship to store and the improvement of buy online pickup in store. I would say, we don't have a specific target on what we would like to see. The customers are going to tell us but we think, as I said, that we want our stores to be a competitive advantage and we want the convenience of our stores to be something that our customers see as a value and we are seeing that now. We are really pleased with it. It puts a lot of pressure on Marvin and his team because we have got new product rolling into the stores that they have to be able to respond quickly to the customer desire to pick it up, but that's really one of our long-term sustaining competitive advantages we believe.

Greg Melich - ISI Group

If I could, if Marvin is there, just of the added labor hours, if you are kind of having to put in this quarter, was it all just related to just overall sales or was this a particular driver there?

Marvin Ellison - Executive Vice President

Overall sales, but we have a very detailed analysis that we conducted at the beginning of the year trying to understand where Craig was investing in new merchandising categories, innovation and new products, as well as when we are forecasting sales, so to be specific we made labor investment in pro in two areas. Speed of check out, so we invested in our cash area. We also invested in loading. Pros want to get in and out buyer, so we made investments there.

We made investments obviously in garden, because of just the overall sales trend and believe or not we made other investments just in a lot, because the transactions were at a record pace and we wanted to just provide assistance with loading and other departments throughout the store, so the overall business drove a lot of the investment but also just a penetration of businesses like pro allowed us to make incremental investments over and above just the overall business trends.

Operator

We will go next to Budd Bugatch with Raymond James.

Budd Bugatch - Raymond James

My question, Carol, for you is kind help us walk through the third and fourth quarter sales guidance or how you would look at that? I know you walked us through the second half, but maybe you could go and parse some of those hurdles that you were facing by quarter during the second half?

Carol Tome - Chief Financial Officer, Executive Vice President

I would be happy to. On the sales front, you should expect our comps to be in a fairly narrow range, so as regarding to let's say 4% for the back half of the year, that gives you an idea. They are going to be in a fairly narrow range. I have already talked about the expenses. Expenses should be lower in the third quarter and then trending more at our guidance of 30% of sales growth in the fourth quarter.

I do want to pause and make sure everyone remembers that we had that extra week, so we got to axe that extra week out, (Inaudible) guidance here. The other thing I should comment on is, our gross margin performance. As we have looked out our gross margin rate up 16 basis points before the half and I guided that for the back half of the year it would be about half of that rate, or call it 8 basis points which translates to 12 basis points for the year.

That's actually slightly under what we had planned at the beginning of the year, but it's purely a reflection of what our consumers are buying in our stores. We are doing a great job of managing what we control supply chain leverage, shrink leverage, cost out, but when a customer comes in and buys a lower margin product, we are going to take that sale all day long and it impacts our rate performance.

Budd Bugatch - Raymond James

Okay. My follow-up question goes to kind of a appliances and cabinets. Do you have a market share number now for appliances that you could share with us? I know kitchen was up double digits as were appliances. I don't know if I heard cabinets in that.

Frank Blake - Chairman of the Board, Chief Executive Officer

Yes. Budd, on the appliance side as reported by independent third parties on a rolling-12, we are at about 11.8% in the industry, so we are still a [distant] and that's versus about 10 last year, Craig. Is that what I recall?

Craig Menear - Executive Vice President

10 unchanged.

Frank Blake - Chairman of the Board, Chief Executive Officer

Yes.

Budd Bugatch - Raymond James

So, up slightly?

Budd Bugatch - Raymond James

Cabinets, how are they performing?

Craig Menear - Executive Vice President

Cabinets continue to do well. We had strong growth in our overall kitchen business, we offer a wide variety of options for our customers whether that would be in-stock cabinets, semi-custom, fully assembled and we did well on the quarter.

Budd Bugatch - Raymond James

Okay. If I could just sneak one other quick one in, supply chain, Carol, you noticed that as a benefit. We haven't talked about that as much in recent quarters. What do you see going forward for that?

Carol Tome - Chief Financial Officer, Executive Vice President

We expect to drive continued leverage in our supply chain. Mark Holifield and team continue to drive productivity improvements, our RDC network is becoming a mature network, but it doesn't stop there. As you know, we are investing in direct fulfillment facilities, the transportation play it will help lower our transportation cost, not because cost of the supply chain transportation. Everything that Mark and team are doing, not just running better facilities, but managing the optimization of transportation should help us grow. As you know when we set out our roadmap to the 12% operating margin by 2015, supply chain was in that roadmap looking at a 20 basis points benefit.

Budd Bugatch - Raymond James

It seem to be though outperforming that now.

Carol Tome - Chief Financial Officer, Executive Vice President

Well. With a double-digit positive comp.

Craig Menear - Executive Vice President

But in 2012, we have picked up three of that, so there is about 17 to go between now and 2015.

Budd Bugatch - Raymond James

Congratulations again. Thank you for taking my questions.

Operator

We will go next to Dennis McGill with Zelman & Associates.

Dennis McGill - Zelman & Associates

Hi. Thank you. Carol, could you just detail what the appliance benefit was to comp both, in the quarter and the first half of the year?

Carol Tome - Chief Financial Officer, Executive Vice President

Well, the appliance benefit to the quarter was 80 basis point. Year-on-year, plenty of that number, I know that appliances are up $307 million year-on-year for the half, but I don't know what the comp is.

Craig Menear - Executive Vice President

Yes.

Carol Tome - Chief Financial Officer, Executive Vice President

We will look back into it.

Dennis McGill - Zelman & Associates

Yes, okay, got it. Then Frank, I guess just big picture, when you see double-digit comps come to the store and even if you think about 8% for the first half of the year, being much stronger than probably what it was a year ago, does it change the way that you think about the recovery and what the stores can handle on what this recovery could look like if the housing markets keeps unfolding?

Frank Blake - Chairman of the Board, Chief Executive Officer

I split that into two parts. First what our stores can handle and then second, the broader comment on the market recovery. In terms of what our stores can handle, as I said in my comments, really an extraordinary job done by our store associates, our supply chain team, our merchants and our vendors to respond to a much sharper increase in sales than we expected and as I said again in my comments, it's easy to say you have a flexible business model. That puts a lot of pressure on you and when you just look at the inventory performance, the leverage and payroll as well as the sales, we are really pleased with our ability to respond flexibly.

In terms of the overall market recovery, as Carol said, in terms of what's underneath our guidance for the year is the housing market is clearly an assist to us. That was something we saw in the second quarter. We saw through the first half. We expect that to continue in the back half. There are some things we are watchful of, but we expect it to continue. Then we have some specific things within our business that moderate that and both Carol and Craig detailed those.

Dennis McGill - Zelman & Associates

On the part of that, as far as how the business responded to the strong comps? Would you say that's better than you expected to be or met your expectation?

Frank Blake - Chairman of the Board, Chief Executive Officer

Yes, better. I would welcome my colleagues here to speak because I think it was a difficult quarter. It's kind of the difficulty that you want to have. You want to be challenged by sales but it required a lot of flexibility and responsiveness.

Carol Tome - Chief Financial Officer, Executive Vice President

Well, some of us were here last time we did a double-digit positive comp and our execution wasn't like it was today.

Marvin Ellison - Executive Vice President

Dennis, this is Marvin, and Frank said it well, would just remind people, we don't increased dock doors or receiving space. We had record transactions and the associates, the merchants, the supply chain deserves a lot of credit. Managing payroll and environment was tricky but we have a new payroll system that Matt Carey and IT team helped us design about 18 months ago and it worked perfectly. So we are very proud. We kept our net promoters score year-over-year relatively flat over 70, which any other time wouldn't be pleased we were flat but in a record transaction quarter, we feel pretty good about the service levels for all of the transactions and customers and freight that we had to deal with. So are very pleased.

Craig Menear - Executive Vice President

That's all I would like to add to. I will be remiss if I didn't call up the fact that between our inventory plan and replenishment team, our merchants working with our suppliers, our suppliers did an awesome job of working with us to make sure that product was flowing and be able to take care of the demand spikes. We couldn't have done it without them.

Dennis McGill - Zelman & Associates

So can you handle a 20% comp?

Craig Menear - Executive Vice President

We would like to try.

Frank Blake - Chairman of the Board, Chief Executive Officer

Yes, we would like to give it a shot.

Carol Tome - Chief Financial Officer, Executive Vice President

Absolutely.

Operator

We will go next to Brian Nagel with Oppenheimer.

Brian Nagel - Oppenheimer

A big picture question. Carol, I want to go back. You commented at the end of your prepared remarks that interest rates is a fact that you are watching. So I think now in the retail community, higher interest rates is the latest Boogeyman which could derail spending here. So the question I have for you is, as you think of Home Depot where, if interest rates start to have an impact on the business, where would you see it? Then, as a follow up to that is, and just to be clear, with interest rates having really ticked up a bit here, have you seen any indications thus far of the skittishness on the part of your consumers as a result of that?

Carol Tome - Chief Financial Officer, Executive Vice President

So let me ask or answer the latter part of your question first. As we look at the health in drivers that impact our business, really looking at turnover and home prices, and as you have known, we have seen a nice increase year-on-year in both of those. We think, based on forecast for both housing and turnover, that that will drive about 250 basis points of our overall growth this year.

Now, how do interest rates come into play for prices or turn over? Well, if you can't get financing then you can't get things to move so it could have an impact. We certainly haven't seen that to-date, so we have tried to do a lot of modeling and correlations to say well what would happen if rates went up another 100 basis points and another 200 basis points. We are not seeing anything that we can point out to as aha it is was a big learning, but just our intuition would tell us consumer psyche can change in a higher interest rate environment, so we want to be cautious.

Brian Nagel - Oppenheimer

Is there any historical pressure if you look at Home Depot through various interest rate cycles as to what point higher interest rates could actually impact the business?

Carol Tomé

If you go back through time in higher interest rate cycles, we are often time powered through those cycles, so. No.

Operator

We will go next to Kate McShane with Citigroup.

Kate McShane - Citigroup

Good morning. A lot of questions have been answered, so this is a little bit more smaller question, but I wondered if you could go into a little bit more detail about what you are seeing from the smaller pro customer. You highlighted you have seen an improvement, but have we seen an inflection with this group and are they comping positively?

Craig Menear - Executive Vice President

First, Kate, I will turn it to Marvin to respond more fully, but yes they are positively comping and the rate of growth is improving. It's not at the same rate of growth as our larger spending pros, but that is actually consistent with how we thought this would develop, but, yes, it's positive and strong.

Marvin Ellison - Executive Vice President

Kate, the point I will add to that is, when we dissect the data understanding why the larger pro is growing at a more robust rate, a lot of times it comes down to liquidity and just access the capital. These smaller pros are remaining same, we were very pleased with their performance in the quarter and just pleased with all the partnership with the merchants in getting the products in the prices that they want. As I mentioned earlier, we made payroll investments on that side of the building, because they told us for years they want to get in and out fast, they want to us to help them grow their business and we think because of the investment in payroll from a loading, from a service and some of the customer service initiatives we put in place and things as simple as dedicated parking, which doesn't appear to be important with your customer, where time is money, those things are very critical. We are pleased with the growth and we hope that we continue to see it.

Diane Dayhoff - Vice President, Investor Relations

Marquita, we have time for one more question.

Operator

We will take our last question from Mike Baker with Deutsche Bank.

Michael Baker - Deutsche Bank

Thanks. Two questions. One, following up on the appliances you had 120 stores and you said you are doing another 120. That's still only putting in little more than 10% of the store base is. Is that the right number longer-term, or is it something that you continue to put that jumbo set in more and more stores over time?

Craig Menear - Executive Vice President

I mean, our intent will be to continue to evaluate the opportunity as we go forward.

Michael Baker - Deutsche Bank

I assume these are just better stores, but is there something specific about these 240 or so stores that make the appliance work there that wouldn't work elsewhere?

Carol Tomé

No. As you can appreciate, when we went into this, we looked at some of our highest volume stores and those two were close clients competitor. As we look ahead, we want to make sure that any incremental investment that we make will be value create.

Michael Baker - Deutsche Bank

One more just on leverage and where you are right now, I think you are just under your benchmark of 2.0 times. Earlier in the year, you talked about potentially taking on more leverage. I think you had said it in December if memory serves or later in the year. Where do you stand right now with your outlook on debt?

Carol Tomé

Our adjusted debt to EBITDA ratio stands at 1.7 times against cap, if you will, at two times. That gives us about $3.4 billion of borrowing capacity as we stand today. We do have $1 billion in a quarter that comes due in December, and so we will take a look at whether or not we want to raise incremental financing at that time.

Michael Baker - Deutsche Bank

Above and beyond what's due?

Carol Tomé

Yes.

Diane Dayhoff - Vice President, Investor Relations

Well, thank you to everyone who has joined us today. We look forward to talking to your next quarter.

Operator

That does conclude today's conference. We appreciate your participation. You may now disconnect.