

# Home Depot (HD)

FORECAST INCREASE

## Raising Estimates, Following Stronger Q2

Rating	<b>OUTPERFORM</b>
Price (14-Aug-18, US\$)	193.10
Target price (US\$)	222.00
52-week price range (US\$)	207.23 - 147.49
Market cap(US\$ m)	222,749
Enterprise value (US\$ m)	242,814

Target price is for 12 months.

### Research Analysts

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- **Raising estimates for 2018 following stronger Q2** results and higher buybacks now expected; 2018 EPS goes to \$9.67 vs. \$9.44 previously, largely flowing through the stronger Q2. 2019 goes to \$10.57 vs. \$10.41 previously. We see steady top line trends into 2H, with potential upside from pricing, Pro initiatives, and a stronger consumer backdrop, along with potential upside from tax and buybacks. Partial offsets may continue to be housing turnover, lapping the hurricane, and freight/fuel which continue to see accelerate.
- **Macro view remains supportive;** Consistent with our recent housing work ([Housing, Without the Turnover?](#)), HD management noted the positives of home prices, aging homes and the consumer, helping offset the impact from lower housing turnover. We would continue monitor the effects that lower turnover can have on home prices and demand. But, for 2018, looking at current GDP + housing drivers would point to HD's 5.3% guidance with potential upside from market share and pricing.
- **Comps cadence balanced in Q2;** Comps of 8.0% included better transactions +2.9% (vs -1.5% in Q1) and ticket +4.9% (vs 5.8% in Q1), +1.2% from inflation and an acceleration in online contribution. Adj. for the hurricane and seasonal shifts, comps accelerated from Q1 on a one, two and three year basis. Pro comps were up double digits, and now represent 45% of total sales, while DIY comps were also solid, supported by seasonal demand.
- **Underlying trend healthy;** 8% comps include 2% from recovered seasonal sales, 1% from hurricane sales, implying a base of 5%. Minus ~1% from inflation points to a core comp of ~4%, similar to Q1, but a better two year stack. Applying that two year trend to Q3, and adding the various puts and takes points to comps of ~6% (depending on the contribution from inflation). 2H guidance implies 4.3% (vs prior consensus +4.9%).

### Share price performance



On 14-Aug-2018 the S&P 500 INDEX closed at 2839.96  
Daily Aug14, 2017 - Aug14, 2018, 08/14/17 = US\$154.26

Quarterly EPS	Q1	Q2	Q3	Q4
2018A	1.67	2.25	1.84	1.69
2019E	2.08	3.05	2.31	2.23
2020E	-	-	-	-

### Financial and valuation metrics

Year	1/17A	1/18A	1/19E	1/20E
EPS (CS adj.) (US\$)	6.45	7.46	9.67	10.57
Prev. EPS (US\$)	-	-	9.44	10.41
P/E rel. (%)	-	119.0	112.3	113.1
Revenue (US\$ m)	94,595.0	101,070.0	108,307.9	112,271.3
EBITDA (US\$ m)	15,181.0	16,600.1	17,792.2	19,254.5
OCFPS (US\$)	7.93	10.17	12.44	12.20
P/OCF (x)	17.4	20.4	15.5	15.8
EV/EBITDA (current)	16.1	14.8	13.6	12.5
Net debt (US\$ m)	21,063	22,308	20,065	18,696
ROIC (%)	33.68	39.79	50.49	52.30
Number of shares (m)	1,153.54	-	IC (current, US\$ m)	23,762.00
BV/share (Next Qtr., US\$)	-	-	EV/IC (x)	-
Net debt (Next Qtr., US\$ m)	-	-	Dividend (current, US\$)	-
Net debt/tot eq (Next Qtr.,%)	-	-	-	-

Source: Company data, Thomson Reuters, Credit Suisse estimates

**DISCLOSURE APPENDIX AT THE BACK OF THIS REPORT CONTAINS IMPORTANT DISCLOSURES, ANALYST CERTIFICATIONS, LEGAL ENTITY DISCLOSURE AND THE STATUS OF NON-US ANALYSTS.** US Disclosure: Credit Suisse does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the Firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision.

- **Expectations for Q3;** We model total comps of 4.3%, US comps of 4.4%, consistent with prior consensus expectations. FX may be a modest negative in Q3. We see upside into the ~6% range for total comps; that's based on similar base business trends as in Q2, plus \$100mn from hurricane sales, 40 bps from the remaining missed Q1 garden sales, some inflation and a slightly negative FX impact.

**Figure 1: Comps bridge for Q3 would suggest ~6%**

Solving for Base Line Comps in Q2...		Building Up Q3 Comps...	
<b>Total Comp</b>	<b>8.0</b>	<b>Base Comp (assuming same 2 yr stack as Q2 base)</b>	<b>4.4</b>
- Hurricane	1.0	+ Hurricane	0.4
- Garden impact	2.0	+ Remaining Garden Demand	0.4
- Inflation	1.2	+ Inflation	1.0
- FX	0.0	+ FX	-0.1
<b>Base Comp for Q2</b>	<b>3.8</b>	<b>Potential Total Comps in Q3</b>	<b>6.1</b>

Source: Company data, Credit Suisse estimates

- **Inflation helped in Q2, but company indicated that could moderate a bit;** The commodity inflation impact on comps was +119 bps vs. +111 bps in Q1. Management indicated that could moderate in 2H. It also is not seeing significant price increases overall, although it is seeing an increase in the number of requests for increases. Net/net our bias would be to the upside for inflation moving into 2H, particularly with tariffs ahead.
- **Addressing potential tariff pressures,** management currently see any pressures as very manageable, with a low-single digit penetration of COGS impacts by recently announced tariffs. Given the large portfolio of categories, HD expects to pass through any pricing pressures that materialize.
- **Digital accelerates;** Sales +26%, accelerating from Q1 and represents the strongest growth since 2015. That was partly helped by seasonal, and contributed 170 bps to comps, the strongest we have seen. 47% of online sales continue to be picked up in store, showing the interconnected nature of the online business. .
- **Category trends include double digit comps** in lumber, indoor and outdoor garden and electrical, driven by inflation, seasonal strength and strong Pro comps. Appliances were above company average, but below the double digits last quarter, which coincide with management commentary on some unit growth impact in select categories impacted by tariffs earlier this year.
- **Margin trends relatively consistent, though slightly higher freight.** Q2 GM was -12 bps (on prior years restated numbers), in line with market expectations and the -10 bps in Q1. The company did lower its GM guidance slightly (from flat to down 4 bps) due to freight, as most companies have discussed. OPEX growth factor was lowered ~103% to 97% (on restated numbers), largely due to the higher sales growth now implied in guidance, with SG&A dollars similar.

**Details of the quarter**

- Q2 EPS came in at \$3.05 vs. CS at \$2.86 and consensus at \$2.84 and up 35.8% y/y, driven by stronger comps and EBIT dollar growth of 9.8% vs CS at 5.8%, consensus at 5.2%. EPS includes a \$0.06 benefit from a lower than consensus tax rate and share count, along with a further \$0.01 benefit from a lower net interest expense. Adjusted for that EPS would have been \$2.98, still above consensus. Comps were better, EBIT dollars ahead by \$206mn, and OPEX dollars lower by \$60mn.
- Comps were stronger; total comps +8.0% and US comps +8.1% (vs. Street estimates of 6.7% for total and 6.6% for US), with US comps showing a sequential acceleration

from Q1 on a one, two and three year basis. Comps were supported by a stronger transaction number, up 2.9% vs -1.5% in Q1, while ticket remained high up 4.9% vs 5.8% in Q1.

- Gross margin (on prior year's restated numbers) was -12 bps vs CS estimates for -24 bps, consensus at -11 bps. Gross margin was impacted by higher transportation costs (16 bps), offsetting 6 bps from mix and recently acquired companies. Full year guidance calls for GM down 4 bps, with weaker trends in Q3 relative to Q4 due to the extra week.
- SG&A (on prior year's restated numbers) leveraged 35 bps vs CS estimates for 5 bps leverage, and consensus estimates for 11 bps deleverage. OPEX dollars were lower than embedded in consensus, up 6.2% y/y and the growth factor of 75% was well below consensus' 110% and 1Q18s 140%. Full year guidance calls for 97%.
- SG&A leverage was driven by BAU leverage of 90 bps, offset by 58 bps of pressure from strategic investments.
- EBIT margin was +23 bps vs. CS estimates for -19 bps and consensus at -22 bps. EBIT dollar growth of +9.8% was well ahead of expectations.
- Guidance is raised, and now implies 2H comps of 4.3% (vs consensus total comps of 5.0%, US comps of 4.7%). Lapping \$662mn (135 bps) hurricane related sales in 2H implies core underlying sales growth of 5.7% implied for 2H.

Figure 2: HD Income Statement

## THE HOME DEPOT, INC. QUARTERLY INCOME STATEMENT ANALYSIS

FY ends Jan., dollars in tho

	FY 15A	FY 16A	Q1 17R	Q2 17R	Q3 17R	Q4 17R	FY 17R	Q1 18A	Q2 18A	Q3 18E	Q4 18E	FY 18E	FY 19E
Net Sales	88,519,000	94,595,000	23,935,000	28,141,000	25,070,000	23,924,000	101,070,000	24,947,000	30,463,000	26,190,278	26,707,631	108,307,908	112,271,299
Cost of Merchandise Sold	58,254,000	62,282,000	15,643,000	18,533,000	16,293,000	15,705,000	66,174,000	16,330,000	20,098,000	17,049,871	17,546,913	71,024,784	73,706,108
Gross Profit	30,265,000	32,313,000	8,292,000	9,608,000	8,777,000	8,219,000	34,896,000	8,617,000	10,365,000	9,140,407	9,160,717	37,283,124	38,565,191
SG&A Expense	16,680,000	17,132,000	4,499,000	4,696,000	4,643,000	4,457,880	18,295,880	4,779,000	5,004,000	4,798,096	4,909,799	19,490,895	19,310,663
D&A	1,690,000	1,754,000	444,000	449,000	454,000	464,000	1,811,000	457,000	460,000	519,645	564,280	2,000,925	2,301,562
Total Expenses (SG&A & D&A)	18,370,000	18,886,000	4,943,000	5,145,000	5,097,000	4,921,880	20,106,880	5,236,000	5,464,000	5,317,741	5,474,079	21,491,820	21,612,225
Total Operating Income	11,895,000	13,427,000	3,349,000	4,463,000	3,680,000	3,297,120	14,789,120	3,381,000	4,901,000	3,822,666	3,686,638	15,791,304	16,952,966
EBITDA	13,585,000	15,181,000	3,793,000	4,912,000	4,134,000	3,761,120	16,600,120	3,838,000	5,361,000	4,342,310	4,250,918	17,792,229	19,254,528
Net Interest Income (Exp.)	-897,000	-936,000	-241,000	-249,000	-247,000	-246,000	-983,000	-239,000	-246,000	-271,975	-271,975	-1,028,950	-1,059,819
Pretax Income	10,998,000	12,491,000	3,108,000	4,214,000	3,433,000	3,051,120	13,806,120	3,142,000	4,655,000	3,550,691	3,414,663	14,762,354	15,893,148
Income Taxes	4,074,294	4,534,000	1,094,000	1,542,000	1,268,000	1,075,097	4,979,097	738,000	1,149,000	923,180	887,812	3,697,992	4,132,218
Net Income from Cont Ops	6,923,706	7,957,000	2,014,000	2,672,000	2,165,000	1,976,023	8,827,023	2,404,000	3,506,000	2,627,511	2,526,851	11,064,362	11,760,929
EPS from Cont Ops	\$5.40	\$6.45	\$1.67	\$2.25	\$1.84	\$1.69	\$7.46	\$2.08	\$3.05	\$2.31	\$2.23	\$9.67	\$10.57
Weighted Average Shares (m)	1,283	1,234	1,204	1,189	1,174	1,167	1,184	1,158	1,149	1,139	1,132	1,145	1,113
<b>Ratios as a % of Sales</b>													
Gross Margin	34.2%	34.2%	34.6%	34.1%	35.0%	34.4%	34.5%	34.5%	34.0%	34.9%	34.3%	34.4%	34.4%
SG&A	18.8%	18.1%	18.8%	16.7%	18.5%	18.6%	18.1%	19.2%	16.4%	18.3%	18.4%	18.0%	17.2%
D&A	1.9%	1.9%	1.9%	1.6%	1.8%	1.9%	1.8%	1.8%	1.5%	2.0%	2.1%	1.8%	2.1%
Total Expenses (SG&A & D&A)	20.8%	20.0%	20.7%	18.3%	20.3%	20.6%	19.9%	21.0%	17.9%	20.3%	20.5%	19.8%	19.3%
Operating Margin	13.4%	14.2%	14.0%	15.9%	14.7%	13.8%	14.6%	13.6%	16.1%	14.6%	13.8%	14.6%	15.1%
Pretax Margin	12.4%	13.2%	13.0%	15.0%	13.7%	12.8%	13.7%	12.6%	15.3%	13.6%	12.8%	13.6%	14.2%
Tax Rate	37.0%	36.3%	35.2%	36.6%	36.9%	35.2%	36.1%	23.5%	24.7%	26.0%	26.0%	25.1%	26.0%
Net Margin	7.8%	8.4%	8.4%	9.5%	8.6%	8.3%	8.7%	9.6%	11.5%	10.0%	9.5%	10.2%	10.5%
<b>Y/o/Y % Change</b>													
Comp Store Sales	5.6%	5.6%	5.5%	6.3%	7.9%	7.5%	6.8%	4.2%	8.0%	4.3%	4.8%	5.4%	5.0%
Two Year Stack	10.9%	11.2%	12.0%	11.0%	13.4%	13.3%	12.4%	9.7%	14.3%	12.2%	12.3%	12.2%	10.4%
Sales Increase	6.4%	6.9%	5.2%	6.3%	8.3%	7.7%	6.8%	4.2%	8.3%	4.5%	11.6%	7.2%	3.7%
Dep'n Increase	2.4%	3.8%	2.5%	3.0%	2.7%	4.7%	3.2%	2.9%	2.4%	14.5%	21.6%	10.5%	15.0%
Total SG&A & Dep'n Increase	2.5%	2.8%	4.9%	6.7%	7.9%	6.4%	6.5%	5.9%	6.2%	4.3%	11.2%	6.9%	0.6%
Total Op. Income Increase	14.3%	13.9%	8.8%	8.8%	10.8%	12.6%	10.1%	1.0%	9.8%	3.9%	11.8%	6.8%	7.9%
Net Income Increase	9.1%	14.9%	11.7%	9.5%	10.0%	13.3%	10.9%	19.4%	31.2%	21.4%	27.9%	25.3%	6.3%
EPS from Cont Ops Increase	14.2%	19.5%	16.2%	14.2%	15.1%	17.6%	15.7%	24.1%	35.8%	25.1%	31.8%	29.6%	9.3%
<b>Y/Y Change (BPS)</b>													
Total Gross Margin	6	(3)	42	42	28	34	37	(10)	(12)	(11)	(5)	(10)	(7)
Total SG&A	(72)	(73)	11	4	(20)	(1)	(1)	36	(26)	(20)	(25)	(11)	(80)
Total D&A	(7)	(5)	(5)	(5)	(10)	(6)	(6)	(2)	(9)	17	17	6	20
Total Expenses (SG&A & D&A)	(79)	(79)	(6)	6	(6)	(26)	(7)	34	(35)	(3)	(8)	(5)	(59)
Total Operating Margin	85	76	47	36	34	60	44	(44)	23	(8)	2	(5)	52
Pretax Margin	43	78	51	34	37	63	46	(39)	31	(14)	3	(3)	53
Tax Rate	65	(75)	(131)	(41)	78	2	(23)	(1,171)	(1,191)	(1,094)	(924)	(1,101)	95
Net Margin	19	59	49	27	13	41	32	122	201	140	120	148	26

Source: Company data, Credit Suisse estimates

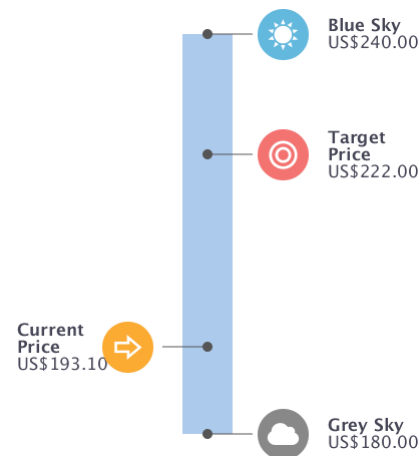
# Home Depot (HD)

Price (14 Aug 2018): **US\$193.1**; Rating: **OUTPERFORM**; Target Price: **222.00**; Analyst: **Seth Sigman**

Income Statement	1/17A	1/18A	1/19E	1/20E
Revenue (US\$ m)	94,595.0	101,070.0	108,307.9	112,271.3
EBITDA (US\$ m)	15,181	16,600	17,792	19,255
Depr. & amort.	(1,754)	(1,811)	(2,001)	(2,302)
EBIT (US\$)	13,427	14,789	15,791	16,953
Net interest exp	(936)	(983)	(1,029)	(1,060)
PBT (US\$)	12,491	13,806	14,762	15,893
Income taxes	(4,534)	(4,979)	(3,698)	(4,132)
Profit after tax	7,957	8,827	11,064	11,761
Other NPAT adjustments	0	0	0	0
Cash Flow	1/17A	1/18A	1/19E	1/20E
Cash flow from operations	9,783	12,031	14,237	13,583
CAPEX	(1,621)	(1,897)	(2,500)	(2,000)
Free cashflow to the firm	8,162	10,134	11,737	11,583
Cash flow from investments	(1,583)	(2,228)	(2,500)	(2,000)
Net share issue/(repurchase)	(6,662)	(7,745)	(5,045)	(3,745)
Dividends paid	(3,404)	(4,212)	(6,085)	(6,469)
Changes in Net Cash/Debt	(1,963)	(1,245)	2,243	1,370
Balance Sheet (US\$)	1/17A	1/18A	1/19E	1/20E
Cash & cash equivalents	2,538	3,595	7,500	11,317
Account receivables	2,029	1,952	1,987	2,159
Other current assets	608	638	325	337
Total fixed assets	21,914	22,075	22,574	22,273
Investment securities	0	0	0	0
Total assets	42,966	44,529	49,185	53,514
Total current liabilities	14,133	16,194	15,632	15,593
Shareholder equity	4,333	1,454	3,374	5,293
Total liabilities and equity	42,966	44,529	49,185	53,514
Net debt	21,063	22,308	20,065	18,696
Per share	1/17A	1/18A	1/19E	1/20E
No. of shares (wtd avg)	1,234	1,184	1,145	1,113
CS adj. EPS	6.45	7.46	9.67	10.57
Prev. EPS (US\$)	-	-	9.44	10.41
Dividend (US\$)	0.00	0.00	0.00	0.00
Free cash flow per share	6.61	8.56	10.26	10.41
Earnings	1/17A	1/18A	1/19E	1/20E
Sales growth (%)	6.9	6.8	7.2	3.7
EBIT growth (%)	12.9	10.1	6.8	7.4
Net profit growth (%)	14.9	10.9	25.3	6.3
EPS growth (%)	19.5	15.7	29.6	9.3
EBITDA margin (%)	16.0	16.4	16.4	17.2
EBIT margin (%)	14.2	14.6	14.6	15.1
Pretax margin (%)	13.2	13.7	13.6	14.2
Net margin (%)	8.4	8.7	10.2	10.5
Valuation	1/17A	1/18A	1/19E	1/20E
EV/EBITDA (x)	16.1	14.8	13.6	12.5
P/E (x)	29.9	25.9	20.0	18.3
Returns	1/17A	1/18A	1/19E	1/20E
ROIC (%)	33.7	39.8	50.5	52.3
Gearing	1/17A	1/18A	1/19E	1/20E
Net debt/equity (%)	486.1	1534.3	594.7	353.2
Quarterly EPS	Q1	Q2	Q3	Q4
2018A	1.67	2.25	1.84	1.69
2019E	2.08	3.05	2.31	2.23
2020E	-	-	-	-

**Company Background**  
The Home Depot, Inc. is a home improvement retailer. The Home Depot stores sell an assortment of building materials, home improvement and lawn and garden products and provide a number of services.

## Blue/Grey Sky Scenario



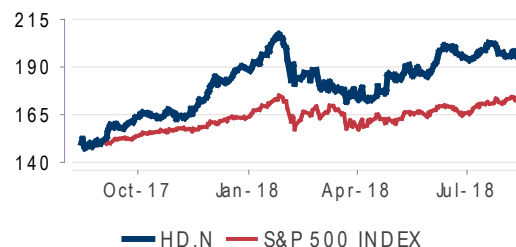
### Our Blue Sky Scenario (US\$) 240.00

Assuming market share gains, and macro support could point to comps in the 6-7% range, coupled with the related fixed cost leverage could point to EPS of \$9.80 in FY18, applying a 24.5x multiple to that points to a \$240 share price.

### Our Grey Sky Scenario (US\$) 180.00

Assuming a step-up in competition, and waning macro support, coupled with a step-up in investment related margin pressure could point to an EPS in the \$9.00 range, applying a lower 20x multiple points to a share price of \$180.

## Share price performance



On 14-Aug-2018 the S&P 500 INDEX closed at 2839.96  
Daily Aug14, 2017 - Aug14, 2018, 08/14/17 = US\$154.26

Source: Company data, Thomson Reuters, Credit Suisse estimates

**Companies Mentioned** (Price as of 14-Aug-2018)  
**Home Depot** (HD.N, \$193.1, OUTPERFORM, TP \$222.0)

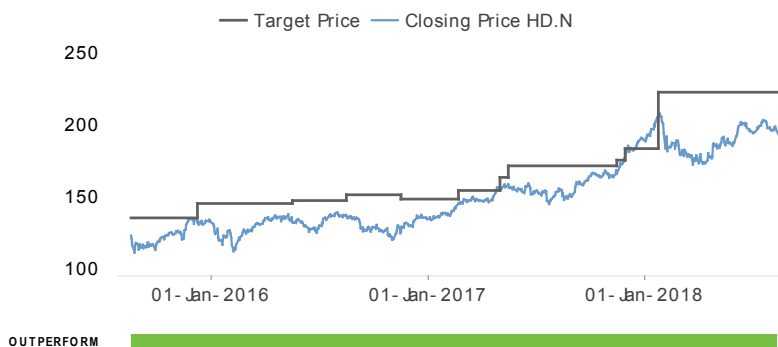
## Disclosure Appendix

### Analyst Certification

I, Seth Sigman, certify that (1) the views expressed in this report accurately reflect my personal views about all of the subject companies and securities and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

### 3-Year Price and Rating History for Home Depot (HD.N)

HD.N	Closing Price	Target Price	
Date	(US\$)	(US\$)	Rating
19-Aug-15	122.76	135.00	O
09-Dec-15	131.90	145.00	
17-May-16	132.00	147.00	
16-Aug-16	136.23	151.00	
16-Nov-16	125.33	148.00	
21-Feb-17	145.02	154.00	
02-May-17	154.95	163.00	
16-May-17	158.26	171.00	
15-Nov-17	165.47	175.00	
29-Nov-17	177.25	183.00	
24-Jan-18	206.22	222.00	



\* Asterisk signifies initiation or assumption of coverage.

### As of December 10, 2012 Analysts' stock rating are defined as follows:

**Outperform (O)** : The stock's total return is expected to outperform the relevant benchmark\* over the next 12 months.

**Neutral (N)** : The stock's total return is expected to be in line with the relevant benchmark\* over the next 12 months.

**Underperform (U)** : The stock's total return is expected to underperform the relevant benchmark\* over the next 12 months.

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Restricted	2%	

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### Target Price and Rating

#### Valuation Methodology and Risks: (12 months) for Home Depot (HD.N)

**Method:** Our Outperform rating and \$222 target price for HD is based on a 23.5x price-to-earnings multiple on our 2018 EPS estimate. This multiple reflects a 20% premium to the market, in line with the long-term average, and recognizing HD's position as a high quality company within a strong sector.

**Risk:** Risks to HD's \$222 target price and Outperform rating are weakness in housing market, faster than appreciated interest rate increases, and general consumer confidence levels weakening. Investing in retail stocks entails certain risks: changes in consumer spending and its components, retail industry competition, and general market risk.

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