Company Overview:

The Home Depot ("HD") is the world's largest home improvement retailer. The Home Depot stores sell a wide assortment of building materials, home improvement products, and lawn & garden products and provide a number of associated customer services.

Name	Ticker	Compounder Score
Home Depot, Inc.	HD	10

Last Twelve Months Highlights:

The Home Depot saw a smaller growth in earnings over the LTM which was nearly all due to the infrastructure investments program launched in 2018 being slower to pay off than management expected. The spending program is set to go through 2020 and deliver technology and store facelifts making for more welcoming customer environment both online and in store. Sales continue to see high single digit growth along with mid digit EBITDA and EBIT growth and stable margins. The dividend was increased by ~15% while HD bought back shares. One thing that remains impressive is the sales per retail square foot which has been increasing the last six years at a mid-single digit clip. This is impressive and shows increased efficiency.

Bull Case:

- ***Strong US Consumer & An Aging Housing Supply:*** Record low unemployment, improving wage growth, and 50% of US homes are older than 40 years of age all bode well for HD. The low interest rate environment and a strong housing sector stimulates home buying/ selling activity which directly benefits sales. Looser credit gives consumers more ability to do bigger scale projects. This has resulted in a continual Increase in Sales per Square foot, increased customer productivity.
- ***History of Excellent Capital Allocation:*** The company has raised their dividend an average of 21.5% per year over the past five years on top of increasing their dividend every year for the past 10 years (current yield 2.46%). Dividend payout ratio bumped from 50 to 55%. Strong buyback strategy: HD has reduced its outstanding share count by roughly 17% over the past five years. $3.9bn bought back in the first 9 months of '19. Total Debt ~$26bn but well utilized capital in our opinion with interest rates near historic lows.
- ***Infrastructure Spending and Commitment to Growing the Business with a Long-Term Outlook:*** $11bn investment from 2018-2020. Improve stores and customer experience, delivered sales and probably most importantly the PRO customers (digital) and modernize the IT infrastructure. Investments in tech, machine learning and AI as well as data scientist we believe will continue to increase efficiency in stores, inventory management, distribution logistics. 50% online orders picked up in store, investment in automated lockers now at 1,300 stores has been very popular with customers. These lockers get customers in the store to potentially buy more things on top of saving shipping costs. Grown online sales by ~$1bn in each of the last 6 years.

Bear Case:

- ***Leverage has increased and does increase the company's interest rate risk:*** *Roughly $*1.75bn in debt is rolling off in 2020 which is likely to be refinanced. Any uptick in interest rates would increase interest expense and depending on the severity could jeopardize HD's "A" S&P credit rating.
- ***Infrastructure Spending & IT Upgrades:*** The unwinding legacy IT systems, with the new investment in IT infrastructure has been more difficult than expected. An inability to convert spending projects into earnings and namely FCF would be very negative for HD. Continual need for technology updates requires excellent management execution. This can be seen the decreasing Operating and Gross Margins throughout 2019.
- ***Impact of Commodity pricing on COGS/ margins:*** The uncontrollable commodity pricing can negatively impact HDs pricing power and general customer demand. Changing commodity prices directly impacts earnings and margins.
- ***Live or die with the Housing Sector and Consumer:*** Any downturn in the housing market, slip in consumer sentiment or employment will impact ability of customers to renovate or take on improvement projects.

Overall Thesis:

We believe HD remains a strong story in the retail sector given company-specific sales and margin initiatives, the duopoly/AMZN-resistant nature of the industry, and significant financial and operating leverage that amplifies EPS growth in better sales environments. With internal momentum building, we expect HD to benefit from its refocused branding and value proposition, which has driven favorable traffic and ticket trends at the retailer. In addition, internal initiatives enable HD to gain share vs. its competitors. These efforts should yield accelerating incremental margins, good cash flow, and EBITDA growth that will necessitate more leverage (thus buybacks and dividends). HD has a proven track record of a deep focus on the culture with a strong customer/ employee experience while also historically proving strong shareholder returns. In our opinion HD makes a relatively boring business innovative and fun by engaging the customer whether it be in the store or its growing online business.

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