Home Depot (HD)

Updated May 10th, 2018 by Josh Arnold

Key Metrics

Current Price:	$186	**5 Year CAGR Estimate:**	10.6%	**Quality Percentile:**	N/A
Fair Value Price:	$172	**5 Year Growth Estimate:**	10.0%	**Momentum Percentile:**	N/A
% Fair Value:	108%	**5 Year Valuation Multiple Estimate:**	-1.6%	**Total Return Percentile:**	N/A
Dividend Yield:	2.2%	**5 Year Price Target**	$277	**Valuation Percentile:**	N/A

Overview & Current Events

Home Depot was founded in 1978 and since that time has grown into a juggernaut retailer with almost 2,300 stores in the US, Canada and Mexico that generate over $100 B in annual revenue. The stock has a market value of $215 B, making it one of the larger companies by market capitalization in the US.

The company's recent Q4 report showed another year of record revenue and earnings. HD's past several years have all seen sizeable increases in comparable store sales, including Q4's 7.5% gain, exceeding market expectations time and again. Higher operating expenses led to slightly lower operating margins, but HD's earnings momentum remains intact. HD guided for another strong year in 2018 on productivity improvements and further gains in comparable store sales.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$1.78	$1.66	$2.03	$2.47	$3.10	$3.76	$4.56	$5.34	$6.45	$7.46	***$9.50***	***$15.30***
DPS	$0.90	$0.90	$0.95	$1.04	$1.16	$1.56	$1.88	$2.36	$2.76	$3.56	***$4.12***	***$6.00***

HD's earnings momentum has been enormous in the past decade as it has been able to fully capitalize on the housing and construction boom that ensued following the Great Recession. A strong, continuous tailwind from new construction as well as homeowners continuing to spend on improvements for existing housing have fueled HD's meteoric rise. With interest rates rising and home prices at or near pre-crisis peaks, these tailwinds should remain intact as it becomes ever more expensive for homeowners to move. We therefore see five-year annual earnings growth of 10%, consisting of a minimal amount of new stores, comp sales in the mid-single digits, a low single digit tailwind from buybacks and a steady, low single digit tailwind from operating margin improvements, per management guidance. HD's EPS growth catalysts are still intact and we see a continuation of its very strong performance in the years to come.

In addition, the company's recent strength of double digit dividend growth should continue as we see the payout rising slightly slower than EPS, reaching $6 per share in five years. HD isn't an income stock with its low 2% yield, but dividend growth investors should delight in its payout growth prospects. Further, as HD matures it may institute a higher payout ratio target for the dividend, further boosting its dividend growth prospects, but that is not our base case.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	14.3	15.3	15.6	15.0	17.9	20.2	19.1	22.1	20.3	21.6	***19.6***	***18.1***
Avg. Yld.	3.5%	3.5%	3.0%	2.8%	2.1%	2.1%	2.2%	2.0%	2.1%	2.2%	***2.2%***	***2.2%***

HD's P/E multiple has moved up substantially in recent years as its earnings growth rates have moved much higher. Indeed, its 10-year P/E multiple average of 18.1 is much lower than it has been in the past five years as investors have bid up the shares on improved, sustained growth. We see the valuation drifting back towards the historical average over time, meaning a small 1.6% headwind to total returns as a result. HD's sheer size means its growth will need to slow at some point but as of now, that looks to be some time in the future as it is not imminent.

The yield should remain in the low-2% range despite strong dividend growth as the stock will continue to move up on higher EPS. HD will therefore continue to represent a strong dividend growth stock, but it will not have an income stock yield until EPS growth slows down. Certainly, investors will not mind this as it means a rising share price.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	36.5%	36.4%	33.0%	33.1%	32.5%	32.8%	32.4%	32.1%	32.0%	32.0%	***32.0%***	***32.0%***
Debt/A	60%	57%	53%	53%	56%	57%	69%	77%	85%	90%	***90%***	***85%***
Int. Cov.	11.8	7.0	7.1	11.3	11.3	12.8	13.1	21.9	15.9	14.4	***16.0***	***18.0***
Payout	51%	54%	47%	42%	37%	42%	41%	44%	43%	48%	***43%***	***39%***
Std. Dev.	43.6%	37.1%	26.2%	23.1%	15.6%	14.3%	16.6%	13.0%	18.5%	13.5%	***18.0%***	***22.1%***

HD's quality metrics have been a mixed bag in the past decade as margins have steadily but slowly moved lower, debt has increased, interest coverage has moved higher and the payout ratio has drifted downward. HD's gross margins remain around 32% and we don't expect that will change as it continues to offer its enormous assortment of products at competitive prices. HD's SKU assortment is so vast that margin movement one way or the other is difficult but given its operating leverage from higher comp sales, this is more than acceptable. Debt has increased of late to fund share repurchases but given that HD is at 90% of assets funded by debt, we expect this will slow somewhat. Interest coverage and payout ratios are both safe and will not be issues anytime soon.

HD's competitive advantage is in its enormous footprint, strong brand recognition and huge assortment. Supplanting HD's dominant position in home improvement will be all extremely difficult for all comers, including rival Lowe's. HD will suffer during a recession but any weakness would be a buying opportunity, as it was during the Great Recession.

Final Thoughts & Recommendation

Home Depot looks like a decent value here but the real appeal is in its EPS and dividend growth outlooks. We expect total annual returns of 10.6% going forward, consisting of the current 2.2% yield, a 1.6% headwind from the valuation heading back to more normalized levels and 10% EPS growth. HD's fundamentals and growth catalysts are intact; the stock is certainly a long-term hold at current prices. HD will be a strong buy when it trades at or preferably)below fair value.

Total Return Breakdown by Year