



# Home Depot (HD)

Updated February 27<sup>th</sup>, 2019 by Josh Arnold

## Key Metrics

<b>Current Price:</b>	\$187	<b>5 Year CAGR Estimate:</b>	10.2%	<b>Volatility Percentile:</b>	23.6%
<b>Fair Value Price:</b>	\$181	<b>5 Year Growth Estimate:</b>	8.0%	<b>Momentum Percentile:</b>	47.8%
<b>% Fair Value:</b>	104%	<b>5 Year Valuation Multiple Estimate:</b>	-0.7%	<b>Growth Percentile:</b>	75.0%
<b>Dividend Yield:</b>	2.9%	<b>5 Year Price Target</b>	\$265	<b>Valuation Percentile:</b>	45.4%
<b>Dividend Risk Score:</b>	C	<b>Retirement Suitability Score:</b>	C	<b>Total Return Percentile:</b>	61.6%

## Overview & Current Events

Home Depot was founded in 1978 and since that time has grown into a juggernaut home improvement retailer with almost 2,300 stores in the US, Canada and Mexico that generate around \$108 billion in annual revenue. The stock has a market value of \$213 billion, making it one of the larger companies by market capitalization in the US.

Home Depot reported Q4 earnings on 2/26/19 and results were very strong, but guidance was a bit soft for the market. Total sales were up 10.9% from the comparable period last year thanks in part to a 3.2% comparable sales gain overall, which included a 3.7% gain in the US. Home Depot has, for many years, produced strong comparable sales gains in the US and abroad, and Q4 certainly continued this trend. In addition, 2018's Q4 included an additional operating week due to a calendar shift, which is not included in the comparable sales number. It did, however, help drive total sales much higher during the quarter. Regardless, the bottom line is that Home Depot's revenue strength continued in Q4.

Gross margins as a percentage of revenue rose slightly in Q4, rising at a pace of 11.5% against a 10.9% increase in revenue. Home Depot's gross margins typically don't move much in either direction, but Q4 was a relative bright spot. Operating expenses, however, rose more quickly than revenue, meaning operating profits rose only 5.9% against the 10.9% gain in revenue.

A much lower tax rate against 2017 and a share count that was ~4% lower helped drive earnings-per-share 37% higher in Q4 year-over-year to \$2.10, capping a full-year growth number of 33.5%.

Home Depot announced a new \$15 billion share repurchase authorization and stated it expected to buy back \$5 billion of stock in 2019, good for around 2.5% of the float. In addition, it boosted the dividend by a staggering 32% to \$5.44 annually, significantly boosting the stock's current yield to nearly 3%.

Management provided detailed guidance for 2019, including 5% comparable sales growth, 3.3% total sales growth, and diluted earnings-per-share of \$10.03, representing growth of just 3% against 2018. Keep in mind the company's tax rate is expected to rise ~2% against 2018 and that the calendar for 2019 contains the standard 52 weeks against the 53 weeks from 2018. In other words, while the headline growth number looks low, it isn't when these factors are adjusted out. We believe the company's long-term growth is well intact.

## Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
<b>EPS</b>	\$1.66	\$2.03	\$2.47	\$3.10	\$3.76	\$4.56	\$5.34	\$6.45	\$7.46	\$9.73	<b>\$10.03</b>	<b>\$14.74</b>
<b>DPS</b>	\$0.90	\$0.95	\$1.04	\$1.16	\$1.56	\$1.88	\$2.36	\$2.76	\$3.56	\$4.12	<b>\$5.44</b>	<b>\$8.00</b>
<b>Shares</b>	1,698	1,623	1,537	1,484	1,380	1,307	1,252	1,203	1,158	1,121	<b>1,100</b>	<b>1,000</b>

Home Depot'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. We see five-year annual earnings growth of 8%, consisting of 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. This is down from our prior estimate of 10% growth simply due to the lateness of the cycle Home Depot is in today; 10% annual growth looks difficult to maintain given where its margins are today in the mid-teens as well as its very high rate of comparable sales growth over the years.

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In addition, the company's streak of meaningful dividend growth should continue as we see the payout rising at the rate of earnings, reaching \$8 per share in five years. Home Depot's recent increase has turned it into an income stock with a nearly-3% yield and it has plenty of room to continue raising the payout in the years to come. Further, as it matures it may institute a higher payout ratio target for the dividend, further boosting its dividend growth prospects.

## Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	15.3	15.6	15.0	17.9	20.2	19.1	22.1	20.3	21.6	19.4	18.6	18.0
Avg. Yld.	3.5%	3.0%	2.8%	2.1%	2.1%	2.2%	2.0%	2.1%	2.2%	2.2%	2.9%	3.0%

Shares have moved slightly higher since our last report, but the stock is still near fair value. Indeed, shares trade for 18.6 times our earnings estimate for this year, which is almost exactly where we see fair value at 18 times earnings. Thus, a very small impact on total returns is now forecast after our previous reports showed Home Depot as overvalued. The yield should remain about where it is in the years to come given that earnings and the dividend should expand at roughly congruent rates.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	54%	47%	42%	37%	42%	41%	44%	43%	48%	42%	54%	54%

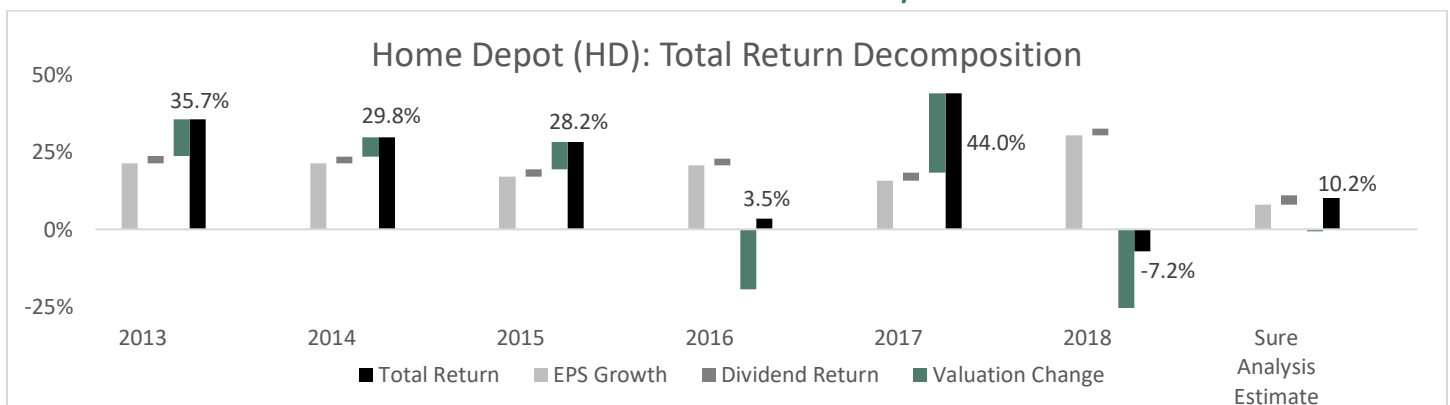
Home Depot's payout ratio is just over half of earnings and we expect it will stay there for the foreseeable future. That means the dividend is not only safe, but it has lots of room to grow in the future as well as earnings expand.

Home Depot's competitive advantage is in its enormous footprint, strong brand recognition and inventory variety. Supplanting its dominant position in home improvement will be extremely difficult for all comers, including rival Lowe's. The company is likely to suffer during a recession, but weakness would be a buying opportunity for long-term investors.

## Final Thoughts & Recommendation

Home Depot looks fairly valued and we continue to like the stock. In addition, it still has appeal is in its earnings and dividend growth outlooks. We expect total annual returns of 10.2% going forward, consisting of the current 2.9% yield, a 0.7% headwind from the valuation and 8% earnings-per-share growth. Home Depot's fundamentals and growth catalysts are intact, and we rate the shares a buy given that they are still trading near fair value, as well as the new, higher yield. Home Depot offers investors the chance to own a stock that is dominant in its industry with terrific earnings and dividend growth outlooks for a reasonable price.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Revenue (\$B)</b>	66.18	68.00	70.40	74.75	78.81	83.18	88.52	94.60	100.90	108.20
<b>Gross Profit</b>	22412	23304	24262	25842	26915	28389	30265	32313	34356	37160
<b>Gross Margin</b>	33.9%	34.3%	34.5%	34.6%	34.2%	34.1%	34.2%	34.2%	34.0%	34.3%
<b>SG&amp;A Exp.</b>	15902	15849	16028	16508	16122	16280	16801	17132	17864	19513
<b>D&amp;A Exp.</b>	1806	1718	1682	1684	1757	1786	1863	1973	2062	2152
<b>Operating Profit</b>	4803	5839	6661	7766	9166	10469	11774	13427	14681	15777
<b>Op. Margin</b>	7.3%	8.6%	9.5%	10.4%	11.6%	12.6%	13.3%	14.2%	14.5%	14.6%
<b>Net Profit</b>	2661	3338	3883	4535	5385	6345	7009	7957	8630	11121
<b>Net Margin</b>	4.0%	4.9%	5.5%	6.1%	6.8%	7.6%	7.9%	8.4%	8.6%	10.3%
<b>Free Cash Flow</b>	4159	3489	5430	5663	6239	6800	7870	8162	10134	10596
<b>Income Tax</b>	1362	1935	2185	2686	3082	3631	4012	4534	5068	3435

## Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Total Assets</b>	40877	40125	40518	41084	40518	39946	41973	42966	44529	44003
<b>Cash &amp; Equivalents</b>	1421	545	1987	2494	1929	1723	2216	2538	3595	1778
<b>Acc. Receivable</b>			1245	1395	1398	1484	1890	1570	1604	1936
<b>Inventories</b>	10188	10625	10325	10710	11057	11079	11809	12549	12748	13925
<b>Goodwill &amp; Int.</b>	1171	1187	1120	1170	1289	1353	2102	2093	2275	2252
<b>Total Liabilities</b>	21484	21236	22620	23307	27996	30624	35657	38633	43075	45881
<b>Accounts Payable</b>	4863	4717	4856	5376	5797	5807	6565	7000	7244	7755
<b>Long-Term Debt</b>	9682	9749	10788	10796	14724	17197	21216	23601	27028	29202
<b>Total Equity</b>	19393	18889	17898	17777	12522	9322	6316	4333	1454	N/A
<b>D/E Ratio</b>	0.50	0.52	0.60	0.61	1.18	1.84	3.36	5.45	18.59	N/A

## Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Return on Assets</b>	6.5%	8.2%	9.6%	11.1%	13.2%	15.8%	17.1%	18.7%	19.7%	25.1%
<b>Return on Equity</b>	14.3%	17.4%	21.1%	25.4%	35.5%	58.1%	89.6%	149%	298%	N/A
<b>ROIC</b>	9.1%	11.6%	13.5%	15.8%	19.3%	23.6%	25.9%	28.7%	30.6%	N/A
<b>Shares Out.</b>	1,698	1,623	1,537	1,484	1,380	1,307	1,252	1,203	1,158	1,121
<b>Revenue/Share</b>	39.11	41.01	44.84	49.47	54.96	61.79	68.99	76.66	85.22	94.67
<b>FCF/Share</b>	2.46	2.10	3.46	3.75	4.35	5.05	6.13	6.61	8.56	9.27

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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