Home Depot (HD)

Updated November 18th, 2020 by Quinn Mohammed

Key Metrics

Current Price:	$270	**5 Year CAGR Estimate:**	9.6%	**Market Cap:**	$290B
Fair Value Price:	$252	**5 Year Growth Estimate:**	9.0%	**Ex-Dividend Date[1]:**	12/04/2020
% Fair Value:	107%	**5 Year Valuation Multiple Estimate:**	-1.4%	**Payment Date[2]:**	12/19/2020
Dividend Yield:	2.2%	**5 Year Price Target**	$387	**Years of Dividend Growth:**	11
Dividend Risk Score:	B	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	10.0%

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 $110 billion in annual revenue. The stock has a market value of $290 billion, making it one of the larger companies by market capitalization in the US.

Home Depot reported third quarter earnings on November 17th. The company recorded third quarter sales of $33.5 billion, a 23.2% increase year-over-year. Comparable sales increased 24.1%, and 24.6% specifically in the U.S. Net earnings of $3.4 billion for the quarter were up 23.9% from $2.8 billion YoY. On a per diluted share basis, $3.18 for the quarter increased 25.7% from the same period a year ago.

The company has spent over $1.5 billion on enhanced pay and benefits in response to COVID-19 since the pandemic struck. They have announced that they will be transitioning from these temporary programs and increase permanent compensation enhancements for frontline and hourly associates, which it expects to cost $1 billion annually.

The company reduced their diluted share count by 2.0% YoY to 1,078 shares as of the end of the third quarter. The company previously expected to buy back roughly $5 billion back in common shares over 2020, but since COVID-19 has decided to temporarily suspend share repurchases. Additionally, sales per retail square foot increased by 23% to $553 from $449 last year.

As of the end of Q3, Home Depot has cash and cash equivalents equal to $15 billion. While the company is doing very well after third quarter, management still is not communicating guidance for 2020, but we are increasing our forecasted 2020 EPS estimate to $11.70.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$2.03	$2.47	$3.10	$3.76	$4.56	$5.34	$6.45	$7.46	$9.73	$10.25	***$11.70***	***$18.00***
DPS	$0.95	$1.04	$1.16	$1.56	$1.88	$2.36	$2.76	$3.56	$4.12	$5.44	***$6.00***	***$9.23***
Shares[3]	1,623	1,537	1,484	1,380	1,307	1,252	1,203	1,158	1,121	1,088	***1,066***	***1,000***

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 9.0%, consisting of comp sales in the high-single digits, a low single digit tailwind from buybacks and a steady, low single digit tailwind from operating margin improvements.

In addition, the company's streak of meaningful dividend growth should continue as we see the payout rising at the rate of earnings, reaching $9.23 per share in five years. Home Depot's small 2.2% yield is in-line historically as the share price has kept up with their enormous dividend growth. The company 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.

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[1] Estimate based on last year
[2] Estimate based on last year
[3] In millions

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	15.6	15.0	17.9	20.2	19.1	22.1	20.3	21.6	19.4	***21.0***	***23.1***	***21.5***
Avg. Yld.	3.0%	2.8%	2.1%	2.1%	2.2%	2.0%	2.1%	2.2%	2.2%	***2.3%***	***2.2%***	***2.4%***

Share price has catapulted itself in 2020, and the stock now trades 7.4% above our estimated fair value. Shares trade for 23.1 times our earnings estimate for this year, while we see fair value at 21.5 times earnings.

As a result, we see a minor 1.4% decrease in the valuation multiple over the next five years. 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	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	47%	42%	37%	42%	41%	44%	43%	48%	42%	***53%***	***51%***	***51%***

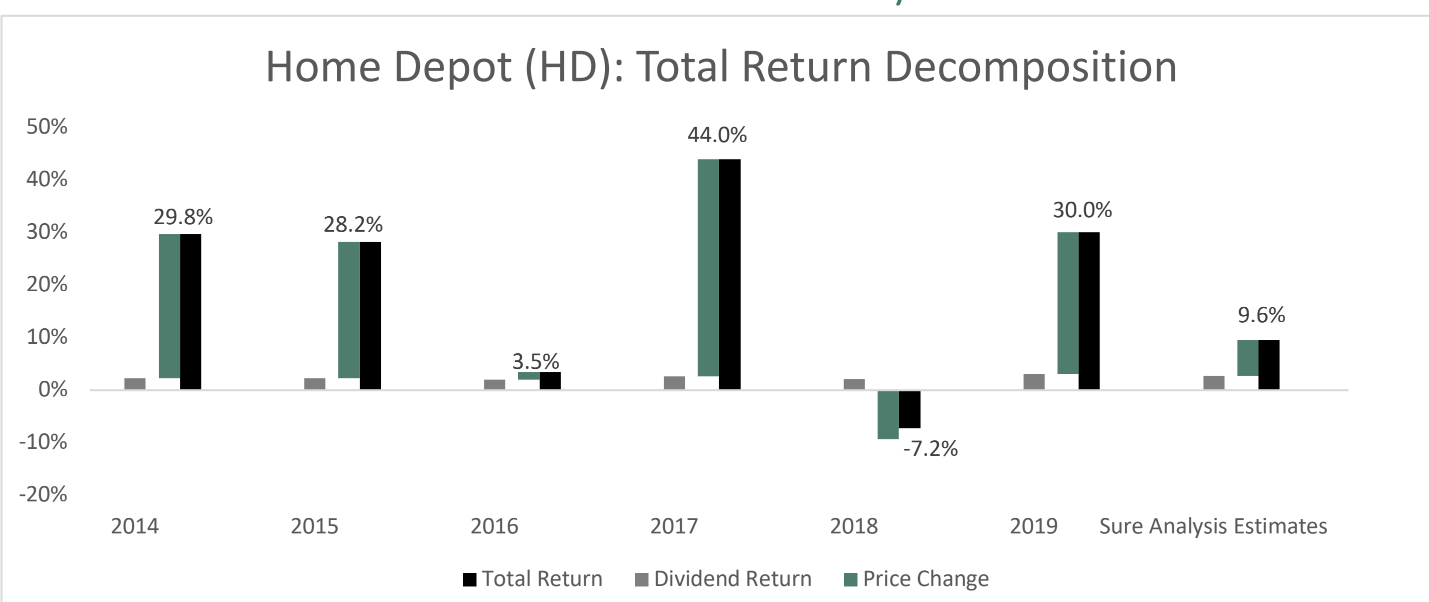
Home Depot's payout ratio is just over half of earnings and we expect it will stay there for the foreseeable future. That means the dividend is not only safe, but it has lots of room to grow in the future as well as earnings expand.

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. Interestingly enough, with the coronavirus pandemic forcing many to stay home, home renovations have been a good use of this time and it shows as the current price of HD has increased 23% year-to-date.

Final Thoughts & Recommendation

Home Depot offers investors the chance to own a stock that is dominant in its industry with terrific earnings and dividend growth outlooks, however the valuation is a tad stretched at current prices. We expect total annual returns of 9.6% going forward, consisting of the current 2.2% yield, and 9.0% earnings-per-share growth. Home Depot's fundamentals and growth catalysts are intact, but we rate the shares a hold due to the lack of margin of safety.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue ($B)	68.00	70.40	74.75	78.81	83.18	88.52	94.60	100.90	108.20	110.2
Gross Profit	23304	24262	25842	26915	28389	30265	32313	34356	37160	37572
Gross Margin	34.3%	34.5%	34.6%	34.2%	34.1%	34.2%	34.2%	34.0%	34.3%	34.1%
SG&A Exp.	15849	16028	16508	16122	16280	16801	17132	17864	19513	19740
D&A Exp.	1718	1682	1684	1757	1786	1863	1973	2062	2152	2296
Operating Profit	5839	6661	7766	9166	10469	11774	13427	14681	15777	15843
Op. Margin	8.6%	9.5%	10.4%	11.6%	12.6%	13.3%	14.2%	14.5%	14.6%	14.4%
Net Profit	3338	3883	4535	5385	6345	7009	7957	8630	11121	11242
Net Margin	4.9%	5.5%	6.1%	6.8%	7.6%	7.9%	8.4%	8.6%	10.3%	10.2%
Free Cash Flow	3489	5430	5663	6239	6800	7870	8162	10134	10596	11045
Income Tax	1935	2185	2686	3082	3631	4012	4534	5068	3435	3473

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	40125	40518	41084	40518	39946	41973	42966	44529	44003	51236
Cash & Equivalents	545	1987	2494	1929	1723	2216	2538	3595	1778	2133
Acc. Receivable		1245	1395	1398	1484	1890	1570	1604	1936	1738
Inventories	10625	10325	10710	11057	11079	11809	12549	12748	13925	14531
Goodwill & Int.	1187	1120	1170	1289	1353	2102	2093	2275	2252	2254
Total Liabilities	21236	22620	23307	27996	30624	35657	38633	43075	45881	54352
Accounts Payable	4717	4856	5376	5797	5807	6565	7000	7244	7755	7787
Long-Term Debt	9749	10788	10796	14724	17197	21216	23601	27028	29202	31483
Total Equity	18889	17898	17777	12522	9322	6316	4333	1454	N/A	-3116
D/E Ratio	0.52	0.60	0.61	1.18	1.84	3.36	5.45	18.59	N/A	-10.10

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	8.2%	9.6%	11.1%	13.2%	15.8%	17.1%	18.7%	19.7%	25.1%	N/A
Return on Equity	17.4%	21.1%	25.4%	35.5%	58.1%	89.6%	149%	298%	N/A	23.6%
ROIC	11.6%	13.5%	15.8%	19.3%	23.6%	25.9%	28.7%	30.6%	N/A	N/A
Shares Out.	1,623	1,537	1,484	1,380	1,307	1,252	1,203	1,158	1,121	1,088
Revenue/Share	41.01	44.84	49.47	54.96	61.79	68.99	76.66	85.22	94.67	100.5
FCF/Share	2.10	3.46	3.75	4.35	5.05	6.13	6.61	8.56	9.27	10.07

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