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## ANALYST QUICK NOTES

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**Home Depot Inc. (NYSE: HD: BUY)**

**Target Price: \$160**

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**5/8/2017**

### What's New?

- HD is scheduled to report 1Q earnings on May 16.
  - The earnings release is normally at 6:00 a.m.
  - The conference call is scheduled for 9:00 a.m.

### What We Expect

- We are modeling 1Q sales at \$23.7 billion.
  - Consensus is \$23.66 billion.
- Our EPS estimate is \$1.60.
  - Consensus is also \$1.60.
- Recent earnings dynamics.
  - 1Q EPS consensus is little changed over last 4 weeks.
  - Over last 4 weeks, there have been 3 estimate increases and no reductions.

### Performance Stats

- HD earnings have topped consensus in 11 of the last 12 quarters.
  - Last miss was May of 2014.
- Average price move on earnings day is 2.9%.
  - Options market implies 3.2% move on 5/16, based on Bloomberg analytics.
- Shares up 17% YTD vs. 8% for S&P 500.

### Why are we comfortable going into the quarter?

- Consensus forecast for comp sales is +4% (fiscal quarter is Feb, March, April).
  - SpendTrend Comp sales for Building Material stores was +6.4 in Feb, 6.7% in March. April not yet reported.
  - Commerce Dept. Building Materials sales +4.4 in Feb., +6.3 in March.
- Favorable comments from Masco, which generates about 30% of sales through HD.
- MAS management is seeing strong demand in the repair and remodeling market and they believe that their initiatives, with Home Depot, are resulting in market share gains for Behr professional paint.

- MAS sees continuing growth in the housing market driven by:
  - Favorable demographics.
  - Rising home prices.
  - The best housing turnover in a decade.
  - Aging homes that are in need of updates or repairs.

#### **Why do we like HD over the next year?**

- Shareholder friendly actions:
  - The trailing four-quarter return on invested capital in 4Q17 was 31.4%, up 330 basis points from last year's fourth quarter.
  - HD increased the quarterly dividend by 29% and raised the payout to 55% of earnings from 50% previously.
  - The company also authorized a new plan to repurchase \$15 billion of shares.
  - The company has repurchased \$67 billion of shares since 2002.
  - Management said that it expects to reach its goal of 14.5% operating margin in the current FY18, which is a year ahead of plan.
- Excellent cost discipline.
  - Expect expenses to grow at half the rate of sales in current FY18.

#### **What inning are we in?**

- Believe the housing market is still in the middle innings of a long upcycle, which will continue to be a tailwind for Home Depot.
- Supply of new homes and the demand for homes have been muted, which is the reason that the market hasn't already become overheated.
  - On the supply side:
    - Economic growth has been sluggish compared with previous recoveries and construction has significantly lagged population growth.
      - Now-resolved glut of existing homes.
      - Scarce builder financing.
      - Shortage of construction workers.
  - On the demand side:
    - Household formation has been very low:
      - Young adults have faced high unemployment.
      - Heavy debt from college loans.
      - Concern that home ownership is not a good investment.
  - Going forward we expect mortgage rates to rise, but remain affordable.
    - Currently about 4.25%
  - We expect an improving job market to boost household formation as the millennial generation leaves the "nest."

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