HD - Q1 2016 Home Depot Inc Earnings Call
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PRESENTATION

Operator

Good day and welcome to The Home Depot Q1 2016 earnings call. Today's conference is being recorded.

(Operator Instructions)

At this time I would like to turn the conference over to Ms. Diane Dayhoff, Vice President, Investor Relations. Please go ahead.

Diane Dayhoff - *The Home Depot, Inc. - VP, IR*

Thank you and good morning to everyone. Joining us on our call today are Craig Menear, Chairman, CEO and President; Ted Decker, EVP of Merchandising; and Carol Tomé, Chief Financial officer and Executive Vice President, Corporate Services.

Following our prepared remarks the call will be open for analysts' questions. Questions will be limited to analysts and investors and as a reminder we would appreciate it if the participants would limit themselves to one question with one follow-up please. If we are unable to get to your question during the call, please call our investor relations department at 770-384-2387.

Now before I turn the call over to Craig, let me remind you that today's press release and the presentations made by our executives include forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These statements are subject to risks and uncertainties that could cause actual results to differ materially from our expectations and projections. These risks and uncertainties include but are not limited to the factors identified in the release and in our filings with the Securities and Exchange Commission.

Today's presentations may also include certain non-GAAP measurements. Reconciliation of these measurements is provided on our website.

Now let me turn the call over to Craig.

Craig Menear - *The Home Depot, Inc. - Chairman, CEO & President*

Thank you, Diane, and good morning everyone. Sales for the first quarter were $22.8 billion, up 9% from last year. Comp sales were up 6.5% from last year and our U.S. stores had a positive comp of 7.4%. Diluted earnings per share were $1.44 in the first quarter.

We were pleased with the start of the year. In the U.S. all three of our divisions posted positive comps in the first quarter, led by our southern division. And all 19 U.S. regions and top 40 markets saw single to low double-digit comps in the quarter.

Internationally our Mexican and Canadian businesses had another quarter of solid performance. Mexico reported positive double-digit comps in local currency, making it the 50th consecutive quarter of positive comp growth. Our Canadian business also posted mid-single-digit comps in local currency for a total of 18 consecutive quarters of positive comp growth.

While weather had somewhat of a positive impact on our business and certainly drove variability in demand, the first quarter was not an early spring story, it was an execution in the core of the store story. We continue to see broad-based growth across our store as both ticket and transactions grew in the quarter. All of merchandising departments posted positive comps and we saw a healthy balance of growth among both our pro and DIY categories with pro outpacing our DIY business in the U.S. As Ted will detail, our customers continue to respond positively to our deep assortment of trusted brands as we are the product authority for both our pro and DIY customers.

The Interline integration is progressing nicely. We continue to move forward on a number of exciting sales driving initiatives and we have outlined a path to truly realize the value of the Interline acquisition and the total pro opportunity over the next 18 to 24 months.

We also continue to believe that blending the physical and digital channels into a seamless customer experience which we call Interconnected Retail provides a unique opportunity for us to expose the power of The Home Depot. This has been and will continue to be one of the central tenets of our Company's strategy and we will remain committed to the investments in our interconnected capabilities. For the quarter, online traffic growth was double digits and our online sales grew 21.5%.

Investing in interconnected capabilities goes beyond our dotcom business as we are also continuing to further invest to more effectively meet customers' demands for increased fulfillment options. The rollout of COM, our new customer order management system, is on track to be fully deployed in our U.S. stores before year-end.

Following behind the COM rollout is the implementation of BODFS or Buy Online Deliver From Store. In certain markets where BODFS has been introduced, the demand has been much stronger than we anticipated. This is a good problem to have but it is challenging delivery capacity which we're working to address. We still expect BODFS to be fully rolled out by the end of the fiscal year.

For the spring season, we have focused on further connecting our in-store and online experiences. We offered a more expanded assortment of spring seasonal products online. We also leveraged our digital assets to more effectively target customers with a personalized message pertaining to relevant products and special buys.

Additionally, we use digital media to highlight local in-store assortments to drive footsteps to our stores. To ensure our stores were properly staffed for the busy spring selling season, we hired over 80,000 associates to meet the demand of these increased footsteps.

We continue to see great productivity from our supply chain. The flexibility and nimbleness of our supply chain was especially evident in the quarter as we navigated spiky demand without sacrificing in-stock levels.

We continue to see dividends from investments made in our supply chain in our in-stocks, inventory productivity, logistics cost and service to our stores and customers. Our BOSS via RDC capability which enables us to fulfill Buy Online Ship to Store orders through our RDC network leverages both our inventory and our fulfillment channels. The cost savings of this initiative have been above our expectations and both our ship times and customer satisfaction scores continue to improve.

We have made great strides with our supply chain over the past several years and we continue to optimize our network with initiatives like supply chain Sync. While Sync is in its early days of a multiyear rollout we are pleased with our initial results.

Though it is early in the year, our view of the macro environment remains consistent. We believe that housing data indicates continued tailwinds for our business. As Carol will detail, because of our out-performance in the first quarter versus our plan, we are increasing our sales and earnings per share guidance for the year. We now expect fiscal 2016 sales growth of approximately 6.3% and diluted earnings per share of $6.27.

Today we have over 400,000 associates and I want to close by thanking them for their hard work and dedication to our customers. In addition to serving our customers in our stores through Team Depot, our associate-led volunteer force, our associates donated their personal time to complete more than 1,000 projects in service to our local communities over the past 12 months.

With that let me turn the call over to Ted.

Ted Decker - ***The Home Depot, Inc. - EVP, Merchandising***

Thanks, Craig and good morning everyone. We had a strong first quarter driven by continued strength across the store, particularly with our pro customer.

An unseasonably warm February was followed by a more normal weather March and April. While weather positively impacted our sales performance in the first quarter, spring has not yet arrived in many of our markets.

In the first quarter total comp transactions grew by 4% while comp average ticket increased 2.5%. Our average ticket increase was somewhat impacted by commodity price deflation mainly from lumber and copper. The total impact to ticket growth from commodity price deflation was approximately 15 basis points.

Transactions for tickets under $50 representing approximately 20% of our U.S. sales were up 2.7% in the first quarter. Transactions for tickets over $900 also representing approximately 20% of our U.S. sales were up 9.5% in the first quarter. The drivers behind the increase in big-ticket purchases were appliances, roofing, sheds and windows, all of which had double-digit comps.

The departments that outperform the Company's average comp were appliances, tools, building materials, lumber, lighting, hardware, millwork and decor. Electrical, paint, flooring, indoor garden, kitchen and bath, plumbing and outdoor garden had positive comps but were below the Company average. Pro heavy categories continue to show great strength as we saw double-digit comps in fencing, pressure-treated decking, boards, fasteners, doors and conduit.

In addition, the core of the store continued to perform well and we saw strength in maintenance and repair categories across the country. Tools storage, commercial industrial lighting, portable power, power tool accessories, hand tools and wiring devices had double-digit comps in the quarter. Decor categories including garage organization, laminate flooring, landscape lighting, vinyl plank and wood flooring had comps above the Company average.

Our store associates did a great job executing our 8th annual Spring Black Friday event and creating excitement in our stores. In particular, special buys around appliances, outdoor power and hardscapes were well received by our customers, resulting in double-digit comps in those categories.

As Craig mentioned The Home Depot is the product authority for both our professional and DIY customers. We have the deepest assortment of the leading programs in the marketplace. Many of these brands are billion-dollar categories for us. Our pros recognize our brand advantage and pro sales outpaced the Company average in the first quarter.

We continue to use detailed analytics to help us balance the art and science of retail. In marketing we maintain our best-in-class creative and we are also optimizing our ad effectiveness with targeted digital marketing. We remain focused on leveraging customer data to build the right message at the right time for the right customer.

As we have made strategic moves away from print and mass marketing to more targeted digital marketing we have seen great results. Since 2010 our return on advertising spend has nearly doubled.

Now let me turn our attention to the second quarter. We continue to be the leader in the marketplace for innovation and value that save our customers both time and money.

To maintain the momentum in our double-digit comping pneumatics category we are introducing the new Milwaukee pneumatic framing nailer which is the latest addition to the M18 fuel lineup. This high powered nailer delivers fasteners much faster than competing battery-powered nailers, saving our pros time on the job site.

And new from DeWalt is the 20-volt Max brushless finish nailer. This compact and lightweight finish nailer has innovative features including depth adjustments and multifunctional LED lights to illuminate work pieces. These are great examples of innovative and exclusive products from trusted best-in-class programs.

For our DIY customers we are excited about the new exclusive launch of Pergo Outlast Plus laminate flooring. This easy-to-install laminate is water resistant and uses SpillProtect24 technology, a proprietary coating that prevents water from seeping into the floor. Outlast Plus flooring allows customers to install laminate flooring in high traffic and water prone areas such as kitchens, bathrooms and mud rooms.

In addition to all the great new products we are excited about our upcoming events. Our Thrill of the Grill, Memorial Day, Father's Day and Fourth of July events are right around the corner. And we have an incredible lineup of great values and special buys to help our customers enjoy this outdoor season to the fullest.

With that it would like to turn the call over the Carol.

Carol Tomé - *The Home Depot, Inc. - EVP, Corporate Services & CFO*

Thank you, Ted, and good morning everyone. In the first quarter sales were $22.8 billion, a 9% increase from last year driven primarily by positive comps sales as well as the impact of Interline Brands. Versus last year a stronger U.S. dollar negatively impacted total sales growth by approximately $196 million or 0.9%.

Our total Company comps or same-store sales were positive 6.5% for the quarter with positive comps of 10.2% in February, 6.7% in March and 4.3% in April. Comps for U.S. stores were positive 7.4% for the quarter with positive comps of 11.8% in February, 7.7% in March and 4.6% in April. We estimate weather driven demand positively impacted our U.S. sales growth by approximately $250 million.

The variability in our comp sales performance during the quarter was due in large part to weather and to the timing of Easter this year versus last year. Our total Company gross margin was 34.2% for the quarter, a decrease of 13 basis points from last year.

The change in our gross margin is explained largely by the following factors. First, as expected we had 25 basis points of gross margin contraction due to the impact of Interline. Second, we had 12 basis points of gross margin expansion in our supply chain driven by lower fuel costs and increased productivity.

For fiscal 2016 we continue to expect our gross margin rate to be about the same as what we reported in fiscal 2015. In the first quarter operating expense as a percent of sales decreased by 122 basis points to 20.7%. Our expense leverage reflects the impact of positive comps sales growth along with great expense control.

For the year we now expect our expenses to grow at approximately 35% of our sales growth rate. Our operating margin for the quarter was 13.5%, an increase of 109 basis points from last year. Interest and other expense for the first quarter was $237 million, up $44 million from last year due primarily to higher long-term debt balances.

In the first quarter, our effective tax rate was 36.5% compared to 34.3% in the first quarter of fiscal 2015. Recall that the effective tax rate in the first quarter of last year was favorably impacted by the settlement of a tax audit.

For fiscal 2016 we expect our income tax provision rate to be approximately 37%. Our diluted earnings per share for the first quarter were $1.44, an increase of 19% from last year.

Now moving to some additional highlights, during the first quarter we opened one new store in Mexico and we ended the quarter with a store account of 2,275 and selling square footage of 237 million. Total sales per square foot for the first quarter were $377, up 6.5% from last year.

Turning to the balance sheet, at the end of the quarter inventory was $13.2 billion, up $913 million from last year, reflecting both the impact of Interline and the seasonality of our business. Inventory turns were 4.8 times, up 1/10th from the first quarter of last year. In the first quarter we repurchased $1.25 billion or approximately 9.45 million shares of outstanding stock.

For the remainder of the fiscal year, we intend to repurchase approximately $3.75 billion of outstanding stock using excess cash, bringing total anticipated 2016 share repurchases to $5 billion. Computed on the average of beginning and ending long-term debt and equity for the trailing four quarters, return on invested capital was 29.2%, 300 basis points higher than the first quarter of fiscal 2015.

Turning our attention to the full year, while U.S. GDP forecasts had pulled back slightly since we built our 2016 sales plan we continue to see strength in the housing market with home price appreciation, housing turnover and household formation trending where we thought they would. Sales in the first quarter exceeded our expectations not just because of favorable weather but because of higher demand for many of our core product categories. While we ordinarily don't raise our sales growth guidance so early in the year we're going to roll forward some of our first-quarter out-performance given the underlying strength of the business.

Further, the U.S. dollar has weakened such that the current spot rate of exchange is now in line with the FX rates we use to build our plan. Because of this we are going to a single point estimate instead of a range for our 2016 guidance.

From the high-end of the guidance range we provided in February today we are raising our sales and earnings per share growth guidance. We now expect our 2016 sales to grow by approximately 6.3% with comps of approximately 4.9%.

For earnings per share remember that we guide off of GAAP. We now expect fiscal 2016 diluted earnings per share to grow approximately 14.8% to $6.27.

We thank you for your participation in today's call. And Derek, we are now ready for questions.

QUESTION AND ANSWER

Operator

(Operator Instructions) Seth Sigman, Credit Suisse.

Seth Sigman - *Credit Suisse - Analyst*

Thanks, good morning. Nice quarter, guys. So in aggregate it seems like weather did help the quarter.

You talked about $250 million or so. Can you elaborate on where you saw that benefit and if that means you actually pulled some sales forward or do you think that's just incremental?

Craig Menear - *The Home Depot, Inc. - Chairman, CEO & President*

So obviously with a warm February we had a great start to the year and we saw outdoor project business in the North very, very strong. The $250 million that we've estimated, that is kind of hard to understand exactly how much of that is pull forward but that's what we're estimating is the demand that we saw from the weather benefit. We think there was $40 million-ish or so of seasonal product pulled forward.

Carol Tomé - *The Home Depot, Inc. - EVP, Corporate Services & CFO*

And the rest of the out-performance was in building material categories like concrete and pressure-treated lumber and so on and so forth. That really is weather-driven demand.

Seth Sigman - *Credit Suisse - Analyst*

Just to follow up there, does that $250 million consider that spring weather hasn't arrived in some markets as you alluded to and would that be factored into that number?

Carol Tomé - *The Home Depot, Inc. - EVP, Corporate Services & CFO*

That's right. We think we pulled forward through spring related categories of $40 million to $50 million.

And as you know, I don't know where you're sitting, Seth, but as you know in certain parts of the country spring has not yet arrived. So we're still anticipating a bang-up spring quarter.

Seth Sigman - *Credit Suisse - Analyst*

Yes, don't we know it. And then just one follow-up on the pro initiatives here, the extension of credit earlier in the quarter, can you talk about how that's going and how incremental to the numbers this quarter that may have been?

Carol Tomé - *The Home Depot, Inc. - EVP, Corporate Services & CFO*

Yes, we're very pleased with the new value proposition that we're offering on our private label card for our pros. You will recall that we are now offering 60 days to pay 365-day returns and discounts at the fuel pump.

What we're seeing with our pros is great receptivity. New accounts are ahead of our sales plan which is great news. But, Seth, remember that we just rolled this out to all stores in January, so there was no measurable impact to the top line because of this but we anticipate that to come.

Seth Sigman - *Credit Suisse - Analyst*

Great, thanks very much.

Operator

Simeon Gutman, Morgan Stanley.

Simeon Gutman - *Morgan Stanley - Analyst*

Thanks, good morning. I just want to clarify something.

When we use the word pull forward and if we take the $40 million out that seasonal just thinking about the other part that quote, unquote was pulled forward, maybe other projects getting done a little earlier, do we know if that's typically a one- to three-month pull forward? I mean these are projects that presumably could get done in other parts of the year and where I'm going is trying to think about how that could impact the second quarter versus others later in the year.

Carol Tomé - *The Home Depot, Inc. - EVP, Corporate Services & CFO*

Here is how we've looked at this. We think there was $250 million-ish of weather-driven demand. It's not all seasonal pull forward.

This is just activity because of great weather earlier in the quarter. And we're not rolling that forward because we anticipated that these were projects that would be completed later in the year and just got done earlier in the year.

So we're not rolling that forward. It will bleed into Q2, Q3, maybe even Q4.

Craig Menear - *The Home Depot, Inc. - Chairman, CEO & President*

To your point I mean if somebody was doing a concrete project that maybe they had planned for the summer and they said hey, look, the ground is not frozen in the North, I can do it now and they do it, it's hard to tell which quarters it's come from but it certainly, probably the next couple of quarters.

Carol Tomé - *The Home Depot, Inc. - EVP, Corporate Services & CFO*

So as we think about the shape of the year and this might help modeling we now think that the first quarter will be the highest comping quarter. As a result the first half will be slightly higher than the back half of the year.

And if you look at the comps that we are projecting for Q2, Q3 and Q4 we expect them to be in a similar range. Not a lot of difference in those comp numbers.

Simeon Gutman - ***Morgan Stanley - Analyst***

Okay, that's helpful. My follow-up on the online business I think you mentioned growth of about 21.5%.

Anything different about the pickup in store percentage that's changed? And then your comment on the delivery strain maybe from delivering from store, is that because Home Depot is offering the customer the option of where they want the product from or that's your system of choosing to deliver from store?

Craig Menear - ***The Home Depot, Inc. - Chairman, CEO & President***

So first of all a comment on the percentage of pickup is around 40% where the customer is choosing the option to pick up their items from HomeDepot.com in our stores. And as it relates to the delivery we had piloted the delivery program for a while.

We saw kind of mid-single-digit growth in deliveries. With the pilot when we went into additional markets, markets like Atlanta, for example, we saw a pretty substantial increase in the customer option to choose that delivery. And we're seeing double-digit growth in deliveries.

Simeon Gutman - ***Morgan Stanley - Analyst***

Okay, thanks.

Operator

Michael Lasser, UBS.

Michael Lasser - ***UBS - Analyst***

Good morning, thank you for taking my question. Carol as you mentioned it's not typical for the Company to raise its guidance after the first quarter and you have seen a strong first quarters in the past. So what's different about what you are witnessing in the business right now that inspires so much confidence for you to move estimates higher?

Carol Tomé - ***The Home Depot, Inc. - EVP, Corporate Services & CFO***

It's really the strength across the store. As you know when we build our sales plan we use are directionally correct but imperfect sales forecasting model which is an economic-driven model. We do not build market share gains into our forecast.

As we look at the performance in the first quarter clearly there was some share shift. Look at appliances. Ted called it out.

Appliances contributed 50 basis points of our comp growth in the first quarter. So we are confident with what we saw in the first quarter and what we're seeing early in May to roll forward the out-performance of the first quarter.

Michael Lasser - ***UBS - Analyst***

So you mentioned GDP forecasts are a little lower, housing is about where you thought it was. So what's changed is you're getting a little bit more market share than you originally thought?

Carol Tomé - ***The Home Depot, Inc. - EVP, Corporate Services & CFO***

We don't plan market share as you know. So we believe there were some share shifts. That was confirmed by NAICS data that came out that showed from a census perspective anyway we did grow share.

The other thing that we must look at is housing and just some other things that are happening within the housing market that we haven't built into our plan but we find to be of interest. Here's the statistic. We've seen home equity values increase 94% since 2011.

How is that possible? Because home prices are up 25% and people have been continuing to pay down their mortgages.

So there's a wealth effect that's occurring with homeowners. This wealth effect as we've talked at length if you feel like your home is an investment and not an expense you spend differently in your home and you can see that in our big-ticket categories.

Michael Lasser - ***UBS - Analyst***

And then my follow-up question is on the expense outlook. You now expect it to grow 35% of the rate of sales.

Is that all due to what's happened in the first quarter? Or do you expect there to be some expense good guys in the remainder of the year? Thank you so much.

Carol Tomé - ***The Home Depot, Inc. - EVP, Corporate Services & CFO***

Well, despite beating our sales plan considerably in the first quarter our total expenses were actually $13 million under our plan. That was driven by lower utilities as you would expect because of warmer weather in February but also we're not seeing the kind of pressure on medical as we had anticipated. So now for the full year we anticipate that our expenses will be lower than our original plan which is helping take our expense growth factor down from what we had said at 40% to now 35%.

Michael Lasser - ***UBS - Analyst***

Okay, good luck with the rest of spring.

Operator

Kate McShane, Citi.

Kate McShane - *Citi Research - Analyst*

Hi, thanks for taking my questions. I wanted to follow up on the other question that was just asked, just given some of the earnings that we've seen so far for Q1 that the health of the U.S. consumer I think is being called into question somewhat.

So I wondered if you could beyond how what you've already mentioned just talk about the DIY business and if there's any read through there to the overall take of the consumer? Just how much of the out-performance of pro versus DIY is driven versus maybe the housing statistics versus your initiatives?

Craig Menear - *The Home Depot, Inc. - Chairman, CEO & President*

I would say that when you look at the strength of the business it really comes across the board. We're really pleased with the mix of both transactions and ticket growth that we had. That's something we look for in terms of balance in the business.

We see the consumer continuing to engage in big-ticket sales with transactions above $900 growing at 9.5% in the quarter. So while our Pro business was strong and we're pleased to see that we're also very pleased to see the growth in our DIY business. So the balance is what really is what we're striving to achieve and we're seeing that balance across the store.

Carol Tomé - *The Home Depot, Inc. - EVP, Corporate Services & CFO*

And again I go back to the housing data. The housing data suggests that homeowners feel like they have a more value than they did before.

Look at negative equity. Homes with negative equity have dropped from 22% at the beginning of 2012 to now 8.5%.

Kate McShane - *Citi Research - Analyst*

Great, that's very helpful. And then my second follow-up question is unrelated, I know you spent some time in the prepared comments talking about Buy Online Ship from Store which I think you're rolling out by the end of the year.

Just wonder if we could have more detail in terms of how much of that program, how much of your merchandise that program will address? Is it going to be eligible for everything that's online and in the store? How will we expect that to work by the end of the year?

Craig Menear - *The Home Depot, Inc. - Chairman, CEO & President*

It pretty much is almost everything we sell. Whether it's online or in-store will be eligible for delivery.

And we'll leverage the supply chain network that we've built out to do that in the most cost-effective way using our RDCs as flow-through points for product that will come from our distribution points that a customer chooses to have delivered. So definitely a broad approach to the assortment that we carry.

Operator

Scott Mushkin, Wolfe Research.

Scott Mushkin - *Wolfe Research - Analyst*

Thanks guys, thanks for take my questions. So I just wanted to go back to the Buy Online Deliver From Store economics, trying to understand it a little bit more.

Our research has suggested particularly millennials really want to do that. They don't really necessarily want to pick up in-store. And I was just wondering looking at the uptake is exceeding expectation what are the margins attached to that business?

Craig Menear - *The Home Depot, Inc. - Chairman, CEO & President*

First of all I would say that in our business we have a lot of project business. We have a lot of things that are big and bulky and so I think that's why in many ways we're seeing significant portion of our customers choose to pick up their product in-store and then potentially have it delivered from store.

We also have pros who are interested in having the product delivered from store to their job sites. It saves them time, it saves their runners from having to come in to the stores overall.

Then candidly we've been doing delivered from store for quite some time, for years. And that's just part of the overall operating cost of doing the business. And so we approach that on a day-in, day-out basis as part of operating the business and our value proposition for the customer across product takes that into account.

Scott Mushkin - *Wolfe Research - Analyst*

So refresh my memory, do you guys charge for that or is that not charged for?

Craig Menear - *The Home Depot, Inc. - Chairman, CEO & President*

Yes we do. Yes, we charge for it and there is options for tighter windows where there's a premium paid.

Scott Mushkin - *Wolfe Research - Analyst*

Okay, perfect. Then I wanted to go into the credit changes extending from 30 to 60 days and just try to understand a little bit more the credit limits attached. I know you guys I think are using a bank to help you with that.

What are your upper credit limits? And is there thought of expanding that out and maybe just a little tutorial on that, that would be great. That's my last question.

Carol Tomé - *The Home Depot, Inc. - EVP, Corporate Services & CFO*

So our private label credit card is underwritten by a third party and I'll give you averages then talk to you about outliers. So for our commercial customers these would be our pros. The average line of credit is $6,600 which seems to adequately meet their needs but we do have some higher spend Pro.

So the third-party underwriter will extend larger lines and we have six-figure lines to many of our customers who ask for those lines. Furthermore, if there's a situation where the credit lines tighten up a bit we have a second look program with another third person provider that will take a second look at the request and up the line of credit.

So we have a number of tools in our toolkit to adequately provide the financing requirements of our pros. The biggest tool is moving to 60 days because think about it, we're providing working capital support for them. They are going to get paid by their customers before they have to pay us back.

Scott Mushkin - *Wolfe Research - Analyst*

And I think you said there's some six figures out there. With the mix of the business are you anticipating that $6,600 I think that you referenced going up meaningfully? Would you guys ever think of taking some of this on your own balance sheet or no?

Carol Tomé - *The Home Depot, Inc. - EVP, Corporate Services & CFO*

No, we will let the customer take us where they take us. We want to grow the pro and if they need more credit we're happy to support them in that effort. In terms of taking it on to our balance sheet we love the arrangement that we have with our third-party underwriter today.

Scott Mushkin - *Wolfe Research - Analyst*

Okay, perfect. Thanks guys. Thanks for taking my questions.

Operator

Chris Horvers, JPMorgan.

Chris Horvers - *JPMorgan - Analyst*

Thanks, good morning everybody. So I wanted to just at the risk of beating a dead horse so to speak follow-up on California and the oil markets.

We've seen someone like Costco seen some variability in California and they sell a lot of food, so it was a bit surprising to us. Are you seeing anything different in those markets that alerts you or causes any concern?

Craig Menear - *The Home Depot, Inc. - Chairman, CEO & President*

No, overall we're really not and the area that we watch most closely is Texas. We have 178 stores in Texas. Texas actually outperformed the Company average in the quarter.

I think all major markets in Texas performed well. Texas clearly has diversified their economy more so over the past few years which I think is a benefit.

Clearly in Western Canada we saw some pressure as you might imagine, not quite as diversified environment there. So we haven't really seen any major shift.

Carol Tomé - *The Home Depot, Inc. - EVP, Corporate Services & CFO*

Actually in California, Governor Brown just released some water restrictions --

Craig Menear - *The Home Depot, Inc. - Chairman, CEO & President*

Which is great.

Carol Tomé - *The Home Depot, Inc. - EVP, Corporate Services & CFO*

And that is good for our garden business, so our California business is doing quite well. We did have a pop-up store in North Dakota. We popped it up during the height of the fracking days. Chris, we're popping that store down.

Chris Horvers - *JPMorgan - Analyst*

It's a big pop-up.

Carol Tomé - *The Home Depot, Inc. - EVP, Corporate Services & CFO*

That's about the only impact really.

Chris Horvers - *JPMorgan - Analyst*

Understood. And can you talk about any research that you've done around millennials and household formation?

Are they coming to form households now? Do you think they will act like Gen X did before them and how do you think it impacts the long-term outlook of the box and the online business?

Craig Menear - *The Home Depot, Inc. - Chairman, CEO & President*

We actually have done a fair amount of research here. And it was part of our strategic planning last summer where we had several groups of millennials actually work on what Home Depot looks like eight to 10 years out as well. What our research tells us is that basically this is a delayed cycle, that the millennial generation has many of the same desires that generations prior to them have.

We're seeing as household formation goes up roughly a third or so of those formations are happening with millennials at the tail end of that age group. It appears there's about a six-year delayed cycle here. But our research indicates that it in many ways they will act the same as previous generations.

Carol Tomé - *The Home Depot, Inc. - EVP, Corporate Services & CFO*

The average age of new home buyers last year was 33 years old. That's the edge of the millennials. So that is another proof point that at some point they want to own a home.

Chris Horvers - ***JPMorgan - Analyst***

Yes. And then one last just clarification question, was there any impact in the monthly to the Easter shift?

Carol Tomé - ***The Home Depot, Inc. - EVP, Corporate Services & CFO***

So if we look at how we reported comps, and I'm talking to the U.S. now, March was reported at 7.7%. If you shifted for like for like for April that comp would have been a 9.2%. April was reported at 4.6%, it would have been like for like 3.6%.

Chris Horvers - ***JPMorgan - Analyst***

Understood. Thanks very much.

Operator

Matt McClintock, Barclays.

Matt McClintock - ***Barclays Capital - Analyst***

Yes, good morning everyone. I was wondering if we could ask a question on appliances.

You know thinking about the longer-term opportunity within that category, particularly now that you're seeing other channels of retail that are maybe more challenged with department store, etc., looking at that is also a new growth opportunity. Can you maybe just update us on your thoughts and maybe how those thoughts have changed now that you're seeing more competition in that category?

Ted Decker - ***The Home Depot, Inc. - EVP, Merchandising***

We haven't seen the impact of any increased competition. Our appliance business is extremely strong again in the first quarter. In fact, it accelerated as we exited the quarter.

We've been leaning into that space as you know. And we're going to expand the appliance square footage another hundred-odd stores again this years.

So we're very happy with the results. In fact, certain markets that competitors entered the space we saw significantly higher performance than the rest of the country.

Matt McClintock - ***Barclays Capital - Analyst***

Perfect. Thank you very much.

Operator

Brian Nagel, Oppenheimer.

Brian Nagel - ***Oppenheimer & Co. - Analyst***

Hi, good morning. Congratulations on a nice quarter.

So my first question with market share, anything as you look at the data to maybe comment to market share one way or the other. And particularly with what seemed to be somewhat volatile weather through the period did that impact market share trends at your chain within the channel through the quarter?

Craig Menear - ***The Home Depot, Inc. - Chairman, CEO & President***

I don't think we really have any way of knowing if weather really impacted share. We're really focused on making sure that we're driving everyday great value for our customers and trying to bring innovative products that solve problems for them. Ted, I don't know if you have any additional comments.

Ted Decker - ***The Home Depot, Inc. - EVP, Merchandising***

No. Again where the weather has been normal or in fact good our seasonal business, so the whole store has been performing. And then things that tied more heavily to the consumer in outdoor garden, that has been extremely strong where we have good weather.

So don't know yet if we would've taken any share there. And then right now April in the North and even now on a day like today with a lot of rain, again we don't see great consumer outside sales. But again you don't know the relative performance at this point.

Brian Nagel - ***Oppenheimer & Co. - Analyst***

Got it, that's helpful. The second question I have is bigger picture in nature, but one of the questions I get a lot from our clients is here is Home Depot's put up great numbers now for a while and how much longer is this going to persist?

And I know an analysis you had talked about it at your analyst meetings is just to look at the productivity of the store, particularly by category. So I guess maybe just a quick update there, as you look around the store and relative to historic peak levels if you will, where are still the biggest opportunities in the categories to drive increased productivity from here?

Craig Menear - ***The Home Depot, Inc. - Chairman, CEO & President***

So I would say that as we look at the business, first of all my starting comment would be we're playing in a $550 billion market all in now with the addition of Interline and playing in the MRO space for multifamily hospitality and institutional. We own less than 20% of that in total.

So we think there's lots of opportunity to grow. We have several initiatives underway. I have both Ann-Marie and Mark Holifield and I will let them comment. But several initiatives underway to drive productivity as we move forward and coordinated effort between our supply chain and our store operations team.

Mark Holifield - *The Home Depot, Inc. - EVP, Supply Chain and Product Development*

Yes, we're very pleased -- this is Mark Holifield -- we're very pleased with the supply chain Sync initiative. We've got that rolled pretty much in the southern tier of RDCs with a good deal of our dollar flow on that.

One of the things that's going along with Sync is the floor load process where we're loading product onto the floor where previously it was loaded on pallets. And that's driving tremendous productivity, just filling trucks much more full as they depart for stores. So still rolling that out, so still lots of opportunity there.

Ann-Marie Campbell - *The Home Depot, Inc. - EVP, U.S. Stores*

And in conjunction with that, there's tremendous opportunity in the back end of the store. So as Mark talked about Project Sync we also focus on getting this product to the shelf.

And as we manage the flow of product in the stores we then really engineer the backend to create a better streamlined process to get the product on the shelves much quicker as well. So a ton of opportunity there.

In addition, we've talked about Buy Online Deliver From Store. We've also talked about Buy Online Ship to Store. And all those are convenient experiences for the customer. And we want to make sure that we lean in and ensure that we organize or labor around where the customer is going and create an efficient and effective process for them.

Carol Tomé - *The Home Depot, Inc. - EVP, Corporate Services & CFO*

And if I could jump in, there's sales productivity opportunities, too. As Craig said huge market to play in, lots of room for growth.

But if you think about it from peak to trough we still haven't fully recovered some categories. So when I look at productivity still to be recovered, special work kitchens, millwork, some of our building materials category still have room to recover from the peak.

Ted Decker - *The Home Depot, Inc. - EVP, Merchandising*

Yes, the building material categories in lumber, millwork, those were still as Carol said off our 2006 peak as we exited last year. And it was nice to see those were some of our strongest departments in the first quarter here in 2016. So it's nice to see larger project business underway.

Brian Nagel - *Oppenheimer & Co. - Analyst*

Well, thank you. Very helpful.

Operator

Peter Benedict, Robert W. Baird.

Peter Benedict - *Robert W. Baird - Analyst*

Hey guys, thanks for taking the question. In the past you've spoken to I think it's roughly 25% of your sales of mix being in a bucket that you've considered at risk of online competition.

Obviously that's a big topic right now. Is that still the right way to think about it? And can you give us any color may be on how the products in the bucket have performed relative to the rest of the box or how you've been merchandising against that bucket?

Craig Menear - *The Home Depot, Inc. - Chairman, CEO & President*

I would say in general it's still a good way to think about it. If you think about those things that carry the highest level of risk would be those that are small package, reasonably high value, easy-to-ship product. So you think about categories like power tools, faucets and so on, as Ted called out we had a tremendous quarter as it related to tool sales.

Quite candidly we're seeing both channels grow in these categories that represent that 25%. We're staying very focused on driving great value for our customer every day.

Peter Benedict - *Robert W. Baird - Analyst*

Okay, good, that's helpful. And then Carol maybe just on leverage, is there a scenario where you would be comfortable revisiting that two times leverage guardrail, what would need to happen for you to even consider something like that?

Carol Tomé - *The Home Depot, Inc. - EVP, Corporate Services & CFO*

Peter, as you know our targeted adjusted debt to EBITDAR ratio is 2. We're slightly under that. We're at about 1.9 today.

We like that 2 as a guardrail. It provides financial flexibility but more importantly just we can sleep at night because we don't have too much leverage in the Company. So we like it.

Now it's not our goal to let that leverage ratio decline and it will as we earn more. So as you've seen us in the past as the leverage point gets to a certain inflection point and if interest rates are attractive, so on and so forth, we will raise incremental debt and use that debt to support our share repurchase program.

Peter Benedict - *Robert W. Baird - Analyst*

Okay, fair enough. Thanks so much.

Operator

Dan Binder, Jefferies.

Dan Binder - ***Jefferies LLC - Analyst***

Thank you. As we look at the comp store sales for the quarter there was a little bit of deceleration which I suspect was weather related. I was just curious if you can comment on whether May has picked back up or seeing trends similar to April?

Carol Tomé - ***The Home Depot, Inc. - EVP, Corporate Services & CFO***

Yes, as I said earlier, one reason that we're confident with our ability to lift the sales for the year is what we're seeing in May.

Dan Binder - ***Jefferies LLC - Analyst***

Okay, good enough. And then on the Pro business I know you said it was above the Company average and there is somewhat of an estimate in there. But just curious is the gap between the DIY and Pro business widening, stable or narrowing?

Craig Menear - ***The Home Depot, Inc. - Chairman, CEO & President***

It's not dramatically different, it was slightly stronger in the first quarter. I think we saw more outdoor project business which can have a tendency to be Pro related if you're doing things like concrete.

Dan Binder - ***Jefferies LLC - Analyst***

And then lastly on the overtime proposal that's out there being reviewed, can you just comment on how Home Depot will be able to adjust if it becomes law?

Craig Menear - ***The Home Depot, Inc. - Chairman, CEO & President***

We look at all factors when we put together our plans. Clearly we were aware that this was possible to come. That's factored into our guidance.

Dan Binder - ***Jefferies LLC - Analyst***

Great, thank you.

Operator

Jaime Katz, Morningstar.

Jaime Katz - ***Morningstar - Analyst***

Thanks, I'm curious about lending standards, you guys have mentioned them in the past, and I'm wondering if there have been any changes, particularly if you have them by any sort of demographic? There have been a few articles out recently saying that millennials have had a more difficult time accessing the credit markets.

Carol Tomé - ***The Home Depot, Inc. - EVP, Corporate Services & CFO***

Well, you can look at it through two lenses. First is just call it consumer credit which may come through bank card or in our case through private label card. We see consumer credit asks being approved 71% of the time, so that's a pretty good approval rate.

Now I will tell you the FICO is pretty high, it is over 700. But that's a pretty good approval rate. It also speaks to the type of customers who shopping inside of our store.

And the approval rates for our Pro card or Pro applicant is about the same, it gets about 70% of the time. Then you need to look at lending standards and for mortgages and lending standards are changing ever so slowly. It's like a glacier melting.

And you can appreciate why because financial institutions have higher capital ratios. It's very hard to make a buck in this low interest rate environment. So you can understand why it's slow to move.

But we factored that in as we think about where our business may go. And if there were to be easing on underwriting standards for mortgages, that would be good news because the affordability index, if you can get a mortgage the affordability index is something like 170.

That's awesome. So if you can get approved you can afford it.

Jaime Katz - ***Morningstar - Analyst***

Okay and then can you guys offer any commentary on any lessons you may have learned so far from Interline Brands or shared best practices you've adopted into The Home Depot model?

Craig Menear - ***The Home Depot, Inc. - Chairman, CEO & President***

Well I think lessons learned would be that our anticipation that we have a customer who has common need across both businesses would be a clear learning. The desire for the customer whether it's an Interline customer to fill in and shop at The Home Depot and/or customers who are shopping in The Home Depot to have a desire to buy through Interline is there.

We're pleased with the start. Bill, I don't know if you have any other comments to add?

Bill Lennie - ***The Home Depot, Inc. - EVP, Outside Sales & Service***

Jaime Bill Lennie. Craig is exactly right.

We're encouraged by the customer feedback and the advantages they see when we combined Interline and Home Depot. And then a second thing that we're pleased with is the collaboration we're seeing within our outside sales organizations and our ability to join forces and sell across the end markets.

Jaime Katz - ***Morningstar - Analyst***

Thank you.

Operator

Mike Baker, Deutsche Bank.

Mike Baker - *Deutsche Bank - Analyst*

Thanks, just one or two may be even three follow-ups. One, just to be clear on the guidance are you raising the full-year guidance because of currency being less burdensome in what you saw in the first quarter? Are you also changing and I guess raising the second-, third- or fourth-quarter guidance or is all the increase just because of what we saw in the first quarter and currency?

Carol Tomé - *The Home Depot, Inc. - EVP, Corporate Services & CFO*

Mike, the increase is solely related to the out-performance we saw in the United States. The reason that we are no longer providing a range is that the exchange rates that we use for our plan are now about the same as the current spot rate. So no need to provide a range, but we're just rolling forward out-performance, except for weather-driven demand, we're rolling over the rest of the out-performance.

Mike Baker - *Deutsche Bank - Analyst*

Okay. So no real change in how you would've thought about the second, third and fourth quarter?

Carol Tomé - *The Home Depot, Inc. - EVP, Corporate Services & CFO*

That's right.

Mike Baker - *Deutsche Bank - Analyst*

Okay, thank you. Two others.

One, Easter, so if I understand it Easter hurt March, helped April I guess that's because of the store, people don't really shop on Easter. But I would've thought that would've been outweighed by people shopping before Easter to do some outdoor projects. But I guess that's not the case. Easter hurts March and it helped April the shift, did I understand that correctly?

Carol Tomé - *The Home Depot, Inc. - EVP, Corporate Services & CFO*

Easter is not a big selling day for Home Depot.

Mike Baker - *Deutsche Bank - Analyst*

But again, the sales around Easter don't offset that I suppose?

Craig Menear - *The Home Depot, Inc. - Chairman, CEO & President*

No.

Carol Tomé - ***The Home Depot, Inc. - EVP, Corporate Services & CFO***

No, they don't.

Craig Menear - ***The Home Depot, Inc. - Chairman, CEO & President***

You lose a weekend effectively.

Carol Tomé - ***The Home Depot, Inc. - EVP, Corporate Services & CFO***

It's a weekend in spring. But again it didn't impact the quarter.

Mike Baker - ***Deutsche Bank - Analyst***

Right, understood. Then one, last, this is maybe a bigger picture question but it sounds like you think some of the housing trends are favorable and we agree with that. One thing I think you look at as important metric and we agree again is that home price appreciation. But home prices are now pretty close to where they were in 2006 if we think about as the peak year.

So do you think -- how do you think about that? Are we concerned that there will be less home price appreciation and then therefore less of a driver to your business?

Craig Menear - ***The Home Depot, Inc. - Chairman, CEO & President***

I think the way we look at and the important factor is when home values are positive it's a good thing for our business. Clearly the customer needed to recover the value of their homes.

We've seen that recovery obviously take place and improve for a large portion of customers. But as long as home values stay positive, it's a good thing. For years and years home values grew on average in the low single-digit 1%, 2%, 3%.

Mike Baker - ***Deutsche Bank - Analyst***

Your view just, so as we are now back towards peak year, your view is that that home price appreciation can continue?

Carol Tomé - ***The Home Depot, Inc. - EVP, Corporate Services & CFO***

We factor that into a longer-term forecast. Now this year we believe home prices will be up around 5%.

It's important to note that it's not fully recovered even with that 5% and it's certainly different in some parts of the country. But we think 5% this year and then we think next year maybe 3%, the year on after that 2%. So it continues to Craig's point because there's just ongoing home price appreciation.

Mike Baker - ***Deutsche Bank - Analyst***

Okay, thank you. Great color. I really appreciate the time.

Diane Dayhoff - ***The Home Depot, Inc. - VP, IR***

Derek, we have time for one more question.

Operator

Dennis McGill, Zelman & Associates.

Dennis McGill - ***Zelman & Associates - Analyst***

Hi, good morning, thank you. Just a couple of quick ones. Carol, on the cash flow can you just refresh how we should think about cash flow dropdown for the year and working capital as you work through the year?

Carol Tomé - ***The Home Depot, Inc. - EVP, Corporate Services & CFO***

Yes, so we think we will generate around $10 billion of cash from the business this year. That includes a slight improvement in working capital, principally in inventory turnover. We're planning to take our inventory turnover up by a 10th in 2016.

Dennis McGill - ***Zelman & Associates - Analyst***

And then the share transaction that is greater than $900 I think you've talked about that as around 20% of late. Where did that peek out in the last cycle?

Carol Tomé - ***The Home Depot, Inc. - EVP, Corporate Services & CFO***

Where did it peak out in 2006?

Dennis McGill - ***Zelman & Associates - Analyst***

Yes, just as a sign of big-ticket share?

Carol Tomé - ***The Home Depot, Inc. - EVP, Corporate Services & CFO***

I don't know. We're going to have to go look at it. I'm not even sure we did that barbell analysis back in 2006.

Craig Menear - ***The Home Depot, Inc. - Chairman, CEO & President***

I don't know that we did in 2006. I can tell you that for the last seven or eight, maybe seven years it's been pretty comparable to that.

And I think the other factor to consider is when we look at 2006 and look at peak performance in our own minds we're not sure what the peak really was because in 2006 we actually had negative transactions. We were firing customers. So we don't know that we actually -- we assume we didn't actually peak in 2006 the way we should have.

Dennis McGill - ***Zelman & Associates - Analyst***

That's fair. Thank you guys.

Diane Dayhoff - ***The Home Depot, Inc. - VP, IR***

Well thank you for joining us on our call today. And we look forward to discussing our second-quarter earnings results in August.

Operator

That does conclude today's conference call. We appreciate your participation.