HD – Q3 2017 Home Depot Earnings Call
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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Home Depot Q3 2017 Earnings Conference Call. Today's conference is being recorded.

[Operator Instructions]

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

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

Thank you, Catherine 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 Tome, Chief Financial Officer and Executive Vice President Corporate Services.

Following our prepared remarks, the call will be open for analyst 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 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 will also include certain non-GAAP measures. Reconciliation of these measures 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 third quarter were $25 billion, up 8.1% from last year. Comp sales were 7.9% last year and our U.S. stores had a positive comp of 7.7%. Diluted earnings per share were $1.84 in the third quarter, up 15% versus last year.

I'm incredibly proud of our performance given that this quarter was one marked by an unprecedented number of natural disasters. From hurricanes and flooding to earthquakes and wildfires our thoughts and prayers continue to be with all of our associates and communities who were directly impacted.

As they always do, our associates and suppliers did an incredible job supporting those in the path of these natural disasters. They worked tirelessly and under difficult circumstances to get product where it needed to be, often as they to faced disruption in their own lives.

Though our store teams worked tirelessly to reopen stores as quick as possible in the wake of these events, several of our stores, particularly in the areas like Puerto Rico, St. Thomas and St. Croix, were forced to remained closed for an extended period of time.

Our solid performance in the quarter was driven by outstanding execution across the entire organization, though our results were not solely due to storm-related activities.

We saw a broad-based growth across our geographies, every region posted positive comps in the quarter, but the storms did impact the durability of performance across the regions.

Internationally, both Mexico and Canada posted another quarter of positive comps in local currency.

As Ted will detail, both tickets and transactions grew in the quarter as we saw growth not only in storm related product categories but in core categories as well. We saw a healthy balance of growth from both our Pro and DIY categories, with Pro sales once again outpacing DIY sales in the quarter.

We believe that the work we're doing to enhance the service capabilities for the unique needs of the Pro customer continues to resonate. Our interconnected strategy continues to drive sales both in stores and online, as online sales grew approximately 19% in the quarter, now representing approximately 6.2% of our total sales, with approximately 45% of our online U.S. orders being picked up in our stores. And should a customer need to return an item purchased online for another item, our conveniently located stores are there for them, with 85% of our online order returns being completed in-store.

For fulfillment options beyond the store, we continue to see great results with our store delivery, which grows every week. We are also currently piloting other delivery options, which we'll talk to you about in more detail at our Investor Conference in December.

The flexibility of our supply chain is a competitive advantage for our business, a fact that was particularly evident given the unpredictability of demand associated with this quarter's natural disasters. And while our supply chain did a fantastic job keeping impacted stores in stock, they did so while continuing to support the business in non-disaster impacted areas as well.

So while this was a unique quarter for us, I am encouraged by the underlying health of the core business. From a macro perspective, we continue to see positive signs in the housing data which we believe serves as a tailwind for our business. As Carol will detail, because of our outperformance in the third quarter and the expectation of additional sales from the rebuilding efforts associated with the storms, we are increasing our sales and earnings per share guidance for the year.

I want to close by thanking all of our associates, especially our store associates, for their hard work and continued dedication to our customers and communities. Helping in a time of need is a core part of the Home Depot culture, and that is exactly what our associates did this quarter. We are very proud of their efforts.

And 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 great third quarter driven by strength in our core business. We also saw incremental demand stemming from the natural disasters during the quarter. I'd like to thank our cross-functional teams and supplier partners for their efforts in mobilizing our response. These efforts allowed us to get product to our communities at their time of need.

We had five departments report double-digit comps in the quarter. This included lumber, appliances, electrical, indoor garden and tools. Building materials and flooring were also above the company's average comp. Decor, hardware, paint, millwork, plumbing, kitchen and bath and outdoor garden were positive but below the company average. Driven by price deflation, lighting was slightly negative.

In the third quarter, we saw growth in both ticket and transactions. Comp average ticket increased 5.1% and comp transactions increased 2.7%. Commodity price inflation in lumber, building materials and copper positively impacted average ticket growth by approximately 105 basis points. Foreign exchange rates also positively impacted average ticket growth by approximately 41 basis points.

Big ticket sales in the third quarter, or transactions over $900, which represent approximately 22% of our U.S. sales, were up 12.1%. The increase in big ticket sales was driven in part by strength in appliances, vinyl plank flooring, special order carpet and several Pro heavy categories. Transactions for tickets under $50, which make up approximately 16% of our U.S. sales, grew by 1.8% in the quarter.

In the third quarter, we saw strong sales with both our do-it-yourself and professional customers. Sales to our professional customers grew double-digits in the quarter, with similar growth rates in both our high-spend and low-spend pros. Pro Heavy categories such as lumber, wire, insulation, gypsum and hand tools all had double-digit growth during the quarter.

Storm-related categories also saw significant growth, with double-digit comps in generators, wet-dry vacs, tarps and ladders. In response to the storms, our merchandising execution, field merchandising and supply chain teams worked together to make real-time decisions to adjust our product assortment and inventory levels. This allowed us to better stage product and optimize our store footprint.

Looking beyond the storm related demand, we continue to see momentum in our core business. Comps in non-impacted markets remain strong with healthy growth in both ticket and transactions. During the quarter we hosted several events that helped drive traffic to create excitement in our stores. We were pleased with our annual Halloween, Harvest, and Labor Day events which reported strong growth year over year.

Now let me turn our attention to the fourth quarter. In our constant pursuit of being the product authority in home improvement, we continue to focus on bringing new and innovative products to market that save our customers both time and money. One area where we continue to demonstrate this product authority is with lithium-ion cordless power tools and now we are on the forefront of bringing this technology to adjacent categories.

In the fourth quarter we are excited to introduce the most powerful cordless compressor in the marketplace. The DEWALT flexible cordless air compressor offers all the convenience and affordability of cordless and allows our customers to continue using the pneumatic tools they already own. Each battery charge provides our customers the power and run time they need to complete a variety of projects. This new DEWALT flexible cordless air compressor is a big box exclusive to the Home Depot.

Adding to our incredible lineup of professional grade power tools we are excited to introduce a new product lineup from Makita that offers an even more powerful cordless solution for multitude of tools. The new Makita LXT product line offers 36 volt power, professional lineup of preset, circular and miter saws, as well as grinders. With these tools our pros will be able to tackle any job faster and with up to 50% more runtime. This new and advance lineup of power tools is also a big box exclusive to the Home Depot.

With fall coming to an end and the winter season rapidly approaching, our associates are preparing for another series of exciting events. In the fourth quarter we will host our Black Friday and holiday events along with our best gift center ever. Our gift center will consist of incredible values and products in the best brands such as Milwaukee, DEWALT, Ryobi, Makita, Diablo and Husky just to name a few.

With that, I'd like to turn the call over to Carol.

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

Thank you, Ted, and good morning, everyone. Before I discuss our third quarter results in detail, I would like to take a minute to touch on the impact of the three hurricanes that affected our business in the quarter.

First we saw increased demand as customers prepared for and started to recover from these events. We also experienced store and DC closings. In fact, we had 236 stores closed for some period during the quarter. We estimate that hurricane related sales positively impacted total company comp sales growth by approximately $282 million in the quarter. These sales were lower margin categories like plywood and generators, and we had additional supply chain costs. So our gross margin on the hurricane related sales was considerably less than our company average.

Finally, we experienced roughly $104 million of hurricane related expense in the quarter for items like people costs, increased security in our affected stores and storm damage. So while our year-over-year sales growth was positively impacted by the hurricanes, our operating profit was negatively impacted by $51 million.

In the third quarter, total sales were $25 billion, an increase of 8.1% versus last year, a weaker U.S. dollar positively impacted total sales growth by approximately $102 million or 0.4%. Our total company comps or same store sales were positive 7.9% for the quarter with positive comps of 7.7% in August, 9% in September and 7.2% in October. Comps for U.S. stores were positive 7.7% for the quarter with positive comps of 7.3% in August, 8.8% in September and 7% in October.

In the third quarter, our gross margin was 34.6%, a decline of 17 basis points from last year. While there were many factors that drove our gross margin performance in the quarter, we can isolate the year-over-year change to the impact of a hurricane-related sale.

In the third quarter, operating expense as a percent of sales decreased by 54 basis points to 19.9%. As I previously mentioned, during the quarter we had approximately $104 million of hurricane-related expenses. Backing out the sales and expenses associated with the hurricane, our operating expense as a percent of sales was better than our plan. Our operating margin for the third quarter was 14.7%, an increase of 36 basis points from last year.

Interest and other expense for the third quarter grew by $11 million to $247 million, reflecting a higher long-term debt balance versus last year, offset somewhat by higher interest income.

In the third quarter, our effective tax rate was 36.9% compared to 36.2% in the third quarter of fiscal 2016. Our diluted earnings per share for the third quarter were $1.84, an increase of 15% from last year.

Now moving onto some additional highlights. During the quarter, we opened one new store in Mexico for an ending store count of 2,283. Total sales per square foot for the third quarter were $412, up 7.9% from last year.

Turning to the balance sheet. At the end of the quarter, merchandise inventories were $13.4 billion, up $178 million from last year, and inventory turns were 5.2 times, up 2/10 from last year.

In the third quarter, we repurchased approximately $2.1 billion or 12.3 million shares of our outstanding stock. This included 5.6 million shares on the open market and 6.7 million shares repurchased through an accelerated share repurchase or ASR program.

For the shares repurchased under the ASR program, this is an initial calculation. The final number of shares repurchased will be determined upon completion of the ASR in the fourth quarter.

Fiscal 2017, we are now targeting share repurchases of $8 billion of which $2.1 billion will occur in the fourth quarter.

During the quarter, we took advantage of an attractive interest rate environment and raised $1 billion of long-term debt, of which $500 million was used to repay debt that came due in September.

Computed on the average of beginning and ending long-term debt and equity for the trailing 12 months, return on invested capital was approximately 32.5%, 340 basis points higher than the third quarter of fiscal 2016.

Turning to our outlook for the remainder of the year, we continue to see underlying strength and momentum in our core business. The macro environment remains supportive and we believe housing is a tailwind for our business.

In addition, we expect the hurricane recovery efforts to continue across a number of our markets. As a result, today we are lifting our fiscal 2017 sales and earnings per share growth guidance. We now expect fiscal 2017 sales to increase by approximately 6.3%, with positive comps of 6.5%. We now expect our fiscal 2017 gross margin to decline by approximately 12 basis points. For the year and reflecting the expense impact of the hurricane, we now expect our expenses to grow at approximately 55% of our sales growth rate. And finally, for the year, we expect our effective tax rate to be approximately 36.3%.

For earnings per share, remember that we guide off of GAAP. For fiscal 2017, we now expect diluted earnings per share to increase by approximately 14% to $7.36.

We look forward to talking with you at our investor conference on December 6 in Boston, where we will give you an update on our key strategic initiatives and our long-term financial targets.

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

QUESTION AND ANSWER

Operator

(Operator Instructions) We'll go first day to Michael Lasser with UBS.

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

Good morning. Thanks a lot for taking my question. So how long do you expect the hurricane related spending to impact your sales results? And how is the trajectory going to look? Is it initially the greatest right around the event and then it tails off over time? Or will it be pretty consistent over the course of the period that you expected to have an impact?

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

Michael, we certainly expect, as Carol called out, to see continued sales increase from the hurricane as we move into 2018. It'll be pretty much in the first half, I think.

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

Yes. So we have a lot of experience with hurricanes and we see that Hurricane Harvey was much like the Baton Rouge flooding last year. Hurricane Irma is much like Super Storm Sandy, although on a smaller scale, and Hurricane Maria, well it's much like Katrina, although on a smaller scale. And what our past experience tells us is that the hurricane related sales tend to be the highest in the quarter immediately following the quarter in which the hurricanes occurred and then they tail off over time. As Craig said, we would expect them to tail off throughout 2018.

For the purposes of building our forecast and guidance today, we have hedged back some of the anticipated hurricane related sales in the fourth quarter because it's the fourth quarter and anything can happen with weather. I will tell you based on the first two weeks of our sales in November, our forecast would appear to be conservative but it's a good thing to put together a conservative forecast.

When we look at the year-on-year impact, we would expect, as Craig mentioned, that there would be no comp divot next year as a result of the hurricanes. We would have the same amount of hurricane sales in 2018 as we had in 2017.

Michael Lasser - *UBS - Analyst*

Carol, do want to explicitly tell us what the amount of hurricane related spending that you expect in the fourth quarter?

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

I would not like to specifically tell you that.

Michael Lasser - *UBS - Analyst*

Okay. I thought I would try. And then, I forget if it was Craig or Ted, one of you gave us a little tease about the analyst meeting and talking about new delivery options that you're piloting. If you were to go free shipping on some dollar threshold across of your all of your online SKUs, how margin diluted would that – you're overall P&L be? It looks like you've got, out of your top 150,000 items right now, you've got about 6,800 that would qualify for free shipping. So what if you went kind of across the board, how margin dilutive would that be?

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

Michael, today we offer free shipping on any order over $45 so the majority of everything we ship today falls under free shipping.

Michael Lasser - *UBS - Analyst*

Okay. Great. Thank you so much.

Operator

Our next question comes from Charles Grom with Gordon Haskett.

Charles Grom - *Gordon Haskett - Analyst*

Thanks. Good morning. I was just wondering if you guys could think to the quarterly progression of sales excluding the hurricane impact throughout the – not only in the U.S. but worldwide?

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

Well, we didn't go back and recalculate the comp but just let me tell you the impact of the hurricane related sales and then you can do the math. We project – not project but we have seen that the hurricane related sales in August were about $10 million, the hurricane related sales in September were about $150 million, and the hurricane related sales in October were about $120 million.

Charles Grom - ***Gordon Haskett - Analyst***

Okay. Yes, we can do the math there. Great. And then, when you look ahead and try to quantify the impact of the top line, I'm just wondering when you think about the gross margin profile of these sales going forward, how historically has it played out? Obviously here in the third quarter they were significantly lower than you would typically see but how do they progress going forward?

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

When you think about the kind of prep sales, if you will, that largely happens as you move into a storm you're selling things like plywood and generators which are very low margin rate goods. As you move past that and get into cleanup and recovery, you then begin to see a more normalized mix of sale across the business, and it depends again on the type of storm that it is. And that has a tendency to be more normalized margin in the business.

Charles Grom - ***Gordon Haskett - Analyst***

Okay. Thanks very much, and good luck.

Operator

Thank you. We'll now hear from Dan Binder with Jefferies.

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

Thanks. Good morning. You talked a little bit about product innovation, specifically the battery technology. Connected home has also been an emerging category. It seems like a natural fit for a few different retailers out there. One has been particularly aggressive. I'm just curious if you could give us some thoughts on where Home Depot is – how Home Depot is positioned to benefit from that?

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

Yes, Dan. It's Ted. I think we're very well positioned. We have quite a bit of product that's selling very nicely with strong growth year-over-year. I'm most excited right now about some of the new thermostat products coming out from Nest. We have great innovation coming from Ring. We've been partnering with Ring for some time. They've given us a number of launch exclusives as well as nuanced product exclusives. I think that speaks to their confidence in Home Depot's ability to bring that type of product to market and sell it.

But we're experimenting with how we display the product. As you know, we're a working warehouse, so how to get that product aggregated in a series of bays with different merchandising approaches is something we're working on. And I'm happy with the number of different formats we're utilizing right now.

Dan Binder - ***Jefferies & Co. - Analyst***

Great. And then as – for my follow-up question, a separate topic on credit. I know you don't own your credit portfolio, but just wondering if you can provide us with some color on how that portfolio is doing; if there's an increase in lending or willingness to lend, delinquencies, write-offs, things of that nature?

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

Yes, thanks very much. So you're right, we don't own our credit portfolio, but we do have visibility into the portfolio. It's a very healthy portfolio with an average net receivable of $12.6 billion. As we look inside the portfolio, we see that it's performing nicely. Our loss rates are up slightly year-on-year, but they're considerably under the historical average. The historical average, just to put it in perspective, is 4.3%.

In terms of approvals for customers applying for our private label credit card, we see on the consumer side that 73% of all applications are being approved with a FICO of around 750. So we write a pretty high quality here. On the Pro side, 72% of all applications are being approved, and for the Pro, that line is around $6,700. So hopefully that's helpful.

Dan Binder - ***Jefferies & Co. - Analyst***

Yes. Thank you very much.

Operator

And we'll continue on to Simeon Gutman with Morgan Stanley.

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

Good morning. Nice quarter. Can I ask if – can you diagnose the health of the do-it-yourself versus the do-it-for-me customer; if you're seeing any changes in frequency or ticket? And I ask because there's a lot of focus on the ticket and traffic breakdown as if there's something to be gleaned about the cycle based how the customer segments are behaving.

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

We actually see growth across both the Pro categories, the do-it-for-me categories and the DIY categories. And we've seen a sequential improvement in the small ticket quarter-over-quarter, you know, tickets below $50, which have a tendency to lean more towards the DIY as well. And the large ticket growth continues as a result of strong Pro business and categories like appliances and roofing and flooring. So not really seeing anything that has us concerned at all about the DIY business.

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

Or do-it-for-me.

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

Right. No, either one.

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

Okay. And my follow up, just two parts. First, if we get a cold winter this year, does that represent a tough compare in any way since we've had a couple warm winters? And it does change any complexion of margin for the next couple quarters? And then the follow-up or the second part was just can you comment on the online sales? It looks like the trajectory slowed. I'm curious why.

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

In terms of the weather, if you will, what happens is some categories will do better in cold weather, other categories will not. So we've had the benefit of project business through warm winters, but then that actually puts pressure on your categories in the cold weather type things like heaters and so on. So it's really a balancing act. One offsets the other.

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

And that's why we tend to look at our business on the half and not the quarters because there always are always these weather related year-over-year compares and we have this bathtub effect that we talked to about in the first half that always occurs. On the margin, the margin is -- what the margin is based on what the sales are, but no real pressure coming at us.

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

Right. We were actually pleased with our growth online. Kevin is here. I'd let him comment.

Kevin Hofmann - ***The Home Depot, Inc. - CMO and President of Online***

Yes, we saw real strength in our flooring business, our blinds and window coverings businesses, our bath business. And as Carol mentioned, we have a number of stores that had days they were closed due to the hurricane impacts and that actually affected some of our online penetration in those stores but that was really the only thing that caused a blip in the quarter for us.

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

And the sales growth was $243 million year-on-year. So we were pleased with that. And just to put the store closings into perspective, they were closed accumulative 809 days, which is the same as having 2.2 stores closed for entire year.

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

Well, thank you.

Operator

Christopher Horvers with JPMorgan has our next question.

Christopher Horvers - *JPMorgan - Analyst*

I wanted to follow up on the expenses. So it looks like ex the hurricane top line and bottom-line SG&A impact, you grew SG&A to sales at about a 39% growth rate. Is that -- how do you think about that ratio as you look forward in the business? I know you typically, sort of, guide to 50% and there's always a kind of productivity opportunity at The Home Depot. Do you think that, that 50% is still the right number or is 40% the right number? Do you see any upward pressure on your sort of marginal flow-through around SG&A versus sales?

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

Well, let's just look at the fourth quarter. And as you know, we don't guide on the quarter, but I'll give you some color in the fourth quarter. Expense growth factor will -- in the fourth quarter, will be similar to what we've guided for the entire year. And as you know, we've now lifted our guidance such that the expense growth factor should be 55% for the entire year, and you may say, why is that?

Well, a few reasons. One, we will have some ongoing hurricane-related expense not to the extent that we experienced in the third quarter, but there is some natural disaster expense that's going to happen in the fourth quarter. Two, we are significantly outperforming our plan, which is a good news story, and that means we're going to be paying more bonuses. So we'll have more success sharing for our hourly associates, and we're delighted with that. But that will put some pressure on the expense growth factor in the fourth quarter. And then there just a little bit of currency nuance in all of this, because when you have a weaker U.S. dollar, your expenses outside the United States, when you translates them back, actually are a little bit higher than they would have been last year.

So hopefully, that helps guide what the fourth quarter would look like. And then, as you know, we got our Investor Day coming up on December 6. And we're going to give new financial targets for 2020. So we'll grind you through everything on our Investor Day.

Christopher Horvers - *JPMorgan - Analyst*

I guess -- but as you think about, it seems like if I look back in 2016, you grew, I think, 30% relatives to sales. So does that indicate any sort of upward pressure on incremental cost versus sales?

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

Yes, at the beginning of the year, we said 50% was a good number to use, and that included rising people costs. And we're not alone. All retailers are faced with rising people cost. And we view our people as an investment. So we have some of that pressure. But Chris, at the end of the day, the operating margin this company wants to lift in a BAU basis. We will leverage expense in a BAU basis. If you want to use 50% as a BAU, that's a good number to use.

Christopher Horvers - *JPMorgan - Analyst*

Understood. And then just curious about your crystal ball. You talked about no dividend from the hurricanes as you look to next year. There's a bigger -- it seems like there's a bigger hurricane this year versus last year. So what gives you the confidence in saying that at this point? I guess, why not let The Street put the divot in there? What are you seeing that would motivate you to guide that way this far out?

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

I mean, as we shared, each storm is different. And Harvey was very different than the other 2 storms. And the situation in Harvey is a much more protracted recovery because of the nature of the storm being water-based and the fact that there are a fair amount of folks that didn't have insurance because they didn't live in a 100-year flood point. Unfortunately, they were in the 500-year flood point. And so we just think that, that recovery is going to be protracted and then a storm like that, we have to go in and basically, people are ripping everything out down to the studs and starting over. That's going to take a while to recover.

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

We have -- I've got a 10-page deck that -- well if you worked for us, I'd show you. So if we look at Harvey and as an example, it's really look so much like the Baton Rouge flooding, but it's 3.7x bigger than the Baton Rouge. So we just modeled our experience in Baton Rouge, kind of multiplied it by 3 point times to get the effect for this year and into next. So it's actually a lot of science that went behind this expectation. But I appreciate the suggestion that maybe we should put a divot, I'm not going to but I appreciate the suggestion.

Christopher Horvers - ***JPMorgan - Analyst***

So it's the first half versus back half '18, basically?

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

Yes, exactly.

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

Yes, we'll be good in the first half of the...

Operator

We'll continue on to Seth Sigman with Crédit Suisse.

Seth Sigman - ***Credit Suisse - Analyst***

Thanks. Good morning, and nice quarter. I wanted to follow-up on the Pro business, nice to see that comps continue to grow in the double-digit range. I realize it's tough to isolate but as you think about some of the initiatives in place, whether it's credit or delivery or integrating the interline catalog, can you maybe point to where you're seeing utilization of some of those offerings is starting to increase and what you think is really driving some of that traction? Thank you.

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

Seth, this is Bill Lennie. It really -- I'd say that Pro business is on a broad-base of strength, whether it's a project business that continues to be strong and as well as a good balance between ticket and transaction. But we have done, made some enhancements to our Pro My View system in the store, which gives our PAS's, our Pro, account sales associates a better view into their customers and better insights on where to reach for category expansion and how to get a better engagement with our customers. I think the acquisition of Compact Power is another area where we can increase the engagement with our Pros. And we know that the more that we get that multilevel engagement, whether it's online, whether it's delivery, whether it's any one of our other services, that we do increase the, reach-in of the customer wallet, we do start to see growth in the share of the customers' business.

Then on top of that, we're also seeing an increase in a number of Pros that are shopping our stores as well. So -- and we've got solid performance against categories against the SIC codes and increasing Pro customer engagement.

Seth Sigman - *Credit Suisse - Analyst*

And then just as a follow-up. As you think about the housing outlook, one of the things we've observed is a pickup in home ownership among millennial consumers. If we assume that continues and it's going to become an increasingly important demographic for the business over time, can you just give us a sense of what you're seeing, if there's anything different in terms of behavior for that customer group and some of the things you're doing to try to target that customer base?

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

Sure. We actually have not seen a ton of difference. Obviously, if you think about new home ownership, some of the things that happened early on and that is categories like paint, categories like outdoor garden, where they're beautifying their home. Those are the simpler projects that began, and that kind of takes place no matter what age group is buying the home. But we're very pleased with the trends. This is something that we saw in our research that the millennials would in fact step into the home ownership. There was just a delayed cycle, and that is playing out. And we think that bodes well for the housing market going forward.

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

And also our research says that, as Craig said, the types of projects that they're going to engage in are very similar to any new home owner. And in research, we see that the millennial is showing an interest to be DIY-ers as well. So actually, quite keen interest to do the project themselves.

Operator

Our next question will come from Brian Nagel with Oppenheimer.

Brian Nagel - *Oppenheimer - Analyst*

You -- with regard to the hurricane sales, we've talked a lot about, and I know this might be a little near-term focus. But is there any way to measure, clearly Home Depot stepped up nicely here in its effort to help customers, but how your market share tracked in these events versus what you would normally consider market share trends in the business.

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

We really have no way of knowing that. It's just -- it's happening. It's unfolding right now. We just don't have any way of knowing that.

Brian Nagel - ***Oppenheimer - Analyst***

Okay, that's fair. The second question I had with regard to online. Again, we called it out as growing but it's still a small portion of the business. As online continues to evolve, have you -- is there any surprises here with regard to -- I mean, what your customers are buying online. And then also, how should we think about just the investment need to continue to support the online initiation.

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

As it relates to any surprises on the online, I think probably, the thing I'd say there is we shared several years back our bubble chart, if you will, in terms of how we thought the online business would play out by categories. And there was a group of businesses in the lower left of that chart that we thought wouldn't have much influence. I think the thing that we now realized is the shopping experience in almost every category starts in the digital world and it truly is an interconnected experience going forward. So we're paying attention to the digital representation across all of our business and as we go forward, creating an interconnected experience if you will, the One Home Depot experience for each category. And that's probably the big, I'd say, learning from a few years back that we've had.

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

To build on that in a bit, Craig you mentioned, our bubble chart, well this is all our key categories and looked at what is the intensity of inquiry online and then matched against the actual purchase behavior. And the purchases haven't changed that much. The large categories, that were large 3 years ago are large today, so a lot of bath, a lot of lighting, a lot of power tools, et cetera, those continue to be big businesses. But some of the most heavily engaged, again, as Craig said, where we're not going to get a lot of purchasing online with Pro commodity. We see the highest engagement online is with our Pros checking inventory levels and price. So again, a very interconnected shopping experience. They're still then going to the store, but they want to make sure everything is there for their project before they go to the store.

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

So that means we have to continue to invest in the experience. And at our investor conference on December 6, we will lay out our investing plans.

Operator

Alan Rifkin with BTIG has our next question.

Alan Rifkin - ***BTIG - Analyst***

And first question for Craig. Craig, you mentioned that the flexibly of your supply chain continues to be an asset benefiting you. Can you maybe just provide a little bit more color on exactly what you are doing there in the sustainability of things?

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

Sure, and I also have Mark Holifield here to jump in. But I'd say the investments that we made in creating the core components of our supply chain, our RDC or rapid deployment network, has been a significant advantage in our ability to flow and point goods where it needs to be. And it all starts there. And Mark, I don't know if you want to add on to that, but...

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

Well, our focus continues to be on creating the fastest and most efficient supply chain in home improvement. And to do that, we're planning and collaborating much more with our vendors through our Sync initiative using our truckload resources much more capably filling our trucks and building our productivity within the 4 walls of our distribution centers and really synchronizing the whole flow of the supply chain to achieve that. And with that great results and working with our suppliers to make that happen.

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

I guess, what have on that, Alan, is Ted called out our field merchandising team. They play a key role in these type of situations, where they truly become the field general on the battlefield, if you will, in a sense. And helped direct and point the supply chain and the merchant's efforts, and that's a key component of what we do as well.

Alan Rifkin - ***BTIG - Analyst***

And just a follow-up, if I may, for Carol. Inventories at $13.4 billion, up about 1.3%, substantially lower than your revenue growth. What effect from the hurricane, if any, was there on your inventory levels? And could you maybe just provide, Carol, some commentary on if those levels are satisfactory to you right now?

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

So the impact of the hurricane on the entire supply chain was enormous, and the team did an awesome job of redirecting products to get it to our stores and customers in need. In terms of our inventory levels, our inventory turnover, we're very pleased where we are. We worked really hard to drive productivity and inventory. And that starts with the products that we source, the great associates who sell them and flow them to our supply chain. One of the initiatives that we are investing in is something we call supply chain sync, we think, which lowers the variability and improve the predictability of orders. One of the outcomes, is with higher inventory productivity, and we're seeing that. So we're very happy, the long-winded answer is to say we're very happy with our inventory level.

Operator

And Matthew McClintock with Barclays.

Matthew McClintock - *Barclays - Analyst*

Carol, you said that you will leverage expenses. In the past, you've said that there's always a natural tendency for your gross margin to want to lift, but you reinvest back in value. And I guess, my question is how do you think about your future growth algorithm coming from further reinvestments in value versus maybe investments in the store experience or investments in deliveries? How should we kind of segment the growth going forward from those 2 buckets?

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

Thank you for asking the question. We're devoting a good part of our Investor Day on December 6 to talk about the future and how we parse through that. There's a BAU point of view, and then there will be in investing point of view, and we'll share with you both to give you a real clear understanding of what we're going to be doing over the next several years. Sorry to kick the can down the road, but we got an investor day in just a few weeks.

Matthew McClintock - *Barclays - Analyst*

Not trying to steal your thunder in any way, but if I can ask a follow-up then. Just on Dan's question regarding connected home. On appliances specifically, how do you think about evolving the selling model of appliances as they become more connected and how to think about tying that into your broader connected home offerings?

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

Well, we're very engaged that the product manufacturers are really coming up with some terrific innovation. We're working with them closely. We have a view into the pipeline of what's coming. We integrate then with other products in the store. As we've said before, we're very much an open source platform where any of our products can work with any other products through an agnostic hub. So yes, we think we're in a great spot, where we added a lot to our online collateral to showcase all products. But in particular, appliances, it's a category we put a lot of efforts into lots of photos and 360-degree spin, and features and measurements and how to get ready for installation, the delivery model and contacting the customer the day before then hours before the actual installation. So it's all part of our end-to-end thinking and business model development for appliances.

Operator

We'll go to Kate McShane with Citi.

Kate McShane - *Citigroup, Inc - Analyst*

My question was on Interline. Now that Interline is integrated and your sales people are able to access that inventory for The Home Depot customer, how much do you think that is contributing to comp? And how much do you think there's room to ramp that business up in a more meaningful way at the store level?

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

First of all, let me start with we're very excited about the Interline business and we continue to work the integration of that business. And we're pleased overall with the direction and results we're seeing in that. And Bill, I'll let you...

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

So Kate, we really have 2 initiatives rolled out into the stores. The first one is Pro MRO, which gives the Pro customer shopping in our stores access to the Interline catalog, and we're seeing that engagement and those sales ramp week over week in a nice fashion rate on target to where we'd expect them to be. Key categories for engagement with Pros are running in plumbing, electrical, HVAC and hardware. So it's right down the center of that in the core of the business. Then the second initiative is our Pro purchase card, which I would really describe as a Pro access card. It gives the Interline customers access to shop our stores and with the swipe card have their purchases build back on to their accounts. And we're seeing that adoption rate ramp back up. We were off to a late launch for that, but it's trending nicely and we're pleased with both initiatives. And then when we're together in December, we'll talk about some next steps and next phases.

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

It's hard -- given the size of our company, it's hard to see that all those sectors flowing through on the top line in a measurable way right now. But the trend is right. The trend is positive and the opportunity set is big. And as we've described, the addressable market in the MRO space is $50 billion. And we're just scratching the surface there. So there's a lot of room to grow.

Operator

And we'll continue on to Dennis McGill with Zelman & Associates.

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

First question, I guess, Ted, on the storm recovery, what you saw in October, I guess, maybe tail end of October into November, are there categories that you could call out as seen a disproportionate benefit from some of the repair item?

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

Well, I think if you look at the categorization of the 2 storms, as Craig said, both are very similar in the preparation you're doing, plywood to board up windows, you got generators and water, et cetera. And then when the storm hits, a lot of things like outdoor tools and chainsaws and debris removal. After that, the flood in the more Houston market, they're -- you're literally ripping the floor to the studs. So you have wiring and wiring devices and gypsum and mud and paint in flooring. Quite a bit of flooring product. Also cabinetry and appliances, et cetera. With the storm in Florida that went up the coast, that's more exterior damage, say, roofing and gutters, some windows, shutters, exterior paint, things like that. So we see the duration of the storm much more out of Houston as we get into the interior fit and finish of flooded out homes.

Dennis McGill - *Zelman & Associates - Analyst*

Okay, that's helpful. And the Carol, on the holiday side, that's been an area in the fourth quarter last several years where you've been able to generate some solid upside and you talked about maybe conservative on the hurricane side of things? How would you frame the holiday side within the forecast in any additional color you can provide on what might be different this year, exciting this year that would create another lift on top of last year's success?

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

Yes. Well, we plan to comp last year’s outstanding results and we're going to do that maybe we have a conservative forecast. So maybe even a bit better.

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

We're pleased with early results.

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

Sure are. In the first 2 weeks, those numbers have started off very strong.

Operator

Scott Mushkin with Wolfe Research.

Scott Mushkin - *Wolfe Research - Analyst*

So I just wanted to, I mean, after that last comment about how strong things are in November. I just want to know outside of the hurricane areas, do you guys want to give us the U.S. comp?

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

I don't think we'll do that. But I can tell you this. Our business, if you look at the business in areas not affected by hurricanes. I mean, we're actually very pleased with the business both from a transaction standpoint, to ticket growth standpoint, growth in key categories across the business. We see strength across the store, across geographies, as we said in our earlier comments. So we're very pleased with the trends in the business right now.

Scott Mushkin - *Wolfe Research - Analyst*

And would you be comfortable calling it sequential strength?

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

Sure.

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

Yes, I mean, and if you look at it as well on a 2-year stack basis, sure.

Scott Mushkin - ***Wolfe Research - Analyst***

Then the one thing which caused to seem -- we have a lot of questions, the one thing hasn't been talked about and we get a lot of questions on is tax policy. Obviously, with the rollout of the House plan, we saw a little step back in some of home-related hardlining names. And I just wondered if you guys had a thought as we go into '18 about tax policy, where we are in the cycle generally, that's kind of questing we get too. And if you have any fears as we move into '18 that we could actually see a slowdown in your business, ex the hurricanes.

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

Sure. So on a broad basis, I'd say we're very supportive of tax reform that would fuel the economy and create jobs. And so that's something that we hope we see take place here. And I think there's obviously, a lot going on between the House and the Senate, and we'll see where this all falls out. As it relates to some of the pieces that are being discussed individually and how that impacts housing, candidly, we don't subscribe to the fact that we believe the mortgage interest deduction elimination would have much of an impact. I mean, we just don't think it has much. And in large part because the majority of households wouldn't have an impact from what's described today. But it's pretty early to tell. We don't know what's going to pass.

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

It's early days. Our research shows that only 22% of tax filers actually use a deduction. And then of the people who have mortgages, only 5% have mortgages of excess of $500,000. And then if we have to think about, well, what is the impact to those who actually have mortgages in excess of $500,000, who might itemize and use deductions. It's really based on their marginal tax bracket. And the way to think about it, it would increase the cost of their mortgage. And with mortgage rates so low, it's not a material impact. In fact, we know that for every 25 basis points, increase in mortgage rate, it's $40 a month. So you can do the math. And you can come up with year on impact, but we just don't -- as we stand here today, don't think there will be a material impact. As we think about housing broadly and fears of slowdown, we don't see that for 2018, 2019 and 2020 for a number of reasons. We talked about new housing stock, home household formation and home price appreciation and you may say, well, home prices are really hot, haven't really fully recovered, peak to trough, well, yes, they have. But on an inflation basis, they're still down double digits. And when you think about the wealth effect that's been created with higher home prices, it's been about 122% increase in equity or about $64,000 per home, and that's translating into spending in the home and a forecast for home price appreciation next year is very good. So we don't -- the rumors are impending slowdown, we don't see because we look the underlying data and then we look at what happens in our stores every day and on our website and we just don't see it.

Operator

Our final question will come from Matt Fassler with Goldman Sachs.

Matt Fassler - ***Goldman Sachs - Analyst***

Two kind of cleanup questions on a couple of tactical items. First of all, obviously, it's a tough quarter to discern the significance of moves and individual line items. But if you could talk about how you think the storm impacted your traffic numbers versus your ticket numbers during the quarter.

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

So again, Matt, we look at the business across regions and looked at non-storm areas versus storm areas. The data around tickets and transactions is actually pretty comparable, and we didn't see a dramatic departure. Obviously, Houston, that market is up and up significantly. But when you look at regions, which are, give or take, 100 stores, we don't see a big departure in the numbers storm versus non-storm.

Matt Fassler - ***Goldman Sachs - Analyst***

And then, secondly, we didn't talk about much about the promotional environment. Obviously, the gross margin ex the impact of the storms, looked very clean. Your plan to business was quite strong and you didn't seem to pay a price for that. Anything noteworthy in the market particularly relative to the first half of the year?

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

No, we see a pretty similar promotional cadence. Most people's Black Friday ads are out and it's pretty much right on last year. So maintaining the current promotional environment.

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

Well, thank you all for joining us today. And we look forward to meeting with you at our investor conference in Boston on December 6.

Operator

Ladies and gentlemen, once again, that does conclude today's conference. Thank you all again for your participation. You may now disconnect.