HD – Q2’24 Home Depot Earnings Call
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PRESENTATION

Operator

Greetings and welcome to The Home Depot Second Quarter 2024 Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Isabel Janci. Please go ahead.

Isabel Janci *- The Home Depot, Inc. - VP, IR & Treasurer*

Thank you, Christine, and good morning, everyone. Welcome to Home Depot's second quarter 2024 earnings call. Joining us on our call today are Ted Decker, Chair, President and CEO; Ann-Marie Campbell, Senior Executive Vice President; Billy Bastek, Executive Vice President of Merchandising; and Richard McPhail, Executive Vice President and Chief Financial Officer.

Following our prepared remarks, the call will be open for questions. Questions will be limited to analysts and investors, and as a reminder, please limit yourself to one question with one follow-up. If we are unable to get your question during the call, please call our Investor Relations department at 770-384-2387.

Before I turn the call over to Ted, 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, factors identified in the release and in our filings with the Securities and Exchange Commission.

Today's presentation will also include certain non-GAAP measures including, but not limited to, adjusted income, adjusted operating margin and adjusted diluted earnings per share. For a reconciliation of these and other non-GAAP measures to our corresponding GAAP measures, please refer to our earnings press release and our website.

Now, let me turn the call over to Ted.

Ted Decker *- The Home Depot, Inc. - President & CEO*

Thank you, Isabel, and good morning everyone.

Sales for the second quarter were $43.2 billion, an increase of 0.6 percent from the same period last year. Our sales in the quarter include $1.3 billion from SRS. Recall that we closed on the SRS acquisition on June 18th, and we’ve included approximately six weeks of their performance in our consolidated results. Comp sales declined 3.3 percent from the same period last year, and our U.S. stores had negative comps of 3.6 percent. Adjusted diluted earnings per share were $4.67 in the second quarter, compared to $4.68 in the second quarter last year.

The team continues to navigate this unique environment, while executing at a high level. During the quarter, higher interest rates and greater macro-economic uncertainty pressured consumer demand more broadly resulting in weaker spend across home improvement projects. Additionally, we saw continued softness in Spring projects, which were also impacted by the extreme weather changes throughout the quarter.

When we look at the performance in the first six months of the year, as well as continued uncertainty around underlying consumer demand, we believe a more cautious sales outlook is warranted for the year. Richard will take you through the details in a moment, but we are now guiding to a comp sales decline of approximately 3.0 to 4.0 percent for fiscal 2024.

Regardless of the current pressure in the environment, our team remains focused on serving our customers and ensuring we have the right products at the right values.

And we remain focused on long-term share growth in the highly fragmented, approximately $1 trillion home-improvement market. Remember, we operate in one of the largest asset classes, which is estimated at approximately $45 trillion, representing the installed base of homes in the United States. Today, we have roughly 17% market share, with tremendous growth potential. That is why we have been investing and executing on our strategy to create the best interconnected experience, grow our Pro wallet share through a differentiated set of capabilities, and build new stores.

Now I'll take a few moments to comment on our acquisition of SRS Distribution. SRS has an exceptional team with a proven growth track record, and we are thrilled to welcome them into the Home Depot family.

While our financials only reflect a portion of their first half performance, for the six-month period matching our first half, they generated high single-digit topline growth, while growing operating income largely in line with sales, compared to the previous year. We are incredibly excited about what we can achieve together by leveraging our combined assets, capabilities, and competitive advantages. We plan to drive incremental growth through several sales and cross synergy opportunities. We will make their more comprehensive product offerings in roofing, pool, and landscape available to all our customers through our Pro desk. And we will offer SRS customers a form of credit tied to their account, which will make purchases in Home Depot stores much more convenient.

The fundamentals of the home improvement market remain strong, and we have significant growth opportunities in front of us. We are gaining share of wallet with our customers, whether they are shopping in our stores, on our digital assets, or through our Pro Ecosystem. Our merchants, store and MET teams, supplier partners, and supply chain teams are always ready to serve in any environment. They did an outstanding job delivering value and service to our customers throughout the quarter, and I'd like to close by thanking them for their dedication and hard work.

With that, let me turn the call over to Ann.

Ann-Marie Campbell - *The Home Depot, Inc. – Senior EVP*

Thanks Ted and good morning everyone.

As you heard from Ted, despite the environment, our associates continue to be engaged and ready to serve our customers. We know that delivering the best shopping experience for any purchase occasion is critical to our success. That's why we continue to invest in our associates, our in-store capabilities, our fulfillment channels and the customer experience.

Over the past year, we've talked about the tools that help us create this differentiated experience, specifically our focus on in-stock and on shelf availability or "OSA" with our sidekick and computer vision applications. Today, our in-stock and OSA are at best-in-class levels and provides the foundation for a fast in and out convenient experience that many of our customers desire, especially our pro customers.

We have also enhanced the tools our associates use for our in-store pros and specialty selling. Within the MyView tool, which has many in-store applications, we have given our associates better visibility to our customers activity with The Home Depot. For example, for our in-store pros, we can see sales trends, specific buying patterns, and expiring perks – equipping our associates with insights to better partner, grow share of wallet, and deliver value for our customers.

To drive conversion for our specialty customers, we launched a new platform known as Pipeline Management that enables Interconnected Project Selling for Kitchen Designs. With this tool, associates and store leaders will now be able to have a consolidated digital view of their pipeline and all activities related to a customer's journey. This allows associates to more easily manage multiple complex projects while more effectively communicating with our customers throughout their journey.

Additionally, we continue to make progress on our organic efforts around our different assets and capabilities to grow share of wallet with the complex project purchase occasion. We're pleased to announce that we now have key pro capabilities in 17 markets, including a broader product assortment, digital assets, a sales force, and broader fulfillment options. Our trade credit pilot program is also underway and while it's still early days, we've seen the program resonate with our customers and the benefits of extending credit for larger scale projects that are staged over a longer period of time. We are also making progress on our order management system as we continue to roll out enhancements to the end to end selling system.

We are very excited about our continued success serving the complex project purchase occasion and are focused on delivering the best customer service to all of our customers. Our store readiness and execution is strong and our associates are engaged. I look forward to the many opportunities ahead of us and I want to thank our associates for all they do to take care of our customers.

With that, let me turn the call over to Billy.

Billy Bastek - *The Home Depot, Inc. – EVP, Merchandising*

Thank you, Ann, and good morning everyone.

I want to start by also thanking all of our associates and supplier partners for their ongoing commitment to serving our customers and communities. As you heard from Ted, during the second quarter, the higher interest rate environment and greater macro-economic uncertainty pressured overall project demand. In addition, our sales reflect a softer spring selling season which was also impacted by extreme changes in the weather throughout the quarter.

Turning to our merchandising department comp performance for the second quarter… our plumbing department posted a positive comp, while power, building materials, appliances, and paint were all above the company average.

During the second quarter, our comp transactions decreased 2.2 percent, and comp average ticket decreased 1.3 percent. However, during the quarter we continue to see our customers trading up for new and innovative products.

Big-ticket comp transactions, or those over $1,000 dollars, were down 5.8 percent compared to the second quarter of last year. We continued to see softer engagement in larger discretionary projects where customers typically use financing to fund the project such as kitchen and bath remodels.

Pros outperformed the DIY customer, but both were negative for the quarter. We saw positive growth with Pros who engaged in our Pro Xtra program, deliveries to the jobsite, and our B2B website.

Turning to total company online sales, sales leveraging our digital platforms increased approximately 4 percent compared to the second quarter of last year and for those customers that chose to transact with us online during the second quarter, nearly half of our online orders were fulfilled through our stores. In addition, during the second quarter, we expanded our partnership with Instacart to improve the interconnected shopping experience nationwide. While we are still in the early days of our expanded partnership, we are encouraged with the results we are seeing.

During the second quarter, we leaned into products and projects that are resonating with our customers. We updated some line structures, focused on innovation and continued to deliver a compelling value proposition while focusing on the customer experience.

- For example, we upgraded the durability of all Lifeproof vinyl plank while also introducing on-trend colors, patterns and lengths. This helped drive positive comps in the category for the quarter.
- In water heaters, we recently modified our line structure to better serve the pro customer needs. We simplified our value proposition, adding new and better features, which drove increased engagement in the category.
- And in Paint, we continue to see the benefits of the investments we are making around our products and our fulfillment options including our in-store service and jobsite delivery capabilities with the pro who paints driving continued share gains in the quarter.
- Finally, we continue to see tremendous success in our Outdoor Power Equipment categories driving both positive unit and dollar comps in the quarter. As we have mentioned before, we have built a strong competitive advantage with our extensive lineup of battery powered platforms that allows us to continue to grow share in these categories.

As we look ahead to the third quarter, our merchandising organization remains focused on being our customers' advocate for value. This means continuing to provide a broad assortment of best-in-class products that are in-stock and available for our customers when they need it. We will also continue to lean into products that simplify the project, saving our customers time and money. That's why I'm so excited about the innovation we continue to bring to the market.

This quarter, we are launching the first to market smart glass door with Feather River. Feather River is a leader in the fiberglass door market and continues to bring innovation to our customers. This new door technology allows customers to easily change the glass from privacy, or frosted, to clear with a push of a button and is compatible with our hubspace ecosystem. This will be exclusive to the Home Depot in the big box retail channel.

Additionally, we continue to lean in with our exclusive partner Milwaukee across the business and have seen great adoption in electrical hand tools. Our partnership is expanding with a broader assortment of Made In The USA tools. These tools provide a high degree of precision with lasting results for our pro customers and will continue to strengthen our position as the number one destination for the electrical trade in the big box retail channel.

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

Richard McPhail - *The Home Depot, Inc. - EVP & CFO*

Thank you Billy and good morning everyone.

In the second quarter, total sales were $43.2 billion dollars, an increase of approximately 0.6 percent from last year. Total sales include $1.3 billion dollars from the recent acquisition of SRS, which represents approximately six weeks of sales in the quarter.

During the second quarter, our total company comps were negative 3.3 percent, with comps of negative 3.7 percent in May, negative 0.9 percent in June, and negative 4.9 percent in July. Comps in the U.S. were negative 3.6 percent for the quarter, with comps of negative 4.1 percent in May, negative 1.4 percent in June, and negative 5.0 percent in July.

In the second quarter, our gross margin was approximately 33.4 percent, an increase of 40 basis points from the second quarter last year, primarily driven by benefits from lower transportation cost and shrink, partially offset by mix as a result of the SRS acquisition.

During the second quarter, operating expense as a percent of sales increased approximately 65 basis points to 18.3 percent compared to the second quarter of 2023. Our operating expense performance was in line with our expectations.

Beginning this quarter, in addition to our GAAP measures, we are providing the following non-GAAP measures: adjusted operating income, adjusted operating margin and adjusted diluted earnings per share, which excludes non-cash amortization of acquired intangible assets. We believe these supplemental measures will help investors better understand and analyze our performance.

Our operating margin for the second quarter was 15.1 percent, compared to 15.4 percent in the second quarter of 2023. In the quarter, pre-tax intangible asset amortization was $90 million dollars, including $39 million dollars related to SRS.

Excluding the intangible asset amortization in the quarter, our adjusted operating margin for the second quarter was 15.3 percent, compared to 15.5 percent in the second quarter of 2023.

Interest and other expense for the second quarter increased by $61 million dollars to $489 million dollars, due primarily to higher debt balances than a year ago.

In the second quarter, our effective tax rate was 24.5 percent, compared to 24.4 percent in the second quarter of fiscal 2023.

Our diluted earnings per share for the second quarter were $4.60, a decrease of approximately 1 percent compared to the second quarter of 2023. Excluding intangible asset amortization, our adjusted diluted earnings per share for the second quarter were $4.67, essentially flat compared to the second quarter of 2023.

During the second quarter, we opened 3 new stores bringing our total store count to 2,340. Retail selling square footage was approximately 243 million square feet.

At the end of the quarter, merchandise inventories were $23.1 billion dollars, down approximately $200 million dollars compared to the second quarter of 2023, and inventory turns were 4.9 times, up from 4.4 times last year.

Turning to capital allocation…

- During the second quarter, we invested approximately $720 million dollars back into our business in the form of capital expenditures.
- And during the quarter, we paid approximately $2.2 billion dollars in dividends to our shareholders.

Our disciplined approach to capital allocation remains unchanged. First and foremost, we will invest in the business and expect capital expenditures of approximately 2 percent of sales on an annual basis. After investing in the business, we plan to pay the dividend and it is our intent to return any excess cash to shareholders in the form of share repurchases.

Computed on the average of beginning and ending long-term debt and equity for the trailing twelve months, return on invested capital was approximately 31.9 percent, down from 41.5 percent in the second quarter of fiscal 2023.

Now I will comment on our updated outlook for fiscal 2024.

As you heard from Ted, given the softer than expected performance in the first half of the year and reflecting continued uncertainty around underlying consumer demand, we believe a more cautious outlook for the year is warranted.

With the recent closing of the SRS acquisition, we are now including their results in our consolidated outlook for the year. For the period matching our first half, which includes periods prior to the acquisition and not fully reflected in our financial statements, SRS generated high single digit percentage sales growth with operating income growing largely in line with sales. We believe that over the next several years, SRS on its own and through our combined pro efforts will help accelerate sales and earnings growth for our company.

Updating our Fiscal 2024 guidance for the factors we just discussed:

- We now expect total sales growth between 2.5% percent and 3.5% including the SRS acquisition and the 53rd week
    - The 53rd week is projected to add approximately $2.3 billion dollars to total sales
    - SRS is expected to contribute approximately $6.4 billion dollars in incremental sales
- Comparable sales are expected to decline between -3% and -4% percent for the 52-week period
    - The high end of our range implies a consumer demand environment consistent with the first half of fiscal 2024
    - While comparable sales for the company are not currently on the trajectory for the low end of the range, a -4% comp implies incremental pressure on consumer demand beyond what we are seeing today
- We expect to open approximately 12 new stores
- Our Gross Margin is expected to be approximately 33.5% percent.
- We expect operating margin to be between 13.5% percent and 13.6% percent.
- And adjusted operating margin to be between 13.8% percent and 13.9% percent.
- Our effective tax rate is targeted at approximately 24% percent.
- We expect net interest expense of approximately $2.2 billion dollars.
- Our diluted earnings per share percent to decline between -2% percent and -4% percent compared to fiscal 2023, with the extra week contributing approximately $0.30 cents.
- We expect our adjusted diluted earnings per share percent to decline between -1% percent and -3% percent compared to fiscal 2023, with the extra week contributing approximately $0.30 cents.

We believe that we have positioned ourselves to meet the needs of our customers in any environment. The investments we've made in our business have enabled agility in our operating model. As we look forward, we will continue to invest to strengthen our position with our customers, leverage our scale and low-cost position to drive growth faster than the market and deliver shareholder value.

Thank you for your participation in today's call, and Christine, we are now ready for questions.

QUESTION AND ANSWER

Operator

[Operator Instructions] Our first question comes from the line of Scott Ciccarelli with Truist. Please proceed with your question.

Scot Ciccarelli - *Truist, Analyst*

Good morning, everyone. So, it sounds like you guys are seeing a bit more of a shift towards, let's call it, broader consumer weakness from what previously seemed to be hesitancy around finance projects. Can you provide a couple examples just so we can better understand kind of the incremental hesitancy on consumer spending patterns?

Ted Decker - *The Home Depot, Inc. - President & CEO*

Well, I think it's just in broader projects, Scot. As we said in the prior couple few quarters, the consumer remains engaged. Our consumer in particular remains quite healthy. Again, these are consumers who have seen their home values go up 50% in the last four years. Their home equity has increased almost 70% since the – right before the pandemic. So, that translates to over $13 trillion. Equity values have been strong. Jobs are strong. Earnings are strong. But we saw engagement the last several quarters in smaller projects. What we saw this most recent quarter is further pressure in larger projects, and we see that in building materials, in lumber, categories that are very specifically tied to construction in a larger project, and that was really the change that we saw as the quarter progressed.

Scot Ciccarelli - *Truist, Analyst*

So, in other words, like it's not necessarily broadening out, but it's increased pressure on, let's call it, project-oriented purchases.

Ted Decker - *The Home Depot, Inc. - President & CEO*

Yes. And you said it. I mean, the change that we believe happened over the course of the quarter is if you go back a bit to the environment that we've been working through, this period of moderation, the first thing we saw was a shift in spending, PCE spending from goods back into services, and we're effectively through that transition. The relative share of spend is more or less equal to where it was before the pandemic. And then, we had some – certainly some pull-forward in our segment. I'd say we're not completely through the pull-forward, but largely. I mean, we're now going on four years from the first spring of the pandemic when people were buying lots of grills and patio furniture, et cetera. We're largely working our way through that.

And then, the higher interest rates started to impact the housing market and housing turnover in particular, which is down some 40%. And I think last quarter – last month, we saw numbers that on an annualized basis were approaching 40-year lows. That's also impacting customers' interest in financing larger projects. Everyone's expecting rates are going to fall, so were deferring those projects. But again, what more recently has happened is a broader concern with the macro economy. There's just a lot of noise with political and geopolitical environment, unemployment ticked up, inflation keeps eating away at disposable income, and I think people just took a pause as we've progressed through the quarter – or more of a pause because of these macro uncertainties.

Operator

Our next question comes from the line of Seth Sigman with Barclays. Please proceed with your question.

Seth Sigman - *Barclays, Analyst*

Hey. Good morning, everyone. I wanted to ask about just performance across different channels. So, core Home Depot retail, I think that's pretty clear. But Home Depot's – or HD Supply, it seems like it's outperformed, but kind of hard to tell from our side, and then on SRS, if you can maybe just elaborate more on the trends you're seeing there. As you step back and think about hopefully an eventual recovery, you've built up this very diverse business over the last few years, I mean, how do you think about the timing of these different segments and how they come out of this? Thank you.

Richard McPhail - *The Home Depot, Inc. - EVP & CFO*

Sure, Seth. Well, we're – I'd tell you we're very proud of all components of our business. We are executing at an exceptionally high level across the core and across the businesses that you call out. While we don't split out HD Supply as part of our core, we are proud to say that we have had and HD Supply has had an exceptional track record as of late, even penetrating through to generate positive sales growth in the second quarter. And so, that's a real bright spot for The Home Depot.

Now, SRS, as we told you when we acquired SRS, this is a growth company acquiring a growth company. SRS has a track record of growing faster than their competition in all of their verticals and has done so for the last 15 years. If you look at what SRS accomplished in the first six months of the year – again, we only owned them for six weeks. So, we only booked six weeks of results. But they grew in the high single-digit percentages in the first half. They had healthy growth in the second quarter, and we expect them to again book single-digit growth in the entirety of the year 2024, even though we'll only own them for seven months. So, these two business models, HD Supply and SRS, are great examples of market leaders who are accustomed to growing share and delivering the bottom line as well.

Ted Decker - *The Home Depot, Inc. - President & CEO*

Yeah. And I'd add to that, Seth. We're not going to break out operating segments. But in HD Supply's case, there's some appropriate comparatives, and SRS, there's very much publicly traded comparatives. And we feel really good about the MRO business, the roofing, the pool and the landscape business against those comparables.

Scot Ciccarelli - *Truist, Analyst*

Okay. That's super helpful. And then, if we just zoom back in on core Home Depot, maybe just speak about your relative performance, if there are categories that you may be seeing some widening gap. You called out a number of categories that seem to be under a lot of cyclical pressure, but were cited as bright spots, outdoor power equipment. You mentioned appliances above average. Obviously, that's been a tough category. I think you even mentioned vinyl plank having positive comps. So, maybe just speak to some of those categories and where you may be seeing that widening gap. Thanks.

Billy Bastek - ***The Home Depot, Inc. – EVP, Merchandising***

Yeah. Thanks, Seth. So, it's Billy. Listen, as I did mention in our prepared remarks and we continue to talk about the finance projects, we continue to see ongoing pressure. I don't think that's new news. Having said that, we called out a number of businesses, and you just mentioned it. Vinyl plank, we saw great performance in both sales and unit comps. Water heaters, as I mentioned. Certainly, paint. We're thrilled with the efforts we've had in paint with the pro that paints and our paint business in total, and again, power across our platforms as well. So, non-finance projects, while we did see some softness in some of the seasonal pieces that we alluded to in our prepared remarks, the continued ongoing pressure of just the uncertainty as it relates interest rates are going to continue to put pressure on those finance projects. But we're pleased with some of the other pieces. I've mentioned larger ticket one-time purchase categories like riders as an example. We continue to see good engagement in businesses like that as well.

Operator

Our next question comes from the line of Michael Lasser with UBS. Please proceed with your question.

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

Good morning. Thank you so much for taking my question. What do you think the key level for the 30-year fixed rate mortgage needs to fall to in order to drive Home Depot's business higher? And does that rate change or that level change if the decrease in rates is due to an erosion in the labor market rather than just a moderation in inflation?

Ted Decker - ***The Home Depot, Inc. - President & CEO***

Hey, Michael. Good morning. Full question there. Hard to pinpoint what that magical rate number is historically and then, as you say, with some added pressure. All I can do is reference, toward the end of last year, when rates came off the highs over 7% and moderated down, I think even hit below 6.5% there for a bit, you saw an immediate increase in housing activity, mortgage applications, mortgage refi applications. And then, unfortunately, the rates spiked back up, I think, almost to 7% again.

So, we're trending down again. I think you're approaching 6.5% for qualified mortgage. And based on what we saw towards the end of last year, we would think you're approaching a level that people are going to engage. Caveat to that would be, again, this broader economic, geopolitical even concerns that people still might pause a little bit until some of this gets sorted out, which would be understandable. But as rates head down towards 6%, we would expect to see activity.

The other thought or piece of this whole puzzle is the amount of folks, as you know, who are in mortgages as low as 3%, plenty of mortgages under 5%. There's definitely a little bit of a golden handcuff dynamic going on with those rates. But again, as time goes on, family dynamic changes, and for one or two years, you might stay in those golden handcuffs and enjoy the low rate, but family size increases, household formation, moves for employment, retirement, et cetera. So, we would see a gradual unlocking of that, even if that adds to a little bit of the delay response to housing from a traditional rate cut environment.

Michael Lasser - *UBS, Analyst*

Okay. Thank you very much. And my follow-up question is the longer that this downturn persists, does Home Depot have an inclination to invest more in price or value as a way to grab market share that it could sustain on an eventual upturn? And maybe as a part of this, could you pull apart your updated gross margin guidance to reflect the underlying dynamics within core Home Depot versus the influence of SRS on this line item? Thank you so much.

Billy Bastek - *The Home Depot, Inc. – EVP, Merchandising*

Yeah. Michael, thanks. I'll take the first part of that, and then I'll hand it to Richard on the second piece of that question. As it relates to just the promotional activity, I mean, listen, we're going to continue to drive innovation and create value for our consumers. We are in a very rational environment as it relates to the home improvement sector. While there's been some pressure in a category like appliances, we don't see the need, nor are in the environment where we need to be more promotional.

We're focused on driving innovation and value, creating opportunities for our customers to come into our stores every day. We don't want to be in the promotional business, and we feel very good about our position in creating these opportunities and excitement in our stores around just those things, and we've seen great adoption. We've been able to bring value into the marketplace. Areas like our proprietary brands continue to perform very well, and we're very pleased with that and don't see a change in really the promotional cadence going forward. Now, I'll toss it to Richard more on the gross margin piece.

Richard McPhail - *The Home Depot, Inc. - EVP & CFO*

Yeah, great. So, let me actually broaden the question, because I think it's important to give the broader context. If you're asking about gross margin, let's just talk about SRS for a moment. So, in last June's Investor Conference, we laid out a base case and we said that there could be contributors to that base case that would push us to grow sales and earnings faster than that base case, right. So, base case was 3% to 4% top line and high single-digit – mid to high single-digit EPS growth. The acquisition of SRS is one of those accelerants that we pointed to in our Investor Conference, pushing us towards the accelerated case.

The objective of SRS is to grow our share with the pro, to accelerate sales growth, to accelerate operating profit growth and to accelerate EPS growth. So, from a sales and operating profit perspective, as you can see, it's already contributing to our company immediately. From an EPS perspective, the acquisition of SRS will be cash EPS accretive in the first 12 months of ownership, as we said in March. It will be cash EPS accretive in the first 12 months of ownership, adjusting for the associated non-cash intangible amortization. So, let's talk about how SRS is reflected in our financials. Again, just as a reminder, we include six weeks of results in Q2 from SRS, and we will include about seven months of SRS in our full year.

So, just thinking about SRS, look, they have a different product mix than Home Depot, right. About two-thirds of their product is roofing and then the remaining third is in pool and landscape. SRS carries similar margins on similar products as The Home Depot. Those products carry a lower gross margin rate than The Home Depot's company average. But their margin simply reflects a different mix than The Home Depot. And so, when we think about gross margin, SRS impacted the second quarter gross margin by about 35 basis points. And if you think about what that means for kind of an annualized figure, you're talking a – kind of a reset of our margin profile of about 45 basis points in gross margin. So, again, that'll be about 35 basis points for 2024, and then if you look at sort of an annualized figure, it's somewhere around 45 basis points. That's kind of a reset to reflect what is in effect a new mix of product at The Home Depot.

So, now let's talk about operating margin and SRS' impact, because it's important to look at gross margin in that context. So, if you – when you add SRS to our mix, it adjusts our base operating margin profile, lowering it by about 30 basis points in Q2 and it lowers our base operating margin profile by just about 40 basis points for the full year of 2024. So, that's 40 basis points for the full year of 2024. Again, if you annualize that number, then the adjustment to our base margin from SRS is about 60 basis points for an annual period. And those are GAAP numbers, and we can get into adjusted numbers if you'd like.

When we think about gross margin, again, for the quarter, we want to point out several exceptional performances across our operators. First of all, significant transportation benefit brought to us by our supply chain partners and our merchant partners, and significant benefit from a decrease in shrink year-over-year. We have now put several quarters of shrink benefit versus last year together in a row and we can point directly at what drives that performance. It's a fantastic team that we continue to invest in, and the returns on those investments are exceptional. That's a long way of saying if you look at our gross margin performance year-over-year and you back out the SRS mix shift of 35 basis points, we're actually 75 basis points versus last year, an exceptional performance in gross margin across the board by our entire team.

Operator

Our next question comes from the line of Simeon Gutman with Morgan Stanley. Please proceed with your question.

Simeon Gutman - *Morgan Stanley, Analyst*

Good morning, everyone. I have a question related to reversion. One way to look at it since 2019, if we look at transactions, they look like they're flat to down a little bit. So, to Ted's point earlier, most of that looks like it's given back on transactions. Ticket though is still up about 30-ish-percent, 34%. So – and I think that's a function of the number of items consumers are putting in the basket and because there was inflation. My question is, if we look at just the inflation piece, are there any signs of product prices either deflating, disinflating, the non-commodity stuff, non-lumber? Any signs of pricing changing in the channel? Thank you.

Ted Decker - ***The Home Depot, Inc. - President & CEO***

No. Simeon, thanks for the question. Your math is sort of spot-on there. The good news is no, we're not seeing any broad step-down in cost to retails. If you look at what we've laid out for AUR this year, we said that we'd have pressure of about 150 basis points of AUR in the first half, that would moderate to 50 basis points in the second half. That is all a function of lapping the cost and associated retail moves from last year. There really isn't a lot of net new activity on the cost or the retail front.

In fact, sort of cost-out and cost-in activity, we have a very robust team that works with our merchants on this, it's all pretty neutral. Right now, not a ton of activity. So, as Billy said, we're not going to be promotional. We're an EDLP retailer that has to give value to our – particularly our pros every day. The cost environment is neutral. The price environment is neutral. We're not seeing a lot of trade-down in particular. We're not seeing an increase in OPP penetration. Things are pretty neutral to several last periods of activity and what we're seeing on the AUR is a matter of lapping. So, we're not seeing that, and we would expect the cost levels from where we are today to largely hold, as well as the retail levels.

Remember, there's – in the cost levels from our supplier base, it's not just a matter of input costs in terms of materials, which you understand with our cost-finance team, we have a very, very good view into that. But everyone over the last four years has seen significant increase in labor costs, and we're still working through transportation costs. So, that 30% you can say, wow, that's highly inflationary and that has to come back. Well, in fact, the cost structure, with labor being a big component, has increased similarly, and that's why we don't see the marketplace irrationally eroding those price levels.

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

Okay. Follow-up, trying to think about what the core business is doing in terms of decremental margins in the second half, and I think some of Richard's comments before gave us some more clues. But it looks like the EBIT dollar guidance of the whole business, dollars are roughly the same at the – we have a midpoint now. We had 1 single point before. So, whatever we're losing from the core, it seems like we're picking back up in SRS. And it looks like the decrementals are somewhere around 20% to 25%. Is that right? Is that the right run rate if this sort of negative comp or low negative comp environment persists?

Richard McPhail - ***The Home Depot, Inc. - EVP & CFO***

So, what I would do is let's – why don't we talk about performance to-date and how our guidance reflects the performance to-date, because we actually have, as I said, outperformed certain expectations in cost of goods sold and the team has managed expenses in an exceptional manner. And so, let me walk through what that means for the guide.

So, you can recall, we began the year with a guide of a negative 1% comp with a 14.1% operating margin. In isolation, if we were to take – well, as we take comp from a negative 1% to a negative 3%, that is, call it, 25 to 30 basis points of natural deleverage that we would see in that reduction in top line expectation. However, we've had favorability year-to-date. We know where it comes from, and that favorability enhances our earnings. And so, instead of taking our 14.1% operating margin – and by the way, I'm excluding SRS in this discussion.

So, for simplification, if we were to set SRS to the side for a moment, naturally, our 14.1% operating margin would drop to something like a 13.9% to a 13.8% at a negative 3%. Instead, at a negative 3%, again, with SRS to the side, we are now guiding operating margin of 14%. So, we have held, in essence, that core 14% operating margin at a negative 3% comp. That's because we are flowing through benefits that we have created through investments that we've made. Now, if we include SRS in this, obviously, as I said, there's about a 40 basis point mix shift in our operating margin base. So, that 14% becomes the 13.6% that we've guided alongside of the negative 3% top-end of the range today.

Simeon Gutman - *Morgan Stanley, Analyst*

I got it. Makes sense. Thank you.

Richard McPhail - *The Home Depot, Inc. - EVP & CFO*

And just to tie it all up together, that 13.6% corresponds with our adjusted operating margin of 13.9%. So, for the year, when we eliminate non-cash amortization expense on intangible assets, we expect to report operating margin of 13.9% on a comp of negative 3%.

Operator

Our next question comes from the line of Chuck Grom with Gordon Haskett. Please proceed with your question.

Chuck Grom - *Gordon Haskett, Analyst*

Thanks. Good morning. You just talked about SRS revenue growth in the high single-digit range year-to-date, which is really strong in this environment. I'm curious, what's driving that success? Were there some acquisitions made by SRS? Has it been all organic? And I guess how do we think about that growth rate as we move into 2025?

Ted Decker - *The Home Depot, Inc. - President & CEO*

Thanks, Chuck. Yes. They remain a robust share-taking grower, and that high single-digit is split between – roughly equally split between organic growth and lapping of acquisitions.

Chuck Grom - *Gordon Haskett, Analyst*

Okay, great. And any thoughts on how the pace of that will go into 2025?

Ted Decker - *The Home Depot, Inc. - President & CEO*

Yeah. We would give any guidance into 2025, but remember their mode of growth, which they have demonstrated this since inception in the mid-2000s, is they're a balanced grower between comping their existing branches – their open base of branches, opening greenfield branches, and then some roll-up

M&A, geographical customer list add-ons. So, that's the profile that they've grown for years and that is exactly the profile that we will support going forward.

Richard McPhail - *The Home Depot, Inc. - EVP & CFO*

And just for clarity sake, SRS is not in our comp base. And so, they are not reflected in our comp sales guidance. They will become comp once we've owned them for 12 months.

Chuck Grom - *Gordon Haskett, Analyst*

Okay. That's helpful. And then, Richard, you've talked about the consumer deferring projects over the past few quarters. But as the prospects for lower rates begin to materialize and then we can start to see the line of sight for maybe a 6% mortgage rate, is it possible that the pace of deferrals begins to ramp higher over the next couple of quarters? And if that's the case, what parts of your business do you think could be most exposed?

Richard McPhail - *The Home Depot, Inc. - EVP & CFO*

Well, it's – intuitively, it's probably the converse of what we've seen. You think about the categories – and Billy, please chime in. But those things that are components of a large project, kitchen, bath, flooring, lighting, are all under pressure, and our customers tell us it's because that large project is being deferred. We're certainly not going to try to call a timing. But just to echo what Ted said, there is certainly a direct relationship between decreases in mortgage rates and the amount of activity that you at least see picking up in turnover. And so, I think the important point here is, as we've said for years, the long-term fundamentals of home improvement demand are strong. We have continued to invest through this period of moderation. 2024 marks the highest amount of CapEx that we've invested back in the business really in the last 15 years, because we are bullish on the future. And timing is uncertain, but we're going to be ready for it.

Operator

Our next question comes from the line of Brian Nagel with Oppenheimer. Please proceed with your question.

Brian Nagel - *Oppenheimer, Analyst*

Hi. Good morning. Thanks for taking my questions. So, my first question just with respect to the pace of comps. So, the numbers you gave in your prepared comments, there was a marked slowdown from June to July. Is there anything notable there or was it just that growing malaise we talked about?

Billy Bastek - *The Home Depot, Inc. – EVP, Merchandising*

Yeah. Brian, thanks for the question. And to reiterate, our comps through minus 3.7%, minus 0.9% and then a minus 4.9%. While we did see some softness in July, as we alluded to in Ted's comments, there's no question that the extreme heat took some sales in weather-related categories, think ACs and fans, think air circulation, think watering. Those typically come for us in the July timeframe, and we saw – as I think everyone on the call is aware, we saw a pull-forward of that significantly back into June. So, it was really just a shift as we saw some of those categories move into the back half of June. And I'll let Richard expand a little bit further.

Richard McPhail - *The Home Depot, Inc. - EVP & CFO*

Yeah. And Brian, Billy's comments were spot-on. There were signs of maybe a little more general weakness. The major driver were those few related categories. There were some signs of more general weakness. That had an influence on our guidance range. But let's just – let's talk about that range and kind of how we've started off the quarter. August has started off at a level consistent with what we would expect in a negative 3% comp result for the year and August comps are better than July, right. And so, there are a lot of factors that went into our guidance. But again, August has started off at a level consistent with what we'd expect in the negative 3% comp case.

Brian Nagel - *Oppenheimer, Analyst*

That's very helpful. I appreciate all that. And the second question I have, I guess, is a bigger picture. But we were talking a lot about SRS, where the acquisition now is closed, you're working on integration. Basically, we're watching Home Depot and there's continued push into their professional market, I mean, should we be expecting you to be exploring other acquisition opportunities there?

Ted Decker - *The Home Depot, Inc. - President & CEO*

Well, Brian, as I said, SRS will continue their activity to fill in geographies, in segments, et cetera. Look, we just made a very large acquisition that we feel great about in early, early days of joint business planning and value creation. We've always talked about utilizing M&A for growth opportunities, whether it's segments or geographies or customer bases, and expect us to continue to do that, but do not expect us to do anything large, having just done this very significant transaction with SRS.

Operator

Our next question comes from the line of Zack Fadem with Wells Fargo. Please proceed with your question.

Zack Fadem - *Wells Fargo, Analyst*

Hey. Good morning. It sounds like the pro spread widened versus DIY relative to Q1. Curious if there's any call-out there. And then, you mentioned positive comps for pros engaging in your new ecosystem. I'm curious what percent of pros this new represents and how you'd expect this trajectory to trend, now that SRS is under your belt.

Ann-Marie Campbell - ***The Home Depot, Inc. – Senior EVP***

Yeah. Hi, Zach. It's Ann-Marie. Pros certainly outperformed do-it-yourselfers in the quarter, and as we have mentioned, we continue to invest in the pro ecosystem to accelerate growth and we'll drive and grow the share of wallet. I'll throw it over to Chip, and he'll just speak a little bit about the investments and what we're seeing there.

Chip Devine - ***The Home Depot, Inc. – SVP, Outside Sales***

Yeah. Thanks, Zach. As we mentioned in the past, we're investing in markets, and last year, we had 14 markets we invested in. We'll be fully invested in 17 markets this year. And when we talk about investing in markets, it's a distribution and supply chain capability play, foundational capabilities that help us better serve the pro, and then most importantly, our expansion of our outside sales team. We've seen positive growth in all of those markets since we've been investing, and we see that quarter after quarter. So, we're very, very pleased with our progress over the last year-and-a-half as we've marched, and we continue to march into 2025 with the same progress and expectation of expansion.

Zack Fadem - ***Wells Fargo, Analyst***

Got you. And then, Richard, two quick ones. First on buybacks and how we should think about the timeline around the return, and then second, on the long-term structural margins. You gave some good detail around the impact of SRS. Curious how we should think about the new high watermark in recovery over time.

Richard McPhail - ***The Home Depot, Inc. - EVP & CFO***

Well, let's talk about share repurchases. So, as we had announced, as part of the SRS acquisition, we financed the acquisition with $10 billion in bond issuances and then some short-term commercial paper raising. We are currently at a 2.6 times debt to EBITDAR ratio. We like to see that ratio around 2.0 times. It's our intent to delever over time before we restart repurchases. That's going to take us likely into the year 2026, and we will obviously update our investors on how that looks over time. But that would be the – kind of the current calculation, sometime in 2026, we'll return.

And then, from a long-term structural perspective, when we laid out our base and accelerated case, we said in the base case, look, we anticipate in the base case that we will always generate some degree of operating leverage, and that will always remain true. We're not going to talk about a high watermark, and we will continue to update you on our views. But for now, we're executing with exceptional expense management, exceptional management in cost of goods sold, and we are delivering – we're over-delivering really on the profitability we would have expected at this top line rate. So, we are happy that we're running the business as it should be run, and we believe in those base case and accelerated cases that we laid out in June.

Isabel Janci - ***The Home Depot, Inc. - VP, IR & Treasurer***

Christine, we have time for one more question.

Operator

Thank you. Our final question comes from the line of Steven Forbes with Guggenheim. Please proceed with your
question.

Steven Forbes - ***Guggenheim, Analyst***

Thanks, everyone. Good morning. Maybe just a quick follow up on SRS. Ted, you mentioned the growth rate and broke it down 50/50 between comp and I think you said lapping acquisitions. So, maybe just give us an update on where the branch count is today? And then, how would you sort of summarize the capital spending needs of that business to fund both greenfield and acquisition-related expansion as included in the CapEx guidance? Thank you.

Ted Decker - ***The Home Depot, Inc. - President & CEO***

Sure. The good news is on their greenfield operations, it's reasonably capital-light. They lease a more modest size facility than a Home Depot DC would be. Think of this as a branch operation, and high-turning inventory and variable pay for the sales force. So, they tend to be break-even in year one of operation.

Similarly, when they make infill acquisitions, they have a great process to get that acquisition up on their ERP system. They literally do it over the weekend. They acquire a company on a Friday, and when that company opens up on a Monday, they are on the core ERP system of SRS. And that lets them get the operating process and technology synergies very quickly. And they have a track record of doubling EBITDA of acquired companies in the first three years of ownership. So, it's reasonably asset-light, it's quickly profitable on a greenfield basis and it's multiples of earnings expansion on an acquired company.

Since we've owned them, they've made – in fact, I think last Friday, they closed on a small pool deal. They have a couple more under LOI. So, these are modest infill acquisitions that they do in the normal course of business. So, we're really excited to watch them grow. And again, it's reasonably asset-light on greenfield and the multiples they're paying, as you can imagine, on smaller regional companies are generally in single-digit EBITDA multiples. So, nice earnings profile on their acquisition case.

Steven Forbes - ***Guggenheim, Analyst***

And maybe – Richard, maybe just a very quick follow-up as we think about sort of restating last year's numbers for intangible amortization. The full year amount for last year, we're looking at 15 basis points as a percentage of sales or maybe correct me if I'm off there.

Richard McPhail - ***The Home Depot, Inc. - EVP & CFO***

Yeah. The total amortization expense last year was $186 million for Home Depot for the full year of 2023.

Ted Decker - ***The Home Depot, Inc. - President & CEO***

And Steve, on branches, they're at about 775. So, when we announced in March, it was 760. You can see their growth profile. They've opened 20-plus branches just in the last few months. So, these folks are super growth-oriented.

Steven Forbes - ***Guggenheim, Analyst***

Great to hear. Thank you.

Operator

Ms. Janci, I would now like to turn the floor back over to you for closing comments.

Isabel Janci - ***The Home Depot, Inc. - VP, IR & Treasurer***

Thank you, Christine, and thank you, everybody, for joining us today. We look forward to speaking with you on our third quarter earnings call in November.