**HD - Q4 2015 Home Depot Inc. Earnings Call**
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## PRESENTATION

**Operator**

Good day ladies and gentlemen. Welcome to The Home Depot fourth-quarter and fiscal 2015 earnings call. Today's conference is being recorded.

(Operator Instructions)

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

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

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

Following our prepared remarks the call will be open for 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 to your question during the call, please call investor relations department at 770-384-2387.

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

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

Now let me turn the call over to Craig.

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

Thank you, Diane, and good morning everyone. Fiscal 2015 was a record year for our Company. We achieved sales of $88.5 billion, the highest in Company history.

We also recorded the highest net earnings in Company history and fiscal 2015 earnings per share grew 15.9% to $5.46. Sales for the fourth quarter were $21 billion, up 9.5% from last year. Comp sales were up 7.1% from last year and our U.S. stores had a positive comp of 8.9%.

Diluted earnings per share were $1.17 in the fourth quarter. Our strong sales performance was driven by a continued moderate housing recovery, exciting merchandising events, solid execution and a benefit from favorable weather. We continue to see broad-based growth across the store and our geographies.

All three of our U.S. divisions posted positive comps in the fourth quarter led by our southern division which posted low double-digit comps while our northern and western divisions recorded high single-digit comps. And all 19 U.S. regions and top 40 markets saw mid-single-digit to low double-digit comps in the quarter.

Internationally, our Mexican and Canadian businesses had another quarter of solid performance. Mexico reported positive double-digit comps in local currency, making it 49 consecutive quarters of positive comp growth.

Our Canadian business also posted high single-digit comps in local currency for a total of 17 consecutive quarters of positive comp growth. Canada ended the year with sales over $7 billion in local currency, reinforcing our position as the number one home-improvement retailer in Canada.

I would like to congratulate Jeff Kinnaird who was recently promoted to President of Home Depot Canada. Jeff is a 19-year Home Depot veteran with strong operational and merchandising experience which has allowed him to be instrumental in our success in Canada.

While there was strength in seasonal holiday decor, gift center and Black Friday events, core categories were also a strong contributor to our performance. Both ticket and transactions grew in the quarter. As Ted will detail, all of our merchandising departments posted positive comps and we saw healthy balance of growth among both Pro and DIY categories with Pro outpacing our DIY business in the U.S.

You will recall during the third quarter we completed the acquisition of Interline Brands, the leading national distributor of maintenance repair and operations or MRO products. We told you that in the second 90 days of integration would be about building out specific business cases. We are moving forward on a number of exciting sales-driving initiatives that have been identified through this process.

For example, we will soon begin offering our exclusive paint brands to Interline's multifamily operators. We have a good sense of what we need to accomplish over the next 18 to 24 months in order to fully realize the value of the Interline acquisition and the total Pro opportunity.

The retail environment is evolving and the blending of the digital and physical worlds remain a common theme. We are responsive to these trends, building out our interconnected capabilities and investing in content, site improvement and improved mobile experiences to solve for a frictionless customer experience. We continue to see healthy sales from our digital business while also seeing year-over-year improvement in customer satisfaction scores.

For the year, our online business grew by approximately $1 billion, a growth rate of over 25% versus the prior year. A significant portion of this online growth leverages the physical store assets that we have as over 40% of our online orders are picked up in stores. This is a testament to the power of our interconnected strategy.

At our December Investor Conference we highlighted our plans to further optimize our supply chain through what we call supply chain synchronization or Project Sync. We have been piloting Project Sync in Houston for some time and have now begun to roll out in a few other regions. Though it is early days, we have seen benefit in transportation savings, inventory turn and a reduction in product lead times. We appreciate the efforts of our cross functional teams internally as well as the increased collaboration with our external partners as all parties involved are working together to develop and adopt engineered flow schedules that serve as the foundation of Project Sync.

Turning to the macro environment, while 2016 consensus U.S. GDP growth projections have moderated, we continue to see positive signs in the housing data with home price appreciation, housing turnover and household formation being the key drivers of growth for our business.

We expect 2016 comp growth of approximately 4.5%. Carol will take you through the details but currency headwinds could result in lower total Company comp growth. Therefore, we expect total Company comp growth of approximately 3.7% to 4.5% and corresponding diluted earnings per share of $6.12 to $6.18.

Today our Board announced a 17% increase in our quarterly dividend to $0.69 per share. We remain committed to maintaining a disciplined capital allocation strategy to create value for our shareholders. We will invest to sustain and grow our business and return excess cash to our shareholders through dividends and share repurchases.

The power of The Home Depot begins with our Company's strong culture and commitment to our values. I want to thank our associates for their hard work and dedication to our customers.

And I'd also like to congratulate Ann-Marie Campbell who was recently promoted to Executive Vice President of U.S. Stores. With more than 30 years with the Company, Ann-Marie brings a deep understanding of Home Depot's operations, culture and customers to the role.

Based on this quarter's results, 100% off our stores qualified for Success Sharing, our profit-sharing program for our hourly associates. This is our largest second-half payout to date and we look forward to continuing this momentum in 2016.

And with that let me turn the call over to Ted.

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

Thanks, Craig, and good morning everyone. We were pleased with our performance in the fourth quarter as sales exceeded our expectations.

We saw strength across the entire store as well as continued growth in our online business. Sales were aided by milder weather and great events including the strong Black Friday and gift center.

All of our merchandising departments posted positive comps. Appliances, tools, building materials had double-digit comps in the quarter. Lighting, plumbing, hardware and indoor garden where above the Company average and decor was in line with the Company average. Outdoor garden, millwork, lumber, kitchen and bath, paint, electrical and flooring posted mid-single-digit positive comps.

Pro-heavy category saw significant growth during the quarter as we saw double digit comps in siding, pneumatics, circuit protection, fencing, fasteners and exterior doors. Our recent assortment update in roofing continues to drive excellent results as we saw double-digit comps in roofing in the fourth quarter.

And we continue to see strength in core maintenance and repair categories with double-digit comps in pumps, security lighting, water heaters, electrical tools, construction adhesives, ladders and caulks. Cleaning, bath fixtures, door locks and pipe and fittings also had comps above the Company average.

We believe that more favorable weather trends in the quarter aided sales growth by approximately $100 million. Our customers took advantage of the milder weather and were able to complete more outdoor projects. For example, we saw double-digit comp sales in pressure washers, hardscapes, mowers, outdoor power, concrete and pressure-treated decking.

Black Friday, gift center and storage events provided great values and were well received by our customers. Our strong Black Friday helped drive double-digit comps in categories like portable power and appliances.

Our gift center performed extremely well and we saw double-digit comps in tools storage, power tool accessories and hand tools. In addition, our associates rallied behind our decorative holiday offering, resulting in comps above the Company average.

In the fourth quarter total comp transactions grew by 5% and for the year we set a new transaction record with over 1.5 billion total transactions. In the quarter comp ticket increased 2%. Our comp ticket increase reflects about 32 basis points of contraction due to commodity price deflation in products such as lumber and copper.

Transactions for tickets under $50, representing approximately 20% of our U.S. sales, were up 3.8% for the fourth quarter. Transactions for tickets over $900, also representing approximately 20% of our U.S. sales, were up 11.9% in the fourth quarter.

The drivers behind the increase in big-ticket purchases were appliances, roofing and special order kitchens. Big-ticket was also driven by several installation service categories such as roofing, sheds and countertops.

Now let me turn our attention to the first quarter. In our ongoing effort to update and refresh our assortments, we will be resetting our door lock assortment in the first quarter. Using our assortment planning tools we were able to more effectively cluster our door lock assortment around styles, finishes and brands.

In addition, we have a new merchandising approach that highlights our brands and their complete collections. Our reset will include great innovative products such as the Schlage Connect and Kwikset 915 electronic locks.

For our Pro customer we are introducing new and exclusive products from Milwaukee, DEWALT, Ryobi and Rigid all leaders in professional tools. The new Milwaukee M18 FUEL with ONE KEY is a revolutionary technology that provides users the ability to control tool settings, track the location of their tools and manage their tool and equipment inventory with their wireless devices. This innovative technology gives our Pro customers the trusted power of the Milwaukee brand with added benefits to make them more productive. Among big-box retailers the Milwaukee M18 FUEL with ONE KEY can only be found at the Home Depot.

In addition to great new products, we are gearing up for the spring selling season. We are excited about our exclusive drill offers from Weber, Nextgrill and KitchenAid and our large assortment online offers numerous options from infrared gas grills to smokers. Our patio assortment continues to expand including new dining set designs from Hampton Bay, an enhanced offering of patio accessories.

For the gardener, we are excited about our expanded selection of exclusive organics from Dr. Earth and Black Magic. Our spring Black Friday event will once again offer amazing values for our customers.

The stores will be loaded with exciting products and exclusives on items like live goods, grills and outdoor power equipment. We are looking forward to a great spring season.

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

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

Thank you, Ted, and good morning everyone. In the fourth quarter sales were $21 billion, a 9.5% decrease from last year. Comp sales were positive 7.1% for the quarter with comps up 6.3% in November, 8.6% in December and 6.7% in January.

The continuing strength in the U.S. dollar negatively impacted total Company comps in the quarter by approximately $350 million, or 1.8%. Comps for U.S. stores were positive 8.9% for the quarter with comps up 8.1% in November, 10.6% in December and 8.2% in January.

For the year, our sales increased 6.4% to $88.5 billion and total Company comp sales were positive 5.6%. Comps for U.S. stores were positive 7.1%.

During the year, a stronger U.S. dollar negatively impacted sales growth by approximately $1.4 billion, or 1.6%. Our gross margin was 34.1% for the fourth quarter, a decrease of 24 basis points from last year and in line with our plan.

The change in gross margin was driven primarily by the following factors: first, we experienced 15 basis points of gross margin expansion due to productivity within our supply chain and lower fuel costs; second, we had 26 basis points of gross margin contraction due to the impact of Interline Brands; and third, we had 13 basis points of gross margin contraction due to a change in the mix a product sold including a higher penetration of lower margin product categories like appliances. For the year, we experienced 6 basis points of gross margin expansion.

In the fourth quarter, operating expense as a percent of sales decreased by 96 basis points from last year to 22%. Our operating expenses were $90 million over our plan. We had some unexpected expenses associated with store maintenance, snow removal and our data breach.

Further, given our sales out-performance to plan we increased our accrual for management bonus and Success Sharing. For fiscal 2015 our operating expense as a percentage of sales was 20.9%, a decrease of 65 basis points from fiscal 2014. Our operating margin for the fourth quarter was 12.1% and for the year was 13.3%.

In the fourth quarter interest and other expense was $236 million, an increase of $138 million from last year. The year-over-year increase reflects two items: first, last year we recorded a $111 million pretax gain on the sale of HD Supply common stock that did not repeat this year; and second, interest expense was $29 million higher than last year, due primarily to higher long-term debt balances.

Our income tax provision rate for both the fourth quarter and fiscal 2015 was 36.4%. Diluted earnings per share for the fourth quarter were $1.17, an increase of 11.4% from last year. For the year, diluted earnings per share were $5.46, an increase of 15.9% compared to fiscal 2014.

Now moving to some additional highlights, during the fourth quarter we opened one new store in Mexico, bringing our total store count at the end of the year to 2,274 stores. At the end of the year selling square footage was 237 million, up slightly from last year, and sales per square foot increased 5.2% to $371. At the end of the year inventory was $11.8 billion, up $730 million from a year ago.

On a currency neutral basis, inventory dollars grew by $872 million. Inventory turns were 4.9 times, up from 4.7 times last year.

Payables grew $758 million from last year. On a currency neutral basis payables were up $834 million.

Moving on to capital allocation, in 2015 we generated approximately $9.4 billion of cash from operations and used that cash as well as proceeds from $4 billion of incremental long-term debt issuances to invest in our business, to repurchase our shares and pay dividends to our shareholders. During the year we invested approximately $3.2 billion back into the business through capital expenditures and the acquisition of Interline Brands.

Further, we repurchased $7 billion or approximately 59 million of our outstanding shares including $2 billion or 16.2 million shares in the fourth quarter. Finally, we paid $3 billion in dividends.

Our capital allocation philosophy supports our commitment to deliver high returns on invested capital. Computed on the average of beginning and ending long-term debt and equity for the trailing four quarters, return on invested capital was 28%, 310 basis points higher than at the end of fiscal 2014.

One more comment on capital allocation. For this month we refinanced approximately $3 billion of our long-term debt that is coming due in March 2016.

This morning we issued a press release with our guidance for fiscal 2016. I want to take a few months to comment on the highlights. Remember that we guide off of GAAP, so fiscal 2016 guidance will launch from our reported results for fiscal 2015.

As we look to 2016, we are projecting total Company comps of approximately 4.5%. Our comp forecast is based on U.S. GDP growth estimates of 2.1%, plus continued recovery in the housing market. With the benefit of five new stores and a full year of sales from Interline Brands, we project total sales growth of approximately 6%.

Our 2016 sales forecast is based on 2015 average U.S. dollar foreign-exchange rates. The U.S. dollar is currently stronger than the average exchange rate. As a result we are providing a range of sales, comp sales and diluted earnings per share growth to reflect the difference between 2015 average exchange rates and current exchange rates.

If currency exchange rates remain where they are today, this would cause a negative impact to fiscal 2016 net sales growth of approximately $800 million, dropping our projected total sales growth rate from 6% to 5.1% and our projected top sales growth from 4.5% to 3.7%. As we discussed during our December investor conference, we are planning our gross margin rate to remain flat to what we reported in fiscal 2015. We don't expect our gross margin rate to be materially impacted by exchange rates.

On a currency neutral basis we are forecasting our expenses to grow at approximately 40% of the rate of our sales growth rate, less than what we experienced in fiscal 2015 as we had $128 million of net breach-related expenses in fiscal 2015 that should not repeat in 2016. For the year, we project that our operating margin will grow by approximately 70 basis points. We don't expect our operating margin to be materially impacted by exchange rates.

For the year we anticipate our income tax provision rate to be approximately 37%. We expect our diluted earnings per share to increase by approximately 13% to $6.18. But if exchange rates remain where they are today, our projected diluted earnings per share would be approximately $6.12.

Our earnings per share guidance includes our plan to repurchase approximately $5 billion of outstanding shares during the year using excess cash. For the year, we project cash flow from the business of roughly $10 billion. Our 2016 capital spending plan is approximately $1.64 billion, a 9% increase from what we spent in fiscal 2015 in support of our strategic initiatives and to maintain our aging store base.

We will also use our cash to repurchase $5 billion of shares and pay $3.4 billion of dividends. As Craig mentioned, we just announced a 17% increase on our quarterly dividend which equates to an annual dividend of $2.76, in line with our targeted dividend payout ratio of 50%. Our commitment to shareholder returns continues to be a hallmark of The Home Depot.

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

## QUESTION AND ANSWER

**Operator**

(Operator Instructions) Peter Benedict, Robert W. Baird.

**Peter Benedict** - ***Robert W. Baird - Analyst***

Hey guys, thanks for taking the question. First question, just an accounting one I guess, how are you going to deal with the Interline Brands sales as we move through 2016? Once we anniversary that do those go into the comp base or are they going to be separate?

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

Yes, Peter, we're going to put Interline into our comp base. We think it's important to operate as one Home Depot. So as a result the comp, as you think about the shape of the year the comp in the back half of the year will be higher than the comps in the first half of the year.

**Peter Benedict** - ***Robert W. Baird - Analyst***

Okay, perfect. That's helpful. And then I mean the numbers don't seem to suggest you've seen any impact from the wealth effect whether it be the energy markets or the stock market.

Obviously everything in big-ticket very strong, but is there as you peel back the information, is there anything you're seeing in terms of consumers starting to pull back on any of the higher ticket stuff? Again the consolidated numbers don't seem to suggest that. Thank you.

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

Peter, we're not seeing that. Our business was good and continues to be good.

**Operator**

Chris Horvers, JPMorgan.

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

Thanks, good morning, and fantastic quarter. I'm trying to understand the underlying tenor of demand. You mentioned about $100 million lift to comps from weather.

It looks about 50 basis points. Was weather a benefit across all three months or was it mainly a November and December impact?

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

Well if we look at our comp performance we saw a double-digit comp in the U.S. in December. And that was really whether driven. December was the warmest month on record in 121 years and Ted, didn't we see a lot of strength in outdoor categories?

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

Yes, so clearly both our Pros and consumers were able to continue with outdoor projects. But really we're seeing comp continue to be strong across the entire store. And while we appreciate the $100 million odd of benefit from weather we don't look at this as a weather story in our fourth quarter.

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

Goodness no. We grew our sales by $1.8 billion. So $100 million of growth on $1.8 billion is not a weather story.

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

And it's geographies as well. We saw strength across really all the markets.

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

Understood. And then I mean do you look at that $100 million as a pull forward and sort of sticking with the weather theme, the first and second quarter tend to be volatile, so how are you thinking about that $100 million and how you are thinking just how perhaps the spring plays out? I know it's easier to look at it on the halves but as we model out the quarter how you are thinking about the first versus the second quarter.

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

Chris, generally you don't see a pull forward from Q4 into Q1 or vice versa. Generally it plays the bathtub effect between the first quarter and second quarter as spring breaks. So we don't believe it's a pull forward.

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

As we built our plan we did build the first quarter as the lowest comping quarter for the year. But that's principally because as we exited the year, as Ted commented, we had commodity deflation in our sales where that commodity deflation continues into the first quarter. So we built a plan to reflect it.

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

Thanks very much.

**Operator**

Simeon Gutman, Morgan Stanley.

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

Thanks, good morning. Nice quarter.

Craig or Carol in following on this theme, this was I think the second strongest U.S. comp since the housing recovery for Home Depot and it comes when other things in retail are getting a little shaky. We talked about weather a little but can you give us examples that you can share of any housing markets that maybe longer in the tooth of recovery that continue to just chug along?

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

Actually, the overall variability that we saw in the quarter by market was kind of directly in line with what we saw last year. And you do get a little bit more market variation as you're in winter months based on how winter breaks. So really there's not a lot of big variability.

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

Got it. So just underlying strength.

And then I may have missed this in the prepared remarks, but on Interline can you share with us how it performed versus expectations, anything on sales or margin? And realize it's early and I don't think a lot of the integration is just getting started but can you do you have a sense of how much overlap there is with the Pro, your Pro, and spending on Interline Brands maybe outside of The Home Depot today?

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

We're obviously in the early days of the integration efforts and we've worked hard across, as we shared we have a common vendor base so we're working through the programs with our vendors. We reduced redundancy in the business and now we are really getting into more of the focus on the sales side of it and sales-driving initiatives.

As we called out we're excited about the fact that we will begin to sell our paint brands to the multifamily operators in the Interline Company. Bill Lennie is here and he might want to comment. We're starting to see some success in crossover but it's very early days.

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

No, it is. We have seen some wins and some initial account engagements. So what that does, it really validates what we see as the value of the Interline acquisition.

It's just that synergy about being able to sell across channel. And as Carol articulated we're working on that vision of one Home Depot that allows our customers to shop either in-store, online or through Interline and having a greater access to a broader range of goods.

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

Okay, thanks.

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**Operator**

Seth Sigman, Credit Suisse.

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

Good morning and congrats on the quarter. I wanted to just follow up on that last question, but specifically on gross margins, Carol your guidance of flat gross margin which is pretty consistent with everything you said before, obviously Interline has a little bit of a near-term impact on that despite lower SG&A.

Once you anniversary the inclusion of Interline, how do you think about the gross margin opportunity from either synergies with Interline or continued supply chain benefits or even lower input costs that suppliers have talked about? And I guess what you see is the offset to that? Thanks.

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

Sure. As Craig mentioned it's really easier to look at our business by half. So as you think about gross margins for 2016 the first half because of the impact of Interline will be down year on year.

The back half will be up year on year. The back half will be up year on year because we will be anniversarying Interline and we will see the benefits of productivity. We've talked to you in the past of our ongoing efforts to drive productivity within our cost of goods.

We have a cost-out team that we stood up several years ago that works directly with Ted and the merchants to drive productivity and first cost which is our largest cost flow. And you've seen us drive incredible productivity in our supply chain. For the year we had 20 basis points of expansion coming off of supply chain.

This productivity that we are driving to our business allows us to invest in lower margin categories, not only Interline but lower margin categories like appliances and other categories, that haven't fully recovered since the downturn. So we feel very confident of the gross margin guidance that we've given for 2016.

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

So I would also comment that I would make we shared at the Investor Conference that our approach is to really to look at the end-to-end value chain and drive deeper collaboration with our vendor partners. And as we work through this with key suppliers, as Ted and I talk to them, we're confident and likewise so are they that there is opportunity to take cost out of the entire value chain which would benefit not only The Home Depot customer in terms of greater value, the shareholder, but also our vendor partners in terms of driving profitability for them as well.

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

Okay, thanks for that. That's very helpful.

Maybe just one follow-up question on Canada which has come into focus recently. Can you just elaborate on the performance in Canada and maybe more importantly how the position of Home Depot has evolved there over time and how are you thinking about perhaps more capital being deployed there by others in the sector?

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

We're actually very pleased with our performance in Canada. Before bringing Bill back he did an amazing job in Canada and Jeff and the team will continue that effort.

We have made significant capital investments in Canada not only in our stores but the experience that our customers have in store but also in our website as we've re-platformed our website and continue to develop our interconnected strategy for Canada as well as a significant investment in our supply chain, deploying our strategy that we developed here in the U.S. into Canada as well. So we're looking forward to continued opportunity to serve our Canadian customers.

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

And I might just throw in, from a store footprint perspective we have 182 stores in Canada where we want the stores to be. So we're very pleased with our store footprint.

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

Thanks so much for the color.

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**Operator**

Michael Lasser, UBS.

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

Good morning, thanks a lot for taking my question. One of the biggest surprises in the fourth quarter was the amount of market share that you were able to grab and that's not even accounting for some of your nontraditional competitors like department stores, messages your building material flows.

So do you have a sense of where it's coming from? Are you seeing capacity come out of the system from some of your traditional competitors and that may be enabling you to gain share? Or have you altered the way you do business such that these share gains are accelerating?

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

Well, I'd say that certainly it is something that we focus on all the time. The customer is clearly investing in our space so we're in a good asset class as it relates to housing.

But incredibly proud of the team's efforts. Whether that is the merchants to be able to deliver incredible values, our stores and our online team to be able to execute against that, our supply chain team that delivered and the nimbleness of our supply chain to be able to react to kind of both weather patterns that happened during the quarter, just really, really pleased with the effort that the team put forth in total.

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

And do you have a sense whether your share gain, and I it seems to suggest on your commentary about the different business segments whether your share gains were larger on the Pro side than they were on the consumer side? I'm not including Interline, I'm just talking in the core business.

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

Right. I mean what I would say is the measure of share is something that's incredibly difficult to get at overall. We do believe we're taking share in the market but the finite number is pretty tough to do that.

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

It really depends on what you're talking about. Ripping double-digit positives, suspect that was a Pro customer. In fact, we know it is a Pro customer through our consumer insights.

Appliances contributed 50 basis points of outcome growth in the quarter. Most of that is consumer. So you really have to look at the category of business and what was driving it.

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

And can you tie those share gains to some of your Pro initiatives, like the credit initiative, the Pro Xtra initiative and some of what you've done recently? I think it's important just to get a sense for how long the market share gains can last.

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

Sure. So I will speak to the private label card perhaps. We just rolled out our new value prop in January so you really can't attribute the strength in Pro, which by the way grew faster than the consumer in the fourth quarter, you can't attribute that to the new private label card.

But we're really excited about what that new private label card is offering to our Pro customers. As you know 60 days to pay, fuel rewards, 365 day returns. It's early days but we are liking what we see.

Our new accounts are up over our target. Our pros are enjoying on average $25 off at the pump when they are using their fuel reward card.

So we really like what we're seeing and we think that is going to bode well for 2016. So you can't attribute that but some of the other initiatives that we've introduced are really helping drive the business.

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

Yes, Michael what I think is happening and we're just very a pleased with the performance across all the categories is we are focused on having the right brands, the right assortments. We've done a lot of work, we've talked about our assortment planning tools.

We feel we have the right line structure in the store with great brands in the right price points. We're focused on everyday value and convenience for our Pro and our consumer customers and I think this is resonating.

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

Thank you so much. Good luck.

**Operator**

Seth Basham, Wedbush Securities.

**Seth Basham** - ***Wedbush Securities - Analyst***

Thanks a lot and good morning. Just to follow up on Michael's question, as you think about 2016 and your comp forecast ex-Interline would you expect the Pro to be a larger driver of your comps in 2016 and 2015?

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

I think we're focused on actually growing all of our segments. We're focused on growing the Pro customer, the DIY customer, the do-it-for-me customer as well as our digital customer.

So we haven't really thought about it as one being radically outsized versus the other. And we look at transactions and ticket as a balance of growth as well.

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**Seth Basham** - ***Wedbush Securities - Analyst***

Got it. A follow-up, as you think about the composition of traffic and ticket into 2016 you're looking for a balance.

What does that dictate in terms of your expectations for the housing market? Do you expect housing prices and turnover to be about in line with 2015 or do you expect any change?

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

We actually expect some changes, so let me walk you through those changes if I may. The first one I'm going to do is walk you from where we exited in the U.S., a comp of 7.1% to the guidance of 4.5%.

That's a 260 basis point delta and the drivers of that are threefold. First it starts with GDP. We're using GDP growth forecast of 2.1%. GDP in the United States for 2015 was 2.4%, so those 30 basis points coming off the top because that's lower GDP.

Secondly, on home prices we anticipate home prices to be up next year 3.5%. That's good. It's down from the growth that we experienced in 2015 of 5.4%, so that's another 30 basis points of growth coming off the top.

And then there's 200 basis points of market share coming off because we just don't build market share to our growth forecast. So that gives you 4.5% comp estimate for 2016.

A few other housing numbers since you asked. I gave you the home price estimate that we are using but we anticipate housing turnover to be up 4.4% of units, household formation to be up considerably. We are forecasting 1.9 million households formed as a block, this year was about 1.3 million households.

The other thing is that we're really spending time trying to get a better understanding is the impact of the age of the housing stock. As you know 65% of the homes in the United States are older than 30 years and there's external research that shows that spending on older homes is higher. John Burns would suggest it's something like 7.5% higher.

Our own internal research suggests it's 8% higher. So this aging housing stock bodes very well for us.

And if we could take you back to the last mild recession, and I'm talking a lot here and I apologize, but if you take it back to the last mild recession of 2001 housing stock was a lot younger 15 years ago. So this is a good news story for us.

**Seth Basham - *Wedbush Securities - Analyst***

Got it. That is a good news story.

Just one last follow-up, obviously you don't factor in market share gains. But anything execution wise that you think will change that that could impact the market share gain trajectory in 2016?

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

We're going to continue to focus on what we've been doing. So no, I don't see any major change.

**Seth Basham - *Wedbush Securities - Analyst***

Great, thank you and good luck.

**Operator**

Jessica Mace, Nomura Securities.

**Jessica Mace - *Nomura Securities - Analyst***

Hi, good morning and congrats on the good result. My first question is about the SG&A guidance. I just want to clarify that 40% of sales growth includes the data breach expenses from last year and if there's anything else we should be factoring in as to why that would be lower than the 50% of sales growth guidance you gave at your Analyst Day.

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

I'm confirming that. You understand that completely.

**Jessica Mace - *Nomura Securities - Analyst***

All right, great. And then I had a question on the interconnected retail.

You showed some good progress in that channel. What are the other near-term milestones we should be looking for in that channel?

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

We're continuing to clearly roll out the investment we've made in our direct fulfillment centers. So we're continuing to a sort those buildings which will give us the capability where we put product across all three buildings to be able to get product to our customers in two business days or less. So you'll see us continue to shrink lead times for our customers.

You will continue to see us invest in enhancements through search visualization as it relates to not only photography but video for our customers. We know there are customers engaged in that.

And Kevin Hofmann is here who runs our online business. Kevin, I don't know if you have an additional comment to make to that?

**Kevin Hofmann** - ***The Home Depot, Inc. - SVP & President, Online***

Sure. And just continuing to develop better experiences for our customers, mobile experience are a big focus for us as well. And as Craig mentioned we're also rolling out our Buy Online, Deliver From Store functionality throughout the year and we think our customers will be excited about that.

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

The great news for us is 40% plus of all the orders that happen in our digital space our customers choose to pick that up in one of our stores. They are conveniently located, they are safe, they know the product is gonna be there, they don't have to worry about it not being on their doorstep. And that's a great opportunity for us as it drives more traffic to our stores.

**Jessica Mace** - ***Nomura Securities - Analyst***

Great, thank you very much.

**Operator**

Dan Binder, Jefferies.

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

Hi, thank you. My question was regarding online. I was wondering if you could give us the growth rate in the quarter.

I think you gave us the year. And what do you think the top two or three things are that are helping the strong conversion there?

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

Our online sales grew $230 million or 23% in the quarter. For the year total online sales were $4.7 billion, that's 5.3% of our total sales, up from 4.5% from last year. So really pleased with the growth.

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

And Kevin do you want to --

**Kevin Hofmann** - ***The Home Depot, Inc. - SVP & President, Online***

So key things driving the growth is really what we talked about: great mobile experiences, great end-to-end interconnected experience. Our focus is not just the transaction online but as Craig said over 40% of our orders actually end up in the store in one way, shape or form.

So what we found is a lot of our online experiences are really about tying the customer back to their store-side shopping journey. And when we look at the total enterprise conversion rate just very, very pleased with our progress there.

Whether they convert online or whether they convert in the store that's really the customer's decision. So really great progress. We set all new records during our Cyber Monday event and our Black Friday event and really, really strong momentum.

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

And then my follow-up just hoping maybe you could comment on a few things. First, what your commodity deflation assumptions are for Q1, what the breakdown was at the $90 million of extra expense in Q4 and what you may be seeing in wage pressures across the Company or regionally?

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

Happy to. So the commodity price deflation pressure, again we don't forecast future deflation. So our forecast is inflation, deflation neutral.

But because we have seen prices come down that has a year-over-year impact it's about 50 bps in the first quarter. Looking at the breakdown of expenses, of the $90 million that were over our plan about one-third of the dollars were related to store maintenance, snow removal and the data breach, the data breach specifically being $9 million and the rest was in our bonus and Success Sharing.

As Craig pointed out all of our stores are eligible for Success Sharing. We are going to have the highest second-half payout in our Company history, so we're excited about that. And then Dan, the third question --?

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

Was regarding wage pressure that you may be seeing either regionally or as a Company, how it increases and so forth.

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

Yes, so thank you for that question. As we told you at our Investor Conference, we do have some people costs coming out as both in terms of wage pressure as well as higher medical costs due to prescription drugs. All of those pressures have been addressed and in the guidance that we have given you.

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

Great, thank you.

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**Operator**

Matthew Fassler, Goldman Sachs.

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**Matthew Fassler** - ***Goldman Sachs - Analyst***

Thanks a lot and good morning. My primary question relates to your big-ticket sales trends.

That comp growth and tickets of $900 or more I think is the second strong guest on record on both a one-year and a two-year basis. A couple of elements there. You mentioned custom kitchens.

Kind of curious whether those megaprojects are getting more traction? And also does the Pro growth that you're seeing, and particularly the acceleration of some of the Pro categories doing better disproportionately impact that big-ticket zone of your sales?

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

Well, I would say Matt on big-ticket we like the progress we're seeing in the momentum. So you specifically mentioned the kitchen cabinet business. That was a strong double-digit comp for us.

And what's encouraging is the pipeline of quotes in our system are at record highs and even now after such a strong Q4 going into Q1 we have a very robust pipeline. Just across the whole store appliances obviously is a big-ticket item that continues to grow.

And our service business, we have nice traction with our home interiors business and exterior business whether it's kitchen installs or roofing, siding, windows. So seeing really across the business.

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**Matthew Fassler** - ***Goldman Sachs - Analyst***

And if it's possible to dissect the acceleration from the 8% growth really high single digits that you've seen year to date to the 12% number, would you say that DIY or other DIY or Pro is disproportionately behind that pickup?

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

Actually both. I mean the install's certainly consumer. Appliance is consumer, roofing has a tendency to be Pro.

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**Matthew Fassler** - ***Goldman Sachs - Analyst***

Great, thank you for that.

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

Matt, the only point on that is as we look at we talk about our top classes that still haven't recovered from peak. And we're still as much as we've recovered in aggregate, all of the lost sales, there is still $2.5 billion in key categories. Those tend to be bigger ticket items.

So special order kitchens, countertops in all manner of millwork still remain below the 2006 peak. So we're watching our ticket carefully as Carol said. But from all indications pipelines are strong and sales continue with good momentum.

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**Matthew Fassler** - ***Goldman Sachs - Analyst***

Great. And then just a couple of cleanup points on the expense line.

Carol, you spoke about the impact of Interline on gross margin rate. Can you talk to the impact if any on the expense ratio and the D&A guidance does suggest a bit of a pickup. Is that primarily related to the deal or is there something else moving that number?

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

The D&A pickup is related to shorter lifed assets being put into service. We're coming into IT in a big way and that capital tends to have a shorter life.

And the impact of Interline is really reflected in the overall expense growth factor for the quarter. We were around 52%-ish. That's really because of Interline, if you back out Interline it was more like 40%.

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**Matthew Fassler** - ***Goldman Sachs - Analyst***

Great, thanks so much.

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**Operator**

Scot Ciccarelli, RBC Capital Markets.

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**Scot Ciccarelli** - ***RBC Capital Markets - Analyst***

Good morning, guys. So a bigger question, I guess two questions technically on e-commerce. We've obviously seen e-commerce disrupt so many retail sectors.

So I guess the two questions are number one, how do you think about the risk of consumers potentially getting increasingly used to shopping for your category especially with the growth of your own platform online? And then two, in your opinion what makes home-improvement different than what we've seen in so many other retail sectors where the box guys tend to battle market share losses and margin compression over time? Why would you be immune to that in your opinion?

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

I think when you look at the business in total there is a combination of factors. There are segments of our business we shared in the past that we believe the best business model is in the store. And the customers have -- they are smart, they have a tendency to gravitate to the best business models.

So we think there's elements of things like concrete and soils and mulches that make sense and that's where the customer will find the best value to purchase the product. There's other categories that are enhanced by the digital experience as Kevin was just sharing a minute ago where our customers actually start their shopping experience online but then finish in store.

Then there's clearly categories that are if you will at risk to transfer online because whether it's breadth of assortment or ease of shipping. And candidly in those categories to date for the most part we actually see growth in both channels. And so the digital business in large part has been incremental growth for us, and we see that opportunity to continue.

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**Scot Ciccarelli** - ***RBC Capital Markets - Analyst***

But do you think there's a risk that as people get more used to shopping at some of those categories that you're terming at risk that you can wind up seeing increased margin compression down the road? Because obviously that's something we've seen in a lot of other retail segments.

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

We run this as one business as a portfolio. We build out the capabilities and the tools to give visibility to our merchants to manage this across channels. So it's all built into our forward look that we shared at our Investor Conference.

**Scot Ciccarelli** - ***RBC Capital Markets - Analyst***

Got you. All right, thanks, guys.

**Operator**

Kate McShane, Citi.

**Kate McShane** - ***Citi Research - Analyst***

Hi, thank you, good morning. My question is on Project Sync.

I know that was a big focus of your Analyst Day and you had mentioned in the prepared comments that it's been rolled out beyond Houston. Can you give us any more detail about where else this has been rolled out to and can you remind us when you see this being completed?

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

It is in the process of rolling out in additional southern areas of the country. And this is a multiyear effort.

**Kate McShane** - ***Citi Research - Analyst***

Okay, thank you. And my follow-up question was just on exclusivity of product.

Again in the prepared comments I think you said that was a differentiator for the Pro. Do you have a percentage of what you're offering or sales percentage is of exclusive product to the Pro customer?

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

Honestly, we haven't calculated that.

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

We've talked about our private brands in the 15% to 20% range. But not talked about the exclusive products.

**Kate McShane** - ***Citi Research - Analyst***

Okay, thank you.

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

Nicole, we do have time for one more question.

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**Operator**

Greg Melich, Evercore ISI.

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**Greg Melich** - ***Evercore ISI - Analyst***

Great, thanks. I'll have two parts to it just to sneak one in.

Carol, I just want to make sure I got the SG&A thing right in the guidance. If it's 40% of sales growth we should be taking 40% of 5.5 when we think about SG&A dollar growth. Is that right?

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

So you should be taking 40% of the sales growth we gave which is 6%.

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**Greg Melich** - ***Evercore ISI - Analyst***

Okay. And then the second question is on working capital. So I hate to end on this but try to find something wrong with these numbers.

Inventory was up a lot but payables were up, too. What do you have in your $10 billion of cash flow guidance for working capital in 2016 and do you feel good about inventories where they are? Are they too hot, too cold, just right?

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

So our inventories are in the best shape we've seen. And I've been here, this is my 21st year so I can speak from authority they are in really great shape. We have 1/10 improvement in inventory plan for 2016 and Mark Holifield is here and I would say we might want to try to get even better than that but that's our plan.

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

Yes, just one thing just color on inventory, one thing to keep in mind his last year we had the West Coast port disruption which led to artificially lower inventory. So we're actually very pleased where our inventory is. And on top of that we're very, very pleased where are in-stock as compared to last year which we're really seeing a material improvement in in-stock versus last year because we are overlapping those poor disruptions from last year.

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**Greg Melich** - ***Evercore ISI - Analyst***

Great. So it's fair to say the $10 billion of cash from operations might include a couple hundred million from working capital but it's nothing, there's no massive move either way?

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

That's correct.

**Greg Melich** - ***Evercore ISI - Analyst***

Okay great. Good luck.

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

Thank you.

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

Well, thank you for joining us on our call today. And we look forward to reporting our first-quarter earnings at the end of May when we will talk to you then.

**Operator**

Once again Ladies and gentlemen, that concludes today's conference. We appreciate your participation today.