HD – Q2 2017 Home Depot Earnings Call
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PRESENTATION

Operator

Good day, everyone, and welcome to The Home Depot Q2 '17 Earnings Call. Today's conference is being recorded.

(Operator Instructions)

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

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

Thank you, Debbie, 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. (Operator Instructions) If we are unable to get to your question during the call, please call our Investor Relations department at (770) 384-2387.

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

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

Now let me turn the call over to Craig.

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

Thank you, Diane, and good morning, everyone. We had a strong quarter, achieving a milestone of the highest quarterly sales and net earnings results in the company history. Sales for the second quarter were $28.1 billion, up 6.2% from last year. Comp sales were up 6.3% from last year and our U.S. stores had a positive comp of 6.6%. Diluted earnings per share were $2.25 in the second quarter, up 14.2% versus last year. We continue to see broad-based growth across the store and all geographies. In the U.S., all 3 of our divisions posted positive comps in the second quarter, as did all of our 19 regions and top 40 markets.

Internationally, both Mexico and Canada posted another quarter of positive comps in local currency. Our solid performance was driven by the outstanding execution of our store and merchant teams, delivering value and service for our customers across multiple events, both in-store and online. As Ted will detail, both ticket and transactions grew in the quarter and all of our merchandising departments posted positive comps. We saw healthy balance of growth from both our Pro and DIY categories with Pro sales once again outpacing DIY sales in the quarter.

We believe that the work that we're doing to enhance the service capabilities for the unique needs of our

Pro customers continues to resonate. We are focused on being a valued partner for our Pros by offering solutions both in-store and at the jobsite that help them to more effectively manage their business. This includes enhancing our leadership position in tool rental.

During the quarter, we closed the acquisition of Compact Power Equipment, a leading national provider of equipment rental and maintenance services. Compact Power has provided larger jobsite equipment retals at more than 1,000 Home Depot stores since 2009. The acquisition is yet another investment to enhance our portfolio of service offerings for our Pro. And though we have worked closely with the Compact Power team for many years, we are delighted to officially welcome them to The Home Depot family.

Our investment in Interline and the MRO customers and other avenue to better serve the needs of our Pros. Use case 1, the rollout of Interline's catalog of products to Home Depot stores, is now implemented, and we are pleased with the early results. We also continue to roll out use case 2, which enables Interline customers to shop Home Depot stores using a swipe card linked to their Interline account. Though it's early days, we are seeing an incremental sales lift from accounts who have been given the swipe card. Our deeper level of engagement with the Interline customers has helped to drive sales growth that outpace the company average in the quarter, and we remain very excited about the MRO opportunity going forward.

Another growth engine for our business is our focus on interconnected retail. Our dot-com business represented 6.4% of sales and grew approximately 23% in the quarter. Our digital team continues to invest on content, sight improvement and better mobile experiences to take the friction out of the interconnected experience online. While our operations team remains focused on improving the interconnected experience in store. The result of these combined efforts is continued improvement in sales and customer satisfaction scores across both platforms. This is the power of interconnected retail. As you know, we look at productivity as a virtuous cycle here at The Home Depot and our efforts to connect our business end-to-end continue to pay dividends that enable us to reinvest in the customer experience. We are pleased with the productivity in the business during the quarter as the end-to-end initiatives to improve freight handling in the store continue to drive labor efficiency and optimize product flow from truck to shelf

Beyond the four walls of our stores, we continue to drive productivity throughout our value chain with initiatives like Supply Chain Sync. Sync is live in all of our RDCs. But as you know, this is a multi-year, multiphase endeavor as we work to onboard each of our suppliers flowing product through our RDCs. We continue to see great productivity from our supply chain as our investment over the past several years is having a positive impact on logistics cost, inventory productivity and service to our stores and customers.

Turning to the macro environment. We continue to see positive signs in the housing data, which we believe serve as a tailwind for our business. As Carol will detail, because of our outperformance in the first half versus our plan, we are increasing our sales and earnings per share guidance for the year. We now expect fiscal 2017 sales growth of approximately 5.3% and diluted earnings per share of $7.29.

The success of our spring selling season is the direct result of our 400,000 plus associates and their passion for our customers that extend well beyond serving them in our isles. For example, this year, we celebrated the 20th anniversary of Home Depot's in-store kids workshops. Held in our stores on the first Saturday of every month, these workshops have become a source of empowerment, accomplishment and pride for millions of children and their families. We like to think that we're fostering the next generation of do-it-yourselfers with some of the most enthusiastic participants over the years, even trading in their mini aprons for larger ones by becoming associates in our stores themselves.

I want to close by thanking all of our associates for their hard work and continued dedication to our customers as they once again successfully navigated the increased demands associated with our busiest selling season.

Based on the first half results, approximately 99% of our stores qualified for Success Sharing, our profit-sharing program for our hourly associates. We are very proud of their efforts. And with that, let me turn the call over to Ted.

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

Thanks, Craig, and good morning, everyone. We had a great second quarter, driven by strength for both our Pro and do-it-yourself customers. In addition, our online business continued its momentum as online sales grew approximately 23% versus last year. We saw broad-based growth across the stores as all of our merchandising departments posted positive comps.

Lumber, electrical, tools and flooring had double-digit comps in the quarter. Building materials, appliances, indoor garden and decor were above the company average. Plumbing, millwork, kitchen and bath, outdoor garden, hardware, paint and lighting were positive, but below the company average.

In the second quarter, total comp transactions grew by 2.6% and comp average ticket increased 3.6%. Commodity price inflation in lumber, building materials and copper positively impacted average ticket growth by approximately 68 basis points. During the quarter, we held a Memorial Day, Father's Day and red, white and blue events. These events drove excitement in our stores for both the customers and associates, and we very pleased with the results.

Looking at big-ticket sales in the second quarter, transactions over $900, which represent approximately 22% of our U.S. sales, were up 12.4%. A few drivers behind the increase in big-ticket purchases were appliances, flooring, certain Pro heavy categories. Transactions for tickets under $50, which now make up approximately 16% of our U.S. sales, grew by 1.5% in the quarter, reflecting, among other things, the return of our outdoor garden business in certain parts of the country.

In the second quarter, Pro sales outpaced the company average, driven by both our high spend and low-spend Pros. We saw strong comps across several lumber and building material categories as well as categories like pipe and fittings, power tools and wire. Sales to our DIY customers also showed strength in the quarter with flooring, storage and organization and patio all outperforming the company average comp. We strive to balance the art and science of retail as part of our core merchandising strategy.

For example, we are using data to help our merchandising execution team, or MET, execute more effectively. MET services the bays in our stores with primary responsibility for planogram integrity and shelf presentation. Currently, each space serve a space on overall store volume. We are initiating unique service rotations based on category specific sales and transactions. MET associates will receive individualized and optimized work assignments through their first films. This allows for the most efficient use of tasking ours and focuses bays service where customers shop most. Looking ahead, we will continue to build the capabilities and invest in people, process and technology in order to leverage our data to better serve our customers.

Now let me turn our attention to the third quarter. We strive to be the product authority in home improvement by providing our customers with the best brands at the best value. Our assortment includes many exclusive brands, and we are excited to be expanding our launch of PPG branded products, a brand that has been trusted by Pros for over 100 years.

This quarter, we are introducing PPG timeless paint. This new product guarantees one coat coverage, is available in both interior and exterior paint. PPG's world-class coating technology improves durability, saving our customers time and money. Product innovation is also at the forefront front of our retail strategy. Flooring, both hard and soft, has been an excellent growth driver for our business this year, and we continue to see great innovation within the category.

New to our assortment is an improved vinyl plank flooring from LifeProof. This innovative product features a highly engineered closed cellphone PVC core that delivers rigidity and strength, yet is lightweight and easy to handle and install. It is also 100% waterproof and scratch resistant and is available in over 40 patterns.

This new LighProof final flooring is exclusive to The Home Depot. We are excited about our upcoming Labor Day, fall cleanup and Halloween harvest events in the third quarter. As always, we will be offering a variety of special buys and values throughout the store and online to help kick off the fall season

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

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

Thank you, Ted, and good morning, everyone. In the second quarter, sales were $28.1 billion, a 6.2% increase from last year. Our total company comps or same-store sales were positive 6.3% for the quarter with positive comps up 5.8% in May, 5.9% in June and 7.2% in July. Comps for U.S. stores were positive 6.6% for the quarter with positive comps of 6.6% in May, 6.2% in June and 7% in July. Versus last year, a stronger U.S. dollar negatively impacted total sales growth by approximately $64 million or 0.2%.

In the second quarter, our gross margin was 33.7%, a decline of 6 basis points from last year. The year-over-year change in our gross margin is explained largely by the following factor.

First, we had 9 basis points of gross margin expansion in our supply chain, driven primarily by increased productivity. Second, we had approximately 8 basis points of gross margin contraction due to a change in the mix of products sold. And finally, we have 7 basis points of gross margin contraction due to higher strength than one year ago.

In the second quarter, operating expense, as a percent of sales, decreased by 44 basis points to 17.8%. In the quarter, our expenses were $20 million over our plan due primarily to a true-up of our bonus accrual. Even so, our operating expenses, as a percent of sales, were better than our plan due to our strong sales performance.

One last comment on expenses. As we told you last quarter, we expect our expense growth factor to vary by quarter given year-over-year comparisons and the timing of investment. Looking ahead, we expect our expense growth factor to be lower in the back half of the year than it was in the first half. Our operating margin for the second quarter was 15.9%, an increase of 38 basis points from last year. Interest and other expense for the second quarter grew by $21 million to $249 million, chiefly do to the impact of adding $4 billion to our outstanding long-term debt over the past year.

In the second quarter, our effective tax rate was 36.6% compared to 37% in the second quarter of fiscal 2016, reflecting the benefit of a new stock compensation accounting standard that we adopted at the beginning of the year.

Our diluted earnings per share for the second quarter were $2.25, an increase of 14.2% from last year.

Moving on to some additional highlights. In the first 6 months of the year, we opened 4 new stores, including 3 in the U.S. and 1 in Mexico. We have not opened a new store in United States since 2013. Our new U.S. stores still open voids, and we are pleased with their initial sales performance.

Total sales per square foot for the second quarter were $464, up 5.9% from last year. Turning to the balance sheet. At the end of the quarter, merchandise inventories were $12.9 billion, up $545 million from last year, and inventory turn were 5.3x, up 1/10 from last year. In the second quarter, we repurchased $2.6 billion or approximately 17.3 million shares of outstanding stock, bringing our year-to-date share repurchases to approximately $3.9 billion

Additionally, during the quarter, we took advantage of an attractive interest rate environment and raised $2 billion of incremental long-term debt. We will use the proceeds of this debt issuance to repurchase outstanding shares, increasing our 2017 share repurchase target from what had been $5 billion to now $7 billion.

Computed on the average of beginning and ending long-term debt and equity for the trailing 12 months, return on invested capital was approximately 32%, 300 basis points higher than the second quarter of fiscal 2016.

Year-to-date, our sales and earnings per share have exceeded our expectation. Turning to our outlook for the remainder of the year. We expect to see continued growth in the repair and remodel market as the U.S. has experienced solid wage growth, faster home price appreciation and the reemergence of first-time homebuyers. As a result, we are lifting our fiscal 2017 sales and earnings per share growth guidance to reflect our first half performance and our confidence in the back half of the year.

In addition, as Craig mentioned, we recently completed the acquisition of Compact Power Equipment and are excited to welcome the Compact Power team to The Home Depot family. As we look to the back half of the year, Compact Power will not have a material impact to our sales or earnings per share forecast, but it will slightly affect our gross margin and expense structure.

We now expect fiscal 2017 sales to increase by approximately 5.3% with positive comps of 5.5%. While this suggest our second half comps will be slightly lower than our first half comps, our sales guidance is based on our planned foreign exchange rates for the back half of the year.

Given the recent performance of the U.S. dollar, there could be some upside to our sales forecast. At the beginning of the year, we expected our fiscal 2017 gross margin to decline by 15 basis points from what we reported in fiscal 2016. Reflecting the impact of Compact Power, we now expect our fiscal 2017 gross margin to decline by approximately 10 basis points.

For the year, also reflecting the impact of Compact Power, we now expect our expenses to grow at approximately 46% of the rate of our sales growth.

Finally, for the year, we expect our effective tax rate to be approximately 36.3%. For earnings per share, remember that we guide off GAAP. For fiscal 2017, we now expect diluted earnings per share to increase by approximately 13% to $7.29. Our updated earnings per share guidance reflects the points I just mentioned as well as $7 billion of share repurchases for the year. So we thank you for your participation in today's call. And Debbie, we are now ready for questions.

QUESTION AND ANSWER

Operator

(Operator Instructions) We'll go first day to Simeon Gutman with Morgan Stanley.

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

Quick question, I guess, on the recovery. The longer the recovery persist, it's just natural… it seems like the market is getting some angst that there's eventually going to be a shooter drop. How do you get comfortable with the tenor of the recovery? Clearly, the business is performing great. And if there are yellow flags, how do you know what you're looking for?

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

I mean, I'd say, Simeon, that we've had, obviously, a protracted recovery here. And it has been clearly driven from housing, which has been a steady but slow recovery in the market. We continually look at month of supply. There's 4.3 months of supply in the market of housing availability against a historical norm of 6. That clearly is helping to drive improvement in the home value appreciation. But housing starts haven't returned to their norm yet, either. The only thing that's kind of running the historical averages is housing turnover. So we see this housing favorability continuing as we look forward. And I think the watch out for us is, you wouldn't want to see affordability become an issue. But at this point, it doesn't seem to be a concern for us at all.

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

Right. As we look at the Affordability Index, it stands at 153%. So long ways to go before that would be a watch out for us. And recovery is a difficult thing to put your arms around. But if you look at simply PFRI dollars, they only recovered 70% of the loss. So if you put that into baseball terms, I guess that's about the sixth inning. The other thing that is really interesting to us is the age of the housing stock. We've talked to you a lot about 66% of the housing stock being older than 30 years. Well, did you know that 51% of the housing stock is older than 40%, and as houses age, we'll they need more repair.

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

It's more spend.

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

Okay, that's helpful. My follow-up is on e-commerce, and I'm sure this will be topical. I just want to ask one angle of it. So in using the power tool category as an analog for how to think of appliances, the pushback that we've been getting is that, look, Home Depot has done a great job in power tools, but they have a lot of exclusive brands and labels, which is different than appliances. And ultimately, appliances will be harder to control, given some of the large national brands. Can you share some thoughts on that comment?

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

Well, what I would say is we have a lot of categories of goods in our stores, over 200 plus categories of goods. And we compete with lots of folks across all of those categories. And candidly, by category, the strategy is different because the categories are different. And so our job is to create the strategies, that allows us to be the customer's advocate for value across the categories and compete accordingly. And it varies by category what our approach is.

Operator

We'll go next to Michael Lasser with UBS.

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

I have two questions on market share. First, it looks like your total sales increased slightly less than the category according to the Census Bureau. So where do you think you might have lost some share to during the quarter, and then I have a follow-up on that.

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

Actually, based on the NAICS 4441, it actually looks that we gained share in the quarter. We don't believe we lost share in the quarter.

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

Yes, we're up 20 basis points.

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

Yes, 20 basis points year-over-year.

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

20 bps to 28-12.

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

Right

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

Okay. And then the second part of the question is on e-commerce. The e-commerce channel within home improvement overall. Do you think that you're gaining share within that channel, within the category? And what rate of growth do you think the home improvement category is growing online?

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

So we actually have an interconnected retail approach and our customers are blending the physical and the digital world together and we look at share in totality as it relates to Home Depot's gain in the market against what the market is growing.

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

And we're pleased with the share gains. It's important to remember that over 43% of our online transactions are picked up inside of a store. This is One Home Depot, not an online or on in-store business, but its One Home Depot.

Operator

We'll go next to Dan Binder with Jefferies.

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

As you just mentioned different strategies for different categories online. Obviously, appliances have been in the news recently. I know you do some of your appliance business online. I was wondering if you could just talk a little bit about the complexity of that transaction. How the customer is shopping it in the store or even if they're ordering it online and where you think your competitive advantages are if you started to see that category become more available online at other competitors?

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

If you look at the interconnected experience, candidly for appliances, there are lots of other categories. In many, many categories, the shopping experience starts in the digital world, even though it might finish in the physical world or in some cases, actually finish in the digital world as well. It is truly a blended experience today where the customer, the front door of our store is no longer at the front door of our physical store for many, many product categories. The customer starts digitally, looking at products, doing research. And then, in many cases, particularly in large ticket, they come in and they actually want to talk to one of our associates before they make a purchase. But we clearly, in big-ticket categories, we sell both in the physical and the digital world.

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

And then if I could just ask one other question related to delivery. Can you give us an update on how many of the stores are able to deliver to the Pro within 2 hours now?

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

Yes, we've actually rolled out the delivery program at the end of fiscal 2016. Mark Holifield is here. I'll let Mark...

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

Yes. Dan, our buy online deliver from store and our deliver from store capabilities were fully rolled out at the end of last year. And we offer the 2 and 4-hour window options at all of them at this point.

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

And Mark, we've certainly sequential growth in our delivery business every week in the quarter. So our customers are responding very well to this offer.

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

Very healthy growth.

Operator

We'll take our next question from Christopher Horvers with JPMorgan.

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

Can you talk about, Carol, last quarter, you talked about Pro being up 2x DIY. Did that trend continue? And can you talk about the growth that you're seeing in the Pro versus DIY? What does that make you all think about what's going on in the market now and in terms of the duration of the growth going forward?

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

Sure. So yes, our Pros grew twice as fast than the DIY, actually expanded that gap a bit in the second quarter. And Chris, I can recall talking to you last August about our sales and our Pros going out on vacation. Well, based on what we're seeing in the stores today, our Pros are not on vacation. The stores are busy and our sales are quite good.

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

Nice. And then I think one of the questions that was asked on our last that I thought it was really interesting and wanted to put out there. You have companies like Wayfair spending a lot on advertising and Amazon's reported to be more interested in the category. So obviously, as you saw these companies get rewarded with sales growth and not necessarily profitability, clear in Amazon's last report. So do you think that given this increased interest and greater advertising spend, do you need to flex some muscles here and maybe deleverage advertising a little bit to the defend The Home Depot been in the home-related categories?

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

Chris, I'd say one of the things I'm very proud of the team, they have worked really hard over the past several years to drive dramatic improvement in terms of the effectiveness of our marketing dollars to reach a customer in a space where they have a high level of interest. So we have been on a path to balance our approach in terms of marketing, both in traditional media and in digital media. And the team has been able to drive incredibly effective returns on our marketing spend.

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

We spend more in digital on the second quarter than we did TV and radio combined. So the team is doing an awesome job at getting more eyeballs higher return on that spend.

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

Yes, our overall advertising spend is up lower single-digits. But as we've essentially made the more significant pivot to digital marketing, it's over half our marketing right now. That's a medium that you can get good insight on the return on your spend. And as Craig said, the team has just done a great job continuing to increase the return on that spend. So leveraging that low single-digit to a much more productive turn on overall ad spend.

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

Like I'm sure you do a lot of key search terms and so forth there. Is that becoming more expensive to you as Wayfair and Amazon focus more on the category?

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

I mean, it varies by category by day, candidly.

Operator

We'll go next to Brian Nagel with Oppenheimer.

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

So my first question, I guess, just follow-up in some other e-commerce type questions. But maybe to exactly Chris was saying some minute ago. You other e-retailers or online only channels at least indicates some interest gain in this category. But from your vantage point, are you seeing anything suggest that anyone's coming out with a much, much price aggressive effort and one that you would have to match or you're choosing to match?

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

I mean, Brian, we've invested, obviously, in tools and capabilities to inform our merchants in terms of the overall competitive position in the marketplace, both in the digital and the physical world. And this, quite candidly, has been something that the company has been focused on since its inception in terms of making sure that we're driving value. Core belief that I have is as merchants, we are the customer's advocate for value, period. And that's the job of The Home Depot and The Home Depot merchandise team every single day. So we must stay focused on a competitive offering. And quite candidly, value is defined by what the customer's willing to pay for.

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

Got it. And my follow-up question, I mean, shifting gears a bit. Flooring, I think you called that out as another bright spot. Again, from a competitive standpoint, there's been -- there's others companies, they're pushing to the flooring from more of a specialty perspective. Overall, what do you see as far as, I guess, how would you characterize the consumer demand of the category? And then are you seeing anything from stepped-up competitions you had to react to?

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

As Craig said, it's a great point. We competed over 220 categories. Flooring is a very big category, and there actually a lot of competitors have been and will be, we see consumer demand very strong and the consumer is responding to The Home Depot value proposition. So we have innovative product. We have exclusive product. We have new technology and exclusive launches at The Home Depot. And we've worked very hard on our in-store selling model. And Ann and her team are just doing a great job communicating that value to the customer in both our hard and soft flooring, and they're both doing extremely well, as I called out, double-digit comps for the category.

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

I was curious about your comment with regard to the reemergence of the first-time homebuyers. Is this the first time you're seeing this? And if this were emerging, would this be enough to offset any slowing of price appreciation if it were to occur?

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

Well, it's really interesting to see what happen for the first-time homebuyers in the second quarter. The highest number of first-time homebuyers since 2005, about 424,000 first-time homebuyers, making up 38% of all homebuyers and up 11% year-on-year. So that is good news. Why? Because first-time homebuyers tend to buy homes that need repair and remodel. So as we see and we anticipated this happening with millennials coming into an age where they start to form families, children or pets or whatever their family unit might look like, they're moving into homes, which bodes very well for us and to your point, it extends the recovery.

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

And then, Ted had mentioned that the 3 events you conducted during the quarter. Just wondered if that differed in any way versus last year? And does that help explain some of the acceleration into July?

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

There were similar events in duration as last year, Kate.

Operator

We'll go next to Matt Fassler with Goldman Sachs.

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

My question relates to your discussion of sales trends by ticket. Can you just remind us whether that's store only or whether that's inclusive of online? And then I have a quick follow-up.

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

Yes, it's all in.

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

It's all in.

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

Right

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

I guess, is there anything about the way consumers are shopping based on project or basket that would change the composition of that sales performance by ticket, just thinking about the outsize, extended outsize growth of the big-ticket piece and the fact that the smaller ticket piece has been growing at a slower rate for kind of equally consistent period of time?

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

The biggest driver behind that has been the recovery of our Pro customer and the growth that we've had in categories like appliances and flooring. Those are big-ticket purchases in and of themselves. So appliance is clearly much larger than our average ticket. A flooring job is significantly larger than our average ticket. And our Pro customer spends dramatically more than the average DIY customer. So those have clearly helped to drive the growth in tickets above $900. And then we did see the recovery in the smaller ticket amount as a result of the garden business coming back to a more normal state in the second quarter.

Operator

We'll go next to Dennis McGill with Zelman & Associates.

Dennis McGill - ***Zelman and Associates - Analyst***

One more question, just going back to appliances and online. I think you said 6% of sales online are for the total store. Can you just maybe just frame appliances relative to that number and just give a little more detail on how you mentioned, Craig, the buying experience in some cases starting digitally and ending digitally. What percentage of those big-ticket transactions in appliances are executed online? Just to kind of get some frame of reference to the category as a whole already being an online category.

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

We don't break that data. I mean, for competitive reasons, we would not share that data. Thanks.

Dennis McGill - ***Zelman and Associates - Analyst***

Okay. Is that -- I won't count that as my question. So my first question is, we'll shift to non-online. When you look at outdoor garden, I guess, for the first half of the year, it's a below-average category. So I guess, with the weather comps year-to-year, it didn't get really get the typically bathtub effect. Carol, when you look at the back half of the year, do you expect that some of that could come back and the full year would balance out? Or is that lost demand at this point?

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

Some of the softness is relative as to the category grew, soil and mulch. And, Ted, I wouldn't think we did much of that.

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

No, I think some of the uptick we saw in July was that extended season. All in, it was a reasonably good season. I wouldn't say great. Certainly, colder in weather early. And it was really wet into June. So some late garden. But I think we've seen that and it just isn't that big until you get into fall and then, hopefully, you'll get a seed season and some planning season.

And then second question just as it relates to inventory. Carol, how would you characterize inventory in the channel today when you just first store, same-store and the acquisitions and so forth as far as what a supplier might be phasing with projects and so for. Is there less inventory throughout the channel today? And if so, can you quantify that in any way?

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

We're growing inventory to support our sales. We also want to drive productivity, as Craig called out in his remarks. And so we're always going to look to improve the velocity of our inventory turn. But my goodness gracious, as Craig always says, customer service starts with in stock. You got to have what the customers want. And certainly, we will do that working with our supplier partners.

Dennis McGill - ***Zelman and Associates - Analyst***

So the inventory, I think, turns into a frame earlier being up a little bit. Is that a same-store representation?

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

That is a One Home Depot representation, includes inventory in our stores and in our distribution centers.

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

I mean, total inventory is up 545 million in the quarter.

Operator

We'll go next to Alan Rifkin with BTIG Corporation.

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

Carol, you mentioned that the expense factor in the second half should be lower than in the first half. Given the fact that typically, second half revenues in aggregate are less than the first half and you said that you forecasted comps to be a little bit lower in the second half versus the first half, is the reason for a lower expense factor in the second half entirely due to Compact Power? Or are there other things going on there?

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

Let me give you a little bit more color on our expenses, if I could, please. As you know, we stepped up our capital spending program this year. Taking our total spending up to $2 billion, including $350 million of capital to invest in our store. And certain of our stores are getting new weight binding packages, new flooring, new lighting, new restroom, new break rooms, so on and so forth. That capital comes with an expect. Now we didn't plan for the activity equally over every quarter. And in fact, a lot of that activity took place in the second quarter. And so I look at our expense performance in the second quarter, while it was planned, expenses related to our store investment, which would include all write-offs of old fixtures and reset expense and that sort of thing, year-on-year, it was up $19 million. So it was pretty lumpy in the second quarter. That won't be as lumpy in the back half of the year, and that's really the driver of the expense growth factor first half versus second half.

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

And then as a follow-up. With respect to Compact Power, either Craig or Carol, could you maybe just talk about the margin structure for that business? Would it be correct to assume that it's a lower gross margin as well as lower SG&A business? And what effect on a full-time basis to EBIT margins does the acquisition of Compact Power in of itself has?

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

Yes, happy to talk about it. First, Compact Power, the revenues for Compact Power are recognized on a net and not a gross basis. So you have gross margin associated with that business. It's highly margin accretive. And Alan, that's one reason why our gross margin guidance for the year has changed from one had been down 15 basis points to now down 10 basis points. Because the revenues are recognized on a net basis and because there are expenses in Compact Power, it puts some pressure on our expense growth factor for the year. We had guided that expenses would grow at 43% of our sales growth. We're now suggesting 46% of our sales growth. That's because there are no revenues. We will report on a net basis, but there are expenses. If you look at the EBIT of Compact Power, it's very accretive. In the back half of the year, this is a small business, strategically very important. But in the back half of the year, Compact Power should contribute $0.01 of EPS accretion.

Operator

We'll go next to Scot Ciccarelli with RBC Capital Markets.

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

Carol, you've already highlighted how the housing stock in the U.S. continues to age. And obviously, that's been a pretty big thing for you over the last, call it, 2 years or so. Do you happen to -- I know it's something you guys have been looking at for a while. So do you happen to have any analytics around the home improvement spending maybe by vintage or do you know if there's an average percentage spend relative to an average home price?

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

Yes, a couple of data points. Homes built before 1980, the average annual home improvement spend is $3,500 a year. Homes built after 2000, the average annual home improvement spend is $1,500 a year. So there's a pretty nice delta as the homes age. The other interesting data point, and we haven't proven this analytically in our own research, but I'm sure we'll do it anyway because I think it's very interesting. We look at John Burn's real estate consulting group a lot. They've got some really interesting data in housing. And they say that for every percentage point improvement in real wages, and real wages are up this year after inflation 2.2%, they say for every percentage points increase, there's a 1% increase in the repair and remodel spend. Interesting, we haven't proven that. But it stands to reason. Got more money in your pocket, you're Going to spend some more money on your home.

Scot Ciccarelli - *RBC Capital Markets - Analyst*

Yes, that makes a ton of sense. And just a quick follow-up. You also mentioned how first-time home buying is finally starting to accelerate. Again, that should be good for duration. But just based on historical purchase patterns, would you expect that to impact your small ticket performance? Presumably, there's a little -- a lot more kind of nickel dime type projects that are probably done, but I don't know if that's true or not.

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

I wouldn't think so, no. Because when they're going into the homes, they need to repaint them. And paint is not just of bucket, I mean, gallon of paint. But it's the tape and tarps and all the other stuff that goes it or refloor...

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

Yes, I would think so other than a trip for picture hanging or something like that, it would be under $50. But yes, your -- which we like.

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

Which we like.

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

Older basket

Scot Ciccarelli - *RBC Capital Markets - Analyst*

Right. So no real change in the cadence between big ticket and small ticket as you wind up getting more first-time home buy?

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

Don't think so.

Operator

We'll go next to Keith Hughes with SunTrust.

Keith Hughes - *SunTrust Robinson Humphrey - Analyst*

You mentioned several times earlier in the call that your Pro is up well in excess of the DIY. Can you give us any insight on product categories that did particularly well with the Pro in the quarter?

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

Well, certainly, our building material categories did very well. Our electrical did very well. Tools, consumers, consumers love our power tools, but the Pros are really the heavy users of that. Lumber is very strong. Lumber prices are near or at all-time highs. Very unit productivity is the commodity prices we know will go up and down. We watch the units very carefully in lumber and building materials, and those have been very strong as well.

Keith Hughes - *SunTrust Robinson Humphrey - Analyst*

You mentioned earlier in the call the introduction about new prove paint initiative. Is that an area, does that rank among your tops in terms of growth with the Pro?

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

Yes, the Pro paint initiative that we have with each of Behr and PPG has been very successful. I'd say overall, we're pleased with our growth in our paint business. I'd say we're holding share, if not gaining a little bit of share in paint. But our Pro paint initiative in particular is multiples higher growth than our DIY paint business.

Operator

We'll go next to Scott Mushkin with Wolfe Research.

Scott Mushkin - *Wolfe Research - Analyst*

So I guess, I wanted to take a step back and ask a broader question. A lot has been asked on the call. I mean, as you guys look at your businesses because obviously, just performing terrifically and obviously, a big tailwind from what's going on macro, but also the great things you guys are doing. What do you worry about?

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

So I'd say, there's 2 things that are up there on the list. And one is we're investing in the One Home Depot experience. That's how the customer views us. Not exactly how we were built, so we have to do some things to get there completely. And you worry about the ability to execute on that fast enough and the change management that comes along with that. Second worry I'd say is the customer and the associate experience in our high volume stores. Clearly, with the growth that we've had, that puts pressure on in those stores disproportionately. And so we're going to have to invest to solve that situation. And we're working to put that in place. But those are certainly 2 worries that we have in the business.

Scott Mushkin - *Wolfe Research - Analyst*

All right, that's really good insight. And then I was just wondering if you could talk about kind of how things are going so far this quarter. I mean, after we had the retail sales numbers out today. They were good. And we experienced sometimes a third quarter lull because DIY is not as strong as Pro. I just wondering any thoughts as we look at the third quarter and anything we should consider.

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

Yes, Scott, as we mentioned just a little bit earlier, we are quite pleased with our sales in August thus far.

Operator

We'll take our next question from Matthew McClintock with Barclays.

Matt McClintock - *Barclays - Analyst*

It's been a little over a quarter since you now had access to Interline inventory in your stores. And I was wondering, conceptually, how should we think about the benefit from that access building and having an impact on your sales? How do you build awareness of that? Is that really what we're waiting on to see an acceleration in the business from that? Or just how to think about that, that benefit layering in over the coming years?

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

I mean, I'll start, and Bill is here who runs our Pro and services business. But as I call out in my comments, we're actually very pleased with use case 1 and use case 2 response from our customers. And with that, as well as the effort of the team at Interline. Interline actually grew above the company average growth in the quarter. So...

Bill Lennie - *The Home Depot - EVP of Outside Sales and Service*

Yes, just, Craig, thanks. A quick comment. We're now live in 1,958 stores. So we basically finished the rollout. We have 1,500 stores that have access to Interline's products next day and an additional 458 stores that are a 2-day delivery. And we're seeing great activity on a broad-based of goods, primarily servicing the trades from plumbing, electrical, hardware. Also strength in the HVAC business. So it's doing a nice job of extending our product reach, giving us access to deeper inventories for Pros that are coming in and looking for project-based purchases. And then, overall, average ticket on par, ramping sequentially week over week and pleased with the progress on the MRO business.

Matt McClintock - *Barclays - Analyst*

And then, Carol, if I can have a follow-up. Just -- and I'm sorry if I missed this. But the 7 basis points of pressure from higher shrink, I have to ask about it because it almost offset the benefit from the supply chain. Could you just talk about what you're seeing there or what's driving that?

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

Yes. As you know, there are many drivers of shrink, including higher theft and changes in operational processes and new systems. We have a cross functional team that is addressing this. We're hearing from other retails that theft is up across the board. But we're really focused on what have did we change inside of our stores that perhaps caused some of this, and in fact the cross functional team has identified a few defects that we are correcting, and we will continue to work on this going forward.

Operator

We'll go next to Peter Benedict with Robert Baird.

Peter Benedict - *Robert W. Baird - Analyst*

First was just kind of labor market and wages and availability of works. I mean, what do guys seeing on that front, whether it be with the seasonal folks that you hire or some of the specialty or full-time folks. That's my first question.

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

Sure. So Peter, we hired seasonally this year, over 90,000 people. And one of the great things that happened in this season was we enhanced our application process through an improved mobile experience and actually, doubled our applicant pool. So we're very pleased with that. It was a better experience for the applicants themselves and was pretty effective on our end as well. We are certainly seeing wage pressure, and that varies market by market. But that's something that we anticipated and planned for and it's actually built into our guidance for 2017.

Peter Benedict - *Robert W. Baird - Analyst*

And then, Carol, just curious on the FX. Just to make sure I understood you correctly. Your guidance right now still assumes, it think it was $250 million headwind from FX for the year. Is that right?

Well, the back half is actually $250 million, that's right. So if you were to add that back, you would calculate the comp to be about the same as what we reported in the first half.

Peter Benedict - *Robert W. Baird - Analyst*

Okay. And then last one, if I could. The store refreshes that you alluded to, remind us how many you're getting done this year? How many you think you may could do in 2018? And Craig, anything specific? I mean, you talked about trying to alleviate some of the customer experience and associates experience friction that may occur in these high volume stores. Anything in particular that you're focused on that you're seeing some improvement from as you kind of work to reengineer the stores a little bit?

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

Sure. For the first part of the question in terms of how many this year, approximately 500 stores will get the updates that Carol referenced earlier as it relates to the signage, navigational signage, lighting, floor, break rooms, restroom and so on. And then in the high volume stores, we have to work to continue to improve the experience for the customer on the front end in particular and get the customers through the registers with greater speed. And then likewise, those stores feel more pressure from BOPIS and BOSS pickup, and we're working to solve that for them as well. And that will be a different scenario by different type of stores, but those are the areas of focus.

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

And Peter, we've got an investor conference in December. So we'll lay out our plans for '18 and beyond at that conference.

Operator

We'll take our next question today from Seth Basham with Wedbush Securities.

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

As we look at the trends in small-ticket sales relative to big-ticket sales, obviously, they've been underperforming for some time. Do you think that you're still gaining market share in some of the small ticket categories?

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

Yes, I would. I mean, the small ticket is healthy. We talked about the transactions being up 1.5, but that also comes with a strong positive comp associated with those transactions. And the mix of the business, we used to talk about under 50 being 20-odd percent and over 900 being 20-odd percent, and that dynamic shifted as the customer has responded, we think largely to the product and the innovation in the store. And again, if we look at this every single week, where the sales coming from in the assortment and we continue to see the customer respond to the innovation in buying the continue on the assortment. An example of that will be in soils and mulch this year. So we talked about garden coming later, which it did. And we had a fine garden business in the second quarter. But we were a little less promotional on commodity mulch, because what we find is the customer is buying heavily into the organics. We have a number of exclusives in organics with Kellogg's and doctor Herbs and some of the Scotts miracle products. And customers are happily trading up. And we're talking 2 and sometimes, 3 and 4x the cost for a bag of organic mulch over commodity mulch. So we look at it very carefully because it's a natural and fair question, but we continue to be comfortable with what the dynamic is of the ticket growth. We look again that it's exclusively this year product mix and then the effect of commodity prices in lumber and building materials. There's been no price impact on our AUR.

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

That's helpful. And given that we have a few minutes in this call as we think about the e-commerce impact is on the small ticket categories. Do you feel like you guys are better or less well-positioned to gain share in some of the smaller ticket categories as a result of what's happening with the online channel?

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

I mean, we feel very comfortable we compete across all segments of the line structure. Opening price point, mid price point, upper price point across channels.

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

Well thank you everyone for joining us today. And we look forward to talking to you next quarter.