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HOME DEPOT, INC.

JPM Retail Round Up Conference

CORPORATE PARTICIPANTS

Richard McPhail

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

OTHER PARTICIPANTS

Christopher Michael Horvers

Analyst

JPMorgan Securities LLC

MANAGEMENT DISCUSSION SECTION

Christopher Michael Horvers

Analyst

JPMorgan Securities LLC

Thank you, everybody, and still good morning; and welcome again to day two of JPMorgan's eighth Annual Retail Round Up. It's my pleasure to have Home Depot – The Home Depot CFO, Richard McPhail, and Executive Vice President with me today.

Richard McPhail

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Great to be here, Chris.

QUESTION AND ANSWER SECTION

Christopher Michael Horvers Q

Analyst

JPMorgan Securities LLC

In terms of format, fireside chat. So, I'll ask questions but I'm going to leave plenty of time for questions at the end. There are mics on the table. Please use the mic to ask questions, and we'll go from there. So maybe, Richard, there's a lot of questions about what's going on in the environment but maybe can you talk about what excites you most about what's going on at The Home Depot right now?

Richard McPhail

A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Well, Chris, first of all, thank you for having us and thank you for everyone here and watching on the webcast. So, I've never been more excited about what the future holds for this company. We have grown over the last two years by $40 billion. It took us almost a decade prior to 2019 to grow by that much. We might not have believed that it was possible to pump that much volume through our system, but we did. We did it through the amazing efforts of our associates, our supply chain, our transportation partners, and our vendor partners. And so, we've proven that, really, the sky is the limit for us.

We just recently had our first store manager meeting in-person that we've had in three years. We typically do that every year in Las Vegas where we bring our store managers together. And one really great element of that is the Product Walk, and that's where we take down space equivalent to several Home Depots and where all of our major vendors come and participate and show us the latest in product innovation.

And in fact, just as far as being fired up about what our vendors are bringing to the market and what we're bringing to the market, level of innovation has never been higher. 90% of the products in that walk were – are going to be brand new for us. But beyond that, it's seeing the excitement of the associate. Our morale has never been higher. We came out of the COVID period staying true to our values, taking care of our people; and we think that that associate is at the heart of The Home Depot experience. And so, when they're happy, we're happy.

Beyond that, we are in a market that has grown considerably over the last few years. And I know you'll want to get into specifics there but my headline here is that we, I think, are in one of the most attractive end markets in our North American economies. Not only is it attractive from how it has grown, but how it is likely to grow. The macroeconomic underpinnings of demand for home improvement have never been stronger.

And I think, most importantly, the investments that we've made and how we're positioned to continue to take share in our market are – have positioned us differently than we ever have been, and that was it – what's interesting about that is it – we had the intention of investing from 2018 to 2020 to really change the experience, having no idea that it would unlock as much share capture as it has over the last two years.

And as we learn more about our ability to take friction points out of the customer experience, as we see more hard results from some of the investments we've made in our delivery capabilities, we just feel great about being able to address parts of that $900-billion-plus addressable market that we never really had the right to win in before, and now we do. So, I think we're set up for a fantastic run over the next half decade to decade. So, I'm as excited as I could be.

Christopher Michael Horvers

Q

Analyst

JPMorgan Securities LLC

Awesome. So maybe talking about those share opportunities, you've been a very regular share gainer...

Richard McPhail

A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Right.

Christopher Michael Horvers

Q

Analyst

JPMorgan Securities LLC

...over the history of the company. And there's this bigger focus on Pros as we look forward and you sort of split the market for 50% Pro, for 50% DIY.

Richard McPhail

A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Right.

Christopher Michael Horvers — Q

Analyst

JPMorgan Securities LLC

How do you think about what your share is in the Pro? Do you have any guess in terms of how that would break down between that previously unaddressable large Pro, that share versus that Chuck in the truck who's coming to the store.

Richard McPhail — A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Well, just to add some definition around that, the Pro shops, as we think, really in sort of three ways. The first is the immediate purchase, right, and so we've always excelled at being the most convenient place to buy home improvement product at the greatest value. There's a second type of occasion which is the planned visit. So, not necessarily emergency but planned visit where the Pro in particular has a bill of materials and he or she are looking to come pick that up, and we're strong there.

But the planned order, the advanced order is a – it's an occasion for the Pro that we've never had the right to win in because we haven't had some of the core capabilities. First and foremost, the ability to deliver product to the job site efficiently and in a dependable way. And so, winning that advanced order really rests on whether a customer believes they can depend on us or not to hit our delivery window.

Now, we could never do that, delivering large flatbed orders out of our stores. Number one, that just put a governor on how much delivery capacity we could actually handle; and number two, we just weren't the most dependable player out there. With the advent of some of our capabilities in supply chain, we're building that dependability. We're building that reputation. We realize that there are customer wallets out there that are much deeper than we ever anticipated. And it's hard to quantify in that $450 billion, but it's a meaningful part of that $450 billion.

Just to give you an example, in Dallas, where we have really the entire portfolio of all-new supply chain assets stood up, we had a customer who, a few years ago, was a $50,000 customer a year. We thought we were getting our fair share of their business. We opened up our flatbed distribution center; we're now doing $500,000 a year with that customer. We had no idea they were this big. And what they tell us is, you're in business now. We can – we're going to give you more of our wallet because we know that you're capable of delivering.

What's so great about that, too, with respect to this particular customer, is the spend in – their spend in our stores increased as their planned purchase and their delivered order increased, their spend in our store increased. And a lot of that has to do with, number one, increased confidence but, number two, the wrapper we're putting around the entire Pro relationship.

Pro Xtra is our Pro loyalty platform that's been relaunched, and it carries with it recognition but also just a more frictionless experience with respect to ordering on a mobile device and allocating purchases to jobs. And then, there's a recognition element, too. And so, we're just – we couldn't be more excited about the ecosystem we're building around that Pro, and it's truly paying dividends and we're excited about what's to come.

Christopher Michael Horvers — Q

Analyst

JPMorgan Securities LLC

Yeah. So, as a follow-up question, right, so if you think about the traditional points that retailers compete on, right, sort of price, assortment, its service and convenience...

Richard McPhail — A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Right.

Christopher Michael Horvers

Q

Analyst

JPMorgan Securities LLC

...very basically. So, the large Pro, you've invested a lot of technology. Now, you're investing around the supply chain. What does a large Pro – what do they really – how would they rank order what their preferences are? And as you think about once you complete most of these buildings over the next year, is there anything lacking from your own capabilities perspective?

Richard McPhail

A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Well, Chris, we're still learning and I think that's the exciting part of this. I will probably say number one is dependability. And dependability isn't just about hitting a time window; it's do you have the depth of the product that I need, what – are you always in stock? That's a change from when we would receive a large order from a Pro and have to literally source it from a dozen stores. Now, those buildings provide the depth that gives the professional the confidence that we can fill their order.

Pricing is important, and we're becoming much more scientific about optimizing price. But I think, again, it's a whole basket of things. I'll tell you, we're still – while we're seeing real results, we're still in the experimental phase, we're still in the learning phase. We don't quite know what the mature model might look like now when we build out this FTC network. We don't quite know what the optimal assortment will be.

And by the way, it'll probably be different in every single market. And so, it's a – we're on a learning curve. And so, as far as gaps go, we just – we have a relentless focus on giving time back to the Pro. I mean, that's what really everything is wrapped up around. Labor costs for our professional customers are a real thing. There's pressure out there and it's a significant component of a Pro's project cost. So, the more time we can save them. When they're – if they're sending a runner into the store, can we take friction out of that process? And we're always looking for opportunities to save time. So, it really kind of boils down to that.

But there's a – while we're very proud of what we've built in terms of tools like our app, our award-winning app, that if you – next time you're in our store, and I'm sure you've all downloaded our app already, but the in-store mode clicks in automatically or asks you if you want to opt in and navigation has never been easier. And so – and our customers tell us that. So, it's just all about taking friction out of the process. We probably have a thousand gaps that we can get better at.

Christopher Michael Horvers

Q

Analyst

JPMorgan Securities LLC

As we think about the scale advantages of The Home Depot, so as you think about the competitive set, and there's a lot of competitive sets in large Pro, once you're through supply chain, do you think the sort of supply chain technology infrastructure is equivalent to the larger competitors in that market? And then, on the scale of the buying, is – do you think you're substantially larger or equivalent to the largest competitors in those markets?

Richard McPhail

A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

I think we're ultimately either the scale player of – we're capable of being the scale player in any market that we decide to be in. I think from a technology perspective and a capability perspective, certainly, the intent is to have capabilities that no one else has. And we've – we're making investments in that statement on a continuous basis. But yes, so I think we're really trying to design something that's never really existed before in our space.

A lot of the folks that you speak of are more specific perhaps to a particular product category. The beauty of The Home Depot is that we have always been about the project, the entire project, selling across categories. And our Pros, even large Pros, shop us across categories. And so the beauty of what we think is the emerging model is, if we can sell that planned order across categories and reduce the number of suppliers that those Pros have to deal with, that's a huge friction point removed and it's a stickiness dynamic that has never been seen in our industry before.

Christopher Michael Horvers

Q

Analyst

JPMorgan Securities LLC

This is just a – maybe for the final point on the Pro side from my side. You talked about that customer in Dallas, the $50,000 to $500,000. How did you induce that, how did you create that figure? Did you lead...

Richard McPhail

A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Right.

Christopher Michael Horvers

Q

Analyst

JPMorgan Securities LLC

...with price or – and then how did you get the – how did you sort of enable that expansion of wallet?

Richard McPhail

A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Well, we don't like to talk about price. We talk about value first. So, we're – and for the Pro, value has many components; price is one, assortment, availability, breadth of assortment, depth of assortment, availability is another, and then the delivery consistency. It does require a different marketing approach – go-to-market approach.

And so, we've always had an amazing outside sales force that has supported our stores. And it's just simply a matter of those outside sales representatives educating our customers. So, we do tours of these facilities with some of our larger customers and they're blown away. They had no idea that we're building this capability. So, you've got to get the word out and we're in the process of that.

Christopher Michael Horvers

Q

Analyst

JPMorgan Securities LLC

In the blown away side, it's just the amount of job lot ?

Richard McPhail

A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

I didn't know that I could get job lot quantities all delivered in a delivery window that you can stand behind and then you're going to hit of the breadth of The Home Depot assortment. And it's not just the breadth that I'm accustomed to as a customer, it's broader and deeper. And so, a great example of that is longer length lumber, which we don't carry in our stores. We just simply can't physically carry it. But we can carry longer lengths of lumber in our DCs and we carry more than job lot quantity, it's in the thousands or tens of thousands of units. And so, it's that broader assortment for the Pro and deeper that is a wow factor for them. There are things that I have never bought from you before that I can now and I can count on your delivery. So those are, I think, the two biggest aha moments for them.

Christopher Michael Horvers

Q

Analyst

JPMorgan Securities LLC

Interesting. So, maybe transition a little bit to the topics that I'm sure you receive a lot of questions on in terms of the environment. The environment has changed; the world has changed a lot, so to speak, since you reported earnings in mid-February. The war has escalated, inflation seems to continue to escalate unabated, mortgage rates are 180 basis points off the bottom and sort of back to 2018 levels. So, I guess, how are you thinking about the risks in your business given all that's changed?

Richard McPhail

A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Well, I want to make sure that I'm going to limit my remarks with respect to performance or things that we've seen to what we've reported publicly, kind of stretching in the first two weeks of the first quarter.

We have learned that it is better to be flexible than it is to be great predictors of the future. That's what the last few years told us. Making longer-term and, in this case, I mean, multi-quarter projections is fine but it actually is not the way we manage the business. We manage the business in a very short cycle way. So, we think about the two largest kind of variable components of our model, they're inventory and they're staffing.

And so, inventory, we turn our inventory five times a year. That's a short cycle business where we are looking at demand in the moment and basing our orders on really just an amazing application of data science. That's put us in a different place than we were in three years ago with respect to anticipating future demand, but that's short cycle. Staffing, we staff our stores and schedule our stores a few weeks in advance. And so, again, very short cycle. So, it makes us nimble and we certainly invest based on multi-year expectations of where we think that demand will be. But, in the moment, we're agile.

Now, with respect to risks, what I can tell you is we think that the environment for home improvement has remained extremely healthy over the last two years. And so, there are so many underpinnings of that that I think are multi-year in nature that that's really sort of where we have our eye. We don't know ultimately – you mentioned inflation. We don't know ultimately how inflation might impact consumer behavior. What we do know is that, again, homes have never been more valuable in both a psychological sense but also a financial sense. The homeowners' balance sheet has never been healthier. And our consumers and our Pros tell us that their backlogs have never been healthier. So, I think that any uncertainty in the short term, there's a counterbalance here which is just the underlying health of what underpins on home improvement demand.

Christopher Michael Horvers

Q

Analyst

JPMorgan Securities LLC

Yes. So, maybe two follow-on questions there. So, as you think about rates, right, so historically, the generator of your business is home price appreciation more than turnover. The correlation between rates and home pricing and turnover is actually very high. The correlation between rates and your sales is not nearly as high. But ultimately, if that's the engine, how do you think about the risk of this rate move getting back to 2018? There was a little bit of a – the category did slow a little bit into 2019, it seemed to follow the spike in mortgage rates. So, how are you thinking about the risks that rates will ultimately diminish the housing engine?

Richard McPhail

A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Well, I think you have to be careful about – there's – there seems to be – the headlines will tell you that there's concern about what rates might mean for housing. Well, let's talk about what they might mean for home improvement because I think it's an extremely important distinction.

We – so, a few just kind of fundamentals of our business. 5% or so of homes turnover each year in the US, similar in Canada and Mexico. That means that 95% of all housing units just sort of remain occupied by those people that occupied them last year. Our addressable market are the 130 million housing units in the US, plus those in Canada and Mexico. And so, we think that that's our market.

So, how sensitive is that market in home improvement? Let's just use some intuition and then some anecdotes we hear from our customers. So, if rates have an impact on housing turnover, how does that impact you if you aren't looking for a home and you love the mortgage rate you're at? And, by the way, I think over 90% of all mortgages originated in the last few years were either fixed rate or very long-term fixed with a variable sort of 7/1, 10/1 ARM. So, how sensitive is your spend to increases in interest rates? We just don't think it's very sensitive.

What's also interesting here is, I think that there's a bit of a false negative out there with respect to housing turnover. Housing turnover in 2021 was the healthiest share of housing turnover we've had in 10 years. Homes are selling, it's just the availability of homes isn't there like it used to. And in fact, I would say, we're in a position of chronic shortage now in the US that's going to take us years to work out of, if ever. But what customers tell us now is, I was able to purchase a home but I couldn't find what worked for me, I just – I had to buy what I could buy. And so that, coupled with the fact that my balance sheet has never been healthier, means I'm going to remodel.

And so, what's interesting is, all of this home activity, regardless of interest rates, seems to be feeding into remodeling more than it ever has. If I can't find a home, chances are I'm going to remodel. Again, my balance sheet has never been healthier, and so our customers tell us, hey, you know what, I can't move right now and so I'm not going to, so I'm going to remodel because I know that I will recoup a return on whatever investment it is I put in my home. It's one of the safest, safest investments I can make. At least, that's the perception and that's borne out to be true over the long-term.

And so, that's sort of the way I look at it. 5% of homes turnover, those folks are going to be a little more sensitive to interest rate fluctuations. But when they do buy a house, they're more likely to undertake a remodeling project. And again, our market is made up of a great number of people for whom interest rates don't mean much.

Christopher Michael Horvers Q

Analyst

JPMorgan Securities LLC

So, I think, for a lot of people, the only memorable housing event in their lifetimes was the global financial crisis, right?

Richard McPhail A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Right.

Christopher Michael Horvers Q

Analyst

JPMorgan Securities LLC

And it was sort of a credit-driven bubble.

Richard McPhail A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Yes. Right.

Christopher Michael Horvers Q

Analyst

JPMorgan Securities LLC

And so, I don't think that's the right analogy, necessarily.

Richard McPhail A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

I don't either.

Christopher Michael Horvers Q

Analyst

JPMorgan Securities LLC

And so, as you as you look back, and I don't know if you've looked at this, so sorry if I'm popping this on you. But like – because I was just thinking, 1992 seems like – the early 1990s is maybe like the more applicable example where you had a Fed surprise, rate shock and it did cause a housing-led mild recession. So, I guess, how are you thinking about the risks of those – the rates leading to sort of a shallow trough in the business but – that's below the line, but the line over the long term is up?

Richard McPhail

A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Well, first of all, I think that we are in a unique set of circumstances now that doesn't have any real analogy. I mean, we have a housing stock that is worth 30% more than it was two years ago. We have home equity values that are $6.5 trillion greater than they were two years ago. So, we have kind of a debt to equity ratio in the housing stock that is at unprecedented lows.

So, I agree with you. There's – the concept of there being a housing-related credit problem, that's just not the circumstance we find ourselves in now. I think that the other difference here is that the housing shortage which, again, I believe, is chronic, the number – I think the months of supply on the market is now under two months; and experts in the field say that there's a shortage of anywhere between 2 million to 4 million units.

And so, what does that shortage really mean for home improvement demand? Well, we think it props up home price appreciation, again, which we think is one of the major drivers. So, I just – I think conditions are so different. And again, there's that psychological point that the home has become much more important over the last few years. We've worn our homes out over the last two years, that's what our customers tell us as well. So, there's a lot of necessity in the investment that they're making in their homes.

Christopher Michael Horvers

Q

Analyst

JPMorgan Securities LLC

One more question for me, then I'll open it up to the audience. So, you're starting here ironically. Your guidance is sort of flowing seasonality off the back half trend. You are hearing other retailers, at Wayfair, you're hearing from Traeger, you're hearing from Tempur-Pedic, that seasonality is resetting into the business. People weren't buying furniture in December. People were buying mattresses January and February of the past two – last year, let's say. They weren't buying this year because they typically buy them on the off holidays that you buy big ticket durables. Traeger, same thing.

So, I guess, to what extent did you actually bake that risk into your outlook that as seasonality returns to more seasonal categories, and so you sort of have the shoulder risk as you lap through two really good springs, two extended outdoor seasons in the fall? To what extent had you seen that? Any sort of seasonality normalization impacting your business and how – is that sort of inherent in your guidance?

Richard McPhail

A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

One of the special things about Home Depot is that we sell the project. And so, what I think is an interesting dynamic to understand is, while there may be, in any given year, a bigger season in some category and maybe there's even a concept of pull forward in some categories over time, we never see it in a macro sense.

So you may have bought a patio set last year, that doesn't mean you're not going to buy a grill this year, right? And it doesn't mean you're not going to paint the bedroom. Home improvement demand is so broad that, again, we've never really seen that kind of dynamic in a macro sense. Sure, we have spring timing that is somewhat weather-related. But even that, I can't think of a year where that materially impacted first half performance as a whole.

So no, I don't – I didn't foresee category-specific risk heading into 2022. And to the extent that we see it, my expectation is that project demand overall, demand across our categories, will remain healthy. So, that's sort of how I think about it.

Christopher Michael Horvers

Q

Analyst

JPMorgan Securities LLC

Awesome. Questions from the audience? Stephanie ?

Christopher Michael Horvers — Q

Analyst

JPMorgan Securities LLC

I live in Missouri and I drive around the Midwest quite a bit. There are a lot of new home developments that are farther and farther out in the suburbs, and they're just sprouting up all over the place. And I'm wondering, is there maybe an opportunity for some unit growth as we see more suburban father out, suburban home populations increase?

Richard McPhail — A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

The housing stock of the United States has to grow. That's just a kind of an immutable fact. We're going to be there as it grows. I think that what's interesting is that we generated so much sales growth over the last decade. Now really, call it, $80 billion since 2010, 2011 without building many more stores.

We had productivity initiatives that allowed that and we've still got a long runway there with respect to making that store more productive. Our supply chain assets really do open up access to new markets. But the truth is, we're so close to everyone; we're so convenient for really any customer in the United States that we feel well-placed to satisfy the demand as it comes. But the housing stock has to grow. We're going to grow right along with it.

Christopher Michael Horvers — Q

Analyst

JPMorgan Securities LLC

Two brief questions. The first one is, you mentioned that you had a meeting, a in-person meeting...

Richard McPhail — A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Right.

Christopher Michael Horvers — Q

Analyst

JPMorgan Securities LLC

...for the first time in a couple years. I'm assuming that more people are probably going back to work at headquarters now.

Richard McPhail — A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Yes, absolutely. We're back.

Christopher Michael Horvers — Q

Analyst

JPMorgan Securities LLC

Can you tell me – yeah, can you sort of tell us how that's going for you and what the benefits of that are?

Richard McPhail A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Right.

Christopher Michael Horvers Q

Analyst

JPMorgan Securities LLC

And the second question is, if and when we do get maybe a more macro slowdown, you said that you're very flexible, which is true with inventory and labor.

Richard McPhail A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Right.

Christopher Michael Horvers Q

Analyst

JPMorgan Securities LLC

But can you maybe give us an insight on how you might think about balancing sales growth with promotion if it's needed to have a little bit more promotion to drive sales? I mean, what is the acceptable relationship there?

Richard McPhail A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Well, let me – I'll take your questions in reverse sequence. I'll tell you that we have – we don't use the word promotion, right, we think about events as time periods where customers are more apt to come to our store. But we want our customer to be able to count on us to get the best price for any project on any given day. And so, that's our philosophy. Our philosophy really is every day low price, it's not promotion.

How do we – so, I'd say, right now, we're – we have been and will always be in the business of demand creation. But right now, I will tell you that we're more in the business of demand capture. Demand creation is what we're born to do. We do that through product innovation. We do that through bringing the best value to our customer every day. Now, value, again, it includes price but it includes assortment and selection. It includes product that's exclusive to us. So, when you think about demand creation, it's every element. It's the product, but it's the experience.

So, I'll tell you that where we – we're investing in ahead of your question. This – we're not a commoditized business. We sell commodities in part, but we are going to build the greatest interconnected experience in home improvement. We think we already have it. But there are so many points of friction that we still see for our customers today. We can change the game. We can give you time back. We can get you to the product faster. We can get the product to you faster. We can delight you because – not only of the product, but because of the experience. And so, that's how we're going to win.

There are two more arms or, I'd say, two more elements of the formula that I talk about all the time. So, the first is best interconnected experience in retail; second is low cost provider. If I'm the low cost provider, I can bring the sharpest value to the customer. We're in that position today. We're going to extend our low cost position. That's our commitment. And third, we're going to be the most efficient investor of capital in our space. We already are with returns on invested capital in the mid-40s but we insist on driving exceptional return on investment.

So, all of that combines to say we lean in to the customer experience and we lean into that low cost provider position to provide great value to the customers. It's always worked for us in the past and it'll work for us in the future.

We're excited to be back in our store support center. And you just get those moments of serendipity where I literally was standing in the breakfast line two weeks ago and I run into a couple merchants who were thinking more deeply about the Pro – they're all thinking deeply but we had some specific questions we were asking ourselves. And there was a supply chain element to the question; and lo and behold, the head of supply chain walks in and then gets in line with us. And so, we had an impromptu, extraordinarily high-value meeting right there in three minutes, and we would have never scheduled it or at least we would have had to find time. Those little moments are priceless. And so, we're getting – we're back and we're getting this back.

Christopher Michael Horvers Q

Analyst

JPMorgan Securities LLC

When you look across your inflation of your costs, where do you see it persisting or increasing and where do you see it coming down?

Richard McPhail A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Well, I think we're in a really dynamic environment right now, and we're not immune to inflation that you've seen in the broader economy. I think what we know we do best is manage in the moment. And so, we're really pleased with our performance in 2021 with respect to understanding costs, mitigating costs, and then ultimately making sure that we were sharp with respect to understanding elasticity and appropriate price levels in the market. And so, we feel like we managed through 2021 which had its own inflation. So, we're confident in our ability to manage successfully in any environment. There is cost pressure, and I wouldn't want to call any inflection point at the moment. But we're – we feel as well positioned as anyone to manage through it.

Christopher Michael Horvers Q

Analyst

JPMorgan Securities LLC

Just to dovetail on that question, as you think about how inflation rose over the year for most categories, true in your category as well, ex-lumber, lumber's always a lot of noise, and most data points indicate inflation was higher on the exit than it was at the start of the fourth quarter. So, I guess, from your perspective, in the context of through the reporting period, have you seen any broad-based inflation issues in terms of impacting the consumer purchase whether it's up and down the continuum? And then the second question is, as you think about your guidance for this year, what are your sort of expectations around inflation as it proceeds through the year and how that might impact unit demand?

Richard McPhail A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Well, taking those questions, again, out of sequence, I don't want to predict inflation. But what I can tell you is, entering 2022, we certainly anticipated the need to respond to cost pressure, and so we're set to be able to do that regardless of what actual level we see.

With respect to customer reaction, we think demand is really healthy. I think you're always going to have extreme cases. Lumber is a great example where, okay, if you see too sharp a spike in any given short time period, you're going to see folks hesitate. But you really have to look at those extreme cases to see to see any sort of elasticity impact.

I think the more important point, though, is project demand is as healthy as it's ever been. And so, I think it's more important for us to think about macro elasticity. And our customers tell us and our Pros that they have never had a higher intent to do projects than they do right now. And so, in short, it's a really healthy environment for us right now.

Christopher Michael Horvers Q

Analyst

JPMorgan Securities LLC

Other questions. I can go on. All right, so as you think about the cost environment and as you look forward in your investments, there – can you just lay us out sort of the puts and takes around the margin structure of the business in 2022, given all the inflation that – there's labor, there's ocean freight, now it's trucking and diesel. And how are you thinking about how that might play out? And how did you plan for it to play out in the P&L?

Richard McPhail

A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Well, there are a lot of ins and outs, which is why we've basically said margins will be essentially flat year-over-year. And without going into the ins and outs of comparison to 2021, which I think can be sort of lower value added analysis, I like to think about what we're aspiring to do. And we talk about two main objectives in the business. Number one is grow our market share with the Pro and the consumer; and number two, deliver shareholder value while we're doing it. To me, the name of the game is return on investment and you drive return on investment through growing operating profit dollars.

So it doesn't mean that we don't pay attention to margin structure, we do. And I'll break down a few elements there. First, operating expense leverage. We have a long history, it's in our DNA, of delivering operating expense leverage. Our cost structure – the elements of our cost structure are largely unchanged from the last decade, really. We've become more efficient and, obviously, we're delivering lower expense to sales than ever before. But we understand the leverage that we're capable of generating and we expect to do that. That's our commitment to ourselves and to our investors. Operating margin is also a function of gross margin. And what I would tell you is, if our mix were static, if our product mix were static, we wouldn't see much fluctuation in our margin rate, most likely.

Our market structure is orderly, pricing is rational, but what we have in front of us is the opportunity to grow in this $900-billion-plus market in ways that we've never been able to before. And so, what does that mean? Well, it means that – take sales from our flatbed distribution centers, where we know that customer that grew from $50,000 to $500,000 is still shopping across our assortment. We'll have opportunities in categories that carry above company average gross margin. We may have opportunities in categories that carry below company average gross margin. But what I am insistent on is that we deliver exceptional return on investment with those sales.

And so, we watch margin but margin rate is going to match those opportunities that we have in front of us. A great story about that is the appliance story, right. In the early part of the 2010s, we realized we had an opportunity to lean in hard to appliances, as other competitors were falling by the wayside. So, we looked at the margin structure of appliances and said, well, this is lower margin than company average but it's an inventory almost-zero model, meaning that return on invested capital is almost infinite. And so, looking back on that, yes, we leaned into a category that had the lower than average margin but we would have done that – looking back on it, we would do it every single time.

So, return on investment is really the name of the game. We want to be the low cost provider and have the most capital efficient platform to enable those sales than anyone else in the market. I think it's – and so, I think it's important to know, we'll be thoughtful about those opportunities, right, these aren't things that we flip a switch on and all of a sudden change the structure of the P&L. That is not going to happen. We'll find opportunities that are exciting. If they deliver exceptional return on investment, we're going to take it.

Christopher Michael Horvers

Q

Analyst

JPMorgan Securities LLC

So, as we think about the large Pro opportunity, right, I mean, you've had to spend a lot of capital and OpEx to get these capabilities in place and you're, call it, a year out from being materially complete. There's – so you're putting a lot of cement in the ground...

Richard McPhail

A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Right.

Christopher Michael Horvers

Q

Analyst

JPMorgan Securities LLC

...depreciable assets in the ground. You're moving some costs upstream, right, in terms of delivering out of a distribution center and not out of the store.

Richard McPhail
A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Right.

Christopher Michael Horvers
Q

Analyst

JPMorgan Securities LLC

Over time, that seems like that would be a highly incremental margin to the business, right, because you had the upfront investment; you have sort of peak depreciation, low point of productivity. Over time, that should drive very substantial incremental margins that's arguably above the store because there's a lot less labor being done to execute the business?

Richard McPhail
A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

That's right.

Christopher Michael Horvers
Q

Analyst

JPMorgan Securities LLC

So, I guess, from our perspective, and I don't think investors necessarily conceptualize that, you would have to really – and like what's the gating factor for margins not to expand, especially because if a traffic-driven, transaction-driven labor model in the store, is it the potential investments? Like, what would suppress the margins such that they couldn't expand?

Richard McPhail
A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

I think suppress is not a word I would ever want to use. We're not – we're growing dollars.

Christopher Michael Horvers
Q

Analyst

JPMorgan Securities LLC

Nobody wants to use that word either.

Richard McPhail
A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

And we're growing return on investment, I don't view it as suppressing something that exists today. We're growing dollars. I think that, certainly, what you're saying is true. So, the ability to facilitate these orders in a lower cost, higher – more highly capital efficient model where you have less labor, where perhaps you can drive higher fixed expense leverage is part of the reason we did this, right.

But more than the financial equation, we did it for the customer experience. We want to be fast. We want to be reliable. We want to have breadth. We want to have depth. Those are the things we care about because that's what creates market share capture. So, I don't think about it as market – it's not margin rate suppression, it's reflection of mix, I think, is the question. It's what opportunities are we going to be able to best capitalize?

And we – look, we put a tremendous amount of belief in the fact that we need to be a project seller. We need to sell across our categories, and we're going to push to do that. We don't know the ultimate mix of opportunities in that $900 billion TAM but we know we're going to be the low cost provider in it. And so, we'll pick our path carefully. We're testing and learning. But I think, from a financial perspective, there's nothing but anticipation and excitement ahead.

Christopher Michael Horvers

Q

Analyst

JPMorgan Securities LLC

And so, from a – I'm sorry, go ahead .

Christopher Michael Horvers

Q

Analyst

JPMorgan Securities LLC

Just on that note, are there additional gating factors beyond just brand awareness for the Pro? Like what is the – what are the biggest challenges in terms of actually getting the Pro to use the services? Are there things you need to build out beyond what you've built, which is obviously very substantial? Or does there need to be a very large ad campaign? Like where's the disconnect?

Richard McPhail

A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

There's definitely – there's an awareness to this. There's a requirement for a sales force for this. That is how the market has always been structured and how we anticipate we'll need it as well. So, awareness is probably number one. The – I think, on the flip side of the coin, the flexibility of being able to experiment in a warehouse that is in a retail environment, so when you set a retail environment, I mean, obviously, we do that with great forethought. But once you've set those days, those days are set for a while. You don't change your assortment.

In a DC, as we learned in the better part of the last decade as we were sorting our direct fulfillment centers that supported online orders being shipped to home, those assortments are not static; they are able to turn and reflect demand in the moment. And so, I think it's a – it's certainly an awareness point but it's also just growing in to understanding what the opportunity is. And the good news is, we can be flexible with what we're putting in those buildings.

Richard McPhail

A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Yes.

Richard McPhail

A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Right.

Christopher Michael Horvers

Q

Analyst

JPMorgan Securities LLC

So, can you speak to that a little bit in terms of how that will affect and how you'll think about the go-to-market as you further expand the marketing around this opportunity? The TAMS is huge, obviously.

Richard McPhail
A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

I really think it comes backs to, number one, take friction out. It's – we do have to increase awareness of how much friction we can take out because that translates into ROI. If – and then, there's psychological pieces of this, too. I have one person to call; instead of 10 suppliers of product, I have one The Home Depot. So, there's that psychological simplicity. But the better we get at dependability – and what we do, we tour customers through these facilities and they're blown away.

And it really is that we're not building something that exists today, we're not getting to parry. Our assortment breadth and depth is something that's never been present in this form before in our industry, so it's – do you have the product I need? Can you get to me when I need it? Price and value are components but, particularly in the environment I think we're heading into for the next half decade, it's more about, if I'm a Pro, can I install the jobs that I'm committed to.

Christopher Michael Horvers
Q

Analyst

JPMorgan Securities LLC

Time is money.

Richard McPhail
A

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

It is. Time is money and I think that that's a – that's maybe the guiding statement I'll end with. Ted Decker, our CEO, talks everyday about the importance of having the best interconnected experience possible. It's all about friction, taking friction out; and it's all about giving time back. So, that's a great, great note to end on .

Christopher Michael Horvers

Analyst

JPMorgan Securities LLC

Awesome. Awesome. Thank you so much, Richard.

Richard McPhail

Chief Financial Officer & Executive Vice President

The Home Depot, Inc.

Great. Thank you. Thanks, everybody.