



Home Depot

Pericles Angelos

Investment Report

Spring 2021

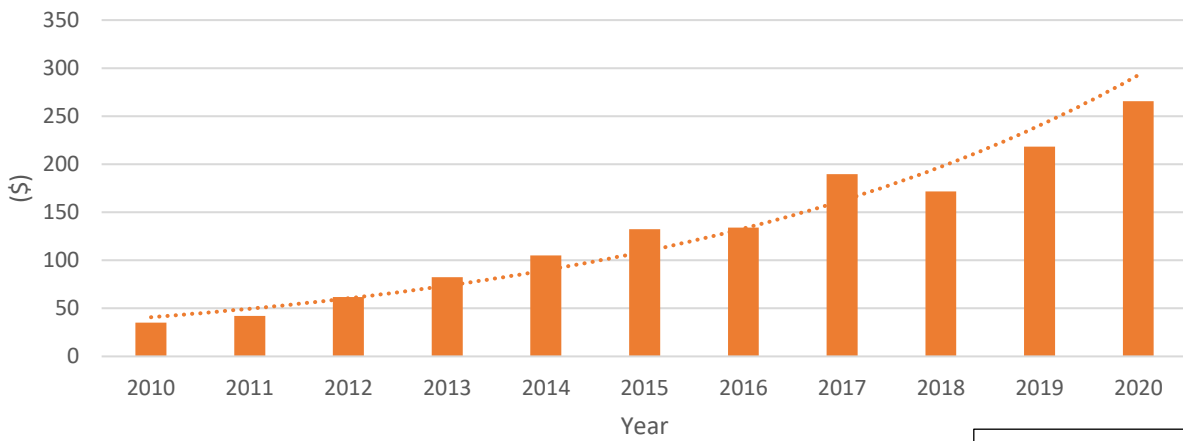
Executive Summary

Source: S&P Capital IQ

Investment Overview	
Ticker	HD
Recommendation	Buy
Target Price	\$428.14
Potential Upside	51% Upside
Market Capitalization	278.0 Billion
Industry	Home Improve. Retail
Outlook	1 Year

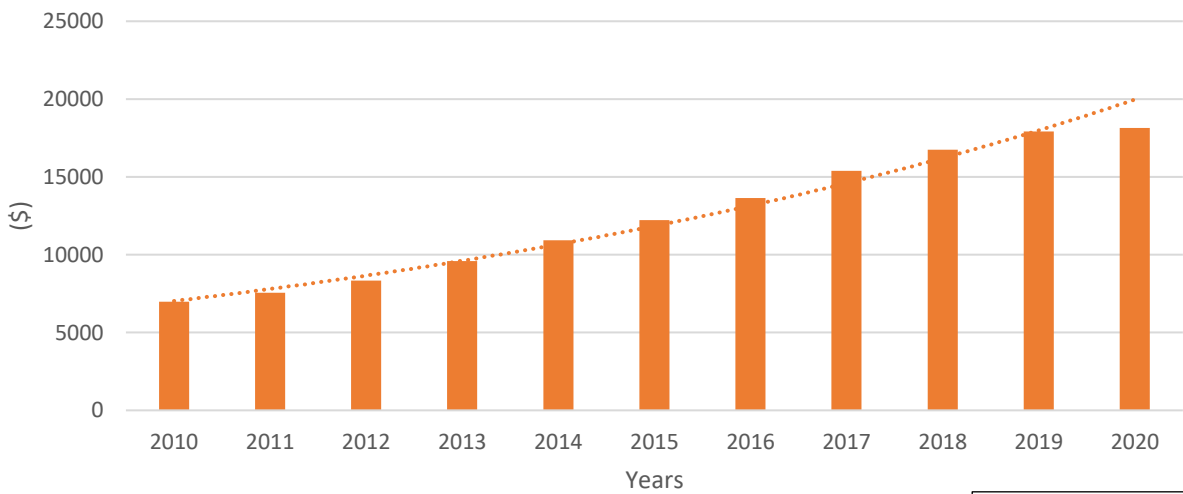
Important Statistics	
P/E	21.6
Beta	1.02
EBITDA	\$20,474 Million
52 Week High/Low	\$305.55/\$140.63
ROE	18.8%
Dividend Yield	2.54%
Gross Margin	34%

Price per Share



Source: S&P Capital IQ

EBITDA



Source: S&P Capital IQ

Investment Thesis

Source: Home Depot First and Fourth Quarter Earnings 2020 Press Release and S&P Capital IQ

Buy Rating for Home Depot

I am initiating a Buy rating for The Home Depot (HD). Home Depot is currently trading on the New York Stock exchange at a price of \$283.51 per share. The price target I am giving Home Depot is \$428.14 per share which represents a potential upside of 51% for March of 2022. With a relatively low price to earnings ratio of 21.6, Home Depot is trading at a discounted multiple compared to other consumer cyclicals and especially the market as a whole. Home Depot is well positioned against other competitors within the Home Improvement industry, being by far the largest in stores owned and market capitalization. Home Depot was a Covid-19 pandemic stock favorite for retail and institutional investors alike. However, the fallout from this global pandemic and an excellent track record over the last decade puts them in a great position moving into next year. Consumers are now spending much more time at home than before the pandemic. Demand for home improvement products is high at the moment and is expected to continue at minimum deep into next year. Finally, with the threat of rising interest rates, Investors are now slowly moving out of high growth stocks and into dividend paying value stocks such as Home Depot.

1. Increased Demand for home improvement products given the present conditions of the Covid-19 pandemic

The global Covid-19 pandemic, which has hit the United States especially hard, has led to individuals spending more time at home than before. As a result of this, home improvement products have been in high demand. A few examples are new investments in home offices for both employees and students, home workout facilities, and countless other improvements. Home Depot saw a huge increase in sales from the first quarter of 2020 to the second quarter of 2020. While vaccines are coming out in North America, fully vaccinating or getting back to what we might consider "Normal" could take at minimum of 3 more months.

2. Post Pandemic home improvements needs will likely continue to expand with changes in work preferences

In the event that North America does emerge from the pandemic in the near future, Home Depot will still be well positioned going into next year. Most likely, many workers will still be working remotely from outside their traditional offices. As each company handles this uniquely, many different options revolve around the freedom to work from home. While some companies will ultimately bring employees back within the next year, there is some certainty to conclude that investments in home offices and other improvements are here to stay. Additionally, before the pandemic Home Depot continuously increased Revenue, EPS, EBITDA, and other important key performance indicators almost every year in the last decade. A very strong financial track record more often than not, indicates future growth in companies. Finally, regardless of economic conditions, home improvement products will always be needed.

3. Home Depot has announced a 10% increase to its already healthy dividend along with a strong financial record

In the 2020 fiscal year, Home Depot paid out \$1.50 per share every economic quarter. In early March of 2020, Home Depot announced a 10% increase to its dividend. For the fiscal year of 2021, Home Depot will now pay out \$1.65 per share per quarter or \$6.60 per share annually. Throughout the last decade, they have continuously increased both their earnings per share and subsequently their dividends per share. Additionally, the looming threat of small increases to the inflation and interest rates have had many investors moving into dividend value stocks such as Home Depot. Finally, while the past might does not determine the future, often times it can give us a look into what is to come. This is important to a company that has consistently performed for the last decade and still has the same strong leadership moving into 2021.

Business Description

Company history and brief overview

Home Depot was founded in Atlanta, Georgia in 1978 by Pat Farrah, Arthur Blank, Bernard Marcus, and Ron Brill. Their initial goal was to build bigger home improvement superstores than any other store they were competing with. This model turned out to be successful and the company went public in September of 1981 in order to gain more capital to build more stores. The company has expended a great deal since then, operating 2,296 total stores throughout North America. While a vast majority of stores are in the United States, Home Depot has 182 stores in Canada and another 120 in Mexico. Home Depot is the biggest player in the home improvement retail industry with a market capitalization of about \$278 billion.

Source: History of Home Depot Webpage

Target Market

Home Depot has two primary target markets. The first being contractors and professionals and the second being the average do-it-yourself individual. Home Depot prides itself on strong customer relations. This is important so professionals always choose Home Depot over its competitors. Having the most stores out of any competitor is also important because no matter where the project might be located, there will most likely be a Home Depot nearby. Additionally, this is even more important to the do-it-yourself customer because they rely on their highly skilled associates to help them through individual projects and programs within the store.

Comparable Companies

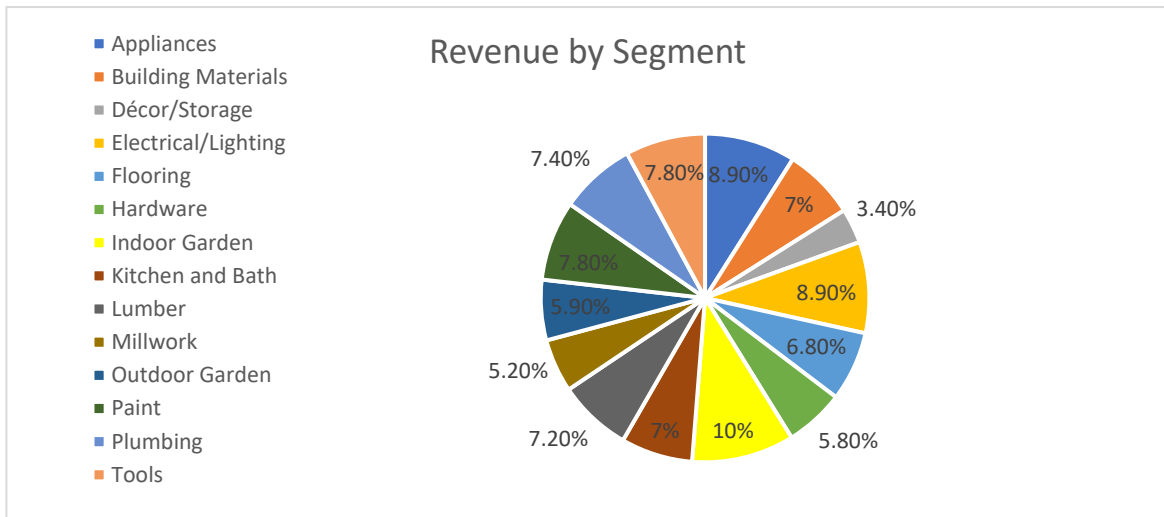
The Home Improvement Retail industry has only a few big companies within it. Home Depot being the Largest. Home Depot's biggest direct competitor is Lowe's. We see that Home Depot has around the same P/E ratio but has a much higher dividend, market capitalization, and EBITDA. Floor and Décor is one of the specialty retailers Home Depot competes against in a few key product categories. However, Home Depot also has much better metrics than them, beating them out in every key indicator. Finally, Home Depot and Walmart might have little product and service overlap between them. However, they are comparable in their size and the fact that they are both retailers. Home Depot's metrics outperform Walmart by having a lower P/E and a higher dividend. This is impressive considering Walmart is often seen as an excellent value stock and company.

Company	EBITDA	P/E	Div (%)	MKT CAP
Home Depot (HD)	\$20,474 Mm	21.6	2.54%	\$278 B
Lowe's (LOW)	\$7,724Mm	21.04	1.48%	\$119.2 B
Floor and Décor (FND)	\$239.3 Mm	56.71	0.00%	\$9.52 B
Walmart (WMT)	\$32,935 Mm	27.47	1.69%	\$373.87 B

Sources: S&P Capital IQ and Finviz

Business Model

Home Depot breaks down its revenue into 14 distinct segments: Appliances (8.90%), Building Materials (7.80%), Décor/ Storage (3.40%), Electrical/Lighting (8.90%), Flooring (6.80%), Hardware (5.80%), Indoor Garden (10%), Kitchen and Bath (7%), Lumber (7.20%), Millwork (5.20%), Outdoor Garden (5.80%), Paint (7.80%), Plumbing (7.40%), and finally Tools (7.80%). While Home Depot has many different revenue segments, their three biggest are Electrical and lighting, Appliances, and Indoor Garden.

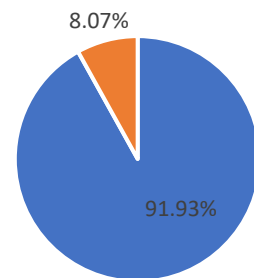


Source: S&P Capital IQ

Where Home Depot's Revenue Comes from and Store Locations

Home Depot has a total of 2,296 stores, all of which are located in North America. 1,944 of these stores are in the United States. Additionally, Canada has 182 stores and Mexico has another 120 stores. Revenue from within the United States makes up a vast majority of their total revenues. As you can see on the graph, almost 92% of revenue comes from the United States while a little bit more than 8% comes from their stores located within Mexico and Canada.

Revenue by Geography



■ United States
■ Outside United States

Source: S&P Capital IQ

Management and Corporate Governance

Top Leadership

The current Chief Executive Officer and chairman of Home Depot is Craig Menear. Menear has been Chief Executive Officer since 2014 and was later named chairman in February 2015. He has now been the CEO and Chairman for over 6 years. Additionally, he has worked within the company for more than 20 years in a variety of different roles such as merchandising, supply chain, store operations, sourcing, and finally marketing. Menear graduated from Michigan State University with a degree in business. Throughout his time at Home Depot, Menear has continuously proven himself to be strong leader.



Source: Home Depot Leadership webpage

CEO and Chairman Craig Menear

Home Depot's current President and Chief Operating officer is Ted Decker. Decker previously worked as the company's Chief Merchant and Executive Vice President before moving to his current position. Decker has worked at Home Depot for more than 20 years, joining in 2000. He has held many different roles within the company such as senior director of business valuation, vice president and senior vice president of strategic business development and finally senior vice president of retail and finance. Before his starting his career at Home Depot, Decker worked for companies such as PNC Bank, Kimberly Clark Corp, and Scott Paper. Decker received his undergraduate degree from The College of William and Mary. Additionally, he went back to school and earned a master's degree in business administration from Carnegie Mellon University. Decker has been instrumental to Home Depot's success over his 20-year career with them.



Source: Home Depot Leadership webpage

President and COO Ted Decker

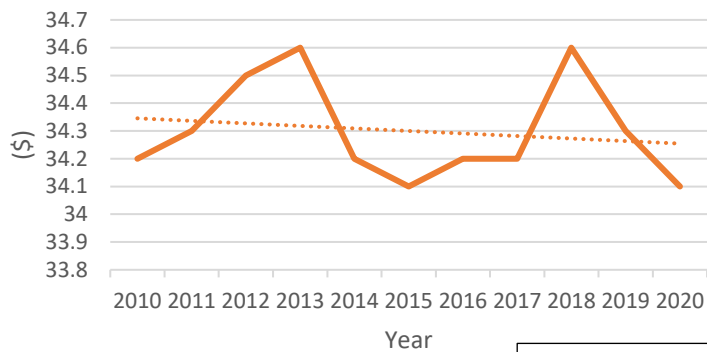
Board Structure

Since 2013, Home Depot has had anywhere from 11 to 14 members on its Board of Directors. As of May 2019, Home Depot currently has 12 members on its board. 11 out of the 12 board members work as independent directors. The only member that is from within the company is Craig Menear who is the Chief executive Officer and the Chairman. Additionally, each board member except for the CEO, serves on two separate committees. Home Depot's four committees are Audit committee, Finance committee, Leadership Development and Compensation, and Nominating and Corporate Governance.

Source: Home Depot Corporate Governance Guidelines and Committee Members and Charters

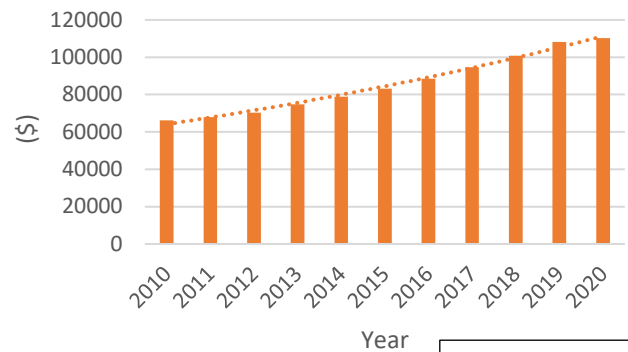
Financial Analysis

Gross Margin (%)



Source: S&P Capital

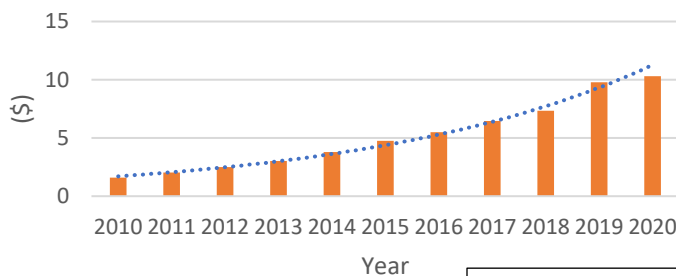
Revenue



Source: S&P Capital

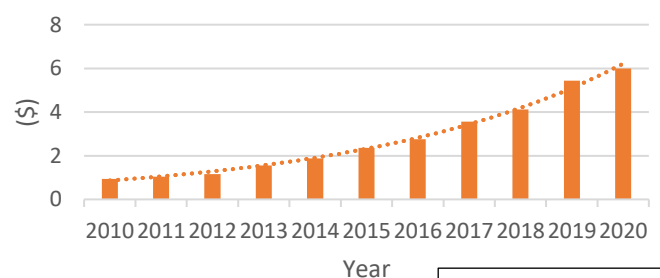
Home Depot has seen continuous growth throughout its long history. Gross margins have remained extremely consistent and revenue has increased every year in the last 10-year period. Even in 2020, which hit many companies hard, Home Depot continued to thrive. Revenues and gross margins are especially important to retailers. Gross margins for Home Depot have stayed between 34.1% and 34.6% since 2010. A relatively small percentage range with a fairly high gross margin has been instrumental to Home Depot's success. A large increase in sales from fiscal year 2019 to 2020 proves why Home Depot continues to perform. According to their 4th Quarter earning report from 2020, Home Depot increased sales by 21.9 billion dollars in 2020. This was a 19.9 percent increase from the fiscal year of 2019. This increase in sales, along with their consistently high gross margins, has been a major driver for Home Depot's increase in revenue. While this is an example from 2020, it is not unique to just 2020 alone. Previous years' revenues have been pushed with the same key factors. Finally, Home Depot's consistently high gross margin is especially impressive based on the company's sheer size. The company operated well over 2000 stores in 3 different countries. Often, this is difficult for large retailers to achieve as a result of having a wide variety of products in such a large geographic area.

Basic Earning per Share



Source: S&P Capital IQ

Dividends per Share



Source: Yahoo Finance

For most of Home Depot's history, they have given their shareholders a dividend. As seen above, dividends have increased every year for the last decade. In the fiscal year of 2020, Home Depot paid out a dividend of \$6 per share. As of recently, Home Depot announced a 10% increase to its Dividend. For fiscal year 2021, they will now be paying out a dividend of \$6.60 per share annually. An increasing dividend yield is a key characteristic of a strong value stock as it gives an additional incentive to own Home Depot past just the possibility of an increase in the share price itself. Basic earnings per share has also seen an increase to an all time high of \$10.29 in 2020. Basic earnings per share is an important indicator of the value of company. This increase over the last decade has shown Home Depot to be a very profitable company.

Industry Analysis

Home Depot is in the Home Improvement Retail Industry and the Consumer Cyclical sector. There are only a handful of large players within this industry. However, there are a few smaller, more specialized retailers that all compete against each other for market share in particular products.

Source: Home Depot 2020 Annual Report and S&P Capital IQ

A look into the Home Improvement Industry

Looking back on this year, the Covid-19 pandemic hit many industries very hard, especially the retail industry. However, after the first quarter of 2020, the home improvement retail industry bounced back particularly well. Once North America realized the severity of the pandemic and the possibility of it lasting longer than expected, consumers began shifting their spending towards Home improvement. As a result of individuals spending much more time at home, a large increase in home improvement spending followed. Those that could began working and going to school remotely. Consumers invested much more into home offices, home workout rooms, general remodels, and many others just to name a few. 2020 was one of the best years for the Home Improvement industry in decades even with a current pandemic.

Outlook into the near future for Home Improvement

The current trend of increased investment into home improvement will likely continue into the next year which is the timeline for this report. Many companies and schools still do not have plans to bring individuals back in person for the time being. Additionally, many companies and schools are giving the option of remote or in person. While the vaccine rollout is happening rather quickly, I believe there is still at minimum of a few months until we get any resemblance of "normal" back. Until then and in the near future, the trend of increased home improvement spending is likely here to stay.

Market Competition

The Home Improvement industry, there are only a few direct competitors to Home Depot. However, there are many smaller specialty retailers that compete for market share within the industry as a whole. Finally, this industry has many, smaller players such as family-owned stores as there are few barriers to enter into this space.

Home Depot's Competitive Positioning

With a market capitalization of over 278 Billion dollars and over 2,200 stores across North America, Home Depot is by far the biggest competitor within the Home Improvement retail industry. Home Depot is positioned very well within this space for a few key reasons. To begin, as a result of being the biggest by stores and market capitalization in the industry, Home Depot has very strong brand recognition. Having a very large number of stores throughout North America, customers are very familiar and comfortable shopping at Home Depot. Another advantage Home Depot has over its competitors is its reputation of having excellent customer service. Home Depot prides itself on helping the do it yourselfers successfully complete any given project. This is primarily due to its skilled and knowledgeable associates giving general guidance to its customers. Customers often come in seeking not only quality products, but quality advice in areas where they might be inexperienced. While brand recognition and customer service might seem simple and unimportant. These are two of the most important characteristics a retailer can have in today's world.

Valuation using the Dividend Discount Model

Dividend Discount Model		k / terminal							
Two Stage Growth Model		g	3.50%	4.00%	4.50%	5.00%	5.50%	6.00%	6.50%
Stage 1 Growth Rate	10.00%	4.24%							
Number of Years in Stage 1	10	4.74%	\$685.67						
Stage 2 Growth Rate	5.00%	5.24%	\$485.86	\$657.97					
Number of Years in Stage 2		5.74%	\$375.32	\$466.62	\$631.54				
Stage 3 Growth Rate		6.24%	\$305.18	\$360.75	\$448.24	\$606.31			
Growth Path	Linear	6.74%	\$256.73	\$293.56	\$346.82	\$430.70	\$582.22		
Cost of Equity Capital	5.74%	7.24%	\$221.27	\$247.14	\$282.45	\$333.52	\$413.94	\$559.22	
Dividends per share, LTM	\$5.58		\$428.14						

Risk-free rate of return	1.15%
Market Risk Premium	4.50%
Beta	1.02
k, Cost of Equity Capital	5.7400%

Average price: \$428.14

Sources: Yahoo Finance and MarketWatch

I believe based on a few key factors, that the dividend discount model is the best way to determine a target price for Home Depot. In this section, I will be going through how each number was chosen

First Stage Growth Rate and Number of Years in Stage 1

As we can see from the above chart, the stage one growth rate is given at 10% and the number of years in stage one is 10 years. Every year since 2011, Home Depot has raised their dividend by at least 10%. In a couple of the years the dividend was raised by more than 10 percent so this section can be seen as slightly conservative. Additionally, looking back 10 years is a great time period for calculating price per share in the near term.

Second Stage Growth Rate

As we can see from the above chart, the stage two growth rate is given at 5%. I chose a five percent second stage growth rate because while Home Depot is a very established company and a value stock, they continue to grow and expand year in and year out. I believe Home Depot will most likely continue to pay out a strong dividend and it will most likely continue to increase even by 5%. Also, I believe this to be a conservative estimate due to the fact since 2011 they have increased their dividend by more than double 5% in some years.

Cost of Equity Capital Calculation

Home Depot has a beta of 1.02, which is already calculated for us meaning it moves fairly closely with the broader market. The risk-free rate of return for the market right now is historically low at around 1.15%. The risk-free rate has been inching a bit higher as of late. However, in recent years it has stayed a bit above 1% so I believe this is a fair assessment. Additionally, for the market risk premium I used 4.5%. This is a historic average that has used decades of economic data in order to stay consistent. The beta, market risk premium, and the risk-free rate of return were all used to calculate a K or cost of equity capital of 5.74%. This I believe to be a fair to slightly conservative estimate.

Target price

After determining all the needed variables, I came out with a fair price of \$428.14. As of today, Home Depot hit another all time high for the third day in a row, trading at around \$305. This means Home Depot has an upside of around 40%.

Investment Risks

Source: Home Depot 2020 Annual Report

Home Depot has a few risks that should be considered before investing

Supply Chain and logistics Issues

Home Depot offers a wide variety of products in all their stores throughout North America. With thousands of stores, in many different locations, selling a wide variety of products, even a small disruption in the supply chain can cause large problems to Home Depot's revenue. The Covid-19 pandemic has caused numerous problems to the supply chain and has had a negative effect on appliances which is one of Home Depot's biggest revenues by segment.

Recession or Strong Economic Downturn, Especially in the housing market

During recessions, individuals often only spend money on essential items. While they will still purchase products from Home Depot, they will be only products that are absolutely needed. Additionally, in recessions, consumer spending on large home improvements is postponed until an economic recovery.

Competition between Home Depot and Specialty Retailers

Home Depot has always had to compete against smaller, more specialized retailers. While it is often good that Home Depot is seen as a store with everything needed for home improvement, this can also be a negative because potential consumers may go to a specialty retailer believing they might have a better selection or better pricing than Home Depot. Home Depot tries to make sure they have as many different products available as possible. These products might be in store or available for the customer to order. This ensures Home Depot is as competitive as possible against specialty retailers.

Lack of Highly Skilled Associates

One of Home Depot's biggest target markets is the do it yourselfer. This target market often comes into the store to receive general guidance on how to finish a particular project or task. If Home Depot does not have enough skilled associates, they most likely will lose a large share of one of their biggest target markets. One way Home Depot is overcoming this risk is by keeping wages and salaries competitive in order to ensure a low turnover rate.

Competitive Pricing

With the internet, consumer can more conveniently than ever comparison shop between potential stores. Home Depot must competitively price items in order to retain its customer base. However, one way that Home Depot is combatting this is through price matching from different retailers. Price matching has greatly helped Home Depot in retaining customers even if the price of the specific item might be less expensive elsewhere.

Sources

Home Depot Leadership Team

<https://corporate.homedepot.com/leadership>

Home Depot Committee Members and Charters

[Committee Members & Charters | The Home Depot](#)

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History of Home Depot

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[HD Stock Price | Home Depot Inc. Stock Quote \(U.S.: NYSE\) | MarketWatch](#)