Home Depot Investor & Analyst Conference
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PRESENTATION

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

So good morning, and welcome to Home Depot's 2017 Investor and Analyst Conference. This morning, you'll be hearing from Craig Menear, our Chairman, CEO and President; Ann-Marie Campbell, Executive Vice President, U.S. Stores; and Ted Decker, Executive Vice President, Merchandising; as well as Kevin Hofmann, President of Online and Chief Marketing Officer. Then we'll take a 15-minute break.

After the break, our speakers will be Bill Lennie, Executive Vice President, Outside Sales and Service; Mark Holifield, Executive Vice President, Supply Chain and Product Development; and Carol Tomé, our CFO and Executive Vice President, Corporate Services. At the conclusion of our second session, we'll open the mic for our question-and-answer period.

I would like to remind everyone that today's presentations made by our executives include forward-looking -- may include forward-looking statements as defined by 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 on the slide and in our filings with the Securities and Exchange Commission. Today's presentations also include certain non-GAAP measures. Reconciliation of these measures can be found on our website at ir.homedepot.com. It is now my pleasure to introduce our Chairman, CEO and President, Craig Menear.

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

Let me start by thanking you all for taking the time to be with us here today. Over the next couple hours, we're going to provide an update on our progress against our commitments that we made at our 2015 Investor Conference and share with you our approach for the next 3 years to position Home Depot to continue to win in the market. I'm going to touch on our progress in meeting our current targets, the definition of the One Home Depot experience, the changing retail environment and where we are investing to address the changes that we are facing. The team will explain how we will enhance the customer experience, invest for the future and create value for our customers and our shareholders.

First, we're on track to hit our targets. In December of 2015 we told you that we would grow our sales to $101 billion by 2018, up from $88.5 billion in 2015, which was the equivalent to opening over 300 new Home Depot stores, which we didn't do! We are on track to achieve this sales result. Our 2018 operating margin target was 14.5%, growing from 13.3% and our 2018 return on invested capital was 35%, expanding from 28%. In fact, we're actually poised to exceed all 3 of these targets by the end of 2018.

And we have completed several of the initiatives that you see here on this page, which support our 5 key strategies. I will not take you through each one of these, but I want to highlight a few of them because this is a journey that we're on, and we continue to focus on creating the One Home Depot experience. Let me take a few minutes and share with you what we mean by the One Home Depot experience.

Our customers no longer think of us in terms of separate channels. They don't think of us as a brick-and-mortar channel and a digital channel separately. We want to enable the engagement with a seamlessness across channels, but candidly, that's not how we were built. Now there's a lot of work that has been done, but we must continue to tie together that seamless flow of information across all channels for both our customers and our associates. So as the customer continues to blend the channels of engagement with The Home Depot, we must invest in the One Home Depot experience.

Under the strategy of connecting associates to customer needs, we've made adjustments to our store fulfillment teams to consolidate and improve the customer experience around buy on-line pick up in-store, buy on-line ship to store and buy on-line deliver from store. We consolidated our outside sales force to better align capabilities of our Home Depot and Interline teams to address specific needs of different Pro customer segments. And we invested in enhanced tools for our associates to better serve our Pro customers.

Supporting our strategy of connecting product and services to the customer needs, our merchant teams has increased the collaboration with our suppliers to drive innovation and efficiency, leading to greater value for our customers and our product. At the end of the day, product is why customers come to The Home Depot, and we must meet the local needs of our customers.

Under Connecting Product from Shelf to Site and to Customer, our supply chain has been a great source of value creation for our customers and shareholders. We have continued to focus on having the product available for sale through initiatives like Project Sync, while driving productivity. We have invested in enhanced delivery capabilities as this is a growing segment for our business.

We've talked a lot about our focus on our interconnected experience. The front door of our store is no longer at the front door of our stores. It's in the customer's pocket. It's on the job site. It's in their home. Developing the One Home Depot experience by bringing the physical and digital worlds together, with ability to handle the scale of Home Depot, required us to complete a re-platform of our website. This re-platform gives us the ability to create differentiated experiences for the customers going forward. Of course, we remain focused on innovating our business model to drive productivity that The Home Depot is known for over the years. While we are pleased with the results that we have delivered, there is more work for us to do in order to continue to drive productivity.

So let's talk about the changing retail environment. As you can see, the retail landscape is changing at unprecedented rates. Some say that it's more change in the last 3 years than the last 10 or 20 years. Clearly, the customer is engaging in an increasing way in the digital channel, but brick-and-mortar still matters. The way customers research product has changed. Instead of going to a store to browse in the aisles, the customer researches reviews and ratings online. The level of delivery and fulfillment options available to customers changed drastically. All of these changes have to be reflected and brought to life in the customer shopping experience.

Within the context of this changing retail environment, customer expectations are increasing. It's imperative that we address these evolving needs with increased speed. More customers now expect improved product delivery, personalized experiences tailored to their needs and a frictionless checkout when they visit a store or the website. As you'll hear from Kevin, data and technology is interfacing in the shopping path from marketing to purchase.

And as a result of this changing retail environment, we also have to change our thought around product categories that we shared with you in 2012. Back then, we talked to you about how we viewed each of our product categories through the lens of potential Internet competition and opportunity. At the time, we thought that there were some categories that were far removed from internet competition. This framework was an organizing principle for us in 2012 when we were still gravitating towards a 2-channel view of the world. Today, we've learned that even products and categories where the store delivers the best value, the experience oftentimes starts in the digital world. No categories are excluded from an interconnected world, and we must invest to deliver the best interconnected experience possible.

So let's now take a look at the investments going forward. While our 5 key strategies are still relevant in this changing retail environment, we have to step up our investments to position ourselves for the future and address the changes that we face. The customer views us as One Home Depot, as I previously mentioned, that's just not how we were built. We were built in silos, with stores serving as our original platform and then adding the online component over the years but still in a siloed capacity. In order to continue the journey to create the One Home Depot experience, we have to de-silo ourselves, leverage our scale and invest in growth in the future. We will invest in our physical stores, our associates, product and innovation, our professional customers, our services business and our supply chain. And underlying all of these investments is our continued investment in IT to create the seamless One Home Depot interconnected experience.

When a customer comes to our physical store, it needs to be a great environment. Our stores must be completely interconnected for us to be able to leverage the scale that we have in our total asset base. So we will invest in the physical experience and capabilities necessary to provide the great One Home Depot interconnected shopping experience.

Lots of customers that visit our store know exactly what they want and are looking to get in and get out quick. Ann-Marie will discuss that we'll invest in the front-end experience to facilitate fast, easy checkout, to drive not only sales but productivity in the business. Many customers choose to pick up orders that they've created on homedepot.com in our stores, and we will invest in capabilities to make that an easy experience.

The Home Depot store is also the hub for complex transactions that take place in home improvement. That might be a plumbing or an electrical problem that you're trying to solve or a complex configuration like a kitchen. We will lean into this opportunity, and that means investing in our associates. Many of these complex transactions have historically required associate knowledge of complex systems to assist the customer. We will invest in simplified associate tools to improve the productivity and support what we call the first day or universal associate. Our goal is to make it easier for our associates to serve our customers and provide an outstanding experience. Our associates are the face of Home Depot, and we'll continue to invest in them. We'll invest in wage. We'll invest in more scheduling flexibility and in tools to drive productivity.

Product is king. And the art side of the art and science of retail is still hugely important. We intend to use our merchants to add value in creating a curated assortment across channels as this has been an effective strategy against all types of competitors that we've faced over the years. We sell the same categories of goods that many others sell, but we don't often sell the same products within those categories.

Localization and speed to market are important, and we will invest to achieve a first-to-market approach. We will invest to enhance the digital experience around product to improve search and the selection process within categories. All of this will be done within the context of an interconnected experience, which we know drives customers to the physical world.

As Ted will discuss, our research tells us that customers give us the right to play digitally in categories related to the home that we're either not in or kind of dabble in today. For example, we dabble in pool products in select regions across the country with a limited assortment. We could actually have a much deeper assortment for the convenience items around pool through homedepot.com. We can leverage our scale and infrastructure to provide great value for the consumer in this category.

The changing demographics in the U.S. offers us an opportunity with our professional customers and our services business. The aging baby boomers more frequently is looking to have projects done for them, either by hiring a pro or allowing Home Depot's services business to do the job for them. Our services business has largely been a business connected through our physical stores. Customers are moving online to begin the shopping experience in this space, and we will invest to connect our services business to the digital world.

As Bill will discuss, we serve many types of pros, and their needs vary based on who they are. The Pro is becoming more and more digitally connected to the stores and, within some segments, the digital experience itself. We're going to invest to enhance the business-to-business digital capabilities in a new B2B website experience. This will be a customized experience to meet the needs of -- specific needs of a specific customer.

Our Pro and our DIY customers expect retailers to adapt to their changing delivery needs. You'll hear from Mark, our intent will be to leverage the capabilities that we've built upstream in our network while significantly improving the downstream proficiencies, leveraging our scale and our convenient locations. The goal is to create the fastest, most efficient delivery in home improvement.

And while our comments today are U.S. centric, the capabilities that we've been discussing will extend to our investments in Canada and Mexico as well. They are facing the same type of changing environments that we are here in the U.S. We will lean into supply chain, the digital experience and the creation of the interconnected One Home Depot experience in both countries as well.

The virtuous cycle of productivity at The Home Depot is what has allowed us to improve the customer experience, increase the competitiveness in the market and deliver on shareholder value over the last 9 years. We will remain laser focused on driving productivity. Our approach to technology development will drive productivity and speed. Our focus on the elimination of waste across the value chain, improved processes, enabling those processes through simplified systems, will support the virtuous productivity cycle.

We are investing not only to protect our position, but we are investing to leverage our scale. The products and services are still a small part of a $600 billion addressable market. Our market includes home improvement products and services and MRO or maintenance, repair and operations products. Our desired outcome of the investments that we're making is to position ourselves for outsized growth for the long term and to continue to create value for our customers and our shareholders.

We have captured market share as we recovered from the economic downturn of 2007 to 2009. We want to position ourselves for the same type of opportunity going forward in this changing retail environment.

Our objectives in the business have stayed the same, as does our strategic framework. Our goals are enhanced, and our initiatives will continue to evolve as we meet the changing requirements of our customer. Our objectives and strategies create value for all. As Carol will discuss, our target is to grow our business to a range between $115 billion and $120 billion in sales by 2020. We plan to invest operating margin rate to accelerate our capabilities, yet it could grow as high as 15% and position Home Depot to be a stronger competitor in the future. We expect this to result in an increase on return on invested capital to as high as 40%.

Today, I've talked to you about change and our need to stay ahead of it. As we invest in the One Home Depot experience, I'd like to share with you what's not changing: our culture! Our culture is the greatest gift we received from our founders, and I truly believe it's a competitive advantage in the market. Our culture is represented by these 2 powerful symbols: our values wheel, which guides the decisions that we make in our business; and our inverted pyramid, who defines who's most important in our business: our customers and our frontline associates.

Once again, I thank you very much for investing your time in The Home Depot today. And with that, I'd like to introduce Ann-Marie Campbell, our Executive Vice President of U.S. Stores.

Ann-Marie Campbell - *The Home Depot, Inc. - EVP - U.S. Stores*

Good morning, everyone. Today, we are going to talk to you about the investments we are making to evolve and keep pace with the changing expectations in retail from the lens of both the customer and the associate experience. As the retail environment evolves, we will push boundaries to consistently exceed customer expectations and deliver a best-in-class customer experience across all channels.

Home Depot is evolving to enhance the interconnected experience. For many types of customers, that experience spreads well beyond the 4 walls of our stores. Kevin will talk to you later about the investments we are making in our digital properties, while I will focus my comments on our stores.

Indeed, the core of the One Home Depot experience is our stores. It remains the hub and in order to deliver on the convenience and value that all customers seek, there are several key areas of investment that I'm going to talk to you about.

Starting with, the store is still the hub, so we must invest to keep them relevant. We're investing to improve convenience and speed of the customer shopping experience. We're also investing in capabilities to drive productivity and improve our in-stock and on-shelf availability. We're investing to make our store associates more productive. And finally, we're investing in our associates. They drive our customer experience, and we have to do everything possible to make associates' experience a very rewarding one. So let me start with my first point. Our stores are still the hub. As Craig mentioned, while the retail environment evolves, our store remains core to the One Home Depot experience. Within this journey, our website has become the front door of our stores, expanding our reach and influence in a very powerful way. And while data suggest that customers are actively leveraging our website, it also indicates that our website is often the beginning but not the end of their journey as the store is typically the next stop.

90% of the U.S. population lives within a 10-mile radius of a Home Depot store. 45% of online orders are picked up in the store, and over 85% of online returns are completed in our stores. Our stores are the hub of an interconnected One Home Depot experience, so we must invest to keep them relevant.

So how did we know what to invest in to keep our stores relevant? We listened to our customers and noticed some recurrent themes. We've been instituting pilots to solve for the most frequent customer pain points around these themes. And given the results of these pilots, we have the confidence that our investments are targeting improvements that would be most impactful from a customer experience standpoint, which leads me to my next main topic, how we're investing to improve convenience and speed of the shopping experience.

The first customer pain point we set out to solve is around navigation. How customers navigate our stores is critical, and always our Wayfinding initiative is aimed at improving the convenience of this experience through a more -- a new, more intuitive sign package and better lighting. We have invested in a better digital navigation experience through store-specific maps on mobile, which allows customers to pinpoint the aisle and bay location of an item they are looking for in the store. Millions of customers are exposed to our online and in-store navigation features on a daily basis. Customer feedback has told us that these new wayfinding enhancements make it easy and simple for customers to find the products they are looking for without the help of a store associate if their need is to be in and out of the store quickly. Our customer service scores in the category of "easy to find" increased 30 percent with the implementation of our new navigation initiatives.

The second pain point for customers centers around checkout. We piloted a redesign of our front end in our stores that allows our customers to get in and out of our stores faster. We invested in systems, capabilities and in new physical infrastructure that makes this possible. We also added self-service lockers at the front of certain stores so our customers can pick up their online orders without needing to stop by the service desk. Again, if their need is speed and convenience, we're investing to deliver that.

Across all these piloted initiatives, we're pleased to see that performance has improved. Our customer service scores and check-out time satisfaction and ease of online order pickup have both increased by 200 basis points, while our order pickup time has seen a 17% reduction. Given these pilot results, we are confident that these investments will help to drive an enhanced customer experience. We will be completing the rollout of these initiatives over the next 3 years.

That brings me to my third topic, which centers on investing in capabilities to drive productivity and improve our in-stock and on-shelf availability. Excellent customer service starts with being in-stock. But beyond just having the product in stock, it has to be on the shelf for a customer to purchase, not stored in an overhead. This is why improving freight handling through our end-to-end initiatives is so critical.

The movement of freight has both a customer service and a productivity component to it that we have to get right. During our 2015 investor conference, we discussed several different documented processes we would be rolling out to improve freight handling in our stores. We talked to you about initiatives such as Smart Sort, Manual Floor Load, Engineered Unload and Directed Packout, all designed to seamlessly move freight from the receiving area in the back of our stores to the shelves. We also enhance the process for moving product from our overhead to shelf through Bay Directed Packdown and Smart List. All of these enhanced capabilities are a part of our end-to-end initiative, which creates a consistent process for every store to optimize how product flows from truck to shelf.

Our focus on end-to-end, in partnership with Mark and the supply chain team, has yielded great results over the past several years. We have seen a 10% reduction in packout time, and there has been a 30% reduction in time spent looking for products in the overhead. For our receiving associates, the number of footsteps required to stage product has declined 90 miles annually per associate.

And although the results of our end-to-end initiative have been positive, there's still more that can and must be done. This is a journey, and we will continue to invest in our end-to-end processes within the store to adapt to our evolving supply chain and delivery capabilities.

This brings me to my fourth point: we will invest to make our associates more productive. Investing to simplify our systems and the selling tools that they use to service our customers is a good place to start. Today, our associates use up to 10 different systems to sell and manage orders across appliances, kitchens, pro, deliveries, et cetera. Navigating the various systems requires extensive associate training and translates to increased customer wait times. There is an opportunity here to improve the experience from both a customer and an associate perspective. So another area of investment focuses on simplifying these legacy systems, replacing them with a system called Order Up. The new Order Up system consolidates all these different systems onto one user interface that is simple and intuitive for any associate to use with minimal training. It doesn't matter if an associate is working their first day at The Home Depot or it's a 30-year veteran. The new simplified system enables them to sell, find, track, release and deliver any customer order. This is the embodiment of the universal or first day associate that Craig mentioned earlier.

Across a variety of order types, early results have shown reduced customer transaction time by up to 35% to 50%, again, helping us deliver the convenience and experience our customers desire while also helping our associates to be more productive with their time. Less time spent learning and navigating our systems means more time in the aisle, engaging our customers and driving a best-in-class customer experience.

Finally, we must invest in our associates because they drive the customer experience. Maintaining a competitive and agile workforce is a key priority, and its need has never been greater. Making sure knowledgeable associates are accessible to our customers when they do need to engage on a more complex product -- project or issue is critical for delivering a best-in-class customer experience. We're enhancing our label model to better align associates' activity with customer needs. We're also implementing technology solutions, like My View, to help associates know our customers better, which I'm sure many of you saw during the product demos outside.

Our associates are our differentiator, and we can't sustain the customer experience we strive to deliver without them. We must invest in them to remain competitive in wages and benefits as well as implement tools that generally make their lives easier. For example, our new workforce management tool will improve associate flexibility by allowing them to swap schedules, work at multiple locations and view their schedules from their mobile device. Our customers continue to rely on our associates to help on complex projects. Collectively, Home Depot associates have a total of 1.7 million years of experience servicing the unique home improvement needs of our customers. Our associates are trusted advisers for our customers, and we will continue to invest in their experience and productivity in a meaningful way.

Before I finish, I do want to touch briefly on the way we serve our communities. At Home Depot, we are more than a store. Serving our communities is an important part of our core values, and our associates live out this value through their actions every single day. We are a place where families learn and spend time together, building their dreams one project at a time. We're committed to teaching the next generation of do-it-yourselfers through a Kids Workshop, which celebrated their 20th anniversary this year and have been attended by some 55 million children over that time. Other customer workshops on a variety of projects are also very popular.

The work our associates do also extends beyond the 4 walls of our store. They are there, serving our communities in their time of need, as we just witnessed in the third quarter. In a period marked by unprecedented number of natural disasters, our associates were there for those impacted, working tirelessly and under difficult circumstances to get products into the hands of those who needed it, often as they, too, faced disruption in their own lives.

Beyond serving our communities, Home Depot is committed to serving those who have served us: our veterans. Since 2011, The Home Depot Foundation has improved more than 34,500 veterans' homes and facilities, and we have pledged a quarter of a billion dollars for veteran-related causes by 2020. In an organization of over 400,000 associates, I know that I speak on behalf of the entire leadership team in saying that we are incredibly proud of the various ways our associates serve our communities, and we will continue to do so going forward.

In closing, we are excited about the opportunities ahead as we strive to deliver the One Home Depot experience by investing in both our stores and associates. We will do this by -- while remaining committed to our culture and values, proudly serving our customers, communities and veterans.
Thank you!

And now it is my pleasure to introduce our Executive Vice President of Merchandising, Ted Decker.

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

Good morning! Today, I'm thrilled to review how we will maintain our position as the #1 retailer in product authority for home improvement. Three years ago, in coordination with Craig's overall strategy, we established 3 objectives for the merchandising organization: we want to maintain our momentum, be the best at balancing the art and science of retail and increase collaboration with each of our supplier partners. These objectives have been successfully guiding our strategies, and we don't plan to change.

We are, however, going to add another objective to emphasize our desire to satisfy customers' rising expectations. As Ann-Marie highlighted, we will also work in merchandising to deliver the best interconnected customer experience in retail. We're a sales-driven organization, and we won't change our strategy of driving the top line with an emphasis on traffic, transactions and units. The Home Depot has been winning in the marketplace. We've taken share since the housing recovery started, and we plan to keep that going. We'll maintain our momentum by focusing on product, value and service.

We are the #1 retailer in product authority for home improvement. Craig often says, we sell the same categories of goods as others in our industry, but we don't sell the same products nor sell them in the same way. We've collaborated with our supplier partners for years to offer the best and most innovative products in our industry.

An excellent example of product innovation is in portable power. With lithium ion battery technology, brushless motors, and integrated electronics, the industry has changed dramatically. Cordless tools now offer the power and run time of previously corded product, and our Pro and DIY customers are rapidly adopting these tools.

We all know that “new” sells, and our suppliers are investing in hiring the best and brightest engineers to innovate and develop new product. Our supplier partners trust Home Depot to launch new products, highlight innovation and be great stewards of exclusive programs in brands like Dewalt Flexvolt, Milwaukee and Makita. These new and exclusive programs continue to grow, and the brands we sell have the leading market share in the industry.

And Home Depot is investing as well as we complete an over $100 million revitalization of our tool corrals, drive events like Ryobi Days and gift center and leverage our Pro customer base. The formula is working as we've gained some 500 basis points of market share and are the destination of cordless power tools. And cordless technology has expanded into more categories, like outdoor power equipment, lighting and pneumatics. This type of product authority is happening across the store.

And another example is in our bath business. We offer the leading lineup of brands in the industry, like KOHLER and Delta, Moen and American Standard, complemented by our leading private-label brands like Glacier Bay, Hampton Bay and Home Decorators Collection. While you see some of these brands at other outlets, Home Depot has many exclusives, like Delta toilets and product launches like the Moen Press & Mark bath accessories. Our merchants and trend and design team partner closely with our suppliers to introduce new styles, finishes and innovations that help our customers complete their dream projects or simply replace a faucet. And we continue to invest in merchandising resets in our stores and product presentation online to bring all of these great new products to life. Moreover, we offer an interconnected experience for our customers. They can shop online, work with a bath designer in store and have products delivered and installed.

We've been building our decor business since our first stores opened. Today, we currently sell over $25 billion of decor-oriented product, from flooring and lighting to window treatments. Over the years, we've leveraged seasonal events to introduce decor categories to our customers, and our decorative holiday businesses is an early example. Initially, we only sold Christmas trees and a few strings of lights. So our customers had to make at least one extra shopping trip to complete their holiday decorations. Over time, we added more lights, artificial trees and ornaments. Today, we have a destination assortment of innovative products with great design and value. And we've developed equally successful programs in Halloween, summer outdoor living and household organization, just to name a few.

Following these success stories, we completed extensive research on customer shopping intent and found we have the authority to play and the right to win in several home decor categories. We believe we are well positioned to help our customers compete -- complete their decor-oriented projects with items like housewares, tabletop, interior furniture, wall decor and textiles.

And consumers are increasingly purchasing decor categories online, so our efforts will largely be digital, where we will leverage our traffic and customer base for a natural scale advantage. Over the last year, we've selectively onboarded over 180,000 decor products from over 500 new suppliers. We're also investing in our interconnected decor shopping experience, with enhanced photography, shop-by-room or collection capabilities and style guides. And we are leveraging our existing capabilities to reintroduce home decor catalogs like the one each of you should have at your seat. We're pleased with our results and are accelerating our decor investments.

Now turning to value. Our pricing strategy remains unchanged since our founders, Bernie and Arthur, decided that customers should be able to get the same great price Monday through Sunday versus having to wait for a deal. It all starts with our Everyday Low Price. And if anyone is buying more, we offer the same everyday lower bulk price. This price philosophy is particular important to our Pro customers who count on us to be priced right every day. And to ensure we remain priced right, we continue to invest in tools and technology to help merchants make sure we have the best value in the marketplace.

Moving on to Service. Having great products at the right value is fundamental, but our customers also come to our stores for great service. And, nobody is better at providing that service than Ann Marie in the U.S., Jeff in Canada, and Sergio in Mexico, and their collective team of some 400,000-strong associates.

There is a “buzz” in our store. The environment is electric, as our associates help customers, create excitement around products, and drive fun events like our recent Black Friday Event.
And our field merchants and MET teams are a competitive advantage as they help to bring our stores to life by executing resets, setting events and driving hyper localized merchandising. A great example is the work these teams did during the recent hurricanes. We were able to modify our plans and get product where it was needed on a real-time basis. Our supplier partners understand these Home Depot advantages, which is why they continue to offer us so much in the way of exclusivity and product allocation.

Now turning to our objective of balancing the art and science of retail. Whenever I talk about balancing the art and science of retail, I'm careful to emphasize that we will always start with the art. Product is king. Our merchants are worldwide authorities in their categories, and few others sell more product than each of our merchants in their respective categories. Merchants are the customers' advocate, and they literally scour the globe for the best products, brands and value. While others may list overwhelming choice, our merchants select the best products and curate the right assortments in our stores while offering a more expansive set of selection online.

We're also focused on the science of merchandising. We're building capabilities and investing in people, process and technology to better leverage our data and build tools to optimize our business. For example, a few years ago, we built a proprietary assortment planning tool, which helps us cluster our stores and customize assortments to fit localized demand. We've built pricing tools to ensure we have the best value in the market. We're building much better space optimization tools to improve in-stock levels while driving turns. And now we are investing in new capabilities to implement a cycle of continuous improvement.

Previously, we would wait for a category to degrade then we would launch a comprehensive line review, which takes months to implement changes. We're now establishing the process and tools to continuously review our assortments, line structure and space requirements so our merchants can better sustain category performance. Our aim is to ride the crest of the wave rather than degrade and have to reset. To accomplish this at scale, we're building out the technology to support an automated end-to-end process that incorporates our assortment, planogram, fulfillment, project planning and execution applications. Going forward, we'll be even more agile and will update our assortments or change space assignments more frequently and with better accuracy.

Let's talk about collaboration. We want to become even more aligned with our supplier partners. Our goal is to win together by taking a collaborative end-to-end approach to the business. If we understand the customer better, reduce complexity, plan collaboratively and increase speed to market, we create more value while better serving the customer. Over the past several years, our suppliers' response to this objective has been tremendous. We've shared data, participated in joint planning sessions and connected the right teams within our organizations.

While there are countless examples of end-to-end collaboration, I'll highlight our recent success with Weber. Weber asked to partner with us on the launch of their upgraded Genesis II grill. Together, we developed a prelaunch marketing campaign, enriched online assets and sold preorders. After launch, our associates brought the product to life in our stores through various events. We carried that spring momentum into fall, and Weber was one of our seasonally relevant brands integrated into our College GameDay campaign, which allowed us to drive sales in a fun way.

Let's take a look at the commercial.

(Video)

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

Now that always makes me smile. Based on our strong results and collaboration, The Home Depot will have 2 Weber grill exclusives this spring and we'll maintain our position as the #1 Weber retailer.

Since Home Depot was founded, we’ve differentiated ourselves from other retailers by delivering a three-pronged value proposition that includes the best products, at everyday low prices, and with great customer service. However, in the new age of retail, customer’s expect even more.

As Craig and Ann-Marie mentioned, the customer expects a seamless interconnected shopping experience where they can easily weave between the physical and digital worlds. Our merchants work closely with online leaders to create an easy and frictionless shopping experience.

Over the last several years, we've invested in our interconnected experience to enhance and scale our capabilities. We've built a new customer order management system. We've rebuilt our e-commerce platform; launched a new site experience; built apps, search and mobile platforms; and staffed call centers, all of which to support our customers' ability to interact with us how, when and where they want. However, we have much more to do. And Kevin will review our initiatives on how we're going to improve the overall experience.

To close, while we sell the same categories of goods as others in our industry, we don't sell the same products nor sell them the same way. We are the #1 retailer for product authority in home improvement. And we will continue to take share and win by maintaining our momentum, balancing the art and science of retail, driving end-to-end collaboration and building the best interconnected customer experience.

Thank you. And now I'd like to introduce our President of Online and Chief Marketing Officer, Kevin Hofmann.

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

Good morning, everyone. My time with you today is going to center on how we are progressing in the areas of marketing and online. Now a couple of years ago, we consolidated those 2 functions as the increasingly digital world of marketing and media began to heavily intersect with the evolving shopping habits of our customers. There's really just a couple of key points that I hope you take away from me today.

First, we've made a ton of progress in leveraging all of the assets and capabilities that we have. Second, I'm going to show you how we are aligning with the One Home Depot strategy, and we're investing to create the best interconnected customer experience. It's an experience that is more flexible, more personal and more easy for our customers.

So let me just start with the first point and some specifics on our progress. We've done a lot of work over the last few years in marketing, and our results have been impressive. For years, we've been talking about the media consumption habits shifting from traditional to digital. And our spend on digital channels is now well north of 50%.

But it's not just where we are advertising that has changed, it's how we are advertising. The most recent data suggests that a majority of consumers use more than one device at a time while they're consuming media. Over 70% of consumers are watching TV with a laptop, phone or tablet nearby.

So it's increasingly difficult to not only capture but keep the attention of the customer. It's for these reasons that we leverage some of the most sophisticated marketing tactics in the industry, and we're seeing great returns and payback, not only because we've chased the customer to those new media consumption models but because we've sharpened our tactics. Productivity has always been a hallmark of The Home Depot, and our marketing team continues to prove that.

We've also seen strong results in our online business. Our most important currency for the collective team comes in the form of visits. It's our reach. It's how we connect with the consumer. And we know that 60% of all of our sales in store or online are influenced by a digital visit, and we've continued to maintain our traffic advantage. We will surpass 1.8 billion visits this year, and our digital visits now rival our physical store transactions. We've grown the online business by approximately $1 billion in each of the last 4 years, and our online sales penetration is about 6.4%, approximately double our nearest traditional competitor. Home Depot now has one of the largest e-commerce operations in the country, the seventh largest as ranked by Internet Retailer, and we continue to take share in key categories. So these interconnected retail efforts continue to be a key growth engine for our overall business. And over the last few years, they've contributed approximately 20% of the company's total growth.

But our online progress, it's not just about a website. And as we've said many times, it's about the interconnected experience. About 45% of our online orders leverage the store in some way for fulfillment. 10% of our online orders actually originate in the store as customers and associates interact together, and the vast majority of our online returns leverage the stores for a convenient return destination. Also, our online assets are leveraged by our store associates as an important customer service tool.

There are a number of key industry benchmarks…that also point to solid progress. For example, the research firm L2, which studies all things digital and ecommerce …they measure over 65 retailers in the areas of mobile, social media, ecommerce, and digital marketing…and they have recognized The Home Depot as the top-ranked big-box retailer for 3 years in a row. Now while external validation is nice to hear, our benchmark will continue to be making improvements in customer satisfaction and ease of use, and we still have lots of work to do. But we'll continue to invest to make sure we are in lockstep with the customer.

So now that I've hit on some progress, let's talk about key investment areas that we plan to do going forward. Our marketing and online teams will be driving the One Home Depot experience. Let me break down for you what that means.

The foundation of the experience, the anchor point of the experience, it's about the products and the solutions that the customer needs. It's what's in the proverbial box. It has to start with being in stock, the right quantities and, importantly, the right brands. We can never forget that the customer is engaging with The Home Depot, looking for products and solutions to help them get their projects done. However, how the customer is engaging around that product, of course, that's changing fast. We'll talk about the 3 areas that we'll be investing in to enable that best interconnected experience.

First, we'll be investing to be flexible. We need to allow the customer to shop how, when and where they want, any time of day, any device, any shopping method. Being flexible means allowing the customer to engage on the customer's terms. But flexibility doesn't just apply to the shopping part of the journey, it transcends into fulfillment. The customer expects us to have the full buffet of fulfillment choices. So that's what we mean by flexible.

Next, having the best interconnected experience will require us to be more personal. Quite simply, we need to understand the personal and unique needs of each customer. Knowing them allows us to target the customer more appropriately, targeting them at the right moment with tailored messages, messages with the right content, the right expertise and, of course, the right offers.

And lastly, all of this has to be easy. At the end of the day, we want the right products and the right solutions purchased and put to use in a frictionless way.

So I'll give you some detail and some examples on investments we'll be making, starting at the top, how we're trying to become a more personal retailer. Becoming more personal will all start with the power of our data. Through our size and our scale, we have a great deal of data on our customers, their homes, their businesses and their preferences and needs. We have most of the U.S. in our database, and nearly 50 million households of the country have been active with us in the last 12 months. Through those interactions, we are now modeling 1.7 trillion data points a week just from our own data sets. And we leverage our data -- combined with third-party data sets, we have an enormous opportunity to understand communities, neighborhoods and businesses at scale. This is all in the quest to understand our customers better.

So data will be at the core of our marketing efforts and a substantial investment focus for us. This data is powerful at the transactional level, but it's also helpful in understanding macro themes. For example, of keen interest, the largest demographic being the millennials. And over the next decade, they will have a significant home improvement spend. We break this large demographic into 2 groups: the younger and the older classes of millennials. The older millennials, now in their late 20s and early 30s, are exhibiting all the same home ownership trends that previous groups did, just with a slight delay. And what's great is that they have a real pride of authorship. They're looking to put their own mark on their homes, and they consider themselves just as likely to do it yourself as previous generations did. And we come from a real position of strength with this cohort group as they have an affinity towards our brand just as much, if not more, than other groups do.

So knowing our customers at the transactional level and at the macro level, like I just showed you, will allow us to target them and reach them more effectively, reaching them in the right ways at the right time in the channels that they are most likely to be open to messages and influencing.

As our customers morph their media consumption habits, we have been and will continue to be right there with them. Our targeting capability leverages some of the most sophisticated technologies available in the market. Here are some examples of that in the digital world. We are one of the first to explore new concepts like weather-triggering ads. These ads are only deployed and invested in when the weather is right. Or local inventory ads, which deploys advertising dollars appropriately based on the inventory levels we have in a specific store or market. And then there's Geo-fencing – which leverage mobile location technology to understand customer traffic patterns, understand neighborhoods where we are over or under penetrated, and even putting geo-fences around brick-and-mortar stores to surgically target our customers with the right ads….allowing us to us to spend marketing dollars in both offensive and defensive ways based off customer mobility patterns.
We're also leveraging partners like Pinterest, leveraging their “Shop the Look” capabilities, allowing us to target the customers early on in their home improvement journey, picking up key signals they're giving off, like style cues, product tastes or project interests. We'll be investing in these areas significantly as the digital world provides us new and exciting ways to reach customers when they're open and accessible to messaging.

Now the scale only a few have, we also manage the placement of advertising across traditional mediums, and we're focused on telling our stories to the right people in the right places. We've seen strong improvements in our return on ad spend, even as viewership in these traditional channels declines. Our improvements, they're largely due to our buying tactics and scale. However, it's now becoming possible to target more surgically even in these traditional channels, and we'll be investing in those capabilities as well. Here's an example.

Using our data to understand Pro versus consumer households, we now have the capability to have 2 households both in the same neighborhood, watching the same program at the same time, in this case, Monday Night Football. We can serve them ads based on their interest and what we know about that household. What you see here is we have a run going on right now, which shows households that shop like a consumer, they'll see holiday gift center and holiday decor on the left; households that shop like a Pro, they're seeing offers and services that are relevant to the contractor on the right. So our data allows us to know our customer at a more individual level. Our targeting capability will help us get to them at the right place at the right time, and we aspire to have all of our messages be tailored to the audience.

Here's some more about what I mean by tailoring. Customers will expect retailers to speak to them at an individual level. The world of traditional one-size-fits-all messaging is quickly falling behind us. We've got diverse customer groups. Here, you see an affluent baby boomer, a Pro and a millennial who happens to be a new homeowner.

The reality is we're peppering them with too much, and sometimes we regress to a lowest common denominator approach. We try to find the one message that somewhat appeals to all of them. But each of these customers has different needs and a different level of expertise. And as our ability to know the customer matures, we no longer have to hope that one message is sufficient for millions of different customers. We are building the capability and investing to tailor our messages and scale.

The affluent baby boomer will get a message which may be more aspirational in nature or a message about our turnkey solutions, our services business, for example. Our Pro can get messages that help them save time, save money, win more jobs. And the millennial new homeowner, well, they'll receive messages about the content of what's possible, content on how to do a project, all rich in the images that actually fit their reality, the reality of the new fixer-upper they just bought.

Overall, when we form a more personal connection with the customer, knowing them, targeting them effectively with tailored messages, we will drive outsized growth for Home Depot.

So back to creating that best interconnected experience we just went through, how we're going to invest to reach our customers in a more personal way. Now let's talk about investments we need to make to become more flexible and easy to do business with.

Now being flexible, we need to allow the customer to engage and shop and get fulfillment on their terms. We have been and will continue to invest in these areas. That means we've had to invest in digital infrastructure. This is the ecosystem required to handle billions of visits from every device imaginable, handling millions of products and the infrastructure to create that more personalized shopping experience I was just mentioning. And we recently went live with an entirely new e-commerce ecosystem, which should serve our business well. It also allows that -- for the agility and the scalability that today's e-commerce world demands. Now as the new shopping methods emerge in the next few years, we'll be investing to make sure we are there.

Being flexible also means continuing to invest in fulfillment capabilities. That's all about customer service and speed. Mark Holifield will be discussing our fulfillment and delivery investments in detail.

And lastly, we'll be significantly investing in our experiences and capabilities. For example, for years, we've had voice-enabled search and image search capabilities in our app. These experiences were probably 1 to 2 years ahead of the customer, but it provided us valuable lessons as the technology becomes more accepted and mainstream. We've dabbled in augmented reality, and we're positioned well once the technology becomes more accepted and mainstream. We've dabbled in augmented reality, and we're positioned well once the technology becomes more mainstream. And we recently partnered with Google and are live on the Google Home devices, leaning in to voice-enabled shopping. Improved experiences are all about making it easier for our customers.

So let me give you some examples on investments we'll be making. We will invest into capabilities that make us more location aware. When the customers receive those tailored weather-triggered ads or those messages influenced by their location, the customer's going to expect to land on an experience that also understands their location, understanding if you're in your home, at your place of business or in a store or not. In the example you see here, there are different product recommendations for Atlanta versus Boston.

We will also invest to build machinery to be more context aware, understanding if the customer is just looking for a simple $100 item or if they're contemplating a full remodel project or understanding if they've been engaged for the last few weeks, trying to get inspired, and maybe they just need some design help. These are all important contextual elements that are vital to creating a great and easy customer experience. We'll be investing to gather intelligence in real time to personalize the experience by the customers' context and provide the best products, content and services for their need and situation.

And lastly, being persona aware. Personalized content curated for individuals, consumers versus Pros, DIY enthusiasts or novices. We will invest heavily to become a more personal store for the customer. So for example, when we recommend products to Pros, we'll show them case packs and pro-grade brands. For the consumer, we'll show them individual quantities.

To help illustrate, let's go back to our affluent baby boomer, our Pro and our millennial new homeowner that we were marketing to in a more personal way. Not only will the marketing message be catered to them, but when they land inside The Home Depot experience, they will also need to have an equivalent personalized shopping experience. Our affluent baby boomer will get an experience to buy and have their new water heater installed on the same day.

They know the drill. They've been through this a few times in their life, and they know exactly what they need. Our Pro will have an experience to buy in bulk. We know he has bought this water heater 500 times. They know exactly what they're looking for. They care about price, inventory availability and how quickly we can get the product to their job site. And our millennials, well, they need content, how to determine what size to buy, gas versus electric, tank versus tankless. They're looking for someone to help them with this first-time intimidating purchase. So investments to enable these experiences that will make it easier for the customer.

So today, hopefully, I got across my primary 2 points: first, how we continue to make considerable progress in the areas of marketing and online; and second, that we'll be investing to create the best interconnected experience. We intend to do that by having all the flexible shopping and fulfillment options the customer is growing to expect and having a more personal connection with them and, of course, making it easy for them to improve their homes.

Thank you very much.

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

All right. Ladies and gentlemen, we're going to take our morning break. We're going to take a 15-minute break. We'll start back at 10:30. Enjoy your break.

(15 Minute Break)

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

Well, welcome back. And as a reminder, please silent your phones. And now I would like to welcome and introduce to you Executive Vice President Outside Sales and Service, Bill Lennie.

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

Well, thank you and good morning. I'm truly excited to be here today to talk to you about our strategy for both the Pro and Home Services business. At our 2015 investor conference, I talked about how we were starting the journey towards One Home Depot for Pros. That journey is gaining steam. We're moving from acting as a convenient store for our Pros to being a primary source for all of their product needs. We are laser focused on servicing our renovator customer and our transactional Pro for the foundation of our business. We're also building upon our MRO offering, by strengthening our account management, assortment and delivery capabilities.

Finally, we continue to leverage our service providers, which in many cases are our best Pros to deliver a great experience for the do-it-for-me customer. With over 40% sales penetration, serving the Pro is important to our success. What we're doing is working. For the past several years, Pro sales have outpaced the DIY business with consistent double-digit comps. Our average Pro customer spends more than $6,000 per year with us. That is the average. We have many customers who spend 7 figures with us and other Pros who spend below the $6,000 average. This spells opportunity as we continue to better know and service our Pros.

Two years ago, we stated our goal was to create a frictionless experience for the professional customer. The learnings garnered from the Interline acquisition have been a step towards achieving this goal. As an example, based on customer feedback, we created a single unified outside sales force that complements our internal sales teams. We have aligned our resources around the end markets we serve, enabling our sales professional to become experts in their field and provide great value and insights to their customers.

We have 4 targeted customer categories. The first is the renovator/remodeler, who we are very familiar with as they are the traditional Home Depot Pro customer. Second is the multifamily property manager, who requires MRO products for ongoing operations, but also needs building materials when taking on large-scale capital projects. The third customer we target is institutional customers, such as schools and hospitals, who function similarly to our multifamily customer with frequent MRO purchases. And lastly, we serve the specialty trades, such as plumbing, HVAC and electrical contractors, who require the right assortment, customer support and inventory solutions for their businesses.

We're not just aligning our sales teams, we're aligning the full organization, including online and marketing as we strive towards a more personalized experience for our customers. One thing that we've learned is there's no silver bullet that allows you to win the Pros business. It's just not that simple. Instead, we're going to market with an integrated One Home Depot approach, which leverages our scale, strengthens our relationships, builds out our capabilities, and moves towards one supply chain.

Our large scale works in our favor. Our stores are conveniently located close to Pro job sites. Our products are globally sourced, offering innovation and great values, saving Pros both time and money. One Home Depot also means building strong relationships by leveraging data and creating a single view of the customer across the company. We offer Pros the products and expertise they need, leveraging our inside and outside sales force.

The Interline integration has progressed nicely with Pro MRO now rolled out in our U.S. stores, allowing customers in Home Depot stores access to Interline's assortment. We continue to ramp up our Pro purchase program, which gives Interline customers the ability to shop in our stores using their house account. Both of these offerings have resonated with our Pros as the most active users are spending more in Home Depot stores and Interline.

As we discussed, customer expectations in retail are changing. We're witnessing a shift towards digital platforms. In some regards, segments of the Pros are no different. As a result, we're focused on creating the best customer experience for these Pros, developing capabilities to meet their needs. Our next big step is to offer a robust integrated digital platform solution. We plan to do this through a true B2B website via homedepot.com, which I'll discuss in more detail in a few moments.

We are building out enhanced capabilities around tool rental, which is another way for us to engage our Pros. We know that over 90% of our Pros plan to rent equipment in the next year, but only a small portion, about 10% rent from us. The acquisition of Compact Power expands our tool rental offering and enables the Pro to do more under one umbrella. We're investing to improve the digital experience for tool rental, including online and mobile reservations, as well as enhancing equipment delivery to improve the rental experience.

Last year we rolled out our upgraded store delivery system offering reliable two and four hour delivery windows. Our Pros have responded positively to this offering and the utilization and sales continue to increase every week. But there is more we can do. As you will hear from Mark, we are embarking upon a path to offer the fastest, most efficient delivery in home improvement.

Truly knowing the customer is vital to winning in the Pro space. Today, we know our Pro customers better than ever and this is allowing our teams to build stronger relationships and gain share of the Pro's wallet. Let me give you a little more color on this. Our transactional Pro remains the core of our business and we serve that customer every day in our stores as well as with their Pro Xtra membership. Our midsize customers, ones that may have multiple crews on job sites, require a bit more of a high-touch service. We assign specific accounts to our Pro Associates in the stores or PASAs, so Pros are better recognized and rewarded in our stores. The results have been stellar, with assigned account spending over 20% more with us on a year-over-year basis.

Finally, we manage our largest accounts through our outside sales force. These sales professionals have deep relationships with their respective accounts. They are experts in diagnosing and servicing the needs of their customers and summoning the full suite of services we offer in order to fulfill those needs.

We recognize the need to equip our associates for success. One of the ways our PASAs have been able to deliver a 20% growth in account spend is through the My View tool found at the Pro desk. My View provides store and customer data in a simple format that arms our Pro sales associates with the information they need, empowering them to serve our customers better.

Here's an example of the store level data that a PASA sees when they go into My View at the Pro desk. As you can see, it paints a clear picture of activity at the store level as well as customer-specific information. When the associate drills down, he or she can get a great view of that customer's spend pattern as well as potential opportunities for growth. The associates focus on 2 key areas of growth to help their Pro customers. Products, which are merchandising categories, that the customer may benefit from in their line of work; and services that provide business benefits that reduce friction for our Pros like credit, tool rental and delivery. New this year are alerts. Alerts indicate potential opportunities that customers may be missing based on their buying habits.

Finally, there are additional products with suggestions that may make sense given how similar customers spend with us today. All of these data points help facilitate a conversation between PASAs and our Pros, allowing them to highlight what we bring to the table in a tailored fashion.

As I mentioned, we are currently working on a B2B website. The goal here is to combine all of our capabilities in a way that provides a personalized experience for any type of Pro. This site will leverage our existing homedepot.com platform and require authentication using valid customer credentials. The site will operate under a couple of key tenets. The first tenet is one account. With this, customers will be able to order products in a manner that suits them. For institutional and multifamily customers, that means features such as workflow management, budgeting, GL coding and approvals.

For general contractors, who may have several associates who purchase on their behalf, we'll provide dynamic item lists, order history and one place to house all of their outstanding quotes. The second tenet is one catalog. Here, we'll provide a complete catalog combining the products from our stores, homedepot.com and Interline that can be shopped wherever and however the customer wants. We believe that by combining one account and one catalog in a digital experience coupled with our physical locations and delivery capabilities, we will create a differentiated B2B experience.

We believe the capabilities mentioned like delivery, tool rental, My View and the new B2B website will lead to increased engagement. The more dimensional our relationship is with the Pro, the more the Pro spends with us. Engagement across dimensions is a true driver of value. We are seeing the value of multidimensional engagement through real-time data. When a Pro enrolls in Pro Xtra, we see their spend increase. As that Pro Xtra member begins to shop multichannel, we see the spend increase again. As we increase our touch points with Pros, they reward us with their loyalty. We believe that the personalized experience we're creating through One Home Depot can lead to exponential growth. As we appeal the new Pros that weren't shopping with us before and earn additional share of wallet with our existing customers.

Our Pros are the key to our Home Services business. There is no way greater to gain a customer for life than performing a quality service for them in their home, especially for those large investments, like a kitchen remodel or whole-home window replacement. Trust is vital in this process and we gain that trust by delivering quality service and standing behind our work. We've partnered with over 100,000 badged installers and complete well over 2 million installations per year. All while building a best-in-class compliance program consistent with our high standards.

Our Voice of the Customer rates our customers' satisfaction with their installation experience. We are very proud of our current score of 4.33 on a 5 point scale. We are building out an "interconnected experience" for Home Services, just like we did for the core business a few years ago. We're investing to bring services to life in the digital world where most customers now begin their shopping experience, leveraging both our physical and digital assets.

As I close out, I want to bring us back to where we began. We've made tremendous progress. Our Pro business has never been stronger and I'm excited about the investments we're making around engagement to ensure that success continues. Our traditional renovator Pro and MRO businesses are blending together as we leverage our assets. We are creating a personalized B2B experience that's powered by One Home Depot. Our home services businesses in many ways is an extension of our Pro strategy as we leverage key installer relationships on a local basis. I'm confident in our ability to build upon recent successes and continue gaining new customers as well as selling more products and services to our existing ones.

And now to talk more about our supply chain, I'll hand it over to our Executive Vice President of Supply Chain and Product Development, Mark Holifield.

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

Thank you, Bill. Good morning, everyone. We heard Craig and my colleagues articulate the goal of creating the One Home Depot experience for our customers. We're very excited about the work ahead to deliver on that in our supply chain. More than ever, a great customer experience depends on great supply chain capability. Given the changing needs of our customers, we are committing to create the fastest and most efficient delivery in home improvement. Let's pause on those words there for a moment. Fastest, our customers want options, speedy options, time-definite options and low-cost options, next day and same day delivery. And customers now expect free or low cost options to also be quick. Most efficient, the low cost producer always wins. We see that in our supply chain and we will leverage our scale to provide low-cost efficient options for direct-to-customer delivery as well.

In home improvement, we are not all things to all people. We are the product authority in home improvement. That means we will have the right delivery options for the wide range of requirement in home improvement, especially for our Pro customers. We will have the right home improvement products in the right places for fast delivery. Home improvement is our core competency, the driver of our scale, the driver of our customers' unique requirements and where our competitive advantage will continue to live.

Let's think about our supply chain in a new way; an upstream and a downstream. The way to think about this is the upstream supply chain moves product to our stores and direct fulfillment centers. And the downstream supply chain delivers to our customers directly. My talk today will be about first, where we are now in our supply chain. Second, what we'll do to further improve our leverage in our upstream network, where today we may have -- we have a competitive advantage. And third, perhaps most importantly, how we will build the competitive advantage in our downstream network, creating the fastest and most efficient delivery in home improvement.

First, where are we now in supply chain? As most of you know, starting a bit late in our history, over the last 10 years, we've invested heavily in our upstream supply chain supporting our stores. As you see there above the tape, we've made progress in creating an optimal flow network with our RDCs, rapid deployment centers, improving our inventory management capabilities and driving further efficiency with our continuing Supply Chain Sync initiative.

And more recently, there below the tape. In the last 4 years or so, we have invested more heavily in what we call the downstream, the direct-to-customer or delivery supply chain. We've implemented new interconnected customer offerings like Buy Online, Ship To Store, and Buy Online, Deliver From Store. We built direct fulfillment centers, creating a 2-day ground parcel network. We acquired Interline brands, the MRO distributor, and we enabled new Pro-focused deliver from store capabilities like 2- and 4-hour delivery windows.

Thanks to the work we've done over the past several years, we now possess a competitive advantage in the upstream. We're positioned well for growth in our delivery offerings and we have unique scale in home improvement, upon which to build a competitive advantage in the downstream.

In terms of scale in home improvement, no one matches ours. We move more home-improvement goods than anyone else. That includes across the oceans, over the rails and on the road. We're the third largest container importer overall in the U.S., giving us unique scale in imports. We manage thousands of inbound truckloads per week in our transportation team, giving us excellent scale in the trucking market. And in delivery, we are geared for the unique requirements of home improvement, particularly for Pro customers, from parcel freight, to flatbed truck delivery, to appliance installation. For example, every day we launch over 1,000 specialized flat bed delivery trucks, equipped with on-board forklifts, for delivery to customers' job sites.

Turning to our upstream network, as far as we've come over the past several years, there is still immense opportunity to improve going forward. In the upstream, we'll continue to invest and optimize to further our competitive advantage. We are further automating and mechanizing our RDC operations to require fewer product touches and faster movement of goods. Simply, we'll be taking the manual out of manual floor load, mechanizing the load out of trailers. We plan to enhance and expand our BDCs, bulk distribution centers, to handle more volume and more SKUs. And our SDCs, stocking distribution centers, we're working to further optimize our flow of goods including seasonal and imports.

In our last investor conference, we introduced our Supply Chain Sync initiative. This program continues. Through better planning and collaboration with our suppliers, we reduced the variability and unpredictability of product lead times. In addition, using intelligent truckload rounding algorithms, making data-driven optimization decisions on inventory and transportation costs, we order more full truckloads. That product then flows to the store in a much more orderly and level fashion, providing our store associates a more predictable and stable flow of freight. At this point, about 70% of our RDC dollar flow is on Sync. We're now expanding Sync to our import flows and to our SDC platform. Our progress in supply chain has not been limited to the U.S. We continue to invest to develop our supply chain in Canada and Mexico. In Mexico, we're expanding our DCs to allow more volume and to developing direct fulfillment capabilities. In Canada, we're increasing our interconnected capabilities, enabling Buy Online, Ship To Store and Buy Online, Deliver From Store, and taking more control of the appliance delivery customer experience.

Shifting to the U.S. and the current state of our downstream supply chain, over the last few years, we've continued to expand our capabilities. We built a network of direct fulfillment centers. These DFCs give us the ability to reach 95% of the U.S. population in 2 days or less with parcel freight and 30% in one day. We're continuously onboarding SKUs to these direct fulfillment centers and today we stock thousands of SKUs, extending our assortment beyond our stores. And beyond what we choose to stock ourselves, we work with our suppliers to offer a total of over 1 million SKUs online for delivery, and we manage most of those deliveries ourselves to ensure fast and efficient customer experiences.

In our stores, we've continued to improve our Deliver From Store capabilities with a focus on our Pro customer needs. From our stores, we deliver building materials and bulky goods with those specialized flatbed trucks with the forklift capability to place the product on the job site exactly where our customer needs them. We offer box truck delivery as well. Customers now have the option to schedule 2- and 4-hour windows for these deliveries, especially helpful for our Pro customers with crews waiting for critical materials.

And new in 2017, we've increased our store delivery options, beginning the rollout of new van and car delivery options. For car delivery, we're partnering with innovative app-based delivery providers. These methods provide lower cost and often faster delivery for smaller orders. We expect these options to be in place in all of our top urban markets, ready for spring of 2018. But despite all the progress in our downstream, our delivery, it's simply not good enough for the future.
Today, our downstream delivery network is fragmented with 4 disparate unconnected components that operate largely independently, our store-based delivery, our online delivery from direct fulfillment centers and vendors, our appliance delivery and our Interline brands delivery. Our stores, while they have all our key SKUs close to our customers, they are not often the most efficient place to pick, pack and ship customer delivery orders, particularly in our top 40 markets.

Our direct fulfillment centers, as efficient as they are, they aren't close enough to provide one-day parcel service to 70% of our customers. And they aren't fully stocked with some of the most important home-improvement SKUs. Our appliance delivery is today a standalone outside network that we can't leverage for other big and bulky deliveries. Our Interline brands business with separate operations and delivery for MRO customers presents an opportunity for leverage of all of our supply chain capabilities.

Finally, we have the opportunity to link our downstream network more fully with our best-in-class upstream network. The ideal supply chain of our future is one where we fully control downstream fulfillment and delivery, one where we are closer to our customers with more of the most important SKUs. One Home Depot supply chain, where we leverage our scale and competitive advantage in our upstream network to build competitive advantage in our downstream network. With One Home Depot supply chain for the future, we will create the fastest and most efficient delivery in home improvement. What will it take to fulfill that vision? Over the next 5 years, we will invest to transform our downstream supply chain with new direct fulfillment centers and delivery capabilities. We will build more direct fulfillment centers. These will be closer to our customers. Stock the most important SKUs and supplant much of our store-based delivery in our top 40 markets.

Second, in addition to the DFCs, we'll open market delivery operation in about 100 locations. These stockless, market delivery operations will be cross-docks that allow consolidation and sortation capability for big and bulky freight and parcel freight and extend our delivery reach. And third, in secondary markets, we will consolidate Store Based Delivery in fewer stores, or Market Delivery Stores. And all of this will be linked to our upstream network to make truly, One Home Depot Supply Chain.

Let’s talk about those direct fulfillment centers first. In our top 40 markets, we will serve customers with next-day and same-day delivery from new direct fulfillment centers. We expect to open a few more direct fulfillment centers similar to and in addition to our existing DFCs, call them parcel plus. These centers will be located to further augment our parcel shipping capabilities, along with other categories shipped via truck. They'll have SKU capacity to continue to offer an extended assortment beyond our stores. More centers means faster delivery of these SKUs to customers.

Additionally, we expect to open about 40 flatbed direct fulfillment centers to serve our top 40 markets. These centers will specialize in big and bulky building material SKUs that are most effectively delivered on our flatbed trucks. Think of lumber, building materials, flooring and the like delivered on a next day and same-day basis.

Finally, in addition to the flatbed DCs -- DFCs, we expect to open about 25 local direct fulfillment centers that will carry the most delivered store SKUs and Interline MRO SKUs. With 25 of these, we will be able to deliver these SKUs on a next-day and same-day basis direct-to-customers in our top 40 markets. With these centers in place in those top 40 markets, we'll be able to minimize our stores' role in pick, pack and ship of next-day deliveries, as these are more efficiently accomplished in a direct fulfillment center.

Next, let me describe the market delivery operations or MDOs. In addition to the direct fulfillment centers, we plan to open about 100 of these. These cross-dock centers will be local hubs that will consolidate the following types of freight for dispatch on to final-mile delivery vehicles appliances, Interline MRO, Pro and DIY delivery from DFCs, vendors and stores. These locations will not hold inventory, but will be cross-docks, consolidating both outbound delivery to customers and reverse logistics returns for immediate dispatch. With these local hubs in about 100 locations, we expect to enable the fastest and most efficient delivery of these home improvement goods.

With the direct fulfillment centers and market delivery operations, we expect to largely supplant store base delivery in our top 40 markets. But beyond those markets and our secondary markets with multiple stores, we have the opportunity to drive efficiency by consolidating delivery in fewer stores. For example, in our Greenville, South Carolina pilot location, we have consolidated delivery from 6 stores to 2, driving efficiency as we increase labor productivity in picking and transportation productivity through better delivery route density. The result of these investments will drive speed of delivery for our customers, efficient fulfillment and delivery operations, and a network tailored to the specialized needs of Home Improvement, particularly for our Pro customers.

Today, our stores provide next day and same day fulfillment and delivery to their local areas. Our parcel plus direct fulfillment centers augment that with an extended SKU mix. Our future investments in local and flatbed DFCs will supplant store delivery with more efficient next-day and same-day fulfillment of all our SKU offerings, including flatbed goods. And our market delivery operations will result in a market-leading appliance and big and bulky delivery capability on top of that. All of that will work to create the fastest and most efficient delivery in home improvement. We're excited about the supply chain journey ahead. Given the scope and scale of the effort, we expect it will take about 5 years to get to the full capabilities I've described. But we have a good start with our upstream network and our existing store-based delivery and direct fulfillment centers. In the downstream, in 2018, we expect to pilot local flatbed DFCs and market delivery operations, with a rollout of all of these platforms through 2022. Over this timeframe, we'll continue to optimize our upstream as well to leverage and extend our competitive advantage there. All told, we expect a capital investment of about $1.2 billion in our supply chain over the 5-year period. It's difficult to fully convey how we view our supply chain from these slides. So let me show you a video that might help to bring our supply chain to life.

(**Video**)

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

We're very excited about the future of our supply chain. When I started in retail supply chain all those years ago, and we didn't even call it supply chain back then, it was pretty much all about moving brown boxes from dock to dock as efficiently as possible. Today, it's much more than that. It's creating a great customer experience at the moment of truth in retail, when we connect customers with products when, where and how they want. Given the opportunity ahead, there is no more exciting place to be in retail supply chain than The Home Depot. Our expectation is simple, to create the fastest and most efficient delivery in home improvement.

And now, for who you've all been waiting for, let me introduce our Chief Financial Officer, Carol Tomé.

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

Thank you, Mark, and let me add my welcome to our investors and analysts. We are glad that you joined us today and we are delighted to have this opportunity to update you on our One Home Depot strategy and financial outlook.

Today, I'd like to cover 4 topics: first, quickly discuss our fiscal 2017 financial guidance; second, share with you our point of view on the economy and the state of the U.S. housing market; third, share our 2020 financial targets; and finally, wrap it up with a discussion on capital allocation.

Let's start by taking a quick look at our 2017 guidance. In November, we updated our sales and earnings per share growth guidance and we confirm that guidance today. We expect fiscal 2017 sales to increase by approximately 6.3%, with comp sales growth of approximately 6.5%. With that, we expect our operating margin to approach 14.6%. As for earnings per share, we project fiscal 2017 diluted earnings per share to increase by approximately 14% to $7.36. By delivering these results, for the fourth year in a row, we will be reporting the highest sales operating margin and diluted earnings per share in our company history.

As a leadership team, we have a solid record of establishing financial targets and then meeting or exceeding those targets. It's been a journey. We first established operating margin and return on invested capital targets back in 2009. Since then, every 2 or 3 years, we have raised the targets. The last time we set financial targets was at our 2015 investor conference. At that time, we believed we would reach an operating margin of 14.5% and return on invested capital of 35% by fiscal 2018. We will exceed our 2018 operating margin target this year and achieve our return on invested capital target in 2018.

As you heard from Craig, today, we are introducing our fiscal 2020 financial targets and I'll cover those targets in detail in just a few minutes. But before I do that, I'd like to turn to our view of the economy and the U.S. housing market. We think the U.S. economy is healthy and we will see continued growth for several years. In addition, housing-related drivers of home improvement spending are trending nicely. And today's consumer spending behavior favors home improvement. And while my macro comments are U.S. centric, we also have favorable economic conditions in Canada and Mexico. As you can tell, our outlook is quite positive. Let's take a deeper look at the drivers of our business.

While the U.S. has been in economic recovery since the third quarter of 2009, U.S. GDP is expected to grow over the next several years, making this the longest recovery on record. One reason we are confident that the recovery will continue is that during this recovery, the cumulative GDP growth rate is just 19%, well below the historical average of 26%. GDP growth is the foundation from which we build our sales growth plan. The current U.S. GDP growth forecast over the next several years is over 2% annually. And just a comment on tax reform. If tax reform is enacted, we expect U.S. GDP growth forecast to increase, which would be good for our business. Further, we think concerns over certain housing-related provisions in the proposed legislation are overblown. And finally, not only would tax reform fuel the economy and create jobs, but with tax reform, The Home Depot would have an immediate and significant benefit to our tax expense and cash taxes.

Before we review the housing market, let's look at consumers. Unemployment has shown a marked improvement and is nearing levels not seen since 2000. Interestingly, consumers are spending, but they are spending differently. With the exception of home improvement, consumers are spending more on experiences than they are on goods. So why are consumers spending on home improvement? Well, there are 4 main drivers of home improvement spend: household formation; home price appreciation, housing turnover; and the age of housing stock. We ranked the drivers on the level of impact from lowest, noted by an equal sign; to highest, noted by 2 plus signs.

Recently, home price appreciation and housing turnover have had 2 plus signs; in other words, the biggest impact on spend. Looking ahead, we think household formation, home price appreciation and the age of housing stock will have the biggest impact on spend.

Household formation has been slow to recover, but we are finally starting to see formation in excess of historical averages. This should continue for a while as about 1/3 of all Americans between the ages of 18 and 34 are still living at home with their parents. And the good news is that as millennials start to form families, they are moving into houses.

We believe home price appreciation has been and will continue to be a key contributor to our sales growth. Once homeowners view their home as an investment and not an expense, we believe they spend more money on their homes. It is, in a way, a wealth effect. With lower mortgage ratios and lower levels of negative equity, people feel like they have more money to spend. In fact, today, there are only about 3 million homeowners with negative equity and since 2011 homeowners with home equity have seen their equity grow by 122% or $64,000 per housing unit. Looking at this chart, while the national home price composite index has fully recovered, there are still many large cities that have not yet recovered. And for cities that have recovered, the economic environment is very good, and continued price appreciation is expected.

We see the wealth effect translate to big ticket spending. For us, big tickets are transactions over $900 and we have seen growth in big ticket spending every quarter since the second quarter of 2011. But as you can see from this chart, the average spend per large home improvement project has not yet returned to the levels seen at peak. Homeowners extract equity from their homes using HELOCs or second mortgages. We've seen an increase in borrowing activity, but considerable capacity remains.

Looking at housing turnover, we expect houses to turn at 4% of units. Turnover will be a driver of spend but only a driver of growth as households increase. Candidly, we have a housing shortage in this country with only 3.9 months of supply. In a normal housing environment, you would expect to see 6 months of supply. While the housing shortage could put pressure on turnover, it helps support home price appreciation.

And one last comment on home price appreciation. The watch-out is if home prices rise to a point where the affordability index is in peril. With an affordability index of 150%, there is plenty of room to grow before we run into that risk. The same holds true in the face of potentially higher mortgage interest rates. Our analysis shows that every 25 basis point increase in mortgage rates drives $40 in additional mortgage expense per month. Mortgage rates have a long way to go before the affordability index is negatively impacted.

The age of the housing stock is going to be an increasingly important driver to our sales. We know we have an aging housing stock in the United States. Today, over 65% of the stock is 30-plus years old. Looking to 2020, 54% of the housing stock will be greater than 40 years old. Home improvement spending in a house over 40 years old is about 30% more than what is spent in a house under 10 years old.

To wrap up our discussion on housing, I'm going to end with private fixed residential investment. For years, we have used this measure: first, as a way to understand historical averages; second, to predict where our sales might go during a recession; and now simply as a way to understand where we are in the recovery.

Based on the current data, PFRI would suggest that we are in the seventh inning of the housing recovery. But what PFRI doesn't predict is what will happen to home improvement spending as housing ages and as the economic recovery continues. So for us, PFRI is just a data point, but that's all. Looking ahead, we will focus on the drivers of home improvement spending: household formation; housing turnover; home price appreciation; and the age of the housing stock.

Now let's turn to our longer-term financial targets. You often hear me say that our operating margin wants to lift. And that's because our financial model epitomizes operating leverage. As sales grow, we leverage fixed costs and expand our operating margin. Further payroll, our largest expense, grows with sales but not at the same rate, driving operating margin expansion.

Finally, productivity is a virtuous cycle at The Home Depot. So looking ahead, in a BAU or business-as-usual environment, our operating margin will lift. On this chart, we are showing that in a mid-single-digit comp environment and assuming business as usual, by fiscal 2020, our operating margin would increase by 100 basis points from what we expect to report in fiscal 2017. But as you've heard today, it isn't business as usual. Retail is changing. Further associate needs, things like the need for flexible hours, higher wage and benefits are also changing. So we are planning to accelerate our investments and reinvest our operating margin expansion. Rather than growing our operating margin by 100 basis points, we will be largely reinvesting in our operating margin expansion.

We define investments as incremental capital and expense dollars; in other words, incremental cash outlay. Over the next 3 years, we will nearly double our investments from what would have been spent in our BAU case.

Today, our leaders have shared the key areas of One Home Depot investment: from investing in our stores, to investing in our supply chain, investing in our digital experience, investing in our merchandising experience and in our people. As you look at the allocation of spending, you can see we are planning a material step-up of spending in our stores, supply chain, IT and other, which includes people investment.

As we turn to our long-term financial targets, note that today we are going to discuss our 2020 targets and in our February earnings call, we will provide specific guidance for fiscal 2018.
So starting with sales. Using our directionally correct but imperfect sales forecasting model, we believe our BAU comp sales growth will average around 4%. This assumes U.S. GDP growth in the 2% area plus 200 basis points of growth coming from the 4 housing drivers I highlighted earlier. We have similar growth forecasts in Canada and Mexico. When we include the sales benefit tied to our accelerated investments, we think our annual sales growth ranges from 4.5% to 6%. The reason for the range is that for some of the investments like store environment, we had a good idea of the sales lift as we've been in a pilot for the past year. In other cases, we estimated the sales lift based on what we should be able to do. Finally, in the case of One Home Depot supply chain, we don't expect the sales benefit to occur until the initiative is complete. Included in our sales growth forecast are a handful of new store openings every year. These new stores fill voids but will not be a significant driver of growth.

Turning to gross margins. Our largest cost pool is cost of goods sold. Within cost of goods, we have a number of efforts underway to drive productivity. For example, we have a cost out team that works hand in hand with our merchants to better understand what the right costs should be, identify strategic cost-out opportunities and address cost increase requests. From a gross margin rate perspective, however, we are planning for our gross margin rate to decline by 40 basis points as we reinvest cost out into lower-margin categories and invest in One Home Depot supply chain.

From an expense perspective, in a BAU environment, we would expect our expenses to grow at 50% the rate of our sales growth. But because of our accelerated investments, our expense growth factor will change. Over the next 3 years, we expect to leverage expenses by 20 to 80 basis points, with the range being a function of sales growth. As we think about operating margin, it's a function of the sales environment. In a 4.5% sales growth environment, our 2020 operating margin will be flattish to what we expect to report for fiscal 2017. In a 6% sales growth environment, our operating margin will grow by 40 basis points. You can see the power of our financial model on this chart. Over the next 3 years, we can nearly double our investments and keep our operating margin flattish and, with higher sales coming from the investments, drive operating margin expansion.

Turning to capital allocation. While we are accelerating our investment plan, our disciplined and balanced approach won't change. Over the next 3 years, we are planning to generate over $37 billion in cash from the business. Included in this cash projection is a slight improvement in inventory turns. We will use our cash to invest in the business, pay dividends and buy back our shares.

Now I know it can be confusing to think of investments as both expense and capital. I've already discussed expenses. On the capital spending front, you should model average annual capital spending of $2.7 billion. This spending will take our average annual depreciation expense to $2.6 billion, which is included in the expense assumptions I just discussed.

To give you a bit more color on how we are thinking about our investments, you can see for each. We've modeled an expected return on investment coming from sales lift, productivity and/or higher customer satisfaction. Even in the face of accelerated investments, we are not changing our 3 shareholder return principles. Our dividend principle is to target a dividend payout of approximately 55% of earnings with the goal of increasing our dividend every year. From a return on capital perspective, our goal is to maintain a high return on invested capital, benchmarking all uses of excess liquidity against the value created for our shareholders through repurchases.

And finally, our share repurchase principle is to use excess cash to repurchase shares as long as it's value-creating. This chart highlights our focused and disciplined approach to optimizing invested capital. Back in 2008, we had $29.2 billion of invested capital with a return on capital of 9.5%. Fast-forward to the end of fiscal 2017, and we expect to have invested capital of $27.2 billion with a return on that capital of over 34%. And looking ahead, we believe we can drive our return on invested capital close to 40% by 2020.

Today, we have $24.75 billion of long-term debt. The staggered maturities and weighted average cost of this debt portfolio provides a competitive advantage, and our strong long-term debt rating of single A provide operating and financial flexibility. By the end of fiscal 2017, we project our adjusted debt-to-EBITDAR ratio to be about 1.9x, close to our target of 2x. As our earnings grow against this target, however, our borrowing capacity will grow. We project borrowing capacity of about $5.7 billion by the end of fiscal 2020, which provides ample flexibility.

As for share repurchases, we've been repurchasing our shares since 2002, and through the first 9 months of fiscal 2017, had repurchased approximately 1.3 billion shares for $73 billion at an average price of about $54 per share.

We intend to repurchase $2.1 billion in the fourth quarter of fiscal 2017, bringing fiscal 2017 share repurchases to $8 billion. Looking to 2020 we are targeting $12.5 billion in share repurchases using excess cash. As a result, today our board of directors authorized a new $15 billion share repurchase program, replacing our existing authorization. The $12.5 billion in future share repurchase is a basis for our 2020 return on invested capital target.

If you look back over the past 9 years, the power of The Home Depot has been seen in our financial results. As we look ahead to One Home Depot, you can see the same is true. Over the next 3 years, we plan to nearly double our investments, and yet our operating margin could reach as high as 15%. We are investing in the future of our company. We are investing to enhance the customer experience, and we are investing to create value.

So we thank you for your time today. And we're now going to break into our Q&A session. So I'd like to invite all my partners up to the stage. Just give us a few minutes to get settled, and then we'll get right to your questions. Thanks very much.

QUESTION AND ANSWER

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

Okay. So how this is going to work is we have 3 of my colleagues from Investor Relations with microphones moving around the audience: Sean, Luke and Elizabeth. If you have a question, please raise your hand, and wait until a microphone gets to you. We want those who are joining us on the web to be able to hear your question. And also, please state your name and the name of your firm before asking your question. So let's get started.

Michael Lasser - *UBS - Analyst*

It's Michael Lasser from UBS. And this can go to anyone. But presumably, Home Depot has been investing throughout its history. So what is different now functionally? And we've become accustomed to you exceeding the goals that you set forth from a sales perspective and from an expense perspective. So is there going to be a different mindset in how you might manage some of that outperformance? Will you reinvest that in the business? And then one last question to put it all in. You're doing a lot with the supply chain and moving away from the delivery to the stores. Could you conceivably close some stores because you are adding a lot of capacity over the next few years?

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

So Michael, I think it wouldn't be right to think about us changing our mindset in terms of trying to work hard to deliver and/or exceed. As Carol said in her comments, what we set out to do. We are a group that is committed to delivering on performance, and our objective would be to go out and achieve at or above what we have committed to. And on the second element, no, I don't think we'd look at closing any stores. We have plenty of opportunity. We have merchants lined up waiting for space, so...

Wayne Hood - *BMO Capital Markets - Analyst*

Wayne Hood with BMO. Ted, it's for you, I guess. As you look at the amount of inventory that continues to come out of the stores and will continue to evolve more, what businesses do you think, as you look out the next 5 to 10 years, could you get into that you're not into today the way you've gotten into Halloween and the way you got into cleaning supplies or now automotive? How do you -- how does the store change over time with that regard? And then my second question to you would be, lumber and building prices are at record levels. At what point do they get to where it starts to have an impact on units and therefore it starts to have an impact on the ability of people to repair, remodel their home?

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

So on the first one, we've always experimented with new categories in the space. So you referenced auto. That's taken a number of bays in the store. Craig mentioned pool. I mean, we have a very, very modest pool business that's usually in outside gardens. So we can do a lot with the categories we have. But something like the decor we mentioned, that again is the customer taking us to project completion. And we think anything we would do is going to be adjacent to our business, and it's going to be where the customer is going to give Home Depot the right to play and the authority to win. On the lumber price, each of framing and panel prices are 20-plus percent over last year, and panel in particular had really spiked. That was up as 40-plus percent higher than last year. And we were starting to see some unit pressure. Fortunately, over the last several weeks, we've seen a dramatic decrease in panel prices. So each of panel and framing are about 20% over LY. So that pressure we were starting to see on units has abated a bit. So don't see any pressure going forward to demand because of pricing and building materials.

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

One additional comment on your first question. When you look at what's happened in terms of growth per box over the last 3 years, there is an opportunity in some categories to actually add more space for holding capacity and really improve the sales opportunity that exists within the category as well.

Michael Baker - *Deutsche Bank - Analyst*

It's Mike Baker from Deutsche Bank. Over here. So Carol, you had mentioned investing costs out in lower-margin categories and supply chain. You didn't talk about price or promotional activity or anything along those lines. So is any of that contemplated in that 40 basis point decline in gross margins? That's question 1. And question 2, real simply, your sales guidance is about 50 to 150 basis points higher than your base comp. So can that be considered what you guys would anticipate for share gains? Is that another way to think about the drivers from those key initiatives?

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

Sure. So first -- to your first question, we are investing 40 basis points of gross margin over the next 3 years. 15 of that comes from the investments that we're making in our supply chain. So we have start-up costs as Mark Holifield builds out our new supply chain. We also have some depreciation expense associated with those supply chain assets that will flow through the cost of goods. So that's 15 of the 40. The remaining 25 comes really from mix. We still have $1 billion of sales that have not recovered from the last recession, and those $1 billion are in very low-margin category. So we expect those sales to grow. That puts pressure on the margin.

We have a bang of appliance business. We love our appliances, and we don't like -- oh, well, the margin's great. But it puts pressure on the overall sales performance. So really, is a mix story. And the second question was on our sales growth guidance. As you know, we tend not to guide market share. But because we've had several pilots underway where we have seen actual lift, we wanted to put that lift in. And based on our directionally correct but imperfect model, anything over that base case would be implied market share gains. Now you might say, "Well, my follow-on question to that, Carol, is, why don't -- why aren't you lifting even higher based on the performance that you're delivering in 2017?" Well, as you know, we are a team that tends to put together a plan that we beat. In fact, we beat our plan every year since 2009.

Scot Ciccarelli - *RBC Capital Market - Analyst*

Scot Ciccarelli, RBC. Another follow-up question on the gross margin. Can you help us understand what kind of vendor support you're looking for or looking at in that contemplation, especially if mix seems to be the primary pressure? And then related to that. Is there any contemplation regarding incremental pricing competition from some of the e-commerce players out there?

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

So as it relates to vendors, I mean, we obviously work with our suppliers to try to figure out how collectively we can take costs out of the entire value chain. That's what Project Sync is all about. That's what we'll continue to do. We want to be able to not only drive efficiency for ourselves. We want to be able to drive efficiency for our business partners as well. So that's really the focus that Ted and the team have had around collaboration and what we're doing with Mark in supply chain. We think there's enormous opportunity to drive value for both our vendor partners as well as ourselves in that process.

Scot Ciccarelli - ***RBC Capital Market - Analyst***

And then the expectation for incremental price competition from e-commerce players?

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

I mean, Ted and team have worked hard to make sure we're priced right every day.

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

We're comfortable where we're priced now. I mean, we believe we have the best everyday value in the marketplace. We're not seeing any heightened promotional activity in the marketplace. Our focus is more on everyday versus up-and-down promotions, and we're very comfortable where we're priced right now and not seeing incremental pressure.

Scott Mushkin - ***Wolfe Research - Analyst***

Scott Mushkin from Wolfe Research. So I had one clarification and 2 questions. So the clarification was on -- Carol you said included in the sales forecast is not a lot of the One Home Depot. I just wanted to get some clarity on that.

And then the 2 questions are capacity. How much capacity are you guys adding like kind of the store equivalent? I think would be good to know. And the second question is, if we do get this tax windfall, corporate tax reduction, where does that money go?

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

Right. So when we built our sales forecast, 4.5% to 6%, that included lift from known pilots as well as what we should be able to do based on all the great activity underway but did not include any sales benefit from One Home Depot supply chain. The only thing included in One Home Depot supply chain is the gross margin pressure that comes along with that over the next 3 years. So you might say that there's an opportunity there. We're obviously rolling this out over a 5-year period, and we wanted to plan for that fairly conservatively. Perhaps I can address the tax element.

So we are proponents of tax reform, and we'll see if it actually gets out of conference and becomes law. But if it does, in its current state, it will be significant for The Home Depot. You could -- you can do the math. But the immediate benefit might be $1.6 billion. So what will we do with that? We will spend it. Cash is fungible at The Home Depot, and we just announced a fairly major investment plan over the next 3 years accelerate what we would have done. So we've got lots of opportunities to use that cash. The scale and size, in terms of the square footage that's added in our supply chain, that might be helpful. We're adding for downstream about 21.5 million square feet with all of the facilities that Holifield -- Mark Holifield shared with you.

Peter Benedict - *Robert W. Baird - Analyst*

Peter Benedict at Baird. For Ted first, the accelerated push into decor, can you talk a little bit about how that's going to be executed? Is it primarily organic? Is there any room for strategic M&A as you look out to that category over the next several years? And then maybe, Mark, if you could speak to the downstream redesign that you've got envisioned here. How do the risks stack up relative to a lot of the stuff you've done upstream here over your career at Home Depot?

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

On digital decor, it's certainly largely a organic initiative. That's the way our team is thinking about it. As we've said, the customer has given us permission to play here. We have a lot of these product categories today in-store and online. This is essentially an experience-driven initiative. We'll certainly onboard new vendors and product categories, but it's really bringing that decor experience to life online. The customer is there, looking for the product. We just need to serve it up in the appropriate manner and capitalize on our traffic.

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

We really have been in this business with Home Decorators Collection for almost, what, the last 10 years.

Overall. And so just think of it as we're in a take advantage of the opportunity that we have there as we built through our stores and using that brand in our stores plus the direct business of $1 billion-plus brand.

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

In terms of the risk of -- the supply chain transformation, we've learned, and we've seen others learn that big-time supply chain transformation can be hard and fraught with risk. I think when we look at our path over the next several years, we know what we know how to do now, and we know what we're just learning how to do.

What you saw on the slides there was the pilot of the new things that we haven't done yet. In 2018, we're going to take a crawl-walk-run approach on those things to manage the risk, and we'll make sure we get it right before we go large. It'd be naïve to think there won't be some turbulence as you transform a supply chain at this scale, but we'll work to minimize that and always take care of our customers first.

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

I can add one other piece of color there. That's why we're targeting an inventory turn of 5.4 times by 2020, to make sure that we don't put a turn target out that's too aggressive given that we have so much change underway. Customer service starts with in-stock, as Ann-Marie told us. Yes.

Alan Rifkin - *BTIG - Analyst*

It's Alan Rifkin with BTIG. So certainly understand that for the next 3 years a disproportionate amount of your spending is going to go toward the supply chain as well as enhancing your performance in the top 40 markets. If the proposed legislation passes and the mortgage interest deductibility drops to $500,000, one would presume that, that's going to affect disproportionately more people in these top 40 markets where the average home price is well above the U.S. average, are you potentially investing in an area that may be susceptible to growth not being as strong as other parts of the country? And then related to that, if I may, Carol. What percentage of your revenues actually come today from the top 40 markets? And then I have a follow-up.

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

So 80% of our sales come from our top 40 markets; hence, our focus on those markets. In terms of concerns about the proposed tax reform and limitations on mortgage interest deductibility, a few things to keep in mind. We don't know what the actual outcome is of the legislation. But let's just take the worst case which is no more -- you limit deductions on -- over $500,000.

No more than 5% of all mortgages in the United States are greater than $500,000. So we've already narrowed it down. And then if you look at itemized filers, only 22% of all filers actually itemize a mortgage deduction. So you really are narrowing down the risks. Not to say there wouldn't be some impact, but in terms of a significant impact to our overall business, we just think it's overblown. We just don't think it's a problem.

Alan Rifkin - *BTIG - Analyst*

And a follow-up, if I may, for Mark. I thought I heard you say that the incremental spending in supply chain will be outsized for the next 5 years. I know that this is a 3-year plan that you're laying out. I'm not trying to get you to commit to 5 years. But for years 4 and 5, should we expect similar ramifications from spending on supply chain as what we're hearing today for the next 3 years?

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

Perhaps I can give a little color on that. If you look at the chart in your takeaway materials, there are 2 pie charts that show our spend. If you look at those pie chart related to supply chain, you can see the increase from BAU investing case to our now-accelerated investing case, that delta is $600 million. Mark talked about a $1.2 billion capital plan. $600 million will be spent in the first 3 years. The remaining $600 million will be sent -spent in years 4 and 5.

Keith Hughes - *SunTrust- Analyst*

Keith Hughes from SunTrust. Heard a lot about investment today. Does the path you're on now change your view on acquisitions? Doing Interline-type transactions, has it increased in this view?

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

No. Actually, our thought process around acquisitions stays the same. We've been focused on really looking at things that bring a capability to The Home Depot that would be more efficient to buy than to build. And that's really where our mindset largely is at today.

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

It's Matt Fassler from Goldman Sachs. And I think these will be for Mark. Two questions on supply chain. First of all, you seem to be tilting strongly in favor of taking delivery out of the stores. I know different retailers have had different strategies discussed over the past couple of years.

Can you talk about what you've seen logistically, economically -- micro-economically to drive that decision? Secondly, consumers' expectations for the cost of delivery and the precision of delivery seems to be changing. They're looking to pay less. What will this new evolving supply chain enable you to do in terms of changing the value proposition to consumers? And are you thinking about evolving your pricing structure as you roll these out?

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

Yes. And in terms of the store's role in delivery, I think the language there I used was largely supplant, which doesn't mean everything. We will still continue to have store-based delivery. Virtually every store will continue to be in the delivery business to some degree. But think about it as in the major markets, we'll be able to pull out most of the delivery from the stores.

If you think about the car and van delivery, that's the kind of delivery, that kind of express delivery, that will continue to live in the stores. So we think 5 years from now, I'd guess that roughly half of the deliveries from stores will be those kinds of low-volume deliveries, car and van, because it's an express-type service that we'll be implementing there. Also, I'd say we have customers come in and say, "I want that lumber." So we need to go get that lumber and deliver it to the customers. So stores will continue to be in the delivery business.

And in the rural stores, they will be the delivery hub. And the market delivery stores and the secondary market stores will still be in that delivery business. In urban markets, is really where we'll supplant that. In terms of the economics of delivery and with the customer, on 90% of our online deliveries, it's free because the customer meets the threshold there for free shipping.

What we find in the local markets and stores today, our customers are very willing to pay for added value services like very fast delivery or like that forklift that drops the product in the right place on the customer's job site. So we'll continue to follow the customer and make sure that we're competitive with our offerings in delivery. It's not a one-size-fits-all approach.

Ann-Marie Campbell - ***The Home Depot, Inc. - EVP - U.S. Stores***

And I think let me add to what Mark said as well because in some of these urban stores, the delivery component and the queue that it takes up drives a ton of inefficiencies in the stores. So relieving the volume in those stores with this high queue product give us the ability to really lean into some of the other areas that Mark talked about, whether it be the buy online, pick up in the store or courier delivery, et cetera. So it should be a really great complement for the store and drive productivity and efficiency both at the store and in our DC as well.

Brian Nagel - ***Oppenheimer - Analyst***

It's Brian Nagel from Oppenheimer. So a couple of questions. First off, bigger picture because obviously, the bigger theme today is investments. How dynamic is the investment plan? Meaning, Carol, you laid out a very good case that -- and I think we see this at the housing market in the United States continues to recover nicely. But look, 3 and 5 years can be a long time. We are -- we have been recovering for a while. So to what extent could you or would you pull back on moderate investments if the housing market begin to not cooperate as much? And I have a follow-up.

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

So let me tell you how we thought about it. We went back to the last recession, not the housing-led recession, but the last time the United States was in a recession was 2001.

And we looked at our sales performance back in 2001, and our sales were flat. So we modeled 0 percent comps for the next 3 years but kept the investing plan in case -- together to see what would happen to the business. In that case, with a 0 percent comp and all the investing still happening, our operating margin falls to 12.3%.

There are a number of retailers in the United States that would kill for a 12.3% operating margin. So I'm not at all suggesting that we might not modify if things come to be different than we think they would be. But in terms of putting our company at risk, we are at not risk in terms of investing to make the best customer experience possible.

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

Brian, I think one of the smartest things we actually did in the economic downturn of 2007 and 2008 was to continue to invest, build out the supply chain capability that allowed us to have the kind of outperformance that we've had over the past several years, and that would be our mindset going in. Again, we do what's right based on whatever the situation was. But our first mindset would be to invest through to position ourselves to take outsized growth from the market.

Brian Nagel - *Oppenheimer - Analyst*

And then my follow-up and maybe 2 quick ones for Ted and Mark. First off, on the merchandising side. Private-label, exclusive brands have been a big part of The Home Depot. As we continue to push more digital and speaking to the customers through those means, do we -- do you push further into the private-label and exclusive brands? Is there a new goal there, so to say?

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

No, I wouldn't say it's a new goal. We think of it as the same mix. We have some great private-label brands. Craig mentioned Home Decorators Collection that we've had for 10 years. That's $1 billion brand. I mean, that is a very strong decor-oriented brand. On the other hand, you need to get some of these flagship, known brands, the same way we have a Milwaukee power tool. You need fill-in-the-blank brand in decor. So I see that same sort of mix online for decor as what we've done in the store from an assortment perspective.

Brian Nagel - *Oppenheimer - Analyst*

And finally, on the supply chain. Is the build-out being done completely in-house? Or are you using some type of consultant -- outside consultants?

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

So far, we've developed this in-house. We -- one thing that I would say, we have a great team of people in our supply chain. I think all of our colleagues can say we have great teams behind us, and that gives us confidence. I wouldn't rule out that we'd use consultants, though, for a specific task within the supply chain: facility design, layout, those sorts of things. So we'll, no doubt, as we go, augment where appropriate with outside help. But we do have a great supply chain team that has developed the supply chain up to now.

Dan Binder - ***Jefferies - Analyst***

Dan Binder with Jefferies. I had 2 questions. First, around competition, and second, around credit. On -- it's fair to say Home Depot has been improving its position, widening the moat through initiatives in merchandising, supply chain, et cetera. With this level -- the stepped-up level investment is way more significant.

I'm just curious if you can discuss what you're seeing on the competitive landscape. Are you seeing threats to that moat? And what -- who or what channel are you most concerned about on the competitive landscape? And then on credit, obviously, a lot of talk about tax reform and that will benefit consumers, improving economy. How are you thinking about credit extension as that happens? Is there an appetite for greater risk? Is there anything built into sales for greater credit extension?

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

I'll start on the competitive front. First of all, it would be important for you all to understand that we don't think about anything as a moat. We don't think we have a moat. We don't think in those terms whatsoever. We wake up sufficiently paranoid every single day of our lives to make sure that we are driving a competitive value proposition in the market for the customer. And it's not that we're seeing anything radical that is causing us to take this increase in investment.

Well, this being driven from the customer back. The changes that the customers are driving in retail is really sending the message to us that we need to accelerate our pace of change to be able to connect with the customer the way they want to connect. And unfortunately, over history, there is -- the road is littered with retailers that didn't change with their customers as their customer changed. And that's simply not an option for The Home Depot.

We have to be there for our customers the way they want to engage with us. And look, when it comes to competition overall, nobody is sitting still. There is nobody sitting back and sitting still. Everybody is trying to improve. So we have to stay aggressive in the marketplace and position ourselves to win.

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

Credit is one of the value propositions that we offer to our customers, as you know, through our private-label credit card. It makes up 23% of all tender in our stores and online. So we're -- we love our private-label program. In terms of extending risk, however, one reason it's worked so well for us is because it isn't a very risky portfolio. The loss rates this year are up slightly, as you might expect, but under historical averages, and we like that actually. You can tell from our overall poster, we're just conservative when it comes to taking too much risk in certain areas, and so we're not going to do it on credit. But we will continue to promote our private-label card inside of our stores and online because it's a great value prop.

Budd Bugatch - ***Raymond James - Analyst***

Budd Bugatch with Raymond James. Of the $11.1 billion of incremental investment in capital and expense, I think $5 billion is targeted at the stores. Can you give us a flavor of how that levels out between expense and capital? And how does that impact wages and training expense and capital? And how many of the stores get refreshed?

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

Sure. So I've been thinking about how to best answer this question because there are a lot of numbers flying around. But firstly, I'll start with the big picture. So the incremental investment is $5.4 billion, of which $3.4 billion is capital and $2 billion is expense. And then perhaps the easiest way to get our arms around how we're spending our money is to go back to the pie chart, where you can see BAU investment compared to now the total investment. And the delta between the pieces of the pie give you an idea of where we are putting our dollars.

So if you look at the pieces of pie related to stores, you will see the increase, the accelerated investment is $2.6 billion, of that amount, 67% is capital and the remaining is expense. You may say, "Well why is there expense associated with store capital?" I know this is long window, I apologize, but why is there expense associated with store capital?

A good rule of thumb is that every time you go into a store to touch the store with a refresh, 20% to 25% of a dollar spent is expense because you've got fixed assets that you have to write off and then you have the labor just to get it done. The next piece of the pie that grows from our base case is online and IT. And that's up about $1.2 billion, of that 60% is capital, 40% is expense. If you continue around the pie, you can see that $600 million delta for the supply chain, that's all capital, and then finally, there's a big bucket called other.

And other is growing $1 billion from our BAU case. Of that other bucket, about 40% is capital and 60% is expense. What's in the other bucket? Capital for Canada and Mexico and our tool rental business. What's in the expense bucket? Lots of things, including investments that we're making in our people that Ann-Marie talked about. And I'll just close this out, and I apologize for going so long, I'll just close this out by reminding everyone that because we're stepping up our capital expenditures, our depreciation expense is also increasing. So over the next 3 years, $1 billion of depreciation expense on top of what had been our BAU case. Hopefully that's helpful.

Budd Bugatch - ***Raymond James - Analyst***

Very, very much. And just my follow-up for Mark on the appliance side. If you are going to increase, I think, the number of appliance service centers and appliance delivery centers, what other ramifications does that have for inventory? And does it have an impact on who does the -- do you do still TPL? Or what you do on that for the home delivery and appliance?

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

Yes. On the appliance delivery, that will fit into the MDO network, the market delivery operations network. About a 100 of those is what I described. Important to note that those will be stockless. They will not carry inventory. We don't plan to change our inventory model for appliances. We really like the process of taking appliances directly from the manufacturer to our delivery hubs and straight to the customer without ever owning that inventory. And we want to preserve that in the process. We want to use those market delivery operations to merge other products and other big and bulky products that can ride well with appliances on to those. So that's how we expect to do that.

Brandon Fletcher - ***Bernstein - Analyst***

Brandon Fletcher with Bernstein. And my questions are on service. Probably for Ann-Marie and then Bill. Totally like the idea of getting to a universal associate. Obviously there is a portion of part-timers that need to be up to speed relatively quickly.

But I wanted to be sure that your longer tenured associates were still a part of the investment plan to be sure that service level differentiation was still there? And if any of the investments are oriented towards those longer-term associates, I'd love to hear that.

And then for Bill, the notion of, as your competition gets deeper into MRO, or maybe closer to Fastenal and Graingers kind of business? Are there investments you're making to where the quality of that advice for a professional is getting stronger and better going forward to lock in the differentiation?

Ann-Marie Campbell - ***The Home Depot, Inc. - EVP - U.S. Stores***

Let me start, Bill. Yes, absolutely. All knowledgeable associates are key to drive in the in-store experience for us. And I want you to think about the investments in the universal associates is getting on our systems.

The work that we have to do with those systems to be very easy for any single associate. And then investing the time and knowledge that we have, the time that will be freed out into gaining knowledge for our associates. So this is not about trying to shrink the knowledge of our associates. What we're trying to do that the systems they use is to use less time there that they can engage in the overall experience.

I talk about 1.7 million years of experience. That comes in very handy when we're thinking about complex projects, which is where our customers engage and when you -- if you have something that happened in plumbing last night. So absolutely, we're going to continue to make sure that investment is there for the experience.

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

And then on the MRO side. I -- the biggest move that we made was to align our sales teams by end market and by customer. So making sure that we have professionals that understand the channel.

There is a different level of support required for a trade versus a multifamily operator versus institutional and a different level of product expertise and service that goes with that. So making sure that we have true professionals that have that product and that business operations knowledge to provide the right level of support. And then second is making sure that we've got our accounts assigned to the right level of support within that portfolio.

So you have some high-touch very complex customers that need that level of expertise, you also have some more simplified businesses that could be supported with inside sales teams, which is a lower cost to serve, but really, the way that they preferred to be engaged and managed.

And then I think the B2B website that we're building out will go a long way to helping us serve some of those simpler accounts. They really primarily want to transact online. They just want a very simple easy method of placing orders and making sure that they've got guaranteed great deliveries. So it's all about optimizing the portfolio, assigning customers to the right level of service and then making sure that we've got the right level of support that every one of those engagement points with our customers.

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

You know, if I could make one follow-on comment too. Our tenured associates in the store that have deep knowledge -- Ann and her leadership team have a program that is a coach program inside of our stores.

And it's so much fun to actually be in the stores and walk and talk to our associates who have actually take on the coaching responsibility and really feel an obligation to help our newer associates come up to speed. That is just a great program that drives a nice sense of pride with our tenured associates and really leverages their knowledge and capability in the stores. It's fun to watch.

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

Thanks. Chris Horvers, JPMorgan. So I want to talk about advertising dollars spend. Do you see it as a point of leverage or de-leverage going forward? As you think about pushing into home decor, Wayfair spends $600 million in advertising, half of what the Home Depot spends.

And so you have this irrational competitive set. And Amazon's pushing more towards decor and home furniture. So how do you think about that dollar spend deleverage? And do you shift more towards that category?

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

I mean I'll start and pass it to Kevin. But my first comment would be, I'm incredibly proud of the team and what they have been able to do to drive real efficiency out of the dollars that we spend, and I think that our overall performance kind of demonstrates that, but...

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

And thank you for that. But certainly it's just not the amount of the spend, it's the efficacy of it and how surgically we can get the right messages to the customer, whether it's the Pro example I gave you or the consumer. And we're pleased with our spend level, we're very pleased with the productivity we're getting. But I also think to Ted's point is the customer's giving us license to just expose them to a couple of other aisles that we can build out digitally. So they're on our site. We're helping them build their room. We just need to help them finish the room. So we have already got the visitor. We've already got the traffic. We just need to push them over a couple of aisles that previously weren't discovered by the customer.

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

Do you think it's a leverage? Or as you think about the plan, are you leveraging advertising? Or is it more growing in line with sales?

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

I think, you could probably think of it is maybe slightly under sales growth, and it'll be an increase but not at the rate of sales growth, at all. We spend about $955 million.

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

And then my follow-up is, I know you haven't given '18 guidance but any comments around the cadence of sales and also the gross margin change?

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

The cadence for '18?

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

Over the 3-year plan.

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

Yes, yes. And when we give our 2018 guidance, that will give you a clear understanding as how we're thinking about that. Good try.

Kate McShane - ***Citigroup - Analyst***

Kate McShane from Citi Research. My question is more on the online business, I wonder if you could quantify the size of the online business that you expect by 2020? And when thinking about the 45% that are picking up in-store, how do you expect that to change with some of the supply chain investments that you're making? And what kind of impact would that have on mix overall? Margin mix?

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

Yes. I'll take the first part. So we have about 6.4% penetration of online sales today, and importantly, we don't chase a penetration number. We don't have a specific goal there. We're very, very focused on chasing the customer experience and what they're signaling with us. So we're going to let that flow as it needs to.

And we have categories that are very, very actively engaged online, Pros looking at inventory levels, Pros looking at pricing, looking at delivery capabilities. They may not exactly transact online, but we want to chase that customer from an experience perspective. So we don't have a specific 2020 target. And then the second part of that was from the on...

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

On pick up in-store, and I guess what I'd say on that, that 45% roughly that's picked up in-store from the online business. About half of that isn't product that's stocked in the store it's actually shipped to the store. So we actually are using the upstream supply chain to move that product very efficiently to the store. That might come from a vendor to our RDC or Rapid Deployment Center, that serves stores with other product. It might come from our direct fulfillment center into our RDC, which is the most efficient path to get product to our stores and it's very efficient for our customers. So that 45%, I don't -- we'll follow the customer there, but it's great for our customers, it's great for us because it leverages a very efficient supply chain to get that product there.

Ann-Marie Campbell - *The Home Depot, Inc. - EVP - U.S. Stores*

And I would add too, Mark. So I'll -- when we think about BOSS or half of that is that, that may also be a part of a project, right? So I'm doing a project, I have 5 items, but I want that vanity online. So it's more convenient for me to ship to the store and then aggregate the other pieces. So you will continue to see that Buy Online, Ship to Store where it is today still going.

Joe Feldman – *Telsey Advisory Group - Analyst*

It's Joe Feldman, Telsey Advisory Group. Two questions. One, wanted to ask about the Pro, it's around 40% of sales now, another similar to Kate's question. Where do you think that will be in 2020? Is that -- are you trying to push towards 50% or something like that?

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

So I'll take the first shot at that. We're not -- we obviously say we're going to let the customer take us where it goes. We're really focused on growing both sides of the business. They are both critically important to us. We are focused on both increase in the number of Pros that are shopping our stores, and we're seeing great success in increasing our share of wallet or the expense and the spend of our existing customers, we're going to focus on execution, look at both customer segments and really try to grow both at the same time.

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

I'd be thrilled if that was 40% 5 years from now. Because that's says we've grown the DIY business at the pace of Pro, which will be awesome.

Joe Feldman – *Telsey Advisory Group - Analyst*

That's great. And then the follow-up, actually for Mark. You made a comment about appliances and I think you outsourced appliance delivery to a third party. Is that something that might change in the future that you'd want to bring in-house? Is that a risk that you guys -- Home Depot has being exposed there?

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

We expect to continue to evolve our appliance delivery offerings up in Canada. Canada is actually taken direct control of the appliance delivery there, working directly with the third-party delivery companies that deliver the appliances. We're not saying we'll get into the appliance delivery business in terms of private fleet and managing that ourselves, but we will take a more direct relationship in managing the customer experience and managing the providers who provide that customer experience.

Greg Melich - *MoffettNathanson - Analyst*

It's Greg Melich with MoffettNathanson. I had a quick question for Carol and then my proper question.

Carol that comp, the 4.5 to 6. Is that more ticket presumably now than traffic? Or is it still a 50-50 mix?

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

The way we build our model is 50-50.

Greg Melich - *MoffettNathanson - Analyst*

Still 50? Okay. So then the real questions. You've mentioned the windfall from taxes. I'll sneak in one that way, Carol.

What do you think competitors and vendors are going to be doing with the infusion? Because presumably most of your vendors and competitors are U.S.-focused businesses paying too high taxes? What are they going to do with the capital as you think about your plans? And then I did want to ask Ann-Marie because we talked so much about it, but how does all the initiatives we're doing change the store labor model? Are people going to be in the store just a lot less tasking, a lot more serving? Are they outside of the store? Just help us explain how that's going to really change in the next 3 years?

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

I'll take the first part of that. I have no idea what our competitors are going to do, but I can tell you what I hope our suppliers do. And I hope they reinvest that in R&D and innovation and continue to drive great innovation in the marketplace.

Ann-Marie Campbell - *The Home Depot, Inc. - EVP - U.S. Stores*

And I'll add. On the labor model piece, we piloted a new labor model. And I want you to think about it more from an activity-based standpoint. We're in -- we're allocating labor to exactly where the customers are. And so let me give you an example, in our stores today, if we sell a paintbrush or we mix paint, we allocate the same number of hours.

Even though one activity may be much more than the other. So our new labor model gives us the ability to really ensure that we have the right labor when the customer needs are there and the activity that they are looking for, we have a dedicated amount of labor to make sure that happens. On the other piece, one of the reasons why I think it's so important for us to simplify our systems, we spend a lot of time today trying to get associates up to speed on a very legacy-based system.

It's old, it was appropriate 5, 10 years ago, however, spending that time training is less time engaging the customer and understanding what the customer needs are. So not only are we focusing on the activity base on the labor standpoint, we are ensuring that the tools and systems they use are so simple that they spend less time entering an order and more time engaging with the customer and making sure that they get everything they need from an experience standpoint.

Joshua Siber – *Morgan Stanley - Analyst*

Joshua Siber, Morgan Stanley. Carol, a quick one for you. If comps were to exceed your plan, are you more inclined to pull forward some of the investments in the out years? Or let margins start to creep a little higher?

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

There is a doability question to all of this. There's only so much that we can do in any 1 year. So if our comps are higher than our plan, you'll see some margin expansion. And let me tell you why. 50% of our expenses are fixed and 50% of our expenses are variable.

Variable expenses grow at sale, but not at the same rate of growth. The expense growth factor for our variable expenses is about 30%. So in an environment where sales exceed our plan, we'll get some operating margin expansion off of that, which would be a good thing.

John Baugh - ***Stifel - Analyst***

John Baugh with Stifel. My question is a follow-up, I guess, for Ann-Marie on the Order Up system. Could you just tell us where we are with that implementation and the cost benefit from that you expect?

Ann-Marie Campbell - ***The Home Depot, Inc. - EVP - U.S. Stores***

So I'll probably won't go into details as it relates to kind of a cost benefit. I'll speak more in line with what are the types of productivity measures we get out of the Order Up system. So one of the things we do as a company, we go through a very agile process.

And when I say agile process in development, it's very important because we look at the reasons or the complexity in our business today and try to solve the easiest one fast, faster that impacts more associates and customers. And so we've gone through that process and something like Order Up and lease, what that means, if you come in for an order, BOPUS or a BOSS order, it makes it quicker for us to just release order to a customer.

Talking about that 17% reduction in time, that's out in all our stores. Then we go through the next benefit case and say where do we see the complexity and the benefit and how can we invest. And we may go down the sales process.

And so at the end of the day, over the next several years, and I won't go by 17, '18, '19 or '20, this will be rolled out across all of our stores and it gives us the ability where we are not leveraging just kitchen cabinets or millwork systems or deeper direct system, it's one system across the board driving that level of productivity. But it's an agile process based on where we see the benefit case and how we can roll that out in our stores.

Laura Champine - ***ROE Equity - Analyst***

It's Laura Champine from Roe Equity Research. My question is for Ann-Marie and it's about the incremental $2.6 billion to be spent on stores in the next 3 years. And it's 2 parts, but just about one slide. On the slide with the photo about digital wayfinding, what's the customer interface for that? And what percentage of customers do you think will actually use it?

And then second part, the modernizing the front of the store, I noticed a new black wall, but I can't imagine that's what modernizing means. So what is -- tell me more about digital wayfinding and more about modernizing the front of the store?

Ann-Marie Campbell - ***The Home Depot, Inc. - EVP - U.S. Stores***

Yes, so digitizing wayfinding, it's on your phone today, right? So before you get to the store, if you want to see the quantity of products, whether we have it in stock or not, that aisle where that product is located, you're able to pull it up on your phone and then when you enter the store, you can navigate quickly to the store.

And you work with that, not only from a digital standpoint or new wayfinding signs also link that process and journey, so the customer is able to get to the product quicker and therefore, exit the store. On the front end, it's a couple of things. Not only are we investing in new monitors or scanning capabilities to make it quicker, we are also instituting in the entire front end new infrastructure, right? Where the customers is able to get out of the store much faster.

In addition to that, the systems are more flexible. Today if you're in our store, no matter what the volume is, you may have 4 self-checkout pods. Now with the flexibility of our front end, we can change our equipment and take that to 6 checkout pods, if necessary. And then we can pull it back to 4 based on the customer flow patterns. Last but not least, we talked about lockers, so not only we talk about the front end and registers, we also think it's important to really drive convenience and value.

And the lockers give our customers the ability to walk into our stores, pick up their product, right? Scan their phone, get the product out of the locker and if they want to leave the store at that time. So it's not just about the front end in infrastructure it's also about capabilities and driving a high level of convenience for the customer as well.

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

And do you mind if I pile on just for a moment? Because when we go into a store -- when you are going to a store that's been touched, you're going to see a very different store.

Because when the signing package goes in, we also polish the floors, we add in-bay lighting , we redo the break rooms and the restrooms. The restrooms for our Pros is actually the place they come to for a break, isn't it? so there's a lot more to it. Ann talked about the kind of sexy fun stuff, but there's a lot more going on in the store to really make that store relevant.

Ann-Marie Campbell - ***The Home Depot, Inc. - EVP - U.S. Stores***

Absolutely.

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

Digital price signs as well. We're starting to work, so not at the wayfinding but actually in our appliance area where it's starting to roll out digital price labels, which takes out a tremendous amount of labor to change pricing on appliances.

Laura Champine - ***ROE Equity - Analyst***

So the only quick follow-up I have is on the digital wayfinding. What's been the uptake so far of customers using that? And how is that expected to change?

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

Yes, I'll take that. So really, whether you're on a PC or mobile -- or on mobile web and a browser or in our app, when you're looking at a product in Home Depot, if it's stocked in the store, you'll see an aisle and bay location and then you can click through and get that mobile map or see where it is in the store. So really, every product view that we have is fully enriched with the location, right?

And then on the app and the mobile web, we literally have hundreds of thousands of customers that use that daily. So it's -- our stores are big and it's sometimes scary to shop for our customers and it's one of the best pieces of feedback we get from them is this, "Thank you for helping me find that product."

Mike Ware - ***Presidium Investment Management - Analyst***

Mike Ware of Praesidium Investment Management. A question for Carol. Carol, you had a slide up in your 2015 Analyst Day, where you showed various merchandise categories and how far below kind of prior peak levels they were and you mentioned it again today, you have a number of categories that are well below peak levels. Can you just kind of update us what those categories are today? And if there's any, if you look at those categories, if there's any particular theme that you could point to, to account for them being so far? Or lagging the overall business?

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

So the amount of dollars of opportunity is $1 billion. That has not yet fully recovered. And it's in a number of categories but it's centered in special order kitchens and millwork. As we think about our reset activity inside of our stores over the next 3 years, we will be allocating capital into those 2 areas because we think that will be one enabler of growth.

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

So we have time for one more question.

Dennis McGill - ***Zelman - Analyst***

Dennis McGill at Zelman. Carol, sorry to go back to tax reform, not knowing if it's actually going to get done, but you made the comment that you would spend anything incremental.

But at the same time, the supply chain initiatives, the in-store investments, it sounds like it'd be hard to pull that forward without being disruptive to the business, so it doesn't sound like it would be there. Can you just talk about how much would be in the business separate from these initiatives? And then how much would be share repurchases or at least how you would think about that?

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

It really all depends on if it happens and when it happens and how we would spend it. Cash is fungible. Right now, we're thinking it might not happen until 2019, so obviously we are using internally generated cash in 2018 to invest in the business and return capital to our shareholders. If it were to happen in 2019, we might use the tax -- cash tax savings to invest in the business and then use -- generated cash to back buy shares, it's all fungible. The point is, we're going to generate a lot, we may get some from tax reform and we will use it. We will invest back in the business and we will return it our shareholders.

Dennis McGill - ***Zelman - Analyst***

And then just related, is there any repatriation opportunity as well in that?

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

There certainly is. We have about $3.5 billion of cash outside the United States, and I would very much love to get that cash back here in a tax-affordable way. Right now, we're still working through what it looks like because it's not clear based on what they are talking about in conference. But we're hoping that there's a good outcome here, and if there is, we will bring it back.

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

Well, thank you. And this concludes our question-and-answer period. I would like to thank our presenters today, Craig, Ann-Marie, Ted, Kevin, Bill, Mark and Carol. And many thanks to investor relations team, Kathi, Lyndsey, Tim, Sean, Luke and Elizabeth. Thanks to Christine and the corporate events team; the merchants for the product demonstration, Wendy, Mike, Fred; and the Dillon team. And to all of our Boston-based volunteers. This concludes our presentation. Let's go to lunch.