

Analysis of the market share of home depot and lowe's

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Home Depot (HD) and Lowe's (LOW) are two Fortune 500 companies – ranked at twenty-three and forty, respectively – and are the leaders in the home improvement retail industry. If given the choice to invest in only one of the companies, I would choose to invest in Home Depot instead of Lowe's. The decision to invest in Home Depot over Lowe's is based on both companies' market shares in the home improvement retail industry; the financial data from both companies' 10-Ks; the growth of Home Depot's stock price over the past decade and their dividend payouts compared to Lowe's; and Home Depot's corporate stability and the emphasis they have placed on the development of the e-commerce side of their business and their in-store operations. While Lowe's is a wonderful company with the potential to offer good returns on investment, in my opinion, the combination of these factors makes Home Depot the smarter investment.

Over the last decade, brick and mortar stores have been under fire from large hypermarkets such as Walmart and online retailers such as Amazon, but the home improvement industry has managed to continue to increase their sales. Since 2009, the industry has increased its sales every year, with a total increase of about \$108.4 billion from 2009 to 2017. Within the market that is estimated to generate about \$390 billion, it is estimated that about two-thirds of revenue comes from the consumer market, with the remainder coming from the professional market. The professional market consists of contractors, construction workers and companies, tradesmen and tradeswomen, and anyone else who uses the products purchased at one of the retailers to build something to sell, or to provide services for someone else. Further analysis estimates the market share of Home Depot and

Lowe's, the two largest retailers in the industry, to be 27.2% and 18.4% respectively.

An example of HD's hold over a larger percentage of the market than LOW can be further summarized by the number of stores that both companies have open in the United States, Canada, and Mexico. As of their most recent 10-K documents, Home Depot has 2,284 stores, and Lowe's has 2,152. By numbers, both have a significant hold over the market; however, Home Depot's (nearly) 9% edge in market share and additional 132 stores give them a competitive advantage over Lowe's. Having a larger market share does not in itself grant HD the advantage, but the factors that went into earning the larger market share does. Typically, the company with the plurality of the market share will have loyal customers, skilled and dedicated employees, a strong business model, and a knack for innovation. Once a company's market share gets large enough, they will begin to experience other benefits, namely decreased costs per unit due to economies of scale – a combination of skilled labor, reduced product costs due to buying in bulk, and size of a corporation.

With costs per unit being lower than the competition due to the larger market share, there is a higher likelihood that Home Depot's revenue growth will continue longer than that of Lowe's. Home Depot's hold over a larger percentage of the market is evident in their revenue statistics that have been recorded over the last three years. In Fiscal Year 2017, HD brought in over \$100 billion in net sales, grossing a profit of more than \$34 billion. In contrast, Lowe's net sales totaled about \$68.62 billion, with a profit of

roughly \$23.41 billion. While both companies have similar margins (a little over 34%), Home Depot's ability to do so with a larger, but not a majority of the market share is extremely impressive. One potential reason for HD's large revenue numbers and the profit margin is that the company has managed to increase the comparable sales increase (%) by 6.8%, and the total of the average receipt for the company increased by 4.5% over FY 2016. Those two statistics, to me, indicate good potential for future growth, especially as Home Depot continues to invest in their e-commerce operations. These sales figures are accentuated in the companies' Consolidated Statements of Cash Flows which shows that from operating activities HD received over \$12 billion in cash, an increase of nearly \$2.5 billion from FY 2016. In juxtaposition, Lowe's only brought in over \$5 billion in cash, down \$500 million from the previous year.

Another piece of valuable information from the statements are the amounts that the companies are spending on investments. Last year, FY 2017, HD spent \$2.271 billion on capital expenditures and on acquiring new businesses. Lowe's spent even more than Home Depot on investments, \$2.613 billion on a combination of capital expenditures, acquiring businesses, and other investments. Lowe's also outspent their chief competitor on investments by roughly \$400 million in 2016; however, in 2015, HD outspent LOW by nearly \$1 billion. Investments open the opportunity for increased future earnings. While Lowe's did put more into investments over the past 2 years, their expenditures will not be enough to make up for the market share difference, or the amount that Home Depot spent on investments in FY 2015.

Due to their revenues, both companies' stock prices have substantially increased over the last ten years, and the increase in Home Depot's stock price has dwarfed that of Lowe's. Shortly after the Great Recession, Home Depot's stock hovered around \$22/share, but a decade later, shares are hovering around \$211/share. Lowe's, on the other hand, was in the same price range ten years ago, but today is hovering around \$115/share.

According to the historical data, the growth rate of Home Depot's stock price has been nearly double that of Lowe's. In addition to HD's higher stock price, they also offer a higher dividend yield per year than LOW. In Fiscal Year 2017 Home Depot shareholders received a dividend yield of 2.4% of the share price for the year (0.6% per quarter); juxtaposed, Lowe's rewarded its shareholders with a 1.68% dividend yield (0.42% per quarter). While the dividend yield may not seem like much, HD awarded its investors \$3.56/share in 2017 while LOW only gave its investors \$1.58/share, nearly doubling the paybacks. For an investor with only a few shares, the dividend payments may not make a difference over the course of a single year, but in the long-term, the dividends from investing in Home Depot (predicated on the continued achievement of performance goals) will provide double the incentive of investing in Lowe's.

In my opinion, the truest sign of a successful business is the willingness and ability to innovate and adapt to changes in technology and market trends. With brick and mortar stores under fire from large hypermarkets such as Walmart and online retailers such as Amazon, Home Depot has managed to not only survive but thrive as the leader of the home improvement retail

industry. Credit for that can go to a variety of places; however, I think that a significant portion of the credit should go to the executives of the company who have provided a stable foundation for the company to grow and face new challenges and competitors. This stability has come from Home Depot's desire to promote from within – exemplified by the tenures of their Senior Leadership Team. Out of the twenty-six member team, only one has been with the company for fewer than five years, with their CEO and Executive VP of U. S. Sales being with the company for over twenty years. With stable leadership that has been growing internally for decades, HD has proved that it is well-equipped to face the challenges of the ever-changing retail environment, even being named “ one of the world's most innovative companies of 2017 according to Fast Company”.

The Home Depot's strategy to combat external market pressures is to rely more on a more integrated e-commerce and in-store approach. Part of this strategy is to use their physical stores to focus on products that are difficult to market online and slowing the expansion of physical stores in favor of expanding their online presence. Through innovating, “ Home Depot has been able to increase revenues per square foot, rather than generating revenues from new square footage”. The increase in sales per square foot indicates that there has been a significant increase in online sales, and HD has especially benefited from 40% of their online orders being picked up in-store, keeping customers coming in (to potentially make additional purchases) and ensuring that customer service still a vital component to their business model. Through adapting to the new e-commerce environment

and embracing an innovative business plan that integrates their online and in-store, Home Depot has set itself up to succeed as the home improvement retail industry leader for years to come.

With all of the positive reasons to invest in The Home Depot over Lowe's, there is a key advantage that Lowe's does currently have – fewer contractual obligations. In total, HD has a little over \$52 billion in contractual obligations, compared to Lowe's which only has a little less than \$33 billion. Breaking down Home Depot's debt, there they have roughly \$1.5 billion in short-term debt, \$40 billion in long-term debt, \$9 billion in lease obligations, and little less than \$2 billion in other obligations. Lowe's, on the other hand, has a little over \$24 billion in long-term debt, \$1.1 billion in short-term debt, \$7 billion in lease obligations, and about \$1 billion in other obligations. Having \$19 billion less in contractual obligations gives Lowe's some added flexibility to be able to apply their cash in other areas such as marketing, purchasing, licensing, human resources, or investments in other areas that will help to grow future revenue. However, these obligation figures are not overly daunting to my eyes as a potential investor because HD does bring in nearly \$32 billion more per year than LOW and is roughly \$11 billion more profitable. In other words, The Home Depot is not in danger of defaulting or having any trouble paying back their debts.

Both Lowe's and Home Depot are pillars in the home improvement retail industry, an industry that brings in roughly \$390 billion annually. However, between the two titans, HD has a fairly strong hold on the market, earning more in revenue and profit than their chief competitor. Along with posting

stronger yearly earnings, Home Depot's stock price is nearly double that of Lowe's and their dividend yield is also higher. Despite their numbers from their 10-K, HD has a stable executive leadership structure, focused on promoting from within and innovation. The twenty-third ranked company on the Fortune 500 list has evolved as a company, adopting a new business model that integrates their e-commerce and in-store operations, providing a solid foundation for future earnings during a tumultuous time for a brick and mortar stores. Due to all those reasons, I would invest in Home Depot over Lowe's.