

Home depot analysis



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Home Depot – 2010 Financial Report For fiscal year ended January 30, 2011 ("fiscal 2010"), Home Depot reported Net Earnings of \$3.3 billion and Diluted Earnings per Share of \$2.01 compared to Net Earnings of \$2.7 billion and Diluted Earnings per Share of \$1.57 for fiscal year ended January 31, 2010 ("fiscal 2009"). The results for fiscal 2010 included a \$51 million pretax charge related to the extension of our guarantee of a senior secured loan of HD Supply, Inc. (the "HD Supply Guarantee Extension"). The results for fiscal 2009 reflected the impact of several strategic actions initiated in fiscal 2008.

These strategic actions resulted in store rationalization charges related to the closing of 15 underperforming U. S. stores and the removal of approximately 50 stores from their new store pipeline, business rationalization charges related to the exit of our EXPO, THD Design Center, Yard birds and HD Bath businesses (the "Exited Businesses") and charges related to the restructuring of support functions (collectively, the "Rationalization Charges"). These actions resulted in pretax Rationalization Charges of \$146 million for fiscal 2009.

The results for fiscal 2009 also included a pretax charge of \$163 million to write-down our investment in HD Supply, Inc. Additionally, fiscal 2009 included earnings of \$41 million from discontinued operations, net of tax, for the settlement of working capital matters arising from the sale of HD Supply. Home Depot reported Earnings from Continuing Operations of \$3.3 billion and Diluted Earnings per Share from Continuing Operations of \$2.01 for fiscal 2010 compared to Earnings from Continuing Operations of \$2.6 billion and Diluted Earnings per Share from Continuing Operations of \$1.5 for fiscal

2009. Excluding the HD Supply Guarantee Extension charge from their fiscal 2010 results, and the Rationalization Charges and the write-down of their investment in HD Supply from their fiscal 2009 results, Earnings from Continuing Operations were \$3.4 billion and Diluted Earnings per Share from Continuing Operations were \$2.03 for fiscal 2010 compared to Earnings from Continuing Operations of \$2.8 billion and Diluted Earnings per Share from Continuing Operations of \$1.66 for fiscal 2009. Net Sales increased 2.8% to \$68.0 billion for fiscal 2010 from \$66. billion for fiscal 2009. Home Depot's comparable store sales increased 2.9% in fiscal 2010, driven by a 2.4% increase in their comparable store customer transactions and a 0.5% increase in their comparable store average ticket to \$51.93. Comparable store sales for their U. S. stores increased 2.5% in fiscal 2010. In fiscal 2010, Home Depot focused on the following four key initiatives: Customer Service: Home Depot's focus on customer service is anchored on the principles of taking care of their associates, putting customers first and simplifying the business.

The roll out of their Customers FIRST training to all store associates and support staff in fiscal 2009 has brought simplification and focus across the business, and they repeated and refreshed the Customers FIRST training during fiscal 2010. The Customers FIRST program is part of their ongoing commitment to improve customer service levels in their stores, and they continued to see the benefit of this training in improved customer service ratings for fiscal 2010 compared to fiscal 2009.

Also in fiscal 2010, Home Depot completed the deployment of their FIRST Phone, a new hand held device that provides multiple functions such as

inventory management, product location and mobile checkout. The core purpose of this new device is to reduce tasking time for their store associates to allow them more time to focus on customer service. Home Depot ended fiscal 2010 with more than half of their store payroll allocated to customer facing activities rather than tasking activities. They have a customer facing store payroll target of 60%, and they believe they will achieve that by 2013.

Product Authority: Our focus on product authority is facilitated by our merchandising transformation and portfolio strategy, including innovation, assortment and value. In fiscal 2010, we made significant progress on our merchandising tools in the U. S. that helped us manage markdown and clearance activity and better control inventory. Our inventory turnover ratio was 4.13 times at the end of fiscal 2010 compared to 4.06 times at the end of fiscal 2009. Additionally, we continued to form strategic alliances and relationships with selected suppliers to bring a number of proprietary and exclusive brands across a wide range of departments.

Productivity and Efficiency: Home Depot's approach to driving productivity and efficiency starts with disciplined capital allocation focused on building best-in-class competitive advantages in information technology and supply chain, as well as building shareholder value through higher returns on invested capital and total value returned to shareholders in the form of dividends and share repurchases. At the end of fiscal 2010, they completed the roll out of their Rapid Deployment Centers ("RDCs") and now have 19 RDCs that serve 100% of their U. S. stores.

Also during fiscal 2010, they repurchased 80.9 million shares for \$2.6 billion, and on February 22, 2011 Home depot announced a six percent increase in their quarterly cash dividend to 25 cents per share.

Interconnected Retail: Home Depot's focus on interconnected retail is based on the view that providing a seamless shopping experience across multiple channels will be a critical enabler for future success. Their multiple channel focus is allowing them to greatly expand their assortment of merchandise, and they are making the investment to build these capabilities, including the roll out of "buy on-line, pick-up in store" next year.

Home depot is committed to having a best-in-class website, and during fiscal 2010 their site was named as a Most Improved Website for customer satisfaction by Foresee, a leading customer satisfaction analytics firm. Home Depot opened eight new stores in fiscal 2010, including one relocation, and closed three stores, bringing our total store count at the end of fiscal 2010 to 2,248. As of the end of fiscal 2010, a total of 272 of these stores, or 12.1%, were located in Canada, Mexico and China compared to 268 stores, or 11.9%, at the end of fiscal 2009. Home Depot generated approximately \$4.6 billion of cash flow from operations in fiscal 2010. They used this cash flow along with cash on hand to fund \$2.6 billion of share repurchases, pay \$1.6 billion of dividends and fund \$1.1 billion in capital expenditures. At the end of fiscal 2010, Home Depot's long-term debt-to-equity ratio was 46.1% compared to 44.7% at the end of fiscal 2009. Their return on invested capital for continuing operations (computed on net operating profit after tax for the trailing twelve months and the average of beginning and ending long-term debt and equity) was 12.8% for fiscal 2010 compared to 10.0% for

fiscal 2009. This increase reflects the impact of the Rationalization Charges which they included in their operating profit for fiscal 2009. Excluding the Rationalization Charges, their return on invested capital for continuing operations was 12.7% for fiscal 2010 compared to 11.1% for fiscal 2009.

Week 2 Activity Ratios of Home Depot vs. Lowe's One key to profitability is how well a company manages and utilizes its assets. Some ratios are design to evaluate a company's effectiveness in managing assets. Of particular interest is the activity, or turnover ratios, of certain assets.

The greater the number of times an asset turns over, the higher the ratio the fewer assets are required to maintain a given level of activity (revenue).

Given that a company incurs costs to finance its assets with debt (paying interest) or equity (paying dividends), high turnovers are usually attractive. |

Receivable Turnover	Year	2009	2010	2011
Home Depot		68.9	63.9	53.9
Lowe's		0.0	0.0	0.0

Receivable Turnover ratio is calculated by dividing a period's net credit sales by the average net accounts receivables.

The receivables turnover ratio provides an indication of a company's efficiency in collecting receivables. The ratio shows the number of times during a period that the average accounts receivable balance is collected.

The higher the ratio, the shorter the average time between credit sales and cash collection. As we can see above, Lowe's has zero receivables, which can be translated to no credit sales. |

Inventory Turnover	Year	2009	2010	2011
Home Depot		4.21	4.19	4.34
Lowe's		4.0	3.72	3.63

Inventory Turnover is an important measure for a merchandising company.

The ratio shows the number of times the average inventory balance is sold during reporting period. It indicates how quickly inventory is sold. The more

frequently a business is able to sell, or turn over, its inventory, the lower its investment in inventory must be for a given level of sales. The ratio is computed by dividing the period's costs of goods sold by the average inventory balance.

The denominator, average inventory, is determined by adding beginning and ending inventory and dividing by two. A relatively high ratio, as in the case of Home Depot compare to Lowe's, usually is desirable. A high ratio indicates comparative strength, perhaps caused by a company's superior sales force or maybe a successful advertising campaign. However, it might also be caused by a relatively low inventory level, which could mean either very efficient inventory measurement or stock outs or lost sales in the future.

Comparing the two industries, we can conclude than Home Depot turns over their inventory a bit faster than Lowe's. Asset Turnover

Year	2009	2010	2011
Home Depot	1.73	1.62	1.73
Lowe's	1.48	1.43	1.41

Asset Turnover is a broad measure of asset efficiency.

The ratio is computed by dividing a company's net sales or revenue by the average total assets available for use during a period. The denominator, average assets, is determined by adding beginning and ending total assets and dividing by two. The asset turnover ratio provides an indication of how efficiency a company utilizes all of its assets to generate revenue. Also, it shows how many sales dollars are generated for every dollar invested in the company's assets. Lowe's had relatively lower asset turnover than Home Depot because their recent investment in PP&E has not yet reached their potentials.

Home Depot is a financially sound company and performs well when compared to its competitors. Based on current business conditions and the potential growth opportunity facing Home Depot, we feel that the bottom line will continue to grow at a healthy rate above the competition in the near future. We believe that the relatively low levels of debt, slightly wider margins, and lower costs make Home Depot an attractive investment for the long run. Shares of Home Depot are currently trading at \$33.92 to what we believe is gaining momentum in the market.

This increase is possibly derived from the market's belief that better than predicted growth will be seen from expansion into foreign markets, specifically China. Week 4 Home Depot - Accounting Policies The retail industry, in general, presents a very competitive market with high price competition and low product differentiation. Although almost any retailer, from supermarkets to superstores, can offer home improvement items at a competitive price, the home improvement industry currently provides a great opportunity for differentiation in regards to the types of services home improvement retailers offer.

To successfully maximize sales and increase revenues in the home improvement industry, retailers such as Home Depot must successfully combine product variety, quality and price and specialized services. As discussed earlier, Home Depot has adopted a business strategy based on these key factors. Consequently, as we look at Home Depot's overall financial results, it is necessary to focus on key accounting policies adopted by the company to measure critical factors and risks. In the "Management's Discussion and Analysis of Results of Operations and Financial Condition" of <https://assignbuster.com/home-depot-analysis/>

The Home Depot, Inc 2011 Annual Report ([www. omedepot. com](http://www.omedepot.com)), management identified three major areas as areas of critical accounting policy and discussed the adoption of four different accounting pronouncements. In addition to the four recently adopted accounting pronouncements identified in the management’s discussion, The Home Depot identified four other major accounting policy changes in it’s “ Notes to Consolidated Financial Statements”. Specifically, The Home Depot adopted four different accounting pronouncements in regards to service revenue recognition, vendor allowances, goodwill amortization and stock based compensation.

The three critical accounting policies, as identified by The Home Depot management refer to the treatment of merchandise inventories, self insurance and revenue recognition. Merchandise Inventory policy is specifically addressed by The Home Depot management in “ Management’s Discussion and Analysis of Results of Operations and Financial Condition” and is assessed in two different ways. Approximately 93% of total inventory is valued at the lower of cost or market utilizing FIFO under the retail inventory method with the other 7% valued under the cost method.

The Notes section of the Financial Statements accounts for the two different methods. According to the Notes, the 7% of inventory valued under the cost method was due to inventory policy of certain subsidiaries and distribution centers. In addition, The Home Depot, Inc. takes a physical inventory count on a regular basis at each store to verify that inventory amounts in the merchandise inventory section of the Consolidated Financial Statements are accurate. Lastly, in regards to merchandise inventory, the company does

account for possible inventory shrinkage or swell based on historical results and industry trends.

Self Insurance accounting policy for Home Depot addresses its treatment of “ losses related to general liability, product liability, workers’ compensation and medical claims”. The total liability is estimated on the total cost incurred as of the specific balance sheet date and is not discounted. The estimate is based on “ historical data and actuarial estimates”. The company also explains in its Management Discussion that they ensure estimates of liability are as accurate as possible by having both management and third-party actuaries review the estimates on a quarterly basis.

Revenue Recognition is the third critical accounting policy identified by The Home Depot management. Revenue recognition at the Home Depot follows the industry norm of recognizing revenue when the customer takes possession of the merchandise or, if a customer makes payment prior to take ownership of the merchandise, Home Depot records the sale as Deferred Revenue on the balance sheet until the sale is finalized when the customer takes possession of the paid merchandise.

Additionally, because The Home Depot also provides a variety of services through their installation and home maintenance programs, they also recognize service revenue at the time when the service is completed and also record any customer pre-paid service revenue as Deferred Revenue on the balance sheet. Week 5 Internet The internet has completely changed the way companies communicate and market to their prospects. Home improvement businesses in the U. S report that the ways they have

traditionally generated leads (i. . yellows pages, direct mail, print media, tv and radio) aren't working like they use to. In fact, 85% of all products and service inquiries now start online and 97% of U. S internet users gather shopping information online and of those more than half characterize their behavior as ' Shop Online, Purchase Offline. ' The convenience of online shopping and the ability to make price comparisons on the internet has completely changed retail trends in the past decades.

Even though most people tend to shop for building materials by visiting physical locations, still Home Depot cannot ignore e-commerce because people increasing buy items of nearly any kind online. Home depot being the largest home improvement retailer is expanding in the online channel aggressively and targeting it as a major growth opportunity. Home depot made it's biggest e-commerce investment over the last two years since it started internet sales in 2001. According to research, 45% Of the 9. million consumers who visited Home Depot's website on average in any given week said their next step was a trip to a Home Depot store, which translates to about 225 customers a day per location. However, e-commerce for the home improvement industry is an underleveraged opportunity. A lot of people think of home Depot as a place you go on a Saturday, or when you do window treatment or carpeting. As such, they can do a better job online for things like branded power tools and replenishable items and also offer delivering services for those items.

Home Depot's operating cost will decrease if customers interacted through the use of the internet due to the following: • Online customers are used to doing their own shopping without any salesperson assistance; therefore the

cost of the salesperson would be eliminated as such. • The range of products that can be offered through the website can be far greater than what one could find at Home Depot's location, thereby giving customers a clear reason to prefer the internet.

These are all advantages that Home Depot can benefit from as a result of the internet. As with the advantages, there are also disadvantages (issues) that Home Depot needs to put into consideration and work diligently to address them. The foremost of these issues are lack of site maintenance and lack of integration between the e-commerce site and the corporate back-office systems. As such, Home Depot must work through these issues in detail in order to arrive at the true cost-benefit for an e-commerce.