

**HD - Q4 2011 The Home Depot, Inc. Earnings Conference Call**  
**EVENT DATE/TIME: FEBRUARY 21, 2012 / 9:00 a.m. EST**

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**Operator**

Good day, everyone, and welcome to today's Home Depot fourth-quarter 2011 earnings conference call. Today's conference is being recorded. (Operator Instructions).

Beginning today's discussion is Ms. Diane Dayhoff, Vice President, Investor Relations. Please go ahead.

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

Thank you, Dave, and good morning to everyone. Welcome to The Home Depot fourth-quarter earnings conference call. Joining us on our call today are Frank Blake, Chairman and CEO of The Home Depot; Craig Menear, Executive Vice President, Merchandising; and Carol Tomé, Chief Financial Officer and Executive Vice President, Corporate Services.

Following our prepared remarks, the call will be open for analyst questions. Questions will be limited to analysts and investors, and as a reminder, we would appreciate it if the participants would limit themselves to one question with one follow-up.

This conference call is being broadcast real-time on the Internet at [Earnings.HomeDepot.com](http://Earnings.HomeDepot.com). The replay will also be available on our site. If we are unable to get your question during the call, please call our Investor Relations department at 770-384-2387.

Before I turn the call over to Frank, let me remind you that today's press release and the presentations made by our executives include forward-looking statements as defined in 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, those factors identified in the release and in our filings with the Securities and Exchange Commission. Today's presentations may also include certain non-GAAP measurements. Reconciliation of these measurements is provided on our website.

Now let me turn the call over to Frank Blake.

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**Frank Blake - *The Home Depot, Inc. - Chairman, CEO***

Thank you, Diane, and good morning, everyone. Sales for the fourth quarter were \$16 billion, up 5.9% from last year. Comp sales were positive 5.7% and our diluted earnings per share were \$0.50. Our US stores had a positive comp of 6.1%.

From a geographic perspective, we saw positive comps in all of our top 40 markets. The unseasonably warm weather helped customer traffic and clearly was a factor in our sales performance. We have also seen the steady recovery of some of the hardest-hit markets, like Florida and California. Our major Florida markets all outperformed the Company average and

California was in line with the Company average. Both states have posted positive comps for eight consecutive quarters.

As Craig will detail, we saw strength in our core merchandising areas as well as in our holiday gift centers, and we had strong growth in customer transactions with sequential comp transaction improvement each quarter this year.

On the international front, our Canadian business had positive comps for the quarter and our Mexican business had another quarter of positive comps, making it 33 quarters in a row of positive comp growth.

Operationally, Marvin and his team are making progress on our customer service initiatives. Based on the changes we've made throughout the year, we now have approximately 53% of our store labor hours dedicated to customer-facing activity. Just four years ago, we were at 40%, so this is a significant improvement in a short period of time. It has required a lot of detailed planning and focused execution at the regional, district and store level to make this happen, and this speaks to the alignment of our store operations and support teams.

We are also very excited about a new service offering our operations team is in the process of rolling out. This year, our stores will be offering in-store repair services for power equipment and power tools. Previously, we had an off-site third-party service that would provide equipment repair. We can provide that service ourselves now, leveraging our tool rental centers and reverse logistics centers. Customers can have tune-ups and other maintenance completed at our stores. We think this will be a significant improvement in convenience for our customers and will enhance the overall value of our power tool and equipment product offerings.

On the merchandising front, Craig and his team continue to develop our merchandising tools. The most significant recent activity was the upgrade of our dot-com platform. This upgrade enhances the layout, visual appeal and responsiveness of our site and gives us a best-in-class platform for future interconnected retail development.

Our supply chain investments continued to deliver benefits for the business, improving our in-stock rate and asset efficiency as we again improved inventory turns this year. As of the end of 2011, we handled approximately 70% of our cost of goods sold through central distribution in the US. This compares to approximately 25% four years ago.

For 2012, as Carol will detail, we are expecting sales growth of around 4%, including the 53rd week, and diluted earnings per share of about \$2.72, again including the 53rd week and without factoring in share repurchases during the year.

There are some interesting challenges in setting expectations for 2012. First, the macro data on housing suggests uncertainty. Private fixed residential investment as a percent of GDP remains nearer its 60-year low, but had a slight uptick in the quarter to 2.26%. The Fed has noted that housing remains a drag on economic recovery, with factors such as delayed household formation and credit supply contributing to a continued imbalance between housing supply and demand.

The Fed has suggested that policy actions will be needed to fix this, but it wouldn't appear that any major policy changes are likely in the near term.

Second, despite this, the performance of our business, particularly in the back half of 2011, would suggest a strengthening market. This quarter's comps were achieved against a very strong fourth-quarter comp in 2010 and exceeded our internal forecasts. But we are mindful that this past December and January were the fourth warmest on record, with much of the nice weather occurring across the heavily-populated Eastern US. Better weather translates into improved sales for exterior categories like building materials and also translates into increased customer transactions, which lift the entire business.

So we think it is too early to say that there has been a significant improvement in our overall market, but we continue to build a strong business on the basic repair and remodel needs of our customers, recognizing that we have a base of over 130 million aging homes. In this environment, we think our growth will be consistent with US GDP, making some adjustments for positive weather impacts in 2011.

In 2012, as in the last several years, we will remain focused on disciplined capital allocation and increasing shareholder return. We will continue to make the necessary investments in our business and return excess cash to our shareholders through share buybacks and dividends.

We raised the dividend twice in 2011 and are targeting a 50% payout ratio going forward.

Finally, I would like to thank our associates for their hard work and dedication during this past quarter and the year. We are very proud of the fact that 96% of our stores qualified for success sharing in the second half of 2011 with our second-highest total payout ever. We look forward to even better results in 2012.

And with that, let me turn the call over to Craig.

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***Craig Menear - The Home Depot, Inc. - EVP, Merchandising***

Thanks, Frank, and good morning, everyone. We are extremely pleased with our performance in the fourth quarter and the quarter's results were driven by several factors -- solid execution of our game plan for the holiday season, including decorative holiday, Black Friday and our gift centers; unusually warm weather that drove increased demand for exterior project categories, which we quickly responded to in order to take advantage of the opportunity; and continued strength in maintenance and repair categories as well as interior projects.

13 out of 14 departments posted positive comps for the quarter. The departments that outperformed the Company's average comp were tools, electrical, building materials, paint, lumber, lighting, outdoor garden and flooring. Hardware, bath, kitchens, indoor garden and plumbing showed positive comps. Comp in millwork was negative for the quarter, as we anniversaried the expiration of an energy efficient tax credit in the US.

Last quarter, I told you the key drivers for our fourth-quarter performance would be seasonal categories, such as decorative holiday, our Black Friday lineup and our gift centers. We delivered positive comp performance for Black Friday and the Black Friday weekend, a strong start to the holiday season. Our gift centers also had positive results, with double-digit comps overall, led by power tools, power tool accessories and hand tools.

And as I mentioned last quarter, we increased our decorative holiday buy this year and delivered double-digit comps in that category. Finally, although it was a slight drag to our overall comp, we posted positive comps in appliances for the quarter against an outstanding performance last year.

Warmer-than-expected weather encouraged customers to tackle exterior projects. Our merchants reacted quickly to this opportunity, working alongside our stores and suppliers to leverage our supply chain and drive results. This nimble response facilitated double-digit comps in gutters, roofing, vinyl siding, patio furniture, fencing, exterior paint, pressure washers, exterior lighting and concrete. These positive results more than offset negative performance in winter weather categories, such as snow removal, fireplaces and portable heating, as the heavy snowfalls of January 2011 were not repeated. Simple interior projects also performed positively in the quarter, driving results in laminate flooring, recessed lighting, bath accessories, ceiling fans, door locks, floor tile and faucets.

We were pleased with our performance in interior paint, driven by a number of products. First, our exclusive line of Behr paints, which have been rated number one by independent testing. Second, our new Glidden Duo paint plus primer, and finally, our innovative line of specialty paints from Rust-Oleum and Martha Stewart.

In addition to the strength in seasonal products, exterior projects and interior projects, the maintenance and repair categories that make up the core of our store continued to execute well in the fourth quarter. Comps in categories such as light bulbs, cleaning, pipe and fitting and caulk were strong in the fourth quarter.

We were pleased with the continued integration of our online business with our stores through expanded assortments, customer reference tools, marketing outreach and online transparency of real-time inventory in our stores.

We saw total transactions grow by 3.6%, while average ticket also increased 2.4% for the quarter. In the U.S., transaction growth was seen across the store, with positive growth in 13 of 14 departments. Transactions for tickets under \$50, representing approximately 20% of our US sales, were up 1.3% for the fourth quarter. Transactions for tickets over \$900, also representing approximately 20% of our U.S. sales, were up 3% in the fourth quarter. Strength in tools and hardware, electrical, building materials, paint and flooring contributed to growth in the average ticket.

During the fourth quarter, the total impact to comp from commodity inflation was approximately 20 basis points. As you will recall, at this time last year, I mentioned that we had seen a number of requests from our vendors for price increases as a result of elevating raw material costs. We

have seen that number level off over the year and we have proactively worked with our suppliers to roll back prices as commodity prices have come down. As a reminder, we review each request on an individual basis and our portfolio strategy drives our go-to-market actions.

As we look back at our initial expectations for 2011, we thought transactions would lead average ticket growth for the year. However, while transaction growth was positive for the year, average ticket growth was even more positive, driven by storm recovery and innovation in areas such as LED and lithium technology and strength in kitchens.

The strong performance in our kitchen business, which has positively comped for the last two years in a row, is a testament to the assortment of value our merchants have delivered in that category.

As we look to 2012, we believe that we are well-positioned, through continued integrations of our merchandising tools, optimization of our supply chain, great values and innovative products, to continue the positive growth trend in transactions and average ticket.

In the first quarter of 2012, we are introducing new products across the store. We are announcing an improved version of our Behr Premium Plus Ultra interior paint and primer in one. This new formula has better stain-blocking capabilities and improved adhesion on multiple surfaces. This enhancement increases durability and scuff resistance, even with a shorter drying time.

In appliances, we are introducing new Maytag ranges equipped with Aqualift cleaning technology, an innovative interior coating that cleans in less than an hour without high temperatures, harsh chemicals or odor. We will also be introducing new washer and dryer laundry pairs from GE and LG.

In our seasonal business, we will be offering a new line of power tools for the garden from Ryobi, starting with a string trimmer and hedge trimmer featuring a 40-volt lithium-ion rechargeable battery system. This lithium technology offers gas-like performance in a quick-charge platform, which can be charged thousands of times over the life of the battery.

Rolling out to all stores in February, we are happy to offer our customers an expanded seven day or less carpet install program. This program, in partnership with Shaw Industries, allows us to offer speed along with a great quality assortment for our customers. Also in flooring, we are upgrading our tile assortment in the first quarter.

Finally, I am proud of the hard work completed by our merchants to drive value for our customers through the special buys available in our stores now as part of our Savings Spectacular event as well as a great spring lineup of product offerings.

With that, I would like to turn the call over to Carol.

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

Thank you, Craig, and hello, everyone. We exceeded the guidance we gave you in November, primarily due to stronger-than-anticipated sales growth in the fourth quarter. We were particularly pleased with our sales performance given the strong comp we reported in the fourth quarter of 2010.

In the fourth quarter, sales were \$16 billion, a 5.9% increase from last year. Comps or same-store sales were positive 5.7% for the quarter, with positive comps of 1.5% in November, 7.1% in December and 8.8% in January. Comps for U.S. stores were positive 6.1% for the quarter, with positive comps of 1.4% in November, 7.1% in December and 10% in January.

For the year, our sales increased 3.5% to \$70.4 billion. Total Company comp sales were positive 3.4% for fiscal 2011, and comps for U.S. stores were positive 3%.

Our total Company gross margin was 35% for the quarter, an increase of 29 basis points from last year. Our supply chain transformation contributed 53 basis points of gross margin expansion in the quarter. This expansion was offset in part as we invested some of the benefit into great values for our customers.

While we had some pressure from shrink in the United States, that pressure was offset by lower shrink outside of the U.S. So for the quarter, total Company shrink had a very little impact to our overall gross margin rate.

For the year, we experienced 20 basis points of gross margin expansion.

Turning to operating expenses, in the fourth quarter, operating expense as a percent of sales decreased by 116 basis points to 26.6%. Our expense leverage was primarily the result of positive same-store sales. We leveraged every major expense line in the quarter and also anniversaried a \$44 million expense benefit that arose in the fourth quarter of 2010 related to our private label credit card.

For fiscal 2011, operating expense as a percent of sales was 25%, a decrease of 68 basis points from last year.

In the fourth quarter, interest and other expense was \$150 million. This was an increase of \$63 million from the fourth quarter of 2010, and reflects higher outstanding debt levels and the impact of certain one-time interest benefits in 2010 that were not repeated in 2011.

For the year, interest and other expense totaled \$593 million.

Our income tax provision rate was 34.4% in the fourth quarter and 36% for the year. Our tax provision reflects the benefit from the reversal of a valuation allowance, as well as certain favorable state and local tax settlements.

Diluted earnings per share for the fourth quarter were \$0.50, an increase of 38.9% from last year. For the year, diluted earnings per share were \$2.47, an increase of 22.9% from fiscal 2010.

Now moving to our operational metrics, during the fourth quarter, we opened four new stores in Mexico and reopened two stores in the U.S., for an ending store count of 2252. At the end of the year, selling square footage was 235 million, flat to last year. Total sales per square foot for the fourth quarter were \$271, up 6% from last year. And for fiscal 2011, sales per square foot were \$299, up 3.6% from fiscal 2010.

Turning to the balance sheet, at the end of the year, inventory was \$10.3 billion, down \$300 million from a year ago. Inventory turns were 4.3 times, up from 4.1 times last year. Our payables-to-inventory ratio also improved, moving to 47%, up from 44% last year. Working capital improvements were a strong contributor to our cash position, which at the end of the year was approximately \$2 billion.

In the fourth quarter, we repurchased \$400 million or 9.7 million shares of outstanding stock. For the year, we repurchased a total of \$3.5 billion or 96.7 million shares of outstanding stock.

Computed on the average of beginning and ending long-term debt and equity for the trailing four quarters, return on invested capital was 14.9%, 207 basis points higher than last year.

As we look to 2012, we are basing our sales growth assumptions on GDP forecasts, which for the U.S. are between 2% and 3%. We've detailed our guidance in our press release, so let me just hit the high points.

First, let me point out that fiscal 2012 will include a 53rd week, so the fourth quarter will consist of 14 weeks. We will report comps on a 52-week basis.

For the year, we expect comp sales to grow in the low single-digit area. The extra week should add approximately \$1 billion in sales, so over the year we project our sales will increase by approximately 4%. We plan to open 11 stores in 2012, two in the United States and nine in Mexico.

We are planning for positive same-store sales growth in every quarter, and like GDP forecasts, predict that comp performance by quarter will be in a fairly narrow band. For 2012, we are projecting moderate gross margin expansion.

Moving to expenses, in 2012, we expect to see some expense pressure in certain areas, like medical expense. On top of this, we plan to expand our broadband Internet service, which will increase the speed of Internet traffic in our U.S. stores by 50%. As a result, we anticipate that on a 52-week basis, operating expenses will grow at approximately 50% of our sales growth rate.

For the year, we project that our operating margin will grow by approximately 50 basis points, taking us to a 10% operating margin by the end of 2012, one year ahead of our target.

For fiscal 2012, we expected diluted earnings per share to increase by approximately 10% to \$2.72. This forecast includes the benefit of the 53rd week, which we estimate will contribute \$0.03.

Using excess cash, we are planning to repurchase approximately \$3.5 billion of outstanding shares during 2012. Assuming that the shares are purchased ratably over the year, we project 2012 diluted earnings per share after repurchases to grow by approximately 13% to \$2.79.

For the year, we project cash flow from the business of roughly \$6.6 billion. We will use our cash to return capital to shareholders in the form of share repurchases and dividends and invest in our business.

Our capital spending plan for fiscal 2012 is \$1.325 billion, reflecting \$662 million for our U.S. stores and supply chain, \$356 million for IT, \$191 million for new stores and \$116 million for our non-U.S. businesses.

We thank you for your participation in today's call, and Dave, we are now ready for questions.

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## QUESTION AND ANSWER

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### **Operator**

Colin McGranahan, Bernstein.

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### **Colin McGranahan - Sanford Bernstein - Analyst**

Good morning. First question just on weather. Was there any way that you went about trying to quantify how much of an impact you thought that had in the quarter?

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### **Craig Menear - The Home Depot, Inc. - EVP, Merchandising**

Colin, it is a little difficult to tell, because when you look at -- we had some real strength in interior projects, and you wonder whether or not that was driven just because higher traffic, because customers could get to the stores. But our best estimate at this point is somewhere between 200 and 250 basis points.

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### **Colin McGranahan - Sanford Bernstein - Analyst**

Okay, that's very helpful. And then just following up, maybe as a question for Carol or Craig, on the gross margin. Can you update us just on how much is remaining in your multiyear gross margin expansion outlook? Specifically, on supply chain; obviously, a pretty good performance here in the fourth quarter in supply chain, with, I think, 50 some basis points of contribution, versus incremental supply chain benefits that you expect as you automate DCs. And so just kind of an update on the gross margin outlook and where you are on that journey, and then how you are thinking about pricing in 2012 and how that might impact gross margin.

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

I can start with the outlook and then Craig can talk about pricing. As you pointed out, we had great margin expansion coming from supply chain for the year. It was 32 basis points of margin expansion coming from supply chain, so we are pleased with that. As we look to 2012, we expect continued margin expansion coming from supply chain, maybe about one third of what we realized in 2011. As you know, we are about 70% penetrated in terms of costs that are centrally distributed. But we are not done. So when we have our investor conference in June, we will update you on our longer-term outlook for gross margin.

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### **Craig Menear - The Home Depot, Inc. - EVP, Merchandising**

Certainly, we are looking to continue to leverage our productivity, but we also want to invest that back in the customer to drive top-line sales, and make sure that we are delivering outstanding values for our customers.

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### **Colin McGranahan - Sanford Bernstein - Analyst**

Okay. Thank you, guys.

**Operator**

Christopher Horvers, JPMorgan.

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**Christopher Horvers - JPMorgan - Analyst**

Thanks. Good morning. Wanted to follow up a bit on the weather question. If you look at the monthly stacks, December in the US was actually the best month. So I guess thinking about that 200 to 250 basis points and December being the best stack against the energy tax credit, do you think you are being perhaps a little conservative in terms of the lift from the weather?

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**Frank Blake - The Home Depot, Inc. - Chairman, CEO**

You are talking on a two-year basis, Chris?

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**Christopher Horvers - JPMorgan - Analyst**

Yes.

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**Frank Blake - The Home Depot, Inc. - Chairman, CEO**

As Craig said, Chris, this is -- it's an art, not a science, on figuring out how much weather contributed to our sales. But certainly, December was a very warm month. January was a very warm month. And peeling apart how much of that is traffic -- so nicer weather, people have an easier time getting to the store -- versus a more general uplift is just very tough. So our best estimate, as Craig said, is it's between 200 and 250 basis points.

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**Christopher Horvers - JPMorgan - Analyst**

I guess maybe the other way to look at that is to say, well, now that perhaps February, it is a little warmer year-to-year, but maybe a little more normal -- or the gap, how has the business performed in the US in February?

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

Right. Well, as you know, February is our hardest compare when you look at how we performed in the first quarter of last year. And if we look at our month-to-date sales, we are quite pleased with our performance.

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**Christopher Horvers - JPMorgan - Analyst**

Okay. And then just one quick one as a follow-up. The buyback of \$3.5 billion, it looks like it would be about a \$55 embedded price into that. Is that the right calculation?

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

We try to use simple math for this. So we took \$3.5 billion, used a \$50 share price, coming up with 70 million shares for the year, cut that in half and used that for the basis of determining the EPS benefit. It is just simple math. We will buy it in based on where the price is, obviously.

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**Christopher Horvers - JPMorgan - Analyst**

Perfect. Thank you.

**Operator**

Wayne Hood, BMO Capital.

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**Wayne Hood - BMO Capital - Analyst**

Carol, my question relates to cash flow from operations, that I think you expect to be about \$6.6 billion this year, roughly flat with last year. And I guess I look at a big jump in your payable-to-inventory ratio at 47%. And in the past, that has been in excess of 50% with where you are or where you are headed with turns. So I am just wondering are you just being conservative in that cash flow outlook, or are we getting to a point where \$6.5 billion to \$7 billion might be kind of a peak operating cash flow number?

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

Wayne, I will say there is some conservatism built in that cash flow forecast. We are not projecting as much working capital benefit in '12 as we enjoyed in '11. And I would say that is conservative, but it is better to be prudent on the cash flow forecast than to get over our skis.

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**Wayne Hood - BMO Capital - Analyst**

Should we be thinking about 47% as a run rate for the coming year payable-to-inventory?

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

Here is how we thought about payables. We looked at it actually from a days perspective, and we are projecting to increase payable days outstanding by two days in 2012.

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**Wayne Hood - BMO Capital - Analyst**

Okay. And my second question related to this is why not repurchase more than the \$3.5 billion? Because given the cash flow outlook, which suggests you are going to add another \$1 billion to your cash balance for the year, unless you're going to make acquisitions or something, I'm not sure why you would want to take that cash balance up by another \$1 billion. Thank you.

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

Certainly not trying to infer that we will be acquisitive, but more conservative from a cash management perspective. Not all of our cash is available; in other words, we have cash outside of the United States, supporting our Canadian, our Mexican, our China sourcing activities. To bring that cash back to the United States would come with a pretty hefty tax. So it is not all available. And we do need -- as you know, our business is very seasonal. We need about \$1 billion just to operate. So that is really what is underlying the guidance.

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**Wayne Hood - *BMO Capital* - Analyst**

All right. Thank you, Carol.

**Operator**

Eric Bosshard, Cleveland Research Company.

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**Eric Bosshard - *Cleveland Research Company* - Analyst**

Good morning. Can you talk a little bit about what you observed with mix across the business in the fourth quarter and perhaps the back half of the year, and how you are thinking about where consumers are spending money in terms of price points as we go into 2012?

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**Craig Menear - *The Home Depot, Inc.* - EVP, Merchandising**

Sure. This is Craig. If we looked at the fourth quarter and in the back half, start with the fact that categories that have been a strength remained a strength. Around maintenance and repair was solid performance as a result.

We did have the continued benefit of the repair going on in some of the areas affected by the hurricanes, which drove things like roofing, as big repair projects. But we really did see strength across the interior of the store. Simple decor projects were very strong for us in the quarter. That continued to build on momentum that we had coming off of Q3.

And then again, with the benefit of the warm weather, we actually saw project business -- exterior project business -- take place at an accelerated rate of what you would normally expect later in the fourth quarter.

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**Eric Bosshard - *Cleveland Research Company* - Analyst**

Great. And then one follow-up. In terms of how you are thinking about promotions and managing your inventory in 2012, understanding that you're talking about growth similar to GDP, which feels a little bit conservative in light of the second half of '11, I'm interested in how you are thinking about the promotional cadence, the promotional intensity, and how you are managing your inventories in anticipation of that.

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**Craig Menear - *The Home Depot, Inc.* - EVP, Merchandising**

Again, we are still focused on continuing to try to drive value for our customers every day. So that is our remaining focus. We are continuing to work to break promotional cycles in our business.

But with the supply chain capabilities that we've put in place, I think this past quarter was an example of the nimbleness that we now have in our business and we can respond. So we feel good about the capabilities that we've built in the supply chain, in particular, our capabilities to respond to seasonal businesses.

So overall, I would say we are well-positioned as we move into 2012.

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**Eric Bosshard - *Cleveland Research Company* - Analyst**

Okay. Thank you.

**Operator**

Dennis McGill, Zelman & Associates.

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**Dennis McGill - *Zelman & Associates* - Analyst**

Good morning. Just a question focused on some of the regions. You mentioned California being at the Company average and Florida being above, and two areas that we wouldn't normally attribute to being volatile from the weather standpoint. So just wondering if you could elaborate there, particularly in California, where it seemed like weather was pretty steady year-over-year, especially with some of the housing metrics improving in those markets.

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**Frank Blake - *The Home Depot, Inc.* - Chairman, CEO**

Dennis, I think that's exactly the point. Wanted to call out California and Florida because they really aren't weather-related, and so that is an indication that there was more than just weather, which ties back to why we triangulate around the 200 to 250 basis points coming from weather. And I think, just exactly as you said, that those markets are more reflective of not a housing recovery, but a stabilization in the markets that we've seen over the last two years as they have just gotten kind off the floor, in effect, on housing.

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**Dennis McGill - *Zelman & Associates* - Analyst**

Is there anything in the product or category results in those areas that would differ from what you talked about nationally that would be indicative of different trends?

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**Frank Blake - *The Home Depot, Inc. - Chairman, CEO***

Nothing radically different in those areas.

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**Dennis McGill - *Zelman & Associates - Analyst***

Okay. And then just lastly on the point, with Florida being above Company average and being a pretty big chunk of the stores, any particular areas that would be offsetting that?

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**Frank Blake - *The Home Depot, Inc. - Chairman, CEO***

In terms of what was below the Company average?

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**Dennis McGill - *Zelman & Associates - Analyst***

Right.

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**Frank Blake - *The Home Depot, Inc. - Chairman, CEO***

So we had some challenged performances in areas of the Southwest, areas of what we call the Northern Plains, some areas that saw some difficulty.

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

But there is more commonality than differences. If you look at our regions, high to low, the point spread one year ago was 13 points. This year, it is 10 points. So there is a narrowing of the geographical differences.

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**Dennis McGill - *Zelman & Associates - Analyst***

Great. Okay. Thanks again.

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**Operator**

Laura Champine, Collins Stewart.

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**Laura Champine - *Collins Stewart - Analyst***

Good morning and congratulations on your results. I had a question about market share. As we look back at 2011, were your share gains more driven by product differentiation or price differentiation, and how does that impact your merchandising and pricing decisions in 2012?

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**Frank Blake - *The Home Depot, Inc. - Chairman, CEO***

Laura, I would say just one general comment, which is our market, certainly for us, is very hard to work through what the share gains and share losses are, between the government reports and the third-party reports. Frankly, the government reports would suggest that we lost share in the quarter, which we have -- that is a head-scratcher for us. And some of the third party share data also had some interesting anomalies.

So I would say more of -- and I would ask Craig to address this -- I mean, really the pricing decisions are driven more by the portfolio strategy and our customer and what we want to do from our customer, rather than from a share gain perspective.

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**Craig Menear - *The Home Depot, Inc. - EVP, Merchandising***

I think the gains that we've made in the business in terms of driving performance has been really three key factors. Number one, it is the work that we continue to do on the assortments, to make sure that we are driving relevant product to the customer and the marketplace. The value proposition around those assortments, so that we are using our portfolio strategy to apply pressure in the marketplace. And then third is our store associates and their ability to drive the business and take care of the customer, get excited about the product that we give them and translate that excitement to our customers.

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

There's nothing like having 96% of your stores in success sharing. That's the second-highest payout in our Company history to motivate our associates.

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**Laura Champine - *Collins Stewart - Analyst***

So just if I can follow up, if I am looking in the stores this year, will they appear more or less promotional than they did in 2011?

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**Craig Menear - *The Home Depot, Inc. - EVP, Merchandising***

I would say you won't see a major difference. Again, we are trying to work to break categories. I've shared in the past there is particular businesses that are tough to break the promotional cycle, but we are working hard to do that. Our objective is to drive everyday great value for our customers.

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**Laura Champine - *Collins Stewart - Analyst***

Great. Thank you.

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**Operator**

Alan Rifkin, Barclays Capital.

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**Alan Rifkin - Barclays Capital - Analyst**

Thank you very much. Carol, the 4.3 time inventory turn is the best number you guys have posted in quite a while. And one would have to believe that part of that improvement is coming from the RDC initiative. I was wondering if you could maybe shed some color on where you think that number can go longer-term in conjunction with the RDC continuing to benefit.

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

Thank you, Alan. I would attribute most of that benefit to RDC and supply chain transformation. And as we look to 2012, we are planning again for improvement in inventory turn. I will say conservatively, it's modest improvement next year. And as we look past 2012, we are on a path, as you know, to reach a five times inventory turn. And when we have our investor conference in June, we will lay out that path for you in greater detail.

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**Alan Rifkin - Barclays Capital - Analyst**

Okay, thank you. And just a follow-up, if I may. I know, Craig, that you said big-ticket \$900 and above was up about 3%. But I was wondering if you could maybe shed a little bit more color on exactly what you are seeing with respect to consumers' appetites for starting to undertake big projects. If you can kind of shed a little bit more color on the \$900 and above transaction.

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**Craig Menear - The Home Depot, Inc. - EVP, Merchandising**

Yes, there is really kind of three factors that are helping to drive that larger ticket transaction. First of all, we are beginning to see the pro perform more as our consumer has been over the past. So we are beginning to see the growth there, which is obviously more around project business.

The strength that we've had overall in our kitchen business and appliance business obviously contributes to the growth in the larger ticket as well.

And then candidly, the third thing is continued innovation that we are bringing to the market, where customers are stepping in to better product, whether it is things like LED, which obviously allows them to save energy, but obviously drives ticket for us, or things like lithium technology or our paint offering, where we are seeing customers step up to better product.

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**Alan Rifkin - Barclays Capital - Analyst**

Okay. Thank you very much.

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**Operator**

Brian Nagel, Oppenheimer.

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**Brian Nagel - Oppenheimer - Analyst**

Good morning. First off, I don't mean to belabor the weather question, but I know it is very topical here, but how should we think about it? You quantified the 200 or 250 basis point benefit from the weather. So as we think about this, how much of that do you think will be simply pulled forward and could result in maybe some sales weakness over the next few quarters? Or is it just likely to imply better consumption of those products?

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**Craig Menear - The Home Depot, Inc. - EVP, Merchandising**

It is a great question, and it is one it is very difficult to get your arms around. I think it is logical to assume that when you are doing exterior projects in the north in January, there may very well be some pull forward in the business from what normally maybe would have transpired in Q2. But it is very difficult to kind of put a number against that.

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

And it is early in the year, obviously. But if we look at ourselves to date, we are ahead of our sales plan. So, again, it is hard to get at.

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**Craig Menear - The Home Depot, Inc. - EVP, Merchandising**

Really hard to get at.

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**Brian Nagel - Oppenheimer - Analyst**

Okay. That's understandable. The second question I wanted to ask -- more of a big picture type question -- but I think a lot of us are looking at the macro housing data, which has clearly gotten better over the last few months. We are grappling with -- we've seen some of this before over the last couple of years, and we thought housing was getting better, only to disappoint.

From your standpoint, just looking from the overall macro environment right now, do you think what we are seeing lately is more sustainable than we've seen the last couple of years?

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**Frank Blake - The Home Depot, Inc. - Chairman, CEO**

Brian, I would say a couple of things. First, we are now not -- we have no government programs to cloud what is happening. So we've kind of now anniversaried the last of that with the tax credit for energy efficiency that Craig mentioned.

And the way we look at it is there are some positives that you definitely see on housing. So you do see affordability is at great levels, and you've got some shadow household formation that eventually will drive demand. And then you see some negatives, and clearly credit availability is one of those negatives that really has to get solved for housing to kind of lead the way on recovery.

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

But it is our point of view that if there is an error in our forecast, the bias is to the upside.

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

Thank you and congratulations on the quarter.

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**Operator**

Greg Melich, ISI.

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**Greg Melich - *ISI Group - Analyst***

Thanks. Carol, you mentioned in your prepared comments that SG&A would grow at 50% of sales this year, a little bit more. Could you help us understand the variability of that, if sales ended up surprising to the upside? So I assume that is based on sort of that 2.5%, 3% growth number. If you ended up staying like the fourth quarter, would you expect that? What sort of leverage would we expect on that?

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

As you can see just by our results in the fourth quarter, our business model defines operating leverage. So if sales grow faster than the forecast we've laid out, we will do much better than the guidance that we've given, since it's growing at 50% of sales.

And maybe I will just give you a little bit more color on the expense line, because I know this is not as good a performance as we reported in 2011 or 2010. So as we think about our projection for 2012, we have some pressure in medical. Now, a year ago, we told you we had pressure in medical, and that didn't turn out to be true. Our HR team introduced some get-healthy programs and medical expense for our Company was actually down year on year. Well, that was kind of a one-time pop. We don't think I will continue into 2012, and we actually think our medical expenses will grow faster than the rate of sales growth in 2012.

As I mentioned in my prepared remarks, we are increasing the bandwidth in our stores, improving the speed of Internet. That comes with some expense that we didn't have in 2011.

As I think you know, we recently acquired Redbeacon. It is in early-stage technology company. We didn't acquire any earnings, and we will be investing in Redbeacon in 2012. And then there

is just some general inflation in other expense categories. But clearly, again, if sales grow faster than the guidance, our leverage will be better.

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**Greg Melich - *ISI Group - Analyst***

Okay, great. Second -- and this follows up to the cash flow from earlier -- the \$6.6 billion, that would also -- I guess I'm trying to reconcile your net income plus D&A to get to that \$6.6 billion. And it seems like there is about a \$700 million difference. And it sounds like you'd split the difference and that might be some working capital improvement.

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

Conservatively, we did not plan for as much working capital improvement in '12 as we saw in '11.

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**Greg Melich - *ISI Group - Analyst***

Okay. All right. That's great. Thanks a lot.

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

You're welcome.

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**Operator**

Scot Ciccarelli, RBC Capital Markets.

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**Scot Ciccarelli - *RBC Capital Markets - Analyst***

I know you touched upon kind of the aging U.S. housing stock out there, and I'm assuming that houses will need more repair and maintenance activity as they get older. How do you guys kind of factor that part into your longer-term sales plans?

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**Frank Blake - *The Home Depot, Inc. - Chairman, CEO***

Again, the point on the aging housing base is that that is what has been sustaining our business over the last couple of years, is the repair, the basic repair business within homes.

What we've seen over the last several years is you can roughly anticipate that growing with GDP. People -- a lot of repairs are discretionary; we see it in our business. And really what helps us is a lifting economy, and that is why we had positive growth in 2010, positive growth in 2011, and why we think we'll have positive growth in 2012.

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**Scot Ciccarelli - *RBC Capital Markets - Analyst***

But, Frank, when you look at -- let's call it what you would think of as kind of (multiple speakers).

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**Frank Blake - *The Home Depot, Inc. - Chairman, CEO***

Could it accelerate, is your question, Scot -- could it accelerate? Yes. I mean, certainly -- certainly we think that as the economy continues to improve, hopefully as unemployment improves, people will continue to want to do small and large projects in their home.

So absolutely that could improve. But as I said, what we found over the last couple of years is that anchoring ourselves to GDP is about the best predictor we have versus sort of baking in an assumption on what happens with an aging housing base.

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**Scot Ciccarelli - *RBC Capital Markets - Analyst***

Understood. Thank you.

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**Operator**

Matthew Fassler, Goldman Sachs.

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**Matthew Fassler - *Goldman Sachs - Analyst***

Thanks a lot, and good morning to you. Two follow-up questions, if I could. You addressed the question of expense growth relative to sales growth. If you think about EBIT dollar growth relative to sales growth, or the flow-through, this year, you generated \$0.34 on the incremental dollar sales down to EBIT, both in the quarter, actually, and for the year. Last year was 44%.

What is your expectation for EBIT flow-through as you take a longer-term look forward? I know in the past -- and this might be quite dated -- we had thought about 20% per annum. It sounds like the run rate is substantially better than that in the past, and also I think for 2012. So any thoughts on that?

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

We continue to surprise ourselves in terms of the productivity of the incremental sales dollar. So Matt, based on the guidance that we've given you, you can calculate the numbers to determine what we are saying for 2012. And when we have our investor conference in June, we will come back and give you a longer-term perspective. Because I think that is really where we are all thinking about, is not just 2012, but '13, '14 and beyond.

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**Matthew Fassler - *Goldman Sachs - Analyst***

Got it. Secondly, you talked about the impact of supply chain to gross margin. To what degree do you think your ticket and your sales benefited from in-stock? Obviously, your inventory is quite

lean, so you're not putting more product on the shelves. But do you think that part of the ticket improvement is in fact a direct function of supply chain and is it possible to quantify that?

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**Craig Menear - The Home Depot, Inc. - EVP, Merchandising**

I would say that there is no question in our mind that part of our improvement in the business has been the work that has been done in the supply chain to make sure that we are delivering the product at the right time, in the right quantities to our store.

I don't think I can tell you a specific number. That is very hard to calculate what that number would be. But we know that by having the capability to have the right product in the right locations, having it in the quantities that the customer needs, when they expect it, certainly, we believe, has been part of our turnaround over the past couple years in transaction growth and sales growth in total.

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

Our in-stock rate in the U.S. is about 99%, Matt. But you know there is a direct correlation, if I can just talk about Canada for a moment. We are running at a 99% in-stock rate in Canada. It was considerably less than that. We've improved the in-stock, and Canada had a positive comp in each month in the fourth quarter.

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**Matthew Fassler - Goldman Sachs - Analyst**

And where was the 99% a year ago, Carol, for the U.S.?

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

Slightly under that.

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**Marvin Ellison - The Home Depot, Inc. - EVP, US Stores**

Right, yes, slightly under. Matt, this is Marvin Ellison. A lot of improvements on IT. Matt Carey and his team deserve a lot of credit. We have inventory visibility in the store that we've never had before. Every item is located, so we know exactly where it is located, on the shelf, in the secondary department. And not only does that help with the transactions, but it saves a ton of productivity for the associates, so they are spending more time selling, less time looking for product. And all of those things added together just creates a better selling process, and hopefully, we will continue to see improvements across the board.

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**Matthew Fassler - Goldman Sachs - Analyst**

Thank you so much.

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**Operator**

Budd Bugatch, Raymond James.

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**TJ McConville - *Raymond James - Analyst***

Good morning, everyone. This is actually TJ McConville filling in for Budd. Let me offer our congratulations as well on the quarter.

A question -- several of our questions have been answered, but Craig, you touched on it a bit earlier, on the improvements in the professional customer. I know we have been patiently looking for some improvement in that part of the business. Can you elaborate on that a little bit more? I know last quarter, Carol told us that the transactions were down, but the ticket was up. Is that the similar trend, or is there some sort of shift going on there?

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**Craig Menear - *The Home Depot, Inc. - EVP, Merchandising***

We are actually seeing improvement right now with the pro in both areas, both transaction and ticket overall. The other thing that we looked at in the fourth quarter is that at this point, it appears that the pros who spend more with us that are our larger pros seem to be performing better, and that is encouraging, that they are getting more jobs, more work.

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

Let me just quantify that for you. When Craig mentions pros who spend more with us, we are looking at pros who spend \$10,000 or more. And that is where we really saw the strength, right, in the fourth quarter?

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**Craig Menear - *The Home Depot, Inc. - EVP, Merchandising***

Yes.

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**Marvin Ellison - *The Home Depot, Inc. - EVP, US Stores***

And TJ, this is Marvin. We talk a lot about initiatives that we've put in place. If you think about service for a second, we had 130 basis point improvement in net promoter score for the overall store, but for the pro area, it was 290 basis points.

So when you think about the sales performance, a lot of that is attributed -- we hope and we are cautiously optimistic to that segment coming back. But also, we believe the merchants, the IT improvements, the service levels in the stores, just making it easier for the pros to shop, and when you combine those two things together, again, we remain cautiously optimistic that we'll continue to see it.

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**TJ McConville - *Raymond James - Analyst***

That's very helpful. And Marvin, could you share what those net promoter score levels, the absolute levels, are for the overall store and the pro, if you wouldn't mind?

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**Marvin Ellison - *The Home Depot, Inc. - EVP, US Stores***

Well, the overall store is 70.7%. For the pro, I don't have that number with me because the pro is aggregated into the overall store number.

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**TJ McConville - *Raymond James - Analyst***

Okay. Fair enough. And the last question I have is housekeeping. How many of the RDCs, Frank, now are mechanized, and are we still on plan to roll out as we expected in FY '12?

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**Mark Holifield - *The Home Depot, Inc. - SVP, Supply Chain***

Good morning, everyone. It is Mark Holifield. At this point, 16 of the 19 RDCs are fully mechanized, and we are in the process of mechanizing two of them in this year.

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**TJ McConville - *Raymond James - Analyst***

That does it for me. Thank you for taking my questions, and best of luck in the coming year.

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**Operator**

Mike Baker, Deutsche Bank.

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**Mike Baker - *Deutsche Bank - Analyst***

First, competitively, are you seeing anything different promotional-wise and any benefit from Sears potentially closing stores?

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**Craig Menear - *The Home Depot, Inc. - EVP, Merchandising***

No, we are really not seeing any major difference in promotional activity in the market right now.

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**Mike Baker - *Deutsche Bank - Analyst***

Okay, thanks. And then just another sort of bigger-picture view, and it has been touched on a couple times. But still trying to figure out -- how much do you think -- are you seeing any of your customers buying higher-end products? Do more higher-end kitchen or higher-end bath remodels, or is it more sort of entry-level price points relative to a couple of quarters ago? Again, just trying to figure out if we are -- if your results should be seen as positive macro sign or is it more sort of Company-specific and/or weather-related. Thanks.

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**Craig Menear - *The Home Depot, Inc. - EVP, Merchandising***

We obviously -- we focus on each segment within the line structure, because we believe that there is opportunity in each, whether that is the opening price point, the mid-price point or the upper price point. So there are certainly areas where customers focus in each one of those segments.

But what I would tell you is that we are pleased with the growth that we've seen in particular categories, as I mentioned, where customers are stepping up in things like LED technology. There is obviously a savings for the customer as it relates to the energy usage in their home, but they are certainly willing to put the outlay out for a higher-ticket product to get that payback on their energy savings. Same thing would hold true in products like lithium technology, where the pro consumer certainly sees the benefit of added power, longer runtimes, more battery charges in their unit. So they are willing to step up and spend at a ticket that is higher than NiCad. Or customers who are stepping in to organic or natural products, which generally carry a higher ticket, but they see the benefit that brings to them.

So we are seeing both, I guess is the way to answer the question. Where the innovation, the value proposition for the customer is there on an upper-end, higher-ticket product, the customer is not afraid to spend money there.

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**Mike Baker - Deutsche Bank - Analyst**

Okay. Could I just ask one more follow-up? Just same type idea, but maybe more specifically within like a kitchen remodel or something like that, where you have an entry-level cabinet that you could buy or sort of mid-level or a higher level, anything in those specific categories, whether it be a bathroom or kitchen, rather than an LED, which is sort of, I think, a step-up than a light bulb, just in the overall scope of the project, are people sort of opting for the higher-end stuff.

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**Craig Menear - The Home Depot, Inc. - EVP, Merchandising**

I would say in the kitchen business, it has actually been a blend. And it hasn't -- it is not that it is skewed one way or another. It has actually been a blend of product.

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

That is the beauty of our offering, because we offer across price points for all customers.

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**Mike Baker - Deutsche Bank - Analyst**

But does that blend different than it may have been a couple of quarters ago, where it would have been all entry-level?

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**Craig Menear - The Home Depot, Inc. - EVP, Merchandising**

No, it has been pretty much the same for the past almost two years.

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**Mike Baker - Deutsche Bank - Analyst**

Got it.

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**Diane Dayhoff - The Home Depot, Inc. - SVP, IR**

Dave, we have time for one more question.

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**Operator**

David Gober, Morgan Stanley.

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**David Gober - Morgan Stanley - Analyst**

Good morning. Thanks for taking my question. Frank, you noted in your prepared remarks that you are now at about 53% of store labor hours allocated to selling. Is there any way to quantify the benefit to the comp that that has been providing or any way to maybe identify specific departments that have benefited from that shift in labor hours?

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**Frank Blake - The Home Depot, Inc. - Chairman, CEO**

I'll ask Marvin to comment on this as well. I think that is difficult -- it's a little bit like the in-stock rate. You know that being better in-stock translates into better sales. You know that having more customer-facing hours should translate into better sales.

If you think about kind of the spectrum of retailers, we are much more customer-assist than many other retailers. Our associates drive a lot of discretionary purchase. So we think it is a plus, but it is very difficult to put a number to it.

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**Marvin Ellison - The Home Depot, Inc. - EVP, US Stores**

This is Marvin. We work with the merchants to try to understand their strategic focus for the year, so we can understand where we invest the labor. As Craig's team tends to focus on the core categories like hardware, we will skew our labor allocation more heavily toward those core departments.

We've seen strength across the business, as reflected in the numbers, but I think Frank said it very well -- hard to quantify specifically. What we do know intuitively is that we are a project business. We sell projects, not items, and that requires a level of service that you won't see in a typical retailer.

So because of that, because of the training, because of the investments of what we estimate to be, on average, about four associates added on the sales floor in payroll for service, we think that it is definitely benefiting the business. But again, quantifying it specifically is always a little difficult.

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**David Gober - Morgan Stanley - Analyst**

Okay. And a follow-up, if I could. Carol, you mentioned that your guidance assumes that the quarterly variability is in a fairly tight band, which surprised me a little bit given the variability in 2011 and some of the seasonal factors. It also implies that on a two-year static basis that the business should continue to accelerate throughout the year. Is that a fair assumption? Is that what you guys are looking for? And is there anything else that we should be aware of within that seasonal outlook?

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

That is a fair assumption. Focusing first on the first half, you would expect the first-quarter comp to be stronger than the second-quarter comp. But again, it is all within a band.

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**David Gober - Morgan Stanley - Analyst**

Okay, thanks.

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

You bet.

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**Diane Dayhoff - The Home Depot, Inc. - SVP, IR**

Thank you to everyone who joined us on the call today, and we look forward to talking to you next quarter.

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**Operator**

That does conclude today's conference. Thank you for your participation.