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Home Depot and Lowe's Research

Ticker: HD

Price: $171.52

Market Cap: $190B

Performance: -7.5% YTD

Ticker: LOW

Price: $92.57

Market Cap: $72.6B

Performance: +1.4% YTD

Let's break down the fundamentals – we will show the stats as HD and LOW in that order:

P/E: 18.4x vs. 20.2x

F P/E: 16.5x vs. 15.7x

P/S: 1.8x vs. 1.0x

F P/S: 1.7x vs. 1.0x

Dividend Yield: 2.45% vs. 2.12%

P/ Free Cash Flow: 34.9x vs. 18.8x

PEG: 1.4x vs. 1.0x

Net Income Margins: 10% vs. 5.2%

Hedge Fund Positioning: 1.1% vs. 4.7%

Return on Assets: 21.3% vs. 9.7%

Ok, so let's walk through these two a bit. Over the last 5 years, Home Depot has been outperforming Lowe's but this year that has changed. Over the last 5 years, HD is up 142% vs. Lowe's at 115%. This year so far Lowe's is outperforming Home Depot by about 9% (+1% vs. -7.7%).

These two stocks, like just about every other stock out there, have taken a beating from the recent market shakedown. For example, before the rout that began in October, Lowe's was up 26% for the year and HD was up 14%. There's another aspect as to why these stocks have fallen though. Housing is seeing some headwinds. What do we mean by this? Let's dive in a little bit because we know that these stats are critical to the success of HD and LOW.

General Stats:

The 30-year fixed mortgage rate is currently at 4.83%, pulling back a bit from November's 5.10% which was the highest in 7 years, according to data from mortgage finance agency Freddie Mac

Existing Home Sales

- Existing home sales are down 5.1% from a year ago (5.5 million in October 2017).
- Single-family home sales sit at a seasonally adjusted annual rate of 4.62 million in October, up from 4.58 million in September, and are 5.3%below the 4.88 million sales pace from a year ago. The median existing single-family home price was $257,900 in October, up 4.3 percent from October 2017
- October existing-home sales in the Northeast increased 1.5% to an annual rate of 690,000, 6.8 percent below a year ago. The median price in the Northeast was $280,900, which is up 3.0% from October 2017

- In the Midwest, existing-home sales declined 0.8% from last month to an annual rate of 1.27 million in October, down 3.1% overall from a year ago. The median price in the Midwest was $197,000, up 2.4% from last year.
- Existing-home sales in the South rose 1.9% to an annual rate of 2.15 million in October, down 2.3% from last year. The median price in the South was $221,600, up 3.8 percent from a year ago
- Existing-home sales in the West grew 2.8% to an annual rate of 1.11 million in October, 11.2 percent below a year ago. The median price in the West was $382,900, up 1.9% from October 2017

New Home Sales

- New home sales dropped 8.9% to a seasonally adjusted annual rate of 544,000 units last month below estimates for 575,000. That was the lowest level since March 2016. The percent drop was the biggest since December 2017.
- New home sales have dropped in four of the last six months
- New home sales are drawn from permits and tend to be volatile on a month-to-month basis. They decreased 12.0% from a year ago
- New home sales in the South, which accounts for the bulk of transactions, declined 7.7% to their lowest level since July 2017
- Sales fell 3.2% in the West
- Sales plunged 18.5% in the Northeast to their lowest level since September 2015
- Sales tumbled 22.1% to a 2½-year low in the Midwest.
- The median new house price fell 3.1% to $309,700 in October from a year ago
- Supply is, however, just over half of what it was at the peak of the housing market boom in 2006.

On the other hand, there are some other things to think about and this may sound bad but it's facts. The more storms we see the better it is for these two.

Let's take a few examples. A report by CoreLogic shows 23,044 homes with a total reconstruction cost value of $8.6B are at high or extreme risk of wildfire damage within the perimeters of the Camp Fire in Northern California and the Woolsey Fire in Southern California. We did some digging and found that Home Depot has a much larger presence in Cali than Lowe's does with 232 locations vs. Lowes' at 111… more than double! This could be a nice opportunity for HD to capitalize on.

In totality, we've seen devastating hurricanes, extreme wildfires, hail, flooding, tornadoes and drought, the United States tallied a record high bill last year for weather-related disasters amounting to $306B in damage. The U.S. had 16 disasters last year with damage exceeding a billion dollars each, the National Oceanic and Atmospheric Administration (NOAA) reported and this ties 2011 for the number of billion-dollar disasters, but the total cost blew past the previous record of $215B in 2005. Meteorologists unfortunately predict the trend to continue upward.

Ok so now let's examine the two a bit to see which we prefer more (although both can easily find a spot in your portfolio).

In Home Depot's most recent quarter they reported Q3 GAAP EPS of $2.51 beating estimates by $0.26 on revenue of $26.3B (+5.1% Y/Y) beating by $60M:

- Comparable-store sales rose 4.8% in Q3.
- The comp sales for the U.S. stores was 5.4%.
- Gross margin rate improved 20 bps to 34.8%.
- SG&A expense rate +30 bps to 18.3%.
- Operating margin rate flat at 14.7%
- Number of customer transactions increased 1.4% to 394.8M.
- Store count +3 Y/Y to 2,286 for the period.
- Upped guidance for the second time and see FY18:
    - Sales: ~+7.2%
    - Comparable-store sales: ~+5.5%
    - Operating margin rate: ~14.5%
    - Tax rate: ~24%
    - Diluted EPS: ~$9.75 (~+33.8%)
    - Share Repurchases: ~$8B

Lowe's on the other hand reported Q3 Non-GAAP EPS of $1.04 beating by $0.06 on revenue of $17.42B (+3.9% Y/Y) beating by $60M:

- Comparable-store sales rose 1.5% in Q3
- Comps for the U.S. home improvement business up 2%
- Gross margin rate down 157 bps to 32.5%.
- SG&A expense rate +180 bps to 24.51%.
- Operating margin rate squeezed 373 bps to 5.5%.
- Merchandise inventory -0.2% to $12.36B.

- Home improvement and hardware stores -11 Y/Y to 2,133.
- The company repurchased $620M of stock under its share repurchase program and paid $390M in dividends in the third quarter.
- FY2018 Guidance:
    - Total sales: ~+4%
    - Comparable-store sales: ~+2.5%
    - Operating margin rate: ~-240 bps to -255 bps
    - Tax rate: ~24%
    - Diluted EPS: $5.08 to $5.13
    - New stores: ~8
- Just a few days ago though Lowe's released an update
- Capital allocation: The company says the board authorized a new $10B share buyback program with no expiration date. The new programs adds to the previous program's balance of $4.5B as of November 2.
- FY19 guidance: Total sales are expected to increase ~2%, comparable sales are expected to increase ~3%; EPS of $6.00 to $6.10 is expected vs. $5.90 consensus.

Ok, as you can see HD easily had the superior quarter. They not only grew revs faster, their comps were also higher, their margins were significantly better, and their guidance was also brighter.

Looking at the multiples above, HD does trade at a slightly steeper valuation than Lowe's but we think its for a reason. The company is not only larger but they run a tighter ship, have a larger reach, are more efficient (not just in margins but also look at their ROA, ROE, ROC) and pay a slightly better dividend.

Given the fact that we prefer HD doesn't mean we feel its time to jump in yet, though. The charts still aren't yelling oversold and the 50 day moving average has crossed below the 200 signaling more short-term downward momentum. Right now we can see HD testing $160. If you're looking at a long-term hold, which is what we would view it as, its still a nice buy down here but we believe it can still be obtained at a cheaper price.