

A Financial Analysis and Valuation of Home Depot

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Abstract. This study aims to research and analyze the firm's valuation of Home Depot by exploring the company's background and recent events, evaluating company performance, forecasting future development, and discovering the firm's strategy and risk. The performance evaluation uses liquidity, solvency, and profitability to assess the firm operations and use of resources. The additional valuation adopts current and next year's forecast financial data to measure the company's EPS and revenue growth rate, P/E, PEG, and GP/A ratios. The results show that Home Depot has high liquidity, high profitability, and low solvency from its operational performance, as well as a high long-term valuation forecast in the home improvement retail industry. This consequence implies that Home Depot may have efficient business management and sound financial health by effectively meeting short-term obligations and using assets to generate revenue. Meanwhile, the company may also pose several risks, including an unstable economic environment, difficulty meeting long-term obligations, the continued decline in annual gross margins and ROIC, and potential stock overvaluation for investors.

Keywords: Financial Valuation, Home Improvement Corporation, Strategy, Risk Assessment.

1. Introduction

The Home Depot, Inc. (HD) is a multinational home improvement corporation founded in 1978 in Delaware, United States. It is the world's biggest home improvement retailer that provides a wide segment of products, which includes building supplies, appliances, furniture, bathroom and kitchen products, electrical equipment, decorations, hardware, outdoor living items, smart home, storage, and tools. The company also offers home services such as home improvement installation, transportation, and other tool and equipment rentals. Because of its large company scale, Home Depot expanded into multiple countries like Canada and Mexico but primarily focuses on the housing and home improvement market in the United States. By the end of fiscal 2023, the company reported net sales of \$152.7 billion, which has decreased \$4.7 billion from last year. This downward trend was due to the unfavorable impact of the comparable sales environment, which resulted in fewer comparable customer transactions and deflation in lumber prices. Invested capital (ROIC) also has decreased by 7.9% from fiscal 2022. It has declined over the last three years because of decreased operating income and rising long-term debt on average. However, online sales in fiscal 2023 increased by 1.1% over 2022, and the same year's net sales were positively influenced by \$276 million due to a declining United States dollar. [1].

According to Warren Buffett, a company's equity valuation depends on its stock's intrinsic value. Value investors consider the projections of future earnings and concentrate on the numbers, people, and industry dynamics in their value estimation, which is linked to changes within and outside the company [2]. In 2023, Home Depot expanded its retail portfolio line by launching new science-based cleaning products in partnership with Ecolab, a leading global provider of sustainable solutions and services for water, hygiene, and infection prevention. Later, the company offered tax-free major appliances to military buyers through a partnership with the Army and Air Force Exchange Service. Other environmental, social, and governance (ESG) changes included the announcement of new targets to reduce carbon emissions and continued investment in veterans' causes. At the end of the year, Home Depot acquired International Designs Group, a firm that owns and runs Construction Resources specializing in refurbishment, remodeling, and home construction business to professional contractors as a prominent distributor. The acquisition added Construction Resources' proficiency in intricate, cross-category specialty projects, enabling Home Depot to enlarge its capabilities to serve

professional contractors and capture a more significant share of the \$475 billion professional customer market [3]. In a statistical summary of 2023, Home Depot spent a total investment of approximately \$4.7 billion in capital expenditures and acquisitions and paid off \$1.3 billion in long-term obligations [1]. However, as the Harvard Joint Center for Housing Studies stated, annual spending in the home remodeling industry may reach its lowest level in 2024. Home remodeling will continue with high prices, rising interest rates, and poor home sales in 2023, creating continued uncertainty in the financial markets and the threat of a recession. This will cause homeowners to increase the likelihood of reducing or postponing unnecessary home improvement services, which can negatively affect the development of Home Depot [4].

Thus, the valuation of Home Depot will fluctuate with internal changes and industry conditions in the last year, which required this study to evaluate and predict multiple company's performances and future development trends to determine its investment possibility.

2. Performance Evaluation

2.1. Liquidity

The capacity of a firm to settle its present financial liability at maturity is the crucial indicator of liquidity, which can prevent the risk of excessive current assets and unmet short-term financing obligations. High liquidity means that a company easily meets its short-term debt, which attracts more investors and thus leads to higher stock prices with rising demand for the company's stock. A study by Sari and Sedana revealed that liquidity significantly impacts the capital structure and thus indirectly affects corporate value. Although the research showed that liquidity has little but a negative influence on company value, capital structure is able to significantly adjust profitability and liquidity to impact corporate value so that high levels can lead to an excellent firm value [5]. Jihadi et al. also illustrated that firm value benefits from liquidity. As such, liquidity is essential in the company's valuation [6].

This study uses three indexes to estimate the profitability ratio of Home Depot and other home improvement companies, ranging in ordering by stringent level: current ratio, quick ratio, and cash ratio. The current ratio compares a firm's current asset to its short-term liability, as a higher ratio confirms that the business has adequate working capital to satisfy current obligations readily. Nevertheless, the uncommon rising inventory can also cause an increase in current assets. Thus, the quick ratio uses a similar calculation but excludes inventory in the current asset. In addition, the cash ratio is calculated by cash to current liabilities, showing whether cash is adequately available for the firm to settle short-term debt [7].

Table 1. Liquidity ratios of Home Depot and its competitors

Company Names	Current ratio	Quick Ratio	Cash Ratio
Home Depot	1.35	0.40	0.17
Lowe's Companies	1.23	0.14	0.06
Floor & Decor Holdings	1.14	0.18	0.03
Tractor Supply Company	1.50	0.28	0.18

Data source: Yahoo Finance

Table 2. Inventory-to-current assets ratio of Home Depot and its competitors

Company Names	Inventory-to-Current Assets Ratio
Home Depot	0.70
Lowe's Companies	0.89
Floor & Decor Holdings	0.84
Tractor Supply Company	0.81

Data source: Yahoo Finance

As shown in Table 1, Home Depot has the highest quick ratio among its competitors, indicating it can cover its present debts with greater liquid assets. The table also reveals a higher current ratio and cash ratio of Home Depot compared to Lowe's Companies and Floor & Decor Holdings, representing more current assets and cash to meet its current obligations. Nevertheless, Tractor Supply Company shows higher current and cash ratios than Home Depot. To compare the two firms further, the study needs to consider the possible illiquid characteristics of inventories. Since the result in Table 2 exposes that all four home improvement retail companies have high inventory-to-current assets ratios, their inventories may impact liquidity calculations. Therefore, the quick ratio may be the most reliable data in this study, demonstrating that Home Depot has the highest liquidity among its competitors. This result implies a lower chance of a cash shortage for the company in the short term.

2.2. Solvency

Solvency looks at the capability of businesses to fulfill long-term debt liability to determine their financial health. This metric assesses the sufficiency of owned capital and the degree to which own capital can offset the reduction in total assets. A persistently high debt level suggests that a business might find it difficult to fulfill its repayment liabilities, raising the likelihood of bankruptcy and negatively affecting its bond rating. According to the research, Syarifah proves that the solvency ratio harms bond ratings, which will affect investors' valuation of the company [8]. Another study by Prasetyo also indicates that corporate value is adversely and dramatically affected by solvency, as gauged by the total debt ratio [9]. Hence, the solvency ratio would be a valuable index for analyzing the value of Home Depot.

The study evaluates the solvency ratio by three ratio tests: total debt ratio, long-term debt ratio, and times-interest-earned ratio (TIE). The first two tests refer to the ratios of total or long-term debt relative to its total assets, as higher ratios reflect that the company is mainly financed by debt and thus hard to pay off its long-term obligations [10]. TIE calculates the earnings without taxes and interest relative to the interest payments made by the corporation. If the ratio is higher, the firm can fully meet its debt with interest [11].

Table 3. Solvency ratios of Home Depot and its competitors

Company Names	Total Debt Ratio	Long-Term Debt Ratio	Times-Interest-Earned Ratio (TIE)
Home Depot	0.99	0.56	11.25
Lowe's Companies	1.36	0.85	7.86
Floor & Decor Holdings	0.59	0.04	32.48
Tractor Supply Company	0.77	0.19	31.8

Data source: Yahoo Finance

Given the data in Table 3, Floor & Decor Holdings shows the lowest ratios of total debt and long-term debt and the highest ratio of TIE. These data signify the retailer's sufficient capability to cover long-term debt, which possesses the largest solvency and the best long-term financial health than others. In contrast, Home Depot occupies the third position compared to solvency, implying the firm may have more risk to meet its long-term liabilities in the future.

2.3. Profitability

Profitability assesses a firm's ability and efficiency to profit from operating activities. Given that it provides information on a corporation's business management and financial well-being, this indicator is essential to the firm and investors [9]. According to research, corporations with high profitability show good performance prospects, thus attracting more investors and increasing the corporate value. The increase in firm value provides evidence of the company's capability to disburse

dividends, which then causes the company's stock price to rise [5]. Consequently, profitability measures a company's likelihood of long-term sustainability and its investment value.

This study uses three profitability ratio tests: profit margin, operating margin, and asset turnover. Profit margin refers to the net income to sales ratio, in which a higher ratio displays a more significant portion of each dollar that remains available to shareholders after interest and taxes are deducted from revenue. Operating margin makes similar but different calculations, as it uses the operating income to sales ratio instead of the net income. This ratio shows the amount a business makes per dollar of sales before interest and taxes, as a higher ratio signifies higher operational efficiency. Lastly, asset turnover measures the ratio of sales to total assets at the start of the year, which gauges the company's effectiveness in using its assets to produce revenue and thus indicates that the higher is better [7].

Table 4. Profitability ratios of Home Depot and its competitors

Company Names	Profit Margin	Operating Margin	Asset Turnover
Home Depot	0.10	0.14	2.00
Lowe's Companies	0.09	0.13	1.98
Floor & Decor Holdings	0.06	0.07	1.01
Tractor Supply Company	0.08	0.10	1.71

Data source: Yahoo Finance

Considering the result in Table 4, Home Depot reveals the highest profitability ratio in all three metrics compared to other home improvement firms. The profit margin and operating margin suggest that Home Depot generates profit, accounting for 10% of total revenue and leaving over 14% of revenue into profit after covering operating expenses. Besides, asset turnover illustrates that the company is making twice as much revenue as its total assets at the beginning of the year, which is above the regular efficiency of using assets. Overall, Home Depot shows a prominent positive sign in effective cost management, operational performance, and asset utilization in the industry. In other words, Home Depot has the highest profitability among its competitors.

3. Valuation

3.1. Forecast

In addition to the existing company performance, the study considers Home Depot's future development tendency to predict its short-term valuation. This research referred to the share price on Nasdaq and actual and forecast data for the next year on Estimize to measure the EPS and revenue growth rate, P/E ratios, PEG ratios, and GP/A ratios for the valuation.

Table 5. Valuation of Home Depot and its competitors

	Home Depot	Lowe's Companies	Floor & Decor Holdings	Tractor Supply Company
Share price	\$371.00	\$231.32	\$115.97	\$242.71
TTM EPS	15.1	13.06	2.27	10.09
NTM EPS	15.35	12.13	1.9	10.22
EPS growth rate	1.7%	-7.1%	-16.3%	1.3%
Revenue growth rate	1.1%	-2.4%	6.0%	2.9%
TTM P/E	24.57	17.71	51.09	24.05
NTM P/E	24.17	19.07	61.04	23.75
PEG	14.84	NA	NA	18.67
GP/A (based on the most recent fiscal year)	66.6%	73.8%	39.9%	56.9%

Data source: Nasdaq and Estimize

In light of the data, Floor & Decor Holdings has the highest P/E ratios of 51.09 and 61.04, the lowest EPS growth rate of -16.3%, and the lowest GP/A ratio of 39.9% (Table 5). These ratios indicate that the firm has a high stock price relative to its earnings, a declining trend in earnings, and low profitability. Tractor Supply Company has the highest PEG ratio proxied by 18.67 and the second lowest GP/A ratio of 56.9%, which means high stock prices and relatively low profitability. Thus, neither Floor & Decor Holdings nor Tractor Supply Company is a worthwhile investment choice, while Home Depot and Lowe's Companies seem more attractive value investment targets.

Based on the financial data analysis, Lowe's Companies shows lower TTM and NTM P/E ratios of 17.71 and 19.07, indicating it may be comparatively cheaper based on past earnings. The firm also has the highest GP/A ratio of 73.8%, which signifies the highest profitability. Nevertheless, Lowe's Companies appears to have a negative EPS growth rate of -7.1% and a negative revenue growth rate of -2.4%, showing a decline in earnings and revenue. In comparison, Home Depot provides a positive EPS growth rate of 1.7% and a revenue growth rate of 1.1%, higher than Lowe's Companies. Although Home Depot has a higher share price and TTM and NTM P/E ratio, the two favorable growth rates indicate an increase in revenue and earnings, which gives investors seeking growth potential an appealing choice for investment. Home Depot also has the lowest PEG ratio and the second largest GP/A ratio of 66.6%, proving that it has a more appropriate stock price and sufficient profitability than others.

Overall, the study concludes that Home Depot has the highest valuation because of its high EPS growth rate, high revenue growth rate, relatively low PEG ratio, and relatively high GP/A ratio.

3.2. Strategy and Risks

From examining the findings, Home Depot is devoted to developing diversified and differentiated products and services to expand its market and establish an outstanding marketing position in the home improvement retail industry. Through acquisition and active cooperation with other companies and institutions, the firm continues to extend its retail portfolio line by launching new products and additional services, which drive innovation and technology adoption. Furthermore, the investment and efforts towards ESG goals help Home Depot enhance its public reputation and brand image, thus improving its financial performance and reducing risk exposure. With the rapid fluctuations in the retail industry pattern in recent years, Home Depot continues to lead the industry in asset liquidity and profitability, demonstrating its efficient operations and management with an establishment of customer loyalty in a highly competitive market. The growth in online sales also suggests that the company puts more emphasis on developing the Internet business to meet customers' needs and improve the shopping experience [1]. From a long-term perspective, the company's current performance, comparably high EPS, and comparably high revenue growth rate may signify a positive sign of Home Depot's future development and the possibility of remaining dominant in the industry.

Home Depot may still face several risk factors in the future. Firstly, the instability of the financial markets and the threat of economic recession continue to negatively affect the home improvement industry's development [4]. This situation may risk the company's future growth if the economic environment continues to deteriorate. Secondly, the low solvency ratio of Home Depot indicates that the firm would find it harder to repay its long-term obligations. This issue may increase the risk of a credit rating downgrade, loss of assets due to outstanding debts, and eventually bankruptcy. Thirdly, Home Depot has a potential risk of a continued decline in annual gross margins from Nasdaq's data. Since the quarterly gross margin trend is volatile, the firm will likely keep falling, which could raise profitability concerns for investors. Fourthly, the PEG ratio of Home Depot is high if viewed individually, which suggests potential overvaluation of the stock relative to its earnings growth and thus could result in a downside risk if the firm fails to meet high growth targets. Lastly, the continuous downward trend of Home Depot's ROIC may signal a deterioration in profitability and capital efficiency and could undermine shareholder value [1].

4. Conclusion

Based on the results, Home Depot has high liquidity and profitability and low solvency in its current company performance, with a high long-term valuation forecast in the home improvement retail industry. The high liquidity and profitability reflect the firm's ability to generate sufficient liquid assets that easily meet short-term liabilities and significant earnings relative to its revenue, meaning effective business management and good financial health. The comparably high EPS growth rate, revenue growth rate, and GP/A ratio with a relatively low PEG ratio also estimate a high value of the company's stock in the future. Even so, Home Depot may still be at risk of crisis, especially in the low solvency, the continuous declining tendency of annual gross profit margin and ROIC, the high PEG ratio separately, and the unstable financial environment for the industry. These factors may negatively influence the firm valuation, resulting in an overvaluation of stock for investors. The study also involves limitations since the research only considers several measurement methods and contrast companies. Some other studies have questioned whether liquidity, solvency, and profitability significantly influence company value, demonstrating that firm valuation's measurement remains controversial in financial research.

Consequently, this study presents essential reference indicators and infinite possibilities for Home Depot's future development. For the long-term overlook, Home Depot will likely maintain efficient internal operations, continue to make acquisitions and partnerships to expand the market, and implement ESG activities to achieve an excellent corporate image. This strategy will thus attract more investors and help the company continue to grow as a leader in the industry.

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