St. John's University
Student Management Investment Fund
Presents:
The Home Depot, Inc. (HD)

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Recommendation: **HOLD**

Price (12/07/2007): $29.49
Shares Outstanding: 1,687,617,000
Market Value: $49,767,825,330

Purchase Price: $49.15
Shares Purchased: 500
Purchase Date: 2002

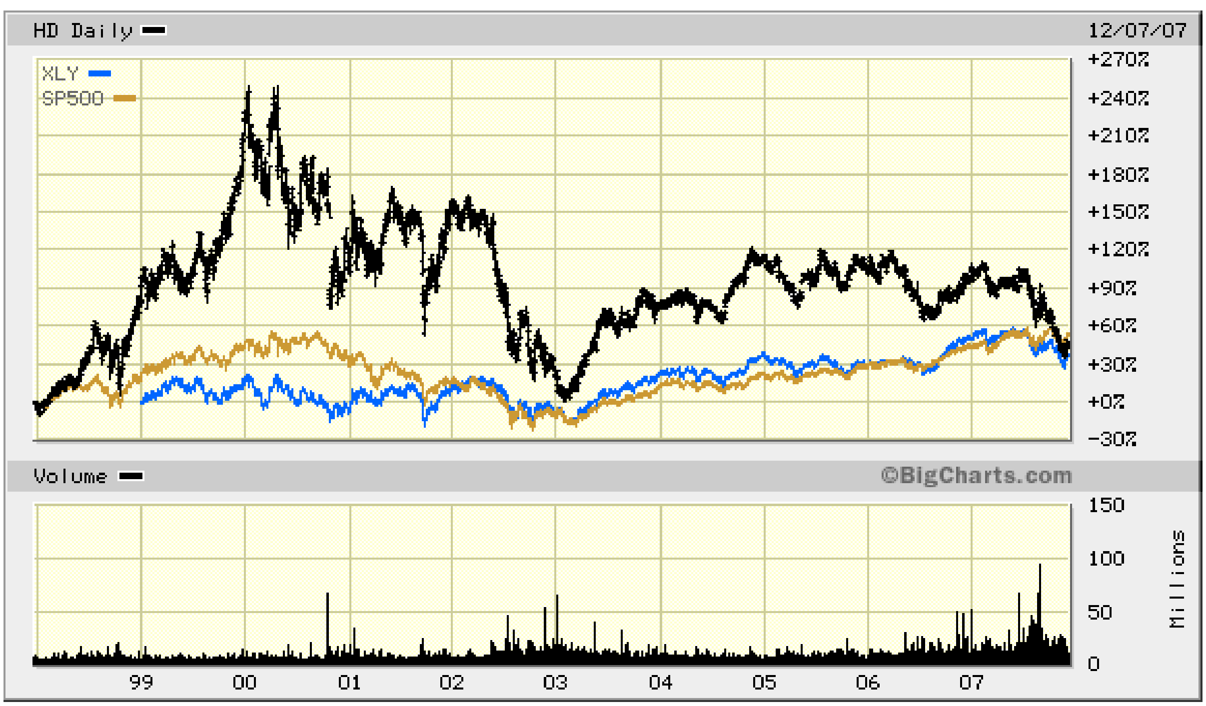

TABLE OF CONTENTS

COMPANY OVERVIEW

Founded in 1978, The Home Depot, Inc. is the world's largest home improvement specialty retailer and the second largest retailer in the United States with fiscal 2006 sales of $90.8 billion and earnings of $5.8 billion. The company mainly operates retail warehouse stores that sell building materials, home improvement, and lawn and garden products. Individual stores stock nearly 45,000 items, including brand name and proprietary items. As of the end of the second quarter in the current fiscal year (2007), Home Depot operates over 2,200 Home Depot Stores, 34 EXPO Design Centers, 11 Home Depot Landscape stores, and two Home Depot Floor stores. Over the past two years, Home Depot has been confronting a saturated domestic market by placing greater emphasis on international expansion. For example, Home Depot acquired The Home Way, a Chinese home improvement retailer, at the end of 2006. Due to this acquisition, Home Depot operates stores in three countries out of the United States – 155 in Canada, 61 in Mexico, and 12 in China.

On August 28, 2007, Home Depot confirmed the sale of HD Supply to affiliates of Bain Capital, Carlyle Group and Clayton Dubilier & Rice for $8.5 billion. The preliminary agreement settled on June 19, 2007 was for $10.3 billion; however, the sale ran into obstacles as the debt markets seized up over the summer. The new provisions of the deal called for Home Depot to pay out $325 million to keep a 12.5% equity stake in the business, and it will guarantee a $1 billion senior secured loan for financing the acquisition. The company expected to net nearly $7.9 billion in cash, which was to be used in a recapitalization plan to repurchase $22.5 billion in common shares. HD Supply distributes products and sells installation services primarily to business-to-business customers, including home builders, professional contractors, municipalities and maintenance professionals. The supply unit focuses on infrastructure, construction, maintenance, and repair and remodeling.

The Home Depot stores serve three primary customer groups:

1. **Do-It-Yourself (DIY) customers**, typically homeowners who complete their own projects and installations.
2. **Do-It-For-Me (DIFM) customers**, usually homeowners who purchase materials and hire third parties to complete the project and/or installation.
3. **Professional Customers**, consisting of professional remodelers, general contractors, repair people and trades people.

REASONS FOR PURCHASE

The Home Depot was originally purchased by the Student Managed Investment Fund in 2002. Five hundred shares were purchased at approximately $49.15 per share, for a total of $24,557. One of the main reasons that this stock was purchased was because of The Home Depot's strength. It is a large, blue chip company that is part of the Dow Jones Industrial Average and the S&P 500. The company aims for long-term growth, so it was a perfect candidate to buy and hold. Additionally, consensus analysts recommended The Home Depot as a "moderate buy," whereas all of its competitors, such as Lowe's and Home Building Materials, were all "holds." The growth prospects were solid and the stock was attractive. The Home Depot's revenue and profit had been steadily increasing as the company was pursuing a strategy of market penetration in the U.S. and expansion in North America. Their revenue had increased 17.09% from 2000 to 2001, and 134% from 1997 to 2001. Also, Net Income increased 17.9% from 2000 to 2001, and 175% from 1997 to 2001.

The Home Depot's stock expected growth rate was remarkable. It had an estimated 3 to 5 year annual growth rate of 19.2% and an estimated EPS growth rate of 18.5%. In 2001, EPS was up 11% from the prior year. They paid the highest dividend in the industry. They were paying out a dividend of $0.20 per share while their closest competitor was paying out $0.08 per share. The Home Depot was splitting its stock once every 2 years. In addition, it was a very liquid company, with $1.56 in current assets to meet liabilities in 2001, making it very easy for them to pay off short-term debt. As you can see, The Home Depot was continuing to grow and outperform its competitors in 2001, even though the economy was in a recession. The company proved that it was not only able to adapt to market conditions, but also able to grow during unfavorable conditions.

In addition to their strong financial performance, The Home Depot offered twice as many products and services as Lowe's. Additionally, the company was striving for employee satisfaction. There were many employees around to help their customers, and employees were being paid the highest salaries in the retail business.

RECENT NEWS

1. The Home Depot is taking steps to sell to a broader range of customers to buffer itself from the housing slump. The company is moving beyond its traditional base of selling supplies to homeowners to include contractors such as small home-builders and plumbers. In March 2006, the company spent $3.5 billion for Hughes Supply Inc., a distributor of maintenance and construction products. Then, in May 2006 the company acquired Florida's Cox Lumber Co. According to Home Depot estimates, the business of selling products to contractors in the United States generates $410 billion in annual sales and is a highly fragmented market, giving the company room to grow. *(Spring 2007)*

2. December 2006: As part of The Home Depot's strategy to expand its business globally it has signed a definitive agreement to acquire The Home Way, China's first home improvement retailer. The Home Way provides the Company with an immediate retail presence in China with 12 stores in six cities. The Chinese home improvement market today is valued at nearly $50 billion and has been growing at a compounded annual rate of 20 percent. *(Spring 2007)*

3. January 2, 2007: The Home Depot announced that they have agreed that Bob Nardelli would leave his position as Home Depot's Chairman, President, and CEO effective January 2, 2007. Frank Blake, the company's current Vice Chairman of the Board of Directors and Executive Vice President, is to succeed as CEO immediately. *(Spring 2007)*

4. February 12, 2007: As a continuation of the strategic review that began in November 2006, the company has announced the hiring of Lehman Brothers to strategic evaluate alternatives for the HD Supply business. The possibilities of a sale, spin-off, or initial public offering have been rumored throughout the financial industry. *(Spring 2007)*

5. April 17, 2007: The Home Depot launched "Eco Option" which is a program designed to help customers easily identify environmentally friendly pesticides, housing materials, and appliances. The company said more than 2,500 products meet the requirements for its new label, with plans for this roster to eventually reach 6,000. Eco Option products include all-natural insect repellents, cellulose insulation, front-load washing machines, and organic plant food. The wide array of Eco Options also includes compact fluorescent light (CFL) bulbs, programmable thermostats, and certified wood. *(Spring 2007)*

6. May 15, 2007: Home Depot posted net income of $1.05 billion, or 53 cents a share, for the end of the first quarter, down from the year-ago $1.48 billion, or 70 cents a share. Sales rose 0.6% from a year ago to $21.59 billion. The results were well below analysts' forecasts for a profit of 60 cents a share and sales of $21.89 billion, according to Thomson Financial. Frank Blake (new Home Depot CEO) said the housing market and erratic weather across the country cut into the spring selling season.

7. June 19, 2007: Home Depot agrees to sell HD Supply to private-equity firms Bain Capital, Carlyle Group, and Clayton, Dubilier & Rice for $10.3 billion. The company also announces that it plans to repurchase $22.5 billion in common shares as soon as possible, using the money from the sale and proceeds from the issuance of senior notes.

8. August 14th, 2007: Home Depot posted net income of $1.59 billion, or 81 cents a share, for the end of the second quarter, down from the year-ago $1.86 billion, or 90 cents a share. Sales fell 1.8% from a year ago to $22.18 billion. Excluding one-time items, the retailer's earnings per share slipped to 77 cents from 82 cents, even as buybacks brought its shares outstanding down 5% to 1.97 billion from 2.07 billion. On that basis, analysts on Wall Street were expecting earnings of 72 cents a share, according to Thomson Financial.

9. August 28th, 2007: Home Depot confirms that it will sell HD Supply to affiliates of Bain Capital, Carlyle Group and Clayton Dubilier & Rice for a lower price than it first planned, saying it will accept $8.5 billion. The company announces that it will pay out $325 million to keep a 12.5% equity stake in the business.

10. September 10th, 2007: Home Depot announces that it expects fiscal-year earnings to decline 7% to 9%. The declines come as the company has been hit by a slumping U.S. housing market and loss of market share. The company also announces the buyback of 289.3 million shares at $37 a share, for a total cost of $10.7 billion.

11. November 13th, 2007: Home Depot posted net income of $1.09 billion, or 60 cents a share, for the end of the third quarter, down from the year-ago $1.49 billion, or 73 cents a share. Sales fell to $18.96 billion from last year's $19.65 billion, missing analysts' forecasts of $19.39 billion, according to Thomson Financial. For the full year ended January 2008, Home Depot expects earnings from continuing operations will decline by as much as 11% from last year. In regards to the completion of the recapitalization plan, Frank Blake (new Home Depot CEO) is quoted in a conference call as saying, "It's not something that will happen in the remainder of 2007. We think it makes sense to look at the housing market and see what's happening in the housing market before we go any further."

INDUSTRY OUTLOOK

Several trends in the *consumer discretionary, home improvement retail industry* have supported the home improvement and furnishings retailers over the past five years. A decline in interest rates that started in 2001 prompted many homeowners to refinance their home mortgages, giving them lower monthly mortgage payments and more free cash to spend. Also, a rise in home values prompted homeowners to pull equity out of their homes to spend on remodeling projects. And the record number of home sales brought new homeowners that needed to buy furniture, tools, and other products at these stores. *(Spring 2007)*

Now these trends are slowing. Many of the homeowners who wanted to refinance have already done so, and the pace of home equity loans is slowing. These factors are hurting home improvement retailers' sales and profits. Fewer consumers are buying and furnishing new homes, and the percentage of home owners making improvements to their homes has been slowly declining – from 29.7% in 1995 to 27.2% in 2005, with a decline in home refinancing and home equity loans. *(Spring 2007)*

The housing market has consistently been the driving force behind home improvement and specialty retail sales. Unfortunately for Home Depot, the housing market has struggled throughout 2007 and analysts expect more of the same in 2008. According to the Federal Housing Finance Board's national house-price index, house prices rose only 1.8% through September, which is the slowest rate of growth since 1995. The inventory of homes for sale has increased in YTD (2007) as new home sales have fallen 24% and existing home sales have fallen 20%. The number of homes starting foreclosure jumped to the highest level since the Mortgage Bankers Association began keeping track in 1972. Homeowners behind in payments rose to the highest level in 21 years.

It has been emphasized time-and-time again by the leadership at Home Depot that when the housing market suffers a decline, same-store sales will suffer as a result. This is precisely the reason why Home Depot (27%) and Lowe's (10%) suffered tremendous declines in net income during the third quarter. Leadership for both companies emphasized for stockholders to be patient based on most predictions that the housing market will continue to worsen in the short-term period. Most experts have gone on the record in stating that they believe the industry will more than likely bottom out at the end of 2008. Therefore, for a short-term investor, Home Depot is probably not the best of breed in the current market conditions. After all, earnings have been depressed by a decline in consumer renovation projects and the company needs to keep increasing operating expenses in order to remodel stores and hire better qualified staff.

With all of that being said, these issues will not impair the company's long-term ability to generate free cash flow. Despite the subprime housing problems in the United States, the U.S. Census Bureau has reported that in the 2007 third quarter, home ownership remained at a healthy 68.2%. While this is in line with recent rates, it is a significant improvement over the 1990s. This statistic is extremely important to home improvement retailers based on the fact that homeowners spend more to maintain and improve homes than renters. Homeownership remains the biggest investment most Americans will make in their lives. Once the housing market begins to stabilize, homeowners will regain the confidence to maintain and improve their homes.

Another trend that supports the home improvement industry is the baby boomers demographic. Baby boomers are slowly entering the retirement years and will be spending more time at home with family. Retirees have long had the reputation of allocating much of their disposable income towards renovating upgrading their residence. This leads the casual observer to believe that home improvement will soon be a burgeoning business in the United States. The last note to point out is the "sweet spot" for refurbishment spending. Homes that are recorded to be 25 years or older are expected to reach 75% of the market over the next seven years. This accounts for nearly 86 million homes in the U.S. If the homeowners want to maintain the value on their homes, refurbishments are going to be necessary to keep the houses up-to-date.

Mortgage rates, which have a significant impact on the home improvement industry, have decreased from last year. The 30-year fixed-rate mortgage averaged 5.96%, down from last year's 6.11%. On December 6th, 2007, President Bush unveiled a new plan to freeze adjustable-rate mortgages at low introductory rates to help in bringing relief to 1.2 million struggling homeowners. The plan has the potential to be a controversial piece of legislation due to the criticism surrounding the idea of bailing out overextended homeowners. While it is perfectly understandable why normal ratepayers would object to this idea, it is important to distinguish that this plan is not for subprime mortgages where homeowners are being forced in foreclosure. This plan is more geared towards the homeowners who going to be unable to handle the significant rise in payments due to the upward adjustment of mortgages within the next two years.

<u>RISK FACTORS</u> *(Spring 2007)*

The Home Depot and the home improvement retail industry face a number of risks in the future. Including:

1. ***Rising costs, a reduction in the availability of financing, weather and other conditions in North America could adversely affect The Home Depot's costs of doing business and demand for their products and services.***
   Interest rates, fuel and other energy costs, labor and healthcare costs, availability of financing, employment, state of the residential construction and housing markets, consumer confidence and general economic outlook, weather, natural disasters, terrorism and other conditions that adversely affect consumer demand for retail products and services could adversely affect The Home Depot's financial performance. These and other similar factors could increase the company's costs, cause customers to delay undertaking or determine not to undertake new home improvement projects, cause customers to delay purchasing or determine not to purchase home improvement products and services, cause customers to delay or determine not to undertake new spending in the commercial, residential, industrial and public infrastructure markets, and lead to a decline in customer transactions.

2. ***Any inability to open new stores on schedule will delay the contribution of these new stores to The Home Depot's financial performance.***
   The Home Depot expects to increase their presence in existing markets and enter new markets, opening approximately one hundred and fifteen new stores and increasing square footage by 4.6%. Its ability to open new stores will depend primarily on their ability to identify attractive locations, negotiate leases or real estate purchase agreements on acceptable terms, attract and train qualified employees, and manage pre-opening expenses, including construction costs. The Home Depot's ability to open new stores also will be affected by environmental regulations, local zoning issues and other laws related to land use. Failure to effectively manage these and other similar factors will affect their ability to open stores on schedule, which will delay the impact of these new stores on its financial performance.

3. ***The Home Depot may not timely identify or effectively respond to consumer trends, which could adversely affect their relationship with customers, the demand for their products and services, and in turn, the company's market share.***
   It is difficult to successfully predict the products and services customers will demand. The success of the company's business depends in part on its ability to identify and respond to evolving trends in demographics and consumer preferences. Failure to design attractive stores and to timely identify or effectively respond to changing consumer tastes, preferences, spending patterns and home improvement needs could adversely affect The Home Depot's relationship with its customers, the demand for their products and services, and their market share.

4. ***The inflation or deflation of commodity prices could affect The Home Depot's prices, demand for their products, and sales and profit margins.***

Prices of certain commodity products, including lumber and other raw materials, are historically volatile and are subject to fluctuations arising from changes in domestic and international supply and demand, labor costs, competition, market speculation, government regulations and periodic delays in delivery. Rapid and significant changes in commodity prices may affect the company's sales and profit margins.

5. ***If The Home Depot cannot successfully manage the unique challenges presented by international markets, the company may not be successful in expanding its international operations.***
   The Home Depot's strategy includes expansion of its operations in existing and new international markets by selective acquisitions, strategic alliances and the opening of new stores and branches. The company's ability to successful execute their strategy in international markets is affected by many of the same operational risks they face in expanding its U.S. operations. In addition, The Home Depot's international expansion may be adversely affected by their ability to identify and gain access to local suppliers as well as by local laws and customs, legal and regulatory constraints, political and economic conditions and currency regulations of the countries or regions in which they currently operate or intend to operate in the future. Risks inherent in their international operations also include, among others, the costs and difficulties of managing international operations, adverse tax consequences and greater difficulty in enforcing intellectual property rights. Additionally, foreign currency exchange rates and fluctuations may have an impact on the company's future costs or on future cash flows from international operations.

RISK FACTORS *(Fall 2007)*

1. While the home improvement market is a $725 billion industry, Home Depot's primary competitive threat is Lowe's. Lowe's has kept increasing market share within the industry based on public perception and customer satisfaction. The company has the reputation of being more consumer oriented compared to Home Depot. While ex-CEO Bob Nardelli had visions of transforming Home Depot into a conglomerate, Frank Blake (new Home Depot CEO) has taken steps to improve the company's struggling retail business. Under his leadership, the company has tried to win back customers through remodeling stores and hiring new well-trained staff to improve service levels. In recent months, Home Depot has been focused on hiring master carpenters and electricians for customer satisfaction.

2. It has been estimated that 56% of home improvement spending is discretionary. Unfortunately, in times of economic uncertainty, consumers have the tendency to reduce spending on big-ticket renovation projects, such as the remodeling of a kitchen. Due to the lower levels of disposable income, high energy prices, and the volatility of the markets, Home Depot has seen same-store sales plunge 6.2% since 3Q 2006 on the back of a 1.8% drop in customer traffic. The weak housing market also represents a significant risk for the industry. A significant long-term downturn has the potential to be catastrophic for companies such as Home Depot and Lowe's. With that being said, most analysts expect the housing market to bottom in late 2008 or early 2009. If these

forecasts turn out to be accurate, the share price will have limited short-term upside. Frank Blake (new Home Depot CEO) has been on record in stating that the home improvement industry will continue to weaken as long as there is housing market turmoil.

3. While the Board of Directors criticized ex-CEO Bob Nardelli for Home Depot's aggressive expansion under his leadership and the subsequent weakening of the company's retail segment, it is hard to argue with the theory behind the purchase of Hughes Supply in 2006. He felt as if the acquisition was essential for the ongoing success and expansion of HD Supply. Unfortunately, Frank Blake (new Home Depot CEO) felt as if the decision alienated the company's core business and sold the supply unit off for $8.5 billion in August of 2007. The sale had both positive and negative aspects within it. The positive is that the company can shift the focus back on the retail business by remodeling the stores and hiring well-trained professionals. The negative is that the company has become more one-dimensional and less diversified in operations.

4. At the end of 2006, Home Depot acquired The Home Way, a Chinese home improvement retailer, including 12 stores in six cities. Although the company has placed greater emphasis on expanding internationally into emerging markets, Home Depot should take a slow and methodical approach to ensure the success of the stores abroad. Many companies have been damaged by investing in foreign countries and not taking the local cultures into account.

5. Home Depot's common shares have the potential of being hurt by sudden increases in interest rates or some other macroeconomic event that may hurt the sales, selling prices, or construction activity associated with homes.

In the ratio and growth rate analysis below, it is important to define the companies that composed the Industry and Index categories. The composition of the Industry category is a sub-industry of the S&P 500 – Consumer Discretionary sector called Specialty Retail. It consists of 18 companies within the S&P 500, as well as Tractor Supply Company. The composition of the Index category is the S&P 500 – Consumer Discretionary sector. It consists of 88 companies within the S&P 500.

RATIO AND GROWTH RATE ANALYSIS

Income / Cash Flow Performance

Sales Growth: Home Depot's rapid growth stage is over, but the company has experienced strong sales growth since 2000. It has consistently beaten the industry average over the past six years. With that being said, the strong sales growth figures for main competitor Lowe's has to be a cause for concern. In recent news, Home Depot's quarterly earnings report (3Q 2007) revealed that sales slid to $18.96 billion from last year's $19.65 billion, missing Wall Street's forecast of $19.39 billion. Lowe's quarterly earnings report (3Q 2007) revealed that sales rose to $11.57 billion from last year's $11.21 billion, missing Wall Street's forecast of $11.78 billion.

Sales Growth	'00 to '01	'01 to '02	'02 to '03	'03 to '04	'04 to '05	'05 to '06	Annual Growth '00 to '06
Home Depot	17.09%	8.77%	11.28%	12.77%	11.52%	11.44%	12.12%
Lowe's	15.63%	20.25%	18.10%	18.24%	18.59%	8.52%	16.49%
Sherwin Williams	-2.79%	2.35%	4.30%	13.06%	17.61%	8.61%	6.97%
Tractor Supply Co.	11.96%	42.39%	21.73%	18.05%	18.93%	14.58%	20.89%
Industry	6.35%	7.51%	10.22%	12.62%	7.93%	8.89%	8.90%
Index	1.14%	3.80%	6.65%	7.50%	8.07%	6.59%	5.60%

Net Income Growth: Similar to sales growth, Home Depot has experienced strong net income growth since 2000. While it has not been as high as Lowe's or Tractor Supply Co., it is important to keep in mind that Home Depot is the industry leader. While the decrease in 2006 can be attributed to various reasons, the 12.49% increase in operating expenses is the main cause. Cost of revenue increased by 12.66% and SGA expenses increased by 11.30%. This is mainly due to a shift in company philosophy of increasing employee wages and training as well as refurbishing stores across the country. Over the past two years, Home Depot has placed greater emphasis on remodeling stores and hiring master carpenters and electricians for increased customer service. The company also took a charge related to ex-CEO Bob Nardelli's $210 million severance package. In recent news, Home Depot's quarterly earnings report (3Q 2007) revealed that earnings slid to $1.09 billion, or 60 cents a share, from last year's $1.49 billion, or 73 cents a share, meeting Wall Street expectations.

Net Income Growth	'00 to '01	'01 to '02	'02 to '03	'03 to '04	'04 to '05	'05 to '06	Annual Growth '00 to '06
Home Depot	17.94%	20.37%	17.47%	16.19%	16.74%	-1.32%	14.32%
Lowe's	24.71%	46.44%	22.18%	19.92%	27.60%	12.30%	25.10%
Sherwin Williams	1545.00%	18.05%	6.89%	18.43%	17.80%	24.35%	81.72%
Tractor Supply Co.	57.32%	48.06%	50.79%	11.28%	33.70%	6.18%	33.06%
Industry	-1.78%	36.67%	22.87%	16.58%	10.58%	5.56%	14.42%
Index	-71.76%	-286.99%	-345.38%	-7.91%	4.89%	26.86%	8.01%

Profitability Measures

These financial ratios are used in assessing a company's ability to generate earnings as compared to its expenses and other relevant costs incurred during a specified period of time. In general, the higher the value is relative to a competitor, the better the company is doing.

Operating Profit Margin: Operating profit margin is a ratio used to measure a company's price strategy and operating efficiency. Home Depot's operating profit margin consistently outperformed competitors and the industry up until 2005. Since that point in time, the company has dropped below main competitor Lowe's and Sherwin Williams due to increasing operating expenses (4.4%) and declining net sales (3.5%). The decline in net sales can be attributed to a reduction in big-ticket renovation projects and a decrease in customer traffic.

Operating Profit Margin	2000	2001	2002	2003	2004	2005	2006	2007 (YTD)
Home Depot	9.2%	9.2%	10.0%	10.6%	10.8%	11.5%	10.6%	9.3%
Lowe's	7.5%	8.2%	9.8%	10.0%	10.1%	10.8%	11.0%	10.3%
Sherwin Williams	10.6%	9.4%	10.3%	10.3%	10.1%	10.1%	11.2%	11.8%
Tractor Supply Co.	4.5%	4.6%	5.3%	6.5%	5.8%	6.6%	6.2%	6.1%
Industry	8.8%	7.7%	8.6%	9.1%	9.2%	8.8%	8.8%	8.6%
Index	9.7%	7.8%	10.2%	10.6%	11.4%	11.4%	11.2%	10.4%

Net Profit Margin: Net profit margin is a ratio that measures how much out of every dollar of sales a company actually keeps in earnings. Similar to operating profit margin, Home Depot's net profit margin was higher across the board up until 2005. At that point, the company's margin dropped below competitors in 2006 and 2007 due to a drop in net sales and net income. As discussed above, the significant drop in net income was due to increased operating costs and the charge related to ex-CEO Bob Nardelli's severance package.

Net Profit Margin	2000	2001	2002	2003	2004	2005	2006	2007 (YTD)
Home Depot	5.6%	5.7%	6.3%	6.6%	6.8%	7.2%	6.3%	5.5%
Lowe's	4.3%	4.7%	5.7%	5.9%	5.9%	6.4%	6.6%	6.2%
Sherwin Williams	0.3%	5.2%	6.0%	6.1%	6.4%	6.4%	7.4%	7.7%
Tractor Supply Co.	2.2%	3.0%	3.2%	3.9%	3.7%	4.1%	3.8%	3.7%
Industry	4.6%	4.2%	5.1%	5.6%	6.0%	5.7%	5.5%	5.5%
Index	4.8%	3.8%	3.9%	6.4%	5.6%	6.4%	6.9%	5.8%

Return On Equity (ROE): Return on equity is a measure of a corporation's profitability that reveals how much profit a company generates with the money shareholders have invested. Despite the fact that Home Depot has shown steady growth in return on equity and has consistently outperformed main competitor Lowe's, it has underperformed Sherwin Williams and the Industry since 2002. The company has been aggressive in repurchasing common shares in YTD (2007) – it has reduced shareholder equity by 37.14%.

Return On Equity (ROE)	2000	2001	2002	2003	2004	2005	2006	2007 (YTD)
Home Depot	18.9%	18.4%	19.3%	20.4%	21.5%	22.9%	22.2%	21.6%
Lowe's	15.9%	16.6%	19.8%	19.5%	20.0%	21.4%	20.7%	19.4%
Sherwin Williams	1.0%	17.8%	22.0%	23.7%	25.3%	27.4%	30.9%	31.4%
Tractor Supply Co.	11.2%	15.3%	18.7%	22.2%	19.4%	20.2%	16.9%	16.6%
Industry	20.3%	16.7%	21.1%	23.6%	27.8%	27.4%	24.7%	27.4%
Index	16.2%	13.3%	20.9%	10.3%	25.4%	62.9%	14.9%	17.0%

Return On Assets (ROA): Return on assets is an indicator of how profitable a company is relative to its total assets. It gives an idea as to how efficient management is at using its assets to generate earnings. Home Depot consistently outperformed competitors in return on assets up until 2005. Since that point in time, the company has fallen behind due to a decline in net income. In recent news, Home Depot's quarterly earnings report (3Q 2007) revealed that net income has fallen 26.8% from this point last year. Besides the decrease in net sales, the reasons for the sharp decline has to do with the increased operating expenses associated with the remodeling of stores and hiring of professional workers as well as the increased interest expense associated with the large issuance of senior notes.

Return On Assets (ROA)	2000	2001	2002	2003	2004	2005	2006	2007 (YTD)
Home Depot	13.4%	12.7%	13.0%	13.4%	13.6%	14.0%	11.9%	9.9%
Lowe's	8.0%	8.0%	9.9%	10.4%	10.9%	12.1%	11.8%	10.5%
Sherwin Williams	0.4%	7.1%	8.8%	9.3%	9.9%	10.7%	12.3%	12.0%
Tractor Supply Co.	5.2%	7.7%	9.6%	11.5%	10.5%	11.5%	10.0%	9.0%
Industry	9.8%	8.2%	9.4%	9.7%	10.2%	10.2%	9.8%	9.9%
Index	5.8%	5.1%	6.0%	7.0%	7.6%	7.7%	7.5%	6.8%

Short-Term Liquidity Measures

These ratios measure the extent to which a company can quickly liquidate assets and cover short-term liabilities.

Current Ratio: The current ratio is mainly used to give an idea of the company's ability to pay back its short-term liabilities (debt and payables) with its short-term assets (cash, inventory, receivables). With the exception of Tractor Supply Co., Home Depot has a similar current ratio compared to Lowe's and Sherwin Williams. The most recent quarterly earnings release reaffirmed that current assets (14%) and current liabilities (10%) are trending downward from 3Q 2006. This is mainly attributable to a decrease in net receivables and accounts payable.

Current Ratio	2000	2001	2002	2003	2004	2005	2006	2007 (YTD)
Home Depot	1.8	1.6	1.5	1.4	1.4	1.2	1.4	1.1
Lowe's	1.4	1.6	1.6	1.6	1.2	1.3	1.3	1.2
Sherwin Williams	1.4	1.3	1.4	1.5	1.2	1.2	1.2	1.0
Tractor Supply Co.	2.2	1.9	1.8	1.9	1.9	1.8	1.9	1.9
Industry	1.6	1.7	1.8	1.8	1.8	1.7	1.7	1.7
Index	1.5	1.7	1.6	1.7	1.6	1.6	1.5	1.5

Quick Ratio (using Inventory): The quick ratio is an indicator of a company's short-term liquidity. It measures a company's ability to meet its short-term obligations with its most liquid assets. Home Depot's ability to meet short-term obligations has been steadily decreasing due mainly to strategic acquisitions for the expansion of HD Supply (e.g. Hughes Supply). Since that point in time, Home Depot has sold off the supply unit for $8.5 billion.

Quick Ratio $_1$	2000	2001	2002	2003	2004	2005	2006	2007 (YTD)
Home Depot	0.3	0.6	0.4	0.4	0.4	0.3	0.4	0.2
Lowe's	0.3	0.4	0.4	0.5	0.2	0.2	0.2	0.1
Sherwin Williams	0.8	0.8	0.8	0.9	0.7	0.7	0.8	0.6
Tractor Supply Co.	0.2	0.2	0.2	0.3	0.3	0.2	0.2	0.2
Industry	0.5	0.7	0.8	0.9	0.8	0.7	0.7	0.7
Index	0.9	1.0	1.0	1.1	1.1	1.0	1.0	0.9

Long-Term Solvency Measures

These ratios measure the ability of a corporation to meet its long-term fixed expenses and to accomplish long-term expansion and growth.

Debt to Equity: Debt-to-equity is a measure of a company's financial leverage that indicates what proportion of equity and debt the company is using to finance its assets. Up until 2005, Home Depot outperformed competitors by maintaining low debt-to-equity. This trend has been reversed over the past two due to the issuance of nearly $9 billion in Senior Notes during the fiscal year of 2006. The additional debt was primarily used for common stock repurchases and to repay outstanding commercial paper.

Debt-to-Equity	2000	2001	2002	2003	2004	2005	2006	2007 (YTD)
Home Depot	9.3	6.5	6.3	3.7	8.2	9.0	31.7	39.4
Lowe's	32.9	35.9	31.0	26.5	21.0	19.7	21.6	25.8
Sherwin Williams	29.7	25.3	27.4	25.6	22.9	22.0	12.8	13.7
Tractor Supply Co.	27.9	10.2	13.9	6.3	8.0	1.7	0.0	13.2
Industry	24.1	23.4	26.5	25.0	24.6	23.4	23.1	25.0
Index	38.4	40.0	41.5	36.0	31.6	32.3	33.4	33.6

Financial Leverage: Financial leverage ratios measure the degree to which a company is utilizing borrowed money. Leverage allows for a greater potential return to the investor than would have been otherwise unavailable. Home Depot has the reputation of being conservative in relation to financial leverage. Nevertheless, the company has recently been aggressive in repurchasing common stock. Since October of 2006, total stockholders equity is down 37.14%.

Financial Leverage	2000	2001	2002	2003	2004	2005	2006	2007 (YTD)
Home Depot	1.4	1.5	1.5	1.5	1.6	1.7	2.1	2.6
Lowe's	2.1	2.1	1.9	1.8	1.8	1.7	1.8	1.9
Sherwin Williams	2.5	2.4	2.6	2.5	2.6	2.5	2.5	2.8
Tractor Supply Co.	2.1	1.9	2.0	1.8	1.8	1.7	1.7	1.9
Industry	2.3	2.3	2.4	2.5	2.8	2.6	2.6	2.9
Index	2.8	4.0	4.4	(2.4)	5.3	5.7	1.1	5.9

Times Interest Earned (TIE): Times Interest Earned (TIE) is a metric used to measure a company's ability to meet its debt obligations. The reason behind Home Depot's high TIE from 2000 to 2005 was an undesirable lack of debt. Due to the large issuance of Senior Notes in 2006, interest expense increased by $249. The drop below Lowe's TIE in 2007 is a cause for concern.

Times Interest Earned (TIE)	2000	2001	2002	2003	2004	2005	2006	2007 (YTD)
Home Depot	201.8	178.0	159.7	111.4	114.0	65.9	24.7	13.3
Lowe's	8.1	7.9	11.4	14.0	17.0	20.5	22.0	20.4
Sherwin Williams	9.0	8.8	13.3	14.5	15.5	14.7	13.4	13.9
Tractor Supply Co.	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Industry	28.6	32.3	27.3	21.6	25.6	21.1	24.8	10.0
Index	18.3	26.6	53.8	55.4	41.7	22.9	20.4	15.9

<u>PRO FORMA INCOME STATEMENT</u> *(in millions)*

Before going into the relative and absolute valuation processes, a pro forma income statement had to be developed for 2008. To come up with an accurate and realistic sales figure for 2008, the first step was to estimate the company's market share for the year. Using a custom industry composed of Home Depot and five competitors, the sales figures for all of the companies were compiled from 2000 to 2007 (YTD). The sales estimates for the five competitors were then obtained from FactSet for 2008. The total sums of the sales figures were then calculated for each year (e.g. $108,881 for 2007).

Sales	2000	2001	2002	2003	2004	2005	2006	2007	2008 (Forecast)
Home Depot	45,738	53,553	58,247	64,816	73,094	81,511	90,837	59,690	76,480
Lowe's	18,779	21,714	26,112	30,838	36,464	43,243	46,927	37,904	51,648
Sherwin Williams	5,212	5,066	5,185	5,408	6,114	7,191	7,810	6,151	8,298
Tractor Supply Co.	759	850	1,210	1,473	1,739	2,068	2,370	1,980	3,048
Building Materials Holding	1,014	1,093	1,162	1,415	2,091	2,912	3,245	1,866	1,955
Builders FirstSource	N/A	N/A	1,500	1,675	2,058	2,338	2,240	1,290	1,488
Total	**71,501**	**82,276**	**93,415**	**105,625**	**121,560**	**139,263**	**153,428**	**108,881**	**142,917**

Using the sales figures, the relative market share for each company was calculated as well as the average change in growth from 2000 to 2007. Home Depot's 2008 forecasted market share was determined by adding the average change in growth from 2000 to 2007 to the 2007 (YTD) market share of the company. At the end of the process, the Home Depot's target market share for 2008 came out to be 53.51%. Using this market share, Home Depot's sales figure forecast for 2008 was calculated as $76,480.

Market Share	2000	2001	2002	2003	2004	2005	2006	2007	2008 (Forecast)
Home Depot	63.97%	65.09%	62.35%	61.36%	60.13%	58.53%	59.20%	54.82%	53.51%
Lowe's	26.26%	26.39%	27.95%	29.20%	30.00%	31.05%	30.59%	34.81%	36.03%
Sherwin Williams	7.29%	6.16%	5.55%	5.12%	5.03%	5.16%	5.09%	5.65%	5.42%
Tractor Supply Co.	1.06%	1.03%	1.30%	1.39%	1.43%	1.48%	1.54%	1.82%	1.93%
Building Materials Holding	1.42%	1.33%	1.24%	1.34%	1.72%	2.09%	2.12%	1.71%	1.76%
Builders FirstSource	N/A	N/A	1.61%	1.59%	1.69%	1.68%	1.46%	1.18%	1.10%

Cost of goods sold for 2008 was calculated using the historical average of COGS as a percentage of sales as well as net sales. Operating expenses for 2008 was calculated using the historical average of operating expenses as a percentage of sales as well as net sales. Interest income for 2008 was estimated upward to $70 million based on the average and median from 2002 to 2007. After omitting 2006, which was an inconsistent figure compared to past years, the average and median came out to be $62 million and $64.6 million, respectively. Based on the immense increase in interest income during 2007 (YTD), the decision was made to slightly increase the estimate for 2008. Interest expense for 2008 was calculated using a weighted average of Senior Notes issued in March and December of 2006 (5.691%). Due to the fact that realized tax rates have stayed relatively consistent since 2000, the average of the past seven years (37.56%) was used. The forecast for diluted shares is purely an estimate based on the transcript for the quarterly earnings report made on November 13, 2007. Despite only completing half of the $22.5 billion recapitalization plan, Frank Blake (new Home Depot CEO) emphasized that the company was going to take a "cautious stance" regarding the completion of the program in 2008.

This is the reasoning behind the conservative forecast regarding diluted shares. After all of the forecasting and estimates, the projected EPS estimate for 2008 came out to be $2.52.

Home Depot

2007 Pro Forma

Market Share	58.53%	59.20%	54.82%	53.51%
	2005	**2006**	**2007 (YTD)**	**2008 (Forecast)**
Net Sales	81,511.0	90,837.0	59,690.0	76,480.0
COGS	55,663.0	62,816.0	40,997.0	52,874.61
Gross Profit	25,848.0	28,021.0	18,693.0	23,605.39
Gross Profit Margin	*31.71%*	*30.85%*	*31.32%*	*30.86%*
Total COGS as % of Sales	68.29%	69.15%	68.68%	69.14%
Operating Expenses	16,485.0	18,348.0	12,700.0	15,769.71
Opr Exp as % of COGS	29.62%	29.21%	30.98%	29.82%
Opr Exp as % of Sales	20.22%	20.20%	21.28%	20.62%
Operating Income	9,363.00	9,673.00	5,993.00	7,835.69
Other Income (Expense)				
Interest Income	62.0	27.0	67.0	70.0
Interest Expense	(143.0)	(392.0)	(497.0)	(662.5)
Net Interest Income (Expense)	(81.0)	(365.0)	(430.0)	(592.5)
Gain on sales of prop/equip	0.0	0.0	0.0	0.0
Other, Net	0.0	0.0	0.0	0.0
EBT	9,282.0	9,308.0	5,563.0	7,243.2
Income Taxes	3,444.0	3,547.0	2,024.0	2,720.54
EAT	5,838.0	5,761.0	3,539.0	4,522.66
Net Income	5,838.0	5,761.0	3,724.0	4,522.66
Diluted Shares (millions)	2,147.0	2,062.0	1,815.0	1,795.0
	(69.00)	(85.00)	(247.00)	(20.00)
EPS	2.72	2.79	1.84	2.52
Realized Tax Rates	37.10%	38.11%	36.38%	37.56%

RELATIVE VALUATION

After calculating the EPS estimate for 2008, the next step in the process was performing the relative valuation for Home Depot. To calculate the relative valuation, the price-to-earnings ratios for Home Depot, Lowe's, Sherwin Williams, Tractor Supply Co., the Industry, and the Index from 2000 to 2007 had to be retrieved. These numbers were obtained from FactSet. At this point, it is important to note that 2000 and 2001 was omitted from the relative valuation based on the fact that numbers did not correlate with the more current information. For example, Home Depot's average P/E ratio for 2000 to 2001 was 42.05 compared to 15.67 for 2002 to 2007. The industry's average P/E ratio for 2000 to 2001 was 70.65 compared to 24.77 for 2002 to 2007. Whereas the forecasting for Home Depot's price-to-earnings ratio for 2008 was determined by using the current stock price ($29.49) and the pro forma income statement's EPS estimate ($2.52), the estimated 2008 ratios for HD's competitors as well as the industry and index were obtained directly from FactSet.

P/E	2002	2003	2004	2005	2006	2007	2008	Arithmetic Average 2002-2007	Median 2002-2007
Home Depot	13.4	20.1	18.7	15.7	14.9	11.2	11.70	15.67	15.30
Lowe's	20.1	24.3	22.5	19.8	16.7	11.3	12.5	19.12	19.95
Sherwin Williams	13.7	15.7	16.5	16.0	17.3	12.9	12.1	15.35	15.85
Tractor Supply Co.	23.6	28.6	25.0	27.2	22.4	16.4	14.4	23.87	24.30
Industry	21.1	31.1	21.8	29.2	31.5	13.9	14.7	24.77	25.50
Index	25.9	41.3	26.7	24.4	25.2	20.9	15.7	27.40	25.55

Using the three competitors, the industry (Specialty Retail in S&P 500 Consumer Discretionary), and the index (S&P 500 Consumer Discretionary) as benchmarks for The Home Depot, historical relationships were established for each year 2002 through 2008.

Historical Relationships	2002	2003	2004	2005	2006	2007	2008	Arithmetic Average 2002-2007	Median 2002-2007
HD / LOW	0.667	0.827	0.831	0.793	0.892	0.991	0.936	0.83	0.83
HD / SHW	0.978	1.280	1.133	0.981	0.861	0.868	0.967	1.02	0.98
HD / TSCO	0.568	0.703	0.748	0.577	0.665	0.683	0.813	0.66	0.67
HD / Industry	0.635	0.646	0.858	0.538	0.473	0.806	0.796	0.66	0.64
HD / Index	0.517	0.487	0.700	0.643	0.591	0.536	0.745	0.58	0.56

Five price estimates were determined by using the 2008 benchmark P/E ratio, the historical relative proportions, and the expected 2008 EPS of $2.52, respectively.

E[EPS2008]	$2.52	
Price Estimates (2008)	**using Average**	**using Median**
HD / LOW	26.252	26.113
HD / SHW	31.007	29.867
HD / TSCO	23.849	24.456
HD / Industry	24.418	23.730
HD / Index	22.911	22.294
	$25.69	**$25.29**

The average of the price estimates using both the average and median benchmark ratios produce price estimates that are below Home Depot's current stock price (12/07/2007) of $29.49, revealing the company's stock to be slightly overvalued.

ABSOLUTE VALUATION

In absolute valuation, the value of an asset is determined by estimating the expected future cash flows from owning the asset and discounting them to their present value. The Dividend Discount Model was used in the absolute valuation of Home Depot to develop estimates of the intrinsic value of the stock. The first step in this valuation is to obtain the cost of capital (k). In this case, we determined two different costs of capital to provide different price perspectives.

The first cost of capital was established by utilizing the CAPM model. The risk-free rate was determined by using the yield to maturity on a 10-Year Treasury Strip. The beta (β) for Home Depot was obtained by using the Bloomberg terminals in the Financial Lab. The market risk premium was taken as a historical average. These variables were inserted into the CAPM formula: **k = risk-free rate + beta (market risk premium)**. This yielded a cost of capital of 13.051%.

Cost of Capital (k_1)	
10-Year Treasury Strip	4.360
Beta (β)	1.337
Market Risk Premium	6.500
CAPM (k_1) =	**13.051%**

A second cost of capital was calculated by taking an equity risk premium and adding it to Home Depot's yield to maturity on a bond expiring in March of 2016. This "nine year bond" was not the optimal choice, but Home Depot is not currently offering a bond maturing in ten years. Our second cost of capital was determined to be 9.396%.

Cost of Capital (k_2)	
HD 5.400% 3/01/2016	6.396
Equity Risk Premium	3.000
Utendahl (k_2) =	**9.396%**

The next step in utilizing the Dividend Discount Model was determining an estimate of 2008 dividends per share. This was established by obtaining dividends (DPS) and earnings (EPS) from 1996 through 2007. It must be noted that the EPS figure for 2007 ($2.34) was calculated by using an estimate for the final quarter's EPS and adding it onto the EPS figures for the three previous quarters. This estimate was obtained from FactSet. Whereas the typical method of calculating DPS is to go about estimating the payout ratio for the year, this absolute valuation was done by estimating the DPS for 2008 and calculating the payout ratio. Over the past few years, Home Depot has developed a history of increasing dividend payouts by 50%. The dividend was increased from $0.10/share to $0.15/share. It was then increased from $0.15/share to $0.225/share. Due to the shaken investor confidence in the housing market, it is my expectation that Home Depot will follow this trend by increasing it to $0.3375 in the third dividend payout of the year. If this were to be the case, the DPS would increase from $0.90 in

2007 to $1.125 in 2008. After dividing the estimated DPS ($1.125) by the estimated EPS ($2.52), the payout ratio was calculation as being 44.643% for 2008.

	1996	1997	1998	1999	2000	2001
EPS	0.43	0.52	0.71	1.00	1.10	1.29
DPS	$0.051	$0.063	$0.077	$0.113	$0.160	$0.170
Payout Ratio	11.860%	12.115%	10.845%	11.300%	14.545%	13.178%

	2002	2003	2004	2005	2006	2007	2008
EPS	1.56	1.88	2.26	2.72	2.79	2.34	2.52
DPS	$0.210	$0.260	$0.325	$0.400	$0.675	$0.900	$1.125
Payout Ratio	13.462%	13.830%	14.381%	14.706%	24.194%	38.462%	44.643%

The average annual growth rate of The Home Depot's DPS was then calculated for 1997 to 2007, 2002 to 2007, and 2003 to 2007.

Average Annual Growth DPS		
1997-2007	2002-2007	2003-2007
0.305	0.338	0.364

Despite the higher four year average, it was decided to take the cautious approach and use the average of the ten year, five year, and four year average annual growth DPS to determine the growth from 2008 to 2012. A projected growth rate of 0.335 was then applied to 2008 expected DPS to determine the DPS in 2009 to 2012.

	2008	2009	2010	2011	2012
DPS	$1.125	$1.502	$2.006	$2.680	$3.579

Using the projected 2012 DPS, estimates for 2013 DPS were calculated by applying different growth rate scenarios from 1% to 9%.

Growth rate (g)	2013 DPS Estimate
1.00%	3.614
2.00%	3.650
3.00%	3.686
4.00%	3.722
5.00%	3.758
6.00%	3.793
7.00%	3.829
8.00%	3.865
9.00%	3.901

Then, the intrinsic value of the Home Depot stock as of 2012 was determined by applying the constant growth version of the Dividend Discount Model to the estimated 2013 DPS. This was executed using both the CAPM cost of capital (k_1) and the second cost of capital (k_2).

Growth rate (g)	PV 2012 DPS (k_1)	PV 2012 DPS (k_2)
1.00%	29.994	43.050
2.00%	33.033	49.354
3.00%	36.675	57.630
4.00%	41.123	68.974
5.00%	46.676	85.478
6.00%	53.803	111.702
7.00%	63.287	159.816
8.00%	76.527	276.861
9.00%	96.303	985.042

To assess the intrinsic value of the stock at 2007, the forecasted DPS from 2008 through 2012 were discounted by the two different costs of capital, along with the 2012 lump sum values determined under varying growth rate assumptions from 1% to 9%.

Growth rate (g)	PV 2007 DPS (k_1) =	2008	2009	2010	2011	2012
1.00%	23.381	0.995	1.176	1.389	1.641	18.181
2.00%	25.027	0.995	1.176	1.389	1.641	19.827
3.00%	26.999	0.995	1.176	1.389	1.641	21.799
4.00%	29.408	0.995	1.176	1.389	1.641	24.208
5.00%	32.415	0.995	1.176	1.389	1.641	27.215
6.00%	36.275	0.995	1.176	1.389	1.641	31.075
7.00%	41.411	0.995	1.176	1.389	1.641	36.211
8.00%	48.581	0.995	1.176	1.389	1.641	43.381
9.00%	59.291	0.995	1.176	1.389	1.641	54.091

Growth rate (g)	PV 2007 DPS (k_2) =	2008	2009	2010	2011	2012
1.00%	35.448	1.028	1.255	1.533	1.871	29.761
2.00%	39.472	1.028	1.255	1.533	1.871	33.785
3.00%	44.754	1.028	1.255	1.533	1.871	39.067
4.00%	51.994	1.028	1.255	1.533	1.871	46.307
5.00%	62.528	1.028	1.255	1.533	1.871	56.841
6.00%	79.266	1.028	1.255	1.533	1.871	73.578
7.00%	109.975	1.028	1.255	1.533	1.871	104.287
8.00%	184.679	1.028	1.255	1.533	1.871	178.991
9.00%	636.677	1.028	1.255	1.533	1.871	630.990

With a current stock price of $29.49, using the CAPM cost of capital, Home Depot is revealed to be overvalued at any dividend growth rate 4% and under and undervalued at any growth rate 5% and over. Our second cost of capital shows Home Depot stock to be undervalued in general.

According to this model, using the CAPM cost of capital, the growth rate must be 4.03% in order for the results of this model to reach the company's current market price. Using the second cost of capital requires a growth rate of (1.10%).

Growth rate (g)	PV 2007 DPS (k_1) =	2008	2009	2010	2011	2012
4.03%	$29.490	0.995	1.176	1.389	1.641	24.290

Growth rate (g)	PV 2007 DPS (k_2) =	2008	2009	2010	2011	2012
-1.10%	$29.490	1.028	1.255	1.533	1.871	23.802

Recommendation

After my thorough analysis of Home Depot, I have come to the conclusion that it would be best to HOLD this stock in the Student Managed Investment Fund. Although the company's market share has continued to decrease year-after-year to Lowe's, Home Depot has remained the nation's largest home improvement retailer. It is also important to point out that the company is under new leadership with the recent ousting of ex-CEO Bob Nardelli. Contrary to Nardelli's vision of a General Electric-type conglomerate, Frank Blake (new Home Depot CEO) is more concerned with the retail aspect of the business. Whereas Nardelli favored slim store staffs consisting of part-time employees, Blake has put greater emphasis on the hiring of a full-time staff and paying them accordingly. According to chief financial offer Carol Tomé, this initiative had led to employee turnover being down 24% on the year. Despite all of the housing market troubles, the company's management has continued to put money towards remodeling stores and hiring master carpenters and electricians to help in consumer satisfaction. While the company may have passed on a tremendous money-making opportunity in selling HD Supply, this further shows that the primary focus has been shifted to the consumer at The Home Depot Stores.

The ratio analysis has shown tremendous results for Home Depot up until 2005. As explained in the research report above, these ratios have been skewed in 2006 and 2007 due mainly to a few significant company decisions. These decisions include the purchase of Hughes Supply and subsequent sale of HD Supply for $8.5 billion, the issuance of $9 billion in Senior Notes in March and December of 2006, and the massive $22.5 planned recapitalization plan in 2007. Traditionally speaking, the company has shown strong profitable ratios by outperforming the competitors and industry in net profit margin and return on equity. The company also has traditionally had stronger liquidity ratios and long-term solvency than the other competitors analyzed. While Home Depot has customarily been fiscally conservative and not borrowed much debt in the past, this trend has been overturned by the recent increases in debt-to-equity and financial leverage. The company has steadily increased dividends for the past 80 quarters, signifying the company's capability of providing constant returns for shareholders. Another important aspect to consider is that throughout all of the housing market troubles, there has not been any speculation concerning a possible dividend cut. My relative valuation reveals the company's stock to be slightly overvalued. The results of my absolute valuation are mixed. The dividend growth rates that the stock must produce in order to sustain its current stock price are 4.03% (using the CAPM cost of capital) and (1.10%) (using the second cost of capital). These rates are both significantly below the current as well as the forecasted annual dividend growth rates.

The last aspect to keep in mind is the recent acquisition of China's The Home Way. It has been estimated that operating profits have received an 11% contribution from the stores in Canada and China. While management has taken a patient approach in regards to further expansion, company insiders are aware of Blake's vision of international expansion for the company. The plan to venture into emerging markets is a testament to how confident management is that they will return strong from the current housing market turmoil.

Note: After having a thorough discussion about the prospects of Home Depot with the other students in SMIF, I have maintained a HOLD rating on the stock. Nevertheless, I have decided to loosen my stance regarding the ownership of the security in light of the fact that the class was pessimistic about the company's future. Therefore, I have agreed to a SELL rating if, and only if, the stock was to go under the price of $23.

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