

Home Depot				
Income Statement				
(\$U.S. millions)				
	2/1/2009	2/3/2008	1/28/2007	1/29/2006
Net sales	71,288	77,349	90,837	81,511
Cost of merchandise sold	(47,298)	(51,352)	(61,054)	(54,191)
Selling, general & administrative expenses	(17,846)	(17,053)	(18,348)	(16,485)
Depreciation & amortization expense	(1,785)	(1,702)	(1,762)	(1,472)
Total operating expenses	(19,631)	(18,755)	(20,110)	(17,957)
Operating income	4,359	7,242	9,673	9,363
Interest & investment income	18	74	27	62
Interest expense	(624)	(696)	(392)	(143)
Other expenses	(163)	0	0	0
Earnings before provision for income taxes	3,590	5,905	9,308	9,282
Current income taxes	(1,566)	(2,650)	(3,569)	(4,057)
Deferred income taxes	288	240	22	613
Income taxes	(1,278)	(2,410)	(3,547)	(3,444)
Earnings from continued operations	2,312	4,210	-	-
Earnings from discontinued operations	(52)	185	-	-
Net earnings	2,260	4,395	5,761	5,838
Weighted average common shares	1,682	1,849	2,054	2,138
Basic earnings per share	1.34	2.38	2.80	2.73

Home Depot				
Balance Sheet				
(\$U.S. millions)				
	2/1/2009	2/3/2008	1/29/2007	1/29/2006
Assets:				
Cash & cash equivalents	519	445	600	793
Short-term investments	6	12	14	14
Receivables, net	972	1,259	3,223	2,396
Merchandise inventories	10,673	11,731	12,822	11,401
Other current assets	1,192	1,227	1,341	742
Total current assets	13,362	14,674	18,000	15,346
Land	8,301	8,398	8,355	7,924
Buildings	16,961	16,642	15,215	14,056
Furniture, fixtures & equipment	8,741	8,050	7,799	7,073
Leasehold improvements	1,359	1,390	1,391	1,207
Construction in progress	625	1,435	1,123	843
Capital leases	490	497	475	427
Property & equipment, at cost	36,477	36,412	34,358	31,530
Less: Accumulated depreciation & amortization	10,243	8,936	7,753	6,629
Net property & equipment	26,234	27,476	26,605	24,901
Notes receivable	36	342	343	348
Goodwill	1,134	1,209	6,314	3,286
Other assets	398	623	1,001	601
Total assets	41,164	44,324	52,263	44,482

Home Depot				
Balance Sheet				
(\$U.S. millions)				
	2/1/2009	2/3/2008	1/28/2007	1/29/2006
Liabilities:				
Short-term debt	0	1,747	0	900
Accounts payable	4,822	5,732	7,356	6,032
Accrued salaries & related expenses	1,129	1,094	1,295	1,176
Sales taxes payable	337	445	475	488
Deferred revenue	1,165	1,474	1,634	1,757
Income taxes payable	289	60	217	388
Current installments of long-term debt	1,767	300	18	513
Other accrued expenses	1,644	1,854	1,936	1,647
Total current liabilities	<u>11,153</u>	<u>12,706</u>	<u>12,931</u>	<u>12,901</u>
Senior notes	10,998	10,966	10,931	2,492
Capital lease obligations	417	415	419	381
Other long-term debt	19	302	311	312
Long-term debt, before current installments	<u>11,434</u>	<u>11,683</u>	<u>11,661</u>	<u>3,185</u>
Less: Current installments of long-term debt	1,767	300	18	513
Long-term debt, excl current installments	<u>9,667</u>	<u>11,383</u>	<u>11,643</u>	<u>2,672</u>
Other long-term liabilities	2,198	1,833	1,243	977
Deferred income taxes	369	688	1,416	1,023
Total liabilities	<u>23,387</u>	<u>26,610</u>	<u>27,233</u>	<u>17,573</u>
Owners Equity:				
Common stock	85	85	121	120
Paid-in capital	6,048	5,800	7,930	7,287
Retained earnings	12,093	11,388	33,052	28,943
Accumulated other comprehensive income (loss)	(77)	755	310	409
Unearned compensation	0	0	0	(138)
Treasury stock, at cost	(372)	(314)	(16,383)	(9,712)
Total stockholders' equity	<u>17,777</u>	<u>17,714</u>	<u>25,030</u>	<u>26,909</u>

Liquidity

- ◆ Liquidity refers to the firm's ability to fund its current operations. There are two common measures used to analyze liquidity.

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

where Current Assets include Cash, Marketable Securities, Inventory, Accts Receivable, and Other Current Assets and Current Liabilities are liabilities due within the next year.

$$\text{Quick Ratio} = \frac{\text{Cash and Marketable Securities}}{\text{Current Liabilities}}$$

- ◆ For firms with negative earnings, the potential for cash flow problems can also be identified using the Cash Burn Rate:

$$\text{Cash Burn Rate} = \frac{\text{Cash}}{\text{EBITDA}} \quad \text{where EBITDA} < 0$$

Leverage and Solvency

- ◆ To what extent is the firm using debt vs. equity financing and is the firm able to meet its debt obligations?

$$\text{Debt to Capital} = \frac{\text{Debt}}{\text{Debt} + \text{Equity}} \qquad \text{Debt to Equity} = \frac{\text{Debt}}{\text{Equity}}$$

$$\text{Times Interest Earned} = \frac{\text{EBIT}}{\text{Interest Expense}}$$

- ◆ Note that we can also write:

$$\text{Debt to Capital} = 1 - \frac{1}{\left(1 + \frac{\text{Debt}}{\text{Equity}}\right)} \qquad \text{Debt to Equity} = \frac{\text{Debt to Capital}}{1 - \text{Debt to Capital}}$$

Liquidity and Leverage for Home Depot

- ◆ Calculate each of the liquidity and leverage measures using Home Depot's Financial Statements (use beginning period or average balance sheet values when comparing income statement and balance sheet numbers).

- ◆ Liquidity:

$$\text{Current Ratio} = \frac{13362}{11153} = 1.198$$

$$\text{Quick Ratio} = \frac{519 + 6}{11153} = 0.047$$

- ◆ Leverage:

$$\text{Debt to Capital} = \frac{11434}{11434 + 17777} = 39.14\%$$

$$\text{Debt to Equity} = \frac{11434}{17777} = 64.32\%$$

$$\text{Times Interest Earned} = \frac{4359}{624} = 6.99$$

Efficiency

- ◆ How effective is the firm in using its assets to generate sales and in turning sales into cash?

$$\text{Inventory Turnover} = \frac{\text{Cost of Goods Sold}}{\text{Inventory}}$$

$$\text{Days in Inventory} = \frac{\text{Inventory}}{\text{Avg Daily COGS}} = \frac{365}{\text{Inv TO}}$$

$$\text{Accts Rec Turnover} = \frac{\text{Sales}}{\text{Accts Rec}}$$

$$\text{Avg Collection Period} = \frac{\text{Accts Rec}}{\text{Avg Daily Sales}} = \frac{365}{\text{Accts Rec TO}}$$

$$\text{Accts Payable Turnover} = \frac{\text{COGS}}{\text{Accts Pay}}$$

$$\text{Avg Payable Days Outst} = \frac{\text{Accts Pay}}{\text{Avg Daily COGS}} = \frac{365}{\text{Accts Pay TO}}$$

$$\text{Total Asset Turnover} = \frac{\text{Sales}}{\text{Total Assets}}$$

$$\text{LT Operating Asset Turnover} = \frac{\text{Sales}}{\text{LT Operating Assets}}$$

Efficiency for Home Depot

- ◆ Calculate each of the efficiency measures using Home Depot's Financial Statements (use beginning period or average balance sheet values when comparing income statement and balance sheet numbers).

$$\text{Inventory Turnover} = \frac{47298}{11731} = 4.032$$

$$\text{Days in Inventory} = \frac{365}{4.032} = 90.528$$

$$\text{Accts Rec Turnover} = \frac{71288}{1259} = 56.623$$

$$\text{Avg Collection Period} = \frac{365}{56.623} = 6.446$$

$$\text{Accts Payable Turnover} = \frac{47298}{5732} = 8.252$$

$$\text{Avg Payable Days Outst} = \frac{365}{8.252} = 44.234$$

$$\text{Total Asset Turnover} = \frac{71288}{44324} = 1.608$$

$$\text{LT Operating Asset Turnover} = \frac{71288}{27476} = 2.595$$

Profitability

- ◆ Profitability relative to sales:

$$\text{Gross Profit Margin} = \frac{\text{Sales} - \text{COGS}}{\text{Sales}} \qquad \text{Net Profit Margin} = \frac{\text{Net Income}}{\text{Sales}}$$

$$\text{Operating Margin} = \frac{\text{Operating Profit}}{\text{Sales}} = \frac{\text{EBIT}(1-T)}{\text{Sales}}$$

- ◆ Profitability relative to assets (or sources of capital):

$$\text{Return on Assets (ROA)} = \frac{\text{Net Income}}{\text{Total Assets}} \quad \text{or} \quad \frac{\text{EBIT}(1-T)}{\text{Total Assets}}$$

$$\text{Return on Equity (ROE)} = \frac{\text{Net Income}}{\text{Book Value of Equity}}$$

$$\text{Return on Capital (ROC)} = \frac{\text{Net Operating Profit}}{\text{Operating Capital}} = \frac{\text{EBIT}(1-T)}{\text{Debt} + \text{Equity}}$$

Profitability (continued)

- ◆ Return on Capital can be decomposed as follows:

$$\begin{aligned} \text{Return on Capital (ROC)} &= \frac{\text{EBIT}(1-T)}{\text{Book Value of Capital}} = \left(\frac{\text{EBIT}(1-T)}{\text{Sales}} \right) \times \left(\frac{\text{Sales}}{\text{Book Value of Capital}} \right) \\ &= \text{After-tax Operating Margin} \times \text{Capital Turnover Ratio} \end{aligned}$$

- ◆ Return on Equity can be decomposed as follows:

$$\begin{aligned} \text{Return on Equity (ROE)} &= \frac{\text{Net Income}}{\text{Book Value of Equity}} = \frac{\text{Net Income}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Total Assets}} \times \frac{\text{Total Assets}}{\text{Equity}} \\ &= \text{Profit Margin} \times \text{Asset Turnover} \times \text{Financial Leverage} \end{aligned}$$

$$\begin{aligned} \text{Return on Equity (ROE)} &= \frac{\text{Net Income}}{\text{Book Value of Equity}} = \text{ROC} + \frac{\text{Debt}}{\text{Equity}} (\text{ROC} - i(1-T)) \\ &= \text{ROC} + (\text{Leverage} \times \text{Spread}) \end{aligned}$$

Profitability for Home Depot

- ◆ Calculate Return on Capital and its components using Home Depot's financial statements.

$$\text{Return on Capital (ROC)} = \frac{4359(1-.356)}{13430+17714} = \left(\frac{4359(1-.356)}{71288} \right) \times \left(\frac{71288}{13430+17714} \right)$$

$$= 9.01\% = 3.94\% \times 2.289$$

- ◆ Calculate Return on Equity and its components using Home Depot's financial statements.

$$\text{Return on Equity (ROE)} = \frac{2312}{17714} = \left(\frac{2312}{71288} \right) \times \left(\frac{71288}{44324} \right) \times \left(\frac{44324}{17714} \right)$$

$$= 13.05\% = 3.24\% \times 1.608 \times 2.502$$

$$\text{Return on Equity (ROE)} = \frac{2312}{17714} = 9.01\% + \frac{13430}{17714} (9.01\% - 5.73\% (1-.356))$$

$$= 13.05\% = 9.01\% + 75.82\% (9.01\% - 3.69\%)$$

Financial Ratios for Home Depot

	Comparable Firms (FY 08)	Lowe's (FY 08)	Home Depot Ratios			
			Fiscal 2008 (2/1/2009)	Fiscal 2007 (2/3/2008)	Fiscal 2006 (1/28/2007)	Fiscal 2005 (1/29/2006)
Liquidity:						
Current Ratio	1.56	1.15	1.198	1.155	1.392	1.190
Quick Ratio	0.42	0.08	0.047	0.036	0.047	0.063
Leverage/Solvency:						
Debt/Capital	32.25%	25.13%	39.14%	43.12%	31.78%	13.18%
Debt/Equity	121.80%	33.56%	64.32%	75.82%	46.59%	15.18%
Times Interest Earned	-	-	6.986	10.405	24.676	65.476
Efficiency:						
Inventory Turnover	-	-	4.032	4.005	5.355	5.378
Days in Inventory	97.27	90.74	90.528	91.136	68.159	67.866
Accts Rec Turnover	-	-	56.623	23.999	37.912	54.377
Avg Collection Period	15.19	-	6.446	15.209	9.628	6.712
Total Asset Turnover	2.07	1.42	1.608	1.480	2.042	2.095
LT Asset Turnover	-	-	2.595	2.907	3.648	3.587
Capital Turnover	-	-	2.425	2.108	3.018	3.097
Profitability:						
Net Margin	0.53%	4.55%	3.24%	5.44%	6.34%	7.16%
Gross Margin	29.95%	34.21%	33.65%	33.61%	32.79%	33.52%
Operating Margin	-	-	3.94%	5.54%	6.59%	7.22%
ROA	1.37%	6.91%	6.33%	8.20%	13.46%	15.14%
ROC	11.59%	10.31%	9.01%	11.68%	19.89%	22.38%
ROE	2.82%	12.85%	13.05%	16.82%	21.41%	24.17%
Effective Tax Rate	41.62%	37.39%	35.60%	40.81%	38.11%	37.10%