Financial Statement Analysis

Home Depot (HD), Lowe’s (LOW), Lumber Liquidators (LL)

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**Industry Profile**

There are many stores in the home improvement sector such as Home Depot, Lowe’s, True Value, Ace Hardware, Menards, and Lumber Liquidators. Home Depot, Lowe’s, and Lumber Liquidators will be discussed in further details in this analysis. This industry includes about 22,000 single location companies and units of multi-location companies, with a combined income of about $190 billion. With increased home re-modeling, repair, and new homebuilding, this industry has seen an escalation in sales. For companies to be profitable in this industry they must have competitive pricing, effective marketing, and efficient and effective supply chain management. Large Companies are able to contend because they offer wide selections of products, supply high volumes of items to builders, and have the ability to provide financing to their customers. Smaller companies compete based on their customer service strengths, specialty products, and quality products (Hoovers, 2017).

**Home Depot**

The Home Depot, Inc. incorporated on June 29, 1978. The Company sells many different types of building materials, home improvement items, lawn and garden products, and provides various services to their customer base. As of January 2017, the company had approximately 2,278 stores located throughout the United States, including the Commonwealth of Puerto Rico and the territories of the United States Virgin Islands and Guam, Canada and Mexico(Reuters, 2017).

The company focuses on 3 main customers. The do it yourself (DIY) customers, do it for me customers (DIFM), and professional customers. DIY customers purchase supplies at their local stores or online and attempt to complete home projects by themselves. The Company also offers a range of clinics and workshops to convey project knowledge. DIFM customers are current home owners purchasing materials themselves and hiring other third parties to complete the project or installation. The Home Depot also offers installation. They can provide estimates as well as finishing full projects at homes. Professional customers are primarily professional renovators/remodelers, general contractors, repairmen, installers, small business owners and tradesmen (Reuters, 2017).

Home Depot also provides financing for their customers by offering third party credit providers. Some of their main product lines include Husky, Everbilt, Hampton Bay lighting, Vigoro, and HDX storage. The company is also cognizant of the environment. Through the Company's Eco Options program, it has created product categories that allow consumers to identify products that meet specifications for energy efficiency, water conservation, healthy home, clean air, and sustainable forestry (Reuters, 2017).

**Lowe’s**

Lowe’s Companies, Inc. (Lowe's), incorporated on August 1, 1952. The Company operates approximately 1,860 home improvement and hardware stores. The Company serves a similar customer base to Home Depot. They serve homeowners, potential home buyers, renters and professional customers. The professional customers mainly consist of home builders, maintenance, and repair work (Reuters, 2017).

The Company offers a range of products for building, remodeling, repair, and maintenance. The Company's home improvement stores stock approximately 36,000 items, with a range of additional items available through its Special Order Sales system, Lowe’s.com, Lowe’s.ca and ATGstores.com. Their products includes but are not limited to tools, lumber, lawn and garden, seasonal, paint, and flooring (Reuters, 2017).

Lowe’s carries product lines such as Valspar paints, Samsung, Sylvania light bulbs, Pella windows and doors, LG, Kobalt tools, Harbor Breeze fans. This company has a large base of suppliers across the world. They have approximately 7,500 suppliers (Reuters, 2017).

**Lumber Liquidators**

Lumber Liquidators Holdings, Inc., incorporated on November 12, 2009, is more of a specialty store than its competitors, Home Depot and Lowe’s. The company specializes in flooring, including hardwood, laminate, and vinyl. The company's product categories encompasssolid and engineered hardwood; laminate; bamboo, cork, vinyl plank, moldings and accessories, and non-merchandise service.

The company provides in-home delivery and installation services to its customer base, this is a major portion of their work. They sell primarily to homeowners and contractors. Lumber Liquidators has approximately 383 store locations in primary or secondary metropolitan areas. Their flooring options are available in several shapes and sizes. They offer flooring enhancements, installation services, tools, and other processing services involved in flooring. They offer over 400 flooring product (Reuters, 2017).

**Competitive Positions**

The table located on page 7 shows where the publically traded home improvement stores are ranked based on market capitalization. Market Capitalization (Cap) is the total dollar market value of a company’s outstanding shares. To calculate it, multiply a company’s shares by their current market price. This number is used to find where a company is “ranked” against its peers. Home Depot shows the highest Market Cap of $176,632 Mil, Lowe’sis second with $62,168 Mil, and Lumber Liquidators is ninth with $1,000 Mil. Home Depot also has the highest Net Income amongst the 3, but is behind Nitori Holdings. The Price to Sale ratio (P/S) is an indicator of value placed on each dollar of a company’s revenues. Home Depot has a higher P/S than Lowe’s or Lumber Liquidators, which can signify overvaluation, but in this case, it is only slightly above the average for the industry, so investors should not be alarmed. Home Depot also has the highest Price to Book ratio (P/B) which shows market price divided by book value. This could again show an overvaluation. Lowe’s and Home Depot are very similar with their Price to Earnings Ratio (P/E) which is market value per share divided by earning per share. This is also in line with the industry average, so no overvaluation. Home Depot has a high debt to equity Ratio (D/E), while Lowe’s is right on average, and Lumber Liquidators is well below average. A high debt to equity ratio could indicate that a company may not be able to satisfy their debts, which in this case does not seem accurate. Lumber Liquidators, showing the low debt to equity ratio is showing that they are able to satisfy their debts, but is the lack of third party financing hurting their ability to expand and grow (Morningstar, 2017)? Is this ratio a good indicator for investors?

While this table is not an all-inclusive way to show industry leaders, it does point to Home Depot holding that position. Another interesting company is Menards, they are an industry leader, but are privately traded, and were not used in this analysis. It seems like this company could be a major player in dethroning Home Depot. Everywhere I drive, I see a new, large, beautiful Menards store being build. They are definitely a force to be reckoned with. On the next page, the table breaks down the above discussion.



**Financial Statement Summary**

The full income statements and balance sheets are located in Appendices A, B, and C. This is a brief snapshot of those statements. As you can see in the incomes statement, Home Depot is producing revenues, expending more to earn their revenues, and producing higher gross profits than their other two competitors. Home Depot is also showing a higher net income. Lowe’s, while a bit lower than Home Depot, is still holding its own as number two in the industry. Its net income has continued to increase over the past three years, as it is consistently increasing revenues. The real alarming company in this analysis is Lumber Liquidators, they have been operating at a net loss over the past two years and it seems like any market share is slipping away. The balance sheet snapshot does a good job of showing the immense assets that Home Depot holds, they also hold a higher liability as well. It appears that Home Depot utilizes more third party financing than the other, and holds a lower stockholders equity than Lowe’s.





**Ratio Analysis**

**Liquidity Ratios**

**Current Ratio:**The current ratio is calculated as follows: current assets/current liabilities. It is most commonly used to measure short term solvency (Brigham, 2016). Creditors generally like to see higher current ratios. In this case Home Depot and Lumber Liquidators are producing higher ratios. This does not always bode well, as it appears in other ratios Lumber Liquidators is hurting. 

**Quick Ratio:** Also known as the acid test ratio, this is calculated as follows: (current assets-inventories)/current liabilities. This is a measure of the firm’s ability to pay off short term obligations without relying on the sale of inventories (Brigham, 2016). In all three companies inventories would most likely have to be liquidated in order to pay off all current liabilities. 

**Asset Management Ratios**

**Total Assets Turnover:** This ratio is calculated as follows: sales/total assets. The industry average for this is 2.14. It appears that Home Depot and Lumber Liquidators is right in line and uses their assets efficiently. Lowe’s is slightly below, but not by much, so they may slightly be using their assets inefficiently (Brigham, 2016). 

**Fixed Asset Turnover:** This is calculated by taking sales/net fixed assets. The industry average is around 4.35. Home Depot and Lowe’s are below this, while Lumber Liquidators is well above. Being below can indicate that these companies are not using their fixed assets. It could also indicate that Home Depot and Lowe’s are selling products online a lot more and require less of their fixed assets (buildings, land) to sell these products (Brigham, 2016). 

**Days Sales Outstanding:** This is calculated by taking receivables/average sales per day. The industry average is around 7.92. Home Depot is right in line, and Lumber Liquidators is much higher, meaning it takes longer for them to get paid after making a sale. This could be a major problem for them (Brigham, 2016). 

**Inventory Turnover:** This is calculated by taking COGS/inventories. Home Depot and Lowe’s are right in line with the average of 4.7. Lumber Liquidators is lower meaning that they could be holding too much inventory, another issue that has arisen for them (Brigham, 2016). 

**Debt Management Ratios**

**Debt to Assets:** This ratio is calculated by taking total debt/total assets. Home Depot and Lowe’s are very similar meaning that they have more debt per asset when compared to Lumber Liquidators. This ratio does not tell the whole story as to reasoning for the higher debt. Could this be a reason why Home Depot and Lowe’s are successful? Ability to grow and expand (Brigham, 2016).



**Times Interest Earned:** This is calculated by taking EBIT/interest expense. This ratio measures the extent to which operating income can decline before the firm is unable to meet its annual interest cost. Both Home Depot and Lowe’s can easily cover their interest charges, Lumber Liquidators is losing money, so they are in serious trouble (Brigham, 2016). 

**Profitability Ratios**

**Profit Margin on Sales:** This is calculated by taking NI available to common stockholders/sales. The industry average is 8.53%, so Home Depot is right in line, with Lowe’s and Lumber Liquidators behind by a wide margin (Brigham, 2016). 

**Basic Earning Power:** This is calculated by taking EBIT/total assets. The higher percentages show that they have a higher degree of financial leverage (Brigham, 2016). 

**Return on Total Assets:** This is calculated by taking NI available to common stockholders/total Assets. The industry average is 18.25%. Lowe’s and Lumber Liquidators is well below average meaning that they have low earning power or high interest costs resulting from above averageuse of debt (Brigham, 2016). 

**Return on Common Equity:**This is calculated by taking NI available to common stockholders/common equity, also shown is the DuPont method**,** which is a multiplication method, both get you the same result (slight rounding). The industry average is 158.65%. Home Depot is doing a good job using their equity (Brigham, 2016).



**Market Value Ratios**

**Price/Earnings Ratio:** This is calculated by taking price per share/earnings per share. Investors are willing to pay a higher percentage per dollar of reported profits for both Lowe’s and Home Depot (Brigham, 2016). **Market/book Ratio:** This is calculated by taking market price per share/book value per share. Home Depot is highly regarded by investors based on this ratio (Brigham, 2016).

**Trend Analysis**

**ROE:** As depicted above in the calculations, this shows the trend analysis for ROE. As you can see, Home Depot is trending upward, Lowe’s is a bit lower, and Lumber Liquidators is falling.

**Profit Margin:** As depicted above in the calculations, this shows the trend analysis for profit margin percentage. As you can see Home Depot is trending upward, Lowe’s is a bit lower, and Lumber Liquidators has crashed.

**Comparative Analysis**

A comparative analysis was done with each ratio calculated above. The key takeaway from the analysis is that it is not a perfect science. Many times inflation can badly distort these ratios. Other issues that arise include how the company controls their inventories? LIFO? FIFO? Are companies purposely putting off collecting debts to inflate certain numbers? Seasonal factors can distort ratios, especially in this industry. Different accounting practices also maybe a factor. There are many questions that need to be answered before being certain on these ratios.

**Changes**

Home Depot is doing a good job in almost every area of this analysis. Their fixed asset turnover ratio is down, but is not really a concern. They may need to look into their current liabilities a more thoroughly. They are a bit higher in the debt to assets ratio. They should work on paying off a few of their debts quicker. This seems like their biggest area of concern, but in all reality they are number one for a reason. As a potential investor, I would not stray away from this company.

Lowe’s is also doing a good job, they have a few more trouble spots than Home Depot. They are also down on their fixed asset ratio and higher on the debt to assets ratio. They need to find a way to increase their net profit margin, whether that is reducing expenses or increasing sales. They also need to increase their market/book ratio to become highly regarded by investors like Home Depot is.

Lumber Liquidators is in a world of hurt, they seem to be losing money, and not receiving payments in time from their customers. They have reported losses in their past two years so this is a sign of major trouble. Their stock has been crashing. It is in their best interest to reevaluate the company and cut costs where they can and try to improve in all other areas.

**Table of Contents**

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**Appendix A**(Morningstar, 2017)





**Appendix B**(Morningstar, 2017)





**Appendix C**(Morningstar, 2017)



