



Home Depot Vs. Lowe's - Battle Of The Hardware Stores

June 15, 2015

Summary

- Home Depot offers exposure to a superior customer mix.
- Better valuation and dividend yield.
- Avoid Lowe's.

Big city residents probably think of Home Depot and Lowe's as interchangeable stores with few differences other than their color scheme. As the suburban and rural readers are well aware, nothing could be further from the truth. While there is some level of overlap in terms of departments and product selection, very little merchandise is available at both locations. The customer service model is very different and as this article will layout, so is the expected return for shareholders.

Basic of the business

Both companies define themselves as home improvement retailers. Both operate primarily in the US. Home Depot had 2,269 stores as of December 2014 - 87% in the US, the remainder in Canada and Mexico. By comparison, Lowe's operates about 1,840 locations - 97% of which are located in the US.

As you dig deeper into the businesses you start to see their profiles diverge. For starters, breaking down revenue into major categories you can see that Lowe's is more exposed to volatility around large purchases (kitchens at 14% of revenue) and discretionary construction (lumber at 12%).

(Dollars in millions)	2014	
	Total Sales	%
Kitchens & Appliances	\$ 8,007	14%
Lumber & Building Materials	6,884	12
Tools & Hardware	6,263	11
Fashion Fixtures	5,591	10
Rough Plumbing & Electrical	4,928	9
Lawn & Garden	4,639	8
Seasonal Living	3,717	7
Paint	3,614	6
Home Fashions, Storage & Cleaning	3,263	6
Flooring	3,219	6
Millwork	3,135	6
Outdoor Power Equipment	2,339	4
Other	624	1
Totals	\$ 56,223	100%

Source: [Lowe's 2014 Annual Report](#)

Compared to Home Depot, where no category is more than 10% (more diversified, less risk) and where smaller purchase categories make up a larger component of sales (indoor garden at 9% of sales).

<u>Product Category</u>	February 1, 2015	
	Net Sales	% of Net Sales
Kitchen	\$ 8,403	10.1%
Indoor Garden	7,550	9.1
Paint	7,300	8.8
Outdoor Garden	6,394	7.7
Building Materials	6,055	7.3
Lumber	6,050	7.3
Flooring	5,986	7.2
Plumbing	5,740	6.9
Electrical	5,648	6.8
Tools	5,384	6.5
Hardware	4,974	6.0
Millwork	4,694	5.6
Bath	3,923	4.7
Décor	2,576	3.1
Lighting	2,499	3.0
Total	\$83,176	100.0%

Note: Certain percentages may not sum to totals due to rounding.

Source: [Home Depot 2014 Annual Report](#)

Continuing to dig deeper, looking at sales productivity, you can see that Home Depot has a clear advantage, wringing more revenue out of every square foot of store space. While difficult to quantify, some of this benefit is probably from a better website but also better store management and simply improving inventory turns.

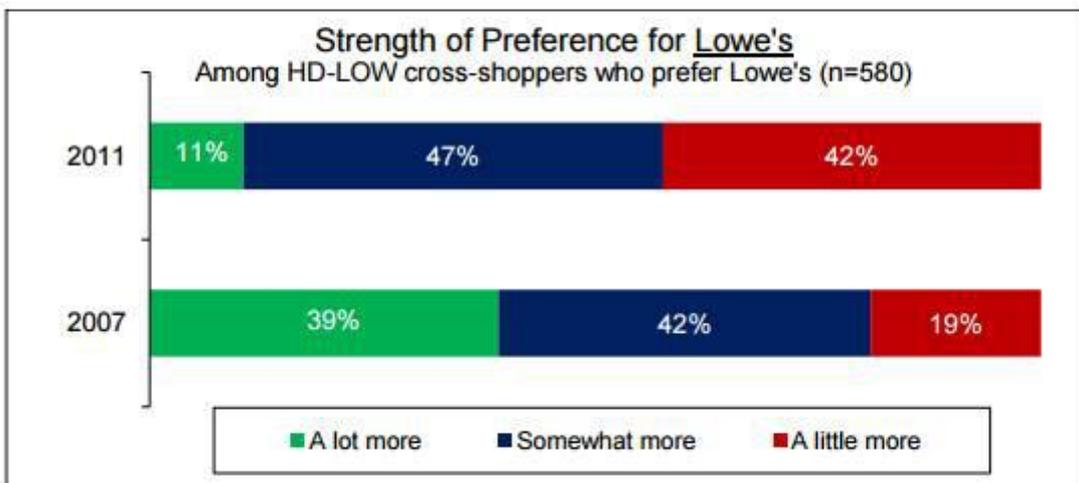
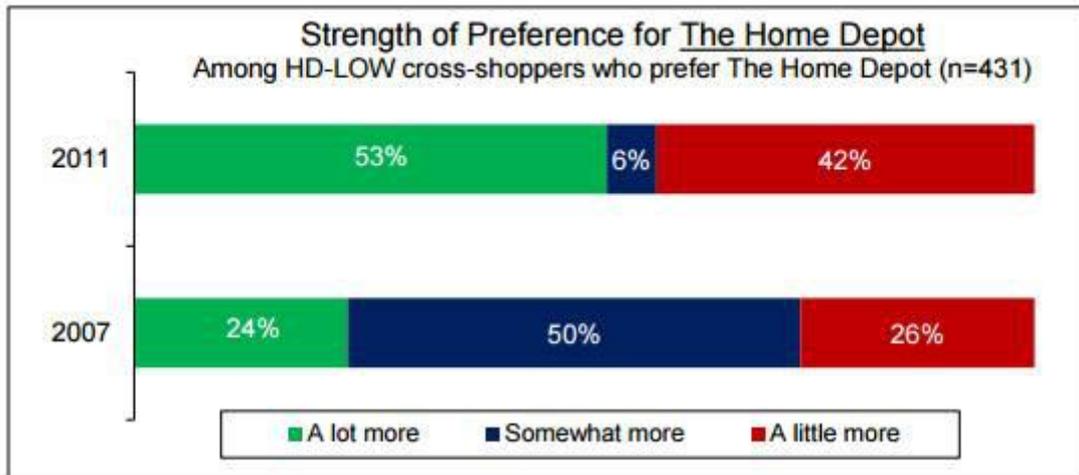
The chart below shows sales per square foot for Lowe's on the left and Home Depot on the right.

Sales per Square Foot (\$)



Source: Lowe's and HD Annual Reports

Some of this outperformance is also attributable to customer preference. Kanter Retail did a study in 2011 comparing shoppers' preference for Home Depot or Lowe's. The results, presented below show that 53% of customers who shop at both retailers had a strong preference for Home Depot vs. only 11% saying the same thing about Lowe's.



Source: "Home Improvement Retail Perspectives, Kanter Retail (August 2011)

Source: Babson.edu

Financial Statements

Not surprisingly, this momentum carries over into the financial statements. While Home Depot is leading in customer preference, sales and traffic, they also have a handy lead in profitability. While gross margins are very similar between the two companies - operating margins are very different.



Source: Lowe's and HD Annual Reports

Again, this difference is most likely related to online sales and inventory turns. It's unlikely that scale can solve for this problem. Typically, scale would help with gross margins as the larger purchaser would receive some form of bulk discount.

The Stocks

At this point you're probably convinced that Home Depot is the better company - they're larger, they drive better sales per square foot, they are more profitable, they are preferred by the customers. It would be logical to assume that Home Depot would trade at a premium.

(click to enlarge)



Source: [Ycharts.com](http://ycharts.com)

As depicted in the charts above, Home Depot currently trades at a 9% discount based on a price to earnings ratio.

Looking at dividend yields, again, Home Depot is the winner with a current yield of 2.1% vs. Lowe's at 1.6%. And I know some of you don't care about dividend yields but prefer dividend growth, well Home Depot wins there again. They raised their dividend 26% at the beginning of the year vs. Lowe's just announced dividend increase of 22%.

In this bake off Home Depot is the clear winner. If you're considering adding one of these stocks to your portfolio, Home Depot is the lower risk and better positioned company.

Link: <http://seekingalpha.com/article/3258775-home-depot-vs-lowes-battle-of-the-hardware-stores>