

2015

MARKET MEASURE

THE INDUSTRY'S ANNUAL REPORT



It doesn't take an Ivy League economist to explain what happens when consumers have more money in their pockets, their homes' values increase and they are more confident about their employment prospects and generally comfortable with the state of the economy overall. They spend more money.

Such has been the case so far in 2015 as home values headed up, unemployment continued to move down and other positive factors came into play that made average consumers feel a bit more comfortable opening their wallets.

Of course what they did once their wallets were open is also important, and this year consumers showed their willingness to once again spend money to improve and maintain their homes.

When the year settles out, the North American Retail Hardware Association (NRHA) is predicting that these favorable economic factors should translate to an increase of about 4.9 percent in home improvement retail sales for 2015.

The increase will bring the overall sales volume for the industry up to \$338.6 billion this year.

This growth continues to outpace inflation and gives a strong indication that consumers have shaken off the recessionary shell shock and returned to more normal spending patterns on home improvement goods and services.

2015's Recipe for Growth

We just made the recipe for growth in home improvement sales seem rather simple, but there are actually many factors that affect whether or not the market will expand. And while home improvement sales have seen measured growth for the past several years, 2015 felt like the first year all of these factors aligned.

Let's face it; even though 2014 saw many of the same economic factors come into play that

we have seen this year, consumers were still very wary about whether these conditions were tenable. This uneasiness appears to have waned in 2015 and can be attributed to several things.

First, consumer confidence was buoyed throughout the year by growth in the job market. Though the job market had expanded in previous, post-recessionary years, unemployment remained high enough that consumers were still cautious when it came to hopes for sustained stability.

Throughout 2015, we saw the unemployment rate drop from 5.7 percent in January down to 5.0 percent in October¹, the lowest rate since April 2008.

This rate not only represents the lowest unemployment in nearly 90 months, but it is also much more in line with the rates the economy was posting in the four years leading up to the recession, when home improvement sales and growth were running at their strongest rate this decade.

Next, 2015 also represented the first time in years that consistently good news was coming out of the housing market.

Historically, housing activity serves as an extremely accurate leading indicator for home improvement growth, especially when you look at the areas of housing starts, existing home sales and home prices.

In 2014 and 2015, all three of these measures produced strong growth.

Existing-home sales throughout 2015 are up 8.8 percent over 2014². By September, housing starts were at nearly an eight-year high of 1.2 million³.

Perhaps most notably, the median existing home price was up 6.1 percent year over year through September². As prices increase,

homeowners feel more comfortable making investments in their homes, and this translates to freer spending on home improvement products.

The final ingredient in 2015's growth recipe came from factors outside of housing and employment. Weather conditions, low interest rates on consumer credit and lower gas prices all contributed positive momentum for home improvement spending.

Growth Ahead?

Can this pattern continue? At least for the short term, the answer is yes.

NRHA is predicting home improvement retail sales' growth will continue into 2016 at a rate of about 4.6 percent, still outpacing inflation and retail spending in other categories.

This growth should be fueled by the continued positive economic conditions outlined above. However, there are several factors industry watchers will want to keep their eyes on that could influence overall performance in either positive or negative ways.

This growth should be fueled by the continued positive economic conditions outlined above. However, there are several factors industry watchers will want to keep their eyes on that could influence overall performance in either positive or negative ways.

On the positive side, the National Association of Realtors indicates that new home construction is not keeping pace with employment activity in a majority of the country's major metro markets⁴.

This slow new-home construction means that there is both pent-up housing demand and that the prices of homes are unnaturally inflated.

This will be important to watch over the near term. If housing starts begin to catch up with demand for growth, it could stimulate home improvement spending. However, the negative impact this growth could have on existing home values could also have a chilling effect on homeowners dipping into equity for projects.

With 2016 being an election year, legislators will also be likely to curb any decisions that might have a negative impact on the economy, so interest rates and legislative changes shouldn't play a big role in industry performance. ➡

1 U.S. Bureau of Labor Statistics data through Oct. 2015
 2 National Association of Realtors data through Oct. 2015
 3 U.S. Census Bureau/Trading Economics
 4 National Association of Realtors, "New Home Construction Trailing Job Growth in Majority of Metro Areas," September 2015

Industry Sales Methodology

NRHA and *Hardware Retailing* take a large number of factors into account when determining overall sales estimates for the industry.

We use a formula that incorporates information from NRHA's annual *Cost of Doing Business Study*, direct retailer research, the U.S. Department of Commerce NAICS 444 sales reports and information from other research outlets as the basis for our calculations.

We then weigh this information against company reports from the industry's publicly traded corporations, wholesaler sales figures and

additional data from retail and industry partners. All of this data is combined to calculate our industry sales estimates and forecasts.

NRHA and *Hardware Retailing's* industry estimates consider sales from all retailers whose primary business is selling home improvement products. We do not include sales from operations that do not utilize a retail sales model or service only other companies.

Our estimates include sales through the industry's hardware stores, home centers, retail lumberyards and big-box outlets.

5.1%

Sales growth reported by Home Depot at mid year 2015.

Source: Home Depot reports

6.5%

Sales growth reported by Ace Hardware Corp. at mid year 2015.

Source: Ace Hardware Corp. reports

63%

Major metro markets where new home construction isn't keeping pace with job growth.

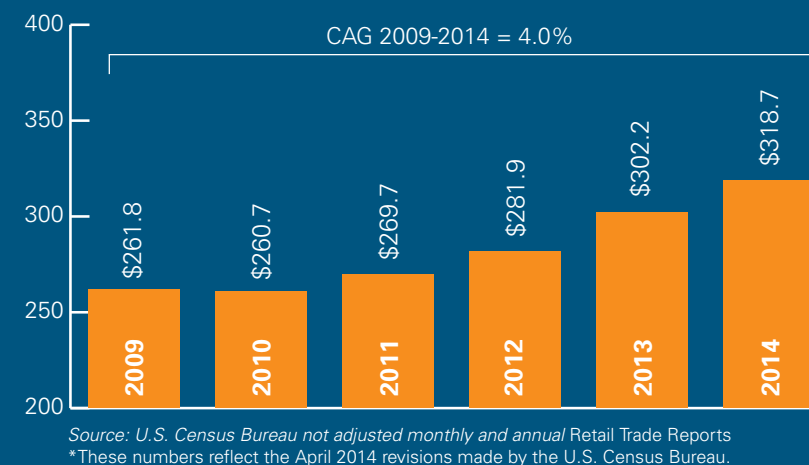
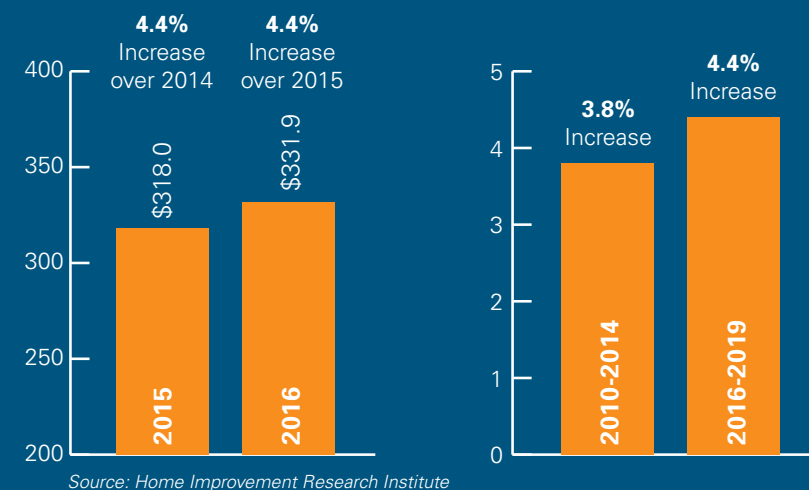
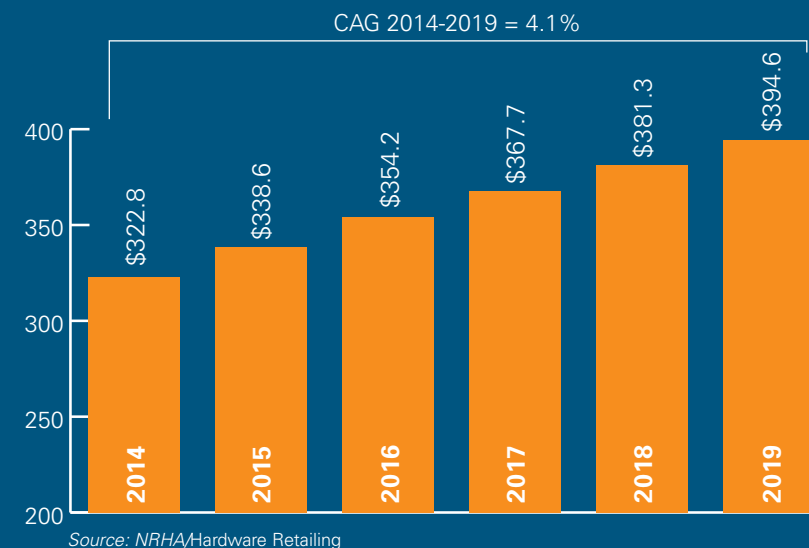
Source: National Association of Realtors

8.8%

Year-to-year increase in existing-home sales through October.

Source: National Association of Realtors

Three Views of U.S. Home Improvement Sales in Billions



| 2014 | |
|---------------------------------|--------|
| Home Improvement Sales By Month | |
| Sales in Billions | |
| January | \$27.4 |
| February | \$26.9 |
| March | \$27.7 |
| April | \$27.2 |
| May | \$27.2 |
| June | \$27.2 |
| July | \$28.2 |
| August | \$27.8 |
| September (p) | \$27.7 |

Source: U.S. Department of Commerce/NAICS 444/Seasonally Adjusted

| Home Improvement Sales Growth 2015 vs. 2014 | |
|---|------|
| January | 7.8% |
| February | 5.4% |
| March | 7.2% |
| April | 2.5% |
| May | 2.8% |
| June | 0.6% |
| July | 5.9% |
| August | 3.7% |
| September (p) | 3.4% |

Source: U.S. Department of Commerce/NAICS 444/Seasonally Adjusted

| 2014-2019 | | |
|---------------------------------------|-----------------|----------------|
| Sales By Type of Store | | |
| Sales in Billions | | |
| 2014 | Hardware Stores | \$40.9 |
| | Home Centers | \$203.4 |
| | Lumberyards | \$80.6 |
| | TOTAL | \$322.8 |
| 2015 | Hardware Stores | \$44.1 |
| | Home Centers | \$210.1 |
| | Lumberyards | \$84.4 |
| | TOTAL | \$338.6 |
| 2016 | Hardware Stores | \$45.6 |
| | Home Centers | \$220.3 |
| | Lumberyards | \$88.3 |
| | TOTAL | \$354.2 |
| 2017 | Hardware Stores | \$48.8 |
| | Home Centers | \$228.3 |
| | Lumberyards | \$90.6 |
| | TOTAL | \$367.7 |
| 2018 | Hardware Stores | \$50.6 |
| | Home Centers | \$235.8 |
| | Lumberyards | \$94.9 |
| | TOTAL | \$381.3 |
| 2019 | Hardware Stores | \$52.3 |
| | Home Centers | \$244.1 |
| | Lumberyards | \$98.2 |
| | TOTAL | \$394.6 |
| Compound Annual Growth Rate 2014-2019 | Hardware Stores | 5.0% |
| | Home Centers | 3.7% |
| | Lumberyards | 4.0% |
| | TOTAL | 4.1% |

Source: NRHA/Hardware Retailing

| 2014-2019 | | |
|--------------------------|-----------------|---------------|
| Outlets | | |
| 2014 | Hardware Stores | 19,850 |
| | Home Centers | 9,720 |
| | Lumberyards | 9,725 |
| | TOTAL | 39,295 |
| 2015 | Hardware Stores | 19,825 |
| | Home Centers | 9,725 |
| | Lumberyards | 9,750 |
| | TOTAL | 39,300 |
| 2016 | Hardware Stores | 19,810 |
| | Home Centers | 9,735 |
| | Lumberyards | 9,750 |
| | TOTAL | 39,295 |
| 2017 | Hardware Stores | 19,800 |
| | Home Centers | 9,740 |
| | Lumberyards | 9,760 |
| | TOTAL | 39,300 |
| 2018 | Hardware Stores | 19,790 |
| | Home Centers | 9,740 |
| | Lumberyards | 9,750 |
| | TOTAL | 39,280 |
| 2019 | Hardware Stores | 19,790 |
| | Home Centers | 9,730 |
| | Lumberyards | 9,740 |
| | TOTAL | 39,260 |
| Percent Change 2014-2019 | Hardware Stores | -0.3% |
| | Home Centers | 0.1% |
| | Lumberyards | 0.2% |
| | TOTAL | -0.1% |

Source: NRHA/Hardware Retailing

| Market Share Profile | | | | | |
|---|--------------------------------|--|---|-------------------------|---------------|
| Top Chains: Industry Share | | | Top Chains: Combined Performance | | |
| | Sales (as % of total industry) | No. of Stores (as % of total industry) | | Net Sales (in billions) | No. of Stores |
| 2010 | 47.2% | 14.4% | 2010 | \$131.3 | 5,725 |
| 2011 | 49.1% | 13.8% | 2011 | \$136.7 | 5,441 |
| 2012 | 50.0% | 14.7% | 2012 | \$146.4 | 5,780 |
| 2013 | 50.2% | 15.0% | 2013 | \$154.8 | 5,885 |
| 2014* | 49.4% | 16.1% | 2014* | \$159.4 | 6,308 |
| 2010-2014 Percentage Point Change | 2.2% | 1.7% | 2010-2014 Compound Annual Growth Rate | 5.0% | 2.5% |

*For 2014, new chain stores were added and others were removed in a top chain reevaluation process.

| Top Chains: Individual Performance | | | |
|--|--------------------------|-----------------------|------------------------|
| | 2014 Sales (in billions) | Stores at End of 2014 | Stores as of Fall 2015 |
| Home Depot Atlanta, GA | \$83.2 | 2,269 | 2,270 |
| Lowe's Mooresville, NC | \$56.2 | 1,840 | 1,846 |
| Menards Inc. Eau Claire, WI. | \$8.7 | 285 | 297 |
| Tractor Supply Brentwood, TN | \$5.7 | 1,382 | 1,465 |
| 84 Lumber Eighty Four, PA | \$2.3 | 249 | 241 |
| Northern Tool + Equipment Burnsville, MN | \$1.4 | 88 | 92 |
| Carter Lumber Kent, OH | \$1.0 | 141 | 146 |
| Sutherland Lumber Kansas City, MO | \$1.0 | 54 | 52 |

Source: Company Reports and Hardware Retailing Estimates
The above represent home improvement retail chain stores that carry at least two core categories and have sales of approximately \$1 billion or more.

PROFIT MARGIN

TOTAL OPERATING EXPENSE

SALES PER SQUARE FEET

GROSS MARGIN PER EMPLOYEE

HARDWARE STORES

2.9%



Almost three cents of every dollar goes to hardware stores' bottom lines on average.

39.7%



Hardware stores' high operating expenses are due to their large investments in payroll.



\$165

Hardware stores average \$52 of product per square foot, resulting in \$165 in sales per square foot.



\$64,608

The number of employees, along with gross margin per employee, remained relatively unchanged between 2013 and 2014.

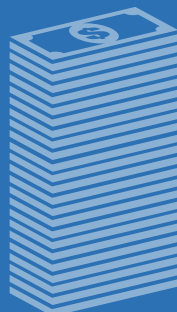
HOME CENTERS

1.7%



Down nearly one percent from 2013, home centers' profit margin declined to 1.7 percent.

33.2%



Home centers' operating expenses remained relatively unchanged between 2013 and 2014.



\$204

In 2014, home center respondents saw sales per square foot increase from \$190 the prior year to \$204.



\$68,393

Home centers averaged around 16 full-time employees that generated more than \$198,000 in sales.

LBM OUTLETS

2.2%



After expenses and cost of goods sold are accounted for, more than two cents of every dollar goes to the bottom line.

24.5%



LBM outlets control operating expenses through low occupancy rates and payroll.



\$778

LBM outlets' sales per square foot was at the highest level in more than five years.



\$82,826

LBM outlets added an average of two additional full-time employees in 2014 while also improving gross margin per employee.

Source: 2015 Cost of Doing Business Study

ALL SIGNS POINTING UP

The North American Retail Hardware Association's *2015 Cost of Doing Business Study* represents the annual financial and operational performance of independent hardware stores, home centers and lumberyard (LBM) outlets.

Retailers across the country submitted their confidential financial reports for the 2014 fiscal year. Once the data was collected, NRHA used medians to develop aggregate income statements, balance sheets and key performance ratios.

The data is segmented into hardware stores, home centers and lumberyard/building material outlets. Within these segments, the data is broken down further into typical, high-profit, single-unit and multi-unit stores and also by sales volume. Additionally, each segment has a five-year historical trends section that compares the yearly income statements, balance sheets and performance ratios.

Use this data as benchmarks for your business and compare your store against the industry average. Measure your performance ratios with others in the industry to better understand your operation's productivity.

Methodology

The annual *Cost of Doing Business Study* is made possible through the cooperation of hardware store, home center and lumber/building materials outlet owners and managers who provide detailed financial and operational information on their individual companies.

Questionnaires were mailed to a sampling of hardware stores, home centers and lumber outlets in the U.S. to collect detailed financial and operational information for 2014. The questionnaire was also made available online.

The analysis in this report is the result of extensive review by NRHA. All individual company responses are completely confidential.

Most of the figures in this report are medians. The median for a particular calculation is the middle number of all values reported when arranged from lowest to highest. The median represents the typical company's results and is not influenced by extremely high or low reports.

To determine high-profit stores, all participating companies were ranked based on net profit before taxes. The high-profit companies in each segment are those that make up the top 25 percent. The figures reported for each of the high-profit segments represent the median for that group.

New This Year!

NRHA is developing a library of resources to help you and your employees better understand the financial metrics in the *Cost of Doing Business Study*. Download some of these new educational materials on average transaction size at www.hardwareretailing.com/codb-transaction.

HARDWARE STORES

Hardware stores that participated in the *2015 Cost of Doing Business Study* grew year-over-year sales by 5.81 percent*. This growth can be attributed to many different elements, but specifically to the overall increase in customer counts and a steady average transaction size. In both 2013 and 2014, the average transaction size was \$20, but in 2014 an additional 4,500 customers visited the store (79,500 in 2014 vs. 75,000 in 2013). This growth along with expense management created a 2-year streak of a 2.9 percent profit margin.

High-performing hardware stores outpaced the typical hardware store in 2014 dramatically, with an additional \$588,858 in sales. This half-million variance is partially due to high-profit hardware store's average transaction size of \$22, which is two dollars more than a typical store, and 17,861 more customers (97,361 high-profit vs. 79,500 typical).

High-profit hardware stores drove additional sales but they also contained their expenses and operating costs. The high-performing hardware stores had 1.5 percent less of sales dedicated to payroll and nearly one percent less tied up in occupancy expenses. Overall, high-profit hardware stores had 36 percent of sales dollars dedicated to operating expenses compared to 39.7 percent for typical hardware stores.

In addition to preserving lower operating costs, high-profit hardware stores were also more efficient with their use of space and employee productivity. They had an additional two dollars in inventory per square foot (\$54 high-profit vs. \$52 typical) combined with a high employee productivity of \$187,235 sales per employee (\$187,235 high-profit vs. \$156,434 typical) that led to an additional \$50 in sales per square foot (\$215 high-profit vs. \$165 typical).

*This growth is from stores that reported both 2014 and 2013 sales volume in this year's study.

How to Use This Study

The *Cost of Doing Business Study* presents financial and operational data that retailers can use to evaluate their own businesses and plan strategic changes. Here are ways to use the information in this report effectively.

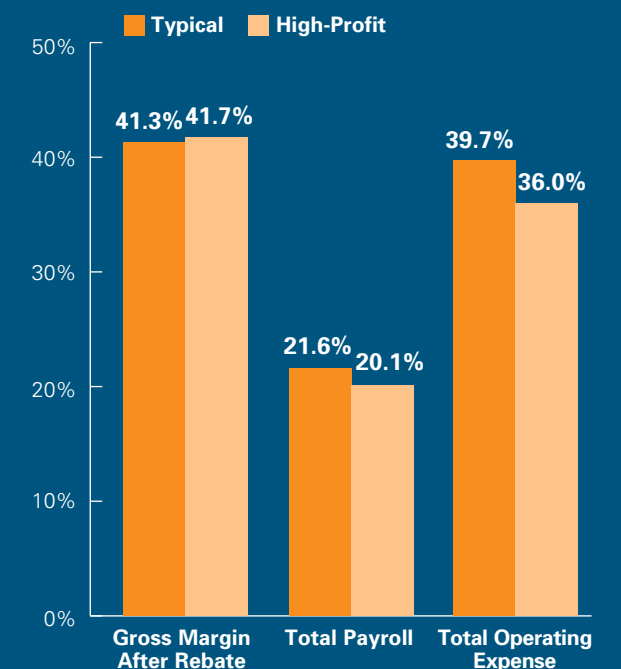
- Determine your expenses as a percent of sales and calculate your balance sheet as a percent of total assets. Compare your numbers to the study results for both typical and high-profit stores.
- Don't look at percentages alone. Compare your real-dollar expenditures as well.
- Compare your numbers to stores of a similar size. Don't limit your comparison to one type of store. Defining hardware stores, home centers and lumber outlets is practical for statistical purposes, but your store may have attributes of more than one type.
- When your numbers differ significantly, determine the cause. Then develop a plan to bring your numbers more in line with high-profit stores.
- Although high profits have little to do with size, sales growth is one of the keys to profitability. Remember, there are basically four ways to generate additional revenue—traffic count, closure rate, transaction size and margins.

While reviewing the numbers on the following pages, it is extremely important to note that each year, this report contains figures from a different sample group of stores. That means overall figures have the potential to vary widely from year to year based on the respondent group of stores participating each year. We use year-to-year comparisons to illustrate general trends over time, not to draw specific year-over-year conclusions.

MEDIAN SALES PER CUSTOMER



KEY BUSINESS INDICATORS



Source: North American Retail Hardware Association. Figures based on responses to 2015 Cost of Doing Business Study.

HOME CENTERS

Home centers thrived in 2014, with year-over-year same-store sales increasing by nearly 12.5 percent*. Sales volume per store also had a positive increase, ending 2013's record of the lowest sales volume since 2000 (\$3,164,772 in 2014 vs. \$2,662,633 in 2013). In harmony with the increase in sales volume per store, home centers' average transaction size grew by \$1 in 2014 (\$42 in 2014 vs. \$41 in 2013) and 10,000 more customers visited home centers (75,000 in 2014 vs. 65,000 in 2013).

Home centers' operating expenses in 2014 were similar to the previous year, decreasing their cost of goods sold (67.1 percent in 2014 vs. 68.2 percent in 2013) but increasing payroll expenses by 1.5 percent (19.0 percent in 2014 vs. 17.5 percent in 2013). With this expense control and growth in sales, home centers in 2014 still experienced a decrease in profit before taxes (1.7 percent in 2014 vs. 2.3 percent in 2013) due to the decrease in "Other Income/Expenses" line (0.4 percent in 2014 vs. 1.7 percent in 2013).

High-profit home centers' profit margin was more than five times greater than the typical home centers (9.2 percent high-profit vs. 1.7 percent typical), a substantial difference and one of the study's most important findings.

High-profit stores sold \$7 more in products per customer (\$49 high-profit vs. \$42 typical) and also controlled their expenses, resulting in their higher profit margin. High-profit home centers had more than 1.5 percent extra tied up in cost of goods sold compared to typical stores but that leveled out since high-profit home centers had 2.5 percent less in payroll (16.5 percent high-profit vs. 19 percent typical). That deduction accompanied by the low rent expense led to high-profit home centers' exceptional profit margin approaching 10 percent.

**This growth is from stores that reported both 2014 and 2013 sales volume in this year's study.*

LBM OUTLETS

LBM outlets that participated in the 2015 *Cost of Doing Business Study* recorded a 5.8 percent increase in same-store sales from the prior year*, mirroring the increase felt by hardware stores and home centers along with the positive sentiment of the housing industry.

This growth can be explained through the significant increase in the average transaction size (\$105 in 2014 vs. \$76 in 2013) accompanied by the additional customer visits (60,882 in 2014 vs. 52,000 in 2013).

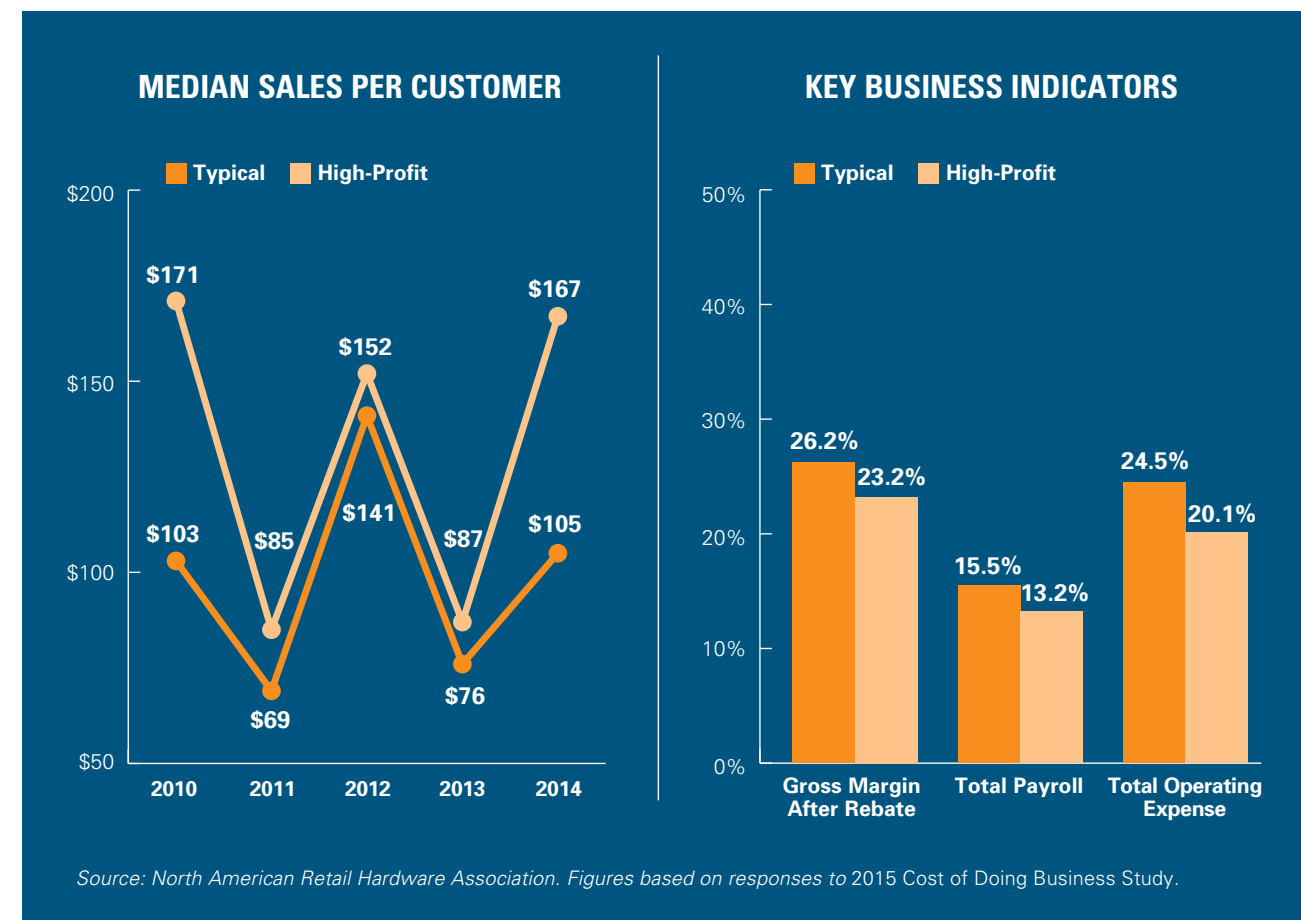
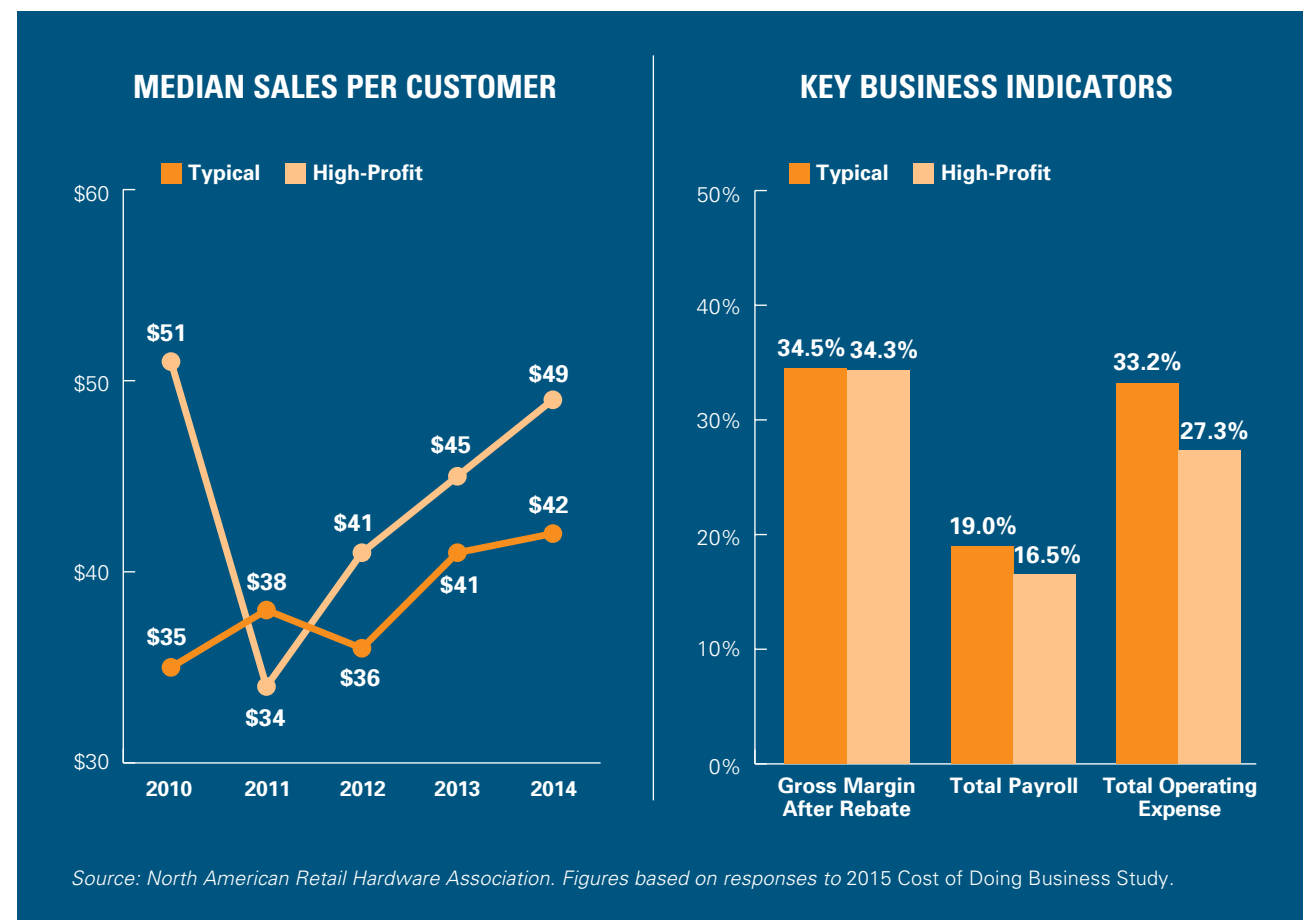
Overall, LBM outlets decreased their operating expenses in 2014 (24.5 percent in 2014 vs. 25.7 percent in 2013), but their profit margin also decreased (2.2 percent in 2014 vs. 3.8 percent in 2013). This decline in profit margin is due to 2014's smaller purchase rebate and a smaller "Other Income/Expenses" line (0.4 percent in 2014 vs. 1.7 percent in 2013).

High-profit LBM outlets excelled in driving sales and controlling expenses, however they did dedicate a

significant amount more to cost of goods sold (79.2 percent high-profit vs. 74.4 percent typical). While a 5 percent difference is significant, it could indicate that high-profit stores are willing to spend more to provide their customers high-quality materials.

Productivity and efficiency were also two areas where high-profit LBM outlets surpassed typical stores. Even though high-profit LBM outlets spent more on goods, they moved their products more quickly resulting in an inventory turn of 7.5 times per year (7.5 times high-profit vs. 4.6 times typical). High-profit LBM outlets also had an additional \$335 in sales per square foot (\$1,113 high-profit vs. \$778 typical), which is not due to their amount of inventory per square foot but rather to how many times they turn their inventory along with their high-performing employees.

**This growth is from stores that reported both 2014 and 2013 sales volume in this year's study.*



Financial Profile of Leading Publicly Held D-I-Y Chains 2014

| Operating and Productivity Profile | Home Depot | Lowe's Cos. |
|--|----------------|----------------|
| Number of Stores (at end of 2014) | 2,269 | 1,840 |
| Average Size of Selling Area (sq. ft.) | 104,000 | 112,000 |
| Total Sales | \$83.2 Billion | \$56.2 Billion |
| Total Asset Investment | \$39.9 Billion | \$31.8 Billion |
| Total Inventory | \$11.1 Billion | \$8.9 Billion |
| Sales Per Square Foot | \$352 | \$280 |
| Inventory Turnover | 4.7x | 4.1x |
| Net Sales to Inventory | 7.5x | 6.3x |
| Total Sales Per Employee | \$224,194 | \$211,365 |
| Average Size of Transaction | \$57.87 | \$65.61 |
| Gross Margin Return on Inventory | 261.0% | 219.0% |
| Income Statement | Home Depot | Lowe's Cos. |
| Net Sales | 100.0% | 100.0% |
| Cost of Goods Sold | 65.2% | 65.2% |
| Gross Margin | 34.8% | 34.8% |
| Total Operating Expenses | 22.2% | 27.2% |
| Net Income (Before Taxes) | 12.0% | 7.6% |
| Balance Sheet | Home Depot | Lowe's Cos. |
| Total Current Assets | 38.3% | 31.7% |
| Cash | 4.3% | 1.5% |
| Receivables | 3.7% | 0.4% |
| Inventory | 27.7% | 28.0% |
| Other | 2.5% | 1.8% |
| Fixed Assets | 61.7% | 68.3% |
| Total Assets | 100.0% | 100.0% |
| Current Liabilities | 28.2% | 29.4% |
| Long-Term Liabilities | 48.5% | 39.3% |
| Net Worth | 23.3% | 31.3% |
| Total Liabilities and Net Worth | 100.0% | 100.0% |

Source: Home Depot and Lowe's annual reports

Profile of Top Four Distributors

| | Ace Hardware Corp. | Do it Best Corp. | True Value Co. | Orgill Inc. |
|---------------------------------------|---------------------|------------------|-----------------------------|------------------|
| Number of Distribution Centers | 17 | 8 | 12 | 5 |
| Current Number of Members | 4,900 ³ | 3,800 | 4,500 | N/A |
| Dollar Volume Most Recent Fiscal Year | \$4.70 Billion | \$2.87 Billion | \$2.02 Billion ¹ | \$1.70 Billion |
| Estimated Dollar Volume Calendar 2015 | \$5.00 Billion | \$3.00 Billion | N/A | \$1.86 Billion |
| % Sales Out of Warehouse | 78.0% | 50.0% | 71.5% | 71.0% |
| % Sales Out of Pool/Relay | 0.0% | 0.0% | 0.0% | 0.0% |
| % Sales Direct-Drop Ship | 22.0% | 50.0% | 28.5% | 29.0% |
| % Sales in LBM | 0.0% | 19.0% | 13.5% | 9.1% |
| Number of Employees | 6,500 ³ | 1,445 | 2,427 | 2,054 |
| Avg. Number of SKUs in Warehouse | 75,000 ³ | 67,000 | 80,000 | 72,000 |
| Sales/Inventory Ratio for 2014 | 6.8 | 11.03 | 4.1 | 5.4 ² |
| 2014 Member Rebate Distributed | \$135,300,000 | \$115,400,000 | \$41,100,000 | N/A |
| % Cash | 37.0% | 77.0% | 45.0% | N/A |
| % Stock | 43.0% | 23.0% | 38.0% | N/A |
| % Other | 20.0% | 0.0% | 17.0% | N/A |

Source: Annual company reports and NRHA Hardware Retailing Estimates

¹ Ratio from gross billings. ² Warehouse sales/average inventory.
³ Approximately.

Profile of Wholesaling Merchandising Groups

| | PRO Group Inc. | Reliable Distributors | Distribution America | Val-Test Group |
|---|----------------|-----------------------|----------------------|----------------|
| Current Number of Wholesale Members | 28 | 93 | 9 | 70 |
| Number Member Wholesalers End 2014 | 29 | 102 | 10 | 70 |
| Number Member-Operated Distribution Centers | 41 | 190 | 12 | 75 |
| Dollar Volume for 2014 Fiscal Year | \$3.00 Billion | \$2.00 Billion | \$1.20 Billion | \$0.90 Billion |
| Estimated Dollar Volume Calendar 2015 | \$3.00 Billion | \$2.00 Billion | \$1.20 Billion | \$0.80 Billion |
| Number of Retail Stores Served by Members | 35,000 | 20,200 | 8,500 | 5,000 |
| Number of Program Stores | 800 | NA | 1,400 | 450 |
| Number of Employees | 16 | 8 | 9 | 11 |

Source: Annual company reports and NRHA Hardware Retailing Estimates

*Val-Test Group's numbers also include pro sales, flooring, maine and decorative concrete.

Go to www.hardwareretailing.com/2015-distributors to see information from other distributors and merchandising groups that participated in our survey!

DECEMBER (2014)

- **Home Depot** bought back HD Supply Holdings Inc., a distributor of fasteners, plumbing parts, chain and other hardware.
- **True Value** president and CEO John Hartmann was featured in the season six premiere of "Undercover Boss" on CBS Television Network. He traveled to stores in disguise and worked in various roles.
- **Lowe's** announced it would sell Sherwin-Williams' HGTV HOME™ brand paints in stores and online.

JANUARY

- **Ace Hardware** announced it had acquired Jensen Distribution Services, a 131-year-old distributor of hardlines goods. Ace Hardware also appointed Hoyoung Pak to serve as president of Ace Wholesale Holdings, a division that includes Emery-Waterhouse and Jensen Distribution Services.
- **Lowe's** partnered with IControl Networks to offer options for customers who want smarter homes.

FEBRUARY

- Alliance International, the **Do it Best Corp.** buying partnership with Home Hardware Stores Limited in Canada, named Greg Mann as its new executive director.

MARCH

- **Lumber Liquidators** was accused of selling flooring that contained higher levels of formaldehyde than permitted by California law.



APRIL

- **Orgill, Inc.** announced plans to increase the size of its Sikeston, Missouri, distribution center by more than 250,000 square feet. The expansion would bring the total size of the distribution facility up to more than 1 million square feet, increasing capacity by more than 25 percent.
- For the second year in a row, InformationWeek, a publication of the business technology community, listed **Do it Best Corp.** as one of the top business technology innovators in the U.S.
- Online retailer **Amazon** launched Amazon Home Services, a program that would sell home improvement services by connecting professionals with consumers and guaranteeing the quality of the work. The services included electrical and plumbing work, home repairs and gutter cleaning.
- **Ace Hardware** launched a free in-store pickup program at some of its stores. The program allowed customers to check their neighborhood Ace Hardware's inventory levels online, and then place orders on the web to pick up in store.

MAY

- **Lowe's** introduced in-store and online 3-D printing and scanning services to customers searching for replacement parts and one-of-a-kind creations. The technology was piloted at Orchard Supply Hardware in Mountain View, California.
- The **North American Retail Hardware Association** (NRHA) and **Independent We Stand** announced the findings of their *Home Sweet Home Study*, which examines the economic impact of spending money at independent home improvement businesses rather than at national home center chains. The results of the study were released at the National Hardware Show® in Las Vegas. Retailers were given access to download marketing materials to promote the study.
- **Do it Best Corp.** came to an agreement with a new overseas affiliate to develop its first retail locations in Saudi Arabia. The agreement provided Saudi Arabia-based Albawardi Group exclusive development rights in the country, which became the 55th country in which Do it Best members operate.

JUNE

- Jonathan Mize, CEO of home improvement supply distributor **Blish-Mize**, was recognized as a notable businessman. The Kansas City business magazine Ingram's named Mize to its 2015 list of 50 Kansans You Should Know.
- **Ace Hardware** and the **PGA Tour** announced a multiyear marketing agreement that designated Ace as the "Official Hardware Store of the PGA Tour and Champions Tour."
- **True Value Company** began hosting one-day certification training workshops for members across the U.S.

JULY

- Canadian distributor **RONA Inc.** announced plans to buy the 20 franchise stores in its network. The purchase means all of the namesake stores across Canada are now wholly owned by RONA.
- **House-Hasson Hardware** announced it had acquired **Long-Lewis Hardware**. The acquisition added some 500 retailers, bringing the total retailers to more than 2,000. It also added about \$30 million in annual sales.
- **Home Depot** announced it would buy Interline Brands, a leading national distributor and direct marketer of broad-line maintenance, repair and operations (MRO) products. The retailer paid about \$1.63 billion.

AUGUST

- **Do it Best Corp.** announced the retirement of president and CEO Bob Taylor effective Jan. 4, with Dan Starr tapped to succeed him in the role. Taylor spent more than 40 years in the home improvement industry.
- **True Value Company** announced that **Busy Beaver Home Improvement Centers** joined the co-op as its newest member. The regional chain operates 16 full-line home improvement centers.
- Canada's **TIM-BR MART Group** announced the sale of the hardlines assets of its distribution arm, **Chalfour Canada Ltd.**, to **Orgill Canada Hardlines, ULC**, a wholly owned, Canadian-based subsidiary of **Orgill, Inc.** Orgill renamed operations in the country **Orgill Canada**.



SEPTEMBER

- **Home Depot** added three new direct fulfillment centers to support its growing online business.
- **PRO Group** recognized Nunda PRO Lumber & Hardware in Nunda, New York, as its 2015 Cosgrave Memorial Award winner. The award is presented annually to a PRO Hardware retailer and recognizes a commitment to the principles and ideals of effective hardware merchandising.

OCTOBER

- **Hardware Holdings, LLC**, announced the change of its corporate name to **World and Main, LLC**, repositioning the company as a national distributor that sources products worldwide.
- The company that developed **Uber** announced **UberRUSH**, which was designed to provide small business owners with same-day delivery services.
- **Ace Hardware** spread its wholesale business across the U.S. with **Emery Jensen Distribution**, a company formed to offer distribution services to independent non-Ace retailers that aren't already served by Ace wholesale companies.

THE STATE OF HOUSING

A Q&A With Kermit Baker



Kermit Baker is a senior research fellow at the Joint Center for Housing at Harvard University and the project director of the Remodeling Futures Program. The goal of this program is to develop

an improved understanding of the dynamics of the U.S. repair and renovation industry so businesses can better take advantage of opportunities the market offers. Baker is also chief economist for the American Institute of Architects. In this role, he analyzes business and construction trends for the U.S. economy.

What does “recovery” from the recession look like currently for the residential housing market?

Generally, the residential market is quite healthy. Prices were a big concern with all the value people lost in their homes during the recession and the fact that they didn't rebound very quickly. But recent numbers from the last three years or so have been very healthy, and so I think house prices have really recovered about as much as anyone expected they would, and are almost back to where they should be in the sense that they were overheated during the housing boom.

Another big piece in the overall puzzle is how many households are being formed. That was a big problem during the downturn. People were just not going out on their own. They were staying home, staying with their parents, whatever else. That only started to turn around about a year or so ago, but those numbers are looking pretty healthy now.

The third piece of the overall puzzle was the homeownership rate. We saw a lot of households becoming renters that we normally would've expected to be owners. And as a result, we lost about, so far, five points in the U.S. homeownership rate, from 69 percent down to 64 percent. It still seems to be falling off. Some people didn't want to buy because they saw how risky it is to own a home. Others would've wanted to buy but couldn't

qualify for a mortgage because mortgage lending has become so restrictive. Others have kind of delayed getting married and having children, and so a rental unit downtown looks more attractive than a 2,000-square-foot single-family, detached home in the burbs.

What is the state of the home improvement and remodeling markets?

The remodeling market fell probably 15 to 20 percent, peak to trough, from the peak of the market in 2007 to the trough of the market in 2011. But, by comparison to what happened on the housing side, that was actually fairly moderate. And it looks like it has recovered. Remodeling spending in 2015 should match or exceed spending in 2007, the previous peak. It looks like the home improvement side of the market has recovered pretty nicely and is essentially all the way back to where it was before the downturn, although it is looking a lot different in terms of the composition.

What was the composition at that time?

What was driving the market during the upturn were really high-end projects, and high-end projects that we would call discretionary projects. We're not seeing the upper-end market return nearly as strong as it was. If you asked contractors what's the average price of the projects they're working on, it's generally 20 to 25 percent lower than it was during the last upturn.

They were sort of the upper-end kitchen remodels, upper-end bathroom remodels, room additions, wing additions, putting on in-law suites or something like that or putting on a game room, a rec room, a media room, a wine cellar.

What are the growth areas now?

One would be more spent on rental units relative to 10 years ago, and relatively less on owner units. And that's going back to the initial story, that we've just seen a dramatic increase in rentership. We've seen a lot of that in the upper end of the market. Rental property owners are saying, “Gee, I really need to fix up my home,



“If you looked at all those trends over the last couple years, you would see great market improvement. Projections are we'll see probably 1.25 million housing starts in 2016.”

my apartments, my rental units to attract these higher rents,” and so they're spending a lot fixing up those homes.

Another big area is under the umbrella of sustainable home improvements. We're seeing more activity in areas that would've been niches 10 years ago that now are simply becoming parts of the market. Things like healthy home retrofits. Things like water efficiency and water conservation projects, reuse of materials and alternative energy sources.

Home automation is kind of an area that fits under that umbrella because a lot of it is used to drive some of the other projects I talked about. So, I think that's becoming a fairly significant piece of the market.

We've been surveying contractors twice a year on what share of their work comes from projects where one of these sustainability areas is an objective, and you get numbers like 20-30 percent of their revenue comes from projects that have a very clear sustainability goal associated with them.

What do you think will get us to full housing market recovery?

If you looked at all those trends over the last couple years, you would see great market improvement. Projections are we'll see probably 1.25 million housing starts in 2016. Maybe 1.4 million or so housing starts in 2017, for 10-15 percent growth this year. By historical standards, those are very healthy. It's just taken a long time for the economy to recover enough and for banks to be comfortable to lend again for this market to come back.

What advice do you have for retailers?

Be a little more cognizant on how their customer is changing. The next big wave of customer growth is going to be millennials, who haven't gotten engaged with home improvement retailing very much. If they are in the market, they're generally renters. That population generally has been making different choices in terms of how they see their home, how they view technology, how they go about making buying decisions—a lot of different things. —

LOOKING AHEAD

An Economic Outlook From Economist Connor Lokar



Connor Lokar is an economist at ITR Economics, an economic research and consulting firm in Manchester, New Hampshire. Lokar provides economic consulting services for small businesses, trade associations and Fortune 500 companies across a spectrum of industries. He specializes in applied research for business cycle trend analysis, growth-cycle trend analysis and the use of cyclical analysis at the business level.

Bright Prospects for 2016

The year 2015 is shaping up to be a good year for hardware stores, home centers and lumberyards in both the U.S. and Canada, despite slowing economies.

And looking ahead into 2016, there are many encouraging signs despite the highly pessimistic landscape being painted in the news.

The drivers of the current macroeconomic slowdown are mostly confined to the industrial side of the economy, where mining activity, heavy manufacturing and overall business-to-business spending are down.

The positive inputs can be found from consistent consumer spending, employment gains and improving residential construction trends. All of these will favor home improvement retailers next year.

For the U.S., we project a 6-percent rise in hardware store retail sales in 2016 and a 6-percent sales increase for home centers and lumberyards.

Gross Domestic Product

With that said, the U.S. economy is slowing down. One of the most popular measures of economic activity is Gross Domestic Product (GDP), which grew by 2 percent in the third quarter of 2015 versus the third quarter in 2014, resulting in the slowest quarterly growth since the first quarter of 2014. Annual GDP growth for the past 12 months slowed to 2.5 percent after a relatively sluggish third quarter.

Improvement in 2016

The U.S. economy will continue to slow through year-end, but we are not headed toward a recession. Growth will begin again heading through the second quarter of 2016 and the U.S. economy will pick up steam throughout the remainder of the year.

Overall, expect more activity in the second half of 2016 than in the first, and for the year as a whole to beat 2015 due to acceleration in the industrial and manufacturing sectors coinciding with already strong consumer spending and residential construction trends.

Existing home sales and new housing starts are going to be strong and consistent. Trends in consumer spending will accelerate. And the manufacturing sector will regain its footing.

The positive economic outlook for 2016 will support further improvement in U.S. employment. The number of unemployed in the U.S. declined to 7.6 million in September. This is the lowest number since April 2008. The drop in the number of unemployed sent the unemployment rate in the U.S. down to 4.9 percent in September, less than half of its most recent peak in January 2010.

The positive trends in U.S. unemployment bode well for consumers' ability to spend, according to index numbers. Hardware stores stand to benefit from this rise in spending ability. U.S. disposable personal income grew by 3.2 percent in August, averaging \$12.3 trillion for the month.

The decline in unemployment and the rise in disposable income led the annual average U.S. Consumer Confidence Index in September to the highest level since February 2008.

Home Sales

Annual growth in U.S. existing home sales rose to 6.4 percent in September. In units, 5.6 million existing homes sold in September on a seasonally adjusted annual basis. This is the highest number of existing homes sold since July 2007. Existing home sales will accelerate to reach 7.3 percent growth for 2015 as a whole and will grow another 8.4 percent in 2016.

The State of Remodeling

A large percentage of remodeling occurs in the first or last year of homeownership. The reason behind this is that new owners make improvements to their homes for enjoyment and long-term owners make improvements prior to selling to get the best return possible.

The annual average National Remodeling Market Index, which tracks major and minor home additions/alterations as well as maintenance and repair activity in the U.S., is hovering near an all-time high.

Looking Ahead to 2016

As a bellwether for the U.S. economy and an indicator of consumer strength, strong housing starts this year and next promise a good outlook for home improvement store retail sales next year.

Total retail sales, growing 2.4 percent year over year, are growing fast enough to keep the U.S. economic engine moving despite the slowdowns and isolated pockets of negativity across the industrial side of the economy.

Strong overall consumer spending, combined with growth in existing home sales and remodeling activity, will drive U.S. retail sales in home improvement stores higher.

Hardware store retail sales over the last 12 months show a 7.5-percent increase from a year earlier, though that pace is expected to decline through year-end. We expect 2016 to be better.

Hardware retailers should be investing in their workforce and their business locations to make sure they can keep pace with the growing market around them.

Taking Action

Producer prices for hard and soft woods are declining, down double-digit percentages in some cases. This is due both to oversupply in the U.S. and the strong dollar, which is making foreign wood, particularly high-end hardwoods for flooring and cabinets, relatively cheap to import. Now is a good time to sell through existing inventory and restock inexpensively.

Foreign goods are comparably very cheap, allowing for competitive retail pricing. ➔

A Look at Canada Housing and Employment

Growth in Canada is a different story in that, currently, there is no growth. Challenges primarily in the oil and gas markets caused economic activity in Canada to contract by 2.4 percent over the last three months versus the same period a year ago. We expect the Canadian economy to close 2015 mildly below 2014. A declining Canadian dollar versus the U.S. dollar and rising oil prices next year will help the Canadian economy get back on track in 2016, although conditions will be more favorable in the U.S.

However, Canadian unemployment has been on the rise since the beginning of 2015, in part due to weakness in the country's energy sector. Canada is rich in natural resources but the economy is dependent on them.

The number of unemployed in Canada was 1.2 million in September. The corresponding Canada unemployment rate rose to 7.1 percent

in September. The Canadian economy will struggle through year-end.

Consumer confidence is lower in Canada, declining for the third month in a row in September and dropping to the lowest level so far in 2015.

Annual growth in Canada's residential building permits reached 7.3 percent in August and the total value of permits over 12 months spanning from September 2014 through August 2015 was \$53.2 billion in Canadian dollars. This is a new record high which will help drive increases in retail sales for Canadian hardware stores.

Due to the recent direction of the economy, growth in Canada residential building permits will slow to 5.3 percent for the full year, but permits will pick up with the economy in 2016 and rise 15.8 percent from 2015 to 2016. Like the U.S. economy, the strongest growth trends reside in the retail and residential markets.

SLOW, STEADY GROWTH IN CANADIAN RETAIL

Provided by Michael McLarney, Managing Director of NRHA Canada

The Canadian economy did not get hit nearly as hard as the U.S. did during the worldwide recession of 2008-2009, but it has been much slower to grow following that time. That slow, steady growth has affected hardware and home improvement retailers, as well.

Hardware and home improvement retailing did shrink during 2008 and 2009, flattening out in 2010. Since then, the industry has made slow, positive gains. By 2014, it was valued at almost \$42 billion, up just 2.6 percent over 2013. Industry sales are forecast to grow in 2015 and 2016 at a similar rate below 3 percent.

By the end of 2014, Canada's hardware and home improvement retailing industry consisted of 1,643 hardware stores, 3,255 building centers and home centers and 303 big boxes. During the year, each of these store formats faced its own set of challenges and opportunities. Building centers showed a healthy increase in 2014, up 4.6 percent. That follows a gain of 2.5 percent in the previous year, ensuring this store format continues to represent almost half of the industry by sales.

In 2014, hardware stores showed a double-digit drop in sales again that year, following a 4.5-percent drop in 2013 and a 2.6-percent drop in 2012, despite the fact that same-store sales by this format remained stable in 2014. However, the decrease overall reflects the emphasis on building centers and home centers by the major retail groups, such as Home Hardware and RONA. Many hardware stores, in fact, are expanding into building centers.

After steady or falling sales over the previous two years, sales of Canada's big boxes showed positive gains in 2014, up almost 5 percent. This growth reflects new stores by both Lowe's Canada and Kent, a successful reboot of RONA's big-box strategy, as well as solid performance by Home Depot Canada.

Canadian Tire, with 490 stores of its own, showed healthy growth of 3.5 percent in its hardware/building material categories in 2014, as the company focuses on rebuilding its brand, especially as a destination for sporting goods. It has also put

renewed emphasis on its hardware, housewares, and home decor categories, so those are expected to continue to grow steadily over the next five years.

Consolidation at the Top

Consolidation within the retail home improvement industry has resulted in just 10 companies comprising 79 percent of the overall industry's sales at retail.

Canada's top retailer is Home Depot for the first time since 2007, when it was displaced by RONA Inc. Buying groups remain significant—five of them are in the Top 10 Home Improvement Retailers. TIM-BR MART Group tops the list of buying groups, in terms of sales at retail, and weighs in at No. 5 on the list. Buying groups hold the No. 6 through 9 positions—Independent Lumber Dealers Co-operative, Castle, Sexton, and BMR respectively.

Big Boxes Make Their Mark

There are more than 300 big boxes in Canada today, with sales of almost \$9 billion. Canada's leading retailer in home improvement is also No. 1 in big-box sales: Home Depot Canada had estimated sales of \$5.65 billion in 2014. Next is RONA, whose sales from its 72 large-format stores generate an estimated \$1.81 billion in sales.

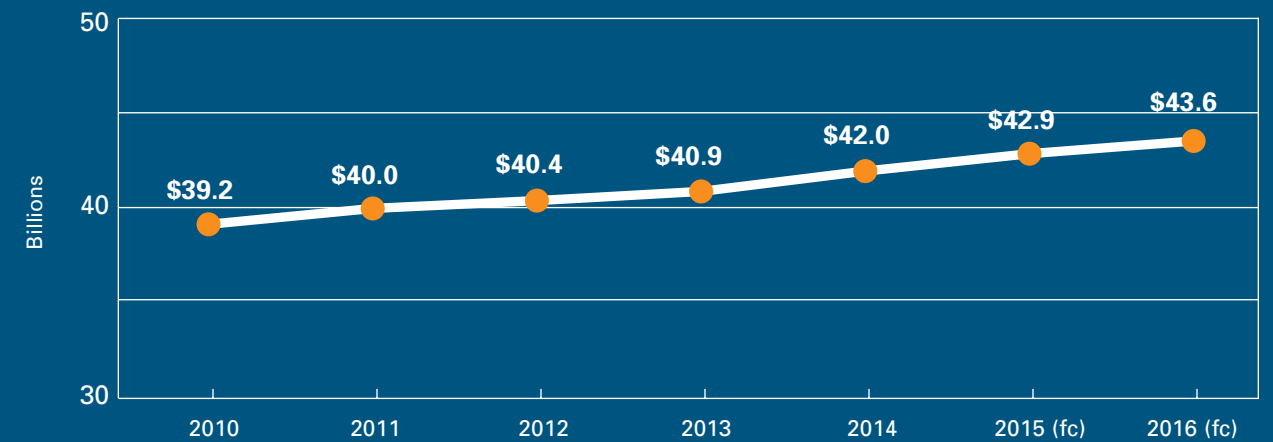
Lowe's Canada began opening stores in Canada in December 2007 and ended fiscal 2014 with 37 stores and more than \$1 billion in sales. Kent remains a dominant player in Atlantic Canada, where eight big-box stores generated an estimated \$267 million in annual sales in 2014.

Buying Group Remains Strong

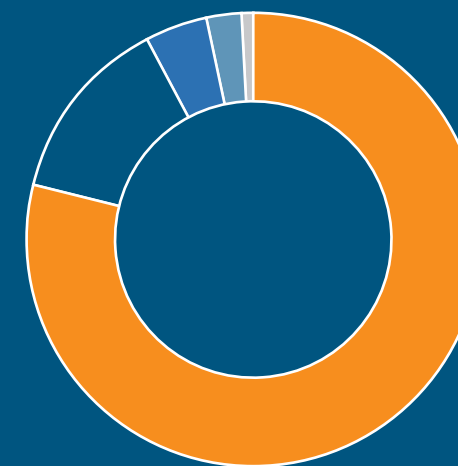
The independent dealer remains a major part of the industry. The buying groups generated almost \$15.5 billion in 2014 from 2,798 stores across a range of banners and affiliations.

Industry growth in recent years has been further supported by steady sales among buying groups, which continue to add specialty members, such as specialty door and window dealers and large pre-fab home builders. ➔

Home Improvement Industry Sales Growth in Billions



Big-Box Stores' Market Share



- 78.9% Rest of the Market
- 13.5% Home Depot Canada
- 4.3% RONA*
- 2.6% Lowe's Canada
- 0.7% Kent*

* Big-box stores only

Top 10 Home Improvement Retailers

| Rank | Company | 2014 Sales in Millions |
|------|-----------------------|------------------------|
| 1 | Home Depot Canada | \$5,655 |
| 2 | Home Hardware Stores | \$5,489 |
| 3 | RONA inc. | \$5,476 |
| 4 | Canadian Tire Retail | \$5,264 |
| 5 | Tim-BR MART Group | \$3,000 |
| 6 | ILDC | \$2,073 |
| 7 | Sexton Group | \$1,800 |
| 8 | Castle | \$1,720 |
| 9 | BMR (La Coop fédérée) | \$1,700 |
| 10 | Lowe's Canada | \$1,100 |
| | Rest of the industry | \$8,694 |

Source: 2014-2015 Home Improvement Retail Report, Hardlines