

Market Measure

The Industry's Annual Report

ooking at external factors alone, one might come to the conclusion that 2017 is shaping up into a booming year for the home improvement retailing industry.

After all, this year has seen strong performance in the housing sector, lower unemployment, an energized stock market, a relaxation of lending restrictions and a consumer base with no shortage of home improvement ideas.

So, why is it that the growth experienced by the industry so far this year has amounted to more of a pop than a boom?

Let's start with the weather.

This has been a particularly odd season for weather across most of the U.S. Some regions had particularly short winters followed by unusually wet springs and summers. Neither of these conditions favors home improvement projects.

In other areas of the country, short winters were followed by incredibly hot and dry spring and summer months where nary a plant would grow (if it were even planted to begin with).

While it is not particularly unusual to see weather have a regional impact on home improvement activities, in 2017, there was hardly an area of the country that was immune to some kind of unfavorable weather conditions.

In addition to an inhospitable visit from Mother Nature this year, there were other manmade obstacles holding industry growth in check.





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The information in this Market Measure was gathered by Hardware Retailing staff from a variety of resources that are attributed throughout.

U.S. Home Improvement Sales

(in billions)

The primary culprit here was the double-edged sword we are facing in the housing market. With banks lending money to consumers again and with unemployment continuing to drop, you would think there would be a ready market for home sales.

However, the downside to these positive factors is the increasing price of homes. According to a housing market forecast from the Home Buying Institute, the rising cost of homes in many areas is literally pricing some consumers out of the market.

"In recent years, home values in many cities have been rising rapidly, to the point that they outpaced wage and income growth. This was mostly the result of an imbalance between supply and demand. In many cities across the country, housing inventories are falling short of demand," the forecast article states.

Rising prices in many markets have seemingly caused some potential homebuyers to take a wait-and-see attitude on moving, which negatively impacts home improvement product sales.

The final factor that might be restraining the industry from more positive momentum is a little tougher to get your arms around. Let's just call it a sort of consumer malaise.

If you look at the retail industry in general, consumers seem to be stepping back a bit from spending on material goods. Home improvement has continued to be a bright spot for all retail sectors, but even in the hammer and nail set, consumers are still not letting go of as much of their hard-earned dollars.

We also anticipate that consumers who choose not to move may begin to tap more readily into their home equity to engage in remodeling projects.

The Results

By our estimates, what this analysis amounts to is that the home improvement retailing industry is growing at a rate of about 4.5 percent in 2017, a full 110 basis points slower than growth during the previous year and slightly below our predictions. While a good bit of that can be attributed to unpredictable and temporary issues such as bad weather, the other economic factors facing the industry may persist in the months to come.

That being said, we are anticipating slightly stronger growth in 2018 (4.7 percent), fueled in part by the continued economic momentum we are experiencing, as well as a modest uptick from building in areas heavily impacted by hurricanes.

We also anticipate that consumers who choose not to move may begin to tap more readily into their home equity to engage in remodeling projects.

This slightly stronger sales trend should continue through 2019, and then we are anticipating a period of slight cooling as we head into 2020.

The Wildcards

There are a few factors to consider that make predicting the direction of any industry difficult.

First is the general unrest many consumers feel about the socio-economic climate of the country. Uncertainty about the economic direction the country, foreign affairs and even social issues can cause a general constriction on consumer spending.

These factors can have a mixed impact on the home improvement industry. On one hand, consumers concerned over world events or economic direction may tighten spending, but they may also spend money on improving their homes.

That's why 2018 and 2019 might prove to be the best years from growth in the industry if all other factors remain constant. The presidential election looming in 2020 could be enough to make consumers sit on their wallets until all the ballots are counted.

Another more immediate factor that could provide a headwind to industry growth is the direction of interest rates. There has been a general discussion that interest rates will rise in the near future. How much and to what extent this could impact consumers' willingness to buy remains to be seen.

The final wildcard is, as always, the weather. While we have seen a few years of unfavorable weather conditions for home improvement product sales, one might expect that we are "due" for a weather cycle that could benefit the industry.

Of course, no one has ever gotten rich on their ability to predict the weather. 🚽



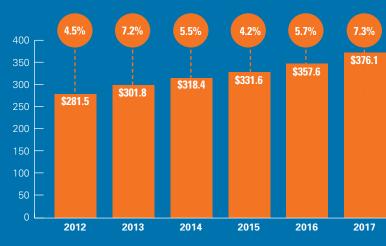
Home Improvement Product Sales Performance (% growth rate)

	2012-2016	2017	2018-202
Consumer	5.2%	5.5%	4.4%
Professional	6.4%	3.4%	2.9%
Total	5.5%	4.9%	4.0%

Source: Home Improvement Research Institute/HIS/Current Prices

Home Improvement Retail Sales

(% change year over year)





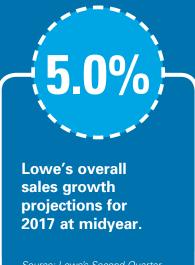


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Source: NRHA 2017 State of Independents Conference Research

Home Depot's overall sales growth projections for 2017 at midyear.

Source: Home Depot Second-Quarter 2017 Financial Report



Source: Lowe's Second-Quarter 2017 Financial Report

2017

Home Improvement Sales by Month (in billions)		
January	\$23.9	
February	\$24.1	
March	\$31.5	
April	\$33.8	
May \$38.6		
June \$36.3		
July	\$32.6	
August (p)	\$33.0	
YTD	\$253.8	
Source: U.S. Department of Commerce/ NAICS 444/Not Seasonally Adjusted		

Home Improvement Sales Growth 2017 vs. 2016		
January	8.6%	
February	4.2%	
March	5.3%	
April	4.4%	
Мау	11.5%	
June	6.1%	
July	8.1%	
August	9.8%	
YTD	7.3%	
Source: U.S. Department of Commerce/ NAICS 444/Not Seasonally Adjusted		

Sales	Sales by Type of Store (in billions)			
	Hardware Stores	\$45.		
	Home Centers	\$222.		
2016	Lumberyards	\$89		
	TOTAL	\$357.		
	Hardware Stores	\$48		
	Home Centers	\$232		
2017	Lumberyards	\$92		
	TOTAL	\$373.		
	Hardware Stores	\$48		
	Home Centers	\$244		
2018	Lumberyards	\$98		
	TOTAL	\$391.		
	Hardware Stores	\$51		
	Home Centers	\$255		
2019	Lumberyards	\$102		
	TOTAL	\$409.		
	Hardware Stores	\$54		
	Home Centers	\$265		
2020	Lumberyards	\$106		
	TOTAL	\$425.		
	Hardware Stores	\$57.		
	Home Centers	\$275		
2021	Lumberyards	\$109		
	TOTAL	\$442.		
Compound	Hardware Stores	4.79		
Annual	Home Centers	4.4		
Growth	Lumberyards	4.2		
Rate 2016-2021	TOTAL	4.4%		

2016-2021			
	Outlets		
	Hardware Stores	19,810	
	Home Centers	9,790	
16	umberyards	9,760	
·	TOTAL	39,360	
	Hardware Stores	19,850	
	Home Centers	9,790	
17	umberyards	9,760	
	TOTAL	39,400	
	Hardware Stores	19,750	
	Home Centers	9,740	
18	_umberyards	9,730	
	TOTAL	39,220	
	Hardware Stores	19,700	
	Home Centers	9,720	
19	umberyards	9,710	
	TOTAL	39,130	
	Hardware Stores	19,700	
	Home Centers	9,700	
20	_umberyards	9,690	
	TOTAL	39,090	
	Hardware Stores	19,675	
	Home Centers	9,680	
21	_umberyards	9,675	
	TOTAL	39,030	
	Hardware Stores	-0.7%	
ent	Home Centers	-1.1%	
	_umberyards	-0.9%	
2021	TOTAL	-0.8%	
	TOTAL ware Retailing	-0.8	

	Market Share Profile				
Top Cha	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
2012	50.0%	14.7%	2012	\$146.40	5,780
2013	50.2%	15%	2013	\$154.80	5,885
2014*	49.4%	16.1%	2014*	\$159.40	6,308
2015	49.7%	16.4%	2015	\$168.55	6,447
2016	51.3%	17.4%	2016	\$183.60	6,846
2012-2016 Percentage Point Change	1.3%	2.7%	2012-2016 Compound Annual Growth Rate	5.8%	4.3%

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

Top Chains: Individual Performance				
2016 Sales (in billions)	Stores at End of 2016	Stores in 2017 (as of October 2017)		
\$94.6	2,278	2,282		
\$65.0	2,129	2,141		
\$10.7*	305	306		
\$6.8	1,595	1,665		
\$2.9	249	256		
\$1.5**	97	99		
\$1.2	145	147		
\$0.9**	48	49		
	2016 Sales (in billions) \$94.6 \$65.0 \$10.7* \$6.8 \$2.9 \$1.5** \$1.2	2016 Sales (in billions) Stores at End of 2016 \$94.6 2,278 \$65.0 2,129 \$10.7* 305 \$6.8 1,595 \$2.9 249 \$1.5** 97 \$1.2 145		

Sources: Company reports and Hardware Retailing surveys The above represent home improvement retail chain stores that carry at least two core categories and have sales of approximately \$1 billion or more. * Source: 2017 STORES Hot 100 Retailers, National Retail Federation **Source: Hardware Retailing estimates

Chain Results

Another Strong Year for Independents

or nearly 100 years, the North American Retail Hardware Association (NRHA) has collected financial and operational data from the independent home improvement industry's hardware stores, home centers and lumberyards.

The result of that research is the annual *Cost of Doing Business Study*, which assesses the performance of retailers who submit their confidential financial reports to NRHA.

The study provides composite income statements, balance sheets and averages for key performance ratios. Highlights from the 2017 study are presented in the following three pages, revealing healthy growth for the sector.

This year's study uses data from the 2016 fiscal year to offer information about the performance of the industry's retail operators, as well as tools they can use to improve their businesses. Retailers throughout the industry use the study for benchmarking, goal setting and planning. The real-world numbers that study participants contribute give an accurate picture of how home improvement retailers of all sizes and store types are performing. Retailers representing 989 independent home improvement stores participated in the 2017 study.

The information is segmented by store type, as well as by typical and high-profit store performance.

Methodology

NRHA gathers the study's data by mailing paper questionnaires to a sampling of hardware stores, home centers and lumberyards in the U.S. Retailers can mail their information to NRHA or upload it online. NRHA provides the analysis in the final report after extensively reviewing the data. Most of the figures in this report are medians, which are the middle numbers in the data when arranged from highest to lowest. The median represents the typical company's results, without extremely high or low outliers skewing the data. To determine high-profit stores, NRHA ranked all participating companies based on net profit before taxes. The high-profit companies in each segment are in the top 25 percent.

How to Use This Study

Here are some pointers for using the 2017 Cost of Doing Business Study effectively.

- Determine your expenses as a percentage of sales and calculate your balance sheet as a percentage 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 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 business's performance differs significantly from the study data, determine the cause and develop a plan to bring your numbers in line with high-profit stores.
- Although high profits have little to do with size, sales growth is one of the keys to profitability.
- When reviewing the numbers on the following pages, note that this report contains figures from a different sample group of stores each year. Overall figures can vary widely from year to year based on the group of stores participating. Year-to-year comparisons are helpful for illustrating general trends over time.



4.2% Highest profit margin

Hardware

Stores

reported since the study began, driven by the highest average transaction size: \$22.



40.3% Total operating expenses were up

slightly due to increases in total payroll and occupancy expenses.

\$

Sales Per Square Feet

\$

Sales Per

Employee

Hardware stores averaged \$51 in product per square foot, resulting in \$188 in sales per square foot.

\$188

Sales per square foot doubled year over year for typical stores, likely due to the unusually high number of multistore respondents.

\$176,657

The average number of employees per typical store increased from 10 to 11, and sales per employee hit an all-time high of \$176,657.

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2.7%

Home center profit margin dipped, decreasing by 1.4 percentage points from 2016's all-time high of 4.1 percent.

4.2%

Profit margin increased 0.5 percentage points above 2016 to 4.2 percent. Average transaction size hit \$199 for typical stores.

27.9%

Total operating expenses for typical stores dropped for the fifth consecutive year.

19.8%

Total operating expenses went down 6.7 percentage points as lumberyards worked toward running leaner operations.

\$607

\$712

Sales per square foot increased from the prior year, with \$129 in inventory stocked for every square foot of selling space.

\$84,303

Gross margin per employee increased from the prior year. Plus, employee counts went up from 16 to 22.

\$92,138

Gross margin per employee went down more than \$4,000 from the year prior, though staff counts increased by one person.

Financial Performance. by Store Type

he following segmented data from the 2017 Cost of Doing Business Study allows retailers to compare their operations' performance against businesses similar to theirs. NRHA divides the analyses into three categories: hardware stores, home centers and lumberyards. The complete study, with an even more detailed breakdown of the data, is available for free to NRHA members or for purchase by nonmembers. Visit **nrha.org** to become a member or to purchase hard copies of the full 28-page report.

Hardware Stores

Hardware stores that participated in the 2017 study saw growing sales and profitability and record performance in areas such as sales per customer, gross margin after rebate and net profit per store.

As an entire group, including high-profit, typical, multistore and single-store operations, hardware stores experienced same-store sales increases of 3.6 percent year over year. Respondents seemed to be driving sales growth by simply selling more to customers.

Employee productivity looked particularly good, with average sales per employee of \$176,657 and average transaction sizes of \$22 per customer—record highs. Top-performing stores averaged \$30 per transaction.

Customer counts for the typical stores participating in the study were 86,162, the best that performance indicator has looked since 2007.

High-profit stores' average customer counts were lower at 75,236, suggesting that those businesses are succeeding at selling more product to top-tier customers.

High-profit operations saw average sales of \$244 per square foot, compared to \$188 per square foot for an average store.

Home Centers

Home centers generated their highest-ever sales per customer figures in this year's study. High-profit stores more than doubled the

bottom-line performance of typical stores, churning out net profits of 5.9 percent of sales compared to the others' 2.7 percent.

At the same time, the top-performing group had a cost of goods sold that was 1,000 basis points lower than that of the average sample stores. These metrics suggest that high-profit stores are more disciplined with cost management.

A major difference between the typical stores and top performers was driven by the volume of customers at the high-profit operations, which experienced an average customer count of 82,958 compared to 57,942 at typical stores.

Typical stores saw inventory turns hit 4.2 percent, which was nearly a 10-year high, while high-profit home centers registered average inventory turns of 2.1 percent.

Typical stores also averaged \$607 in sales per square foot versus \$581 at high-profit stores.

Lumbervards

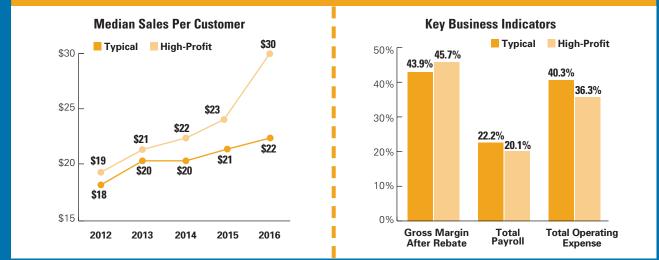
Lumbervards continued to drive profits as sales improved, according to the 2017 study.

Same-store sales for lumberyards increased 3.8 percent, for an average of nearly \$5.8 million in sales.

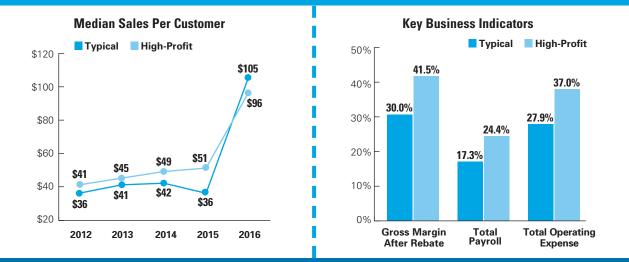
Higher margins and careful expense management helped high-profit stores yield particularly strong results in this year's study. This group netted profits of 7 percent compared to a still healthy 4.2 percent at the typical lumberyard.

High-profit respondents' sales of \$4.8 million were slightly lower than the average stores. Top performing stores' higher net profits reflected more frugal management, shrewd buying and careful expense controls than at typical operations.

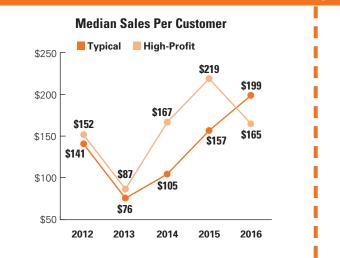
Overall, lumberyards have driven labor costs down, resulting in the study's lowest-ever recorded payroll expense of 11.5 percent. Managing these numbers along with other expenses made an important difference for high performers versus average stores. Top performers also profited from margins that are a full 2.5 percent higher than their average counterparts. 🚽



Home Centers

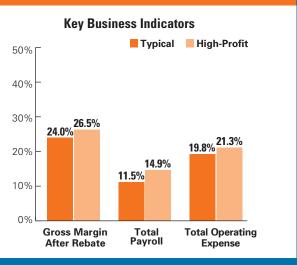


Lumberyards



Source: North American Retail Hardware Association. Figures based on responses to the 2017 Cost of Doing Business Study

Hardware Stores



Financial Profile of Leading Publicly Held DIY Chains 2016

Operating and Productivity Profile	Home Depot	Lowe's Cos.
Number of Stores (at end of 2016)	2,278	2,129
Average Size of Selling Area (sq. ft.)	104,000	100,000
Total Sales	\$94.6 billion	\$65.0 billion
Total Asset Investment	\$43.0 billion	\$34.4 billion
Total Inventory	\$12.5 billion	\$10.5 billion
Sales Per Square Foot	\$398.46	\$305.24
Inventory Turnover	4.9x	4.1x
Net Sales to Inventory	7.5x	6.2x
Total Sales Per Employee	\$232,993	\$270,904
Average Size of Transaction	\$60.35	\$68.82
Gross Margin Return on Inventory	257.50%	214.80%
Income Statement	Home Depot	Lowe's Cos.
Net Sales	100.0%	100.0%
Cost of Goods Sold	65.8%	65.4%
Gross Margin	34.2%	34.6%
Total Operating Expenses	20.0%	23.3%
Net Income (Before Taxes)	13.2%	8.0%
Balance Sheet	Home Depot	Lowe's Cos.
Total Current Assets	41.3%	34.9%
Cash	5.9%	1.6%
Receivables	4.7%	0.3%
Inventory	29.2%	30.4%
Other	1.4%	2.6%
Fixed Assets	58.7%	65.1%
Total Assets	100.0%	100.0%
Current Liabilities	32.9%	34.7%
Long-Term Liabilities	57.0%	41.8%
		40 70/
Net Worth	10.1%	18.7%

Profile of Top Four Ace Hardware Corp. Do it Number of Distribution Centers 20 **Current Number of Members** 4,400 **Dollar Volume Most Recent Fiscal Year** \$5.1 billion \$3. % Sales Out of Warehouse 81.0% % Sales Out of Pool/Relay 0.0% % Sales Direct-Drop Ship 19.0% % Sales in LBM N/A Number of Employees 7,000** Avg. Number of SKUs in Warehouse 95,000 Sales/Inventory Ratio for 2016 6.9 2016 Member Rebate Distributed \$157.9 million \$115 % Cash 38.0% % Stock 35.0% 27.0% % Other % Other 22.0%

Sources: Annual company reports *Number of stores served, since Orgill is not a cooperative and does not have members. **Approximate numbers.

Profile of Wholesaling Merchandising Groups						
PRO Group Inc. Distribution America Val-Test Group						
Current Number of Wholesale Members	79	10	65			
Number of Member-Operated Distribution Centers	150+	11	68			
Dollar Volume for 2016 Fiscal Year	\$5.25 billion	N/A	\$720 million			
Estimated Dollar Volume Calendar 2017	\$5.25 billion	N/A	\$680 million			
Number of Retail Stores Served by Members	35,000	10,000	4,000			
Number of Program Stores8002,000200						
Number of Employees 17 10 7						
Source: Annual company reports						

Best Corp.	True Value Co.	Orgill Inc.
8	12	7
3,800	4,400**	6,225*
.2 billion	\$2.07 billion	\$2.19 billion
33.0%	70.0%	71.6%
0.0%	0.0%	0.0%
67.0%	30.0%	29.4%
22.0%	15.0%	9.0%
1,450	2,350**	2,385
67,000	80,000	75,000
12.16	5.4	8.36
5.5 million	\$23.1 million	N/A
77.0%	92.0%	N/A
23.0%	8.0%	N/A
0.0%	0.0%	N/A
0.0%	0.0%	N/A

December (2016)

- The National Labor Relations Board (NLRB) addressed a potential labor law violation by Menards. The NLRB's complaint alleged the big-box home improvement retailer violated labor laws by classifying delivery drivers as independent contractors instead of employees.
- Walter Hachborn, former president and Home Hardware Stores Ltd. co-founder. died Dec. 17 at the age of 95. He helped grow Home Hardware into Canada's largest independent home improvement retailer.
- Lowe's Canada announced plans to grow the Canadian company RONA and Ace Hardware Canada. Lowe's also acquired licensing rights to the Ace brand in Canada.

January

- Sears Holdings Co. announced 150 store closures to "enhance liquidity and stabilize operating performance." The company also confirmed its sale of Craftsman to Stanley Black & Decker for \$900 million.
- United Hardware celebrated its 60th anniversary at its January market.
- Walmart planned to eliminate about 1,000 human resources, technology and e-commerce jobs by month's end.



February

- 84 Lumber caused a stir with a politically charged advertisement featuring immigration and a wall during the Super Bowl. The ad directed viewers to the 84 Lumber website, which crashed from an overload of visitors. The full-length commercial garnered millions of views on YouTube.
- Lowe's announced another round of staffing cuts at its corporate headquarters and two support facilities, eliminating more than 500 positions.

March

- **Home Depot** agreed to pay \$25 million for damages that financial institutions faced as a result of the retailer's September 2014 data breach.
- The Sherwin-Williams Co. announced its \$11.3 billion deal to buy **The Valspar Corp.** would be delayed until June 2017.
- Central Network Retailing Group (CNRG), bought McLendon Hardware, a company with seven stores in Washington state.
- Lowe's Canada announced plans to consolidate Ace Canada operations so the big-box retailer and cooperative would share Canadian distribution functions. Ace Canada was set to close two distribution centers and its main office in the country, planning to move into the Lowe's Canada office.

April

• Ace Hardware Corp. hired Grainger executive Mark Spanswick to be president and general manager of Ace Wholesale Holdings LLC. He spent 27 years working for industrial supplier W.W. Grainger. At Ace, Spanswick leads the wholesale division, which is a compilation of the co-op's two acquisitions it made with Emery-Waterhouse Co. and Jensen **Distribution Services** in addition to a new distribution arm created in 2015.



May

- Lowe's announced its \$512 million purchase of Texas distributor, Maintenance Supply Headquarters, to grow its pro business.
- Hardware Distribution Warehouses Inc. announced its purchase of a 670,000-square-foot facility in Marshall, Texas, to serve as the new corporate headquarters. The facility will also allow consolidation of its Houston and Shreveport, Louisiana, distribution centers to the new location.

June

- Amazon announced it would acquire the high-end grocery chain Whole Foods Market for \$13.7 billion, giving the online retailer a network of more than 460 brick-and-mortar stores.
- **Do it Best Corp.** was named the largest private company in Indiana by the Indianapolis Business Journal. The ranking is based on annual revenue.
- **Orgill Inc.**'s Post Falls, Idaho, distribution center began serving retailers in five states throughout the northwestern U.S. as well as customers in western Canada. The company originally announced the new center in August 2016.

Julv

• **Home Depot** announced an agreement to purchase Compact Power Equipment Inc., a national provider of equipment rental and maintenance services, for \$265 million in cash.

- in America.

August

• **True Value** president and CEO John Hartmann addressed a *Bloomberg* story that the Chicago-based co-op was considering a potential sale. Hartmann told Hardware Retailing that their retailers "own the company and anything that would change that, they would have a say in."

• The company that owns T.J. Maxx and HomeGoods in the U.S. introduced Homesense, a new big-box chain with its first location in Massachusetts

September

• The **Equifax** data breach may affect small business owners differently than everyday consumers, according to a class-action lawsuit filed on behalf of about 28 million small business owners in the U.S.

• Walmart announced plans for a new corporate headquarters in Bentonville. Arkansas. **Amazon** announced plans to build a second headquarters somewhere in the U.S. or Canada, with more than 200 cities bidding for the business.

October

• Ace Hardware Corp. purchased the majority stake in e-commerce startup The Grommet.

Walmart purchased Parcel, a delivery logistics startup that focuses on overnight and same-day last-mile delivery.

• Sears Canada Inc. will liquidate its assets after its board rejected a business plan proposed by the company's top executive.

• Menards founder John Menard Jr. is the wealthiest person in the state of Wisconsin, with a net worth of \$9.9 billion, according to Forbes' list of the 400 richest people

November

Westlake Ace Hardware announced it will acquire Buikema's Ace Hardware, an independently owned business that operates seven stores in the Chicago area.

Checking the Foundation of the 2017 Housing Market

A Q&A With George Ratiu



Solid demand and steadily increasing home prices have been two of the biggest housing headlines in 2017. To learn more about housing trends this year and predictions going into

2018, Hardware Retailing spoke with George Ratiu, director of quantitative and commercial research at the National Association of Realtors (NAR). He oversees a portfolio focused on macroeconomic trends, commercial real estate and global investments. Overall, Ratiu and his organization maintain a moderately optimistic outlook for the 2018 housing market.



Hardware Retailing (HR): What trends have you seen develop in the 2017 U.S. housing market? George Ratiu (GR): This year, the housing market saw pretty solid demand, especially during the first half of the year. From the midpoint of the year on, there was an extremely tight inventory, both for new home sales and especially for existing homes. A lot of buyers are finding a very tight market, which prevents them from buying homes, and in turn, lowers sales. Just as importantly, we've seen a pickup in sale prices each month this year.

HR: New housing starts and existing home sales are increasing slightly over 2016 levels. What does that say about the housing market?

GR: There's sort of a domino effect at work here. Many homebuilders are not building enough new inventory, so first-time homebuyers are finding it increasingly difficult to enter the housing market due to higher prices and more competition.

HR: In August, housing prices reached their 66th consecutive month of gains. NAR said high prices have prevented many prospective homebuyers from entering the housing market. How might continually rising existing home prices impact the housing market in the long term?

GR: Rising prices are good and bad. They're a reflection of market dynamics. But when we look at price trajectory from the perspective of a growing population, comprised mostly of Generation X, millennials and Generation Z, rising home prices, mortgage prices and high student debt, then accelerating home prices will harm the housing market in the long term because first-time homebuyers simply won't be able to afford it.

HR: How do you foresee tax reform impacting the housing market?

GR: For homeowners, tax reform is a very important issue. As the proposal currently stands, it's likely to have an impact on the prices of homes across



the country. By our estimate, it would be a roughly 10 percent decline in home prices. When you look at homeowners who are staring at a 10 percent loss in their homes, they're looking at an immediate \$26,000 loss for an average-priced house. I don't think any homeowner will be in a position to think about remodeling or building a new home given that significant loss. For new home sales, I foresee a tremendous impact as well. I see a negative impact for new home sales and the remodeling industry if the tax reforms go forward as currently written.

HR: What do 2017 U.S. housing trends say about the economy overall?

GR: Considering that before the recession, it was the housing industry that put the economy in recession, in a sense it's been housing that brought the economy back. With price appreciation, homeowners' wealth has also been increasing, which has meant that homeowners have been a whole lot more optimistic and have been spending a lot more, which drives the economy. In 2017, due to a slowing housing market, we're likely restraining some level of economic growth. Going into 2018, my expectation is that at the current rate, we'll continue to see soft economic gains.

HR: What growth and challenges have the residential and commercial real estate markets experienced this year?

GR: The one common challenge that both residential and commercial markets have experienced this year is a tightness of inventory. From there, the other common thread is price appreciation. We've seen

a 6 percent price appreciation on the residential side, which is significant because it far outpaces the trajectory of income growth. Obviously that impacts a lot of potential buyers.

When we look at the fact that interest rates are expected to increase, that impacts first-time buyers. I see tightness of inventory, accelerating prices, strict mortgage underwriting standards and availability of capital as the major factors in residential and commercial real estate markets.

HR: What should homeowners and retailers be mindful of as we head into 2018?

GR: Consumers have been feeling a lot more optimistic about the market and have been spending a lot more freely. We see that in auto sales and household appliance sales. I think going into 2018, as long as unemployment and wages remain on an upward trajectory, consumer optimism and spending are likely to grow. I think consumers should pay attention to tax reform. There are significant changes proposed to the treatment of taxes for individuals and corporations and any of those changes are likely to impact their bottom lines. So consumers and retailers should pay attention to Congress and make their voices heard.

For retailers, I think the outcome of tax reform is likely going to alter a lot of business practices moving forward. If we're seeing a decrease in wealth across the board, that's likely going to reduce the optimism and lead to lower spending, which for retailers, means a reduction in sales in the future. 🚽

Hurricanes and Home Improvement

A O&A With Jack Kleinhenz



Jack Kleinhenz is chief economist for the National Retail Federation (NRF), the world's largest retail trade association. Formerly with the Federal Reserve Bank in Cleveland, Kleinhenz is a

contributing forecaster to The Wall Street Journal. CNBC, the Federal Reserve Bank of Chicago and the Federal Reserve Bank of Philadelphia.

Hardware Retailing (HR): What trends are impacting the home improvement retail sector?

Jack Kleinhenz (JK): According to data from the American Society of Interior Designers, singlefamily and multifamily residential sectors have show positive revenue trending gains since December 2016. Interior design firms are optimistic, which will have a positive impact on home improvement spending.

Residential and nonresidential construction are also clocking a monthly average of 12 percent and 3 percent respectively in the first eight months of 2017. Residential construction spending includes any spending related to existing homes, new homes, second homes and anything people will need to invest, repair, replace or update. This is a very positive outlook for the home improvement sector, and the trend seems to be on the uptick.

I regularly review a monthly report of retail sales in the building materials sector, and it's coming in at a fairly nice rate, in excess of 5 to 6 percent. With strengths in the housing market and higher wages, people feel good about their own wealth from home prices and the values of their investments, which all point in the direction of continued home investment, repair and renovation projects.

The retail sector, in general, has been suffering from a lack of pricing power. And if you're a convenience-style hardware store, you can't rest your business on price. So, it has to be about offering something else.

I recently went to four different stores looking for nylon paracord. I finally found a hardware store that, even though they didn't carry what I needed, the owner got online with me to find somewhere that did. I asked him if I could pay him for his help, and he said, "I just want you to come back sometime in the future."

HR: What do current economic indicators sav about the end of 2017, going into 2018? What does that mean for consumers?

JK: Strong momentum in the second quarter carried us through into the third quarter. The third quarter is a bit of a surprise. I expected more of a speed bump from the hurricanes. We don't know yet if it's an overall loss or just delayed spending. We do know that the supply chains were impacted, whether ports, factories or trucking. In general, we believe that the economy should return to its pre-hurricane path and any loss of spending will be made up going into 2018.

We saw the first vestiges of the impact of the hurricanes in the employment data. They couldn't get the surveys and collect the data from firms in Florida and Texas, so that causes a concern. On the other side of the coin, the retail sector navigated reasonably well through September. There was a boost in spending on building supplies and materials, but some sectors didn't do so well because people were displaced from the region.

The momentum before the hurricanes was the combination of rising incomes and employment. Reasonably, we'll see a rebound into the fourth quarter and into next year, but it will be a delayed response.

Looking at GDP, a softer first quarter is possible, with 2.3 to 2.5 percent growth. It remains to be seen, but there is room to be optimistic.

The most recent consumer confidence index reading was a new cycle high. Some of that is due to wage increases, which are up 2.9 percent year over year and are up 2.7 percent year over year for the quarter.



Consumer spending continues at a good sturdy rate, but it's not a breakout speed, largely because consumers continue to be very pragmatic about their spending.

Although wages have recently risen, they have not kept pace with higher inflation activities like health care, rent and medical services. Those expenses have been outpacing inflation, and wages have barely been meeting inflation.

Consumer spending continues at a good sturdy rate, but it's not a breakout speed, largely because consumers continue to be very pragmatic about their spending. It still bodes well for a good start in 2018.

HR: How might the economy affect small businesses in 2018?

JK: Running small businesses will continue to be an ongoing balancing act of having the right pricing and the product when the customer needs it.

Small business optimism is also a function of local demographics. It's not all one monolithic economy. We have much different spending paces,

for example, in the Southwest compared to the Southeast. Some areas will continue to require a lot of effort and "stick-to-itiveness" to be successful. Population growth has flatlined in some parts of the U.S., which can affect small businesses, especially with aging populations. Sometimes that can be good, with people staying in their homes, but older people also delay improvements because of fixed incomes and other expenses. Medical spending, taxes and utilities could delay projects that would happen if they were 10 or 15 years younger. But I think the home improvement industry is on the front line of these aging-in-place developments. On the other side of the coin, you have to ask, "What's going on with millennials?" There has been some delayed purchasing, but now they're getting back on track, buying homes, making improvements and spending wisely, which should be a positive development in a broader sense for the industry.

HR: What will consumer optimism be in 2018?

JK: What you should be asking is, "Does consumer confidence translate to spending?" I haven't seen that to be the case.

Consumers are asking, "Do I have a job, am I making more money, what do my retirement investments look like?" All of those seem to be on the right trajectory, which gives them the ability to spend. Their willingness to spend is a different issue. We're different than we were before the

Great Recession. We're not taking out as much credit, and banks have tightened up credit requirements for consumers. 🚽

Canadian Retailers Face Challenges, Opportunities

Provided by Michael McLarney, Editor-in-Chief, Hardlines Inc.

anada's retail home improvement market grew at a modest but healthy pace in 2016, up 2.9 percent from the year before. Conditions helping this growth included Canada's red hot housing market, low interest rates and aging housing stock—all factors driving renovation sales. And that modest growth has maintained itself in 2017 and is forecast to continue in 2018.

Varying economic conditions, not to mention weather, impacted Canadian retailers through last year, while 2017 has proven to be steady, if not exceptional, for most regions. A few exceptions persist: The Greater Toronto Area of Southwestern Ontario has seen healthy growth over the past two years, and despite changes last summer to real estate laws in British Columbia, that province's Lower Mainland around Vancouver also remains strong. As a result, the industry is forecast to grow by a slightly higher rate in 2017 of 3.5 percent.

Big-Box Format Makes Big Gains

Big boxes enjoyed the greatest sales growth of all the retail formats, thanks both to strong incremental gains by Home Depot Canada and to new stores built by Lowe's Canada in 2016. While Lowe's has built some new stores in 2017, the focus has been on converting some of its RONA Home and Garden big boxes to the Lowe's banner. In fact, the market share of these big-box retailers is now at a record high, accounting for more than one-quarter of all retail home improvement sales.

Industry Consolidation Continues

Along with Home Depot Canada and Lowe's Canada, Home Hardware Stores Ltd. and Canadian Tire Retail make up well over half of all sales by hardware stores and building supply retailers in Canada. These "Top Four" retailers collectively grew their sales at a rate almost double the industry average last year, driving more consolidation at the top and ensuring that the big players in this industry continued to get bigger in 2016.

However, the majority of Canada's home improvement retailers are members of a lumber and building materials (LBM) buying group, offering an effective way for smaller businesses to pool their purchasing power into larger volumes. While affiliation with buying groups helps independent retailers stay competitive, the groups nevertheless faced tough market conditions in 2016. Much of that came in the form of competition from the industry's top retail chains, such as Home Depot Canada and Lowe's Canada.

In terms of sales volume, the largest group in Canada is represented by the building center retailers within Home Hardware. Collectively, sales by LBM retailers in Home Hardware exceed \$4 billion. That group is followed closely by Independent Lumber Dealers Co-operative, with collective retail sales by its members of \$3.8 billion. TIMBER MART and Castle follow, with estimated sales of \$2.8 billion and \$2 billion respectively. The other noteworthy groups in Canada are Sexton Group, Delroc Industries and Quebec-based Groupe BMR and Pilon Ltée.

Challenges to Retailers

The list of issues shared by retailers across the country is topped by the insurgence of internet sales. Retailers are looking for ways to create an experience in their stores that ensures they remain a destination for their local markets. Some are doing this through increased customer service and better product knowledge, niches within the store that are carefully tailored to local needs and a strong involvement in community events and fundraising.

Finding—and keeping—good employees also looms large as a challenge everywhere. The sense by many young people that retail is a job and not a career choice makes staffing a big concern for many. And competition from other fields is just part of the problem. In many instances, retailers will look to their competitors to poach good people.

Finally, creating growth in a relatively stable marketplace puts the onus on retailers to look for ways to steal market share. These conditions are expected to persist into 2018. 🚽

Home Improvement Industry Sales Growth (in billions)

Top 10

Rank

1

2

3

4

5

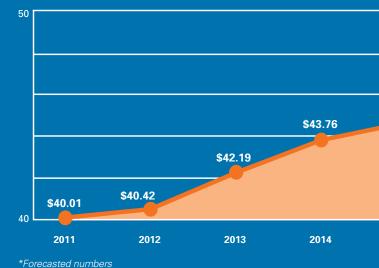
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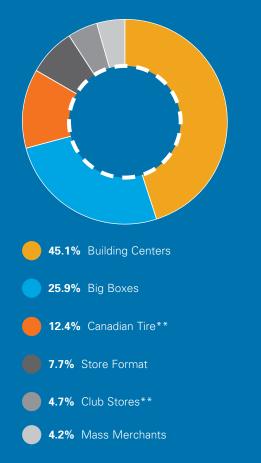
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9

10



Market Share by Store Format





			\$49.10
		\$47.54	
\$44.62	\$46.00		
2015	2016	2017*	2018*

10 Home Improvement Retailers				
Company	2015 Sales in Millions	2016 Sales in Millions	Percentage of Change	
Home Depot Canada	\$7,195	\$7,700	7.0%	
Lowe's Canada	\$6,600	\$6,900	4.5%	
Home Hardware Stores	\$5,865	\$6,140	4.7%	
Canadian Tire Retail	\$5,435	\$5,690	4.7%	
ILDC	\$2,650	\$3,800	43.4%	
TIMBER MART	\$2,840	\$2,800	-1.4%	
Castle Building Centres	\$1,875	\$1,950	4.0%	
Sexton Group	\$1,885	\$1,800	-4.5%	
Groupe BMR	\$1,200	\$1,200	0.0%	
Kent Building Materials	\$769	\$784	2.0%	

Source: 2017 Hardlines Retail Report