THE INDUSTRY'S 2012 ANNUAL REPORT

Home Improvement Industry Continues Its Positive Climb

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Now that the smoke has settled on the nation's political landscape, we're starting to get back to business as usual. And, while in the throes of an election it's easy to get caught up in the extreme politicking of both parties, the only way to tell the true efficacy of any administration is through the context of time. The home improvement industry is no different.

For years, we've found ourselves caught in purgatory between recession and recovery. No one, including analysts at *Hardware Retailing*, really knew how deep the recession pulled the economy down, and media reports left us hinged between hope and doubt.

Now after two years of positive—albeit slow—growth, we are starting the climb out of that hole. But what is maybe more obvious from the calculated growth over the past two years is how much farther and slower that climb will be than anyone ever anticipated.

Looking Back

It's no secret that three years ago, the economy took a blow. And with a majority of that downturn stemming from problems in the housing market and unemployment, home improvement retailers were hardly spared the turmoil.

So in 2010, when we saw a glimmer of positive growth after such a dramatic downturn, we grew hopeful at the possibility of recovery. But as a wary country, we moved cautiously and waited for 2011 to reassure us and confirm recovery.

Then 2011 came and ended. The home improvement industry posted sales of $278.3 billion, 3 percent higher than 2010. Two years of positive growth was promising, but unemployment was still high, housing inventory remained off-balance and banks kept a tight grip on loans. Retailers and consumers remained gun-shy, not ready to forgive and forget the past years' struggles, and we all wondered if growth in 2011 was just a first-class ticket to a double dip.

Continuing the Climb

Thankfully, 2012 reports are showing some positive signs, both in the market and in consumer confidence. Caution is beginning to subside as we welcome the first signs of organic growth. Stronger-than-usual overall sales were fueled by an unseasonable short winter and warmer weather. Unfortunately, those temperatures kept climbing warmer and warmer, and summer climate hit record numbers. Should the weather have been a bit more in line with historic accounts, we think 2012's 4.3 growth would have been even stronger.

Consumers learned a hard lesson in the past five years, and they aren't extending themselves financially as they once did. They continue to purchase smaller ticket items and they're choosing to finance those purchases out of pocket or through short-term credit.

This year is about adjusting for the past and looking forward.

Positive Factors Impacting Growth

Many signs are pointing to a positive future for the home improvement industry, including:

- employment numbers on the rise,
- homebuilders starting to look longingly at empty lots again,
- housing starts and inventory starting to level out, creating a healthier balance,
- and, possibly the most promising factor, growing positive consumer confidence.

Before you start celebrating, keep in mind there are several challenges that could produce substantial obstacles for recovery.

National and Personal Debt

Debt will continue to be an inevitable challenge for the economy. Both national and personal debts continue to drive consumer behavior. As national debt continues to grow and the solvency of Medicare and other programs hinge in the balance, consumers are hesitant with spending.

The looming threat of a school loan crisis also continues to weigh heavily on consumers' minds. Just five years out of the housing bubble burst and credit crisis, growing education fees are strapping today's younger consumers with more debt. Adjusting their budgets for those payments leaves consumers who are entering their prime house-buying years with less discretionary income.

Consumers learned a hard lesson in the past five years, and they aren't extending themselves financially as they once did. They continue to purchase smaller-ticket items, and they're choosing to finance those purchases out of pocket or through short-term credit.

Weather/Global Issues

Additional issues exerting pressure on the health of the industry include factors we cannot predict.

As the weather continues to take on vastly different patterns than traditional weather models, it grows harder and harder to plan for inventory. Retailers who heed the advice of weathermen are finding themselves with backrooms full of snow shovels as consumers browse salesfloors in shorts and tank tops. Past inventory strategies are crumbling under the unpredictable nature of weather.

Additionally, uncertain global issues could also create greater headwinds to growth. Should the Euro and Greece's rocky economic stability start to migrate back to the markets of North America, or should the U.S. be forced into foreign policies that prove taxing on the economy, we may start revising our forecasts.

Inflation

And even as the economy shows signs of improvement, domestic financial issues such as inflation could prove detrimental to the health of the industry. While inflation rates at historically low levels recently, uncertainty over the direction inflation may go in the future discourage investment and have dire effects on consumers' confidence and willingness to shell out their hard-earned dollars.

Changing Consumer Habits

Finally, we must take into account the changing shopping habits of consumers. Technology, for instance, is quickly changing how and where consumers buy. These developments could have significant effects on the future of the industry. While online sales are included in most retail forecasts, it is hard to anticipate where and to what degree

Industry Sales Methodology

NRHA and *Hardware Retailing* take a large number of factors into account when determining our 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 weight 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 using a formula to determine 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, big-box outlets and retail lumberyards.

future technologies will drive the industry and the economy.

Opportunities for Retailers

In addition to the anticipated growth retailers will see in 2013, there are many opportunities for them.

Niche areas. Americans always find ways to spend money on their hobbies and luxuries. Whether it's a pet niche that caters to Fido or a beer-making niche that replaces a couple's extravagant brewery trip, retailers are finding promise in niches that differentiate their assortments from the competition.

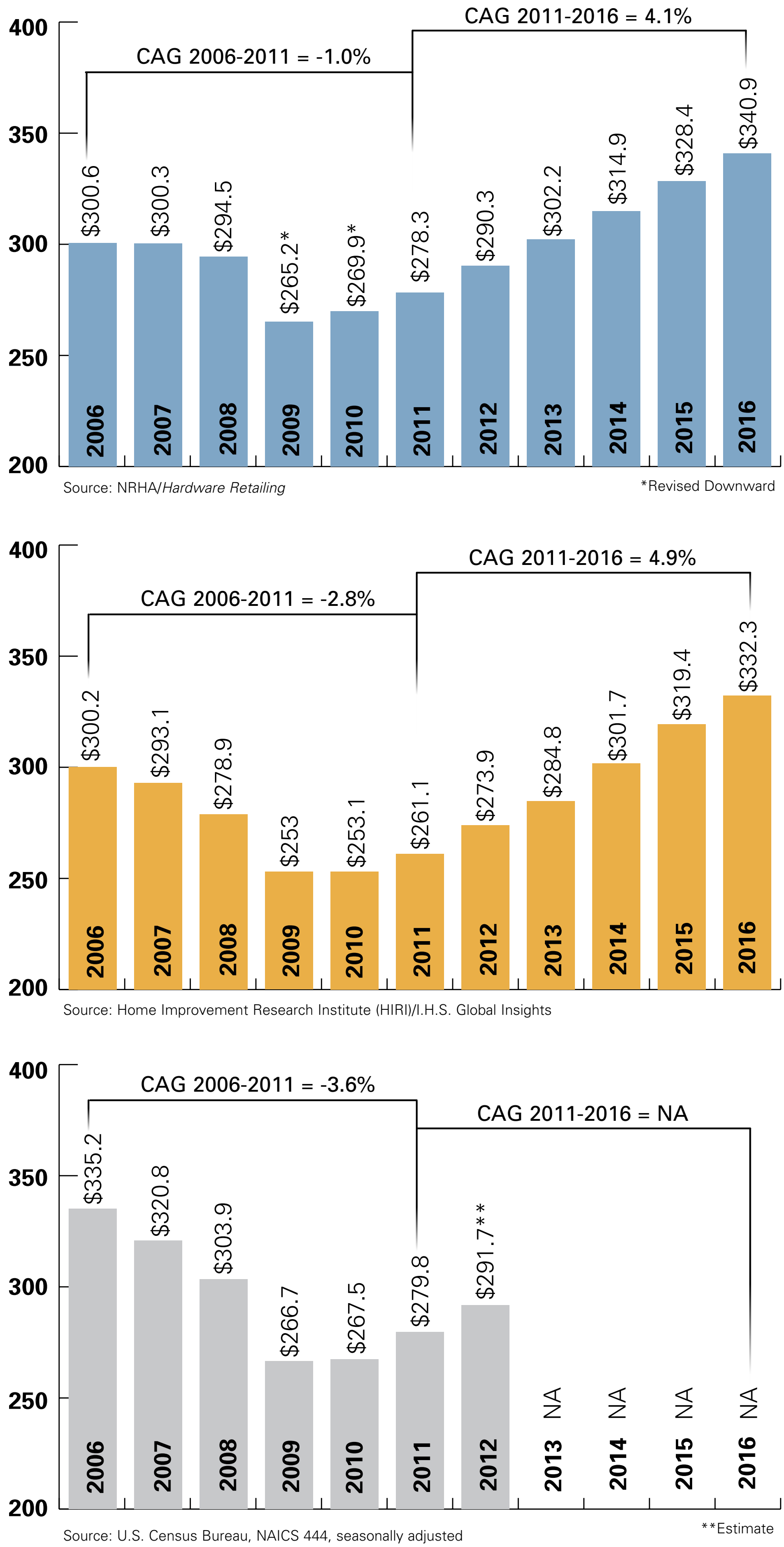
Home Aesthetics. Today's consumer is opting for a $1,000 face-lift for the kitchen, but she is not willing to take out a loan to remodel.

The good news is that reports do show the size of the average ticket is on the rise, so while consumers may not be ready to do a whole remodel, they are increasing the spend on home improvement projects.

Overall, jitters are easing as continued growth offers hope, and analysts anticipate growth through 2013 and beyond. But our analysts have adjusted 2009 and 2010 numbers to reflect a greater effect from the recession and believe any rebound will unfold as a gradual and calculated increase. We anticipate the future growth of the home improvement industry will look much different from the boom years of the '90s.

The following information provided in *Hardware Retailing*'s *2012 Industry Annual Report* offers a clearer picture of the current state of the home improvement industry. By using the following data as benchmarks, you can compare your operation to your peers' and get an idea of where we stand as an industry.

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



2012

DIY Sales By Month

Sales in Billions

January	$24.9
February	$24.9
March	$25.3
April	$24.5
May	$24.0
June	$23.5
July	$23.9
August	$24.4
September (p)	$24.6

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

Sales Growth 2012 vs. 2011

January	10.5%
February	12.5%
March	13.7%
April	8.8%
May	4.3%
June	-0.3%
July	1.0%
August	2.9%
September (p)	4.5%

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

2011-2016

Sales By Type of Store

Sales in Billions

2011	Hardware Stores	$37.9
	Home Centers	$173.1
	Lumberyards	$67.3
	TOTAL	$278.3
2012	Hardware Stores	$38.3
	Home Centers	$181.7
	Lumberyards	$70.3
	TOTAL	$290.3
2013	Hardware Stores	$39.6
	Home Centers	$188.3
	Lumberyards	$74.3
	TOTAL	$302.2
2014	Hardware Stores	$41.9
	Home Centers	$192.4
	Lumberyards	$80.6
	TOTAL	$314.9
2015	Hardware Stores	$43.9
	Home Centers	$203.6
	Lumberyards	$80.9
	TOTAL	$328.4
2016	Hardware Stores	$45.7
	Home Centers	$211.7
	Lumberyards	$83.5
	TOTAL	$340.9
Compound Annual Growth Rate 2011-2016	Hardware Stores	3.8%
	Home Centers	4.1%
	Lumberyards	4.4%
	TOTAL	4.1%

2011-2016

Outlets

2011	Hardware Stores	19,940
	Home Centers	9,750
	Lumberyards	9,775
	TOTAL	39,465
2012	Hardware Stores	19,920
	Home Centers	9,720
	Lumberyards	9,750
	TOTAL	39,390
2013	Hardware Stores	19,900
	Home Centers	9,710
	Lumberyards	9,725
	TOTAL	39,335
2014	Hardware Stores	19,900
	Home Centers	9,650
	Lumberyards	9,775
	TOTAL	39,325
2015	Hardware Stores	19,890
	Home Centers	9,675
	Lumberyards	9,785
	TOTAL	39,350
2016	Hardware Stores	19,870
	Home Centers	9,670
	Lumberyards	9,780
	TOTAL	39,320
Percent Change 2011-2016	Hardware Stores	-0.4%
	Home Centers	-0.8%
	Lumberyards	0.1%
	TOTAL	-0.4%

Market Share Profile

Top Chains Industry Share	Sales (as % of total industry)	No. of Stores (as % of total industry)	Top Chains Combined Performance	Net Sales (in billions)	No. of Stores
2007	50.9%	13.8%	**2007**	$152.8	5,672
2008	48.3%	13.7%	**2008**	$142.1	5,532
2009	48.2%	13.4%	**2009**	$130.7	5,318
2010	47.2%	14.4%	**2010**	$131.3	5,725
2011	49.1%	13.8%	**2011**	$136.7	5,441
2007-2011 Percentage Point Change	-1.8%	0%	**2007-2011** Compound Annual Growth Rate	-2.8%	0.1%

Top Chains Individual Performance

	2011 Sales (in billions)	Stores at End of 2011	Stores as of Fall 2012
Home Depot Atlanta	**$70.4**	**2,252**	**2,250**
Lowe's Mooresville, N.C.	**$50.2**	**1,753**	**1,745**
Menard Inc. Eau Claire, Wis.	**$7.2**	**260**	**270**
Pro-Build Holdings Denver	**$3.5**	**439**	**435**
84 Lumber Eighty Four, Pa.	**$1.6**	**265**	**251**
Sutherland Lumber Kansas City, Mo.	**$1.0**	**56**	**55**
Stock Building Supply Raleigh, N.C.	**$0.8**	**57**	**57**
Carter Lumber Kent, Ohio	**$0.7**	**190**	**198**
Orchard Supply Hardware San Jose, Calif.	**$0.7**	**89**	**89**
BMC Boise, Idaho	**$0.6**	**80**	**88**

Source: Company Reports and *Hardware Retailing* Estimates
**The above represent top home improvement outlets with approximately 10 percent or more of sales coming from consumers.

Annual Survey Suggests Improvements

For retailers participating in the *2012 Cost of Doing Business* study, fiscal year 2011 was a year where top-line business conditions improved across the entire survey sample. This was the case regardless of store type, so whether you operate a hardware store, home center or LBM outlet, chances are you probably saw a slight improvement in sales last year, if this survey is any indication.

Unlike the trend witnessed in last year's study, the sales gap between average performers and their high-profit counterparts wasn't nearly as wide as it was in 2010. This indicates that, as a whole, business conditions were slightly better for the majority of retailers in the sample group, which included more than 1,000 stores across the various store types represented in the study.

For example, the percentage difference in sales between the typical and high-profit hardware stores was a tick over 20 percent in 2011, compared to a 56-percent difference reported in 2010. For home centers, the sales gap between typical and high-profit performers in 2011 was just 3 percent, compared to an 86-percent chasm in 2010. And for lumber/building material outlets (LBM), the top-line difference between typical and high-profit stores was just over 18 percent, versus a whopping 100 percent from last year's study.

This, coupled with the sales gains reported across the board, indicated that, while the economy is still in recovery mode, and while housing activity is still at historically low levels, the independent segment of the industry is finding ways to grow sales and record a profit, no matter how slight it may be.

Another indication that business conditions are improving, be it ever so slightly, was the return of customer counts to near pre-recession levels for home centers and LBM outlets. This was no doubt good news for these retailers who rely on business from pro customers.

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.

HARDWARE STORES

Definition: Hardware stores carry little or no lumber and building materials but do carry full lines of core home repair and maintenance products.

Key Performance Differences:

Customer Count: 78,300 customers per year patronizing the typical hardware store vs. 86,700 customers per year at high-profit stores

Average Transaction: $17 at typical stores vs. $18 at high-profit stores

Gross Margin: 41.9 percent at typical stores vs. 43.4 percent at high-profit stores

Inventory Turns: 1.9 times at typical stores vs. 2.3 times at high-profit stores

Bottom Line: 1.5 percent profit before taxes at typical stores vs. 7.4 percent at high-profit stores

While sales for the average hardware store participating in the study increased from 2010 to 2011, the results at the bottom line weren't as positive. The typical hardware store in 2011 saw just 1.5 percent of sales drop to the bottom line, compared to 7.4 percent of sales for the high-profit hardware stores in the study. It wasn't in any one area where the high-profit group excelled against their typical counterparts, but in better expense control measures across the board, starting with more effective purchasing.

Cost of goods sold for high-profit hardware stores was more than a point and a half better than at the typical store, resulting in a gross margin of 43.4 percent for high-profit stores, compared to 41.9 percent for the typical hardware store in the study.

High-profit hardware stores are also able to attract nearly 15 percent more customers than typical hardware stores while ringing up a dollar more at checkout. This was accomplished without excessive additional advertising and promotion expenses, as both groups reported this figure ar 2.5 percent of sales.

Salesfloor productivity was another key difference between the two groups, with high-profit hardware stores generating $178 per square foot in sales from $45 in inventory (compared to $146 and $48 for the typical hardware store) in a slightly smaller footprint.

High-profit stores also had more cash on hand as a percent of total assets than their typical counterparts, producing a much higher cash-to-current-liabilities position for the high-profit group.

Whether measuring inventory productivity by looking at inventory turnover rate or sales-to-inventory ratios, high-profit hardware stores were, again, considerably more productive at moving product. Typical hardware stores saw inventory turns of 1.9 times versus 2.3 times at high-profit hardware stores.

HOME CENTERS

Definition: Home centers are a mix of hardware store and lumberyard. They carry full assortments of hardlines shelf goods as well as commodity lumber and building materials in a minimum of 10,000 square feet of selling space.

Key Performance Differences:

Customer Count: 98,190 customers patronizing typical home centers vs. 104,380 at high-profit stores

Total Operating Expenses: 32.1 percent at typical home centers vs. 27.1 percent at high-profit stores

Inventory Turns: Increased turns for both typical and high-profit stores compared to 2010 levels.

Bottom Line: 1.5 percent profit before taxes at typical stores vs. 4.5 percent at high-profit stores

For the average independent home center operator participating in the study, sales also increased compared to last year's group—to the tune of more than 18 percent. This may be explained by an increase in building material sales to pro customers, as indicated by the dramatic increase in inventory turns between 2010 and 2011. The average operator in the 2011 study saw increased inventory turnover of 2.9 times versus 2.3 times in 2010.

Another indication of better times for independent home centers was evident in the growth of customer counts compared to last year, which in 2010 hit a five-year low of 85,500. In 2011, this number rebounded to more than 98,000 customers, many of which were no doubt contractors. For the high-profit stores in the study, customer counts of 104,380 were slightly down from last year, but were basically on par with pre-recession levels.

There was more profit parity between typical and high-profit home centers compared to any other store type surveyed in 2011. But the difference in the bottom line between average and high-profit stores was primarily gained through aggressive expense controls in payroll, occupancy and other miscellaneous categories.

Total expenses at the typical store in the study were 32.1 percent in 2011, versus 27.1 percent for the high-profit group. The question is whether these high-profit operators will be able to continue to grow operations while sustaining this expense structure. More than likely, they won't, and it was nothing more than a holdover recessionary mentality.

LUMBER/BUILDING MATERIALS OUTLETS

Definition: Lumber/building materials outlets (LBM) capture the majority of their sales from lumber and building materials and typically have salesfloors less than 10,000 square feet. *Note: due to the low number of outlets in this year's study, figures can be dramatically different from year to year. Please take this into account when examining typical and high-profit stores.*

Key Performance Differences:

Customer Counts: Back to pre-recession levels in 2006/2007

Change in Customer Mix: Percent of business with consumers increased dramatically compared to 2010

Bottom Line: Widest profitability gap between typical outlets (1.6 percent) and high-profit stores (9.6 percent) of any store type surveyed

If you want to see how the recession and housing crisis have played out most dramatically over the past several years, look no further than the P&Ls of the industry's LBM retailers. However, in 2011, this group saw the biggest year-over-year rebound at both the top and bottom lines, which was good news for all store types.

While overall sales for the average LBM outlet in 2011 were just under 2008 levels, the $2.96 million recorded by the typical LBM outlet was more than 25 percent higher than the $2.22 million reported for last year's group.

Again, small gains in the housing market might contribute to the rebound. However, increases in remodeling activity might be at play, too, which is evident by the increase in percent of consumer sales for both average and high-profit stores. For the average LBM outlet participating in the study, the percent of consumer customers increased from 22 to 30 percent from 2010 to 2011, indicating that when the pro-oriented business dried up during the recession, many retailers scrambled to find ways to find more consumer (and even commercial/industrial) business.

Another indicator of this is that the average LBM operator advertised more in 2011 than during the previous two years combined. For example, in 2011, the average LBM outlet spent $32,500 in advertising, versus $13,300 in 2010.

On the buy side, the high-profit operators bought better in 2011 than the typical merchant, with cost of goods sold coming in nearly 3 percent lower for high-profit stores than their typical peers. This not only led to the early gross margin advantage by comparison, but was followed by aggressive expense-control measures, resulting in one of the widest profitability performance gaps seen in years (9.6 percent profit before tax for high-profit operations compared to 1.6 percent for typical outlets).

Financial Profile of Hardware Stores

Operating Profile	2007	2008	2009	2010	2011
Avg. Size Selling Area (sq. ft.)	9,100	9,097	9,000	8,760	9,069
Total Sales	$1,893,907	$1,425,296	$1,430,459	$1,330,152	$1,365,361
Sales per Store	$1,421,740	$1,415,739	$1,413,209	$1,287,986	$1,322,079
Total Asset Investment	$664,480	$809,795	$698,504*	$687,707	$691,696
Total Inventory	$436,800	$509,432	$450,000	$443,571	$436,632
Productivity Profile Per Unit	**2007**	**2008**	**2009**	**2010**	**2011**
Sales per Square Feet of Selling Area	$156	$156	$157	$147	$146
Inventory per Square Feet of Selling Area	$48	$56	$50	$51	$48
Net Sales to Total Assets	2.9x	1.8x	2.0x	1.9x	2.0x
Net Sales to Total Inventory	4.3x	2.8x	3.1x	3.0x	3.1x
Total Sales per Employee	$135,404	$149,025	$148,759	$143,110	$165,260
Avg. Size of Transaction	$16	$17	$17	$16	$17
Profitablility Profile	**2007**	**2008**	**2009**	**2010**	**2011**
Gross Margin	39.4%	41.0%	39.7%	40.6%	40.6%
Net Profit (Before Taxes) to Net Sales	2.5%	2.6%	2.2%	2.2%	1.5%
Gross Margin Return on Inventory	133.3%	162.2%	128.5%	122.2%	131.3%
Return on Net Worth (Before Taxes)	8.5%	8.6%	8.3%	7.8%	5.7%

Source: North American Retail Hardware Association. Figures based on responses to annual *Cost of Doing Business* study.
**Average of five years historical assets due to influence of response data*

Income Statement 2011

Net Sales	100%
Cost of Goods Sold	59.4%
Gross Margin	40.6%
Patronage Dividend/Purchase Rebate	1.3%
Gross Margin Plus Purchase Rebate	41.9%
Total Expenses	40.9%
Gross Operating Profit	1%
Other Income	0.5%
Net Profit (Before Taxes)	1.5%

Source: North American Retail Hardware Association.
Figures based on responses to annual *Cost of Doing Business* study.

Balance Sheet 2011

Current Assets	75.7%
Fixed Assets	24.3%
Total Assets	100%
Current Liabilities	15.1%
Long-Term Liabilities	32.4%
Total Liabilities	47.5%
Net Worth	52.5%
Total Liabilities and Net Worth	100%

Source: North American Retail Hardware Association.
Figures based on responses to annual *Cost of Doing Business* study.

Financial Profile of Home Centers

Operating Profile	2007	2008	2009	2010	2011
Avg. Size Selling Area (sq. ft.)	12,000	12,000	12,000	10,600	14,000
Total Sales	$5,635,077	$5,172,285	$4,169,156	$3,836,680	$3,746,433
Sales per Store	$3,634,461	$3,847,389	$3,379,518	$3,024,520	$3,461,677
Total Asset Investment	$1,943,465	$1,852,690	$1,823,371*	$1,748,807	$1,845,215
Total Inventory	$948,000	$985,631	$924,000	$897,137	$915,227
Productivity Profile Per Unit	**2007**	**2008**	**2009**	**2010**	**2011**
Sales per Square Feet of Selling Area	$303	$321	$282	$284	$268
Inventory per Square Feet of Selling Area	$79	$31	$77	$84	$64
Net Sales to Total Assets	2.9x	2.8x	2.3x	2.2x	2.0x
Net Sales to Total Inventory	5.9x	5.2x	4.5x	3.4x	4.1x
Total Sales per Employee	$165,203	$192,369	$194,225	$183,304	$224,286
Avg. Size of Transaction	$35	$41	$38	$35	$38
Profitablility Profile	**2007**	**2008**	**2009**	**2010**	**2011**
Gross Margin	35.1%	33.5%	31.7%	31.3%	31.6%
Net Profit (Before Taxes) to Net Sales	1.9%	1.0%	1.7%	2.1%	1.5%
Gross Margin Return on Inventory	138.9%	135.3%	121.1%	110.4%	137.0%
Return on Net Worth (Before Taxes)	5.9%	9.6%	5.1%	5.5%	4.8%

Source: North American Retail Hardware Association. Figures based on responses to annual *Cost of Doing Business* study.
**Average of five years historical assets due to influence of response data*

Income Statement 2011

Net Sales	100%
Cost of Goods Sold	68.4%
Gross Margin	31.6%
Patronage Dividend/Purchase Rebate	1.3%
Gross Margin Plus Purchase Rebate	32.9%
Total Expenses	32.1%
Gross Operating Profit	0.8%
Other Income	0.7%
Net Profit (Before Taxes)	1.5%

Source: North American Retail Hardware Association.
Figures based on responses to annual *Cost of Doing Business* study.

Balance Sheet 2011

Current Assets	71.6%
Fixed Assets	28.4%
Total Assets	100%
Current Liabilities	14.8%
Long-Term Liabilities	18.5%
Total Liabilities	33.3%
Net Worth	66.7%
Total Liabilities and Net Worth	100%

Source: North American Retail Hardware Association.
Figures based on responses to annual *Cost of Doing Business* study.

Financial Profile of D-I-Y Lumberyards

Operating Profile	2007	2008	2009	2010	2011
Avg. Size Selling Area (sq. ft.)	7,500	7,200	5,000	6,000	7,077
Total Sales	$5,088,503	$4,083,096	$3,872,256	$2,289,127	$3,054,280
Sales per Store	$4,252,288	$3,022,463	$3,237,253	$2,216,316	$2,957,154
Total Asset Investment	$1,631,225	$1,602,620	$1,370,317*	$1,186,173	$1,531,101
Total Inventory	$750,000	$852,593	$630,000	$489,889	$799,235
Productivity Profile Per Unit	**2007**	**2008**	**2009**	**2010**	**2011**
Sales per Square Feet of Selling Area	$567	$420	$647	$369	$432
Inventory per Square Feet of Selling Area	$100	$68	$126	$82	$113
Net Sales to Total Assets	3.1x	2.5x	2.8x	1.9x	2.0x
Net Sales to Total Inventory	6.8x	4.8x	6.1x	4.7x	3.8x
Total Sales per Employee	$257,714	$241,797	$249,019	$221,632	$244,342
Avg. Size of Transaction	$105	$98	$127	$103	$69
Profitablility Profile	**2007**	**2008**	**2009**	**2010**	**2011**
Gross Margin	23.2%	29.3%	25.6%	25.8%	31.8%
Net Profit (Before Taxes) to Net Sales	1.1%	0.8%	-0.2%	0.9%	1.6%
Gross Margin Return on Inventory	134.3%	185.5%	135.4%	120.8%	121.6%
Return on Net Worth (Before Taxes)	4.4%	7.0%	-0.5%	3.5%	10%

Source: North American Retail Hardware Association. Figures based on responses to annual *Cost of Doing Business* study.
**Average of five years historical assets due to influence of response data*

Income Statement 2011

Net Sales	100%
Cost of Goods Sold	68.2%
Gross Margin	31.8%
Patronage Dividend/Purchase Rebate	0.7%
Gross Margin Plus Purchase Rebate	32.5%
Total Expenses	31.3%
Gross Operating Profit	1.2%
Other Income	0.4%
Net Profit (Before Taxes)	1.6%

Source: North American Retail Hardware Association.
Figures based on responses to annual *Cost of Doing Business* study.

Balance Sheet 2011

Current Assets	76.4%
Fixed Assets	23.6%
Total Assets	100%
Current Liabilities	22.7%
Long-Term Liabilities	27.5%
Total Liabilities	50.2%
Net Worth	49.8%
Total Liabilities and Net Worth	100%

Source: North American Retail Hardware Association.
Figures based on responses to annual *Cost of Doing Business* study.

Financial Profile of Leading Publicly Held D-I-Y Chains 2011

Operating and Productivity Profile	Home Depot	Lowe's Cos.
Number of Stores (at end of 2011)	2,252	1,745
Average Size of Selling Area (sq. ft.)	104,352	112,894
Total Sales	$70.4 Bil.	$50.2 Bil.
Total Asset Investment	$40.5 Bil.	$33.5 Bil.
Total Inventory	$10.3 Bil.	$8.4 Bil.
Sales Per Square Foot	$299	$255
Inventory Turnover	4.3x	3.7x
Net Sales to Inventory	6.8x	6.0x
Total Sales Per Employee	$212,689	$202,451
Average Size of Transaction	$53.28	$62.00
Gross Margin Return on Inventory	235.0%	290.4%
Income Statement	**Home Depot**	**Lowe's Cos.**
Net Sales	100%	100%
Cost of Goods Sold	65.5%	65.4%
Gross Margin	34.5%	34.6%
Total Operating Expenses	25.9%	28.0%
Net Income (Before Taxes)	8.6%	6.5%
Balance Sheet	**Home Depot**	**Lowe's Cos.**
Total Current Assets	35.9%	33.3%
Cash	4.9%	3.0%
Receivables	3.1%	2.4%
Inventory	25.5%	24.9%
Other	2.4%	3.0%
Fixed Assets	64.2%	66.6%
Total Assets	100%	100%
Current Liabilities	23.1%	23.5%
Long-Term Liabilities	32.7%	21.0%
Net Worth	44.2%	55.5%
Total Liabilities and Net Worth	100%	100%

Source: Company Reports

Profile of Wholesaling Cooperatives and National Distributors

	Ace Hardware Co.	Do It Best Co.	True Value Co.	Orgill Inc.	Handy Hardware Wholesale	United Hardware Dist. Co.
Number of Distribution Centers	14	8	13	5	2 [5]	1
Current Number of Members	4,600 [1]	4,000	4,645	NA	1,293	664
Number of Non-Member Accounts Served	0	0	NA	NA	28	487
Dollar Volume Most Recent Fiscal Year	$3.709 Bil.	$2.68 Bil [2]	$1.865 Bil.	$1.317 Bil.	$243 Mil.	$190 Mil. [3]
Estimated Dollar Volume Calendar 2012	$3.9 Bil.	$2.79 Bil.	NA	$1.470 Bil.	$241 Mil.	$200 Mil.
% Sales out of Warehouse	78%	50%	72%	71%	70%	80%
% Sales Out of Pool/Relay	0%	0%	NA	0%	0%	1%
% Sales Direct-Drop Ship	22%	50%	28%	29%	30%	19%
% Sales in LBM	0%	25%	9%	8%	NA	4%
Number of Employees	4,000 approx. [1]	1,404	2,437	1,752	310	340
Avg. Number of SKUs in Warehouse	60,000	67,000	81,300	73,000	47,500	55,000
Sales/Inventory Ratio for 2011	6.9%	11.4 [2]	6.1	5.4	4 to 1	6
2011 Member Rebate Distributed	$74.458 Mil.	115.7 Mil. [2]	$57,001	NA	NA	3.0% [4]
% Cash	41%	74%	41%	NA	NA	50%
% Stock	33%	26%	14%	NA	NA	50%
% Other	26%	0%	45%	NA	NA	NA

Source: Company reports

[1] Fiscal year ending Dec. 2011.

[2] Fiscal year ending June 2012.

[3] Fiscal year ending Nov. 2011.

[4] Warehouse sales only

[5] At the time of press, Handy Hardware had announced its Mississippi distribution center plans to close at the end of 2012.

Profile of Wholesaling Merchandising Groups

	PRO Group Inc.	Distribution America	Val-Test Group	Reliable Distributors
Current Number of Wholesale Members	29	10	98	107
Number Member Wholesalers End 2011	30	10	101	107
Number Member-Operated Distribution Centers	42	14	102	200
Dollar Volume for 2011 Fiscal Year	$3 Bil.	NA	$950 Mil. [1]	$2.2 Bil.
Estimated Dollar Volume Calendar 2012	$3 Bil.	NA	$975 Mil. [1]	$2.2 Bil.
Number of Retail Stores Served by Members	35,000	9,000	5,000	23,000
Number of Program Stores	800	1,400	200	NA
Number of Employees	21	10	11	9

Source: Company reports

[1] Includes marine.

December 2011

After objections from a conservative Christian group, **Lowe's Cos.** pulled its advertising from The Learning Channel's "All-American Muslim" television show and experienced a backlash from many customers.

January 2012

Central Network Retail Group, LLC (CNRG), a multi-format, multi-brand operating company specializing in strategic partnerships and acquisitions, acquired NFL Building Center, a lumber and building materials center located in Daphne, Ala. CNRG also reopened NFL's Gulf Shores, Ala., location in the spring.

Lowe's purchased ATG Stores, an online home improvement retailer, in a move to broaden the company's product assortment. ATG Stores operates more than 500 websites and offers 3.5 million products from more than 3,300 manufacturers.

Home Depot acquired Redbeacon, an online home services platform that connects consumers with contractors for their home maintenance, repair and remodeling needs.

February 2012

Orgill, Inc. featured its first-ever Canadian-focused model store, North Lake Lumber, among its other two model stores—Midtown Hardware and Freedom Home Center—at its Spring Dealer Market in Orlando, Fla.

Benjamin Moore & Co. and **Orchard Supply Hardware** formed a new alliance to distribute paint.

March 2012

After a successful test of an in-store payment system, **Home Depot** released plans to introduce PayPal into nearly all of its 2,000-plus stores. It also planned to build a 1-million-square-foot e-commerce distribution center in McDonough, Ga., to support its growing online sales.

Just months after **Sears** announced the closing of as many as 120 Sears and Kmart stores, the retailer released plans to close another 62 retail locations.

Don Phillips was named vice president of operations for **House-Hasson Hardware**. In his new role, Phillips began supervising House-Hasson's Knoxville, Tenn., and Prichard, W.Va., warehouses.

April 2012

April retail sales (excluding automobile, gas stations and restaurants) decreased 0.1 percent (seasonally adjusted) from March, marking 22 consecutive months of retail sales growth, according to the National Retail Federation.

May 2012

Consumer confidence improved in each of the past nine monthly surveys, rising to its highest level since October 2007 as a result of more favorable job and wage prospects, according to a survey by Thomson Reuters/University of Michigan.

Sears' board of directors approved plans to pursue a partial spin-off of its interest in Sears Canada, reducing its stake in the company from 95 percent to about 51 percent.

Independent home improvement retailers attending the **National Hardware Show®** were the focus of the May 31 episode of "Designing Spaces," the well-known Lifetime Television Network home improvement series.

June 2012

Menards prepared to launch four stores in metro Detroit, a region where it had no presence.

Berkshire Hathaway Inc. fired Denis Abrams, chief executive at its **Benjamin Moore & Co.** paint unit. Bob Merritt, a former restaurant executive, was named as a replacement.

July 2012

Designed specifically for stores with 5,000 square feet or less, **Ace** launched an "Express" format for both current Ace retailers and other business owners seeking to integrate the Ace brand into their existing offerings.

On July 11, Sikeston, Mo., city leaders and **Do it Best** executives broke ground on a new $30 million distribution facility, which would replace the co-op's original facility in nearby Cape Girardeau. Do it Best CEO Bob Taylor said he expected the new facility to open in early 2014.

Wholesale hardware distributor and industrial supplier **Bostwick-Braun** purchased Blackstone Supply, a paint sundries and hardware distributor headquartered in Providence, R.I.

Board members of **RONA Inc.** unanimously rejected a non-binding proposal from Lowe's to acquire all of RONA's issued and outstanding shares at a price of C$14.50 per share.

August 2012

True Value reported revenue of $536 million for the quarter ending June 30, an increase of 1.2 percent or $6.5 million, up from $529.5 million for the same period a year ago. Strong farm and ranch sales, a new partnership with Benjamin Moore and strong increases in the company's manufactured proprietary paint brand sales helped mitigate the decrease in the co-op's sales brought on by unusual weather patterns across much of the U.S.

The new **RONA** satellite store in Calgary's Douglasdale neighborhood was the first of 10 planned satellite stores as part of RONA's "New Realities, New Solutions" strategic plan. At just 5,400 square feet of retail space and carrying only 7,500 SKUs, the store would rely on a nearby RONA big box for shipping of larger orders within 24 hours and access online to 30,000 more products.

September 2012

Ace President and CEO Ray Griffith announced his plans to retire from the hardware cooperative on March 31, 2013. The company's Board of Directors named Ace's Chief Operating Officer John Venhuizen his successor.

True Value CEO Lyle Heidemann said the co-op is prepared for aggressive retail growth in 2013, expanding into new markets, strengthening current stores through the Destination True Value program and expanding category programs.

Home Depot announced plans to close its remaining seven big-box stores in China as the company shifted its focus in that market to specialty stores and online offerings.

October 2012

Orgill, Inc. announced several changes among its senior management team, including the retirement of two veteran executives—Ken Post, Orgill's chief merchandising officer, and Steve East, vice president of advertising. Orgill's current Senior Vice President of Sales Brett Hammers will replace Post, while Jeff Curler, who currently oversees Orgill's Worldwide Sourcing initiative, will replace East. Both retirements will be effective at the end of 2012.

Lowe's formally withdrew its non-binding proposal to RONA inc.'s board of directors to acquire all of RONA's issued and outstanding common shares.

November 2012

William M. Fondren, who served as chairman of **Orgill, Inc.'s** board of directors since January 2005, announced his retirement from this role, effective Dec. 31, 2012.

RONA Inc. announced its long-time CEO, Robert Dutton, was stepping down. Dominique Boies, executive vice president and CFO, stepped in as acting CEO.

Handy Hardware CEO Ken White announced the two-year old distribution center in Meridian, Miss., would close its loading docks Dec. 31.

By Liz Lichtenberger,
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Building a Stronger Future

Housing Industry Shows Signs of Health

For the past few years, we've heard the housing market will recover "eventually." Despite unemployment and foreclosure numbers climbing, we were told that "eventually" things would improve.

It might not be safe to say that "eventually" is here, but if the numbers tell us anything, "eventually" may be on its way.

The new year brought a change with it. In early 2012, sales of both new and existing homes picked up considerably, according to the Joint Center for Housing Studies of Harvard University, thanks to better job growth and higher consumer confidence.

That growth carried throughout the year. Take a look at the numbers:

According to the U.S. Census Bureau, new home sales are higher for each of the first three quarters of 2012 than they were compared to each of those quarters last year.

According to joint press releases from the U.S. Census Bureau and the U.S. Department of Housing and Urban Development, new residential sales in August were at a seasonally adjusted annual rate of 373,000, up 27.7 percent from the August 2011 estimate of 292,000. And in September, the number was even higher: a seasonally adjusted annual rate of 389,000, 5.7 percent above August and 27.1 percent above the September 2011 estimate.

According to the National Association of Realtors (NAR), pending homes sales in September were up 14.5 percent from September 2011.

More Renting

Rental rates have continued to climb throughout the 2000s, according to the Harvard study. Thanks to some homeowners who are forced to rent because their homes have gone into foreclosure, and to the aging of the population, rental rates have increased among middle-aged and married households (among others).

And they may continue to increase: the Harvard study says those under the age of 25 are most likely to rent, but renting among that group has slowed with the recession, as many new college graduates can't find jobs and are forced to move back home. However, as unemployment rates drop, we could see more renting among that age group.

Consumers with good jobs will be more likely to build new homes, buy existing ones, or find a place to rent. It's worth noting the unemployment rate recently dropped to less than 8 percent, its lowest since January 2009.

The rental numbers mean both good and bad news for home improvement retailers. While renters aren't spending as much on home improvements as homeowners are, they are still doing small projects, such as painting and decorating. And landlords are staying busy with maintaining properties and doing any repairs that come their way.

Fixing It Up

Homeowners, too, are staying busy with maintenance and repairs. Some choose to take it a step further and make some upgrades to their homes.

According to the National Association of Home Builders (NAHB), the Remodeling Market Index climbed from 45 to 50 in the third quarter of 2012, the highest it's been since the third quarter of 2005. Three indicators of the market's condition—maintenance and repairs, minor additions and alterations and major additions and alterations—all rose as well.

That's good news for retailers. Homeowners who feel better about how the market's faring are going to be more likely to make improvements to their homes, and those DIYers need anything from new tools to paint to hardware to lighting—and much more.

Foreclosures Are Down

RealtyTrac, which publishes a database of foreclosures and bank-owned homes, says the worst of the foreclosure crisis may be over. According to RealtyTrac, foreclosures have fallen in about 62 percent of the country's 212 largest metro markets in the third quarter of 2012. This means more stability in the housing market. In fact, in 58 percent of those markets, foreclosures have fallen to lower than 2007 levels.

Inventory, Starts Balance Out

Home inventory is dropping, too, leading to multiple offers and homes being sold for higher prices. According to the NAR, total housing inventory at the end of September was 2.32 million existing homes for sale, a 3.3-percent drop from August. At the current sales price, all inventory would be gone in 5.9 months (down from a 6-month supply in August).

The good news for retailers, of course, is that a tighter inventory means a better chance for new home construction, which means more sales as builders buy lumber and other building supplies.

Proceed Cautiously

Of course, there's still room for improvement. An article from the *Wall Street Journal* states that higher prices by still-wary suppliers mean fewer new homes being built, as buyers choose to go with the cheaper alternative of buying an existing home. This is unfortunate for the housing market, as sales of new homes provide more money than sales of existing homes. It's also a missed opportunity to help employment levels; the NAHB estimates that each new home build creates three new jobs.

Retailers, Take Note

So what does this mean for retailers? The housing market may not be where it was in the late 1990s and early 2000s, but it's certainly better than the past few years. Retailers should be able to look forward to selling smaller projects to renters, maintenance and repair supplies to landlords, and larger projects to homebuyers—especially those who have purchased foreclosures or fixer-uppers that will need lots of work. And if all goes well, more new homes will be built, which means more LBM sales for retailers.

To sum it up: It's not as good as it once was (and never may be), but it certainly could be worse (as we all know from the past few years).

Looking Up From Last Year

On the whole, 2011 was better than 2010. Retail sales tended to be up, and unemployment tended to be down from the year before. However, housing was still lower than most would prefer. New home sales continued to drop, while existing home sales stayed low. Most potential homebuyers weren't ready to make the leap just yet. In 2012, however, we may have begun the recovery, as new and pending home sales and inventory numbers continue to improve.

Overall, it looks to be a promising future as we head into 2013: The NAR predicts affordability will remain throughout much of next year and that home activity should increase.

Housing Affordability

	Median-Priced Existing Single-Family Home	Mortgage Rate [1]	Monthly P&I Payment	Payment as % Income	Median Family Income	Qualifying Income [2]	Composite Affordability Index [3]
2009	$172,100	5.14	$751	14.8%	$61,082	$36,048	169.4
2010	$173,100	4.89	$734	14.4%	$61,313	$35,232	174.0
2011	$166,200	4.67	$687	13.4%	$61,455	$32,976	186.4
Sept. 2012 (p)	$184,300	3.7	$677	13.2%	$61,728	$32,496	190.0

[1] Effective rate on loans closed on existing homes.

[2] Based on a 25% qualifying ratio for monthly housing expense to gross monthly income with a 20% down payment.

[3] Index equals 100 when median family income equals qualifying income.

Source: *National Association of Realtors*

Housing Statistics By Region

New Homes Sold* (thousands of homes)

Year	Total U.S.	Northeast	Midwest	South	West
2008	485	35	70	266	114
2009	375	31	54	202	87
2010	323	31	45	173	74
2011	306	21	45	168	72
Sept. 2012 (p)	31	3	3	16	9

Source: *U.S. Census Bureau*

Existing Homes Sold* (thousands of homes)

Year	Total U.S.	Northeast	Midwest	South	West
2009	5,156	868	1,163	1,914	1,211
2010	4,907	817	1,076	1,860	1,154
2011	3,787	449	863	1,471	1,004
Sept. 2012 (p)	2,410	480	1,030	1,690	1,010

Source: *National Association of Realtors*

Housing Starts* (thousands of homes)

Year	Total U.S.	Northeast	Midwest	South	West
2008	906	121	135	454	196
2009	554	62	97	278	117
2010	587	72	98	298	120
2011	609	68	101	308	133
Sept. 2012 (p)	872	75	143	451	203

Source: *U.S. Census Bureau*
*Seasonally adjusted annual rate

Sales Mimic National Averages

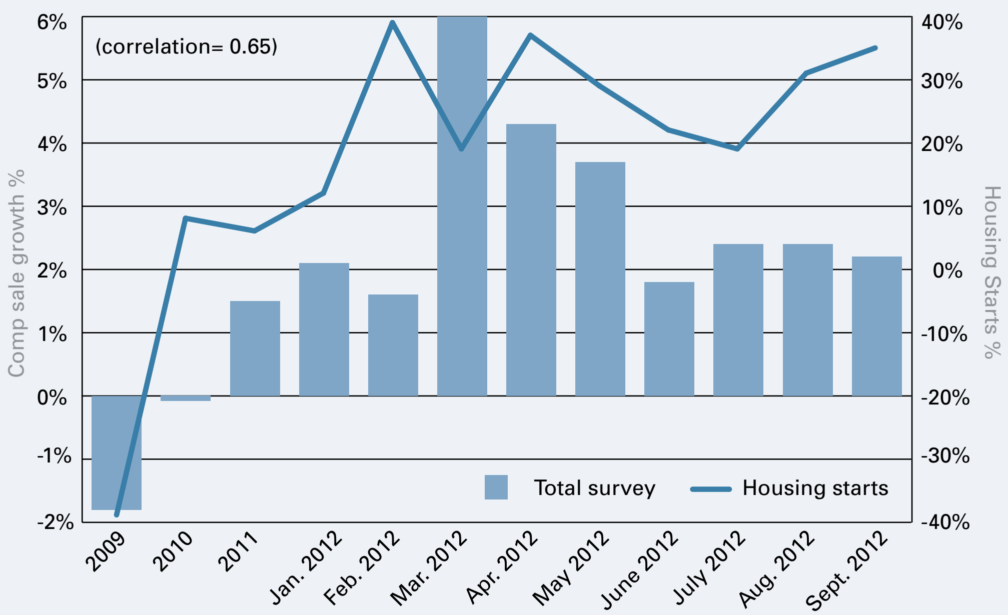
According to the North American Retail Hardware Association (NRHA) Executive Quarterly Index, which surveys independent home improvement retailers from across the country to gauge the industry's health on a quarterly basis, sales from the independent home improvement sector closely correlate to national data.

According to the survey, a direct correlation linked the positive upticks in housing starts to positive comparable-store sales in the independent home improvement sector. Additionally, comparable-store sales growth in the independent home improvement sector has also closely mirrored growth in consumer confidence since 2009.

Other key findings from the NRHA Executive Quarterly Index for the third quarter of 2012 included:

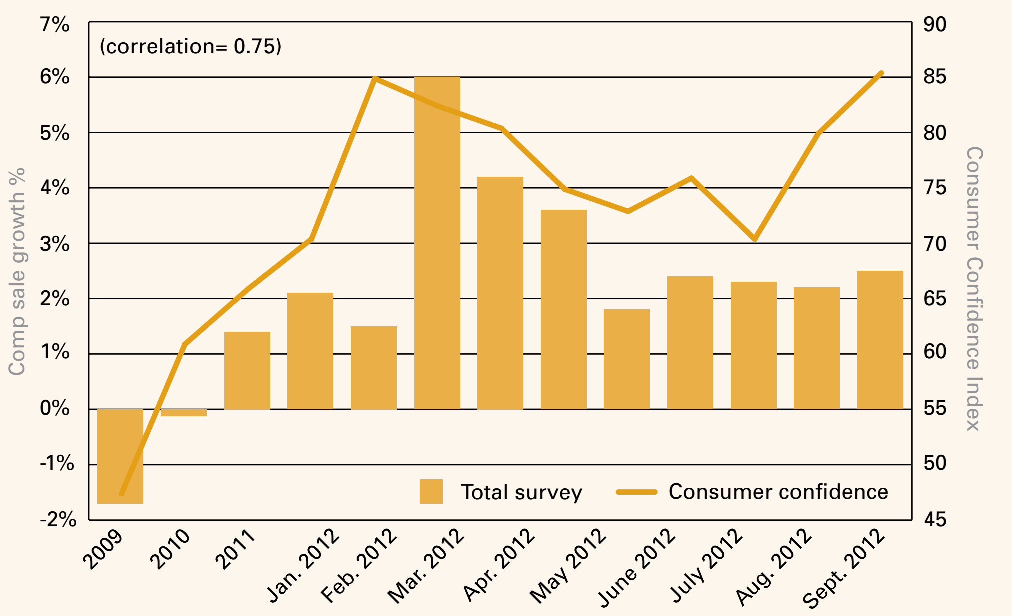
- Sales were up 2 percent year-over-year in the third quarter of 2012. This appears roughly in-line with forecasts for the timeframe.
- The South and West regions saw the best growth. Northeast and Midwest growth trailed the South and West.
- Fourth quarter sales growth for 2012 is expected to improve relative to third quarter sales.
- Sales growth forecasts for 2013 are expected to grow 3 to 4 percent over 2012.

Independent Home Improvement Comp.–Store Sales Growth vs. Housing Starts



Independent home improvement sales growth tightly correlated with housing starts.
Source: NRHA Executive Trends Survey, *U.S. Census*

Independent Home Improvement Comp.–Store Sales Growth vs. Consumer Confidence



Independent home improvement sales growth tightly correlated with consumer confidence.
Source: NRHA Executive Trends Survey, *The Conference Board*

Provided by NRHA Canada

Canada At A Glance

Biggest Issues Facing Canadian Home Improvement Retailers in 2012

Though just mere miles north of the U.S., Canada's home improvement market can often face a vastly different set of challenges and opportunities than the U.S. market. Overall, many Canadian retailers say the market generally didn't take as hard a hit economically as the U.S. market. Retailers we spoke with remained confident about the future.

"This year has been a lot better than 2011," says Brad Swanson, owner of Swanson Home Hardware Building Centre in Kitchener, Ontario, Canada. "For 2012, our store sales are on track to be 6 to 7 percent up. And that kind of strength is fairly average for the entire Canadian home improvement industry."

Below is an excerpt from NRHA Canada's Industry Report with commentary from Swanson. For more details or to purchase the report, visit www.nrhacanada.com.

Arrival of U.S. Retailers

Target's effect has been wide and deep as it prepares to open up to 135 stores in the spring of 2013. It has affected the competitive positions of many other retailers, ranging from grocery and pharmacy to hardlines.

Other companies expanding in Canada include Lumber Liquidators and Williams-Sonoma, as well as a number of U.S. modular home companies looking for business north of the border, as the U.S. housing market has remained soft.

"The U.S. is definitely starting to come up to Canada in larger numbers," Swanson says. "U.S. manufacturers come in waves. Nordstrom has arrived and Target is on its way. This arrival will definitely change the market."

Lowe's Attempt to Purchase RONA

The attempted buyout of Canada's largest home improvement retailer, RONA Inc., by Lowe's Cos. met strong opposition, fueled by concerns of increased consolidation and by a strong sense of nationalism.

That bid was turned down by RONA's board and by a number of shareholders, including a group of RONA dealers themselves. It also became a cause celebre for both the Quebec government and many Canadians fearful of losing the commitment to Canadian products and supply.

Lowe's had attempted to duplicate its success in Australia, where a joint-venture with Australian retailer Woolworth has resulted in both the ground-up development of a new big-box banner, Masters, and the acquisition of Banks, a wholesaler similar to RONA. Like RONA, Banks owns its own stores and recruits independents under its banner.

According to Lowe's, this mixed-ownership model fits with its strategy for international expansion. However, faced with political backlash and mixed results as it battles

U.S.-based retailer Lowe's bid to buyout RONA, Inc. The bid was turned down by RONA's board and shareholders.

"For 2012, our store sales are on track to be 6 to 7 percent up. And that kind of strength is fairly average for the entire Canadian home improvement industry."

–Brad Swanson, owner of Swanson Home Hardware Building Centre

to build sales and share value back home, Lowe's finally chose to withdraw its bid for RONA, at least for now. Robert Dutton, RONA's longtime CEO, resigned suddenly in November without disclosing any reasons publicly and raising speculation his departure may ultimately spur a sale, merger or radical network changes.

Slow Growth and the Move to Smaller-sized Stores

Canadian consumers appear to favor retailers move toward smaller-sized stores. Home Depot Canada, for example, has not opened any new stores in two years.

RONA has decided that the big box has reached its zenith, and is not only focusing on smaller "proximity" stores (35,000 square feet), but is closing or downsizing two dozen of its big boxes.

The only chain that is actively opening stores is Lowe's Canada, and even that company is feeling the pinch of "overstoring," as seen by its attempt to buy RONA.

Focus on the Contractor

The pro business is getting renewed focus as the major players create strategies to serve them better.

RONA recently introduced "Contractor First by RONA," a dedicated pro outlet.

Kent, the major home improvement player in Atlantic Canada, launched its own pro store, Kent Contractor Supply. The first such store was in Newfoundland, a response to the construction boom in the province thanks to the natural resources sector there.

Home Depot Canada has added a number of services for contractors, including compact equipment rentals (a program that is already in place with 400 stores in the U.S.), and services such as Drywall Direct, a next-day service that will deliver drywall and related products to anywhere on the job site.

"The best thing we can offer is the best customer service," Swanson says. "And for a while, the box stores let that slip. But the managers aren't stupid. They recognized that customer service was one of the store's weaknesses and they're taking the steps to get better. We have to watch that service level and product knowledge. We have to always be better."

Focus on the Front End

Building-supply dealers are looking more seriously at adding—or expanding—a retail component to their operations. These provide higher margins than commodities and make their stores an important one-stop shop for contractors.

The availability of strong hardware supply in Canada has endured, thanks to the strengthening of Chalifour Canada under the ownership of the LBM buying group TIM-BR MARTS Ltd.

Similarly, RONA's acquisition in late 2010 of TruServ Canada, a hardware wholesaler in Western Canada, has given that company the money and resources to expand its services and reach to independents.

The presence of Memphis-based distributor Orgill, Inc. in Canada has been gaining momentum as well. Orgill now supplies independents across Canada with a wide range of products, offering strong competition to existing Canadian wholesalers.

Strength of the Independent

The renewed strength of independents post-recession in Canada has been a testament to their viability.

The move to smaller stores and the emphasis of companies like Home Depot on customer service both reflect the strengths intrinsic in independents.

As consumers look increasingly to their own communities, the movement to "shop local" is gaining favor in Canada, as it is in the U.S.

As consumers look increasingly to their own communities, the movement to "shop local" is gaining favor in Canada, as it is in the U.S.

"I think the economy is feeling better in Canada," Swanson says. "The one thing that has hurt us is the Canadian dollar. There aren't too many times the U.S. dollar is less, which isn't as good. We get fewer business exports, which drive the Canadian markets. But we've had a lot of good news with good employment numbers, so we are positive."