2018

Market Measure

The Industry's Annual Report

While 2018 has shaped up to be another relatively strong year for sales in the home improvement industry, we may be facing a perception problem that could temper growth in the months to come.

Let's talk about some of the positive forces that have allowed the home improvement retailing industry to once again outpace overall retailing this year.

The driving force behind home improvement retail sales for the first half of 2018 has been the economy. Unemployment figures remain low, wages have risen and housing prices are up. Though interest rates have risen, they are still low by historical standards.

This good economic news translates to more consumers buying and selling homes and renovating.

The positive housing momentum has resulted in strong performance. Every source we use to monitor the home improvement market reports strong sales in 2018.

The North American Retail Hardware Association (NRHA) estimates predict that industry sales for 2018 should come in at approximately $394 billion, an increase of about 5.5 percent over 2017.

This number is slightly higher than we predicted last year, partly as a result of interest rates holding steady and also because of the way product sales were driven by record storm preparation and damage experienced in various parts of the country. It is also important to consider that we have seen, and should continue to see, some upward pricing pressures on many home improvement-related products.

What We'll Cover

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

By all accounts, the industry is shaping up to have another strong year this year, remaining a slight step ahead of overall retail sales.

Looking solely at government statistics for the industry, the projected figure for the year is relatively similar to NRHA's, with total sales estimated around $394.6 billion for 2018—a 4.4 percent increase from the U.S. Census Bureau figures from last year.

Lastly, estimates from the Home Improvement Research Institute (HIRI) show industry sales for 2018 totaling approximately $398.2 billion, a 6.3 percent increase over last year's performance.

By all accounts, the industry is shaping up to have another strong year this year, remaining a slight step ahead of overall retail sales.

For industry retailers, there are a few important points to note. Overall, it appears professional purchases are growing at a much faster clip than consumer purchases. In fact, according to HIRI, industry sales to pros will grow at about 9.9 percent in 2018, compared to just 4.7 percent for consumers.

This data shouldn't be surprising as homebuilding and larger remodeling projects taking place during a healthy economic cycle are tied to pro purchases.

At the retail level, we see a greater percentage of home improvement sales going online. In fact, Home Depot grew its online sales by 23.1 percent during the first six months of fiscal 2018, according to a company report. Both Home Depot and Lowe's have made ongoing efforts to grow their online presence, offering services such as buy online, pick up in store.

Even as online sales capture more of the retail home improvement market, it's important to note that the two largest online sellers of home improvement products, Home Depot and Lowe's, are still anchored in the brick-and-mortar world.

While Amazon has seen its sales of tools and home improvement items increase in recent years, its total 2017 sales of $6.1 billion are still dwarfed by online sales through brick-and-mortar-based retailers like Home Depot, which recorded online sales of $24.9 billion in the first quarter alone, according to GlobalData Retail.

On the Horizon

The return of the housing market, solid employment numbers and still-steady interest rates have helped home improvement retailing remain strong.

However, one thing we have learned over the last few decades is that all good things must come to an end.

The billion-dollar question is, will the end of the expansion period for the industry appear suddenly or will we see a gradual erosion in growth?

Our analysis suggests that we might be in store for the latter. We might start to enter a more subdued growth cycle as early as late 2019 or 2020.

So, what are some of the factors we will need to watch for?

How the Federal Reserve deals with interest rates will be a major concern in the months ahead. According to The Conference Board, a global research group, "growth will encounter more headwinds in 2019, especially with the Federal Reserve set to raise interest rates four more times by the end of next year."

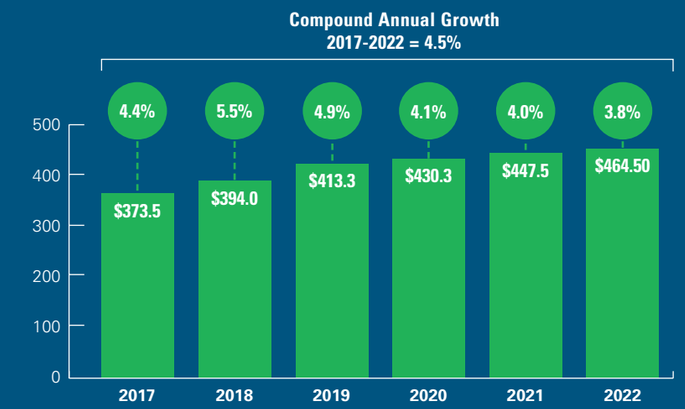
And while the impact of rising interest rates might start to blunt momentum found within the housing market as early as 2019, there is another less-tangible headwind facing the industry: the wait-and-see consumer.

Wait-and-see consumers are people who, even with affordable housing, interest rates at a manageable level and a strong economic outlook, are still waiting to invest in the housing market in earnest.

According to the National Association of Realtors, "in the third quarter of 2018, 63 percent of people believe that now is a good time to buy a home, which is the lowest percent recorded" since 2015. Reluctance to buy is even more evident in consumers under the age of 34, the National Association of Realtors reports.

NRHA is predicting softer growth for the industry over the next two or three years because of looming interest rate hikes, consumers already hedging on whether to buy a home and another election cycle getting ready to ramp up in late 2019. By 2022, we expect the home improvement retail market could be seeing growth in the high 3 percent range.

U.S. Home Improvement Sales
(in billions)



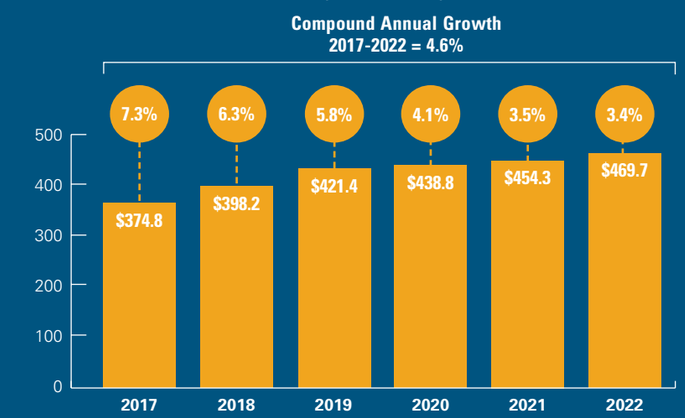
*Source: NRHA/*Hardware Retailing

71%

of independent industry retailers expect their sales to increase moderately from 2018 to 2021.

Source: NRHA 2017 State of Independents Conference Research

Home Improvement Product Sales Performance
(in billions)



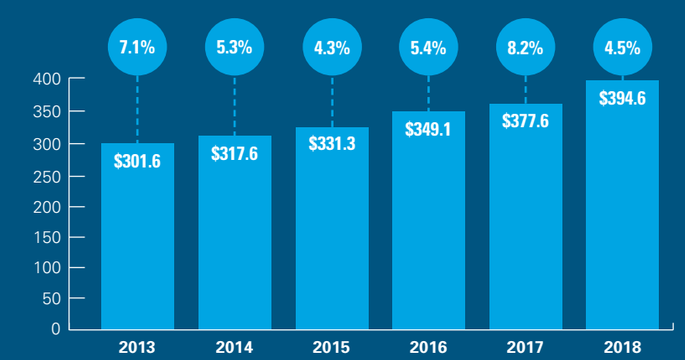
Source: Home Improvement Research Institute/IHS/Current Prices

7.2%

was Home Depot's overall sales growth projection for 2018, as of November.

Source: Home Depot Third-Quarter 2018 Financial Report

Home Improvement Retail Sales
(% change year over year)



Source: U.S. Department of Census/Monthly Retail Sales Report NAICS 444/SA

4.5%

was Lowe's overall sales growth projection for 2018 at midyear.

Source: Lowe's Second-Quarter 2018 Financial Report

2018

Home Improvement Sales by Month
(in billions)

January	$32.0
February	$32.4
March	$32.0
April	$31.8
May	$32.5
June	$32.5
July	$32.6
August (p)	$32.9
YTD	$258.8

Source: U.S. Department of Census/ Monthly Retail Sales Report NAICS 444/SA

Home Improvement Sales Growth 2017 vs. 2016

January	4.6%
February	4.9%
March	3.9%
April	1.9%
May	8.0%
June	4.5%
July	3.8%
August	4.8%
YTD	4.5%

Source: U.S. Department of Census/ Monthly Retail Sales Report NAICS 444/SA

2017-2022

Sales by Type of Store
(in billions)

2017	Hardware Stores	$47.9
	Home Centers	$232.9
	Lumberyards	$92.7
	TOTAL	**$373.5**
2018	Hardware Stores	$50.8
	Home Centers	$245.5
	Lumberyards	$97.7
	TOTAL	**$394.0**
2019	Hardware Stores	$50.4
	Home Centers	$257.9
	Lumberyards	$105.0
	TOTAL	**$413.3**
2020	Hardware Stores	$52.1
	Home Centers	$268.9
	Lumberyards	$109.3
	TOTAL	**$430.3**
2021	Hardware Stores	$54.6
	Home Centers	$279.2
	Lumberyards	$113.7
	TOTAL	**$447.5**
2022	Hardware Stores	$58.1
	Home Centers	$288.9
	Lumberyards	$117.5
	TOTAL	**$464.5**
Compound Annual Growth Rate 2017-2022	Hardware Stores	3.9%
	Home Centers	4.4%
	Lumberyards	4.9%
	TOTAL	**4.5%**

*Source: NRHA/*Hardware Retailing

2017-2022

Outlets

2017	Hardware Stores	19,850
	Home Centers	9,790
	Lumberyards	9,760
	TOTAL	**39,400**
2018	Hardware Stores	19,250
	Home Centers	9,785
	Lumberyards	9,760
	TOTAL	**38,795**
2019	Hardware Stores	19,150
	Home Centers	9,730
	Lumberyards	9,700
	TOTAL	**38,580**
2020	Hardware Stores	19,100
	Home Centers	9,720
	Lumberyards	9,650
	TOTAL	**38,470**
2021	Hardware Stores	19,000
	Home Centers	9,680
	Lumberyards	9,640
	TOTAL	**38,320**
2022	Hardware Stores	18,900
	Home Centers	9,710
	Lumberyards	9,620
	TOTAL	**38,230**
Percent Change 2017-2022	Hardware Stores	-4.8%
	Home Centers	-0.8%
	Lumberyards	-1.4%
	TOTAL	**-3.0%**

*Source: NRHA/*Hardware Retailing

Market Share Profile

Top Chains: Industry Share			Top Chains: Combined Performance		
	Sales (as % of total industry)	**No. of Stores** (as % of total industry)		**Net Sales** (in billions)	**No. of Stores**
2013	50.2%	15.0%	**2013**	$154.8	5,885
2014*	49.4%	16.1%	**2014***	$159.4	6,308
2015	49.7%	16.4%	**2015**	$168.6	6,447
2016	51.3%	17.4%	**2016**	$183.6	6,846
2017	51.9%	17.7%	**2017**	$193.9	6,988
2013-2017 Percentage Point Change	1.7%	2.7%	**2013-2017** Compound Annual Growth Rate	5.8%	4.4%

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

Top Chains: Individual Performance

	2017 Sales (in billions)	Stores at End of 2017	Stores in 2018 (as of fall 2018)
Home Depot Atlanta	$100.9	2,284	2,286***
Lowe's Mooresville, North Carolina	$68.6	2,152	2,155***
Menards Inc. Eau Claire, Wisconsin	$10.0*	306	316
Tractor Supply Brentwood, Tennessee	$7.3	1,685	1,725
84 Lumber Eighty Four, Pennsylvania	$3.3	268	266
Northern Tool + Equipment Burnsville, Minnesota	$1.5**	97	100
Carter Lumber Kent, Ohio	$1.4	147	150
Sutherland Lumber Kansas City, Missouri	$0.9**	49	48

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: America's Largest Public Companies 2018, Forbes*
***Source:* Hardware Retailing *estimates*
****Store counts include operations in the U.S., Canada, Mexico and all other locations.*

A Real-World Look at Retailers' Financials

The annual *Cost of Doing Business Study,* compiled by the North American Retail Hardware Association (NRHA), collates data from hardware stores, home centers and lumberyards. Retailers have contributed their financial information for about 100 years, allowing NRHA to present an industry-specific report for independent operators to benchmark their businesses.

The 2018 study provides composite income statements, balance sheets and averages for key performance ratios. The data comes from the 2017 fiscal year. Highlights from the 2018 study are presented in the following pages, showing mostly positive results for independents.

Retailers throughout the industry use the *Cost of Doing Business Study* to gauge the health of their stores compared to similar operations. They also use the data to set goals for improvement and develop plans for future growth.

The financial reports that study participants contribute give an accurate look at how home improvement retailers of all sizes and store types are performing. Retailers representing 1,033 independent home improvement stores participated in the *2018 Cost of Doing Business Study.*

The information is segmented by store type and by typical and high-profit store performance. Companies are further broken out by sales volume, single-store businesses and multistore operations.

Methodology

Every year, NRHA gathers the data by mailing questionnaires to hardware stores, home centers and lumberyards in the U.S. NRHA provides an analysis of aggregate numbers in the final report after extensively reviewing the data. Individual company responses are confidential. Most of the figures in this report are medians. The median represents the typical company's results, without extremely high or low outliers skewing the data. To identify high-profit stores, NRHA ranks all participating companies in their segments based on net profit before taxes. The high-profit companies are in the top 25 percent of their store types.

How to Use This Study

Here are some pointers for using the *2018 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. Take time to 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 store 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.

	Hardware Stores	Home Centers	Lumberyards
Profit Margin	**3.6%** Despite sales per customer staying even at $22 from the prior year, profit margin dipped from 4.2% to 3.6%.	**3.1%** Profit margin increased at typical home centers, up from 2.7 percent in the prior fiscal year.	**3.7%** Typical lumberyards, on average, saw their profit margin drop from 4.2% to 3.7%.
Total Operating Expense	**38.4%** Total operating expenses dropped some, potentially reflecting a slight decrease in payroll costs, occupancy and other operating costs.	**29.8%** Total operating expenses at typical stores grew year over year, rising from 27.9% to 29.8%.	**18.9%** Total operating expenses at typical lumberyards decreased from 19.8% to 18.9%.
Sales Per Square Feet	**$193** Sales per square foot hit an all-time high, reflecting high inventory turnover in the independent home improvement sector.	**$299** Sales per square foot fell, likely because 2017's study had an unusually high number of large home center participants.	**$872** At typical lumberyards, sales per square foot increased $120, representing an all-time high metric for this group.
Sales Per Employee	**$174,357** Sales per employee at typical stores decreased about 1 percent year over year.	**$260,489** Sales per employee decreased by about $8,000 compared to the prior year at high-profit home centers.	**$327,138** Sales per employee fell by nearly $60,000 from the year prior. Average staff counts increased from 15 to 18 people.

Source: 2018 Cost of Doing Business Study

Overall 2017 Business Performance

The following data from the *2018 Cost of Doing Business Study* is divided into three sections so retailers can compare their businesses' performance with home improvement operations that are similar to theirs. NRHA segments the numbers by three types of retail outlets—hardware stores, home centers and lumberyards. The complete 28-page study, with a more detailed breakdown of the data, is available to buy at **nrha.org** and is free to NRHA training members.

Hardware Stores

Hardware stores reported somewhat mixed results, experiencing a slight dip in profit before taxes and no year-over-year change in average sales per customer, which stayed at $22.

Typical stores' average operating profit was 3.6 percent. Top-performing stores also experienced lower profit before taxes, though an average of 9.1 percent was still healthy.

An increase of 240 basis points in the cost of goods sold appears to have contributed to bottom-line decreases for both typical and high-profit operations.

In addition, typical stores' cash on hand slipped from 7.5 percent to 4.6 percent, and high-profit stores fell from 11.9 percent to 9.7 percent.

Inventory productivity improved at typical stores. Inventory turns averaged 2.4 times, generating overall sales per square foot of $193—a record high for hardware store study participants.

Top-performing hardware stores did a better job of controlling expenses than typical stores. High-profit operations' payroll expenses were 18.7 percent of sales, while typical stores' payroll costs were 21.7 percent.

Home Centers

Home centers reported a solid year overall, with growth in sales and gross margin.

For typical stores, gross margin after rebate grew by 230 basis points, and sales were 7.4 percent higher than in the prior year. Profit before taxes was up for typical stores and top performers, at 3.1 percent and 6.3 percent, respectively.

Home centers' better management of expenses contributed to a solid year overall. Typical home centers' payroll was 16.7 percent of profits and high-performing operations' payroll was 17.4 percent, showing year-over-year cost decreases. Typical stores had a record low accounts payable of 6.7 percent.

In addition, home centers' cost of goods sold went down 140 basis points and rebates were up 90 basis points, contributing to bottom-line improvements from the previous fiscal year.

High-profit stores also controlled other operating expenses better than typical stores, with a decrease from 9 percent in the year prior to 6.7 percent. Typical home centers' other operating expenses increased from 6.7 percent to 8.7 percent.

Lumberyards

Lumber and building material sellers, like home centers, experienced sales growth in the most recent fiscal year, but had positive and negative results in other areas.

Sales increased by 7.4 percent, and sales per customer also got a boost, growing 3.5 percent to $206. Average sales per square foot were $872 and inventory per square foot was $166, hitting record highs for lumberyard participants in the study.

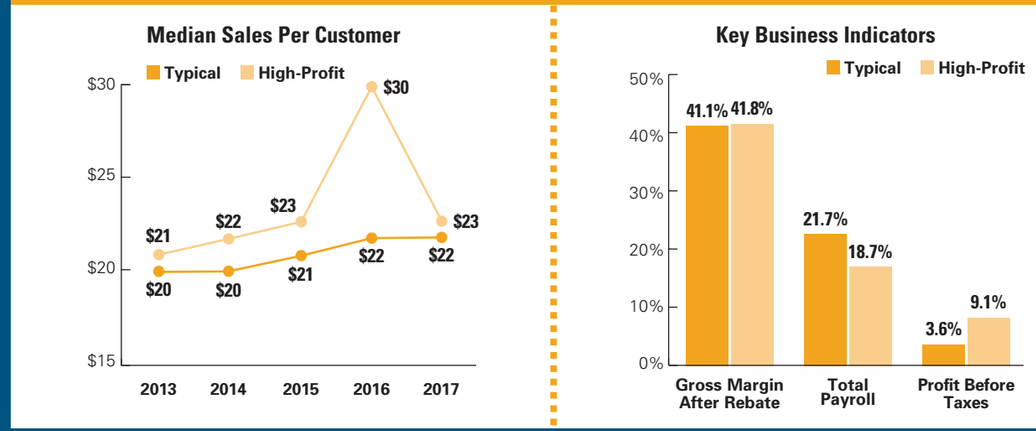
However, employee productivity and gross margin after rebate were down from the prior year. Typical stores reported average gross margins of 23.2 percent, for a 25-year low.

Typical lumberyards' profit before taxes was 3.7 percent, a dip from 4.2 percent. Top-performing operations fared better, with profit increasing from 7 percent in 2016 to 7.7 percent in 2017.

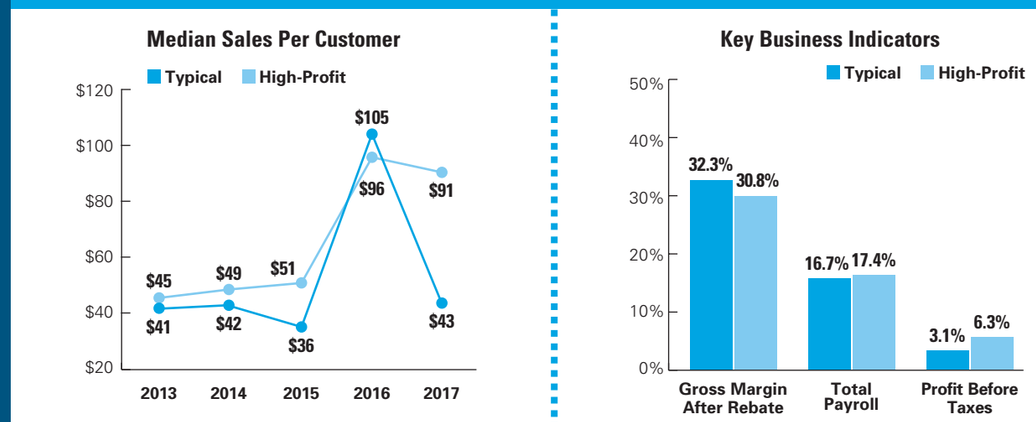
High-profit stores had higher payroll percentages, occupancy costs and other operating costs than their typical counterparts, suggesting that lower-performing operations had trimmed expenses to the point of costing productivity.

Customer counts at typical stores were flat year over year at just over 29,000 people, while high-profit stores made impressive strides. The top performers saw a nearly 50 percent increase in customer counts, averaging 43,000 customers for the fiscal year.

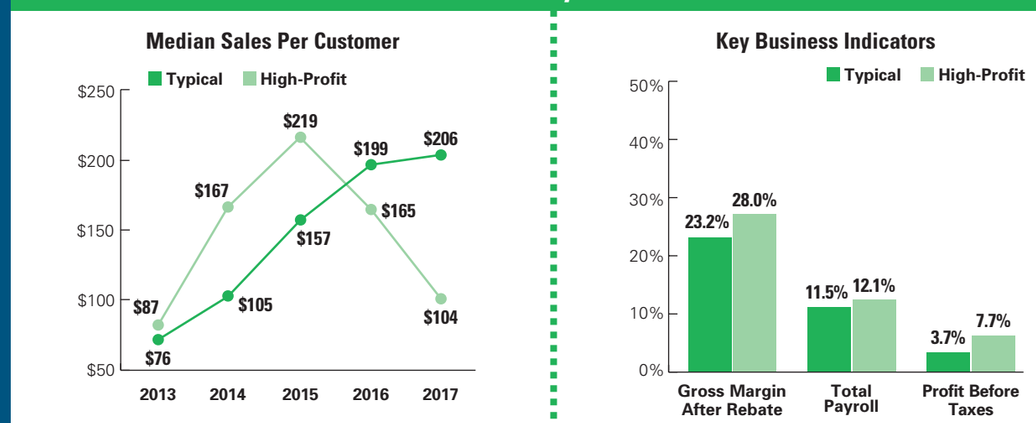
Hardware Stores



Home Centers



Lumberyards



Source: 2018 Cost of Doing Business Study

Financial Profile of Leading Publicly Held DIY Chains 2017

Operating and Productivity Profile	Home Depot	Lowe's Cos.
Number of Stores (at end of 2017)	2,284*	2,152*
Average Size of Selling Area (sq. ft.)	104,000	112,000
Total Sales	$100.9 billion	$68.6 billion
Total Asset Investment	$44.5 billion	$35.3 billion
Total Inventory	$12.7 billion	$11.4 billion
Sales Per Square Foot	$417.02	$319.07
Inventory Turnover	5.1x	4.0x
Net Sales to Inventory	7.9x	6.0x
Total Sales Per Employee	$244,320	$269,094
Average Size of Transaction	$63.06	$72.00
Gross Margin Return on Inventory	269.7%	205.5%
Income Statement	**Home Depot**	**Lowe's Cos.**
Net Sales	100.0%	100.0%
Cost of Goods Sold	66.0%	65.9%
Gross Margin	34.0%	34.1%
Total Operating Expenses	19.5%	22.4%
Net Income (Before Taxes)	13.6%	8.0%
Balance Sheet	**Home Depot**	**Lowe's Cos.**
Total Current Assets	42.5%	36.2%
Cash	8.1%	1.7%
Receivables	4.4%	0.3%
Inventory	28.6%	32.3%
Other	1.4%	2.0%
Fixed Assets	57.5%	63.8%
Total Assets	100.0%	100.0%
Current Liabilities	36.4%	34.3%
Long-Term Liabilities	60.4%	49.1%
Net Worth	3.2%	16.6%
Total Liabilities and Net Worth	100.0%	100.0%

Source: Home Depot and Lowe's annual reports
**Figure represents companies' total store count in the U.S. and other countries.*

Profile of Top 4 Distributors

	Ace Hardware Corp.	Do it Best Corp.	Orgill Inc.	True Value Co.
Number of Distribution Centers	21	8	7	12
Current Number of Members	5,100	3,800	N/A	4,300
Dollar Volume Most Recent Fiscal Year	$5.4 billion	$3.7 billion	$2.6 billion	$2.06 billion
% Sales Out of Warehouse	80.0%	30.0%	N/A	70.0%
% Sales Out of Pool/Relay	N/A	0.0%	N/A	N/A
% Sales Direct-Drop Ship	20.0%	70.0%	N/A	30.0%
% Sales in LBM	N/A	27.0%	N/A	15.0%
Number of Employees	7,800	1,507	N/A	2,380
Avg. Number of SKUs in Warehouse	110,000	67,000	N/A	83,000
Sales/Inventory Ratio for 2017	6.9	13.1*	N/A	5.6
2017 Member Rebate Distributed	$150.6 million	$108.5 million*	N/A	$20.6 million
% Cash	41.0%	72.0%	N/A	100%
% Stock	32.4%	28.0%	N/A	N/A
% Other	26.8%	0.0%	N/A	N/A

Sources: NRHA distributor surveys
**Fiscal year ended June 30, 2018.*

Profile of Wholesaling Merchandising Groups

	PRO Group Inc.	Distribution America	Val-Test Group
Current Number of Wholesale Members	79	7	60
Number of Member-Operated Distribution Centers	150+	10	60
Dollar Volume for 2017 Fiscal Year	$6 billion	$1 billion	$700 million
Estimated Dollar Volume Calendar 2018	$6 billion	$1 billion	$650 million
Number of Retail Stores Served by Members	35,000	9,000	2,000
Number of Program Stores	800	1,500	150
Number of Employees	17	10	5

Sources: NRHA distributor surveys

December (2017)

- **Lowe's** named Vikram Singh senior vice president and chief digital officer. The goal of the brand new chief digital officer position is to "accelerate Lowe's digital evolution and drive a holistic integrated strategy to make shopping more flexible, convenient and intuitive" in stores and online.
- The **Home Depot** acquired bedding and bath business **The Company Store**, which operates five brick-and-mortar locations in Wisconsin, Maine and North Carolina, and an online store.
- **Target** purchased delivery startup **Shipt Inc.** to complete same-day deliveries from about half of its stores by summer 2018.

January

- **Westlake Ace Hardware** has made plans to purchase **The Dennis Co.**, a five-store home improvement chain based in Washington state.
- **House-Hasson Hardware** is using mobile computers and headsets in its corporate headquarters warehouse and upgraded electronic scanners to speed up ordering and deliveries for the independent hardware stores and lumberyards the company serves.

February

- **Home Depot** announced it would sell **Tesla** solar panels and batteries in dedicated spaces in 800 retail locations. Tesla employees would staff the areas and demonstrate the company's solar panels and batteries, called Powerwalls.
- **Lowe's** presence in Canada has evolved, with business acquisitions and branding changes included in the company's growth strategy. One of its newest changes is the rebranding of 17 home improvement stores in Quebec.

March

- **PRO Group** and **VAL-TEST Group** partnered "to leverage both groups' strengths to deliver superior value to member wholesale distributors, suppliers and the retailers they serve," PRO Group says.
- **Orgill Inc.** announced the death of former president and chairman Joseph "Joe" Orgill III.
- The **True Value Co.** announced a plan to sell 70 percent ownership in the organization to private investment firm **ACON Investments**, subject to member approval. The deal would transition the company away from the co-op model.
- **The Home Depot** had to pay $27 million to settle claims that it improperly disposed of hazardous waste in California.

April

- **Westlake Ace Hardware** named Joe Jeffries its new CEO. Jeffries replaced Tom Knox in the role. Westlake is a chain that operates in 10 states and is corporately owned by the **Ace Hardware** co-op.
- The majority of **True Value**'s retailer shareholders approved the sale of 70 percent of the company's stock to private-equity firm **ACON Investments**.

May

- **Lowe's** named Marvin Ellison, former chairman and CEO of **J.C. Penney Co.**, as president and CEO.
- **Orgill Inc.** was one of 43 U.S. companies recognized with a presidential export award. Orgill received its first "E" Award in 2014 and was this year honored with the "E" Star Award, which recognizes previous winners of the "E" Award for expanding U.S. exports.
- **Do it Best Corp.** has formed a partnership with **Paint Sundries Solutions** to provide Do it Best members opportunities for growth.

June

- **Home Depot** committed to investing about $11 billion in "internal improvements," including more distribution centers. Rather than focusing on expanding with new stores, the company will open approximately 170 warehouse and distribution facilities throughout the U.S.
- The U.S. Supreme Court ruled that states have the power to require online retailers to pay sales tax on purchases made online.

July

- **Ace Hardware Corp.** announced plans to expand its retail support center in West Jefferson, Ohio.
- **Home Hardware Stores Limited**'s president and CEO, Terry Davis, has announced his plans for retirement. Davis will be helping transition the company to a new leader.

August

- **Orchard Supply Hardware**, a home improvement chain with 99 locations in California, Oregon and Florida, will close nationwide by the end of fiscal 2018, parent company **Lowe's** confirmed.
- **Orgill Inc.** announced that the company will be expanding its distribution center in Kilgore, Texas. The company will nearly double the size of the existing facility.

September

- The **Central Network Retail Group** (CNRG) will acquire 14 **Mac's Hardware** locations throughout the Midwest.
- Kevin Macnab has been named president and CEO of **Home Hardware Stores Ltd**. Macnab previously served as vice president of finance, real estate and information technology for **Toys R Us**, and later became the president of **Toys R Us Canada**.

October

- **PRO Group Inc.** has promoted controller Heidi Wodark to chief financial officer. Wodark joined PRO Group in 2007, and has served in the controller position since then.
- **Sears Holdings Corp.** filed for bankruptcy protection and confirmed plans to close another 142 stores.

November

- **Orgill Inc.** announced Ron Beal will continue to serve as chairman and CEO, and Boyden Moore will serve as president. Brett Hammers will become the company's executive vice president of worldwide sales and supply chain, and Eric Divelbiss will serve as CFO and executive vice president of finance and administration.
- **Do it Best Corp.** promoted Steve Markley, who will serve executive vice president of operations. William "Dent" Johnson will now serve as the company's vice president of merchandising.

Taking a Look at Housing

A Q&A With Kermit Baker

To learn more about the ways housing affects the overall economy, *Hardware Retailing* spoke to Kermit Baker. He is a senior research fellow at Joint Center for Housing Studies of Harvard University, and is the project director of the Remodeling Futures Program. He also serves as the chief economist for the American Institute of Architects.

***Hardware Retailing (HR)*: What trends are you seeing in the current housing market?**

Kermit Baker (KB): The housing market continues to be quite strong on the construction side. Single-family housing starts were slow in getting underway coming out of the recession, but they're growing and have grown at a solid 7 or 8 percent pace for the last few years. It looks like there's enough demand and enough new households that the number of housing starts is going to continue to go up for a while.

Existing-home sales are still pretty weak. There isn't a lot of inventory out there, and we're not seeing the turnover of homes that we've historically gotten. The single-family market was very slow to recover from the recession. Now, we're starting to see that pull back more toward normal conditions.

Millennials are a big part of the story. They're getting married and having children later. I think the economy has recovered for millennials, and we'll see homeownership numbers begin to pick up.

Given how tight the labor market is now, we're seeing wages pick up throughout the economy. That is also helpful for establishing a more balanced housing market.

HR: What does the health of home construction say about the U.S. economy?

KB: Everything seems to be percolating along pretty well for the economy, but next summer will be the 10th anniversary of this economic expansion. That will make it the longest economic expansion in post-World War II history. I think there's a bit of concern that the music will stop sometime in the not-too-distant future and slow down the potential of the construction market.

Some signs of concern we're seeing are inflation starting to pick up again and interest rates moving up, indicating that the Federal Reserve wants to slow things down.

We've got a very tight labor market. We're running some reasonably serious federal budget deficits. All those things play together. We might have a mild recession in the broader economy. If that happens, construction would slow as a result of the economic downturn, not because markets are overbuilt or overpriced.

HR: What are the impacts of tariffs on home construction and remodeling?

KB: Construction material costs have grown almost 10 percent over the last year. Some of that is because of tariffs or threatened tariffs on products that are used in construction, such as steel and aluminum. We're also seeing cost increases in wood products and in gypsum board, concrete, diesel fuel and metals besides steel and aluminum.

> **We're seeing solid remodeling numbers. Rather than trading up to a new home, people are more likely to be fixing up their homes.**

Construction is more vulnerable to price changes due to tariffs than other industries because there's such a lead time. A contractor may bid on a project, but they won't be buying materials for three to nine months. They're exposed to volatility to materials costs as they're occurring. That makes them cautious. If you're buying materials and making the product immediately, then when prices go up, you can pass the cost directly to consumers. In construction, you have to hedge more because of the time lags between when you're making decisions and when you're actually going to purchase products.

HR: How is the remodeling market doing?

KB: We're seeing solid remodeling numbers. Rather than trading up to a new home, people are more likely to be fixing up their homes. Hurricanes, fires and other natural disasters add to spending in that market, too. An undersupplied construction market, strong house prices and more natural disasters than usual are generating pretty healthy growth.

We produce a leading indicator for remodeling activity that suggests market activity is going to continue to grow in the 7 or 8 percent range for the remainder of 2018 and into 2019. Those are very healthy numbers.

HR: What can we expect to see in the housing market in 2019?

KB: I think we will see more of the same. Single-family construction has been moving up at a high single-digit pace for several years now, but we're still well below the long-term trend. I think we're going to have about 900,000 single-family starts this year. That number historically would be well over a million.

HR: Is it surprising things haven't picked up more?

KB: Yes. Typically, when you get strong house price gains, which we have seen recently, that encourages builders to build more. The problem is that land prices are rising, the cost of government regulation is driving up prices of homes, there's a construction labor shortage and there's inflation in building material costs.

It's hard to build affordable or entry-level homes at prices a moderate-income family or household can afford. Just getting folks into the market is a problem, but that's essential for a well-functioning housing market. The strength has to start at the bottom.

In addition, house prices have been growing more rapidly than household incomes. That creates an affordability problem. We're seeing that regionally across the country. It's not a huge issue nationally, but it is a very significant problem in most of the coastal markets across the country.

Looking Forward to 2019's Economy

A Q&A With Anthony Nieves

Anticipating the economic ripples new and proposed tariffs would have was a major concern for manufacturers and retailers alike in 2018. To give more information on the subject and other economic matters that could affect retailers, *Hardware Retailing* spoke with Anthony Nieves, a certified professional in supply management. He serves as the chairman of the Non-Manufacturing Business Survey Committee for Institute for Supply Management®, which measures the Purchasing Managers' Index® (PMI) as well as the Non-Manufacturing Index® (NMI).

***Hardware Retailing* (HR): How have tariffs on steel and other raw materials affected manufacturers in 2017?**

Anthony Nieves (AN): Many of our respondents are indicating that they're concerned about the tariffs, but there remains a lot of uncertainty about how those effects are going to move through the supply chain. It's possible those effects will increase costs on products but, at this juncture, it has not.

HR: Have these steel tariffs affected consumer confidence?

AN: Not at this point. All other reports outside our own indicate consumer confidence is at an all-time high and it isn't significantly impacting the confidence level of the respondents and their companies or industries. In fact, we're seeing a more robust scenario, where activity is increasing in anticipation of tariffs. We've also seen municipalities accelerating their purchasing, as they're under the wire before the end of the fiscal period.

HR: In November, NMI stood at 61.6 percent, which was a 3.1 percent increase over the month before. What does this rising figure say about the U.S. economy?

AN: On the nonmanufacturing side, we had 104 consecutive months of growth. After the recession ended, we saw slow and steady incremental industry growth. All indications from the New Orders Index, which shows upcoming purchases, predict good rates of growth for the remainder of the year. When we take the NMI, it indicates a 4.6 percent increase on real gross domestic product.

> **Retailers should know that lead times and cycle times have lengthened, and that has to do with ongoing capacity constraints and logistic challenges.**

HR: What do other nonmanufacturing industry indicators say about the overall economy, especially as we head into 2019?

AN: One key indicator is the Bureau of Labor Statistics' Jobs Report. The employment index is currently 62.4 percent, which is the highest reading since 1997.

In our current economy, employment is reflective of how the overall economy will go, especially in the nonmanufacturing sector. That employment index indicates to me that this is a really strong economy overall.

The downside to that is that we've had labor shortages as was reported on both the manufacturing and nonmanufacturing side.

HR: Is there any solution to the skilled labor shortage and logistics obstacles in the short term?

AN: It looks like these are long-term issues. I think part of it is that we just don't have enough people in certain skilled labor segments.

HR: How do you predict the economy will affect manufacturers who work with small businesses in 2019?

AN: Right now, with discretionary spending where it is and unemployment as low as it is, and the fact that the construction industry is really going gangbusters and residential and commercial renovations are up, there doesn't seem to be any potential economic slowdown at this point and into the start of 2019.

HR: What issues should manufacturers who work with small business owners keep an eye on in 2019?

AN: Retailers should know that lead times and cycle times have lengthened, and that has to do with ongoing capacity constraints and logistic challenges.

There's a countrywide trucking shortage in wholesale distribution. Wholesale trade is very much an intermediary for the retail industry and many others.

With capacity constraints happening, our respondents are telling us suppliers are having difficulty delivering orders in a timely fashion.

For big companies and small operators, cash liquidity will be important. It's a matter of looking at small businesses and their net receivables and then going in and transposing that into payables. The cycle time between receivables and payables will become increasingly important.

Retail foot traffic and online traffic are both up, so businesses that weren't as competitive or as strong in those areas have been flushed out. What we're seeing now is high demand from consumers. Discretionary spending is high, and that could benefit home improvement retailers in the year ahead.

Canadian Retailers Will See Modest Growth

Provided by Michael McLarney, managing director of NRHA Canada

Canada's retail home improvement industry grew at a healthier rate than anticipated in 2017, but conditions affecting the industry point to a slowdown through the end of 2018. That moderation is expected to continue into 2019, as well, according to the *Hardlines 2018 Retail Report*.

Sales by hardware stores, building centers and big boxes; Canadian Tire; and related sales by Walmart and Costco; were up 5.1 percent year over year in 2017. But retailers' sales are forecast to slow down to below 4.5 percent annually to the end of 2019.

All Retail Formats Experiencing Growth

Retail formats aren't faring uniformly. Larger organizations, such as Home Hardware and Lowe's through its RONA division, have been supporting their operators by helping them expand services with lumber and building material divisions. This has led to expectations of higher growth levels for those companies compared to smaller independents.

The smaller hardware store format remains viable, however, even though sales overall are slipping as store numbers stay pretty flat.

Though their net sales slipped by 1.4 percent in 2016, home centers and building centers rebounded with 8 percent growth in 2017. Retailers across the country saw business increase dramatically.

The home centers and building centers are most widely represented in Canada by the lumber and building materials buying groups, which support independent retailers with group purchases, mainly in key commodities such as lumber, plywood, roofing and insulation.

Sales through the big boxes in Canada are holding steady and continue to account for about one-quarter of all sales in the retail home improvement market.

This sector continues to grow despite no new stores from Home Depot. Lowe's Canada continues to invest in its RONA and Reno-Depot big-box stores. However, big boxes still have far less market share in Canada than their counterparts in the U.S.

Top Retail Groups Continue to Make Gains

Consolidation continues in Canada, with four retail groups composing far more than half of all sales in the Canadian industry. The retail groups are Home Depot Canada, Lowe's Canada, Home Hardware Stores and Canadian Tire.

Lowe's takeover of RONA in 2016 has accelerated consolidation. The four retail groups' market share accounts for almost 60 percent of the market.

On a regional basis, the greatest growth is forecast to come from the west, particularly in Alberta, as the economy there continues to gain steam. That province's retail home improvement sales are expected to grow by more than 5 percent annually. British Columbia is close behind, with anticipated annualized sales growth of 4.8 percent through this year and 2019. Saskatchewan will also perform well to the end of 2019.

Modest Growth Forecast

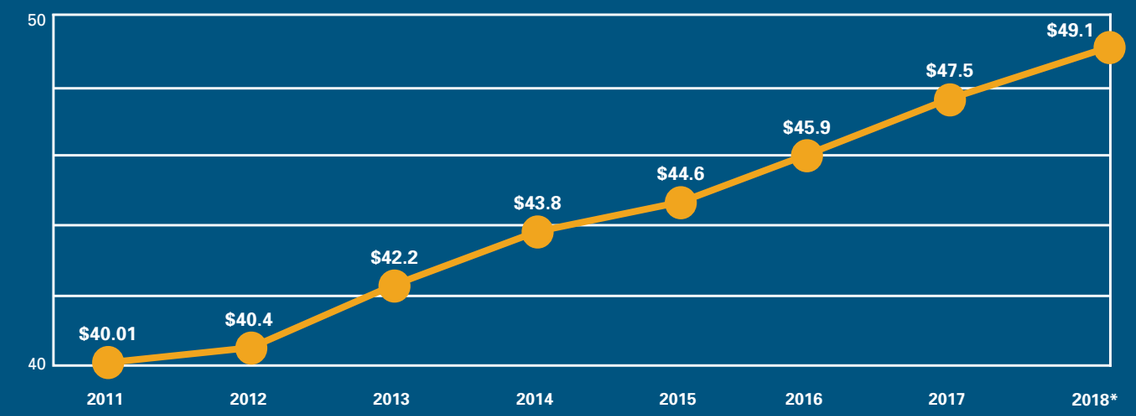
Retailers have faced headwinds, despite some positive developments, including a favorable start to 2018.

Extreme weather conditions turned out to be one more challenge for retailers. The summer was too hot in most parts of the country to favor outdoor projects, while forest fires, especially in western Canada, had a further negative effect on the industry. That was followed by a cold autumn, furthering discouraging outdoor activities and projects.

A weak housing market, rising interest rates and mixed consumer confidence heading into 2019 mean retailers should prepare for moderate growth in the coming year.

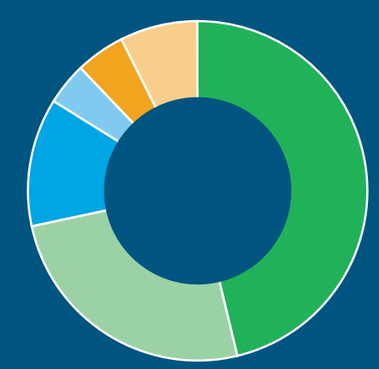
The *Hardlines 2018 Retail Report* forecasts growth of about 4.2 percent in 2018, a dip from 2017's level, and stability in 2019 and 2020.

Home Improvement Industry Sales Growth
(in billions)



*Forecasted numbers

Market Share by Store Format



- **46.3%** Building Centers
- **25.4%** Big Boxes
- **12.2%** Canadian Tire*
- **7.3%** Hardware Stores
- **4.7%** Club Stores*
- **4.0%** Mass Merchants

*Hardware and home improvement stores only

Top 10 Home Improvement Retailers

Rank	Company	2016 Sales (in billions)	2017 Sales (in billions)	Percentage Change
1	Home Depot Canada	$7.7	$8.2	5.8%
2	Lowe's Canada	$6.9	$7.2	4.9%
3	Home Hardware Stores	$6.1	$6.4	4.7%
4	Canadian Tire Retail	$5.7	$5.9	3.4%
5	ILDC	$3.8	$3.9	3.4%
6	TIMBER MART	$2.8	$2.9	4.8%
7	Castle Building Centres	$2.0	$2.1	6.3%
8	Sexton Group	$1.8	$2.1	15.0%
9	Groupe BMR	$1.2	$1.2	3.3%
10	Kent Building Materials	$0.8	$0.9	15.9%

Source: Hardlines 2018 Retail Report