The Hidden Home Improvements Market
CSG Home Improvements Industry Summary: 2005

Even knowledgeable Chain Store Guide customers at times refer to this industry in terms of the battle between its two most prominent nationwide stars, Home Depot and Lowe’s. To limit this market’s focus to just these two companies is a giant error. These are by far the two biggest retailers in this industry followed by number three Menard, a remarkable success as a regional power. All three maintain their primary focus, as big boxes, on the Do-It-Yourself consumer’s needs which are primarily based on repairs, remodeling and the purchase of home improvement products such as lighting, cooling and heating equipment, flooring and major appliances.

In CSG’s current annual ranking of the industry’s Leading Companies, the companies ranked seven through ten are Pro Dealers whose primary focus is on the contractor. These include both residential builders, creating everything from houses to apartment complexes and condos, as well as commercial contractors who are responsible for projects such as malls, office buildings and hospitals.

As Pro Dealers supply all products needed for construction, from tools to building materials, they typically maintain an extremely loyal customer base. This is in large part due to the strong customer support they provide to the professionals they serve. This includes regular job-site visits (which often result in additional sales), highly knowledgeable personnel and training classes and videos that advise both professional and DIY customers on the latest techniques and products.

Until a few years ago the products Pro Dealers offered were fairly basic though obviously professional grade. Recently, they have greatly increased their product mix to feature high-end and even custom home improvements for everything from restaurant grade kitchen appliances to opulent bath fixtures to custom pools and hot tubs. At last year’s Coverings show, several high end, international manufacturers noted they were looking to approach contractors through distributors with their exotic bath and outdoor products. Most traditional and big box retailers can’t offer these products the proper niche. The manufacturers weren’t aware of the growing role Pro Dealers were beginning to play in supplying contractors in this segment of the market. As many of these products are custom designed or offered to match a certain décor, they are often not stocked by the dealer but are easily supplied on a per project basis.

CSG’s Directory of Home Center Operators and Hardware Chains contains information on more than 5,000 companies and 17,700 key personnel contacts. Chain Store Guide covers headquarters and subsidiaries operating more than 24,000 units with total combined sales of over $220 billion. All listed companies report total sales of at least $1M.
The Pro Dealer market has become so important that *Home Channel News* now offers a third Scoreboard issue, which is dedicated to analyzing the Top 350 Pro Dealers. That these companies are so well run is evidenced by their constant growth in the market.

- Over the past five years sales for the seven Pro Dealers now listed in *CSG*’s overall Top Ten increased 105%.
- Total sales of companies we list in the *CSG* home center file went from $147.7 billion to $220.6 billion over this period, an increase of 49%.
- Last year sales for the top seven Pro Dealers increased just over 40%. At the same time combined sales for the Top three Home Depot, Lowe’s and Menard increased 14.6% and total sales of all *CSG* listed companies increased 12.7%.

<table>
<thead>
<tr>
<th>Rank</th>
<th>Company, Headquarters’ Location</th>
<th>2004 Sales</th>
<th>2003 Sales</th>
<th>2002 Sales</th>
<th>Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>The Home Depot Inc., ATLANTA, GA</td>
<td>$73,094,000,000</td>
<td>$64,816,000,000</td>
<td>$58,247,000,000</td>
<td>1,729</td>
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<tr>
<td>2</td>
<td>Lowe's Companies Inc., MOORESVILLE, NC</td>
<td>$36,460,000,000</td>
<td>$30,838,000,000</td>
<td>$26,112,000,000</td>
<td>1,112</td>
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<tr>
<td>3</td>
<td>Menard Inc., EAU CLAIRE, WI</td>
<td>$7,000,000,000</td>
<td>$6,065,000,000</td>
<td>$5,500,000,000</td>
<td>200</td>
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<td>4</td>
<td>Stock Building Supply, RALEIGH, NC*</td>
<td>$3,580,000,000</td>
<td>$2,732,000,000</td>
<td>$2,700,000,000</td>
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<tr>
<td>5</td>
<td>84 Lumber Co., EIGHTY FOUR, PA*</td>
<td>$3,460,000,000</td>
<td>$2,584,000,000</td>
<td>$2,177,000,000</td>
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<td>6</td>
<td>Lanoga Corporation, REDMOND, WA*</td>
<td>$2,750,000,000</td>
<td>$1,952,000,000</td>
<td>$1,450,000,000</td>
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<td>7</td>
<td>BMHC, SAN FRANCISCO, CA*</td>
<td>$2,091,025,000</td>
<td>$1,415,071,000</td>
<td>$1,161,494,000</td>
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<td>8</td>
<td>Builders FirstSource Inc., DALLAS, TX*</td>
<td>$2,058,047,000</td>
<td>$1,675,093,000</td>
<td>$1,500,006,000</td>
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<tr>
<td>9</td>
<td>Bradco Supply Corp., AVENEL, NJ*</td>
<td>$1,344,170,000</td>
<td>$995,693,000</td>
<td>$850,000,000</td>
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<td>10</td>
<td>The Strober Organization Inc., BROOKLYN, NY*</td>
<td>$1,300,000,000</td>
<td>$480,000,000</td>
<td>$460,000,000</td>
<td>91</td>
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* Denotes Pro Dealers.

Remember Home Depot too is seeking more affluent customers through their Expo Design Centers. Here they emphasize designer services alongside brands that are higher end than Home Depots typically offer. Still they can’t stock nearly the breadth of specialty products Pro Dealers can offer customers to meet the specific demands of their many varied projects.

Of course, Home Depot has announced that it plans to shut more than a third of its 54-store Expo Design Centers. The company plans to sell the real estate of 15 locations, eventually closing those stores while converting five additional Expo locations to the Home Depot format. Earlier this year, Home Depot said it would not open any new Expo locations as the company continued to invest in, and modify, the core of the Expo business. For those who think industry leaders Home Depot and Lowe’s can do no wrong, think again. Those who don’t think anyone can compete with these juggernauts now know better.

**346 of our Top 500 corporate listings are Pro Dealers:**
With all the publicity garnered by Home Depot and Lowe’s, Pro Dealers show no fear of the big box competition. When Pro Dealer corporate executives and store managers are asked what they do to compete with the big boxes they typically announce that they don’t view them as true competitors.
Pro Dealers clearly have a different target audience which they are sure they know and relate to better than big boxes seem able to. They also feel confident they have an edge with knowledgeable DIYers who remain a part of their customer base. They note that these customers, though non-professional, prefer professional grade equipment and product as well as the superior instruction and related materials available from the Pro Dealer. They feel they that the customer’s ability to be in and out quickly while avoiding long checkouts and searches through long aisles is no small advantage. Personnel at Pro Dealers can pinpoint the proper tool or product for a specific job while personnel at the big box often have trouble locating a product.

Corporate sales across the industry have seen a dramatic increase in recent years. This is due in large part to the historically low interest rates we have witnessed which led to a record wave of refinancing. This in part resulted in the current housing boom we are experiencing which has helped explode the Pro Dealer side of the market as well as the remodeling craze which has enhanced the DIY end of things.

The Growing Home Channel

*Total annual retail home channel sales, 2000 to 2004*

<table>
<thead>
<tr>
<th>Year</th>
<th>Sales</th>
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<tbody>
<tr>
<td>2000</td>
<td>$339.7</td>
</tr>
<tr>
<td>2001</td>
<td>$350.7</td>
</tr>
<tr>
<td>2002</td>
<td>$363.0</td>
</tr>
<tr>
<td>2003</td>
<td>$385.6</td>
</tr>
<tr>
<td>2004</td>
<td>$435.9</td>
</tr>
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Total sales for the U.S. home channel industry rose 13 percent in 2004, doubling 2003’s 6.2 percent growth rate and quadrupling 2002’s anemic 3.5 percent growth rate.
Pro Dealers Take Off
Pro Dealers in CSG/HCN Top 500 by Sales Growth Brackets

- Annual Sales Growth: 83.4%
- 51%+ Annual Sales Growth: 7.1%
- 21% - 50% Annual Sales Growth: 35.9%
- 11% - 20% Annual Sales Growth: 20.6%
- 1% - 10% Annual Sales Growth: 19.9%

In 2003, 63.1% of pro dealers on the Top 500 experienced growth; in 2004, 83.4% of dealers had growth. On the flip side, in 2003, 8.6% reported sales growth of more than 20 percent; in 2004, a whopping 43% of pro dealers grew sales by more than 20 percent.
Independents, Regionals and Buying Groups:

With the great success of the industry’s top chains, let’s not feel too sorry for the regional dealers and independents. Of the companies listed on the HCN/CSG compiled Top 500 Scoreboard 220 (44%) operate less than 5 locations and 60 (12%) are single unit operations.

Key Category Breakdown of HCN/CSG Top 500

<table>
<thead>
<tr>
<th>Category</th>
<th>Count</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pro Dealers</td>
<td>346</td>
<td>69%</td>
</tr>
<tr>
<td>Companies operating 1 - 4 locations</td>
<td>220</td>
<td>44%</td>
</tr>
<tr>
<td>Single Unit Operators</td>
<td>60</td>
<td>12%</td>
</tr>
</tbody>
</table>

The success of these smaller companies is due in large part to the practice of strong customer centric management policies which allow the customer to complete a successful shopping experience quickly and efficiently with the knowledge that he or she leaves with all the tools and products necessary to complete the job.

Home Depot has circulated internal memos seeking means to reduce the problem of customers overlooking an essential part of a purchase for their project. Often these customers prefer not to return to a cumbersome, distant big box location to search for one item and go instead to the more compact venue of the hardware store or pro dealer where they may also be given additional instruction. While this costs Home Depot a sale, the bigger fear is the loss of customers to the convenience and service of the competition.

Perhaps the greatest savior of most regional chains and independent dealers is the buying/marketing group. These companies are essentially distributors who deal exclusively with annually contracted members. National in scope, they essentially incorporate the buying power of a large chain and allow members the ability to stock most products at a cost far lower that would otherwise be possible.
Cost saving is only one of the advantages of belonging to a buying group. Additionally, the services these companies offer members are invaluable:

- Private label, low cost products offered to members are of premium quality as groups operate their own private label development operations, which include state of the art testing facilities.
  - Increasingly manufacturers are looking for private label opportunities and should be seeking out buying groups to participate in their private label programs.
- Marketing and merchandising practices and materials are honed at the corporate level. Member training is available at clinics held at multi-annual trade expositions (essentially regional group trade shows) as well as on site, at member’s facilities.
- Co-op advertising allows even the smallest member to have its name promoted regionally through national television, radio and print media.
- Pool ordering provides direct shipment to each location saving the small chain time and money.

**Multitasking CSG Products:**

Home Depot is the number one dealer of flooring in the world. Lowe’s is the number two retailer of major appliances in the US. Until five years ago Home Depot refused to carry major appliances. They now rank number four nationally. These facts stated, CSG’s Home Center & Hardware products present excellent opportunities when combined with other CSG products.

- **CSG’s Home Furnishings** database products are a natural complement for our Home Center/Home Improvements products. Nearly 2,300 companies listed in the CSG Home Center/Home Improvements database sell floor coverings; nearly 1,000 offer carpeting.
- The **CSG Discount/GM** database offers a section of retailers of products for pets. More than 1,100 companies listed in our Home Center/Home Improvements database carry pet supplies.
- For customers of CSG’s Consumer Electronics database, more than 1,000 companies listed in our Home Center/Home Improvements database sell small appliances. Nearly 500 sell major appliances.
  - CSG lists more than 1,200 companies that offer air conditioners and electrical fans through its Home Center/Home Improvements database products.
  - Nearly 1,800 listed companies offer home heating equipment.
- **CSG’s Home Improvements** database products presents a major addition to the offerings from CSG’s Discount/GM database.
  - More than 1,500 companies in the Home Center/Home Improvements database offer housewares.
  - More than 2,300 companies in the CSG Home Center/Home Improvement database sell household chemical products.
- While fewer than 300 companies listed sell apparel, Farm & Home stores are major vendors of apparel in their communities. Several indicate that apparel accounts for approximately 40% of sales.
More than 2,000 listed companies sell home décor. This presents an excellent opportunity to partner with our Discount/GM and Department Store database products.

CSG Real Estate and Retail Design:

Through the past two years this industry has begun a trend to locate and design stores according to somewhat radical new plans. Industry DIY leaders such as Home Depot and Menard, major Pro Dealers and perhaps more importantly independent Ace members have begun campaigns to locate in urban settings with brand new store designs intended to match the environment of the neighborhood.

Following a local Ace dealer’s lead, Home Depot has begun opening stores in upscale urban areas such as New York’s Upper East Side. These locations are created to blend with the local neighborhood and feature unique store plans and functions including a uniformed doorman, a concierge desk at the entrance and areas in which customers may sit and consult with computer-aided designers.

Even the fairly conservative regional power Menards recently opened, a 240,000-square-foot store in St. Paul's diverse Midway neighborhood. It is the retailer's first two-story unit and features merchandise boutiques that are more upscale than seen at the typical Menards. Included among the new assortments are more than 40 kitchen vignettes. The store also contains Menard’s latest window and paint displays along with the retailer's first indoor garden center with live plants.

We are still in the early stages of this new era of real estate and store (re)design innovations for this industry. That stated there is no time better than the present to look into the budding opportunities the home improvement industry presents to real estate and retail design specialists.

Conclusion:

Clearly this industry has undergone a great deal of change over the past several years. National economic factors have fed a booming market economy. Corporate modernization, in terms of structure and systems, has bolstered the performance of companies from disparate backgrounds, serving distinct but sometimes overlapping customer profiles.

As retail channels continue to blur across most markets one cannot afford to overlook the opportunities presented by this complex industry.