Kubas Consultants

Hardware and Housewares – Looking Ahead

presented to

CHHMA
Canadian Hardware and Housewares Manufacturers Association

Spring Conference 2007

4 April 2007

Agenda

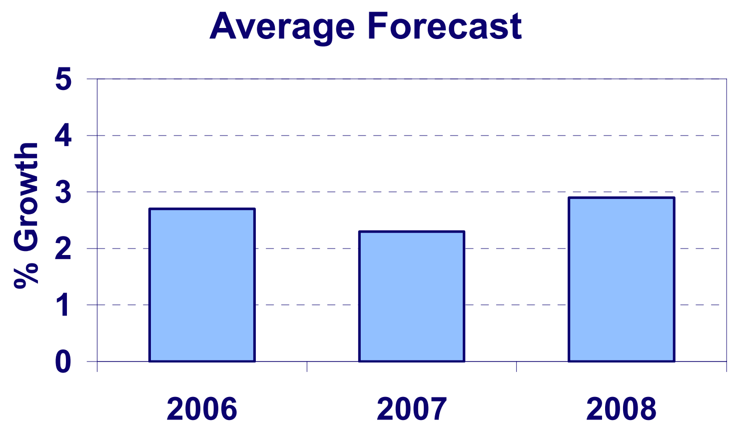
- Economics and Demographics
- Retail Outlook
- Top Retailers
- Developments
- Wrap-Up

Economics & Demographics

Economic Outlook

Current Forecasts

Real GDP Forecasts	2006	2007 f	2008 f
BMO Capital Markets	2.7%	2.3%	2.9%
CIBC World Markets	2.7%	2.1%	2.7%
RBC Financial Group	2.7%	2.5%	3.0%
TD Bank Economics	2.7%	2.4%	2.9%



- **Expect slightly slower growth in 2007**
  - 2.3% average forecast
- **Then a pick-up in 2008**
  - 2.9% average forecast

Economic Factors

- **Canadian GDP growth to lag US**
  - But US GDP growth on same pattern
- **Good news: Relatively stable inflation, interest rates, Canadian $**
  - Import and export prices should be relatively stable too
- **Really good news: Record low unemployment to continue**
  - People who work are people who buy!
- **Wild Card #1: Federal elections**
  - Canada: 2007 or 2008?
  - US: 2008
- **Wild Card #2: How long can Alberta keep it up?**
  - Economic balance across Canada is on shaky ground

2006 Census

- **Stronger population growth than expected**
  - 1.0% per annum 2001to 2006
  - Versus 0.8% per annum for 1996 to 2001
  - Difference is about 75,000 more people – enough for an extra small city every year
- **Household growth exceeds population growth**
  - 1.5% per annum
  - Good news if you sell hammers and toasters rather than socks and potatoes
- **Reality check: Minimum 4% per annum business growth required to stay even**
  - If you sell hammers and toasters …
  - To cover household growth *plus* inflation

More Urbanization

- **45% of population in 6 largest markets in 2006**
  - VECTOM – all in the million+ club
- **68% of population in 33 CMAs**
  - Each at least 115,000 people
- **90% of all population growth in above CMAs**
  - Particularly in suburbs
- **Good news for …**
- **Big Box stores**
  - Can cover majority of market with about 70 locations

Retail Outlook

Overall Retail Outlook

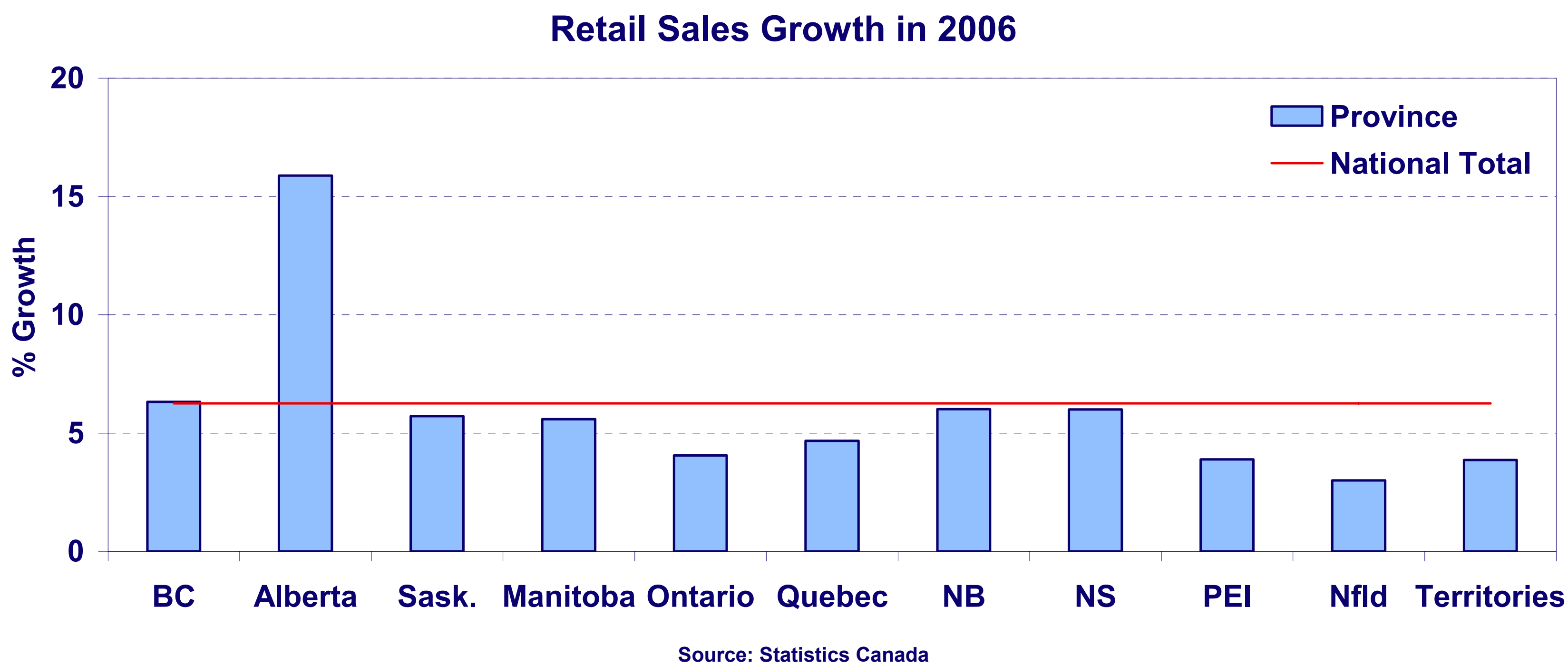
- **The big numbers:**

Retail Sales	2006	2007f	2008f
Total, Billions	$391.4	$411.0	$433.1
Annual Growth	6.2%	5.0%	5.4%

Source: Statistics Canada and Kubas Consultants' current forecast

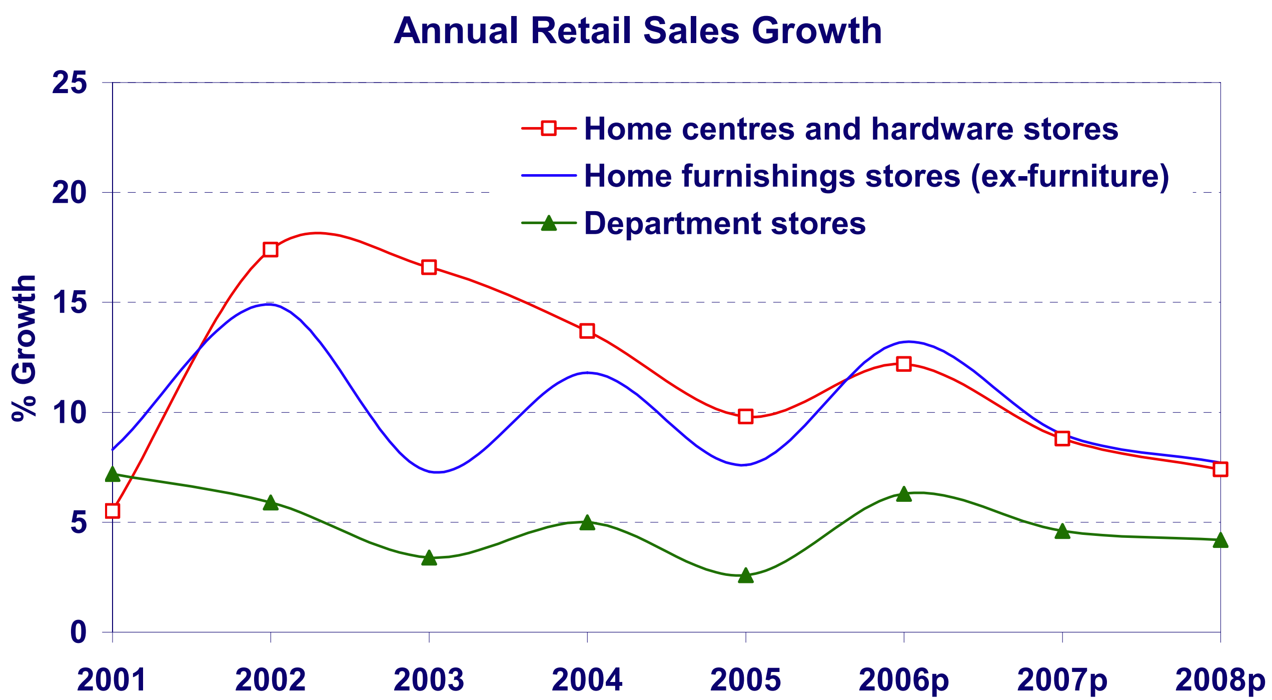
- **Statistics Canada on 2006 retail: "… strongest annual growth rate since 1997"**
- **But the overall average may be misleading for *your* business**
  - Best in 2006: Used & recreational motor vehicle & parts dealers, + 14.3%
  - Worst in 2006: Computer and software stores, - 4.3%
- **And it depends on where you are …**

Regional Disparity



- **What's wrong with this picture? Only Alberta was above average, at +15.9%**
  - 2006 retail growth with Alberta: 6.2%
  - Without Alberta: 4.8% – which would be a "slow" year
- **In 2006, Ontario up only 4.1%, and Quebec only up 4.7%**
  - Both were below average
  - Ontario + Quebec = 58% of total retail

Retail Sector Outlook



Source: Statistics Canada and Kubas Consultants' current forecast

- **Home improvement and furnishings stores: cooling off from previous highs**
- **Department stores: average to below average growth going forward**

Retail Product Sales Outlook

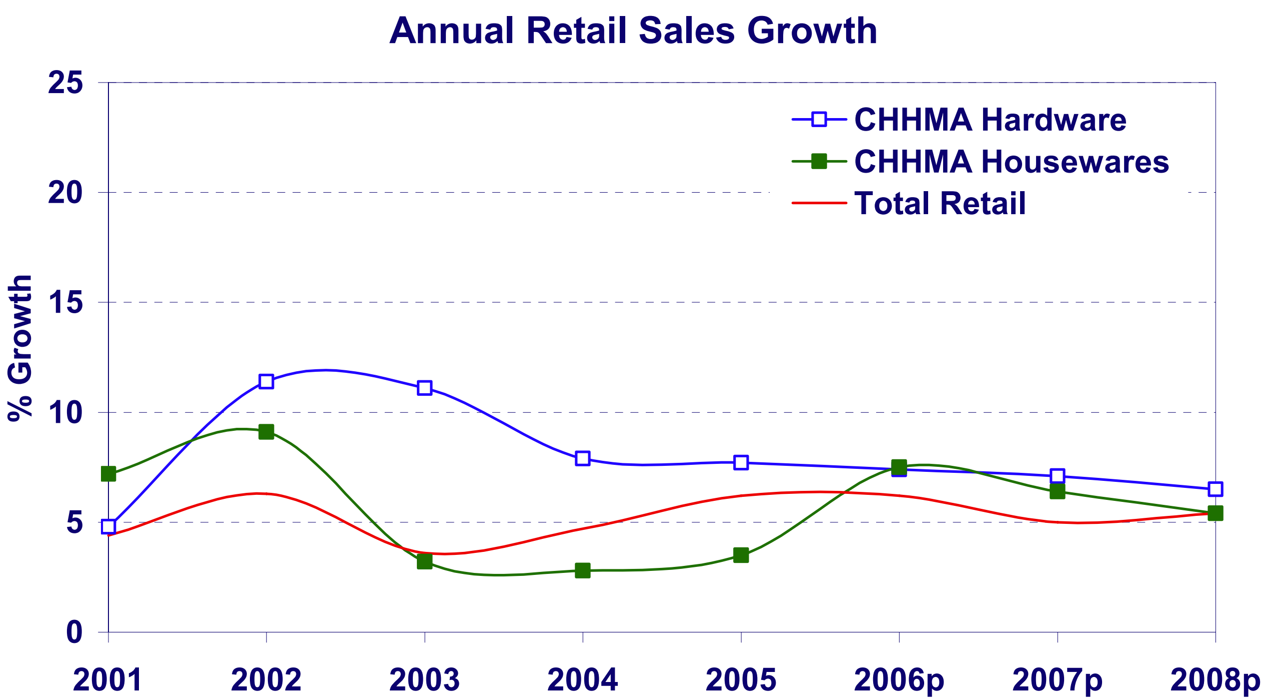
- **The big numbers:**

Retail Sales	2006	2007f	2008f
CHHMA Hardware	$15.1	$16.2	$17.2
CHHMA Housewares	$9.8	$10.4	$10.9
CHHMA Total	$24.9	$26.5	$28.2

Source: Statistics Canada and Kubas Consultants' current forecast

- **Notes:**
  - "CHHMA Hardware" excludes lumber and building supplies, includes lawn and garden, excludes plants and flowers
  - "CHHMA Housewares" includes non-electrical products, plus small appliances, plus household supplies
- **2006 market for CHHMA members' products: about $25 billion**
  - Split about 60:40, Hardware to Housewares
- **And rising to $28 billion in 2008**
  - About +12% over two years

Retail Product Growth Outlook

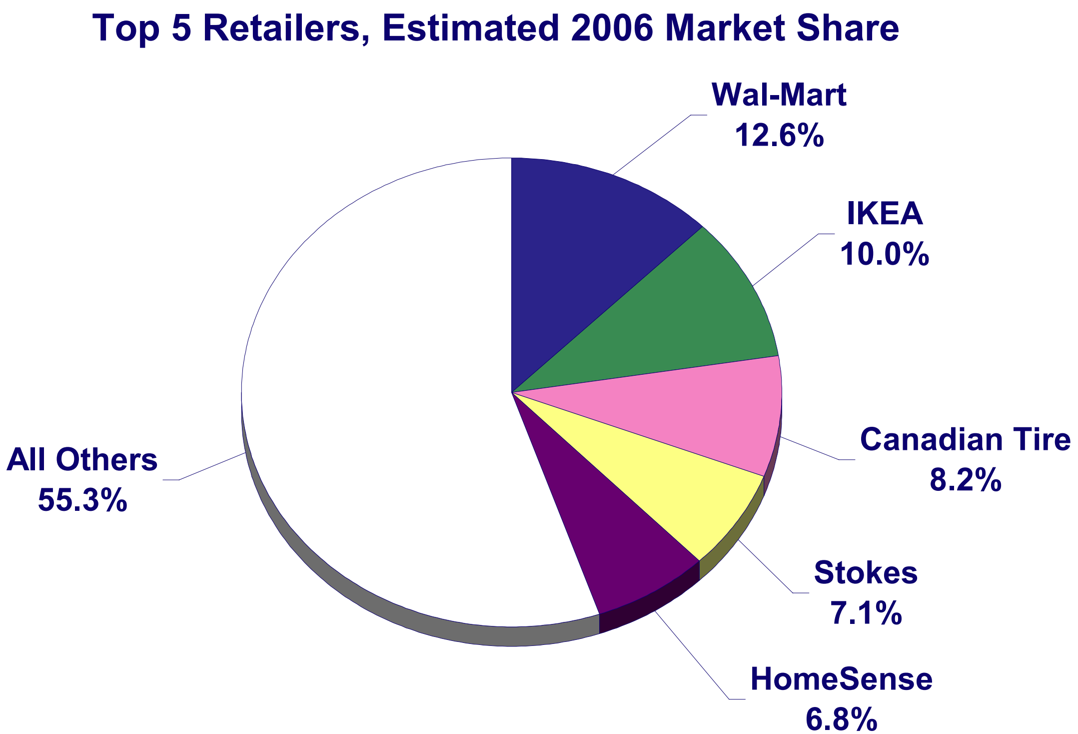


Source: Statistics Canada and Kubas Consultants' current forecast

- **Expect 5% to 7% retail sales growth for CHHMA product groups**
  - At or just above retail average
- **In other words, "good growth"**
  - Ahead of the retail average
  - But slightly off from 2006

Top Retailers

Housewares

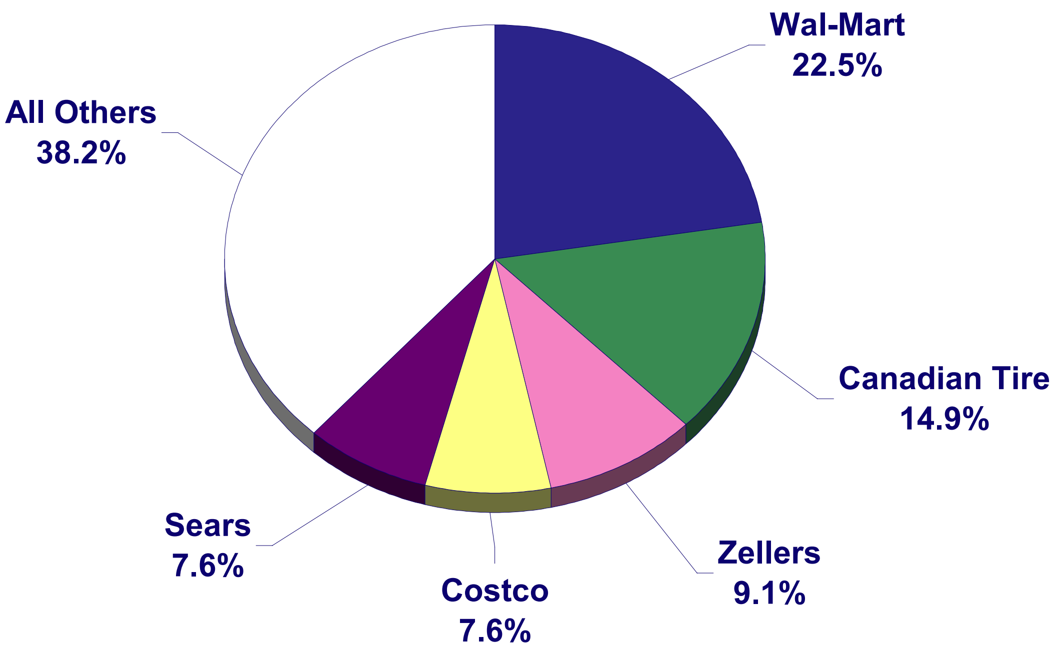


Source: Kubas Consultants, Major Market Retail Report. Results based on consumer surveys in top 6 markets.

- **Notable:**
  - Real Canadian and London Drugs significant in the West
  - Benix in the East
- **Rise of “mid box” – HomeSense and Home Outfitters**
  - About 12% total share in 2006, versus nothing 5 years ago
  - A housewares format adapted to a power centre

Small Appliances

Top 5 Retailers, Estimated 2006 Market Share

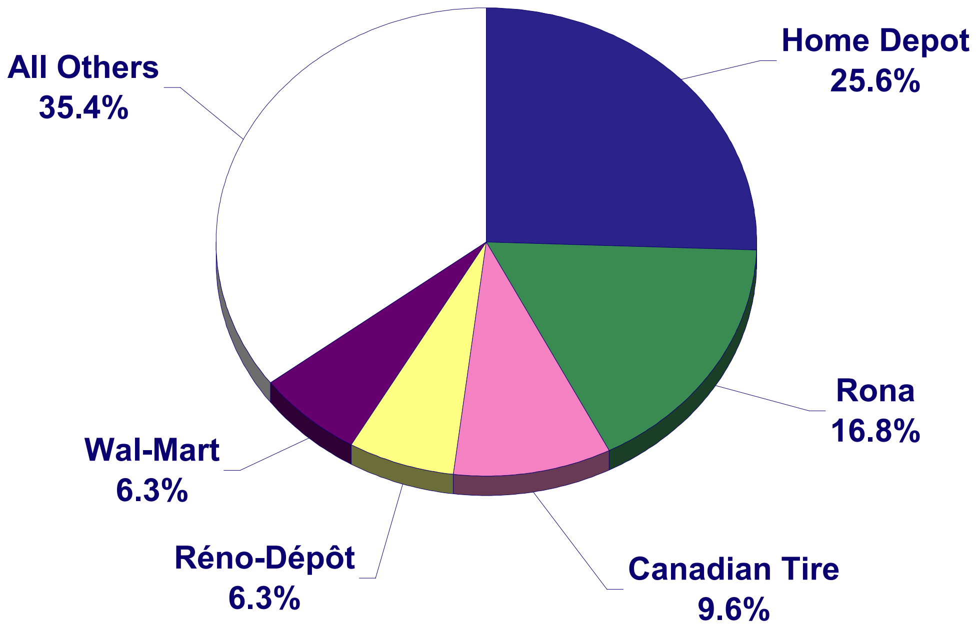


Source: Kubas Consultants, Major Market Retail Report.
Results based on consumer surveys in top 6 markets.

- **Notable:**
  - London Drugs #2 in West
- **Less success for "mid box"**
  - Because big players are more dominant

Paint & Decorating

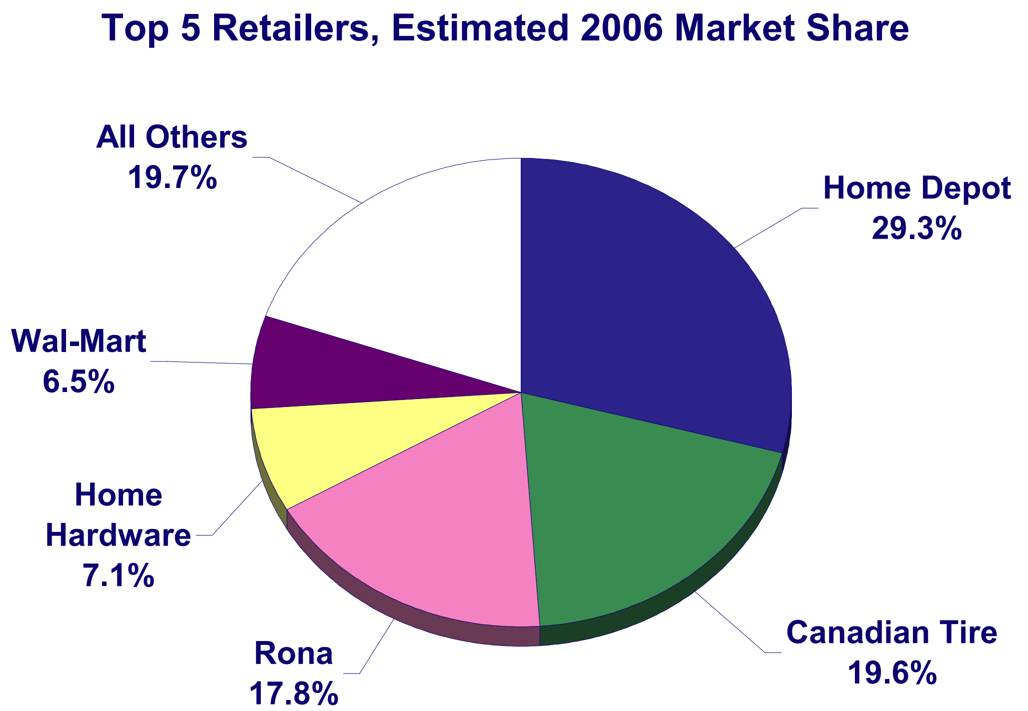
Top 5 Retailers, Estimated 2006 Market Share



Source: Kubas Consultants, Major Market Retail Report.
Results based on consumer surveys in top 6 markets.

- **Notable:**
  - Rona + Réno-Dépôt total very close to Home Depot
- **Specialists relegated to minor status**
  - Colour Your World, Glidden, General Paint

Hardware & Home Improvement

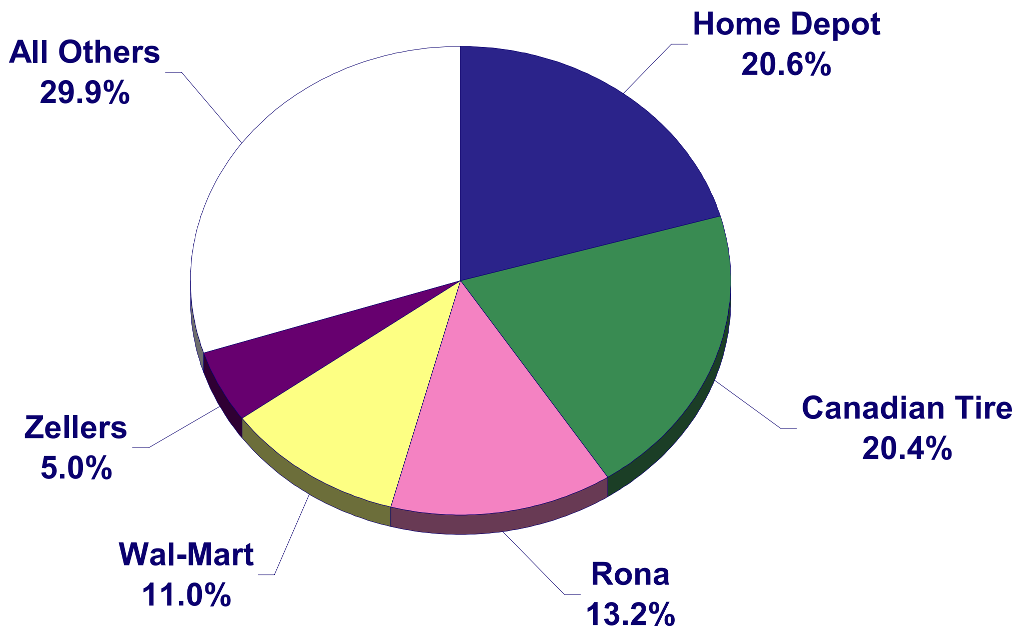


Source: Kubas Consultants, Major Market Retail Report.
Results based on consumer surveys in top 6 markets.

- **Notable:**
  - Rona + Réno-Dépôt total would be #2, ahead of Canadian Tire
- **Big stores particularly dominant in major markets**
  - Very little room for smaller players

Lawn & Garden

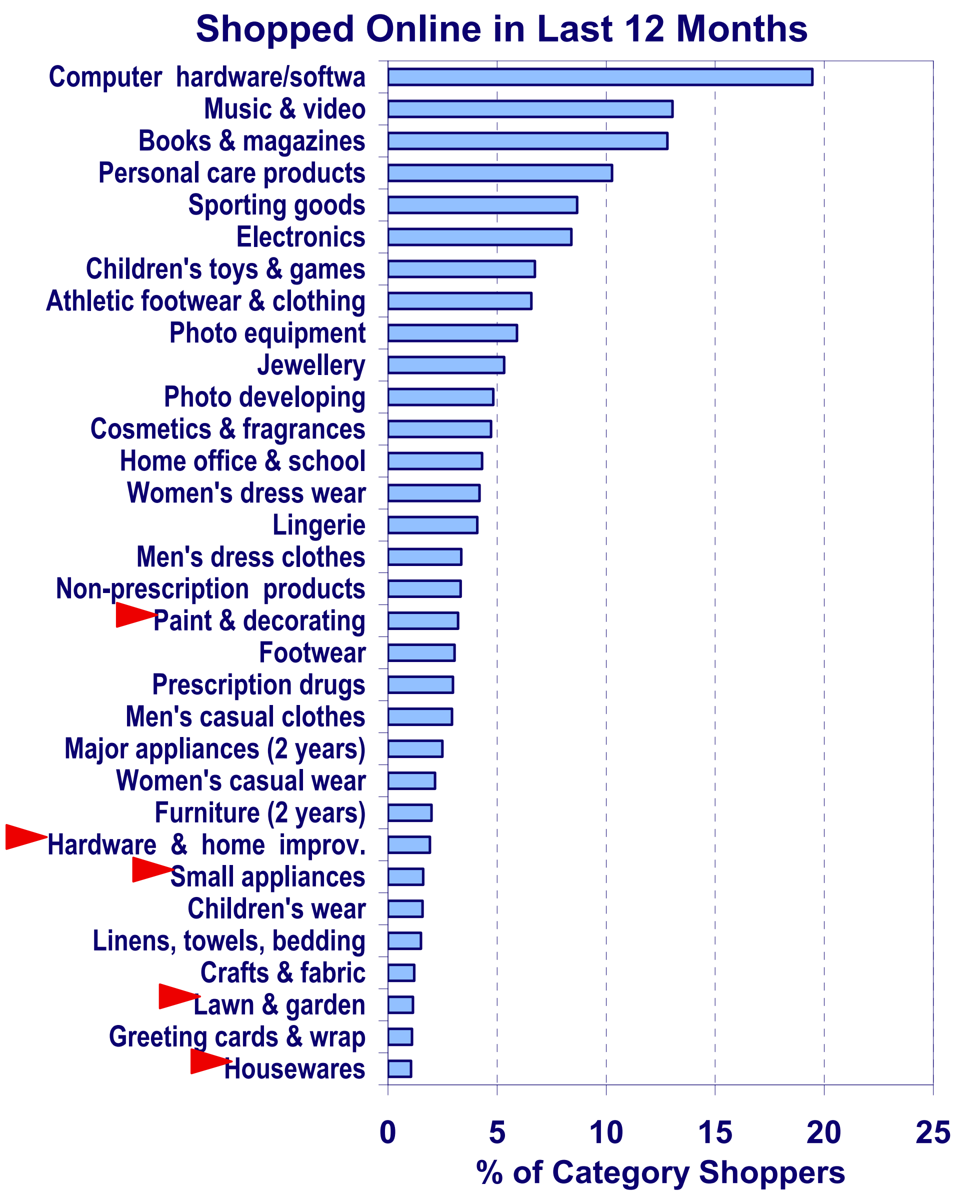
Top 5 Retailers, Estimated 2006 Market Share



Source: Kubas Consultants, Major Market Retail Report.
Results based on consumer surveys in top 6 markets.

- **Notable:**
  - Rona + Réno-Dépôt total still less than Canadian Tire
  - Canadian Tire #1 in East, edging out Home Depot
  - Real Canadian #5 in West

Bricks Versus Clicks



- **E-commerce is still a small factor in hardware and housewares**
  - Well under 5% shopping
- **But this doesn't mean you can ignore the Internet!**
  - 58% of consumers say Internet is Good or Excellent for *general* product information – #2 highest rating after flyers

Source: Kubas Consultants, Major Market Retail Report. Results based on consumer surveys in top 6 markets.

Overall at Retail

- **Conditions vary by subcategory**
- **Housewares and small appliances:**
  - More diverse, less domination
  - More competitive
- **Hardware, home improvement, and related categories:**
  - More dominated by fewer retailers
  - Less competitive

Developments

Housing Boom Will End, Sometime

- **Canada's housing boom has supported CHHMA members**
- **But it's going to end, sooner or later**
  - Look at what's happening in the US
- **Average annual new households in Canada over last 5 years: 175,000**
- **Average annual new housing starts in Canada over last 5 years: 222,000**
- **A difference of + 26%**
  - Going to by latent demand left over from 1990s – but when does it run out?
  - Going to increased rental vacancy, which used to be very low
  - When does catch-up building become over-building?
- **Housing market cycle is notoriously difficult to predict**
  - About 10 years plus or minus 3
  - So current cycle could end sometime between 2007 to 2013
  - Hard to recognize change before it happens
- **Best we can hope for: A soft landing**

Combo Store Wars

- **Sparked by Wal-Mart Superstore coming to Canada**
- **Very important: *It's not just about food***
- **The US experience over last 10 years:**

Share of Non-Automotive Retail	1997	2006	Change
Combo Stores	5.5%	12.8%	Up 2½ times
Conventional Supermarkets	25.0%	20.8%	Down 1/6
Conventional Department Stores	14.7%	9.2%	Down 1/3

Source: US Census Bureau

- **Canadian incumbents expand**
  - Especially Loblaw, via Real Canadian Superstore, and Costco
  - And thereby expand non-food too
- **All other food, drug, and general merchandise stores affected**
  - Sobeys, Shoppers Drug Mart, Sears, Canadian Tire, etc., etc.
  - And look for ways to fight back, in any product category
- **The combo store imperative: cost efficiency**
  - Including holding down supplier prices

Lowe's

- **Lowe's to open first Canadian stores in Toronto in 2007**
- **Not the least bit afraid of competition**
  - Very comfortable going head-to-head against Home Depot in the US
- **Rapid Canadian expansion can be done easily enough**
  - Lowe's has nearly 1,400 stores in the US
  - Can cover most of Canadian market with 70 locations
  - That's just 5% more
  - From the Lowe's point of view, it's not a big deal
- **Lowe's has some different strengths, which will cause novel ripple effects in the market**
  - Like appliances, both small and major
  - So Home Depot Canada is beefing up appliances …
  - Which will affect Sears, Future Shop, The Brick, …
  - Now, combine this Wal-Mart Superstore …
- **Good potential for a price war**
  - Which will also affect vendors and suppliers

Wrap-Up

Looking Ahead

- **The economy is still in fairly good shape**
  - 2007 to be a little slower, but a rebound expected in 2008
  - Population, households, jobs, etc. keep growing
  - Prices should be relatively stable
- **Retail in generally good shape**
  - Somewhat slower – but still good – growth ahead
  - Different circumstances in different sectors
  - But hardware and housewares prospects at or slightly above average
- **But the risk factor is increasing**
  - Retail strength is not broadly based
  - Overdependence on one province for growth
  - Not “if” housing boom ends, but “when” and “how”
- **Expect big changes in hardware and housewares retail**
  - Who the major players are could change significantly
  - Cost cutting and price wars will be passed along to vendors
  - Pressure will build with time
- **Overall: Good outlook for volume and sales, but not as good for margins**

Thank You!

Your questions?

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