

Industry Report: Home Improvement Retailers

Long-term concerns about the housing market's rebound, the high national unemployment rate and softened consumer spending have plagued many home improvement retailers in recent fiscal quarters. Industry leader Home Depot Inc. expects same store sales to decrease 4-6% for the fourth quarter of 2009. Meanwhile, Lowe's Companies Inc. recently reported that it expected same store sales to decline 2-6% in the fourth quarter as compared to the previous year. Market conditions are not likely to stabilize until new home sales show significant, prolonged improvement. While some regional real estate markets have shown sales growth since the beginning of fiscal 2009, industry analysts believe the outlook on a national level may not significantly rebound until at least mid-2010.

When analyzing the stock ledger of retailers carrying home-building and home improvement items, Tiger Valuation offers the following inventory valuation considerations:

- **Inventory Mix By Category** – Going-out-of-business (GOB) recovery values for items such as doors, windows, kitchen cabinets and interior moldings are largely contingent on the availability of common, popular sizes and styles. For example, smaller windows that do not meet egress building codes will likely be slower to move in a liquidation sale, thus generating lower net recovery values as compared to more standardized sizes with higher turnover rates. Larger or elaborately shaped windows with high retail values also typically carry relatively lower liquidation prices due to their unique applications. A similar bell-curve sizing principle applies to home interior merchandise such as room doors and kitchen fixtures. In the case of kitchen cabinets, the absence of certain key sizes or configurations necessary to complete various sets will dramatically reduce the liquidation value of other complementary pieces. The valuation of exterior trim boards, framing lumber and plywood would also be conditional on the available inventory mix at the start of a liquidation sale.
- **Supportive Inventory** – Certain merchandise categories require supportive inventory in order to complete the sale of the main item. An overstock of supportive accessories relative to the availability of the primary item would have a negative impact on recovery values. For example, vinyl siding requires many installation accessories such as J-channel, undersill trim, F-channel, soffit, outside corners and inside corners. These items are often color-matched to the siding stock and are carried under the same brand name. Imbalanced ratios of these types of installation components will impact the recovery of the main product. By themselves, supportive inventory items carry a negligible retail value if they cannot be sold in conjunction with the main item. Home center retailers must continuously address this balance throughout other categories such as tile, wood and laminate flooring, kitchen cabinets and exterior decking.
- **Industry Trends** – Industry trends can affect inventory values if retailers do not keep their merchandise offerings up-to-date with the most popular colors, finishes and styles. Within a merchandise category such as paints, finish tones and colors cycle in and out of style and excessive stock in the wrong color or finish can greatly reduce salability of products in a GOB environment. Faucet fixtures and kitchen cabinet offerings are other examples of items with cyclical style trends. Furthermore, product offerings for merchandise such as laminate flooring or composite decking evolve quickly and it is important for retailers to stay on top of new developments in the marketplace. Having current versions as opposed to the prior year's product will positively impact the projected recovery value of trend-sensitive items.
- **Seasonality** – The net recovery value of certain categories are greatly impacted by the time of year. For example, the liquidation value of spring and summer items such as decking, patio furniture, gardening tools and supplies would be greatly affected by the time of year in which a GOB event is held. By contrast, goods with a winter focus include storm doors and windows, insulation, snow and ice-prevention products. In analyzing a company's inventory levels, special attention should be paid to the amount of seasonal merchandise and packaway. An excessive amount of out-of-season product will negatively impact net recovery values.
- **Brand Names** – Well-established brand names and labels typically generate higher recovery values in GOB events. Name brands for virtually any merchandise category (windows, doors, flooring, plumbing fixtures, faucets, door hardware, siding, roofing, trim boards, etc.) generate higher liquidation values as compared to lesser-known or generic brands.

Optimism for a housing market rebound in 2010 has led some home improvement retailers such as Lowe's to project modest same store sales increases for early next year. Meanwhile, increases in the percentage of home owners undertaking "do-it-yourself" projects will also be a key factor for growth within the home improvement retail industry. Competition for market share is likely to remain tight amongst retailers offering home-building merchandise. Retailers maintaining a balanced, seasonally relevant product mix that is responsive to ongoing industry trends and the installation needs of its customers are likely to be the most successful in the marketplace.