

Lowe's Companies, Inc., 2013

www.lowes.com, LOW

Headquartered in Mooresville, North Carolina, Lowe's is among *Fortune's* top 50 companies and is the second-largest home improvement store in the world, trailing only Atlanta, Georgia-based Home Depot. Lowe's operates 1,745 stores totaling 197 million square feet of retail selling space with all Lowe's stores being located in the USA, Canada, and Mexico. Lowe's has an agreement, as a one-third owner, with Australian Woolworths Limited to develop a Lowe's-themed store in Australia.

Lowe's in late 2013 acquired Orchard Supply Hardware for approximately \$205 million in cash, plus the assumption of payables owed to nearly all of Orchard's suppliers. The acquisition gave Lowe's a new customer base in California. Lowe's plans to have Orchard operate as a separate, standalone business, retaining its brand under the leadership of Orchard's current management team. Based in San Jose, California, and with fiscal 2012 annual revenue of \$657 million, Orchard operates 91 neighborhood hardware and garden stores primarily located in densely populated markets in California. Under the terms of the transaction, Lowe's acquired at least 60 of these stores. On average, Orchard stores have about 36,000 square feet of selling space, compared to 113,000 square feet for an average Lowe's home improvement store. Lowe's currently operates 110 stores in California.

Lowe's stores offer appliances, lawn and garden, lumber, plumbing, electrical, power tools, flooring, and much more for home repair and construction. Lowe's principle goal is "to execute better than our competitors, and make the process of home improvement as seamless and simple as possible for customers." Lowe's customers are primarily homeowners, renters, homebuilders, and commercial construction firms. Lowe's has 160,000 full-time employees and 85,000 part-time employees, all of whom are led by CEO Robert Niblock. Lowe's has a chief rival, Home Depot, which reported a profit of \$4.5 billion in 2012 on sales of \$74.75 billion.

Lowe's fiscal 2012 sales increased 0.6 percent to \$50.5 billion, while earnings increased 6.5 percent to \$2.0 billion. But Lowe's total customer transactions in 2012 declined to 804 million from 810 million the prior year. Lowe's fiscal year 2012 ended January 31, 2013.

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History

The first Lowe's was opened in North Wilkesboro, North Carolina, in 1921 by Lucius Lowe as "Lowe's North Wilkesboro Hardware." However, from the start, in addition to hardware, the store also offered produce, groceries, tobacco products, and dry goods. Lowe died in 1940 and his daughter Ruth Buchan inherited the business and sold it the same year to her brother Jim Lowe. In 1946, Lowe's was officially founded. Jim Lowe hired Ruth's husband, Carl Buchan, after World War II and the two men ran the store together until 1952 when they split, with Buchan taking control of the hardware business and Jim Lowe opening up Lowes Foods in 1954, which is still operational today.

After the split, Buchan began expanding Lowe's throughout the 1950s opening stores in several North Carolina markets. However, Buchan died from a heart attack in 1960 at age 44, and Lowe's five-man executive team took the company public in 1961. The following year, Lowe's totaled 21 stores and had annual revenues of over \$32 million.

During the 1960s and 1970s, the U.S. housing market expanded rapidly with professional builders becoming Lowe's primary customer. In 1982, Lowe's reported its first billion-dollar revenue year with a record profit of \$25 million. Starting in the 1980s, however, Lowe's, in addition to builders, started focusing on the home do-it-yourself (DIY), whose aim was for weekend projects to add value to their homes.

In 1994, the "modern" Lowe's began with all new store expansion, having stores greater than 85,000 square feet of retail space. As of 2012, Lowe's opens two styles of stores: 117,000-square foot stores in large markets and relatively smaller 94,000-square foot stores in smaller markets. In 2007, Lowe's opened its first stores in Canada, where it currently operates

20 stores and in 2010 the first store opened in Mexico. Lowe's plans to open 150 stores in Australia in the next five years.

Internal Issues

Vision and Mission

The Lowe's mission statement is:

Lowe's Promise: We are committed to delivering better customer experiences across the entire home improvement spectrum, by pulling together the best combination of possibilities, support and value for customers wherever and whenever they choose to engage.

Lowe's vision statement is as follows:

We will provide customer-valued solutions with the best prices, products and services to make Lowe's the first choice for home improvement.

Lowe's focuses its employees on the following core values:

- Customer Focused
- Teamwork
- Ownership
- Passion for Execution
- Respect
- Integrity

Lowe's markets the slogan:

Never stop improving.

Organizational Structure

As illustrated in Exhibit 1, Lowe's operates from a divisional-by-region organizational structure. Some analysts suggest that Lowe's may have too many top executives.

Lowe's Locations

Exhibit 2 reveals where all the Lowe's stores are located. The company plans to open 10 new stores in 2013.

Supply Chain

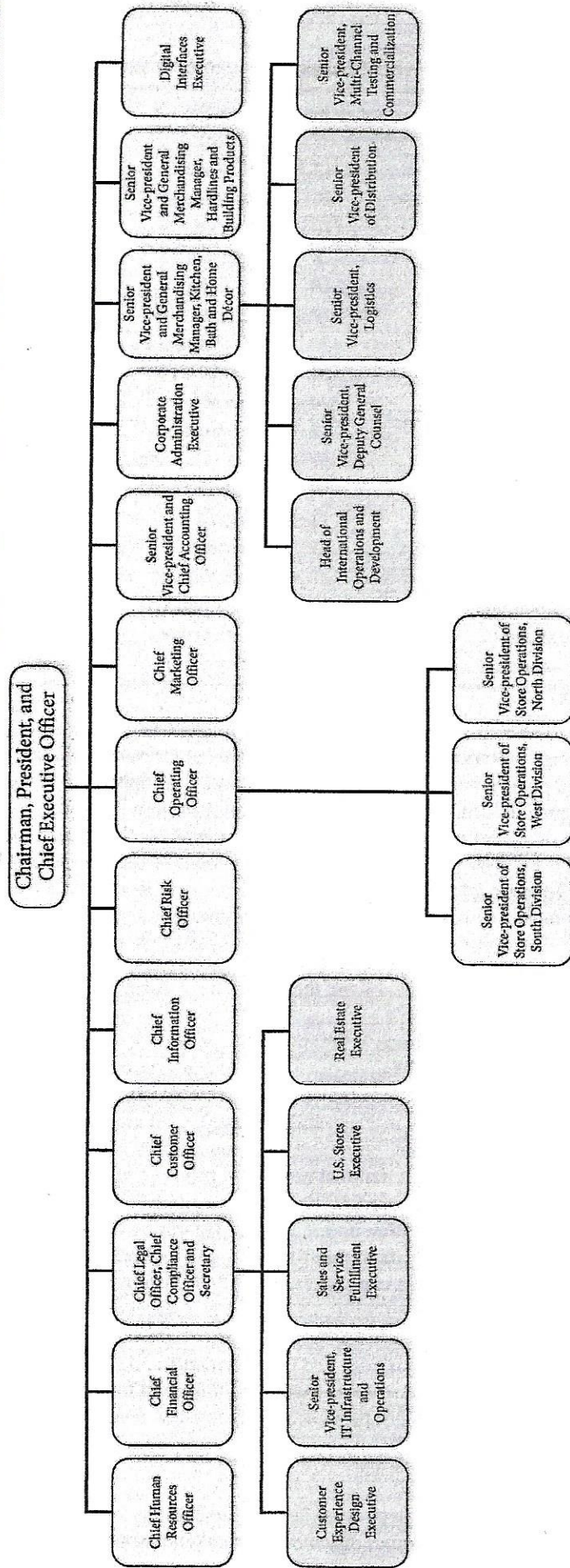
Lowe's receives products from more than 7,000 vendors with the largest single vendor only supplying around 7 percent of total purchases. To facilitate product movement, Lowe's operates 14 highly automated regional distribution centers in the USA with each distribution center serving around 120 stores. In addition, Lowe's operates 15 flatbed distribution centers for items such as vinyl siding, ladders, lumber, and other products that require special handling.

Lowe's considers its supply chain finance (SCF) to be one of its top means for gaining competitive advantage over rival firms such as Home Depot, Ace, and True Value. Because most rival firms offer the same or similar products, maximizing SCF efficiencies can be critically important. Lowe's considers three key areas of its SCF strategy to be (1) standardization of payment terms, (2) incentives for buying organization, and (3) break even for the suppliers.

Sustainability

Lowe's emphasizes sustainability and in 2012 was awarded the ENERGY STAR Sustained Excellence Award for the third straight year and also was awarded the WaterSense award from the EPA for the fourth straight year. The awards can be attributed to Lowe's overall mission to protect the natural environment by continually expanding product offerings that are Energy Star and WaterSense qualified as well as offering numerous solar-powered alternatives.

EXHIBIT 1 Lowe's Organizational Structure



Source: Based on company documents.

EXHIBIT 2 Lowe's Stores by State and Province (as of February 3, 2013)

Alabama	39	Massachusetts	27	Oklahoma	29
Alaska	5	Michigan	47	Oregon	13
Arizona	32	Minnesota	11	Pennsylvania	81
Arkansas	20	Mississippi	24	Rhode Island	5
California	110	Missouri	48	Wyoming	1
Colorado	28	Montana	5	South Carolina	49
Connecticut	16	Nebraska	5	South Dakota	3
Delaware	10	Nevada	17	Tennessee	60
Florida	120	New Hampshire	13	Texas	141
Georgia	63	New Jersey	39	Utah	16
Hawaii	4	New Mexico	14	<i>Total U.S. Stores</i>	<i>1,715</i>
Idaho	8	New York	66	Alberta	6
Illinois	37	North Carolina	111	British Columbia	2
Indiana	44	Vermont	2	Ontario	26
Iowa	11	Virginia	67	Saskatchewan	1
Kansas	11	Washington	36	<i>Total Canadian Stores</i>	<i>34</i>
Kentucky	42	West Virginia	18	Nuevo Leon, Mexico	5
Louisiana	31	Wisconsin	8	<i>Total Stores</i>	<i>1,745</i>
Maine	11	North Dakota	3		
Maryland	28	Ohio	83		

Lowe's has installed recycling centers in more than 1,700 stores across the USA, helping customers to recycle rechargeable batteries, cell phones, fluorescent light bulbs and plastic shopping bags. Lowe's recently expanded its appliance recycling programs and reduced its carbon footprint by installing more than 3 million new energy-efficient fluorescent lamps in stores. Lowe's is currently updating the lighting at 34 distribution facilities.

Segments

Lowe's provides an excellent breakdown of revenues by product category. Exhibit 3 provides the most recent two years of available data. Note that no single category accounts for more than 11 percent of revenues and there have been consistent revenues across all categories over the two most recent years.

Within the wide product categories, Lowe's offers both national brand-name and private-brand products. Many customers shop for brand name they know and trust to be the same regardless of the store they are sold. Private brands however do provide product differentiation from competitors in innovations, design, and are often cheaper as well. Lowe's private brands include tools, paint, plumbing, flooring, lumber, and much more. Virtually all product categories are offered in both national brand and private-branded options. Lowe's also offers a much larger selection of home improvement products than Home Depot, even offering designer towels, towel racks, and many more upscale home-decorating options.

Lowe's also offers credit financing to customers through its consumer credit card with GE Money Bank. The card allows qualified customers to receive 5 percent off all purchases, and with purchases over \$299, customers can select to receive no interest financing or 5 percent off the purchase price. In addition, Lowe's offers a commercial account for small- to medium-size businesses with minimal monthly payments and the company also provides accounts receivables for commercial customers that pay in full each month.

Lowe's does not provide a breakdown of revenues or profits by geographic region.

Strategies

Lowe's initial strategy was focusing on builders but with the housing boom in the 1960s, Lowe's added the DIY home improvement market. Lowe's has always engaged in both market development and market penetration, adding stores across the USA and now in Canada, Mexico, and

EXHIBIT 3 Lowe's Sales by Product Category

	(Dollars in millions)					
	2012		2011 ¹		2010 ¹	
	Total Sales	%	Total Sales	%	Total Sales	%
Plumbing	\$ 5,448	11%	\$ 5,400	11%	\$ 5,146	11%
Appliances	5,210	10	5,341	11	5,392	11
Tools & Outdoor Power Equipment	4,967	10	4,749	9	4,563	9
Lawn & Garden	4,390	9	4,411	9	4,363	9
Fashion Electrical	4,049	8	4,034	8	3,744	8
Lumber	3,448	7	3,256	6	3,205	6
Seasonal Living	3,332	7	3,239	6	3,137	6
Paint	3,306	6	3,219	6	3,068	6
Home Fashions, Storage & Cleaning	3,026	6	2,997	6	2,891	6
Flooring	2,857	6	2,857	6	2,771	6
Millwork	2,791	5	2,897	6	3,067	6
Building Materials	2,790	5	3,040	6	2,760	6
Hardware	2,702	5	2,691	5	2,561	5
Cabinets & Countertops	1,817	4	1,810	4	1,810	4
Other	388	1	267	1	337	1
Totals	\$ 50,521	100%	\$ 50,208	100%	\$ 48,815	100%

¹Certain prior period amounts have been reclassified to conform to current product category classifications.

Source: 2012 Annual Report, p. 65.

Australia. Having two store sizes is an advantage because Lowe's tailors the respective store size market to particular markets. Lowe's does, however, experiment with various layouts at various locations; nevertheless, having the same principle layout at most stores provides customers familiar in their shopping experience. Also, Lowe's has slightly larger stores than rival Home Depot with an average store size of 113,000 to 105,000 square feet. Both Lowe's and Home Depot have on average 32,000 square feet of garden space. Lowe's also stocks 40,000 items, up to 10,000 more than certain Home Depot stores. Having wider aisles, more signs, and better store lighting are also competitive advantages of Lowe's. In addition, Lowe's has around 69 to 89 percent full-time employees to Home Depot's 59 percent. Despite these "competitive advantages," Home Depot is outperforming Lowe's, and by what some analysts say is by alarming margins.

Lowe's is continuing its expansion and is attempting to better attract customers who normally would not visit home improvement stores. In addition, Lowe's has implemented a new strategy to attract an increasing number of female customers.

Lowe's has over 190,000 products online and recently started shipping items to customers from service stores and regional distribution centers. Historically, Lowe's only shipped online purchased items from its dedicated Internet warehouse. This new strategy enables Lowe's to provide faster deliveries, reduce order filling costs, and improve profitability overall. Building on the increased online presence, Lowe's plans to reduce its brick-and-mortar expansion plans by 15 stores annually thereafter, or around a 50 percent reduction in planned new stores.

Finance

Lowe's recent balance sheets are provided in Exhibit 5.

The Economy

Home prices are slowly rising in the USA and home construction too is rising, both good news for Lowe's. June 2012 new home sales in the USA were up 15.1 percent over the prior year.

EXHIBIT 4 Lowe's Companies, Inc. Income Statement

	(In millions, except per share and percentage data) Fiscal years ended on		
	February 1, 2013	February 3, 2012	January 28, 2011
Net sales	\$ 50,521	\$ 50,208	\$ 48,815
Cost of sales	33,194	32,858	31,663
Gross margin	17,327	17,350	17,152
Expenses:			
Selling, general and administrative	12,244	12,593	12,006
Depreciation	1,523	1,480	1,586
Interest—net	423	371	332
Total expenses	14,190	14,444	13,924
Pre-tax earnings	3,137	2,906	3,228
Income tax provision	1,178	1,067	1,218
Net earnings	\$ 1,959	\$ 1,839	\$ 2,010
Basic earnings per common share	\$ 1.69	\$ 1.43	\$ 1.42
Diluted earnings per common share	\$ 1.69	\$ 1.43	\$ 1.42
Cash dividends per share	\$ 0.62	\$ 0.53	\$ 0.42

Source: 2012 Annual Report, p. 38.

Sales of existing homes are increasing, up to 4.37 million units in June 2012 from 4.18 units in June 2011 or a 4.5-percent increase. Unemployment rates have fallen to just below 8 percent in the USA, and are trending downward, good news for Lowe's. More and more people are remodeling their homes, also good news for Lowe's. The top four homebuilders in the USA are: D.R. Horton Inc., KB Homes, PulteGroup Inc., and Lennar Corp.; all four companies are growing and this is good news for Lowe's.

The 30-year fixed mortgage rate is over 3 percent and rising. Despite low rates however, banks are still reluctant to lend. Throughout much of the previous decade, banks would allow someone to purchase a home with as little as 5 percent down, but now banks are commonly requiring 20 percent cash down. In addition, banks are also requiring higher credit scores to qualify for a mortgage. Scores as high as 720 would historically be automatic for a loan, but scores as high as 755 are now *not* automatic for approval. Low interest rates are allowing many people to refinance their homes, thus providing them with additional cash to potentially spend on home improvement projects.

CEO Frank Blake of Home Depot in October 2012 said: "This housing market has been very very bad and it's going to take some time to recover." Blake's comments were on the heels of the Federal Reserve blaming the U.S. housing situation for the country's overall slow economic recovery. In Blake's opinion, when customers start to consider home improvement projects, such as installing a new granite countertop as a home investment rather than a cost, then the housing market is likely heading for a more sustainable recovery.

Competition

Largely dependent on the state of the economy and especially the state of the housing market, competition is intense in the home improvement industry. Major players Lowe's and Home Depot have the greatest market share, but many other firms such as True Value Hardware, Ace Hardware, and even Walmart all facilitate increased competition. For example, Ace markets its business as a one-stop place where a customer can receive friendly help with an appropriately sized store that enables customers to find everything they need "without the use of a gps." This marketing strategy is clearly aimed at behemoths Lowe's and Home Depot and suggests that by being large warehouse stores, customers do not receive the personal attention Ace can deliver. True Value positions its business model around each store being independently owned and operated, providing customers with a store that offers products more tailored to local needs.

EXHIBIT 5 Lowe's Companies, Inc. Balance Sheet

	(In millions, except par value and percentage data)	
	February 1, 2013	February 3, 2012
Assets		
Current assets:		
Cash and cash equivalents	\$ 541	\$ 1,014
Short-term investments	125	286
Merchandise inventory—net	8,600	8,355
Deferred income taxes—net	217	183
Other current assets	301	234
Total current assets	9,784	10,072
Property, less accumulated depreciation	21,477	21,970
Long-term investments	271	504
Other assets	1,134	1,013
Total assets	\$ 32,666	\$ 33,559
Liabilities and shareholders' equity		
Current liabilities:		
Current maturities of long-term debt	\$ 47	\$ 592
Accounts payable	4,657	4,352
Accrued compensation and employee benefits	670	613
Deferred revenue	824	801
Other current liabilities	1,510	1,533
Total current liabilities	7,708	7,891
Long-term debt, excluding current maturities	9,030	7,035
Deferred income taxes—net	455	531
Deferred revenue—extended protection plans	715	704
Other liabilities	901	865
Total liabilities	18,809	17,026
Commitments and contingencies		
Shareholders' equity:		
Preferred stock—\$5 par value, none issued	—	—
Common stock—\$.50 par value;		
Shares issued and outstanding		
February 1, 2013	1,110	
February 3, 2012	1,241	555
Capital in excess of par value	26	14
Retained earnings	13,224	15,852
Accumulated other comprehensive income	52	46
Total shareholders' equity	13,857	16,533
Total liabilities and shareholders' equity	\$ 32,666	\$ 33,559

Source: 2012 Annual Report, p. 39.

In addition to brand-name stores, there are thousands of local mom-and-pop hardware stores that customers trust and frequent.

Lowe's and Home Depot compete with many stores offering similar products. Walmart offers many of the same lawn and garden options, as well as lights, paint, tools, and many other

EXHIBIT 6 A Comparison of Lowe's with Home Depot

	Lowe's	Home Depot
Number of Employees	161K	331K
Net Income (\$)	1.9B	4.1B
Revenue (\$)	51.1B	71.4B
Revenue (\$)/Employee	317K	216K
EPS Ratio (\$)	1.52	2.65
Market Capitalization	31.3B	78.9B

home improvement items. Sears, Big Lots, SAMs, Costco, and thousands of specialty stores that focus exclusively on lighting or flooring for example are also fierce competitors. Although many building contractors use Lowe's or Home Depot's programs for purchasing materials, many are loyal to other local businesses. The Internet is also becoming more and more of a competitor for firms in the home improvement industry.

Lowe's has not been performing as well as Home Depot. Note in Exhibit 6 that Home Depot has more than double the earnings of Lowe's and has a significantly higher earnings per share (EPS).

Home Depot

Founded in 1978 in Atlanta, Georgia, Home Depot is the largest home improvement chain in the world with over 2,250 retail stores in all 50 U.S. states, Puerto Rico, Guam, Canada, and Mexico. Home Depot is the fourth-largest retailer in the USA and fifth largest in the world. Home Depot offers a large assortment of home improvement products at fair prices. At a Home Depot, customers can find experienced sales associates in flooring, plumbing, electrical, gardening, and many other areas. Home Depot offers in-home installation to any customers who do not wish to install their own flooring, sinks, and other products. Major brands that are sold exclusively at the Home Depot include: BEHR Paint, Chem-Dry, Homelite, Martha Stewart Living, Thomasville, among others. Home Depot recently replaced its old slogan: "You can do it. We can help" with: "More saving. More doing."

Home Depot is expanding its Internet business rather than expanding overseas, according to its CEO Frank Blake. Blake's comments came on the heels of Home Depot closing all seven of its China-based stores in October of 2012, after a failed expansion attempt there. Blake also offered the comment that Home Depot can live without having a brick-and-mortar presence in Brazil or any other country. But what they cannot afford to do is *not* be the best home improvement company in the world. Home Depot still sells products to Chinese customers on its website, 360buy.com, and is continually looking to partner with other e-commerce sites. The trend toward shopping from the Internet, in particular mobile applications on smartphones, is a trend Home Depot plans to capitalize on.

True Value

Headquartered in Chicago, Illinois, True Value has more than 5,000 independent retail hardware store locations worldwide. All of the stores are independently owned and operated by regular people. True Value has 12 regional distribution centers and more than 3,000 associates. True Value supports True Value Hardware and Home Center Stores as well as Grand Rental Station, Party Central, Taylor Rental, Induserve Supply, and Home & Garden Showplace.

Home & Garden Showplace acts as the garden center identity of True Value. There are more than 260 Home & Garden Showplace stores across the USA. Like all True Value stores, each store is independently owned and purchases retail merchandise through True Value's distribution centers and various True Value buying programs. The other divisions of True Value total more than 400 stores across the USA and are also all independently owned and operated.

All True Value store locations vary from small towns to large cities and stores reflect various sizes. Each respective independent retailer offers product categories and assortments tailored to local customer needs allowing customers across the country to shop a business that is uniquely focused on local needs. According to True Value, all its well-stocked stores offer superior customer service and a compelling shopping experience.

From 2009 to 2011, True Value reported net revenues of \$1.8 billion in each of the three years, and long-term debt of \$121, \$137, and \$143 million, respectively. In 2012, True Value's stated goals were to grow retail sales by 2 percent, expand by adding another 100 stores with more than 1.1 million square feet of selling space, investing in a new Farm and Ranch category, and providing shareholders with a dividend for the sixth consecutive year.

Ace Hardware

Founded in 1924 in Oak Brook, Illinois, Ace Hardware was named after Ace fighter pilots of World War I who overcame all odds in fighting for the Allied Forces. Ace has more than 4,400 locations across the USA and operates locations in 60 different countries. Ace competes much like True Value with all stores being independently owned and operated. Ace, like True Value, markets this strategy as enabling business owners to tailor their products to meet local customers' needs more effectively. Also, it places more of the initial capital risk on the franchisee and offers many products under the Ace brand. This store branding generally produces higher margins than selling brand-name items.

According to *Franchise Times*, Ace is the sixth largest franchise operation in the world trailing only McDonald's, 7-Eleven, KFC, Subway, and Burger King. Ace has received numerous awards in customer satisfaction. J.D. Power and Associates ranked Ace the highest in customer satisfaction among home improvement stores for five years in a row from 2007 to 2011; Ace was ranked the same by *Business Week* from 2008 to 2010.

Future

Lowe's opened its first store in Canada in 2007 and currently has 34 stores across the country. Lowe's has recently shown interest in acquiring Rona, a Canadian-based chain that has 79 big box locations and more than 700 smaller stores. A takeover by Lowe's would provide a substantial footprint in Canada, but in September 2012, Lowe's withdrew its friendly offer for Rona and some analysts believe that the move is a precursor to a hostile takeover. Lowe's activity in Canada is a stark contrast to announced store closings in its U.S. operations. Lowe's is closing 20 underperforming U.S. stores in 2012 and reducing its pace of growth.

U.S. big box stores such as Target are popping up all over Canada, and these retailers are basking in the benefits of pent-up Canadian consumer demand. However, setting up and operating a retail store in Canada poses some unique challenges because all packaging and labeling must follow Canadian rules, including using both English and using metric weights and measurements. Stores operating in Quebec must also be able to serve customers in French, have French on all signage and advertising material, and produce French versions of web pages. With the Canadian population approximately one-tenth of that of the USA, the added administrative and legal expenses have often been deemed by large retailers to not be worth the effort. Should Lowe's expand into Canada, or renew efforts to acquire Rona?

Would you recommend Lowe's enter the Australian market with 150 new stores as currently planned in an attempt to match Ace's international presence. Lowe's currently operates two different size stores to better serve local markets. However both of these store fronts are similar in size. Would you recommend Lowe's reduce the size of its stores to match Home Depot, and even smaller stores such as Ace and True Value?

Analysts believe Lowe's will hold steady in coming years in terms of revenues and profitability, primarily because the housing market and general economy are improving. But shareholders and investors expect more than flat earnings.

What do you think are the best strategies for Lowe's to outperform Home Depot as the housing market and world economy continue to improve? Design a three-year plan for CEO Niblock with specifics outlining the appropriate course of action.