

# Demographics to re-shape a mature sector

## Reinstate coverage of 16 Hardline Retail companies

We are generally constructive on the Hardline Retail sector despite its outperformance of the last year. As a group, our coverage universe is forecast to post average revenue, earnings and EPS growth of 5.4%, 9.6% and 14.2% from 2011-2013, which we view as normalized medium-term growth. We believe valuations are reasonable at a sector average of 14.0x 2012E P/E, with 20.6% average ROIC and good earnings visibility for most companies. Our top picks are **HD, ORLY, DLTR, PETM and PIR**.

## Prefer autos, dollar stores, pets, home improvement

We see positive structural drivers for autos, dollar stores, pet retail and home improvement, almost irrespective of the state of the economy. Autos and dollar stores are both benefiting from a more cautious consumer and the growing Hispanic population. Aging of the Baby Boomers is expected to lift pet retail and dollar stores, with the benefit to home improvement more medium term.

## Downside earnings risk in consumer electronics and office

In CE, a weak product cycle, store saturation and intensifying competition from the internet and Apple underpin our cautious view. Office retail is expected to face strong macro headwinds from budget cuts and the European debt crisis.

## Baby Boomer retirement sets an austere tone for spending

The aging of the Baby Boomers, with their focus on maintaining their wealth and their health, is expected to exacerbate the current developed world trend towards austerity. The number of people in their 60s and 70s is expected to increase by 34/46%, respectively, to a combined 18% of the total population in 2020, up from 15% in 2010. We expect the aging of the Baby Boomers to have a profound impact on retail channels and the housing market.

## Rise of Hispanics key to future consumption trends

Hispanics, conversely, are the fountain of youth for the US economy, responsible for over 90% of the increase in the overall adult working age population between 2010-20. With an average age of just 27, we believe they will focus on education and consumption and will directly offset some of the Baby Boomers retrenchment.

## Valuation undemanding; polarized performance to continue

YTD, 11 out of 16 companies have outperformed the S&P500, rising by 18.2% on average. With the exception of LOW, the stocks that have underperformed are down an average of 43% YTD, and we see few near-term positive catalysts to reverse this. Earnings visibility (ex-CE and office) is fairly solid, and Price Objectives on our 9 Buy-rated stocks represents 19% upside potential, against a projected 11% increase in the S&P500 in 2012 to 1,350, based on our house view.

## Bank of America Merrill Lynch

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Table 1: Hardlines Comp Table

| Ticker | Rating       | 2012E   | Q-R-Q |
|--------|--------------|---------|-------|
|        |              | P/E (x) |       |
| BBBY   | Buy          | 13.9    | B-1-9 |
| PIR    | Buy          | 13.2    | C-1-9 |
| WSM    | Buy          | 14.8    | B-1-7 |
| HD     | Buy          | 14.4    | B-1-7 |
| LOW    | Neutral      | 14.3    | B-2-7 |
| BBY    | Underperform | 8.5     | C-3-7 |
| RSH    | Underperform | 8.8     | C-3-7 |
| AAP    | Neutral      | 12.0    | B-2-7 |
| AZO    | Buy          | 14.3    | B-1-9 |
| ORLY   | Buy          | 18.2    | B-1-9 |
| SPLS   | Underperform | 10.4    | B-3-7 |
| ODP    | Underperform | NM      | C-3-9 |
| DLTR   | Buy          | 17.2    | B-1-9 |
| FDO    | Buy          | 15.6    | B-1-7 |
| NDN    | No Rating    | 16.7    | 6     |
| PETM   | Buy          | 16.1    | B-1-7 |
| TSCO   | Buy          | 21.5    | B-1-7 |
| VSI    | Neutral      | 20.5    | C-2-9 |

Source: Bloomberg, BofA Merrill Lynch Global Research estimates

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Refer to important disclosures on page 31 to 33. Analyst Certification on Page 29. Price Objective Basis/Risk on page 25. Link to Definitions on page 29.11119472

## Demographics to reshape a mature sector

We are generally constructive on the Hardline Retail sector despite its outperformance of the last year. As a group, our coverage universe is forecast to post average revenue, earnings and EPS growth of 5.4%, 9.6% and 14.2% from 2011-2013, which we view as normalized medium-term growth. Share buybacks averaging \$650mn or 4% of outstanding shares per year in 2012-13 are expected to account for almost one-third of EPS growth. Valuations are reasonable at a sector average of 14.0x 2012E P/E, with 20.6% average ROIC and good earnings visibility for most companies. Our top picks are HD, ORLY, DLTR, PETM and PIR.

## Baby Boomer retirement sets an austere tone

The aging of the Baby Boomers, with their focus on maintaining their wealth and their health, is expected to exacerbate the current developed world trend towards austerity. The number of people in their 60s and 70s is expected to increase by 34/46%, respectively, to a combined 18% of the total population in 2020, up from 15% in 2010. We expect the aging of the Baby Boomers to have a profound impact on retail channels and the housing market.

## Rise of Hispanics key to future consumption trends

Hispanics, conversely, are the fountain of youth for the US economy, responsible for over 90% of the increase in the overall adult working age population between 2010-20. Almost one in six Americans is Hispanic, and this ratio will rise even as immigration slows given that the Hispanic population is projected to grow more than five times faster than the non-Hispanic population from 2010-2020. With an average age of just 27, we believe they will focus on education and consumption and will directly offset some of the Baby Boomers retrenchment.

**We believe these opposing forces will do battle to shape the next decade of growth for the Hardline Retail industry, creating both headwinds and opportunities for corporates and investors. This dynamic is the focus of this report and will be a key factor influencing our stock recommendations.**

## Prefer autos, dollar stores, pets, home improvement

We see positive structural drivers for autos, dollar stores, pet retail and home improvement, almost irrespective of the state of the economy. Autos and dollar stores are both benefiting from a more cautious consumer and the growing Hispanic population. Aging of the Baby Boomers is expected to lift pet retail and dollar stores, with the benefit to home improvement more medium term.

## Downside earnings risk in consumer electronics and office

In consumer electronics, a weak product cycle, store saturation and intensifying competition from the internet and Apple underpin our cautious view. Office retail is expected to face strong macro headwinds from budget cuts, political paralysis and the European debt crisis.

## Valuation undemanding; polarized performance to continue

YTD, 11 out of 16 companies have outperformed the S&P500, rising by 18.2% on average. With the exception of LOW, the stocks that have underperformed are down an average of 43% YTD, and we see few near-term positive catalysts to reverse this. Earnings visibility (ex-CE and office) is fairly solid, and Price Objectives on our 9 Buy-rated stocks represents 19% upside potential, against a projected 11% increase in the S&P500 in 2012 to 1,350, based on our house view.

Upside earnings risk from supply chain initiatives; superior capital allocation

Productivity enhancements, superior supply chain and more aggressive capital allocation are driving 20% EPS growth and doubling of ROIC

One-of-a-kind value retailer with room to almost double its network while leveraging a MSD comp

Differentiation and trade up driving 20% EPS growth and doubling of ROIC

## Top picks

### Home Depot - PO \$46

Superior strategy and execution are underpinning HD's decoupling from the housing market. Comps have outperformed, as the company has gained share through improved merchandising and supply chain management, engagement with the pro customer and a sophisticated multi-channel approach. In fact, we think HD's supply chain investments could deliver better-than-expected cost savings as well as revenue upside, making its 10% EBIT margin target by 2013 conservative. With free cash flow forecast to exceed \$3bn in 2012-13, HD's sector-leading dividend payout ratio has been raised from 40% to 50%. We expect buybacks to be \$3.5bn in 2011 and at least \$2.5bn in 2012-13. Downside risks are further weakening in the housing market, deterioration in the competitive landscape, unseasonable weather and poor execution in supply chain upgrades.

### O'Reilly - PO \$90

ORLY's outsized growth is forecast to continue through the medium term, with ample bottom-up and top-down drivers. With CSK entering the optimization stage, in our opinion O'Reilly can post strong revenue growth and rising margins, cash flow and returns through the medium term. ROIC is forecast to more than double between 2010 and 2013E to 25.6%. The company offers the largest exposure of peers to the \$59bn, high-growth commercial market, and has demonstrated proven execution and superior supply chain management. ORLY has put into place a more aggressive capital allocation program, with \$1.5bn in authorized buybacks and the company leveraging up. Offering a rare combination of top-down structural growth and bottom-up company-specific drivers, O'Reilly deserves to trade at a premium in our view. The key risks are difficulties in continuing to increase sales and profits at former CSK locations, and an inability to continue to leverage its infrastructure build-out.

### Dollar Tree - PO \$93

Against a macro backdrop that favors the small-box value retailer, in our view Dollar Tree (DLTR) is well positioned to grow and take share. Its diverse customer base and national presence reduce risks, while its relatively small store network in the US and Canada offers an attractive growth trajectory without significant investment requirements. We view its fixed selling price as a key point of differentiation and competitive advantage, and the company's ability to maintain its gross margin in a tight range of 34.2-35.9% for the last five years is testimony to its superior sourcing model and flexible assortment. With solid fundamentals and attractive growth opportunities, in our view a premium multiple is deserved. The key risks are a further downturn in the economy, changes in the competitive landscape, and unforeseen difficulties with store expansion.

### PetSmart - PO \$56

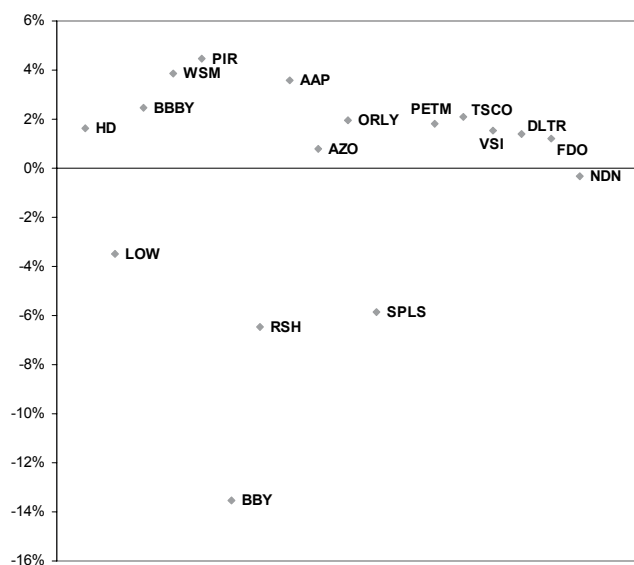
As the leader in a growing industry with favorable demographics, PETM is the only Hardline Retail company under coverage benefiting from trade-up to super premium food, private label/exclusives and services. From 2010-13, ROIC is forecast to almost double to 28.4%. Hardgoods are improving but still well below their peak, and rising pet adoptions, after two years of declines, bode well for the industry. Earnings and EPS are forecast to grow at a 12.7/19.6% CAGR from 2011-13, at the high end of the Hardline Retail sector. Rising returns and positive earnings momentum, with guidance lifted three times this year, should underpin multiple expansion from the current 2012E P/E of 15.8x. Key risks include increased competition, slower-than-expected turnaround of hotels and hardgoods, high input costs and reputational risk from food recalls.

Positive earnings surprises driven by improved merchandising and remodels to support multiple expansion

## Pier 1 - PO \$18

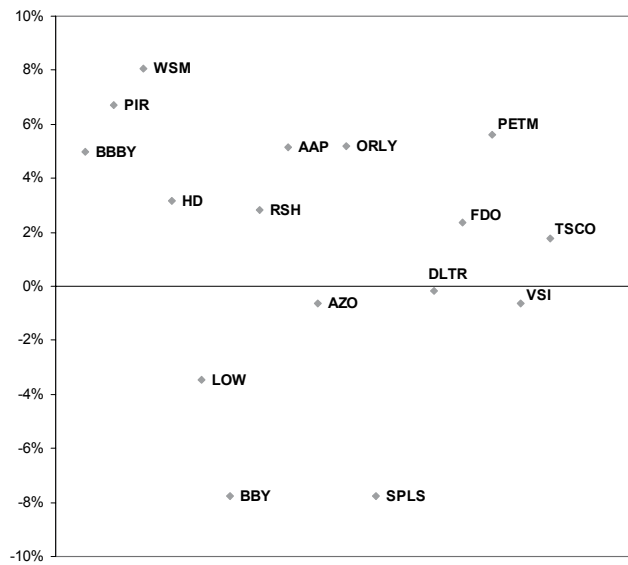
Having re-established its distinct market niche, PIR's improved merchandising is driving better-than-expected sales and margins, and remodels and a full e-commerce launch in mid 2012 are expected to build on this momentum. With its more robust and sustainable business model, in our view Pier 1 remains on a strong growth trajectory and we forecast EPS to grow by 16.3/18.8% in 2012/13, 4/7% above Street estimates PIR can continue to deliver at least mid-single-digit comps and operating leverage, in our opinion. Historical peak sales psf and margin levels are achievable targets to aim for in the near term, but we do not see them as limitations to future performance. Positive earnings surprises and a mid-20s ROIC should support continued multiple expansion of the stock from the current 12.6x 2012E P/E, in our view. The key risks are a further macro downturn, given the discretionary nature of its sales mix, poor execution of its initiatives, especially e-commerce, IT and remodels.

Chart 1: 2012 BofAML EPS estimates vs. St.



Source: Bloomberg data, BofA Merrill Lynch Global Research estimates

Chart 2: 2013 BofAML EPS estimates vs. St.



Source: Bloomberg data, BofA Merrill Lynch Global Research estimates

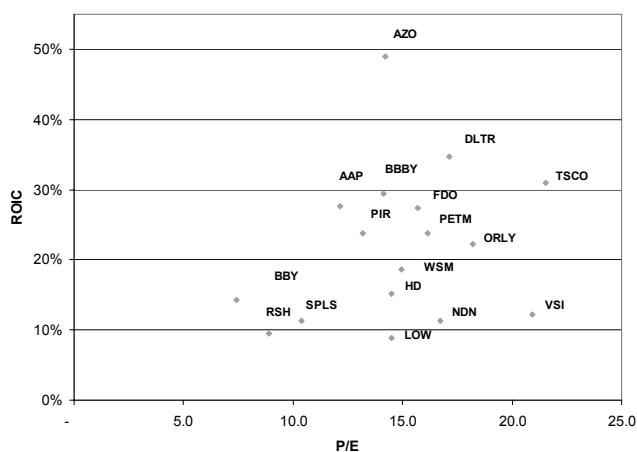
## Valuation

### Polarized performance to moderate but gap to remain

Year to date, 11 out of 16 companies in our coverage universe have significantly outperformed the S&P500, rising by 18.2% on average. With the exception of LOW (which has performed largely in line with the S&P500), the four stocks that have underperformed (BBY, RSH, SPLS and ODP) are down an average of 43% YTD, and we see few near-term positive catalysts to reverse this. At around 7-10x 2012 consensus P/E, valuations of this group appear to be inexpensive because share prices have fallen faster than earnings expectations are deteriorating, but we see material downside earnings risk for these two sub-sectors, and our estimates are below the Street. After the significant share price weakness of 2011, however, we expect downside risk for the consumer electronics and office retailers to be more limited in 2012, while we look for an average of 19% appreciation for our ten Buy-rated stocks against a projected 11% increase in the S&P500 in 2012E to 1,350, based on our house view.

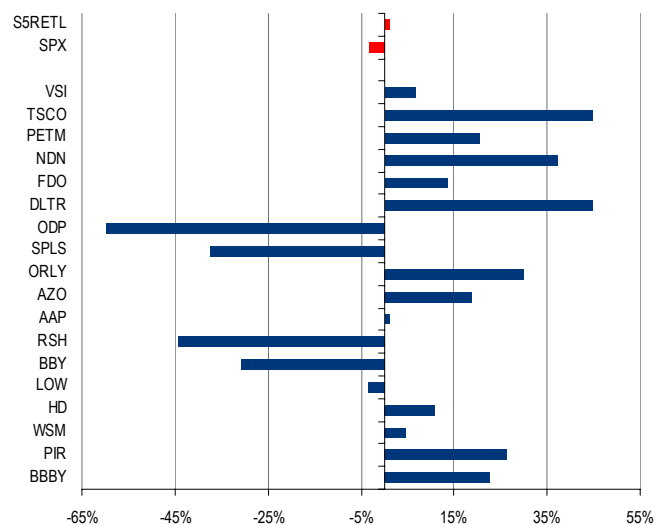
Excluding CE and office retail, earnings visibility for the Hardline Retailers is reasonably high, in our view. Most of our Buy-rated stocks are improving their ROIC and expected to grow their EPS by 15-20% per year, and we value them at mid-upper teen P/Es. Square footage growth and comps generally range from low- to mid-single digits, with some earnings leverage and share repurchases expected to lift earnings and EPS. Unlike the apparel retailers whose margins can be heavily influenced by the volatile cotton price, for example, the cost exposure of the Hardline Retailers tends to be more diversified and their gross margins more a function of the relative performance of various product lines. With few exceptions, most business are still essentially running on one cylinder (lower-margin consumables and necessities), with higher-margin discretionary products and services remaining a drag on growth.

Chart 3: Hardlines ROIC vs. 2012E P/E



Source: Bloomberg data, BofA Merrill Lynch Global Research estimates

Chart 4: Hardlines YTD Stock Performance



Source: Bloomberg

### Structural growth can last for years and is worth paying for

Our base case assumption is that the [consumer remains challenged throughout 2012](#), but we do not view this as an across-the-board impediment to growth. We prefer sub-sectors where we see positive, multi-year structural drivers reshaping the industry and its growth prospects, almost irrespective of the state of the economy. These positive structural drivers tie into our demographic themes and include:

- Aging of the auto fleet coupled with industry consolidation. In 2005, there was an even number of new and old (7+ year old) cars on the road, and now old cars outnumber new by 1.5x. New car sales and scrappage rates would both need to change significantly to reverse this trend.
- The remodeled dollar store is a growing retail channel because it is patronized disproportionately by two expanding groups (older consumers and lower-income consumers), and more recently by belt-tightening middle-income consumers who are trading down as well as upper-income consumers who now think it's hip to be frugal.
- Pet retail is benefiting from an increase in the number of Empty Nesters who may spoil their pets more than they did their own children.
- Home improvement is on the cusp of a major renovation cycle driven by foreclosures as well as the sale of homes from increasing numbers of older owners who may have lived in their homes for >20 years to younger buyers who are excited about home ownership and the prospect of renovating the older homes they are purchasing.

## Price objective and valuation summary

Table 2: Hardline retail price objectives

| Ticker                      | Rating       | Investment<br>Opinion | Current<br>Price | Price<br>Objective | %<br>Upside Potential | Current P/E<br>(2012E) | P/E ratio<br>at PO<br>on 2012E | 3 yr. forward<br>EPS CAGR<br>est. | ROIC<br>2011E | Price Objective P/E | Justification                                                                |
|-----------------------------|--------------|-----------------------|------------------|--------------------|-----------------------|------------------------|--------------------------------|-----------------------------------|---------------|---------------------|------------------------------------------------------------------------------|
| <b>HOME FURNISHINGS</b>     |              |                       |                  |                    |                       |                        |                                |                                   |               |                     |                                                                              |
| BBBY                        | Buy          | B-1-9                 | \$ 60.28         | \$72               | 19.4%                 | 13.5                   | 16.1                           | 16%                               | 26.1%         |                     | Modest premium for consistent execution despite maturing business            |
| PIR                         | Buy          | C-1-9                 | \$ 13.26         | \$18               | 35.7%                 | 12.6                   | 17.1                           | 18%                               | 24.0%         |                     | Modest premium for BTE momentum in earnings recovery                         |
| WSM                         | Buy          | B-1-7                 | \$ 37.35         | \$44               | 17.8%                 | 14.1                   | 16.7                           | 17%                               | 17.0%         |                     | Modest premium for high growth and returns of DTC                            |
| <b>HOME IMPROVEMENT</b>     |              |                       |                  |                    |                       |                        |                                |                                   |               |                     |                                                                              |
| HD                          | Buy          | B-1-7                 | \$ 38.90         | \$46               | 18.3%                 | 14.0                   | 16.6                           | 16%                               | 13.3%         |                     | Modest premium for BTE earnings recovery without a housing recovery          |
| LOW                         | Neutral      | B-2-7                 | \$ 24.21         | \$26               | 7.4%                  | 14.0                   | 15.1                           | 12%                               | 8.5%          |                     | Valued on par with the sector with earnings recovery not expected until 2013 |
| <b>CONSUMER ELECTRONICS</b> |              |                       |                  |                    |                       |                        |                                |                                   |               |                     |                                                                              |
| BBY                         | Underperform | C-3-7                 | \$ 23.76         | \$23               | -3.2%                 | 7.2                    | 6.9                            | 6%                                | 15.7%         |                     | Significant discount for low earnings visibility and momentum                |
| RSH                         | Underperform | C-3-7                 | \$ 10.30         | \$10               | -2.9%                 | 8.0                    | 7.8                            | 17%                               | 8.5%          |                     | Significant discount for low earnings visibility amid restructuring          |
| <b>AUTO PARTS</b>           |              |                       |                  |                    |                       |                        |                                |                                   |               |                     |                                                                              |
| AAP                         | Neutral      | B-2-7                 | \$ 66.95         | \$75               | 12.0%                 | 11.6                   | 13.0                           | 16%                               | 24.3%         |                     | Discount to AZO and ORLY for AAP's weaker cost control and distribution      |
| AZO                         | Buy          | B-1-9                 | \$ 323.58        | \$375              | 15.9%                 | 14.0                   | 16.2                           | 17%                               | 49.0%         |                     | Solid medium term growth despite a maturing business                         |
| ORLY                        | Buy          | B-1-9                 | \$ 78.57         | \$90               | 14.5%                 | 17.6                   | 20.2                           | 20%                               | 17.4%         |                     | Premium for higher sustainable growth, strong execution and rising returns   |
| <b>OFFICE PRODUCTS</b>      |              |                       |                  |                    |                       |                        |                                |                                   |               |                     |                                                                              |
| SPLS                        | Underperform | B-3-7                 | \$ 14.26         | \$13.5             | -5.3%                 | 10.1                   | 9.6                            | 7%                                | 11.0%         |                     | Discount for unfavorable industry dynamics and worsening macro               |
| ODP                         | Underperform | C-3-9                 | \$ 2.18          | \$2                | -8.3%                 | NM                     | 123.9                          | NM                                | NM            |                     | Discount for unfavorable industry dynamics and worsening macro               |
| <b>DOLLAR STORES</b>        |              |                       |                  |                    |                       |                        |                                |                                   |               |                     |                                                                              |
| DLTR                        | Buy          | B-1-9                 | \$ 81.28         | \$93               | 14.4%                 | 16.9                   | 19.3                           | 18%                               | 36.2%         |                     | Sector leader, with consistent execution and national coverage (plus Canada) |
| FDO                         | Buy          | B-1-7                 | \$ 56.45         | \$67               | 18.7%                 | 15.3                   | 18.2                           | 17%                               | 27.4%         |                     | Numerous avenues for growth                                                  |
| <b>MISCELLANEOUS</b>        |              |                       |                  |                    |                       |                        |                                |                                   |               |                     |                                                                              |
| PETM                        | Buy          | B-1-7                 | \$ 48.02         | \$56               | 16.6%                 | 15.8                   | 18.4                           | 20%                               | 19.3%         |                     | Sustainable, above-sector growth in earnings and returns                     |
| TSCO                        | Buy          | B-1-7                 | \$ 70.28         | \$80               | 13.8%                 | 20.4                   | 23.2                           | 17%                               | 23.5%         |                     | Largest player in niche industry, consistent execution, solid growth metrics |
| VSI                         | Neutral      | C-2-9                 | \$ 35.89         | \$41               | 14.2%                 | 19.5                   | 22.3                           | 15%                               | 12.3%         |                     | Growth scarcity premium to gradually narrow as growth converges              |

Source: Company reports, Bloomberg, BofA Merrill Lynch Global Research estimates

Table 3: Hardline Retail Valuation

| Company Name               | Ticker | Share Price | Rating       | Investment Opinion | Mkt Cap (US\$m) | EPS 2011E | EPS 2012E | EPS 2013E | CAGR 2011-13 | P/E 2011E | P/E 2012E | P/E 2013E | PEG (x) | ROIC 2011E | EV/EBITDA 2011E | Debt: Capital '11E | Div. Yield |
|----------------------------|--------|-------------|--------------|--------------------|-----------------|-----------|-----------|-----------|--------------|-----------|-----------|-----------|---------|------------|-----------------|--------------------|------------|
| <b>HOMEFURNISHINGS</b>     |        |             |              |                    |                 |           |           |           |              |           |           |           |         |            |                 |                    |            |
| BedBath&Beyond             | BBBY   | \$60.28     | Buy          | B-1-9              | \$15,240        | \$3.83    | \$4.48    | \$5.12    | 16%          | 15.8      | 13.5      | 11.8      | 1.00    | 26.09%     | 8.8             | 0%                 | 0.0%       |
| Pier1Imports               | PIR    | \$13.26     | Buy          | C-1-9              | \$1,551         | \$0.90    | \$1.05    | \$1.25    | 18%          | 14.7      | 12.6      | 10.6      | 0.84    | 23.98%     | 7.2             | 2%                 | 0.0%       |
| Williams-Sonoma            | WSM    | \$37.35     | Buy          | B-1-7              | \$4,018         | \$2.26    | \$2.64    | \$3.08    | 17%          | 16.5      | 14.1      | 12.1      | 0.99    | 17.00%     | 6.6             | 1%                 | 1.8%       |
| <b>HOMEIMPROVEMENT</b>     |        |             |              |                    |                 |           |           |           |              |           |           |           |         |            |                 |                    |            |
| HomeDepot                  | HD     | \$38.90     | Buy          | B-1-7              | \$63,251        | \$2.39    | \$2.78    | \$3.21    | 16%          | 16.3      | 14.0      | 12.1      | 1.03    | 13.34%     | 9.0             | 38%                | 2.6%       |
| Lowe's                     | LOW    | \$24.21     | Neutral      | B-2-7              | \$32,943        | \$1.60    | \$1.72    | \$2.01    | 12%          | 15.1      | 14.0      | 12.1      | 1.27    | 8.50%      | 7.0             | 35%                | 2.1%       |
| <b>CONSUMERELECTRONICS</b> |        |             |              |                    |                 |           |           |           |              |           |           |           |         |            |                 |                    |            |
| BestBuy                    | BBY    | \$23.76     | Underperform | C-3-7              | \$9,585         | \$3.34    | \$3.31    | \$3.74    | 6%           | 7.1       | 7.2       | 6.3       | 1.22    | 15.67%     | 3.0             | 22%                | 2.6%       |
| RadioShack                 | RSH    | \$10.30     | Underperform | C-3-7              | \$1,153         | \$1.18    | \$1.29    | \$1.61    | 17%          | 8.8       | 8.0       | 6.4       | 0.52    | 8.47%      | 2.2             | 49%                | 2.4%       |
| <b>AUTOPARTS</b>           |        |             |              |                    |                 |           |           |           |              |           |           |           |         |            |                 |                    |            |
| AdvanceAuto                | AAP    | \$66.95     | Neutral      | B-2-7              | \$5,657         | \$4.94    | \$5.78    | \$6.61    | 16%          | 13.6      | 11.6      | 10.1      | 0.86    | 24.28%     | 7.2             | 32%                | 0.4%       |
| AutoZone*                  | AZO    | \$323.58    | Buy          | B-1-9              | \$14,360        | \$19.47   | \$23.18   | \$26.52   | 17%          | 16.6      | 14.0      | 12.2      | 0.99    | 48.98%     | 10.6            | 158%               | 0.0%       |
| O'ReillyAutomotive         | ORLY   | \$78.57     | Buy          | B-1-9              | \$11,251        | \$3.71    | \$4.46    | \$5.30    | 20%          | 21.2      | 17.6      | 14.8      | 1.08    | 17.37%     | 11.8            | 26%                | 0.0%       |
| <b>OFFICEPRODUCTS</b>      |        |             |              |                    |                 |           |           |           |              |           |           |           |         |            |                 |                    |            |
| Staples                    | SPLS   | \$14.26     | Underperform | B-3-7              | \$10,227        | \$1.35    | \$1.41    | \$1.54    | 7%           | 10.6      | 10.1      | 9.3       | 1.60    | 11.03%     | 4.5             | 15%                | 2.7%       |
| OfficeDepot                | ODP    | \$2.18      | Underperform | C-3-9              | \$604           | \$(0.08)  | \$0.02    | \$0.13    | NM           | NM        | NM        | 16.6      | NM      | NM         | 2.2             | 39%                | 0.0%       |
| <b>DOLLARSTORES</b>        |        |             |              |                    |                 |           |           |           |              |           |           |           |         |            |                 |                    |            |
| DollarTree                 | DLTR   | \$81.28     | Buy          | B-1-9              | \$10,224        | \$4.05    | \$4.81    | \$5.59    | 18%          | 20.1      | 16.9      | 14.5      | 1.15    | 36.17%     | 11.4            | 16%                | 0.0%       |
| FamilyDollar^              | FDO    | \$56.45     | Buy          | B-1-7              | \$7,096         | \$3.15    | \$3.68    | \$4.31    | 17%          | 17.9      | 15.3      | 13.1      | 1.05    | 27.39%     | 8.8             | 40%                | 1.2%       |
| 99¢OnlyStores              | NDN    | \$21.88     | No Rating    | 6                  | \$1,560         | \$1.17    | \$1.31    | \$1.48    | 12%          | 18.7      | 16.7      | 14.8      | 1.52    | 11.24%     | 8.4             | 1%                 | 0.0%       |
| <b>MISCELLANEOUS</b>       |        |             |              |                    |                 |           |           |           |              |           |           |           |         |            |                 |                    |            |
| PetSmart                   | PETM   | \$48.02     | Buy          | B-1-7              | \$5,653         | \$2.54    | \$3.05    | \$3.63    | 20%          | 18.9      | 15.8      | 13.2      | 0.96    | 19.25%     | 8.4             | 36%                | 1.1%       |
| TractorSupply              | TSCO   | \$70.28     | Buy          | B-1-7              | \$5,152         | \$2.90    | \$3.45    | \$4.00    | 17%          | 24.2      | 20.4      | 17.6      | 1.39    | 23.48%     | 12.1            | 0%                 | 0.5%       |
| VitaminShoppe              | VSI    | \$35.89     | Neutral      | C-2-9              | \$1,051         | \$1.60    | \$1.84    | \$2.11    | 15%          | 22.4      | 19.5      | 17.0      | 1.53    | 12.28%     | 10.7            | 1%                 | 0.0%       |

Source: Company reports, Bloomberg, BofA Merrill Lynch Global Research estimates

Table 4: Hardlines Same-store Sales

|                             | 2002        | 2003        | 2004        | 2005        | 2006        | 2007        | 2008         | 2009        | 2010        | 2011E       | 2012E       | 2013E       |
|-----------------------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------|-------------|-------------|-------------|-------------|-------------|
| <b>Home Furnishings</b>     |             |             |             |             |             |             |              |             |             |             |             |             |
| BBBY                        | 7.9%        | 6.3%        | 4.5%        | 4.6%        | 4.9%        | 1.0%        | -2.4%        | 4.4%        | 7.8%        | 5.0%        | 5.0%        | 5.0%        |
| PIR                         | 4.7%        | -2.2%       | -5.8%       | -7.1%       | -11.3%      | -1.8%       | -9.2%        | 1.5%        | 10.9%       | 9.0%        | 5.5%        | 5.5%        |
| WSM                         | 2.5%        | 4.0%        | 3.5%        | 4.9%        | 0.3%        | 0.3%        | -17.2%       | -5.1%       | 9.8%        | 4.5%        | 3.5%        | 3.0%        |
| Average                     | 5.0%        | 2.7%        | 0.7%        | 0.8%        | -2.0%       | -0.2%       | -9.6%        | 0.3%        | 9.5%        | 6.2%        | 4.7%        | 4.5%        |
| <b>Home Improvement</b>     |             |             |             |             |             |             |              |             |             |             |             |             |
| HD                          | 0.0%        | 3.8%        | 5.4%        | 3.1%        | -2.8%       | -6.7%       | -8.7%        | -6.6%       | 2.9%        | 2.5%        | 2.5%        | 2.5%        |
| LOW                         | 5.6%        | 6.7%        | 6.6%        | 6.1%        | 0.0%        | -5.1%       | -7.2%        | -6.7%       | 1.3%        | -1.0%       | 1.8%        | 2.5%        |
| Average                     | 2.8%        | 5.3%        | 6.0%        | 4.6%        | -1.4%       | -5.9%       | -8.0%        | -6.7%       | 2.1%        | 0.8%        | 2.2%        | 2.5%        |
| <b>Consumer Electronics</b> |             |             |             |             |             |             |              |             |             |             |             |             |
| BBY                         | 2.4%        | 7.1%        | 4.3%        | 4.9%        | 5.0%        | 2.9%        | -1.3%        | 0.6%        | -1.8%       | -0.4%       | -1.0%       | 1.0%        |
| RSH                         | -1.0%       | 2.0%        | 3.5%        | 1.0%        | -5.6%       | -8.2%       | -0.6%        | 0.8%        | 4.1%        | -2.5%       | 1.5%        | 4.5%        |
| Average                     | 0.7%        | 4.6%        | 3.9%        | 3.0%        | -0.3%       | -2.7%       | -1.0%        | 0.7%        | 1.2%        | -1.5%       | 0.3%        | 2.8%        |
| <b>Auto Parts</b>           |             |             |             |             |             |             |              |             |             |             |             |             |
| AAP                         | 5.5%        | 3.1%        | 6.1%        | 8.7%        | 2.1%        | 0.7%        | 1.5%         | 5.3%        | 8.0%        | 2.0%        | 2.5%        | 3.0%        |
| AZO                         | 8.8%        | 3.0%        | 0.0%        | -2.0%       | 0.4%        | 0.1%        | 0.4%         | 4.4%        | 5.4%        | 6.3%        | 5.2%        | 3.5%        |
| ORLY                        | 3.1%        | 7.8%        | 6.8%        | 7.5%        | 3.3%        | 3.7%        | 1.5%         | 4.6%        | 8.8%        | 5.5%        | 6.0%        | 5.5%        |
| Average                     | 5.8%        | 4.6%        | 4.3%        | 4.7%        | 1.9%        | 1.5%        | 1.1%         | 4.8%        | 7.4%        | 4.6%        | 4.6%        | 4.0%        |
| <b>Office Products</b>      |             |             |             |             |             |             |              |             |             |             |             |             |
| SPLS                        | 0.4%        | 3.9%        | 4.2%        | 3.2%        | 2.4%        | -2.7%       | -8.5%        | -2.0%       | -1.0%       | -0.5%       | 0.0%        | 1.0%        |
| ODP                         | -2.2%       | -4.1%       | 2.7%        | 3.2%        | 2.0%        | -5.0%       | -13.0%       | -13.3%      | -1.0%       | -1.5%       | 0.5%        | 2.0%        |
| Average                     | -0.9%       | -0.1%       | 3.5%        | 3.2%        | 2.2%        | -3.8%       | -10.8%       | -7.6%       | -1.0%       | -1.0%       | 0.3%        | 1.5%        |
| <b>Dollar Stores</b>        |             |             |             |             |             |             |              |             |             |             |             |             |
| DLTR                        | 1.0%        | 2.9%        | 0.5%        | -0.8%       | 4.6%        | 2.7%        | 4.1%         | 7.2%        | 6.3%        | 5.2%        | 4.5%        | 4.5%        |
| FDO                         | 5.8%        | 3.8%        | 1.9%        | 2.3%        | 3.7%        | 0.9%        | 1.2%         | 4.0%        | 4.8%        | 5.5%        | 5.0%        | 4.5%        |
| NDN                         | 3.2%        | 4.8%        | -1.8%       | 0.3%        | 2.4%        | 4.0%        | 3.7%         | 3.9%        | 0.7%        | 6.0%        | 4.0%        | 4.0%        |
| Average                     | 3.3%        | 3.8%        | 0.2%        | 0.6%        | 3.6%        | 2.5%        | 3.0%         | 5.0%        | 3.9%        | 5.6%        | 4.5%        | 4.3%        |
| <b>Pets</b>                 |             |             |             |             |             |             |              |             |             |             |             |             |
| PETM                        | 9.6%        | 7.0%        | 6.3%        | 4.2%        | 5.0%        | 2.4%        | 3.8%         | 1.6%        | 4.8%        | 5.0%        | 4.5%        | 5.0%        |
| <b>Other</b>                |             |             |             |             |             |             |              |             |             |             |             |             |
| TSCO                        | 9.6%        | 7.0%        | 9.9%        | 5.7%        | 1.6%        | 3.5%        | 1.4%         | -1.1%       | 7.0%        | 7.0%        | 4.5%        | 4.0%        |
| VSI                         |             |             |             |             | 6.6%        | 6.2%        | 6.2%         | 5.2%        | 7.1%        | 7.0%        | 5.5%        | 5.0%        |
| Average                     | 9.6%        | 7.0%        | 9.9%        | 5.7%        | 4.1%        | 4.9%        | 3.8%         | 2.1%        | 7.1%        | 7.0%        | 5.0%        | 4.5%        |
| <b>Hardlines Average</b>    | <b>3.8%</b> | <b>3.7%</b> | <b>3.3%</b> | <b>2.7%</b> | <b>1.4%</b> | <b>0.1%</b> | <b>-1.8%</b> | <b>0.9%</b> | <b>4.5%</b> | <b>3.5%</b> | <b>3.3%</b> | <b>3.5%</b> |

Source: Company reports, BofA Merrill Lynch Global Research estimates

Table 5: Hardlines, 2-year Stack Comp

|                             | 2001        | 2002        | 2003        | 2004        | 2005        | 2006        | 2007        | 2008         | 2009         | 2010        | 2011E       | 2012E       | 2013E       |
|-----------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------|--------------|-------------|-------------|-------------|-------------|
| <b>Home Furnishings</b>     |             |             |             |             |             |             |             |              |              |             |             |             |             |
| BBBY                        | 12.1%       | 15.0%       | 14.2%       | 10.8%       | 9.1%        | 9.5%        | 5.9%        | -1.4%        | 2.0%         | 12.2%       | 12.8%       | 10.0%       | 10.0%       |
| PIR                         | 12.3%       | 9.2%        | 2.5%        | -8.0%       | -12.9%      | -18.4%      | -13.1%      | -11.0%       | -7.7%        | 12.4%       | 19.9%       | 14.5%       | 11.0%       |
| WSM                         | 7.5%        | 4.5%        | 6.5%        | 7.5%        | 8.4%        | 5.2%        | 0.6%        | -16.9%       | -22.3%       | 4.7%        | 14.3%       | 8.0%        | 6.5%        |
| Average                     | 10.6%       | 9.6%        | 7.7%        | 3.4%        | 1.5%        | -1.2%       | -2.2%       | -9.8%        | -9.3%        | 9.8%        | 15.7%       | 10.8%       | 9.2%        |
| <b>Home Improvement</b>     |             |             |             |             |             |             |             |              |              |             |             |             |             |
| HD                          | 4.0%        | 0.0%        | 3.8%        | 9.2%        | 8.5%        | 0.3%        | -9.5%       | -15.4%       | -15.3%       | -3.7%       | 5.4%        | 5.0%        | 5.0%        |
| LOW                         | 3.6%        | 8.0%        | 12.3%       | 13.3%       | 12.7%       | 6.1%        | -5.1%       | -12.3%       | -13.9%       | -5.4%       | 0.3%        | 0.8%        | 4.3%        |
| Average                     | 3.8%        | 4.0%        | 8.1%        | 11.3%       | 10.6%       | 3.2%        | -7.3%       | -13.9%       | -14.6%       | -4.6%       | 2.9%        | 2.9%        | 4.7%        |
| <b>Consumer Electronics</b> |             |             |             |             |             |             |             |              |              |             |             |             |             |
| BBY                         | 6.8%        | 4.3%        | 9.5%        | 11.4%       | 9.2%        | 9.9%        | 7.9%        | 1.6%         | -0.7%        | -1.2%       | -2.2%       | -1.4%       | 0.0%        |
| RSH                         | 11.0%       | 0.0%        | 1.0%        | 5.5%        | 4.5%        | -4.6%       | -13.8%      | -8.8%        | 0.7%         | 5.4%        | 1.6%        | -1.0%       | 6.0%        |
| Average                     | 8.9%        | 2.2%        | 5.3%        | 8.5%        | 6.9%        | 2.7%        | -3.0%       | -3.6%        | 0.0%         | 2.1%        | -0.3%       | -1.2%       | 3.0%        |
| <b>Auto Parts</b>           |             |             |             |             |             |             |             |              |              |             |             |             |             |
| AAP                         | 10.6%       | 11.7%       | 8.6%        | 9.2%        | 14.8%       | 10.8%       | 2.8%        | 2.2%         | 6.8%         | 13.3%       | 10.0%       | 4.5%        | 5.5%        |
| AZO                         | 9.0%        | 12.8%       | 11.8%       | 3.0%        | -2.0%       | -1.6%       | 0.5%        | 0.5%         | 4.8%         | 9.8%        | 11.7%       | 11.5%       | 8.7%        |
| ORLY                        | 12.2%       | 11.3%       | 10.9%       | 14.6%       | 14.3%       | 10.8%       | 7.0%        | 5.2%         | 6.1%         | 13.4%       | 14.3%       | 11.5%       | 11.5%       |
| Average                     | 10.6%       | 11.9%       | 10.4%       | 8.9%        | 9.0%        | 6.7%        | 3.4%        | 2.6%         | 5.9%         | 12.2%       | 12.0%       | 9.2%        | 8.6%        |
| <b>Office Products</b>      |             |             |             |             |             |             |             |              |              |             |             |             |             |
| SPLS                        | -1.0%       | -4.5%       | 4.3%        | 8.1%        | 7.5%        | 5.7%        | 3.4%        | -7.5%        | -10.5%       | -3.0%       | -1.5%       | -0.5%       | 1.0%        |
| ODP                         | -1.1%       | -7.7%       | -3.8%       | -2.9%       | 3.3%        | 4.1%        | 3.5%        | -11.5%       | -26.3%       | -14.3%      | -2.5%       | -1.0%       | 2.5%        |
| Average                     | -1.0%       | -6.1%       | 0.3%        | 2.6%        | 5.4%        | 4.9%        | 3.5%        | -9.5%        | -18.4%       | -8.6%       | -2.0%       | -0.8%       | 1.8%        |
| <b>Dollar Stores</b>        |             |             |             |             |             |             |             |              |              |             |             |             |             |
| DLTR                        | 5.8%        | 1.1%        | 3.9%        | 3.4%        | -0.3%       | 3.8%        | 7.3%        | 6.8%         | 11.3%        | 13.5%       | 11.5%       | 9.7%        | 9.0%        |
| FDO                         | 9.3%        | 9.9%        | 9.6%        | 5.7%        | 4.2%        | 6.0%        | 4.6%        | 2.1%         | 5.2%         | 8.8%        | 10.3%       | 10.5%       | 9.5%        |
| NDN                         | 7.9%        | 9.5%        | 8.4%        | 3.0%        | -1.5%       | 2.7%        | 6.4%        | 7.7%         | 7.6%         | 4.6%        | 6.7%        | 10.0%       | 8.0%        |
| Average                     | 7.7%        | 6.8%        | 7.3%        | 4.0%        | 0.8%        | 4.2%        | 6.1%        | 5.5%         | 8.0%         | 9.0%        | 9.5%        | 10.1%       | 8.8%        |
| <b>Pets</b>                 |             |             |             |             |             |             |             |              |              |             |             |             |             |
| PETM                        | 7.9%        | 16.1%       | 16.6%       | 13.3%       | 10.5%       | 9.2%        | 7.4%        | 6.2%         | 5.4%         | 6.4%        | 9.8%        | 9.5%        | 9.5%        |
| <b>Misc.</b>                |             |             |             |             |             |             |             |              |              |             |             |             |             |
| TSCO                        | 4.2%        | 13.4%       | 16.6%       | 16.9%       | 15.6%       | 7.3%        | 5.1%        | 4.9%         | 0.3%         | 5.9%        | 14.0%       | 11.5%       | 8.5%        |
| VSI                         | 0.0%        | 0.0%        | 0.0%        | 0.0%        | 0.0%        | 6.6%        | 12.8%       | 12.4%        | 11.4%        | 12.3%       | 14.1%       | 12.5%       | 10.5%       |
| Average                     | 4.0%        | 9.8%        | 11.1%       | 10.1%       | 8.7%        | 7.7%        | 8.4%        | 7.8%         | 5.7%         | 8.2%        | 12.6%       | 11.2%       | 9.5%        |
| <b>Hardlines Average</b>    | <b>6.4%</b> | <b>6.0%</b> | <b>7.2%</b> | <b>6.5%</b> | <b>5.6%</b> | <b>3.9%</b> | <b>1.8%</b> | <b>-1.9%</b> | <b>-1.8%</b> | <b>5.0%</b> | <b>7.9%</b> | <b>6.6%</b> | <b>6.7%</b> |

Source: Company reports, BofA Merrill Lynch Global Research estimates

Table 6: Hardlines Square Footage Growth

|                             | 2002         | 2003         | 2004        | 2005        | 2006        | 2007        | 2008        | 2009        | 2010        | 2011E       | 2012E       | 2013E       |
|-----------------------------|--------------|--------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| <b>Home Furnishings</b>     |              |              |             |             |             |             |             |             |             |             |             |             |
| BBBY                        | 17.2%        | 18.7%        | 12.1%       | 11.1%       | 8.9%        | 8.6%        | 6.2%        | 5.3%        | 3.9%        | 4.0%        | 4.0%        | 3.9%        |
| PIR                         | 10.0%        | -3.1%        | 7.6%        | 3.2%        | -9.0%       | -10.0%      | -2.2%       | -3.4%       | -0.7%       | 0.5%        | 1.3%        | 1.2%        |
| WSM                         | 17.2%        | 11.8%        | 11.4%       | 8.6%        | 8.3%        | 5.3%        | 7.1%        | -1.1%       | -4.1%       | -4.6%       | 2.0%        | 1.9%        |
| Average                     | 14.8%        | 9.1%         | 10.3%       | 7.7%        | 2.7%        | 1.3%        | 3.7%        | 0.2%        | -0.3%       | 0.0%        | 2.4%        | 2.4%        |
| <b>Home Improvement</b>     |              |              |             |             |             |             |             |             |             |             |             |             |
| HD                          | 13.7%        | 10.2%        | 9.8%        | 7.0%        | 4.2%        | 4.9%        | 1.3%        | -1.3%       | 0.0%        | 0.0%        | 0.6%        | 0.5%        |
| LOW                         | 17.4%        | 14.9%        | 13.7%       | 13.3%       | 12.1%       | 10.8%       | 7.4%        | 3.2%        | 2.1%        | -0.2%       | 0.9%        | 0.8%        |
| Average                     | 15.5%        | 12.5%        | 11.8%       | 10.1%       | 8.2%        | 7.9%        | 4.3%        | 1.0%        | 1.0%        | -0.1%       | 0.7%        | 0.7%        |
| <b>Consumer Electronics</b> |              |              |             |             |             |             |             |             |             |             |             |             |
| BBY                         | 13.3%        | 9.8%         | 7.3%        | 9.0%        | 22.0%       | 16.0%       | 11.6%       | 3.4%        | 3.6%        | 0.8%        | 0.7%        | 1.2%        |
| RSH                         | -0.9%        | 2.5%         | 3.1%        | -2.4%       | -10.0%      | 1.1%        | 0.8%        | 0.4%        | -0.5%       | -0.3%       | 0.3%        | 0.3%        |
| Average                     | 6.2%         | 6.2%         | 5.2%        | 3.3%        | 6.0%        | 8.6%        | 6.2%        | 1.9%        | 1.5%        | 0.2%        | 0.5%        | 0.8%        |
| <b>Auto Parts</b>           |              |              |             |             |             |             |             |             |             |             |             |             |
| AAP                         | -3.3%        | 4.2%         | 4.5%        | 8.5%        | 2.8%        | 6.2%        | 5.7%        | 1.1%        | 3.9%        | 3.9%        | 3.8%        | 4.2%        |
| AZO                         | 1.6%         | 4.2%         | 6.0%        | 5.0%        | 5.3%        | 4.7%        | 8.6%        | 4.6%        | 5.2%        | 4.4%        | 4.0%        | 4.0%        |
| ORLY                        | 8.9%         | 14.7%        | 13.2%       | 17.8%       | 12.3%       | 13.0%       | 86.6%       | 4.3%        | 4.6%        | 4.8%        | 4.5%        | 5.6%        |
| Average                     | 2.4%         | 7.7%         | 7.9%        | 10.4%       | 6.8%        | 8.0%        | 33.6%       | 3.3%        | 4.6%        | 4.4%        | 4.1%        | 4.6%        |
| <b>Office Products</b>      |              |              |             |             |             |             |             |             |             |             |             |             |
| SPLS                        | 2.8%         | 4.1%         | 4.1%        | 5.6%        | 5.4%        | 6.2%        | 5.4%        | 2.2%        | 1.3%        | 1.1%        | 1.0%        | 0.8%        |
| ODP                         | 8.0%         | 1.8%         | 5.0%        | 5.9%        | 8.6%        | 4.5%        | 3.0%        | -8.4%       | -2.0%       | -2.7%       | -1.5%       | -1.6%       |
| Average                     | 5.4%         | 2.9%         | 4.6%        | 5.8%        | 7.0%        | 5.4%        | 4.2%        | -3.1%       | -0.3%       | -0.8%       | -0.3%       | -0.4%       |
| <b>Dollar Stores</b>        |              |              |             |             |             |             |             |             |             |             |             |             |
| DLTR                        | 29.0%        | 29.4%        | 21.0%       | 13.0%       | 14.0%       | 8.0%        | 6.7%        | 6.6%        | 8.7%        | 7.0%        | 6.5%        | 6.6%        |
| FDO                         | 13.3%        | 10.8%        | 8.2%        | 8.4%        | 4.6%        | 4.5%        | 2.3%        | 1.6%        | 2.3%        | 3.7%        | 5.9%        | 5.3%        |
| NDN                         | 28.0%        | 31.4%        | 19.0%       | 6.0%        | 7.0%        | 4.0%        | 4.0%        | -1.4%       | 3.6%        | 5.6%        | 9.6%        | 9.1%        |
| Average                     | 23.4%        | 23.9%        | 16.1%       | 9.1%        | 8.5%        | 5.5%        | 4.4%        | 2.3%        | 4.9%        | 5.4%        | 7.3%        | 7.0%        |
| <b>Pets</b>                 |              |              |             |             |             |             |             |             |             |             |             |             |
| PETM                        | 3.4%         | 8.6%         | 10.8%       | 12.2%       | 9.2%        | 9.8%        | 10.0%       | 3.1%        | 2.9%        | 2.9%        | 2.6%        | 2.6%        |
| <b>Other</b>                |              |              |             |             |             |             |             |             |             |             |             |             |
| TSCO                        | 61.0%        | 9.0%         | 14.0%       | 16.0%       | 16.0%       | 15.0%       | 11.8%       | 8.7%        | 7.6%        | 8.4%        | 8.4%        | 8.4%        |
| VSI                         |              |              |             |             | 11.3%       | 11.4%       | 17.6%       | 9.2%        | 10.5%       | 9.9%        | 10.0%       | 9.4%        |
| Average                     | 61.0%        | 9.0%         | 14.0%       | 16.0%       | 13.6%       | 13.2%       | 14.7%       | 9.0%        | 9.0%        | 9.1%        | 9.2%        | 8.9%        |
| <b>Hardlines Average</b>    | <b>13.2%</b> | <b>10.1%</b> | <b>9.5%</b> | <b>8.3%</b> | <b>6.9%</b> | <b>6.2%</b> | <b>9.8%</b> | <b>2.2%</b> | <b>3.0%</b> | <b>2.8%</b> | <b>3.5%</b> | <b>3.5%</b> |

Source: Company reports, BofA Merrill Lynch Global Research estimates

Table 7: Hardlines Net Income Growth

|                             | 2002  | 2003  | 2004   | 2005    | 2006    | 2007   | 2008    | 2009   | 2010   | 2011E  | 2012E  | 2013E |
|-----------------------------|-------|-------|--------|---------|---------|--------|---------|--------|--------|--------|--------|-------|
| <b>Home Furnishings</b>     |       |       |        |         |         |        |         |        |        |        |        |       |
| BBBY                        | 37.6  | 32.2  | 26.4   | 13.4    | 7.1     | (8.3)  | (24.5)  | 41.1   | 32.0   | 18.2   | 11.5   | 9.4   |
| PIR                         | 29.1  | (7.6) | (44.3) | (141.2) | (315.2) | 34.3   | (42.0)  | 101.4  | nm     | 1.5    | 14.3   | 16.8  |
| WSM                         | 67.1  | 26.6  | 21.1   | 17.0    | (8.0)   | (4.7)  | (81.0)  | 167.5  | 114.6  | 12.2   | 12.4   | 12.0  |
| Average                     | 44.6  | 17.1  | 1.1    | (36.9)  | (105.4) | 7.1    | (49.1)  | 103.4  | 73.3   | 10.6   | 12.7   | 12.7  |
| <b>Home Improvement</b>     |       |       |        |         |         |        |         |        |        |        |        |       |
| HD                          | 20.4  | 17.5  | 16.2   | 16.7    | (1.3)   | (26.9) | (29.1)  | (7.2)  | 21.7   | 11.3   | 11.0   | 11.0  |
| LOW                         | 42.6  | 27.6  | 16.9   | 27.1    | 12.3    | (9.5)  | (21.9)  | (17.1) | 10.5   | 2.1    | 0.0    | 8.5   |
| Average                     | 31.5  | 22.5  | 16.5   | 21.9    | 5.5     | (18.2) | (25.5)  | (12.2) | 16.1   | 6.7    | 5.5    | 9.7   |
| <b>Consumer Electronics</b> |       |       |        |         |         |        |         |        |        |        |        |       |
| BBY                         | 10.3  | 28.6  | 16.8   | 22.1    | 20.8    | 2.2    | (14.1)  | 11.1   | 6.1    | (11.0) | (12.3) | 6.0   |
| RSH                         | 11.7  | 15.8  | 13.0   | (37.8)  | (41.9)  | 75.6   | 15.9    | 9.2    | (3.0)  | (39.1) | 5.4    | 17.2  |
| Average                     | 11.0  | 22.2  | 14.9   | (7.9)   | (10.5)  | 38.9   | 0.9     | 10.1   | 1.6    | (25.1) | (3.5)  | 11.6  |
| <b>Auto Parts</b>           |       |       |        |         |         |        |         |        |        |        |        |       |
| AAP                         | NM    | 70.9  | 18.2   | 23.8    | (1.5)   | 4.8    | 8.0     | 8.9    | 20.7   | 10.3   | 10.5   | 8.8   |
| AZO                         | 57.8  | 20.2  | 10.0   | 1.6     | (1.0)   | 4.6    | 7.7     | 2.8    | 12.0   | 15.0   | 10.2   | 7.7   |
| ORLY                        | 23.6  | 22.1  | 23.5   | 29.1    | 11.6    | 8.9    | 5.9     | 51.5   | 39.1   | 18.0   | 14.7   | 14.0  |
| Average                     | 40.7  | 37.7  | 17.2   | 18.1    | 3.0     | 6.1    | 7.2     | 21.1   | 23.9   | 14.4   | 11.8   | 10.2  |
| <b>Office Products</b>      |       |       |        |         |         |        |         |        |        |        |        |       |
| SPLS                        | 36.6  | 32.3  | 28.3   | 10.7    | 20.9    | 7.4    | (9.8)   | (10.8) | 12.0   | 3.6    | 1.4    | 6.4   |
| ODP                         | 37.2  | (0.3) | 15.6   | 23.0    | 18.1    | (22.3) | (126.6) | (36.9) | (30.0) | 57.1   | 121.0  | NM    |
| Average                     | 36.9  | 16.0  | 22.0   | 16.9    | 19.5    | (7.5)  | (68.2)  | (23.8) | (9.0)  | 30.3   | 61.2   | 6.4   |
| <b>Dollar Stores</b>        |       |       |        |         |         |        |         |        |        |        |        |       |
| DLTR                        | 25.6  | 14.8  | 1.5    | (3.5)   | 10.4    | 4.8    | 14.0    | 39.7   | 29.1   | 18.3   | 14.9   | 12.2  |
| FDO                         | 14.5  | 12.2  | 6.0    | (15.6)  | 2.7     | 8.7    | (4.0)   | 25.0   | 20.9   | 10.3   | 11.9   | 12.9  |
| NDN                         | -     | -     | -      | -       | (14.5)  | (70.4) | NM      | NM     | 15.5   | 14.2   | 11.6   | 12.9  |
| Average                     | 20.1  | 13.5  | 3.8    | (9.6)   | (0.5)   | (18.9) | 5.0     | 32.3   | 21.8   | 14.3   | 12.8   | 12.7  |
| <b>Pets</b>                 |       |       |        |         |         |        |         |        |        |        |        |       |
| PETM                        | 178.9 | 32.7  | 13.6   | 12.9    | 6.7     | 8.3    | (4.0)   | 2.9    | 20.9   | 20.3   | 13.0   | 12.4  |
| <b>Other</b>                |       |       |        |         |         |        |         |        |        |        |        |       |
| TSCO                        | 49.4  | 57.9  | 14.5   | 29.9    | 10.6    | 5.0    | 8.6     | 10.9   | 40.3   | 27.2   | 15.3   | 13.6  |
| VSI                         | -     | -     | -      | -       | -       | 41.2   | (115.7) | NM     | 308.4  | 52.4   | 17.4   | 17.3  |
| Average                     | 24.7  | 28.9  | 7.2    | 15.0    | 5.3     | 23.1   | (53.6)  | 10.9   | 174.3  | 39.8   | 16.4   | 15.5  |

Source: Company reports, BofA Merrill Lynch Global Research estimates

Table 8: Hardlines EPS Growth

|                             | 2002  | 2003  | 2004   | 2005    | 2006    | 2007   | 2008 *  | 2009 ** | 2010   | 2011E  | 2012E | 2013E |
|-----------------------------|-------|-------|--------|---------|---------|--------|---------|---------|--------|--------|-------|-------|
| <b>Home Furnishings</b>     |       |       |        |         |         |        |         |         |        |        |       |       |
| BBBY                        | 36.5  | 30.7  | 25.6   | 16.4    | 12.4    | (2.6)  | (21.6)  | 40.2    | 33.2   | 24.7   | 17.1  | 14.3  |
| PIR                         | 30.3  | (3.8) | (42.5) | (142.3) | (311.6) | 34.8   | (40.7)  | 101.2   | nm     | 3.8    | 16.3  | 18.8  |
| WSM                         | 61.3  | 27.2  | 20.8   | 17.9    | (6.7)   | (0.1)  | (80.2)  | 166.3   | 110.4  | 15.9   | 16.8  | 16.6  |
| Average                     | 42.7  | 18.0  | 1.3    | (36.0)  | (102.0) | 10.7   | (47.5)  | 102.6   | 71.8   | 14.8   | 16.7  | 16.6  |
| <b>Home Improvement</b>     |       |       |        |         |         |        |         |         |        |        |       |       |
| HD                          | 20.8  | 20.3  | 20.0   | 20.5    | 2.7     | (18.8) | (21.6)  | (7.9)   | 24.1   | 17.6   | 16.1  | 15.6  |
| LOW                         | 39.8  | 27.9  | 16.5   | 27.7    | 15.3    | (6.6)  | (19.8)  | (16.7)  | 15.3   | 11.9   | 7.6   | 16.3  |
| Average                     | 30.3  | 24.1  | 18.3   | 24.1    | 9.0     | (12.7) | (20.7)  | (12.3)  | 19.7   | 14.7   | 11.8  | 15.9  |
| <b>Consumer Electronics</b> |       |       |        |         |         |        |         |         |        |        |       |       |
| BBY                         | 8.9   | 26.3  | 16.2   | 21.9    | 22.8    | 11.9   | (7.9)   | 9.7     | 8.7    | (2.2)  | (4.7) | 12.5  |
| RSH                         | (5.8) | 24.4  | 17.4   | (32.6)  | (36.1)  | 83.8   | (11.7)  | 12.0    | 3.3    | (30.0) | 9.4   | 25.0  |
| Average                     | 1.6   | 25.3  | 16.8   | (5.3)   | (6.6)   | 47.8   | (9.8)   | 10.8    | 6.0    | (16.1) | 2.3   | 18.8  |
| <b>Auto Parts</b>           |       |       |        |         |         |        |         |         |        |        |       |       |
| AAP                         | NM    | 65.5  | 17.0   | 27.4    | 1.2     | 7.2    | 18.6    | 9.1     | 31.7   | 25.1   | 17.1  | 14.3  |
| AZO                         | 67.6  | 32.8  | 23.5   | 10.3    | 3.8     | 13.6   | 17.8    | 17.2    | 27.2   | 30.0   | 19.1  | 14.4  |
| ORLY                        | 21.5  | 20.2  | 20.9   | 26.8    | 9.9     | 8.0    | (2.0)   | 37.8    | 35.1   | 21.5   | 20.3  | 19.0  |
| Average                     | 44.6  | 39.5  | 20.5   | 21.5    | 5.0     | 9.6    | 11.5    | 21.4    | 31.3   | 25.5   | 18.8  | 15.9  |
| <b>Office Products</b>      |       |       |        |         |         |        |         |         |        |        |       |       |
| SPLS                        | 34.4  | 25.8  | 26.8   | 11.5    | 22.7    | 10.3   | (8.7)   | (12.0)  | 11.4   | 6.8    | 4.4   | 8.8   |
| ODP                         | 35.6  | 1.7   | 14.9   | 23.1    | 29.3    | (19.0) | (126.9) | (37.0)  | (30.7) | 57.4   | 121.0 | NM    |
| Average                     | 35.0  | 13.7  | 20.8   | 17.3    | 26.0    | (4.3)  | (67.8)  | (24.5)  | (9.7)  | 32.1   | 62.7  | 8.8   |
| <b>Dollar Stores</b>        |       |       |        |         |         |        |         |         |        |        |       |       |
| DLTR                        | 24.1  | 13.8  | 2.7    | 0.5     | 15.6    | 12.9   | 21.0    | 40.9    | 36.1   | 25.3   | 18.8  | 16.2  |
| FDO                         | 13.6  | 12.6  | 7.0    | (13.4)  | 10.6    | 13.1   | 1.9     | 24.9    | 24.4   | 22.1   | 17.0  | 17.1  |
| NDN                         | -     | -     | -      | -       | (14.9)  | (70.4) | 569.7   | 230.8   | 12.7   | 13.7   | 11.6  | 12.9  |
| Average                     | 12.6  | 8.8   | 3.3    | (6.4)   | 3.8     | (14.8) | 197.5   | 98.9    | 24.4   | 20.4   | 15.8  | 15.4  |
| <b>Pets</b>                 |       |       |        |         |         |        |         |         |        |        |       |       |
| PETM                        | 126.0 | 26.8  | 11.8   | 16.0    | 11.4    | 13.7   | 0.5     | 4.8     | 26.3   | 26.2   | 20.2  | 19.1  |
| <b>Other</b>                |       |       |        |         |         |        |         |         |        |        |       |       |
| TSCO                        | 37.5  | 54.0  | 13.3   | 29.0    | 10.5    | 7.4    | 16.2    | 13.3    | 37.7   | 28.9   | 18.9  | 16.1  |
| VSI                         | -     | -     | -      | -       | -       | 41.2   | (115.7) | (471.3) | 291.9  | 41.5   | 16.0  | 13.7  |
| Average                     | 37.5  | 54.0  | 13.3   | 29.0    | 10.5    | 24.3   | (49.8)  | (229.0) | 164.8  | 35.2   | 17.4  | 14.9  |

Source: Company reports, BofA Merrill Lynch Global Research estimates

## Demographics to re-shape a mature sector

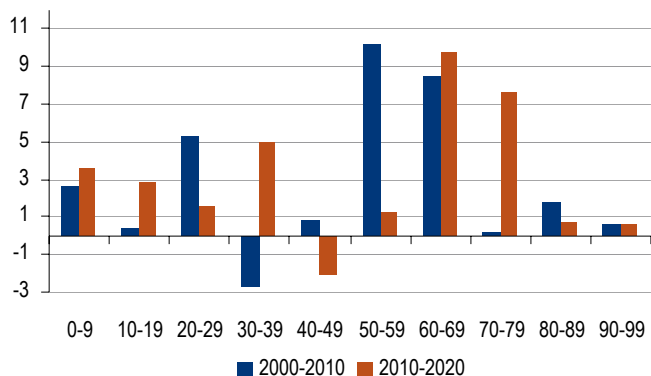
Discussions of age and ethnicity, with the requisite gross generalizations and simplifications needed to move the conversation forward, are, by their nature, sensitive and risk causing unintended offense. However, we think this is an analysis worth undertaking given the potential for these trends to drive longer-term consumption trends in the US. Here, we focus on two of the fastest-growing demographics, people aged 45 and over and Hispanics, and the implications for the Hardline Retail space.

## Aging exacerbates austerity

The aging of the Baby Boomers is expected to be one of the defining trends for consumption over the next decade. Based on projections from the US Census Bureau, the number of people in their 60s and 70s is expected to increase by 34/46%, respectively, to a combined 18% of the total population in 2020, up from 15% in 2010 and 13% in 2000. We expect the aging of the Baby Boomers, coupled to a lesser extent with the rise of the Echo Boomers and Millennials, to have a profound impact on retail channels and the housing market.

To put this shift into context, in 2000, people in their 20s and 30s numbered 81.6mn and outnumbered people in their 60s and 70s by 123%. By 2010, the younger cohort had increased to 84.2mn and outnumbered the older cohort by 86%. By 2020, the younger cohort will number 90.8mn and outnumber the older cohort by just 45%. From 2000-2020, the total US population is projected to increase by 21%, but the younger cohort's growth will lag overall growth at 11%, while the number of older people is expected to surge by over 70%.

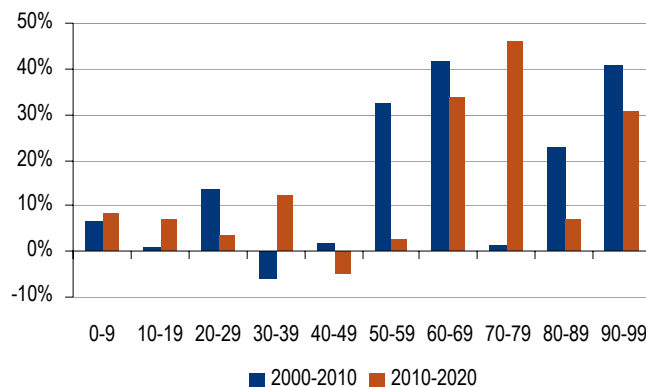
Chart 5: Decade Changes of Age Groups (million population)



Source: US Census Bureau.

Householders aged 65+ were the only age group to see incomes rise between 2007 and 2010...and they account for the largest group of householders

Chart 6: Decade Changes of Age Groups (%)

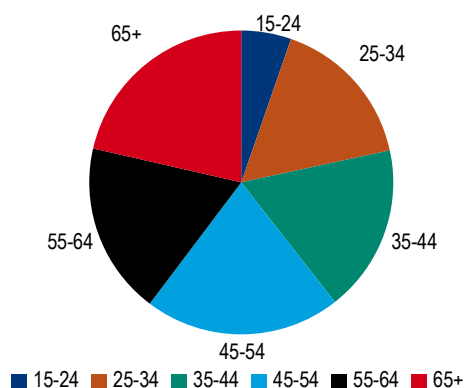


Source: US Census Bureau

In the last few years, while many people entering retirement have seen their incomes and assets seriously eroded by the recession, average incomes of the 65+ cohort have actually been relatively insulated due to social programs, fixed pensions and relatively low exposure to the stock market. According to the US Census report on poverty as of 2010, people aged 65 and over had the lowest incidence of poverty (9%) compared to other age groups, and their average incomes actually increased by 5.5% since 2007, in contrast to 6.2-9.2% declines in income for people in the four age groups spanning 25 to 64. Moreover, households led by householders aged over 65 years accounted for the greatest number of households, at 21.4% of total households, followed by 45-54 year olds at 20.7% and larger than the other age groups. From a per-capita consumption

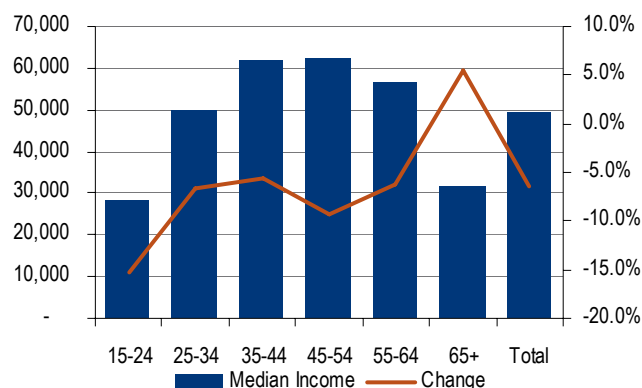
perspective, the sheer increase in the number of older people suggests that consumer companies will pay more attention to this cohort in the coming years.

Chart 7: Breakdown of Households by Age of Householder (2010)



Source: U.S. Census Bureau

Chart 8: Median Household Income in 2010 and % Change since 2007



Source: U.S. Census Bureau

Renovation demand is expected to be one of the few bright spots of the housing market in the coming years

We see several investment implications of this demographic shift over the coming decade. The key beneficiaries are expected to be home improvement, dollar stores, pet retail and health supplement retail, while consumer electronics retail could suffer from relatively stagnant growth in the number of younger people.

#### More homes to change hands, from older owners to younger buyers

Aging of the population will underpin a significant changeover in housing over the next 10 years, in our view. While home ownership for the overall population is 65.4%, home ownership for people aged 60 and over is 78.8%. People in their 60s and beyond are far more likely to have lived in their homes for 20 or more years, and they are more likely to sell to much younger buyers. For first-time home buyers, older homes that may have not been updated for many years tend to be more affordable.

In the medium term, we think sales of homes by older owners to younger owners could help support home improvement demand, even if prices and transaction volumes remain subdued. Lowe's has commented on the "2x" spending on home improvement of Millennials who are enthusiastic first-time home owners and accounted for half of the first-time homebuyers in 2010. This could be an important demand driver over the coming decade, in our view. Home Depot and Lowe's same-store comps have been modestly decoupling from the housing market as people expect to be in their houses for longer and are undertaking small maintenance projects as well as – to a more limited extent – big-ticket projects again.

Moreover, both companies are investing heavily in strengthening their multi-channel presence by offering hundreds of thousands of SKUs online, in-store pick-up of online orders and having staff dedicated to creating how-to videos. In addition, Lowe's now offers a customized home management service, MyLowe's.com. Longer term, we believe these investments could result in market share gains for the leaders because of their superior connection with younger consumers who will eventually become homeowners as the housing market unfreezes and pent-up household formation is released. We estimate that around 2.6mn households have not been formed as a result of the recession; the annual run-rate has slowed to around 550,000 per year since 2007 from a normal pace of 1.2mn.

The dollar store channel can gain share as its market expands and remodels improve its appeal with higher-income shoppers

Lastly, for the Boomer generation, aging in place due to the depressed housing market will require the retrofitting of homes. We expect safety equipment and minor remodeling projects to accommodate older residents to be a new area of demand for the home improvement retailers in the coming years.

#### **Dollar stores' addressable market is expanding**

Dollar stores already generate a significant amount of income from older shoppers; according to Family Dollar, people aged 45 and over account for 71% of its total sales, up from 68% in 2010. With the top three dollar stores having over 21,000 stores between them, compared to over 6,000 discount stores and over 16,000 grocery stores, dollar stores offer convenient locations ranging from rural to suburban and urban. At 8-12k sf vs around 150k sf for a Wal-Mart Supercenter or 40-50k for a grocery store, the boxes are easily navigable, and the small-medium product sizes suitable for smaller households.

Store remodels and improving assortments of both national brands and private label have been key to broadening the appeal of these stores to wealthier trade-down customers. By definition, the core low-income customer is likely to remain under pressure, so widening the customer base is key to sustained growth. In short, in our opinion the dollar stores continue to have a long runway for growth as they take share from other channels and expand their networks, particularly into the under-penetrated Western US.

#### **More empty-nesters coddling their pets**

Pet retail has been one of the most consistent and resilient markets within hardlines. At their worst, comp store sales growth decelerated to (2.6)% in 4Q07 from their usual run-rate of mid-single digits as discretionary hardgood sales fell by double-digits. With Baby Boomers entering retirement as empty-nesters with more time for hobbies and discretionary income to spend on pets, we expect pet retail to benefit from the ongoing humanization of pets. PetSmart's core customer is female, average age 46, earns 30% more than the national average and spends 78% more than average on her pet. We think the breadth of assortment, superior customer service as well as unique retail experience and services that PetSmart offers for both owners and their pets will remain in high demand.

#### **Aging and rising health care costs lift demand for preventative self-care**

Demand for vitamins and health supplements is growing at 6-7% per year with the aging population. In addition, rising health care costs are encouraging more preventative self-care. The Vitamin Shoppe's core customer is very representative of this growing segment. The typical VSI consumer has relatively higher levels of income and education and is in the 40-60 year-old range. VSI has a very loyal customer base, with 4.4mn Healthy Awards customers of which around 100,000 spend over \$1,000 per year with the company. Many customers view VSI's products as non-discretionary lifestyle supplements to help them maintain or improve their standard of living. As a result, VSI's business is relatively insulated from the macro economy, posting sector-leading comp-store growth of 6.2% in both 2007 and 2008, 5.2% in 2009 and 7.1% in 2010.

#### **CE retail is facing a demographic bust**

On the other hand, CE retail is expected to be a casualty of an aging population, given lower technology adoption rates and different requirements among older consumers, which have not yet been targeted in a meaningful way by the tech manufacturers in our view. Over the next decade, the number of people in their 30s is projected to increase by over 12% to 45.5mn, but the increase in the number of people in their 20s is projected to lag the overall population's 10%

growth, edging up by only 3.6%. The more than 50% drop in new household formation of the last four years highlights the pressures facing young people in terms of high unemployment and record student debt. In fact, as we discuss in the following section, the vast majority of the growth in this younger age group is likely to be Hispanic, which underscores the importance of connecting with this key demographic.

## The rise of the Hispanic population

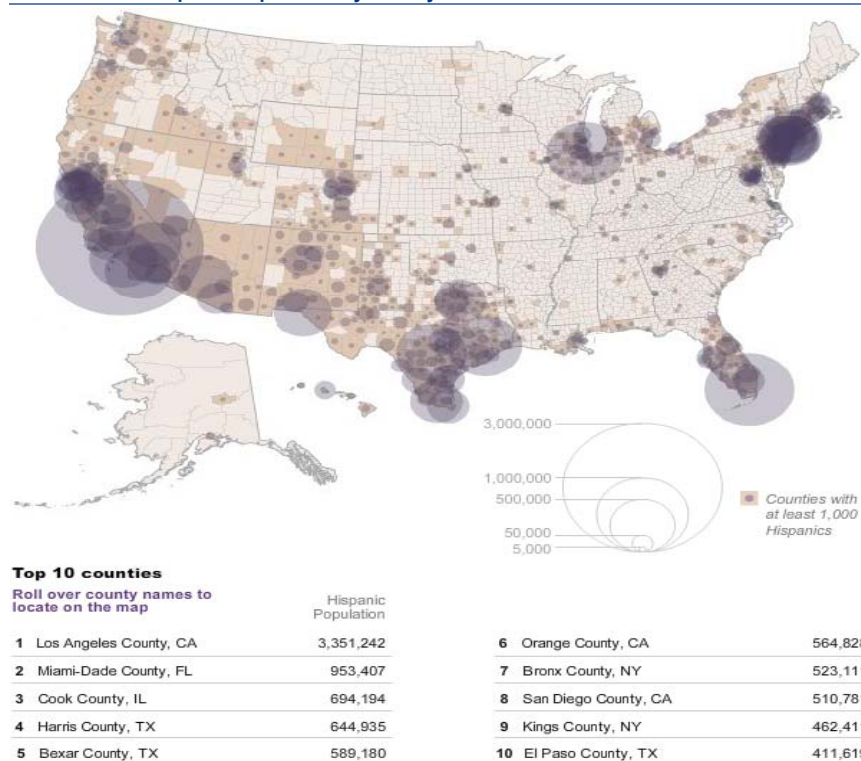
Understanding the implications of the fast-growing Hispanic population, the largest minority group in the US, is essential for anticipating future consumption trends, in our view. Based on a study by Packaged Facts, buying power or personal disposable income of this demographic is estimated at \$1tr currently, and could rise to \$1.3tr by 2015.

Almost one in six Americans is Hispanic, and this ratio will continue to rise even as immigration slows. Based on estimates by the Pew Research Center, the US Hispanic population is projected to increase by 32% over the next 10 years to 65.3mn, or 19% of the population, up from an estimated 49.3mn and 15.9% of the population in 2010. At a 2.84% CAGR, the Hispanic population is projected to grow more than five times faster than the non-Hispanic population's 0.55% CAGR from 2010-2020, albeit slower than the 4-5% annual growth in the past few decades but still significant. Excluding Hispanics, population growth would be only approximately 0.5%.

With the understanding that terminology can be unintentionally political, for the sake of simplicity we have chosen to use the term Hispanic, which was adopted by the US Census Bureau to classify people from Spanish-speaking countries ranging from Mexico to Peru. It goes without saying that the Hispanic population is highly diverse in almost every aspect. Before delving into some major demographic trends for Hispanics overall, we highlight some of these key differences:

- Generational differences can be enormous, with first generation immigrants tending to be different from native born Hispanics and potentially very different from those whose families have been in the US for three generations or more. In general, incomes and educational levels rise and family size declines with increased acculturation.
- Country of origin (and therefore culture, family size, etc) differs greatly by region of the US, with 90% of the Hispanics in the Southwest coming from Mexico, while those in the Northeast tend to be from Puerto Rico, Dominican Republic or Cuba. California and Texas are home to almost half of the Hispanics in the US today, and Hispanics account for almost 38% of the populations of these two states.

### Exhibit 1: U.S. Hispanic Population by County - 1990



### Exhibit 2: U.S. Hispanic Population by County - 2009

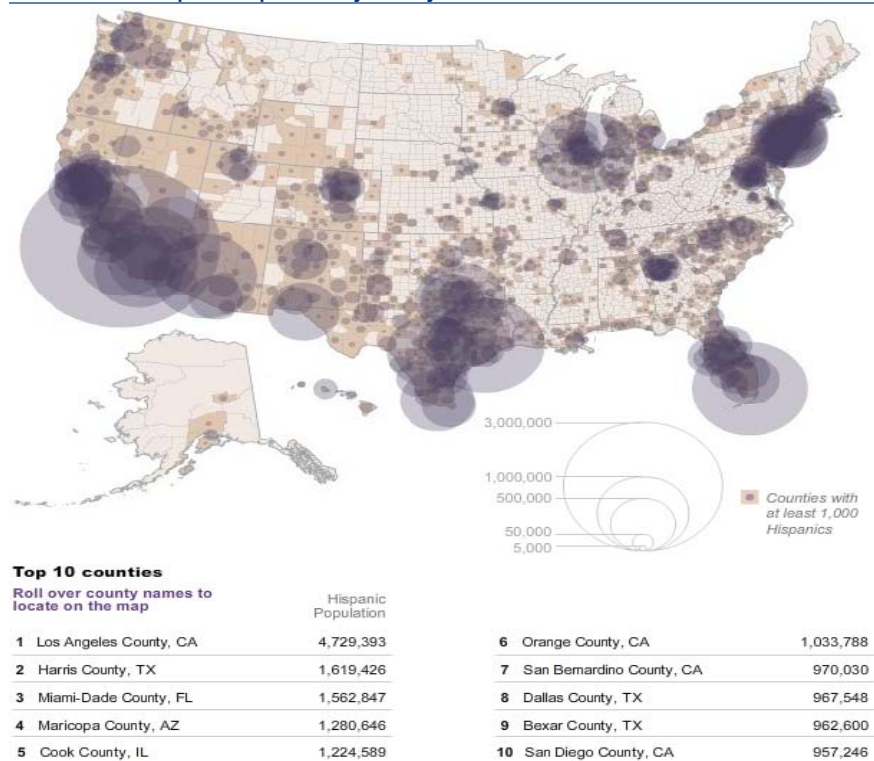


**Table 9: Demographic Statistics of the Top Ten Hispanic Populations in the US**

| Population ('000) |        | Nativity*     |      | Age           |    |
|-------------------|--------|---------------|------|---------------|----|
| All Hispanics     | 48,348 | All Hispanics | 37 % | All Hispanics | 27 |
| Mexicans          | 31,674 | Hondurans     | 69 % | Cubans        | 40 |
| Puerto Ricans     | 4,412  | Guatemalans   | 68 % | Colombians    | 34 |
| Salvadorans       | 1,736  | Peruvians     | 67 % | Peruvians     | 34 |
| Cubans            | 1,677  | Colombians    | 66 % | Ecuadorans    | 31 |
| Dominicans        | 1,360  | Ecuadorans    | 65 % | Dominicans    | 29 |
| Guatemalans       | 1,077  | Salvadorans   | 63 % | Salvadorans   | 29 |
| Colombians        | 917    | Cubans        | 59 % | Hondurans     | 28 |
| Hondurans         | 625    | Dominicans    | 57 % | Puerto Ricans | 28 |
| Ecuadorans        | 611    | Mexicans      | 36 % | Guatemalans   | 27 |
| Peruvians         | 557    | Puerto Ricans | 1 %  | Mexicans      | 25 |

| High School*  |     | College*      |     | Proficient in English |     |
|---------------|-----|---------------|-----|-----------------------|-----|
| All Hispanics | 26% | All Hispanics | 13% | All Hispanics         | 63% |
| Peruvians     | 30% | Colombians    | 29% | Puerto Ricans         | 81% |
| Puerto Ricans | 29% | Peruvians     | 29% | Mexicans              | 63% |
| Colombians    | 27% | Cubans        | 24% | Cubans                | 58% |
| Cubans        | 27% | Ecuadorans    | 18% | Colombians            | 57% |
| Ecuadorans    | 27% | Puerto Ricans | 16% | Peruvians             | 56% |
| Mexicans      | 26% | Dominicans    | 15% | Dominicans            | 53% |
| Dominicans    | 25% | Hondurans     | 10% | Ecuadorans            | 49% |
| Hondurans     | 24% | Mexicans      | 9%  | Salvadorans           | 45% |
| Salvadorans   | 24% | Guatemalans   | 8%  | Hondurans             | 40% |
| Guatemalans   | 21% | Salvadorans   | 7%  | Guatemalans           | 39% |

| Income        |        | Living in Poverty |     | Homeownership |     |
|---------------|--------|-------------------|-----|---------------|-----|
| All Hispanics | 40,200 | All Hispanics     | 23% | All Hispanics | 48% |
| Ecuadorans    | 50,700 | Hondurans         | 27% | Cubans        | 59% |
| Colombians    | 50,000 | Guatemalans       | 26% | Colombians    | 51% |
| Peruvians     | 48,000 | Dominicans        | 25% | Mexicans      | 50% |
| Cubans        | 42,000 | Mexicans          | 24% | Peruvians     | 47% |
| Salvadorans   | 42,000 | Puerto Ricans     | 24% | Salvadorans   | 45% |
| Mexicans      | 40,000 | Salvadorans       | 19% | Ecuadorans    | 43% |
| Guatemalans   | 39,000 | Ecuadorans        | 16% | Puerto Ricans | 39% |
| Puerto Ricans | 38,010 | Cubans            | 15% | Guatemalans   | 32% |
| Hondurans     | 36,300 | Colombians        | 12% | Hondurans     | 32% |
| Dominicans    | 35,000 | Peruvians         | 12% | Dominicans    | 26% |

Notes: Nativity refers to those born outside the US and neither parent was a US citizen. High School refers to those aged 25+. College refers to a Bachelor's degree. Source: Pew Hispanic Center

## The fountain of youth

The Hispanic population is far more heavily skewed toward children, with a relatively small number of elderly. One out of five children in the US today is Hispanic, but by 2020 that figure is projected to rise to one in four. While working age people aged 18-64 account for 60-61% of the total populations of both Hispanics and non-Hispanics in the US, one-third of the Hispanic population was children while only 6% was elderly in 2010. In contrast, the non-Hispanic population had a smaller % of children (22%) and more than twice the % of elderly (14%).

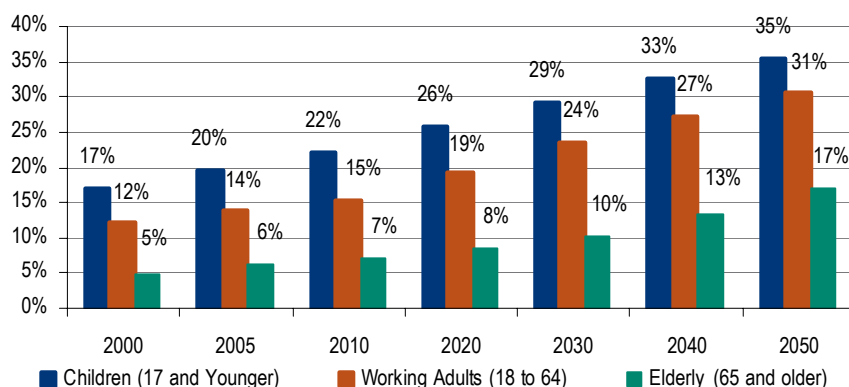
Looking at the 2010-2020 period, Hispanic children will account for 69% of the increase in total number of children and over 90% of the increase in the overall working age population. With an average age of 27 in 2010, Hispanics will contribute only 13% to the increase in total number of elderly.

Coupled with the rise of native born generations, the young profile of the Hispanic population is driving rapid increases in higher education. Between 2009-2010, college enrollment of Hispanics aged 18-24 grew by 24% to a new high of

12.2mn. Similar to the national average, the percentage of Hispanic women in higher education exceeds that of Hispanic men. Continuation of this trend could be very supportive of future consumption potential given the higher average incomes earned by college graduates. Within Hardlines Retail, we believe home furnishings could particularly benefit from rising female educational levels and incomes.

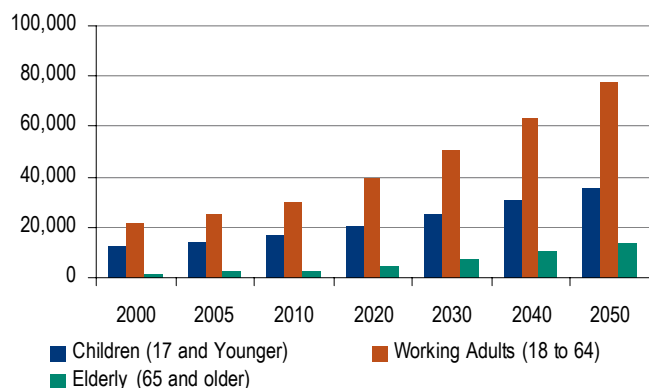
While the rapid growth of the Hispanic population relative to the overall population has implications for virtually every retailer, in our view the youthful profile of this demographic could be particularly meaningful for Best Buy, since technology consumption is higher for younger people.

Chart 9: Hispanics as % of Each Age Group



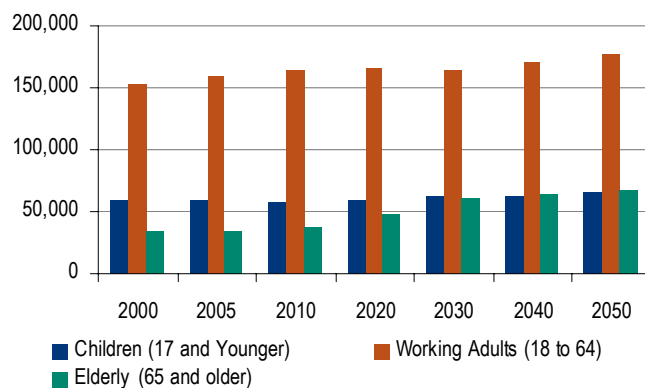
Source: Pew Research Center: U.S. Population Projections 2005-2050

Chart 10: Hispanic U.S. Population (2000-2050)



Source: Pew Research Center: U.S. Population Projections 2005-2050

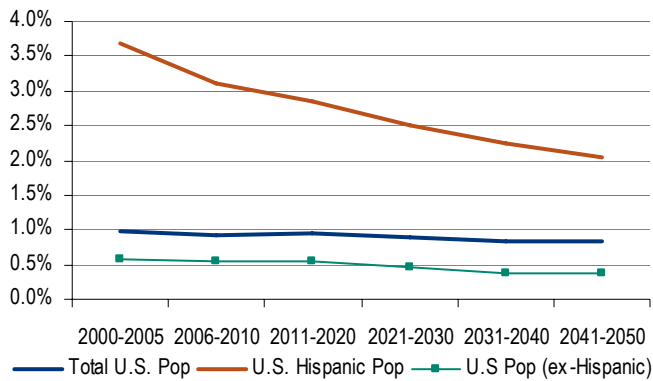
Chart 11: Non-Hispanic U.S. Population (2000-2050)



Source: Pew Research Center: U.S. Population Projections 2005-2050

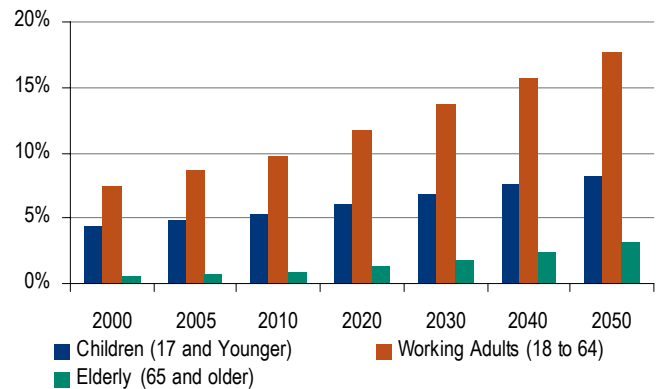
14 December 2011

**Chart 12: US Population Growth Trends (2000-2050)**



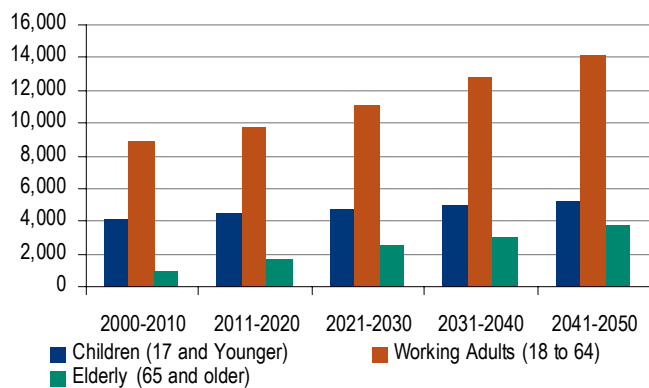
Source: Pew Research Center: U.S. Population Projections 2005-2050

**Chart 13: Hispanic Population as % of US Total Population (2000-2050)**



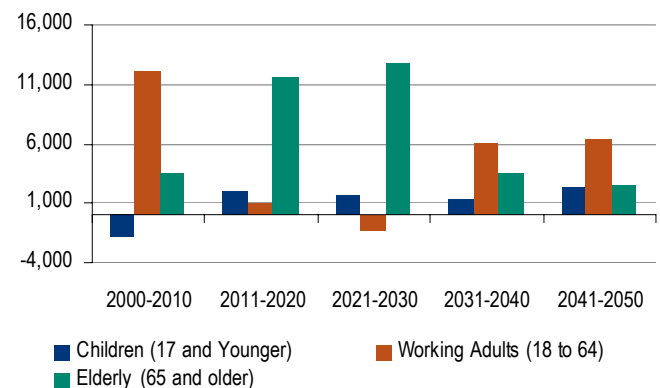
Source: Pew Research Center: U.S. Population Projections 2005-2050

**Chart 14: Change in Hispanic Population (2000-2050)**



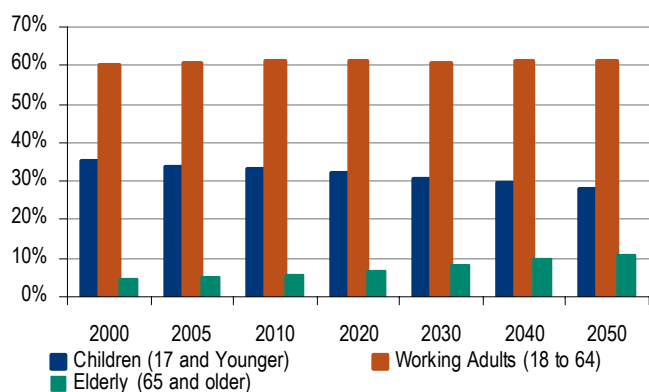
Source: Pew Research Center: U.S. Population Projections 2005-2050

**Chart 15: Change in non-Hispanic Population (2000-2050)**



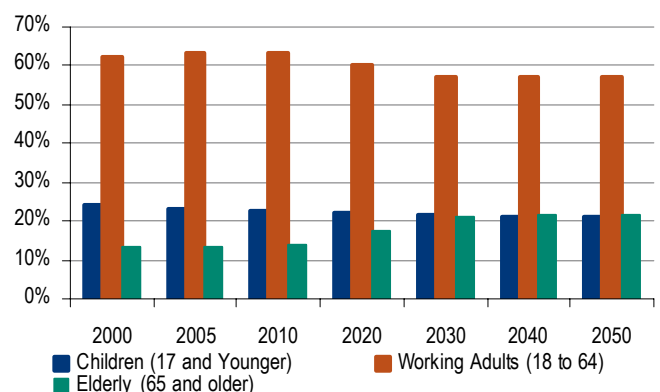
Source: Pew Research Center: U.S. Population Projections 2005-2050

**Chart 16: Hispanic Population Age Composition (2000-2050)**



Source: Pew Research Center: U.S. Population Projections 2005-2050

**Chart 17: Non-Hispanic Population Age Composition (2000-2050)**

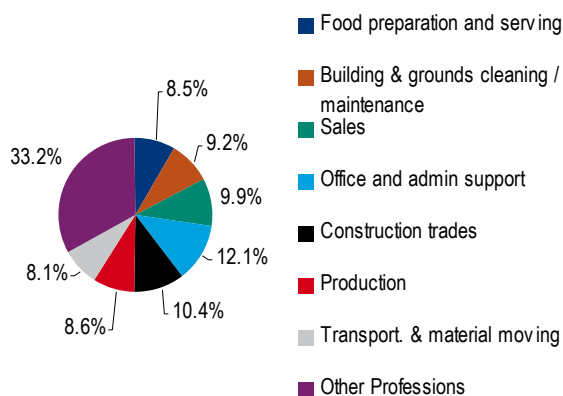


Source: Pew Research Center: U.S. Population Projections 2005-2050

### Top Hispanic professions

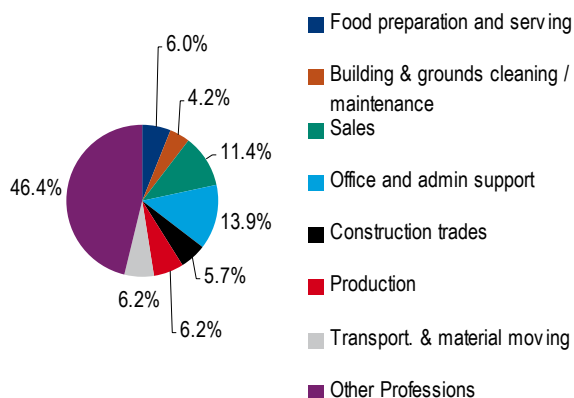
Based on data from the Pew Hispanic Center, we analyzed the profession distribution of the Hispanic population compared to the overall population. Office and administrative support was the largest profession, at 12.1% of Hispanics. However, construction and building & grounds/maintenance employed over 20% of Hispanics, double the proportion of the non-Hispanic population. Based on profession alone, we think DIY-oriented retailers such as home improvement and auto parts should benefit from the rapid growth of this demographic. At the same time, the average Hispanic household income of less than \$40,000 would make this group part of the natural target market of the dollar stores. As California accounts for 28% of the total Hispanic population and only Dollar Tree and 99¢ Only Stores have a developed presence in the state, we see ample growth opportunities for this retail channel.

Chart 18: Top Hispanic Professions – 2009



Source: Pew Hispanic Center

Chart 19: Non-Hispanic Participation Within Top Hispanic Professions - 2009\*

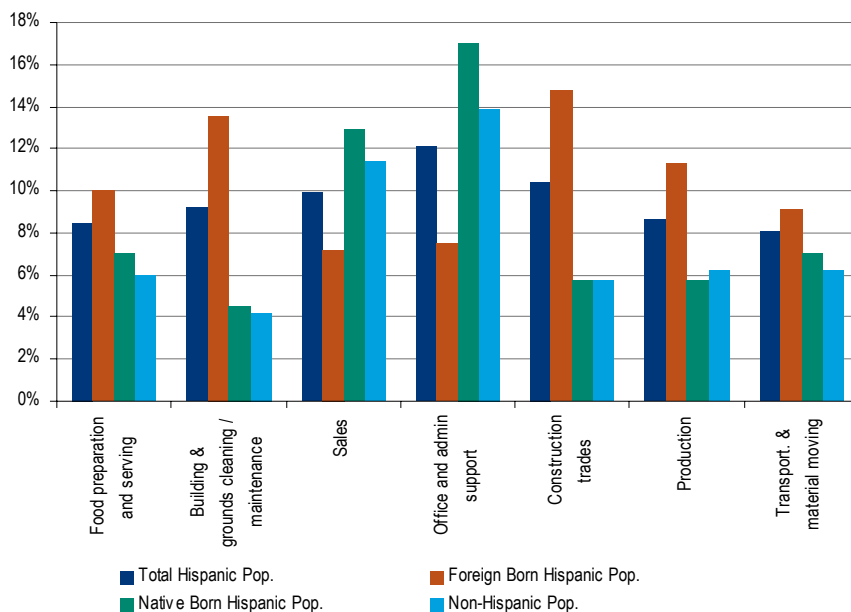


Note: The top 5 professions of the non-Hispanic US population were office & admin support (14%), sales (11%), management (9%), production (6%) and transport & material moving (6%). Source: Pew Hispanic Center

### Generation influences opportunities and consumption power

Almost half of Hispanics aged 18 and over in the US were born in the US, while over 90% of Hispanics under age 19 were native born. Generation makes a tremendous difference in profession and consequently income level. The chart below shows that a native-born Hispanic person is roughly twice as likely to be employed in sales and office & administrative support as a foreign-born Hispanic person. Conversely, native-born Hispanics are only half as likely to be engaged in building & grounds cleaning & maintenance, construction and production. Importantly, there is relatively *little* difference between the professions of native-born Hispanics and non-Hispanics in terms of their participation in these fields. This finding underscores significant consumption power among the Hispanic population in the coming years, in our view.

**Chart 20: Top Hispanic Professions: Native vs. Foreign Born Hispanics vs. Non-Hispanics - 2009**

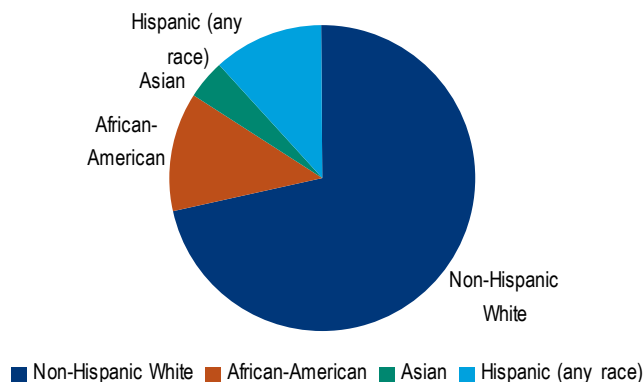


Source: Pew Hispanic Center

### Median incomes still trail most other groups

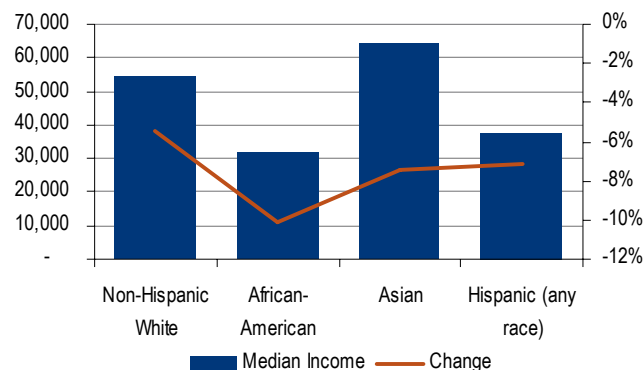
Average incomes of this cohort have declined by more than the national average since 2007, according to the recent study on poverty by the US Census Bureau. Household incomes of Hispanics declined by 7.2% from 2007 to 2010 to \$37,759. There are also more Hispanic children living in poverty than any other group, given the larger families and population skew towards kids. However, given the significant generational career differences, in our view median or average incomes for the Hispanic demographic are perhaps less meaningful than for some other ethnic groups, which could be more static.

**Chart 21: U. S. Census Breakdown of Households by Ethnic Origin - 2010**



Source: U.S. Census Bureau

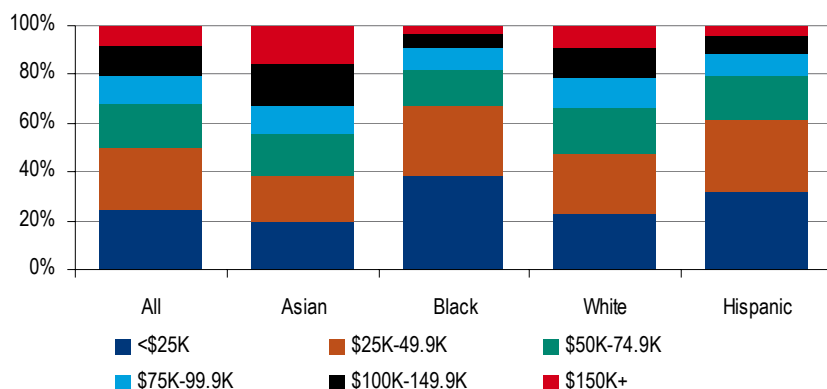
**Chart 22: U.S. Census Median Household Income by Ethnic Origin in 2010 and % Change since 2007**



Source: U.S. Census Bureau

The following chart shows that in 2009, 32% of Hispanic households had an income of less than \$25,000, while 30% had an income of \$25,000-\$49,900. In contrast, the national average for both income categories was 25%. Interestingly, the percentage of Hispanic households with an income of \$50,000-\$74,900 was similar to the national average at just under 18%.

**Chart 23: Household Income Distribution, by Race and Hispanic Origin of Householder - 2009**



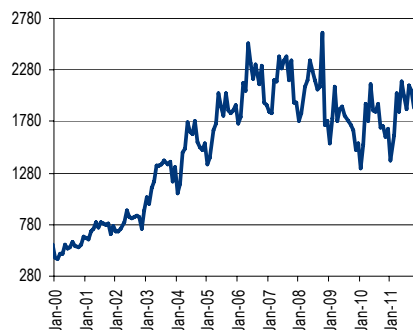
Source: Mintel from the U.S. Census Bureau, Current Population Survey, Annual Social and Economic Supplement

### Remittances could decline longer term, lifting domestic spending power

Given that two-thirds of Hispanics in the US were originally from Mexico, we look at remittances reported by the Bank of Mexico as a proxy for the group. After growing by an average of 25% per year from 2000-2006, remittances declined by (4%) and (16%) in 2008 and 2009 and were flat at \$21bn in 2010. Latest figures from the Bank of Mexico showed remittances increased by 10.4% to \$1.9bn in October. YTD the average remittance is almost \$330, up 3.7%.

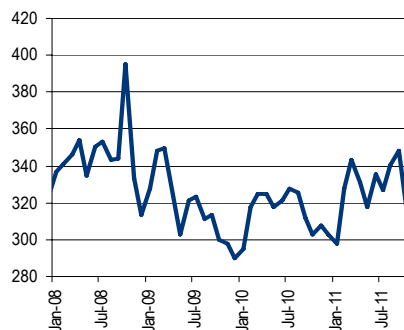
We see potential for remittances to decline in the longer term as 1) more overseas family members migrate to the US and no longer need support; and 2) an increase in the number of native-born Hispanics relative to foreign-born migrants gradually weakens ties to more distant relatives. If remittances gradually start to dwindle, this could translate to stronger spending power in the US.

**Chart 24: Mexican Remittances (\$mn)**



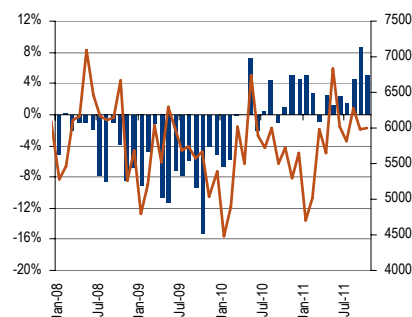
Source: Banco De Mexico

**Chart 25: Average Remittance (\$)**



Source: Banco De Mexico

**Chart 26: Transaction Count ('000)**



Source: Banco De Mexico

## **Price objective basis & risk**

### **Advance Auto Parts, Inc. (AAP)**

We value Advance Auto at a PO of \$75, representing a 2012E P/E of 13x. This valuation is inline with its historical median and reflective, in our opinion, of its lower profitability/returns and execution risks versus its main competitors. Upside risks are lower oil prices, which would increase miles driven, sluggish new car sales, which would promote aftermarket demand, and increasing average age of vehicles on the road. If Advances improved supply chain and online ordering system generate higher in-store availability and lower logistics costs, revenue and margins could surprise on the upside. Downside risks are execution of its distribution upgrade, inability to fully leverage its infrastructure build out, continued underperformance of DIY, potential inability to control costs well on a consistent basis, an intensified competitive environment, rising gas prices, and a material increase in new car sales, which could hamper aftermarket sales on a short-term basis.

### **AutoZone Inc. (AZO)**

We value AutoZone at a PO of \$375 representing a FY12E P/E of 16x. We believe a premium rating is justified by AutoZones superior earnings track record, market leadership, national presence, advanced supply chain network, industry-leading margins and sector-leading returns. The key downside risks facing AutoZone are inability to fund buybacks through new debt-issuance due to instability in the credit markets, commodity cost changes, intensified competition, changes in scrappage rates and new car sales, and execution of its entry into Brazil. Upside risks are weaker-than-expected new car sales, which cause faster aging of the fleet, faster-than-expected growth in DIFM, and a successful entry into new LatAm markets.

### **Bed Bath & Beyond Inc. (BBBY)**

Out-sized growth may be in the past for this maturing brand, but quality and consistency will sustain premium valuations, in our view. Our PO values Bed Bath & Beyond at \$72, representing a 2012E P/E of 16x. Its unparalleled earnings track record, high returns and relatively low-risk business model justify a premium to its five-year historical median of 15x. Upside risks are an improved macroeconomic environment that eliminates some consumer uncertainty, a better housing market and a material increase in the expansion of newer concepts. Downside risks are deterioration in demand from macro changes, unsuccessful expansion or delays within newer concepts, a more intense promotional environment, and an acceleration in consumers willingness to buy housewares online.

### **Best Buy Co., Inc. (BBY)**

Our 12-month PO \$23 is based on 7x our 2012E EPS. Given structural headwinds, we believe a multiple that is toward the lower ends of historical ranges is warranted. Downside risks to our Price Objective and investment thesis are deteriorating ASPs on bigger-ticket items from a narrowing product cycle, worse-than-expected competition from online retailers, vendors, discounters and mass merchants, vendor consolidation, difficulties with international expansion, and a more cautious consumer. Upside risks are a better-than-expected reception to its Connected World strategy in the US and overseas and faster-than-expected market share gains in mobile.

### **Dollar Tree, Inc. (DLTR)**

Our 12-month price objective of \$93 is based on a multiple of 19x our 2012E EPS. In our view, a multiple that is above the five-year average multiple, of 15x,

is appropriate, given the company's consistent results during today's challenging environment. Downside risks are an increased slowdown in the economy, which could negatively impact sales, changes in commodity costs, which could increase cost of goods sold and hamper consumer spending, changes in federal or state laws, which could constrain business practices, supply chain difficulties, changes in the competitive landscape, and unforeseen difficulties with store expansion. Upside risks are an increase in sales due to consumers striving to conserve spending and/or trade down, more favorable commodity prices, supply chain efficiencies, a stable competitive landscape, and a smooth progression of store expansion both domestically and in Canada.

### **Family Dollar Stores, Inc. (FDO)**

Our PO of \$67 is based on 18x FY12E P/E, which is toward the high-end of its historical range. In our opinion, Family Dollar deserves a premium for its visible, sustainable, above-market growth and improving fundamentals. Downside risks are an increased slowdown in the economy, unfavorable swings in commodity costs, changes in federal or state laws, supply chain difficulties, changes in the competitive landscape, and unforeseen difficulties with store expansion and renovations. In addition, Wal-Mart's plans to accelerate its Express store openings could pose a competitive threat. Upside risks are a more favorable or relatively stable economy, more favorable commodity prices, supply chain efficiencies, a stable competitive landscape, better-than-expected consumer reception to remodeled stores, and a smooth progression of store expansion and enhancement initiatives.

### **Lowe's Companies, Inc. (LOW)**

Our PO of \$26 is based on a 2012E P/E of 15x, a 10% discount to our implied multiple for Home Depot and essentially inline with its five-year median P/E of 15x. Valuations are likely to remain capped until the company starts to post more encouraging results. Upside risks include reacceleration in the housing environment, better-than-expected results from MyLowe's.com and other online/IT initiatives, better-than-expected market share gains and better-than-expected results from SKU rationalization and vendor negotiations. Downside risks include further weakness in housing, friction in relationships with vendors, deterioration in the competitive landscape, unseasonable weather and poor execution in international expansion.

### **Office Depot, Inc. (ODP)**

Our 12-month price target of \$2 is based on a multiple of 0.1x 2012E P/S, which is below the historical median and warranted given continued uncertainties. Upside risks are higher levels of employment, an improvement in the small business environment and better-than-expected results from ODP's restructuring and growth initiatives. Downside risks are continued high levels of unemployment, an increase in government austerity measures, further deterioration in the small-to-medium customer base, worse-than-expected macro or currency weakness in Europe, an acceleration in market share loss to Staples and slower-than-expected progress in ODP's initiatives.

### **O'Reilly Automotive, Inc. (ORLY)**

Our PO of \$90 represents a 2012E P/E of 20x. Our target multiple is at the high end of its historical range and represents a premium to AutoZone's historical average of 13x over the last five years. We believe a premium for ORLY is justified by its fastest growth among peers, proven DIFM market success, strong execution notably with the CSK integration, the most extensive logistics network and a strong balance sheet, cash flow and share buybacks. Upside risks to our

PO and investment view are continued synergies and efficiencies following the successful integration of CSK, lower oil prices, which would increase miles driven, sluggish new car sales which would promote aftermarket demand and increasing average age of vehicles on the road. Downside risks are an inability to fully leverage its infrastructure build-out, an intensified competitive environment, declining miles driven, weather impacts particularly in hurricane-prone states, difficulties in continuing to increase sales and profits at former CSK locations, rising gas prices and a material increase in new car sales which could hamper aftermarket sales on a short-term basis.

### **PetSmart, Inc. (PETM)**

Our PO of \$56 is based on 18x 2012E P/E and is toward the high-end of its historical range. PETM deserves a premium to the Hardline Retail sector for its visible, sustainable and above-market growth, supported by positive demographics and excellent execution, in our view. The downside risks are: an increased focus on pet consumables from discounters, warehouse clubs, grocery and dollar stores, persistently high gas prices could hinder human travel, which would impact slower-than-expected turnaround PetSmarts pet boarding business, as well as weigh on demand for hardgoods and premium pet food, persistently high commodity prices (soy and corn) could impact the gross margin, changes in consumer spending behavior, and reputational risk from food/product recalls due to consumers emotional attachment to pets. The upside rising are: stronger-than-expected acceleration in services, stronger-than-expected recovery in hardgoods, better-than-expected pick up in adoptions and pet ownership.

### **Pier 1 Imports Inc. (PIR)**

Our 12-month price objective of \$18 is based on 17x 2012E EPS. A multiple similar to its peers Bed Bath & Beyond and Williams-Sonoma and a small premium to its five-year median of 15x are justified by PIRs improved fundamentals and more sustainable growth, in our opinion. Downside risks to our price objective are: a material deterioration in consumer confidence which hurts discretionary spending, store remodels fail to improve traffic and traction as we expect, online and IT initiatives stumble, worse-than-expected cost pressures, and unexpected weakening in merchandising execution. The share price could exceed our PO if rapid store remodels showcase PIRs strong merchandise assortment better than we expect, e-commerce and in-store pick up of online orders improves sales and traffic to the stores, and consumer confidence improves.

### **RadioShack Corp. (RSH)**

Our 12-month price objective of \$10 is based on a multiple of 8x our 2012E EPS, which is towards the lower end of its historical ranges and warranted in our opinion given continued challenges. The main upside risks are better-than-expected consumer traction with the Verizon re-launch, recovery in Signature and CE and faster-than-expected ramp up of the Target kiosks. Downside risks are slower-than-expected Verizon phone sales, continued weakness at Sprint and poor execution in repositioning Signature and CE.

### **Staples, Inc. (SPLS)**

We value Staples at a PO of \$13.50, representing a 9.5x 2012E P/E. This represents a discount to its five-year median of 15x and, in our opinion, reflects continuing macro challenges and a lack of near-term catalysts. Barring an unlikely improvement in the macro, we think near-term upside is limited as earnings and multiples will be under pressure. Upside risks are higher levels of employment, further synergies resulting from Corporate Express, better-than-expected

performance in Europe and faster-than-expected growth in high-margin services. Downside risks are budget cuts, continued high unemployment, further deterioration in the small-to-medium customer base, worse-than-expected macro or currency weakness in Europe and slower-than-expected take-up of services. Also, if the Corporate Express integration proves less effective longer-term than planned, Staples will be negatively affected. Changes in the competitive landscape, given restructuring at its two big box competitors, could also impact the shares.

### **The Home Depot, Inc. (HD)**

Our 12-month price objective of \$46 is based on 16.5x our 2012E EPS. Over the past five years, Home Depot shares have traded between approximately 10x and 20x. We believe the shares should trade toward the upper end of this range based on the continued stabilization of industry trends. Downside risks are further weakening in the housing market, deterioration in the competitive landscape, unseasonable weather and poor execution in supply chain upgrades. Upside risks are a noticeable acceleration in the housing market or further acceleration in same-store sales trends.

### **Tractor Supply Company (TSCO)**

The five-year historical trading range is 11-30x, with a median of 18x. Relative to the market, the shares have traded between a 20% discount and a 60% premium to the S&P 500 on a historical basis. Our 12-month price objective of \$80 is based on a multiple of 23x our 2012 EPS estimate. We believe that a multiple at the upper end of the five-year range is warranted, given the company's consistent performance and favorable growth prospects.

Downside risks to our price objective are: an increased slowdown in the housing market, unseasonable weather affecting farmers' business operations, mass merchants or warehouse clubs growing increasingly promotional, consumers trading down from quality pet food to grocery food, unfavorable changes in commodity costs, and unforeseen difficulties with domestic expansion. Upside risks to our price objective are from: traction gained from multiple sales and margin initiatives, a marked reacceleration in the housing market or overall macro environment, better-than-planned cost controls, favorable changes in commodity costs, and improved vendor terms.

### **Vitamin Shoppe, Inc. (VSI)**

Our \$41 PO is based on 22x our 2012E EPS, which is essentially inline with its historical average of 23x. With outsized earnings growth tapering off, we value the company at a premium to the Hardline Retail average for its solid growth potential. VSIs growth prospects and share gain opportunities remain healthy, but with EPS growth forecast to slow to mid-teens in 2012/13, similar to other companies in our universe, we see few near-term catalysts to underpin further multiple expansion. Downside risks to our PO are an increased slowdown in the economy, unfavorable changes in commodity costs, changes in federal or state laws, health-related studies from credible sources that could have negative implications for certain products, supply chain difficulties, changes in the competitive landscape, changes in consumer sentiment, difficulties with new product introduction, and unforeseen difficulties with store expansion. Upside risks to our PO are a materially better macroeconomic environment, more favorable commodity costs, supply chain efficiencies, a stable or easing competitive landscape, relative ease of adaptability for e-commerce strategies, and a smooth progression of store expansion.

### **Williams-Sonoma, Inc. (WSM)**

We value Williams-Sonoma at \$44, representing a 17x 2012E P/E. This valuation is similar to its five-year median P/E multiple of 17x and a premium to the Hardline Retail sector for the company's successful, high-returning DTC strategy. The upside risks to our price objective are: earlier-than-expected success in international, a material improvement in the economic environment or in the housing sector, or further improvements within brand segments, which would also be viewed very positively and thus provide upside to our price objective. Downside risks are a further deterioration of the housing market, an intensified promotional environment, or if same-store sales at emerging brands do not make up for the slower growing maturing concepts.

### **Link to Definitions**

#### **Consumer & Retail**

Click [here](#) for definitions of commonly used terms.

### **Analyst Certification**

I, Denise Chai, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

**US - Retail Hardline Coverage Cluster**

| <b>Investment rating</b> | <b>Company</b>             | <b>BofA Merrill Lynch ticker</b> | <b>Bloomberg symbol</b> | <b>Analyst</b>    |
|--------------------------|----------------------------|----------------------------------|-------------------------|-------------------|
| <b>BUY</b>               |                            |                                  |                         |                   |
|                          | AutoZone Inc.              | AZO                              | AZO US                  | Denise Chai, CFA  |
|                          | Bed Bath & Beyond Inc.     | BBBY                             | BBBY US                 | Denise Chai, CFA  |
|                          | Dollar Tree, Inc.          | DLTR                             | DLTR US                 | Denise Chai, CFA  |
|                          | Family Dollar Stores, Inc. | FDO                              | FDO US                  | Denise Chai, CFA  |
|                          | O'Reilly Automotive, Inc.  | ORLY                             | ORLY US                 | Denise Chai, CFA  |
|                          | PetSmart, Inc.             | PETM                             | PETM US                 | Denise Chai, CFA  |
|                          | Pier 1 Imports Inc.        | PIR                              | PIR US                  | Denise Chai, CFA  |
|                          | The Home Depot, Inc.       | HD                               | HD US                   | Denise Chai, CFA  |
|                          | Tractor Supply Company     | TSCO                             | TSCO US                 | Vincent J. Sinisi |
|                          | Williams-Sonoma, Inc.      | WSM                              | WSM US                  | Denise Chai, CFA  |
| <b>NEUTRAL</b>           |                            |                                  |                         |                   |
|                          | Advance Auto Parts, Inc.   | AAP                              | AAP US                  | Denise Chai, CFA  |
|                          | Lowe's Companies, Inc.     | LOW                              | LOW US                  | Denise Chai, CFA  |
|                          | Vitamin Shoppe, Inc.       | VSI                              | VSI US                  | Denise Chai, CFA  |
| <b>UNDERPERFORM</b>      |                            |                                  |                         |                   |
|                          | Best Buy Co., Inc.         | BBY                              | BBY US                  | Denise Chai, CFA  |
|                          | Office Depot, Inc.         | ODP                              | ODP US                  | Denise Chai, CFA  |
|                          | RadioShack Corp.           | RSH                              | RSH US                  | Denise Chai, CFA  |
|                          | Staples, Inc.              | SPLS                             | SPLS US                 | Denise Chai, CFA  |

## Important Disclosures

### Investment Rating Distribution: Retailing Group (as of 01 Oct 2011)

| Coverage Universe | Count | Percent | Inv. Banking Relationships* | Count | Percent |
|-------------------|-------|---------|-----------------------------|-------|---------|
| Buy               | 100   | 55.56%  | Buy                         | 31    | 32.63%  |
| Neutral           | 43    | 23.89%  | Neutral                     | 16    | 39.02%  |
| Sell              | 37    | 20.56%  | Sell                        | 14    | 40.00%  |

### Investment Rating Distribution: Global Group (as of 01 Oct 2011)

| Coverage Universe | Count | Percent | Inv. Banking Relationships* | Count | Percent |
|-------------------|-------|---------|-----------------------------|-------|---------|
| Buy               | 2073  | 54.13%  | Buy                         | 923   | 49.12%  |
| Neutral           | 961   | 25.09%  | Neutral                     | 460   | 52.57%  |
| Sell              | 796   | 20.78%  | Sell                        | 287   | 38.32%  |

\* Companies in respect of which BofA Merrill Lynch or one of its affiliates has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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| Investment rating | Total return expectation (within 12-month period of date of initial rating) | Ratings dispersion guidelines for coverage cluster* |
|-------------------|-----------------------------------------------------------------------------|-----------------------------------------------------|
| Buy               | ≥ 10%                                                                       | ≤ 70%                                               |
| Neutral           | ≥ 0%                                                                        | ≤ 30%                                               |
| Underperform      | N/A                                                                         | ≥ 20%                                               |

\* Ratings dispersions may vary from time to time where BofA Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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