



# MADISON'S TIMBER PREVIEW

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April 05, 2012

Investment news outlets were abuzz this week with word of a Rona buyout by Lowe's, the world's second-largest home improvement chain. Rona released a statement mid-week denying the rumours, but the company enjoyed a nice bump in share prices nonetheless. Lowe's shares, meanwhile, after taking a dive early in the day, recovered to Tuesday's levels by the end of trading Wednesday.

Rona shares climbed 12 per cent on Tuesday after Lowe's CFO Robert Hull expressed interest in exploring "all options" should Rona be for sale. Rona responded by stating that it does not currently believe a combination with another company is in its best interests, sending the stock lower during Wednesday.

Rona's Tuesday low of \$9.32 rose as high as \$10.48 in TSX trading, then closed at \$10.35 on Wednesday afternoon. By the end of trading Thursday, Rona shares stayed at the \$10.50 level.



Despite Rona's apparent lack of interest, it is nonetheless a positive for shareholders that Lowe's is open to discussing mutually beneficial commercial alternatives for the two companies, according to the *Financial Post*.

Rona, the largest home improvement retailer in Canada, has roughly 840 corporate, franchised, and affiliated stores giving it approximately 18 per cent of total market share. Of its 1,745 stores globally, Lowe's operates 31 Canadian stores.

Robert Hull, who has served as Lowe's chief financial officer since March 2003, said on Tuesday Lowe's online business, which accounted for about 1 per cent of total sales in 2011, could easily account for 5 per cent to 10 per cent of sales in five years. The company, which recently bought online homegoods chain ATG Stores, said there was potential for more acquisitions to boost that business.

Hull also sees opportunity for the retailer to expand further in Canada and have a total of about 100 stores there, up from 31 now, which are mostly in Ontario.

By comparison, Home Depot operates 180 stores in Canada, of its 2,252 total stores. Some analysts believe there is not enough room in Canada for three big box stores to operate successfully.

In its quarterly financial statements, Rona said on February 23 that it was shifting its focus away from big-box stores. The company revealed plans to close 10 big-box stores and convert 13 others into smaller outlets, as part of a new focus smaller concept stores. Twenty of the 23 stores were in Ontario. It operates 22 stores in Quebec.

Rona's same-store sales fell 7.3 per cent in the fiscal year ended December 25, 2011. The retailer said the newer stores would be a third of the larger stores' size, but offer customers better service at a lower cost to shareholders.

Lowe's, meanwhile, after underperforming on same-store sales for 11 straight quarters, is now investing in everything from in-store technology to its online business to win back shoppers from industry leader Home Depot.

In a statement after market close on Tuesday, Rona said combining with another company would not be in the best interests of the company or its stakeholders. Analysts noted Wednesday that Rona has a shareholder rights plan, which are often designed to discourage takeover attempts.

Some investors said late last year that it made sense for the two chains to get together to better fight Home Depot.

Taking the opportunity to capitalize on the hot news item, Scotiabank analyst Anthony Zicha Thursday pegged the chances of the Canadian home improvement retailer receiving a takeover offer from Lowe's Corp at 60 per cent. He also hiked his price target for Rona shares to \$13, from \$10.50

It seems beating Home Depot won't be so easy, whether Rona and Lowe's merge or not.

Analysts at Bank of America/Merrill Lynch said Wednesday they now expect Home Depot shares to reach \$60, suggesting a 20 per cent upside to the stock's Tuesday closing price of \$50, noting that higher sales are driving margin expansion, and the company is buying back more stock as well.

Home Depot shares, which have risen 19 per cent year-to-date, fell 29 cents, or down 0.6 per cent, in premarket trading Wednesday.

Shares of Home Depot have a 2.32 per cent dividend yield, based on Tuesday's closing stock price of \$50.

"The stock has technical support in the \$45 price area. If the shares can firm up, we see overhead resistance around the \$50-\$53 price levels," explained the BoA/Merrill Lynch note.

By market close Thursday, Home Depot shares were up 1.43 per cent over the previous day, from \$49.85 to \$50.62.

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