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BUSINESS OVERVIEW FOR APPLIANCE STORES

Executive Summary

1. **Appliance retailers are suffering the effects of the housing and economic downturn. However, with a breadth of products from large appliances to consumer electronics, savvy retailers are actively adjusting marketing plans to capture market share.**

2. **Independent appliance retailers continue to hold consumer preference by offering superior service and support.**

3. **Consumers are getting more and more serious about energy efficient appliances, providing retailers the opportunity to educate consumers and win share of those actively interested in reducing their energy use.**

4. **Remodels, which drive new appliance purchases, may be down; but consumers are staying in their homes longer and can still recoup 70% of their remodeling investment.**

Executive Summary Point #1

Tough Times Call For Savvy Marketing

About 53,000 appliance stores throughout the U.S. generate over $82 billion in revenue each year. The current economic downturn has significantly impacted business. New and replacement purchases are down—sales of home appliances were down 10% in the first half of 2008 compared to the same period a year ago. For large appliances in particular, consumers tend to hold off on purchasing big ticket items during economic uncertainty. Unless the old one breaks, consumers are waiting. However, independent and chain appliance stores sell a range of goods including consumer electronics and small appliances, as well as the large home appliances.

Throughout the retail industry, discretionary spending is slow. Retail sales (excluding gas, autos, and restaurants) increased just 1.3% during June, year-over year. Overall retail sales fell 0.9% in June, the largest decline since August 2005. Even tax rebate checks did not prompt big purchases. The National Retail Federation reports that consumers were practical with their rebate checks and tended to use them to offset high gas and food prices.

New home sales are down, reducing the market for new appliance purchases. The NAHB forecasts a total of 957,000 homes (single-family and multifamily) will be started during 2008, compared to 1.34 million during 2007.

Existing home sales are also down, decreasing the number of consumers who are customizing a home once they move in. Existing home sales are projected to reach 4.39 million during 2008 compared to 4.96 million during 2007. As consumers stay in their homes, some are updating them. The amount they are spending to update them has declined, however, since home owners have less equity available and they are concerned they will not recoup their investment due to falling home prices.

Consumer electronics (CE) offer a positive note for appliance retailers who include them in their product mix. The CE industry is expected to grow revenues 6.1% during 2008. The rate is lower than during 2007, but it is higher than projected levels in other industries, such as housing and new vehicles.

TVs deliver the largest portion of CE industry revenue with about 16% of CE shipment dollars. TV shipments are expected to increase 13% during 2008. Next generation DVD players are expected to be the next shooting stars for CE. Shipments are expected to explode by 173% during 2008 as consumers take advantage of decreasing DVD-player prices and install high quality theaters.

The average U.S. household spends $1,405 per year on CE products, an increase of $120 from the figure reported during 2007. While men traditionally own more and spend more on CE devices, women are increasingly influencing CE purchases for their households. Women made 45% of all CE purchases during 2007. In general, consumers 45 years and younger, with children, and with higher incomes spend more on CE than the average adult.

What's a retailer to do? Retailers and remodelers interviewed by Pioneer Press report that one option is to increase their marketing budgets. Past experience shows that downturns are a good time to protect and even gain market share.

Best Buy is planning to make their move during the weak economy. They announced a new five-pronged approach to double their sales to $80 billion over the next five years. Among their plans is a strategy to capture more share from competitors in categories in which they are currently weak, most notably appliances and mobile phones.

Incentives are another option—one retailer is offering mid-range customers discounts on several appliances purchased at the same time in order to prompt more spending from consumers who are active in the market.

Finally, continuing focus on the upper-end segment remains important. Sales of high-end brands have not been greatly affected since more affluent customers have not been as impacted by economic conditions.

Executive Summary Point #2

Service Keeps Independents Competitive

***Consumer Reports* 2008 ratings of appliance stores confirm what many independent retailers know—personal service and support make a difference. Independent appliance retailers out-scored all major retailers and manufacturers in the service and support categories in *Consumer Reports'* appliance ratings. Consumers who seek help at independents face far fewer issues with automated voice systems, transfers between associates, and difficulty reaching a technician. Smaller independents won high marks for service and checkout ease.**

Among major retailers, Sears faired better than other major competitors on service and support. Neither Lowe's nor Home Depot won high marks for their support.

In the small appliance category, Amazon.com ranked first for the third year in a row. Consumers like their selection, prices, and free shipping.

Independent owners keep up the fight against big-box retailers by maintaining the tradition of well-trained, specialized salesmen who deliver personal service. Trust, special orders, and taking the time to help individuals keep loyal customers coming back.

Independents are also fighting warehouse sellers by joining buying groups that combine purchasing power from thousands of independents to obtain competitive pricing and better support from the big manufacturers. Nationwide, an appliance buying group supplies more than 6,000 stores around the country, combining $11 billion in collective purchasing power.

Buying groups offer independents advantages, particularly in a difficult economic climate. By storing large orders in community warehouses, independents have access to vast selection and inventory with much more flexibility and lower overhead. Concurrently, their electricity costs and other overhead remain lower since their stores are smaller than big box retailers.

As consumers become more knowledgeable that independents offer competitive pricing with better selection and superior service, independents have a strong position to compete with large format retailers.

Executive Summary Point #3

Focus On Energy Efficiency

Consumers are more interested in saving energy than ever. Energy Star appliances are one well-publicized solution for consumers looking to protect the environment and reduce their energy costs.

Best Buy, which won the 2008 Energy Star Excellence in Appliance Retailing Award, reports that consumers are increasingly asking about energy efficiency in the appliances they are evaluating. Best Buy is capitalizing on the trend by offering training programs to educate sales people and customers about energy efficiency.

Eco-consciousness is not limited to appliances. Consumer electronics manufacturers are marketing their environmental consciousness as well. For example, HP announced a new "Eco Solutions" program that includes product labeling highlighting the environmental attributes of the product.

A third of remodelers also indicate they are receiving more requests from homeowners who want to improve the energy efficiency of their homes in the wake of rising energy costs. The National Association of Home Builders' quarterly Remolding Market Index shows 47% of remodelers have installed high-efficiency kitchen appliances in the last few months. Newer energy-saving technologies, such as tankless water heaters, are growing in popularity as well.

The trend is expanding beyond casual consumer interest. Builders are marching to the

energy efficiency drum with a new National Green Building Standard that is in the final stages of review. A new Certified Green Professional designation has proven to be popular since its introduction in early 2008. The certification is available to builders, designers, marketers and other non-NAHB members who take green practices instruction, have industry experience, and adhere to a code of ethics.

The government is further coding energy efficiency into consumers' way of life. President Bush signed a new law in December, the Energy Independence and Security Act of 2007, including historic changes that will significantly increase energy efficiency. The Association of Home Appliance Manufacturers supported the bill, which includes energy efficiency standards and water limit requirements for several major home appliances.

Executive Summary Point #4

Remodeling Market Still Delivers Returns

Remodeling drives the purchase of new appliances, particularly kitchen remodels. Overall, the remodeling market is down, though certain segments and regions are performing better than others.

Remodeling volume fell about 4% during 2007 and a 7% decline is expected during 2008, according to the National Association of Home Builders. Improvements are suffering the most, with a 5% fall in 2007 and another 11% slide expected for 2008. Maintenance and repair spending was down only 1% in 2007 and is expected to grow in 2008 and 2009. Long term, the NAHB expects business to pick up strongly once the current economic climate has passed.

Geographically, areas where home prices have not fallen steeply are more likely to see higher amounts of remodeling. The Midwest is in better condition to see an uptick, particularly around Columbus Ohio, Cleveland, Indianapolis, and Milwaukee. Metro areas expected to be stable during 2008 are Boston, Buffalo, NY, New York City, and Oklahoma City. Oil-based areas in Texas and several other metro areas where home prices have been steady are also expected to host more remodeling. The markets with the lowest remodeling activity are those where housing prices have fallen the most, California and Florida.

The size of remodeling projects has been affected by the housing market as well. Mid-range projects are showing a better payback than upscale projects, reports the NAHB. Today, homeowners still see about 70% return on their remodeling investment, compared to 80% during 2003-2005. Replacement projects, such as windows and siding, are holding their value more than discretionary projects.

Outdoor buildings and outdoor living spaces continue to be popular, particularly in the Southwest. Green remodeling and aging-in place remodels are also seeing relative growth as well.

Sources: *Appliance Magazine*, 1/10/08, 1/14/08, 2/19/08, 4/2/08, 4/28/08, 5/29/08, 7/7/08, 7/8/08; *Bucks County Courier Times*, 7/20/08; Bureau of Labor Statistics, 2007 Quarter Census of Employment and Wages; *Consumer Reports*, 8/08; National Association of Home Builders, 5/12/08, 6/25/08, 7/8/08; National Retail Federation, 7/15/08; Pioneer Press, Twincities.com, 7/18/08; *USA Today*, 7/13/07; US Bureau of the Census, 2002 Economic Data; *Wall Street Journal*, 7/10/08.

Updated: 07/08

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