

Northern California Hardware Store



Client Number: 0818

Issue Number: _____

Presented To:

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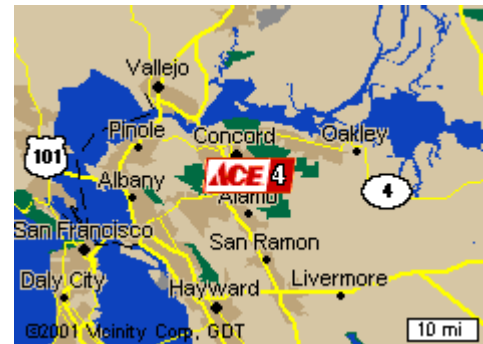
EXECUTIVE SUMMARY



Company Description

1000 Oaks ACE Hardware, Inc. is an ACE hardware franchisee located in Walnut Creek, California—a relatively densely populated (65,000) and affluent (median income: \$46,000) suburb of San Francisco. The store has been under its current ownership, a husband and wife team since 1981.

Formed as an S Corporation, **1000 Oaks ACE Hardware** realized a Gross Profit of \$891,000 in 2001 on a total income of \$2.2 million. Total Assets are \$1.12M of which 68% is current inventory.



The company, which has been in existence since 1960, has owned a variety of retail hardware stores over the years in the East Bay. All stores have always enjoyed an excellent local reputation even before the current owners took over and moved to the existing location in 1981. The facility is approximately 6,600 square feet (plus 2,000 square feet of covered side yard) and is packed neatly to the ceiling with the full range of home improvement, do-it-yourself, general hardware products one would expect of a full service local hardware store:

- ◆ Paint and Painting Supplies
- ◆ Plumbing Tools, Fixtures, and Equipment
- ◆ Electrical Tools, Fixtures, and Equipment
- ◆ Automotive Tools and Supplies
- ◆ Housewares
- ◆ Fasteners
- ◆ Gardening Tools, Equipment and Supplies
- ◆ Tools and General Hardware.

1000 Oaks ACE Hardware achieved sales of \$293/sq.ft. in of 2001, 57% higher than the average retail hardware store.

The company is composed of the 2 owners and 16 employees (6 full-time, 10 part-time). The hours of operation are Monday-Saturday 8am-6pm and Sunday 9am-5pm. The two owners combined spend approximately 60 hours/week in the business.



As an ACE franchisee, **1000 Oaks ACE Hardware** enjoys the significant benefit of the ACE national advertising campaign (currently featuring John Madden), along with all of the identity programs generated by the corporation. ACE, of course, also provides greatly increased purchasing power and passes these savings along to its franchisees. **1000 Oaks ACE Hardware** purchases approximately 80% of its inventory from ACE. Importantly, the ACE corporation also distributes “patronage dividends” to **1000 Oaks ACE Hardware** approximately 8-9 months following the close of business each year. For example, these dividends amounted to approximately \$44,000 in combined cash and stock options for the year 2000.

Obligations of **1000 Oaks ACE Hardware** to ACE include a capital stock subscription, first and careful consideration of ACE merchandise, certain payment and return terms, confidentiality agreements, and certain minimum payments.

The current owners are selling this attractive, popular, and on-going business at a time when they plan to retire. The business is at a point where an increased marketing and sales emphasis on the convenience and high-service segment of the home improvement retail industry—as opposed to the much larger “big box” stores such as Home Depot and the similarly large chains such as OSH—could drive a 50% increase in overall revenue based on the experience of other ACE franchisees.

PRODUCTS AND SERVICES

Product Support

ACE continues to lead the industry with record-breaking service levels to retailers on its 60,000 SKUs of product. Thanks to the combined efforts of the Merchandising and Retail Support teams, unit service levels in 2000 reached an all-time high of 96.2 percent versus 95.6 percent in 1999. That difference in percentage points equates to millions of additional retail sales and thousands of satisfied ACE customers.

To further provide ultimate service to ACE customers, the ACE Merchandising team is developing a “never outs” list on basic SKUs and also has successfully linked the SKU assortment offerings within related retail support center networks. By doing so, retailers now have access to the same product offering in neighboring retail support centers, giving them the opportunity to always be in stock on the products they need.

Another area being developed that will lead to even higher service levels is ACE’s test of a store managed inventory system. Currently being piloted at ACE’s company store in Schaumburg, Ill., ACE’s inventory team orders the weekly product needed in certain categories based on prior sales history. Based on early success, the system will be expanded to include additional departments, and the performance, cost savings and all-around efficiencies gained will be benchmarked and shared with all retailers.

To help retailers generate add-on retail sales, ACE launched the new impulse sales program in 2000. Developed through extensive analysis of point-of-sale information, the program features integrated end cap inventory, related sidewinder merchandise and add-on clip strip inventory designed to improve retailers’ average ticket sales.

Retailers also can get an edge on the competition by offering their customers a wide array of ACE Brand products. The 8,200 ACE Brand SKUs offer customers a high-quality, cost-competitive alternative to national brands. Following extensive market research, coupled with retailer and vendor feedback, an enhanced ACE Brand packaging was unveiled in 2000 that features an enlarged ACE logo, color coding for quicker category identification, Preferred, Premium and Professional bands to identify different quality levels and an ACE Promise of Satisfaction Guarantee logo. ACE also aired its first ACE Brand infomercial in 2000 for the unique ACE Brand 51-piece

GearWrench +Plus wrench and ratchet set, available exclusively at ACE Hardware.

The one line of ACE Brand products manufactured by ACE is ACE Paint. ACE Paint's two manufacturing facilities, located in Matteson and Chicago Heights, Ill., combined can produce up to 20 million gallons of paint annually.

In 2000, the ACE Paint Division completed the launch of the Illuminations Color Palette and further refined more than 75 percent of the paint formulas to improve overall quality. To provide better support to ACE retailers, the ACE Paint Technical Service department is now open seven days a week, 10 hours a day, 362 days a year.

Customer Experience

One of the primary goals of ACE's Vision 21 strategy is to provide an exceptional shopping experience to ACE customers. To develop proven, one-on-one relationships with existing customers, and encourage generations of all ages to shop ACE, a number of initiatives are well underway to continue to make ACE "the place" for decades to come.

ACE's company-owned Solutions Concept Stores in Longview, Wash., and Highlands Ranch, Colo., are testing grounds for merchandising ideas, décor and layout ideas. Each store spans approximately 30,000 sq. ft. and caters to both female and male shoppers with unique product displays, how-to information, a multimedia resource center and an exceptionally trained sales team committed to accommodate any customer service request. These stores take customer convenience to the next level by displaying merchandise based on consumer use rather than by product type.

Programs being rolled out and tested at the Solutions Concept Stores, as well as other ACE stores throughout the country, include the ACE Gift Card and ACE Credit Card. More than 3,000 ACE retailers currently have the ability to accept the ACE Gift Card, while 60 pilot stores are actively marketing and selling the cards. In addition, more than 2,000 retailers offer their customers the benefits of the ACE Credit Card, including special pricing promotions on large ticket items.

To further leverage ACE retailers' relationships with its best customers, the Helpful Hardware Club now encompasses more than 1.4 million members. Offered by approximately 750 ACE stores, the Helpful Hardware Club provides customers with many benefits, including quarterly rewards certificates based on

purchases, national coupon book promotions, as well as a free subscription to ACE homeplace, ACE's quarterly consumer magazine launched in spring 2000 that is filled with helpful home improvement tips and advice.

Retailers who offer the Helpful Hardware Club are reaping the rewards, too. The average transaction of Helpful Hardware Club retailers is significantly higher than non-participating stores' average ticket sales. Moreover, special promotions are helping to further drive in-store traffic. The average response rate of targeted campaign promotions is 15 percent, as compared to typical mass marketing campaigns that tend to have an average return rate of 1.5 percent. For ACE Contractor Centers, the ACE Contractor Club is being rolled out to give contractor members points worth one percent of their total purchases. The points will be able to be redeemed for lifestyle merchandise once the contractor has exceeded his or her prior year's purchases with the ACE store.

While retaining current customers is crucial, so is attracting the next generation of shoppers to ACE. That is why ACE has established the ACE Kids Club, which currently includes 10,000 members. More than 250 ACE retailers actively market the program in their stores, providing kids' projects and activities on a regular basis. Children who are members of the ACE Kids Club also receive a special message from ACE on their birthday.

All of ACE's advertising, marketing, interactive marketing and public relations campaigns are integrated to bring one consistent message to customers – ACE is the place for all of their everyday home project needs.

CORPORATE SUPPORT

In 2000, ACE's Retail Operations team was restructured to provide the highest level of support to retailers in Vision 21. As part of the realignment of resources, each territory geographically was reduced in size and many of the administrative tasks were alleviated so that ACE's entire field team can now spend 100 percent of its time focusing on driving retail sales and profits.

The Retail Operations team's sole responsibility is to execute the four Vision 21 cornerstones: improving retailers' sales and profits; streamlining processes to gain efficiencies; unifying the ACE Team to move in the same direction; and providing ultimate satisfaction to customers each and every time they shop ACE. To accomplish these cornerstones, each member of the field team is empowered to focus on the five Vision 21 business drivers, which include entrepreneurship, category management (Discovery), retail pricing performance, customer relationship management (Helpful Hardware Club) and people resources (training).

The new organization is divided into four divisions: East, Gulf Coast, Midwest and West. Included in the divisions are a total of 24 regions, with six regional managers (formerly retail sales managers) who are empowered to coach and train, as well as lend their expertise at retail. The regional managers are closely linked with their team of retail business managers (formerly retail consultants) to work one-on-one with the retailers in the territory to develop and implement growth plans, manage ACE's retail performance, facilitate retail success initiatives and ensure each store remains at its highest level of competitiveness in the marketplace.

Each regional team also includes one or two new business managers (formerly market development managers) to develop new opportunities in open markets for the company, as well as a retail development manager (formerly project manager). This new Retail Operations team structure has been designed to align all resources with Vision 21 and to be focused on retail – not wholesale – initiatives. Above all, they are action-oriented and empowered to make things happen.

Moreover, each division now has a retail specialist team, headed by a retail assistance manager, that includes the visual merchandisers, Discovery implementation specialists, store planners, performance training consultants and Helpful Hardware Club, financial and real estate specialists. This team of

specialists is on hand to set into action the initiatives developed in the growth plans.

The Retail Operations teams are now headquartered out of the four divisional offices located in Raleigh, NC, Atlanta, GA, Kansas City, MO, and Denver, CO. Retailers who have questions for their field team should no longer call their retail support center, but rather contact their appropriate divisional office.

The backbone of ACE Hardware is its extensive retail support network, complete with 16 retail support centers (RSCs) throughout North America, including two in Canada. ACE's state-of-the-art RSCs operate seven days a week, 362 days a year, receiving and warehousing shipments of products from thousands of manufacturers. The products are then sorted to fill customized orders received from retailers and shipped to ACE stores. Each center utilizes the latest technology to ensure accuracy of order filling and delivery, which has helped contribute to ACE's industry-leading service levels.

ACE added to its distribution power in 2000 by opening a new 800,000 sq. ft. retail support center in Loxley, Ala., to service 325 ACE retailers in the Gulf Coast region. The grand opening event, called the ACE Loxley RSC Kickoff – Southern Hospitality II, ranked among the region's largest tailgate parties with complimentary food and beverages, marching bands, contests, prizes and an autograph session with Alabama football legend Ken Stabler. More than 4,000 Loxley residents, area ACE retailers and community officials received a first-hand look at the distribution facility by taking walking tours of the center, which features 30,000 sq. ft. of office space, 80 dock doors and 40-foot-high ceilings.

The Loxley facility is also ACE's first retail support center to feature an innovative layout that replicates an ACE retail store – with “departments” like paint and sundries and lawn and garden. This arrangement facilitates the containerization process since merchandise is organized by category, and saves ACE retailers time in unloading the products at their store. All of ACE's retail support centers will be transformed to this kind of lifestyle format in the future to keep all members of the ACE team focused on the company's primary objective – retail.

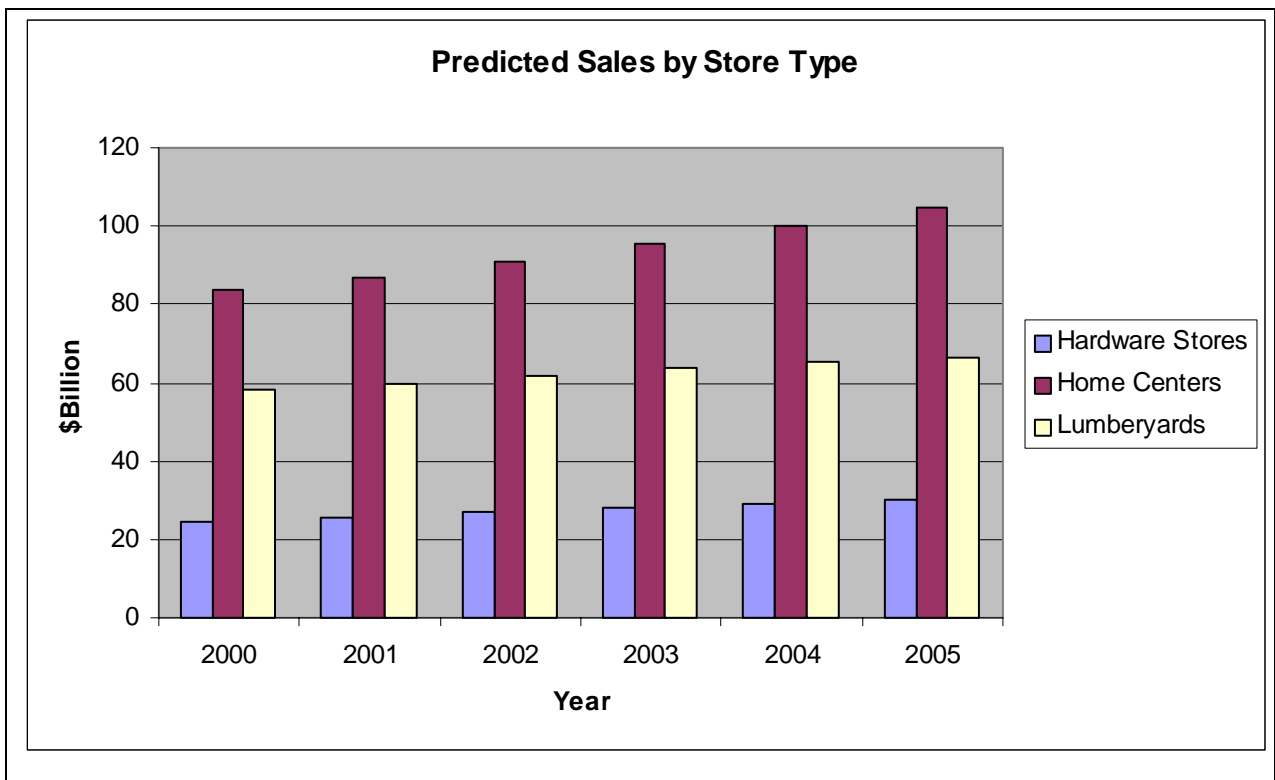
To provide even better service to more than 300 retailers in the mid-Atlantic states, ACE also broke ground in August 2000 for a new 778,000 sq. ft. facility in Prince George, Va. Situated on a 155.4-acre plot of land, the Prince George RSC will house an estimated \$40 million in inventory (approximately 60,000

SKUs) and have 30,000 sq. ft. of office space, 85 dock doors and 40-foot-high ceilings. The center is scheduled to begin shipping to retailers in September 2001.

In 2000, ACE also announced plans to expand its La Crosse, Wis., facility by more than 50 percent in response to growing sales and an increasing number of ACE retailers in the upper Midwest region. The 200,000 sq. ft. addition will bring the La Crosse facility's total square footage to an estimated 550,000 sq. ft. The expansion project, targeted for completion in mid-2001, will add as many as 40 employees to the work force over the next two years.

Additional strides were made throughout ACE's retail support network in 2000 to accomplish a zero tolerance goal for errors. The new outbound scanning process is improving the way product moves from ACE's vendors through the RSCs to stores nationwide. The primary objective is to bring merchandise to ACE stores in a way that assures delivery of the right order in the right form at the right place and on time, every time.

INDUSTRY OVERVIEW



ECONOMIC SLOWDOWN DOESN'T HURT D-I-Y SALES

It is difficult to predict the short-term and long-term effects of the terrorist attacks. While the economy had been turning the corner before the events of Sept. 11, it now looks like the expected recovery will not take place until 2002. However, Americans are probably more likely to spend money on their homes than on a new auto or a vacation. The National Retail Hardware Association is predicting sales for 2001 will increase nearly 3 percent and rise another 3 percent to 4 percent next year.

The remarkably resilient housing industry has been one of the few bright spots in the economy. Sales of existing homes set a record in August, although they slowed somewhat afterward. A prolonged period of low interest rates has helped drive the housing market to near-record levels. Furthermore, the National Association of Home Builders is predicting demand for new housing at 1.8 million units a year for the next decade, which compares to 1.6 million housing starts a year during the 1990s.

HIGH-PERFORMANCE RETAILERS BREAK FROM PACK

Home improvement retailers of all sizes continue to post strong sales and profits, even as the economy has cooled. However, the industry's slowing

growth rate has placed more pressure on smaller stores to improve their performance. High-performance hardware stores, home centers and lumberyards are well positioned to weather any short-term business slowdowns, but their under performing counterparts are in jeopardy.

The financial struggles of TruServ Corp. have led other distributors to make an aggressive play for the top-tier True Value retailers. Across the industry, there has been a general increase in the number of dealers who are considering switching suppliers. While top retailers are in demand by suppliers, the smaller, low-profit stores find themselves with fewer options. These under performing retailers need to find ways to increase customer traffic to survive in the marketplace, since that is one of the biggest areas of difference between their financial performance and that of high-profit stores.

RANKS OF THE PUBLICLY TRADED SHRINK

Last year's Market Measure report contained detailed financial information for nine publicly traded home improvement retailers. Since that time, two of the chains—Payless Cashways and D.I.Y. Home Warehouse—have gone out of business. In addition, HomeBase has essentially shifted focus away from the hardlines industry with its conversion to a new House2Home home decor concept. National Home Centers, which attracted little interest in the financial community, has now gone private. These moves are the latest steps in the consolidation of the retail segment of our industry and do not denote an industry-wide weakness. Home Depot and Lowe's are the only publicly traded retailers that posted strong results in 2000, as all publicly traded retailers were affected by depressed lumber prices.

INTERNET ATTENTION TURNS TO ONLINE MARKETPLACES

Internet-only retailers did not find their pot of gold in the home improvement arena, and it remains to be seen whether traditional retailers will see meaningful results from their online selling efforts either. However, the Internet remains full of promise and opportunity for those companies willing to experiment. Online marketplaces and industry portals are where the next wave of activity will be concentrated, as these technology applications offer real potential to reduce costs and increase efficiencies up and down the channel.

Retail Store Performance

While hardware stores of all sizes continue to generate strong earnings, it is becoming harder for many smaller format stores to post profits. And this development continues to raise questions. Perhaps more importantly, what is

the potential impact their closings could have on the home improvement retailing industry?

First, it should be noted that the majority of hardware stores remain profitable and many are posting record profits. While the typical store earned a return on investment of more than 5 percent, the top quartile of hardware stores posted a return on net worth of more than 20 percent last year.

If this is the case, what's the typical profile of an under performing hardware store and what financial constraints does it face? Simply stated, many of these hardware stores are too small to survive in today's market.

Many of the least profitable stores generate under \$500,000 in annual sales and average only 4,000 square feet of selling floor space. While these smaller stores are able to control variable costs, they lack the sales to adequately cover the fixed costs of operating their businesses.

For example, they can keep their payroll expense in line with their sales by paying lower wages. But many other expenses, such as telephone charges and insurance premiums, are too high for the amount of sales dollars they generate.

One of the most important factors in generating hardware store profits is a retailer's ability to drive sales increases. The typical smaller store lacks that ability; most reported a sales decline last year. Coupled with rising expenses, the typical small store posted a loss from its retail operations in 2000. Except for small, under performing stores, most hardware stores could weather a downturn in the economy. At the other end of the spectrum, the top-performing hardware stores generated a 4 percent sales increase in 2000.

Using standard break-even analysis, the majority of hardware stores could lose between 5 percent and 10 percent of their business and still remain profitable. As a result, the hardware store segment as a whole remains healthy.

Small stores represent fewer than 15 percent of the hardware retailers who responded to the National Retail Hardware Association's (NRHA) annual Cost of Doing Business Study. This low percentage suggests that these stores represent fewer than 5 percent of all independent home improvement stores and less than 1 percent of their sales.

Many of these smaller stores have strong balance sheets that could maintain the business for some time or allow for investments to expand the business.

All of these numbers come from the Cost of Doing Business Study, which is based on the income statements, balance sheets and operating data provided by 700 hardware stores, home centers and lumberyards. This report, which is prepared by the Profit Planning Group, also shows that the industry's top-performing retailers have the potential to significantly grow their businesses.

For example, high-profit hardware stores, home centers and lumberyards posted growth potential indexes of more than 20 percent. This number means these stores can increase sales by at least this much by using only internally generated funds.

Other than sales growth, what factors are driving these stores' profits? The Profit Planning Group points out that high-profit stores seldom perform bet-all critical profit variables. However, one of the most common attributes they share is strong sales per square foot. The average hardware store has sales per square foot of \$127, while the typical high-profit store generates \$165 per square foot. High-profit home centers post sales of \$413 per square foot, nearly 50 percent higher than the average home center.

1000 Oaks ACE Hardware boasts sales of \$293/sq.ft. as of 2001, 57% higher than the average.

The major factor driving this higher sales performance is not average transaction size. Rather, it is customer traffic. Both typical and high-profit hardware stores generate an average transaction of \$14. But a high-profit store pulls in 15 percent more customers annually. High-profit home centers draw nearly 20 percent more customers annually than the typical store.

The most successful hardware stores and home centers annually generate more than 12 and 10 transactions per square foot, respectively. Most retailers should be targeting that goal.

SALES AND MARKETING

Competition

Major competitors within a five-mile radius include:

Orchard Supply Hardware Concord

Yardbirds Concord

Home Depot Concord

Piedmont Lumber Walnut Creek

Management indicates that the Big Box competition has actually added sales, as the customer who wants personalized service—where someone knows your name—will only go to 1000 Oaks ACE Hardware.

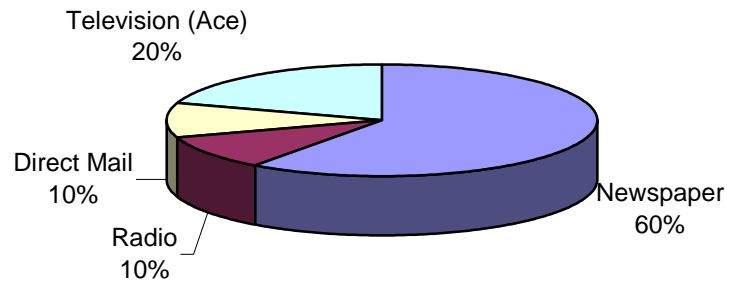
Customer Base

The current customer base is measured as follows:

- ◆ 40% Female, 60% Male
- ◆ Majority are Homeowners
- ◆ Ages from 30-60
- ◆ Higher Income
- ◆ Convenience-oriented
- ◆ A 3-mile radius around the store includes the Cities of Walnut Creek, Pleasant Hill, and Concord. The population within that radius is estimated at 20,000
- ◆ Traffic Counts: Ygnacio Valley 33,800/day east of Oak Grove, 56,300/day west of Oak Grove. Oak Grove 20,800 northbound, 14,300 southbound
- ◆ A 300 home residential development 1.5 miles away is expected to be completed within the year

Promotions and Advertising

Advertising Budget: \$15,500



PERSONNEL

<i>Number</i>	<i>Titles</i>	<i>Annualized Salary</i>	<i>Job Duties</i>
1	President/Owner	\$60,000	Ordering, Stocking, Customer Service, Computer Updates, Pricing Updates, Employee Management, Some Bookkeeping, Cashiering
1	Treasurer/Owner	\$60,000	As above, along with most of the bookkeeping (deposits, sales tax, payroll)
1	Manager	\$30,000	Employee Management, Cashiering, Ordering, Customer Service, some Computer work
5	Stock Clerks/Part-time cashiers		Cashiering, Stocking, Customer Service
10	Floor salespeople		Customer Service, Stocking, Cashiering, Computer Inventory Updates

FACILITY

Lease Details

Current Monthly Rent	\$10,665
Commenced	1/14/1994
Terminates	8/31/2004
Option to Renew	5 years at fair market rent
Premises	6,545 sq. ft. plus 2,000 additional exterior currently provided at no additional charge
Percentage Rent	3% of Gross Sales
Monthly Promotional Fund Charge	\$75
Security Deposit	\$700



EQUIPMENT LIST

- ◆ three PACE smart station cash registers
- ◆ three Okidata invoice printers
- ◆ four battery backup supplies
- ◆ three credit card machines
- ◆ three check guarantee machines
- ◆ two copy machines
- ◆ five back room PACE computers
- ◆ two symbol units
- ◆ one ACE color match computer w/printers
- ◆ two Harbil paint shakers
- ◆ three ATM approval machines
- ◆ two kd50 key cutting machines
- ◆ two paint colorant dispensers
- ◆ Panasonic phone system
- ◆ one five tier nail bin
- ◆ one ten tier screw bin
- ◆ one laser jet printer
- ◆ one fax machine
- ◆ two safes
- ◆ two file cabinets
- ◆ two desks
- ◆ three flat bed dollies
- ◆ two hand trucks
- ◆ one pallet jack
- ◆ one open sign
- ◆ two scales
- ◆ one wire counter
- ◆ one rekey kit for locks
- ◆ one chain saw sharpener
- ◆ one glass cutting machine
- ◆ approx 150 4' by 8' tall lozier store fixtures in current ACE colors
- ◆ approx 32 3' by 6' tall lozier store fixtures in current ACE colors
- ◆ approx 23 sections of locked glass cabinets
- ◆ one Laminator