

Management Discussion & Analysis

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1. CORE BUSINESS AND STRATEGY

Core Business

Hardware & Lumber Limited is a Jamaican company retailing and wholesaling building materials, home improvement supplies, household items and agricultural products. The Company also offers residential and commercial construction services.

Our parent company, GraceKennedy Limited, is one of the Caribbean's largest and most dynamic groups. Headquartered in Jamaica, the group now has interests in the United Kingdom, North and Central America and the Caribbean and it is listed on the stock exchanges of Jamaica and Trinidad and Tobago.

Our Mission

"Hardware & Lumber Limited is committed to improving people's lives by providing agricultural, building and lifestyle solutions".

Our Vision

"We will maximize shareholder value over the long-term, by satisfying the agricultural, building and home improvement needs of our customers. We are dedicated to delivering quality, choice and convenience – and that depends on us having great people with the right skills, necessary tools, and shared vision."

Our Core Values

1. Our word is our bond
2. The promise that is kept
3. Ethics and integrity
4. Respect and consideration
5. Commitment and openness

Our core values are paramount in the execution of strategy.

Strategy and Key Performance Drivers

Hardware & Lumber Limited utilises the Balanced Scorecard (BSC) system in tracking and assessing performance which is cascaded to all divisions and departments. Areas of focus include financial performance, customer centricity, efficiency of internal processes and the fostering of learning and growth of our people. Key financial indicators include net profit, net free cash flow and return on equity while non-financial indicators include customer satisfaction, brand recognition, audit ratings, employee satisfaction and performance assessment of our team members.

Using the BSC Strategy Map we have established strategic initiatives in each area to drive and track performance. All initiatives are specific, measurable and time based. All team members have quantifiable objectives that are directly linked to one or more initiatives. This ensures that individual and team performance will lead to the achievement of the financial and non-financial goals of the company.

We are also ensuring that our team members are being trained in the skills and provided with the tools that are necessary to perform their roles well.

Employee and customer satisfaction are routinely measured and initiatives are identified and implemented to improve overall scores.

The company also utilizes a single Enterprise Resource Planning (ERP) software platform to manage and record all transactions. Information from the platform is used for the continuous evaluation of performance in each of our core sectors to make changes to the business and/or the business model to ensure we are always relevant to the markets we serve.

Our Brands:

Our company operates with three distinct brands, as well as the Company brand of H&L. these are as shown below:



We operate twelve hardware retail outlets across Jamaica



We operate five retail agricultural outlets across Jamaica



We operate with an island-wide sales team supplying resellers, contractors and major projects.

2. FINANCIAL PERFORMANCE

Financial Summary

All figures J\$ millions	2010	2009	Change
Revenues	5,729	5,941	(212)
Net Profit/(Loss)	19	(226)	245
Cash and cash equivalents	93	7	86
Shareholders Equity	952	904	48

In 2010 revenues of \$5,729 million represent a decline of 3.6% compared to the \$5,941 million earned in 2009. In spite of the decline in sales, the Company generated net profit of \$19 million compared to a net loss of \$226 million in 2009. Cash and cash equivalents improved by \$86 million, and shareholders equity also improved by \$48 million.

Revenues:

Revenues in 2010 were down 3.6% largely due to the general decline in the economy, continuing challenges faced in the Jamaican construction industry and the impact of Tropical Storm Nicole.

Gross Margins:

In 2010 gross margins improved to 26.0% compared to 23.8% in 2009 as a result of a number of factors including: a significant reduction in shrinkage, a reduction in obsolete inventories, improved pricing, Jamaican dollar strength versus the US dollar and reductions in input costs.

Direct and Administrative Expenses:

Expenses declined by 3.3% in 2010 when compared to 2009 as a result of the implementation of several cost reduction and efficiency improvement projects during the year.

Finance Costs:

Finance costs decreased by 42.0% in 2010 compared to 2009 due to significantly lower interest rates following the implementation of the Jamaican Debt Exchange program in the first quarter, and foreign exchange gains resulting from the appreciation in the Jamaican dollar.

Segment Performance and Developments

The Company is comprised of three main operating divisions:

- Wholesale of hardware and building products (“H&L Wholesale”)
- Retail of household and hardware products (“Rapid True Value”)
- Retail and wholesale of agricultural products and equipment (“AgroGrace”)

Segment operating and financial performance is detailed in Note 5 of the Financial Statement.

H&L Wholesale

The Wholesale and Special Projects Division showed a significant decrease in revenues of 20% when compared to 2009 largely due to the continued postponement of major hotel and housing construction projects across the island. However, improved product availability in the last quarter of the year enabled the division to improve customer satisfaction and revenues. With improved supplies of key products, we are well positioned to participate in many of the housing and construction projects scheduled to start in 2011.

Rapid True Value

Revenue generated by the Retail Division declined by a marginal 1.2% relative to the prior year against the continued decline in construction and home improvement activities. In response to the decline in available business, efforts were focused on improving customer service, product availability and in-store merchandising which began to yield results in the second half of the year. In particular, the revamping of our flagship Lane Plaza store in Kingston yielded significant improvements in terms of customer count and basket size in the last quarter. Plans for 2011 include the revamping of additional outlets to better serve our customers, continued improvement in product availability and choice, along with improvements in customer service and product knowledge.

Marketing initiatives undertaken during 2010 were focused on promoting Rapid True Value as an excellent source for consumer home improvement and construction needs.

Throughout 2010, RTV continued to benefit from being agents for GraceKennedy Money Services Ltd. offering Western Union ® Remittances and Bill Express ® services in our Lane, Mandeville, Ocho Rios and Montego Bay outlets. We added FX Trader ® services in the last quarter. We believe that the patrons of these services shop at Rapid True Value.

AgroGrace

Revenue generated by the Agro Grace Division increased by 4.5% when compared to 2009. Agro Grace continues to hold a very strong position in the market as a result of its wide product range, availability and excellent customer service. Larger acreages in production were offset by severe drought conditions for the first 4 months, followed by an unusually wet Summer, then severe flooding from tropical storm Nicole in September.

The vegetable sector continues to be the main contributor to revenues, particularly in the delivery of vegetable seeds and pesticides..

We continued to have a high level of activity in the field in terms of testing, demonstrations and development of new products and the training of various farming groups. We expect 2011 to be a satisfactory year for the division, with several new products to be launched.

Financial Position

Total assets decreased marginally by 0.13% to \$2,984 million compared to \$2,988 million in 2009. The significant movements were an increase in prepayments and other receivables of \$99 million, offset by a decrease in retirement benefits of \$79 million.

Shareholders' Equity

Shareholders' equity at the end of 2010 was up 5.3% to \$951 million compared with \$904 million at the end of the prior year. The increase is due to net profit and revaluation gain on land and buildings.

Dividends

No dividends were paid in 2009 or 2010.

Stock Performance

The company's stock price increased from \$3.50 per share on January 4, 2010 to \$4.65 on December 31, 2010.

The market capitalization at the end of 2010 stood at \$376 million.

Capital Investment

Capital expenditure for the year totalled \$50.8 million, compared to \$31.6 million in 2009. Refurbishing of the stores, computer software, computer and office equipment were the main expenditures.

3. EMPOWERED PEOPLE: LEADERSHIP DEVELOPMENT & EMPLOYEE ENGAGEMENT

We are firm believers that our people are our greatest asset and accordingly focus is placed on four (4) major areas:

1. Ensuring continuity of leadership
2. Developing effective leaders
3. Protecting our people
4. Developing staff at all levels

Leadership Development

We continue to participate in the GraceKennedy Supervisory Development and Executive Development Programs. The goal is to develop the next generation of leaders, through a series of customised supervisory and leadership development interventions, which will be critical to our continued success. Our aim continues to be to develop ethical and high performing leaders who embody the characteristics and values of the GraceKennedy Group.

Employee Engagement

The past three years have been difficult for all of our employees. This has been reflected in a decline in our Employee Satisfaction Index (ESI) from 2007 to 2009. However, we have seen significant improvement in our ESI score for 2010, due to the implementation of initiatives aimed at addressing areas of concern to our team members. Work will continue in 2011 to further improve our employee satisfaction.

Improved communications, increased employee involvement and support for social activities continued in 2010. Using the GraceKennedy Employee Assistance Programme (EAP), we continue to encourage our employees to consult with our group counsellors, and accommodate immediate relatives where necessary.

The GraceKennedy Career Centre website was also launched during the year, providing a reference point for information and resources on career development that assists our employees with career planning within or outside of GraceKennedy Limited.

Board and Management Transitions

Ms Grace Silvera and Mrs Andrea Coy were appointed Directors on July 26. Mr Joe Taffe resigned as a Director on February 14, 2011, and Mrs Grace Burnett was appointed as a Director on the same date. Mr Dave Myrie resigned from the Company, effective March 31, 2011.

We would like to thank Mr Taffe and Mr Myrie for their significant contributions during their years of service to the Company.

Corporate oversight of Hardware & Lumber continues to be part of the portfolio of GraceKennedy Group Chief Operating Officer, Mr Don Wehby.

4. RISK MANAGEMENT & INTERNAL CONTROLS

Hardware & Lumber's activities expose it to a variety of risks and these activities involve the analysis, evaluation, acceptance and management of a combination of risks. Operational risks are an inevitable consequence of being in business. The company's aim is therefore to achieve an appropriate balance between risk and return and minimize potential adverse effects on financial performance.

Risk management policies are designed to identify and analyze these risks, to set appropriate risk limits and controls, and to monitor the risks and adherence to limits by means of reliable and up-to-date information systems. The company regularly reviews its risk management policies and systems to reflect changes in markets, products and emerging best practices.

The Board of Directors is ultimately responsible for the establishment and oversight of the risk management framework. It provides policies for overall risk management, as well as principles and procedures covering the specific areas of risk. The more important risks are credit risk, liquidity risk, market risk and other operational risks. Market risk includes currency risk and interest rate risk.

Credit Risk

Refer to Note 3a of the audited financial statements.

Liquidity Risk

Refer to Note 3b of the audited financial statements.

Market Risk (including Currency Risk, Interest Rate Risk)

Refer to Note 3c of the audited financial statements for both Currency and Interest Rate Risk.

Committee of Sponsoring Organisations of the Treadway Commission (COSO) Update

Hardware & Lumber continued the rollout of the COSO programme which began in 2008. This programme aims to establish awareness and a consistent set of proactive risk and control practices throughout the GraceKennedy Group through the implementation of a formal risk assessment process, documented policies and procedures, documented training and communication plans, a rigorous self-assessment process and an effective monitoring process.

The GraceKennedy Group has established a review of business processes to the targeted stage of the COSO programme which is scheduled for verification by Group Internal Audit in 2011. All subsidiary companies are required to comply with a set of procedures including the existence of controls for the top ten business risks, established from the wider risk analysis in the Balanced Scorecard (BSC) programme.

As part of the COSO programme it is required that:

- The head of each business/subsidiary company along with their first line reports take full responsibility for the company's risk appetite and risk mitigation strategies.
- Each identified risk has an appropriate control, an owner and a projected date to reduce the risk to an acceptable level.
- Exception reporting is done for controls that do not exist, including identifying an owner and a date for implementing the control.
- At least a quarterly review of risk movements and a revision of the controls that have not functioned as intended is completed.

Internal Controls & Business Processes Review

During the latter part of 2009 GraceKennedy retained the services of an international advisory firm to carry out a review of internal controls, risk management and governance processes. Hardware & Lumber completed this review in 2010, and has implemented the recommendations. This has strengthened the internal controls, risk management and governance processes in the Company. Substantial improvements in our customer service, product availability, and store environment were also achieved.

The company is committed to maintaining a safe environment for our customers and associates and protecting the environment of the communities in which we do business. Our Environmental, Health and Safety (EH&S) continues to be deployed across all of our operations, with team members at each location having been trained on the execution of the EH&S programs. We have also successfully renewed our permit to operate our sufferance wharf at New Port East.

Hardware & Lumber is committed to conducting business in an environmentally responsible manner. This commitment impacts all areas of our business, including store operations, energy usage, supply chain, product selection and delivery of product knowledge to our customers.

Management's Responsibility for Financial Statements

The financial statements presented in this Annual Report are the responsibility of the management of Hardware & Lumber. These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and properly reflect certain estimates and judgments based upon the best available information.

The financial statements of the Company have been audited by PricewaterhouseCoopers ("PwC"), an independent registered public accounting firm. Their accompanying report is based upon an audit conducted in accordance with International Standards on Auditing (ISA).

The Audit Committee of the Board of Directors, consisting solely of independent directors, meets at least four times a year. PwC, the internal auditors and representatives of management are invited to discuss auditing and financial reporting matters. The Audit Committee regularly reviews the internal accounting controls, the reports of PwC and internal auditors and the financial condition of the Company. Both PwC and the internal auditors have free access to the Audit Committee.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2010 based on the framework in Internal Control–Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2010 in providing reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. The effectiveness of our internal control over financial reporting as of December 31, 2010 has been reviewed by PwC, as stated in their report which is included herein.

5. CORPORATE SOCIAL RESPONSIBILITY & SPORTS DEVELOPMENT

Grace & Staff Community Development Foundation

Hardware & Lumber continued to actively participate in the Foundation, which celebrated its 31st Anniversary in 2010. A joint project between GraceKennedy Limited and its employees, the Foundation was established in 1979 to facilitate the development of communities that border our business locations. It primarily provides support for inner city youths who have the academic potential, but are at risk due to social and economic circumstances and supports activities which promote community development. There are many staff volunteers from Hardware & Lumber, who have committed themselves to making a difference in our society, both through Grace & Staff and other church and community organizations.

6. OUTLOOK: 2011 AND BEYOND

Certain statements contained in the Management Discussion & Analysis of Financial Condition and Results of Operations are forward-looking statements that involve risks and uncertainties. The forward-looking statements are not historical facts, but rather are based on current expectations, estimates, assumptions and projections about our industry, business and future financial results. Our actual results could differ materially from the results contemplated by these forward-looking statements due to a number of factors, including those discussed in other sections of this Annual Report.

Despite the continued difficulties and uncertainties in 2010 and the anticipated challenges in 2011, Hardware & Lumber remains committed to its core values and strategy. We will remain focused on making our customers happy, while pursuing innovation, operational efficiency and developing our people. We will continue to refresh our Rapid True Value retail outlets using the Destination True Value model, which has been very successful at our Lane Plaza outlet in Kingston. Continued strengthening of our category management processes will also improve product range and availability to our consumers.

A number of new products and services will be launched in 2011 which are anticipated to add value for new and existing customers. The contribution to profitability from these new initiatives will be dependent on the purchasing power of consumers which at this point in time is being negatively affected by the ongoing recession in Jamaica.

Risk management and internal controls will remain a focus area in 2011, as we continuously strengthen our control systems, utilizing the methodology provided by the international advisory firm contracted in 2009.

The Government of Jamaica in February 2010 took steps to address the country's debt problem by instituting the Jamaica Debt Exchange (JDX) Programme. Hardware & Lumber Limited considers this programme in the best long term interest of shareholders. The JDX Programme has helped to stabilize the exchange rate, and significantly reduced interest rates. We have not yet seen significant increases in investment in construction or agriculture, but there have been numerous announcements of housing projects in which we plan to participate in 2011. We also anticipate improved economic activity due to the restarting of the alumina plants and increased employment related to the Jamaica Development Infrastructural Program.

A material percentage of the company's profits in 2010 originated from firstly, exchange gains based on the revaluation of the Jamaican dollar in 2010 after the JDX, and secondly because of the significantly lower interest rate regime which prevailed after the JDX. If the exchange rate continues to be relatively stable and if interest rates, having been reduced by the JDX continue at these lower levels then it is expected that the Company will benefit from reduced costs which emanated from these two areas in 2010 through 2011.



Simon Roberts - CEO
March 28, 2011



Andrew Kerr - CFO
March 28, 2011