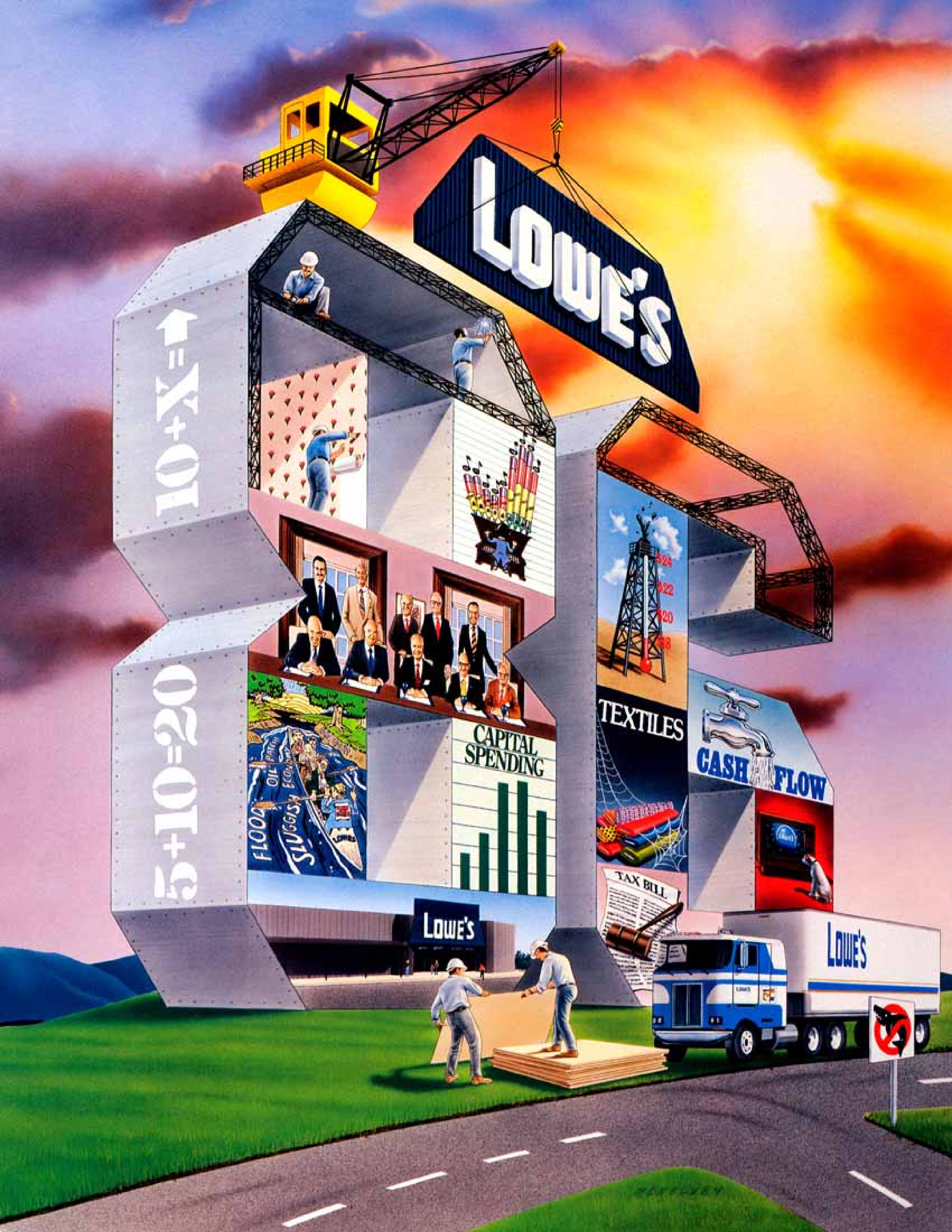
LOWE'S
10+X=↑
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CAPITAL SPENDING
CASH FLOW
FLOOD
OIL
ECONOMY
SLUGGISH
TAX BILL
LOWE'S
LOWE'S

Contents

Financial Highlights

Fiscal years end on January 31 of following year

	Change	Fiscal 1986	Fiscal 1985
Sales	+10%	$2,283,480,000	$2,072,569,000
Net earnings	−13	52,219,000	59,714,000
Cash flow [1]	+ 8	90,743,000	83,859,000
Per share:			
Earnings	−18	1.34	1.64
Cash dividends	+11	.40	.36
At year-end:			
Shareholders' equity	+33	540,534,000	407,373,000
Total assets	+13	$ 969,219,000	$ 856,191,000
Number of stores	+ 6%	300	282

[1] Equivalent to "funds from operations" in the consolidated statements of changes in financial position, before extraordinary item.

Company Profile

Lowe's Companies, Inc. is a specialty retailer, an upscale discounter of building materials and related products for the do-it-yourself (DIY) home improvement and home construction markets.

Lowe's presently operates more than 300 retail stores in 21 states located principally in the South Atlantic and South Central regions of the United States.

Each store functions as a "two-gun store," catering to our dual customer franchise of retail customers and professional contractors, by combining the merchandise, sales, and services of:

- a building materials supplier
- a hard goods discounter
- a hardware store
- a home fashions and interior design center
- a lumber yard
- a heating and cooling, plumbing, and electrical supply center
- a home electronics and appliance dealer
- a lawn and garden center.

Our product assortment, which includes many nationally advertised brands, is counted in stock-keeping units which currently number more than 26,000. Our new stores stock about 15,000 of these. Our average store in 1986 did $7.8 million in sales, of which 55% was to retail customers and 45% to professional contractors.

Our employees numbered 14,783, or an average of 49 per store at the end of 1986.

Lowe's has been a publicly owned company for twenty-five years, since October 10, 1961. Our stock has been listed on the New York Stock Exchange since December 19, 1979; on the Pacific Stock Exchange since January 26, 1981, and on The Stock Exchange (London) since October 6, 1981. Shares are traded under the ticker symbol of LOW.

Lowe's general offices are located in the town of North Wilkesboro in western North Carolina.

Letter to Shareholders

Dear Shareholders:

1986 was supposed to be Lowe's best year ever. It was also the year Halley's Comet was to blaze unforgettably across our firmament in fiery glory.

The comet came and went, but it didn't so much blaze as fizzle, and that's about what happened to our earnings. We had based our expectations on the best available forecasts for the economy, housing starts, and interest rates. But nobody predicted so drastic a plunge in oil prices, the Southeast's worst drought in a century, or declining housing starts in the textile region.

However, we don't intend to make excuses or brood on past events. We prefer to think of 1986 as a year to grow on, and then prove that belief. We still relish the challenge of leadership, and therefore choose to continue to grow toward our full potential in our industry, by building for the future, and thereby laying the foundation for sustained long-term earnings growth.

Earnings Perspective

Obviously, we are disappointed in our 1986 earnings results. Later in this letter we discuss some contributing factors in more detail. But the most important thing for you to know is that our earnings decline was not from 300 stores — it can be attributed to 45 stores. While our 25 stores with the worst performance were bogged down in the oil patch, we disrupted normal business at 20 of our best stores by retrofitting 14 and relocating 6. With the 45 stores excluded from 1984, 1985, and 1986, the total operating earnings from the "rest of the chain" not only beat last year but surpassed their results of 1984, our best reported earnings year ever.

The "rest of the chain" includes new stores in new markets, retrofits, and all other expansion projects of 1984 and 1985. And when we consider the expanded potential that those 20 stores now have, and the growth we are enjoying from prior year retrofits, we're glad we did it!

Cash Flow Trends

Many observers believe trends in cash flow are more important than trends in earnings. Indeed, the respected general public investment publication *Value Line* does. Their "value line" for the price of a company's shares is computed from cash flow per share times a multiple. In our public financial reports, including this one, we give a simplified version of cash flow. Its primary components are earnings after taxes, depreciation, and deferred income taxes, and it is equivalent to "funds from operations" in funds flow statements.

As shown on page 1, before an extraordinary item, our 1986 cash flow was $90.7 million, up 8% from last year. Longer term trends are shown in the inside back cover of this report.

Sales Performance

Even in a disappointing year there were many significant achievements, most notably the surpassing of $2.2 billion in sales. That's an increase of $200 million or 10% over last year's record $2 billion, and we did it in a continued competitive environment, in an economy that was at least as much bomb as boom. According to the "1987 Retailer Giants Report" of *Building Supply Home Centers* magazine, the sales increase recorded by Lowe's is equal to the year's total sales for the 25th ranked company in our $82 billion industry.

Specifically, retail sales increased by 15% to end the year at $1.26 billion. Contractor sales increased 5%, to $1.02 billion. Sales from comparable stores (those open more than a year on January 31, 1987) posted a 6% sales gain.

Sales per store for the average number of stores open, a measure that includes partial year results from new stores as well as comparable store results, totaled $7,836,000. Retail sales per average store were $4,336,000 and have posted a five-year average annual compound growth rate of 15%. Contractor sales per average store have grown 12% per year since 1981. In 1986, for the sixth year, retail sales were the dominant component of Lowe's sales mix, which finished the year at 55% retail, 45% contractor sales.

We continue to refine and expand Lowe's product assortment, to buy and promote shrewdly, to display our goods effectively in bigger and better facilities, and to staff our stores with the best trained and most capable operations people in the business.

Oil Patch Update

We were disappointed with our 1986 performance in the oil patch. Our losses in Texas and Oklahoma more than offset the small profit that we realized in Louisiana. We continued to remerchandise stores, expand product assortments, build warehouses, and reposition these 1985 acquired units toward the retail market, but we had to do it without the support of contractor sales that we had counted on as the foundation for those stores' operations.

Nevertheless, we believe that we will be able to report better results for 1987 even if the oil price sticks at $15 per barrel. That's because we have

Robert L. Strickland **Leonard G. Herring**

trimmed our overhead to produce the best possible results within the existing market conditions. When the economy of that region turns around, we will be in an advantageous position as a low-overhead operator in a reviving market.

From Texas to Taxes

Everyone knows that in 1986 a tax reform bill was passed by the House and Senate and signed into law by President Reagan. In 1987 Lowe's will begin to receive the benefits of a lower tax rate. In 1987 the combined rate for state and federal taxes will be 43%, and in 1988 the new rate of 38% will be in effect for the whole fiscal year. In 1986, however, we were taxed at a 49% rate, and the single most noticeable effect of the tax bill was the loss of our investment tax credits, which impacted earnings downward by 7¢ per share.

Some major retailers have promised to pass on their tax savings to their customers by reducing their gross margins. We intend to pass along our savings to our shareholders in the form of increased earnings. After all, you are the group affected by events like the loss of investment tax credits, so it is only right that you should benefit from a "good news" provision of the tax bill.

Debt Retirement

In 1986 we also decided to repurchase $30 million in public notes on which we were paying 11.5% interest.

This helped reduce the average interest payment required to finance Lowe's debt obligations. Although the debt retirement reduced 1986 earnings by 7¢ per share, the advantages of a lower average interest rate will contribute to future earnings.

Financial Position

Our financial position is strong. Shareholders' equity increased 33% in 1986, to $541 million from $407 million in 1985. At the end of 1984 it stood at $341 million, so the last two years have seen an important increase of $200 million.

Stock Offering — In April 1986 we sold 2.2 million shares of stock through a public offering which netted the company $83 million. At the same time we issued 300,000 shares to our ESOP, for a total of 2.5 million shares. The combined proceeds of $94.6 million were used to finance the purchase of land, buildings, and equipment for new and existing stores, and to fund our requirements for working capital. We now have 39.6 million shares outstanding, and we're not currently planning any further equity offerings.

ESOP — We are extremely proud of our ESOP, which has proven to be an outstanding asset for our company, our employee shareholders, and our other shareholders as well. All employees completing one thousand hours of service and one full year of employment are eligible for membership. They have full voting rights on all shares allocated to their accounts on an annual basis. In 1986 we were able to pass through to employee shareholders cash dividends totaling $2.1 million. These funds were deducted from our federal taxable income, resulting in a tax benefit of $1.1 million which was treated as an addition to capital surplus. This year's funding of $11.6 million of our ESOP contribution with 300,000 shares of new stock, raised new equity capital in the most cost-effective way. The ESOP trust is Lowe's largest shareholder, with approximately 18% ownership of the company.

Commercial Paper — We have recently begun to offer low-interest commercial paper to investors as one way of meeting our seasonal needs for working capital.

Dividends — We paid a dividend of 10¢ per share in each quarter of 1986, bringing the year's dividend payment to 40¢ per share. Considered historically, a share which cost $12.25 in 1961 is now thirty shares with a cost basis of 41¢ each. Therefore, the 1986 cash dividend of 40¢ per share is virtually a 100% annual yield on the original investment.

Strategic Market Growth

By the end of 1986 we had completed the third year of our "5 + 10 = 20" expansion plan, in which 5 represented our targeted percentage of unit growth in new stores in new markets, while 10 stood for the percentage of additional space to be gained in current markets. The 20 is representative of the total amount of incremental retail square footage. When the plan was conceived in 1983, Lowe's had a total of 2.5 million square feet of retail sales space. In 1986 we opened our 300th store, and increased our total size more than 22% in retail square footage. Our average store size has increased from 12,900 square feet to 14,800 square feet. We now have more than 4.4 million square feet, and by the end of 1987 we will have more than five million square feet, or double our size in a four-year period.

Our current major expansion thrust is to "store up" and dominate the heartland of our trading area. We see 1987 as the springboard year for a new expansion plan that we are calling "10 + X," where 10 represents our goal in percentage of added space in existing stores, while X is the opportunity for new stores and timely small acquisitions. Included in the 10% growth will be retrofits, relocations, and space gained through our brand new "Phoenix" program. Phoenix receives detailed discussion elsewhere in this report; in essence, it is an economical way to increase space by as much as 50% in the smaller, mature Lowe's stores of the Southeast, where our well-established image and our existing distribution network will net us the highest possible return on our expansion investment.

Charter Amendments

In 1986 our shareholders voted overwhelmingly in favor of three amendments to our charter which help assure that control of Lowe's will remain in the hands of those who have the company's best interests at heart. The amendments provided for:

1) authorization of a new class of preferred stock
2) classification of Lowe's Board of Directors
3) "fair price" requirements in the event of a bid for a hostile takeover.

All the amendments passed with a majority of more than 65% of all shares outstanding and 74% of all votes cast. Lowe's management is proud to regard this response as a vote of confidence, and we will endeavor to continue to deserve it.

Our World Class Board of Directors

At the annual meeting our shareholders approved and elected two of America's leading retail executives to further enhance our Board of Directors. They are Mr. William A. Andres, formerly Chairman of the Board of Dayton Hudson Corporation, and Mr. John M. Belk, Chairman of the Board of Belk Stores Services, Inc. We are honored to welcome them, and we have already benefitted from their energy and their expertise.

We are also most pleased to announce that The Honorable Russell B. Long, former United States Senator from Louisiana, has accepted nomination to be a member of our Board. Senator Long was a long-time chairman of the Senate Committee on Finance, and is widely recognized as the foremost national proponent of Employee Stock Ownership Plans.

1986 — A Longer Perspective

1986 was a double anniversary year for Lowe's, marking 40 years in the building supply business and 25 years as a public company. These time frames fit rather neatly into the classic life-cycle phases of Birth and Growth. The first 15 years, 1946 through 1960, we define as Lowe's Birth years. During this time, we developed Lowe's marketing thrust to customers, our basic product offering, and our unique organizational life-style, and we ended the period with almost $31 million in annual sales.

In 1961 we entered our real Growth phase with a new top management team, public ownership, and a keen sense of opportunity at hand. And we have ended our 25th year of this Growth phase in the position of industry leadership, with almost $2.3 billion in annual sales.

We define our customers, our suppliers, our employees, our shareholders, and our directors as Lowe's partners-in-interest. Many of you, in each group, are long-term partners, and we appreciate the many ways you continue to support our efforts to make Lowe's the best company it can be.

The two of us, having joined Lowe's in the mid-fifties, have experienced some of the Birth years and all of the Growth years so far. And we deeply believe, and pledge to you, that the best for Lowe's is yet to come. We position the company as a marathoner, not a sprinter. Marathoners will continue to run. Lowe's will continue to grow.

We are launching 1987 as a year of hard work, creativity, vigilance, excitement, and confidence.

Cordial good wishes,

Robert L. Strickland

Robert L. Strickland
Chairman of the Board

Leonard G. Herring

Leonard G. Herring
President and
Chief Executive Officer

North Wilkesboro, North Carolina

Lowe's Investors Want to Know

Wendell Emerine

"If retail sales have a higher profit margin than contractor sales, why hasn't your gross margin improved?"

Wendell Emerine, Executive Vice President:

In 1986 we geared our advertising to promote our big new and retrofitted stores that have been the focus of our expansion program. To attract customers into those units, we added more tabloid inserts to our advertising schedule. In fact, we ran promotional tabs in 33 out of 52 weeks last year.

The promotional prices featured in the tabs had to be offered in our smaller stores as well, because the new large stores were not geographically isolated but were part of our cluster plan to develop Lowe's existing markets. But by "cherry-picking" two to three hundred items for the tabloids every other week, we reduced the margin in those smaller stores where the product assortment was limited.

Now we've learned our lesson, and we've refined our advertising strategy. From now on there will be large tabs and small tabs, depending on the market. We are selecting promotional items more judiciously, and the promotions are more carefully targeted.

In a related effort to improve our margin, we're adding product lines with proven margin growth potential. These include ready-to-assemble furniture and fast-selling light fixtures. We have also added garden centers to 110 older stores, the better to sell plants, fertilizers, stone, mulch, patio sets, and other high-margin outdoor items. Because the installation of those centers wasn't completed until last August, we missed most of the 1986 gardening season; but we're ready to profit from this year's spring thaw.

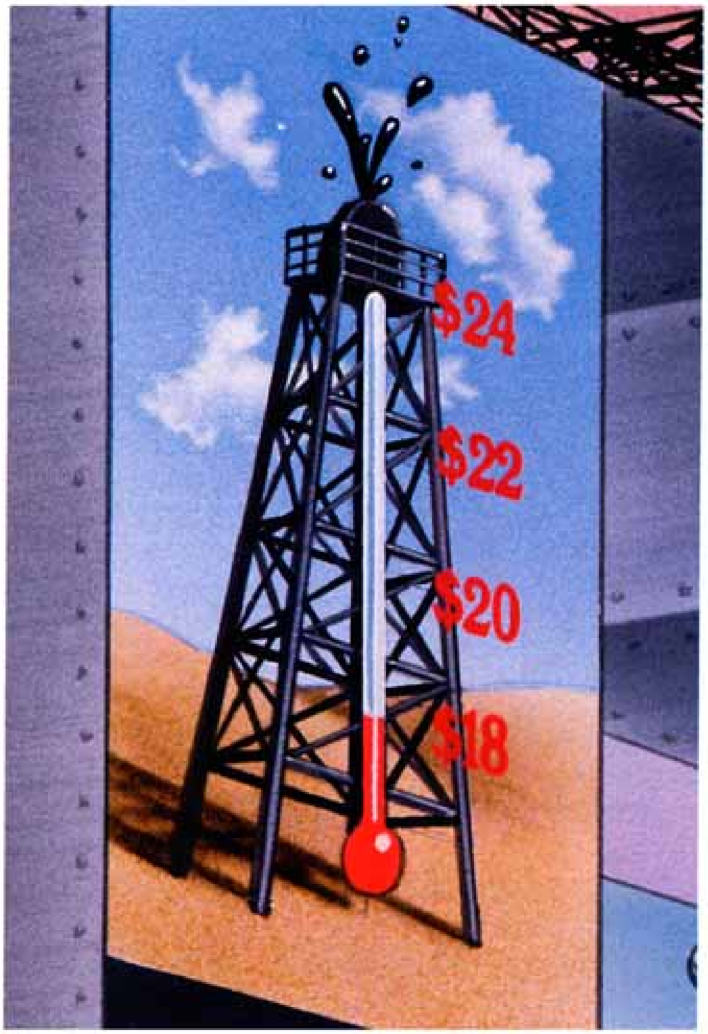
"Warehouse retailers are popping up all over. What are you doing about the competition?"

In spite of a popular misconception, there are only eight or ten markets where Lowe's meets warehouse operators like Home Depot and Builders Square head-on. In those markets, Lowe's unique customer franchise (professional contractors as well as retail consumers) gives us a significant edge. We emphasize different product lines than they do, and less than half of our product mix parallels theirs. For example, we offer home electronics and appliances; they don't. Also, our array of customer services includes product delivery and a variety of credit programs.

We still believe our real competition to be the specialty retailers and single, family-owned stores that are traditional in the small-to-medium markets of Lowe's heartland. But as we grow from state-to-state

and our markets change, the key to individual market dominance will be flexibility and responsiveness.

"What are you going to do about your stores that are losing money in the oil patch?"



After serious evaluation and analysis, we have decided not to sell or close those stores, which represent vast potential for expansion in those markets when the regional economy turns around. Even if the oil price loiters at current depressed levels, we are positioning our stores to break even in 1987, and with luck we may realize a modest profit. We have trimmed labor overhead, and we have finished remerchandising several units. We've added warehouse space and holding areas for more inventory. Our belief in the potential of retail sales there is supported by evidence that our retail competition in those markets fared better than Lowe's during our period of transition.

Before becoming Lowe's stores, those units were dedicated to contractor sales. That circumstance appealed to us as a great opportunity for Lowe's to add our retailing expertise. We figured that the contractor business would carry us through the process of adding retail space and remerchandising those stores. Then the bottom fell out of the oil market, and the professional building business dried up, yanking our cushion out from under us.

At first it was difficult to tell how badly Lowe's business would be hurt. Builders had projects underway that continued according to plan, and our best estimate was that we would lose between twenty and twenty-five percent of our contractor sales. In the end, it turned out to be more like fifty percent. And because our schedule for retrofitting, computerizing, and remerchandising those stores had not been hyper-accelerated, we were unprepared to make up the losses with new retail sales.

It is now just two years since Lowe's bought into the oil patch, and those stores as a group are operating at about forty percent of their sales capacity. That isn't tragically far below the normal curve for brand new stores, which take between two and three years to achieve Lowe's average sales level. We feel we've already absorbed the downside impact in the oil patch, and our stores there shouldn't continue to be a drag on earnings. They are now lean, efficient operations offering Lowe's retail lines to new Lowe's customers.

A few years ago, popular opinion was writing off areas like New England and Detroit as moribund markets — and look at those areas now. We haven't changed our minds about the oil patch as a growth opportunity for the future of Lowe's.

"How would you describe the near future for Lowe's?"

Our near future will grow from our recent past. In a relatively short time, Lowe's is changing from a small chain of small stores into a large chain of large stores. Back in 1983 and '84, a Lowe's store with 30,000 square feet was something new and much larger than we were used to. We had no experience designing, stocking, or operating big stores. We went through a tough learning experience.

Now we have eighty large stores, and we understand their complexities. Lowe's has entered a period of major refinement. We're refining our construction process, so that super-retrofitting will be done in stages with less disruption of business. We are initiating the new Phoenix expansion plan in our older small-town markets, and we are already completing the pre-Phoenix plan to give those stores a quick "pick-me-up." We are also refining our advertising approach, our product mix, and our personnel. We are determined to grow our margin without losing aggressiveness in promotion, and our goal is to reduce our SG&A expenses to help get our profitability back up where we — and our investors — want it to be.

"What is this new expansion program called 'Phoenix'?"

Dwight Pardue, Senior Executive Vice President, Real Estate:

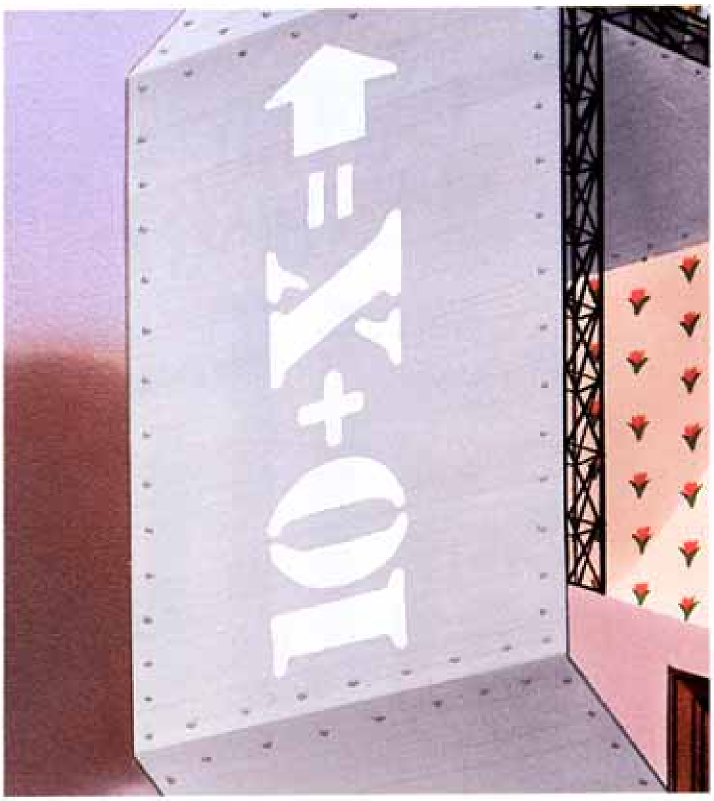
The legendary phoenix was a bird that was reborn from its own ashes to soar in spectacular new plumage. Lowe's Phoenix program is a plan for the renovation and enlargement of our older, smaller stores. Beginning this year, Lowe's stores of 10,000 and 11,000 square feet will be receiving an average of 5,000 square feet of additional sales space. The beauty of the Phoenix treatment is that it can be accomplished economically, in just three or four months, without major curtailment of normal business.

The difference between the Phoenix plan and retrofitting is that when we retrofit a store, we take an old property and completely transform it, from the

Dwight Pardue

front curb to the back fence. Retrofitting costs only half as much as building from scratch, but it does entail considerable interference with normal sales activity. The Phoenix treatment is much more economical than retrofitting, and is designed for the least possible interruption of business.

Between now and 1990, more than a hundred stores will be either retrofitted or given the Phoenix treatment. This will bring our average store size up to 20,000 square feet from our 1986 average store size of 14,800 square feet, and will enable us to give our valued customers at older stores the same benefit of Lowe's expanded product line that is available to customers at our newer, larger stores.



"Why is Lowe's placing so much emphasis on expansion at the expense of earnings growth?"

It's a generally recognized fact that in the evolution of a retail chain, if you're not growing, you're shrinking. And if you consider the focus of Lowe's current expansion efforts, you'll see that our energies are targeted at our existing markets. Our strategy is to dominate those markets by bringing our older, smaller, and previously acquired units up to conformity with the most dynamic stores in the chain. In this way we are laying a solid foundation for future earnings growth. It is really an investment rather than an expense.

"Is Lowe's planning to make any more acquisitions?"

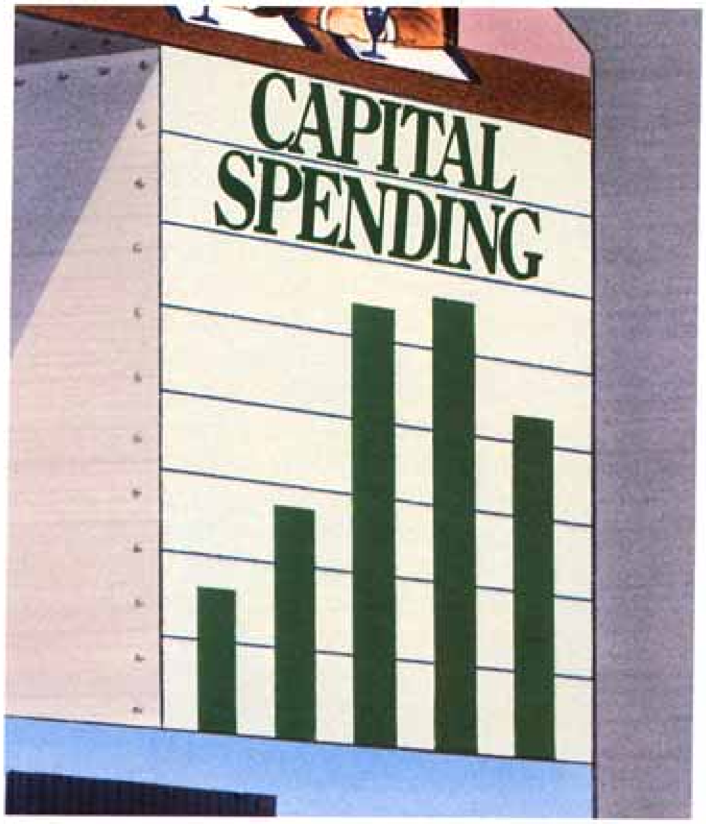
We think of our new expansion plan as "10 + X," where the 10 stands for percentage of new space in existing units and X represents the opportunity for new stores and future acquisitions. These acquisitions would probably be in the nature of family-owned stores or small chains, and they would have to meet several criteria. They would have to be capable of serving both of Lowe's customer bases; they would have to be located within the service area of our distribution centers, and they would have to help us achieve our aim of "storing up" Lowe's current trading area.


Harry Underwood

"Why did you retire $30 million of debt in 1986?"

Harry Underwood, Senior Vice President of Finance and Treasurer:

Lowe's public notes paying 11.5% interest were bought back on the open market to reduce the ongoing interest rate that the company pays on its debt. We paid a premium of $5.7 million to holders of those notes. This was to the economic advantage of the company



because of the tax law change, and will have a positive impact on interest payments and earnings for 1987.

"What is your capital budget for 1987?"

Lowe's capital needs will be about $110 million for 1987, significantly less than the $139 million required for 1986. Of that $110 million, approximately $85 million will go for expansion (new stores, retrofitting, and the Phoenix plan). Around $20 million will be spent on equipment, both new and replacement, for existing stores. The rest will go for support services.

"What will Lowe's tax rate be in 1987?"

As a result of the tax law change, the effective rate for combined federal and state taxes decreases from 49% in 1986 to approximately 43% for 1987. The actual combined rate goes to 38% on July 1, 1987, but the "blended" rate for fiscal 1987 is 43%.

"What is the 1987 outlook for depreciation?"

Depreciation will be up in 1987 because of Lowe's continuing multi-year expansion program.

"How will Lowe's meet its financing requirements for 1987?"

In recent years we have used long-term borrowing or equity offerings. In light of current lower interest rates, we have decided to offer commercial paper as one source of Lowe's seasonal needs for working capital. Commercial paper carries one of the lowest rates of any financial instrument, and it introduces Lowe's to a new investing public.

Our financing requirements will also be met by cash flow from operations and by intermediate-term financing when necessary.

"What is your economic forecast for the year ahead?"

We predict a somewhat stronger economy for Lowe's trading area in 1987. Consumer spending should be strong; interest rates should remain low. Starts on multi-family dwellings will probably continue to decline, but single-family starts should be stable. Overall, we predict only moderate inflation in the range of two or three percent.

Cliff Oxford

"Given the consensus that the generally sluggish level of economic activity is unlikely to show marked improvement in 1987, how can you expect to report an improvement over Lowe's disappointing 1986 earnings performance?"

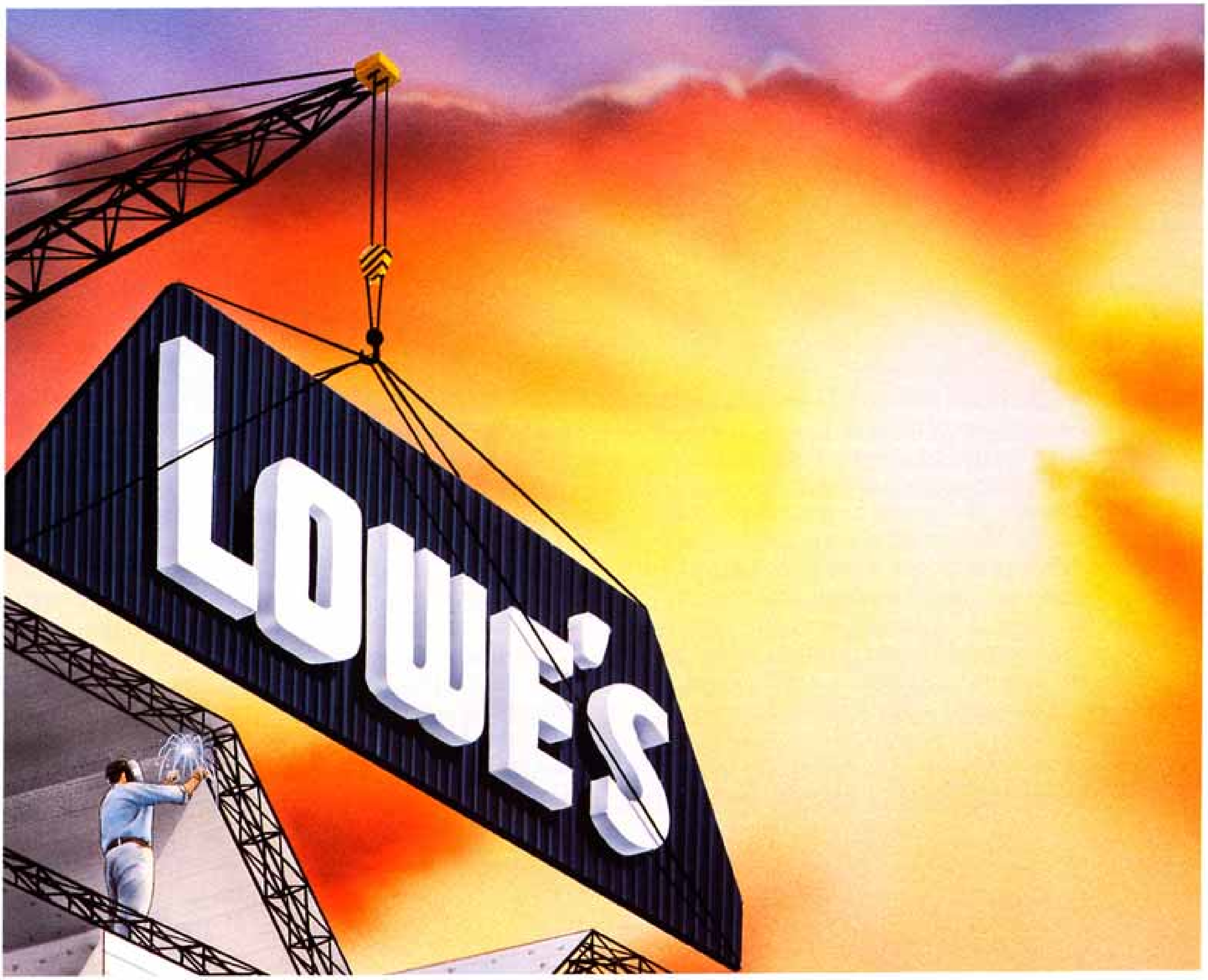
W. Cliff Oxford, Vice President, Corporate Relations:

Although 1986 was a disappointing year for earnings, it was also a record year for Lowe's in terms of sales growth, cash flow, dividends paid, and expansion in new stores and retail square footage.

Earnings were negatively affected by the economic slump in the oil patch and by the worst drought in this century in the Southeast, the heart of Lowe's trading area. Earnings were also affected by nonoperational events: specifically, the loss of investment tax credits (7¢ per share), accelerated property tax deductions (3¢ per share), the cost of retiring $30 million of debt (7¢ per share), and the increased cost of casualty insurance (6¢ per share). Although we don't expect the insurance situation to improve in 1987, neither do we expect to experience another radical change in its impact on earnings.

Earnings were enhanced by 6¢ per share from settlement of a class action suit filed against several plywood manufacturers. We are encouraged by our opportunities in 1987 to manage our business with a lower income tax rate, a more favorable expansion comparison in terms of number of projects undertaken, a lower average interest rate on our debt obligation, and lower planned expenditures in our capital budget. We should also benefit from a retail repositioning of our oil patch stores, the opportunity to enhance our gross margin with a larger retail base, a new advertising program for all stores, and a new merchandising face-lift for our family of smaller, mature stores.

With all these factors in our favor, and barring a major economic downturn, we should be able to report improved earnings for 1987.



Our World Class Board

Left to right, seated: William H. McElwee, Sr., Leonard G. Herring, Robert L. Strickland, Petro Kulynych, Gordon E. Cadwgan; standing: Jack C. Shewmaker, John M. Belk, Russell B. Long, Robert G. Schwartz, William A. Andres.

Our Board of Directors has long been one of Lowe's most valuable assets. On this occasion of our twenty-fifth anniversary as a public company, it's appropriate that we acknowledge the strength and leadership that the Board has given Lowe's Companies through our early years of growth.

Five of our directors have been members of the Board since 1961; they now collectively represent 125 years of experience. Our newer directors have been recruited from the highest echelons of retailing and finance, each bringing unique wisdom and expertise to the challenge of guiding Lowe's and charting our course for the future. Like Lowe's, two of the retailing organizations represented by our new directors were named to the Levering, Moskowitz, and Katz list of *The 100 Best Companies to Work For in America*.

We are proud to introduce the three newest members of our Board, and our most recent nominee for membership. As history records new chapters to Lowe's success story, the contribution of our Board of Directors is sure to continue as a dominant theme.

William A. Andres was born in Fayette, Iowa, and studied business at Upper Iowa University before entering the Army in 1944. After spending a year in Germany with the Army of the Occupation, he returned to Iowa and married his wife Betty at the original "little brown church in the vale."

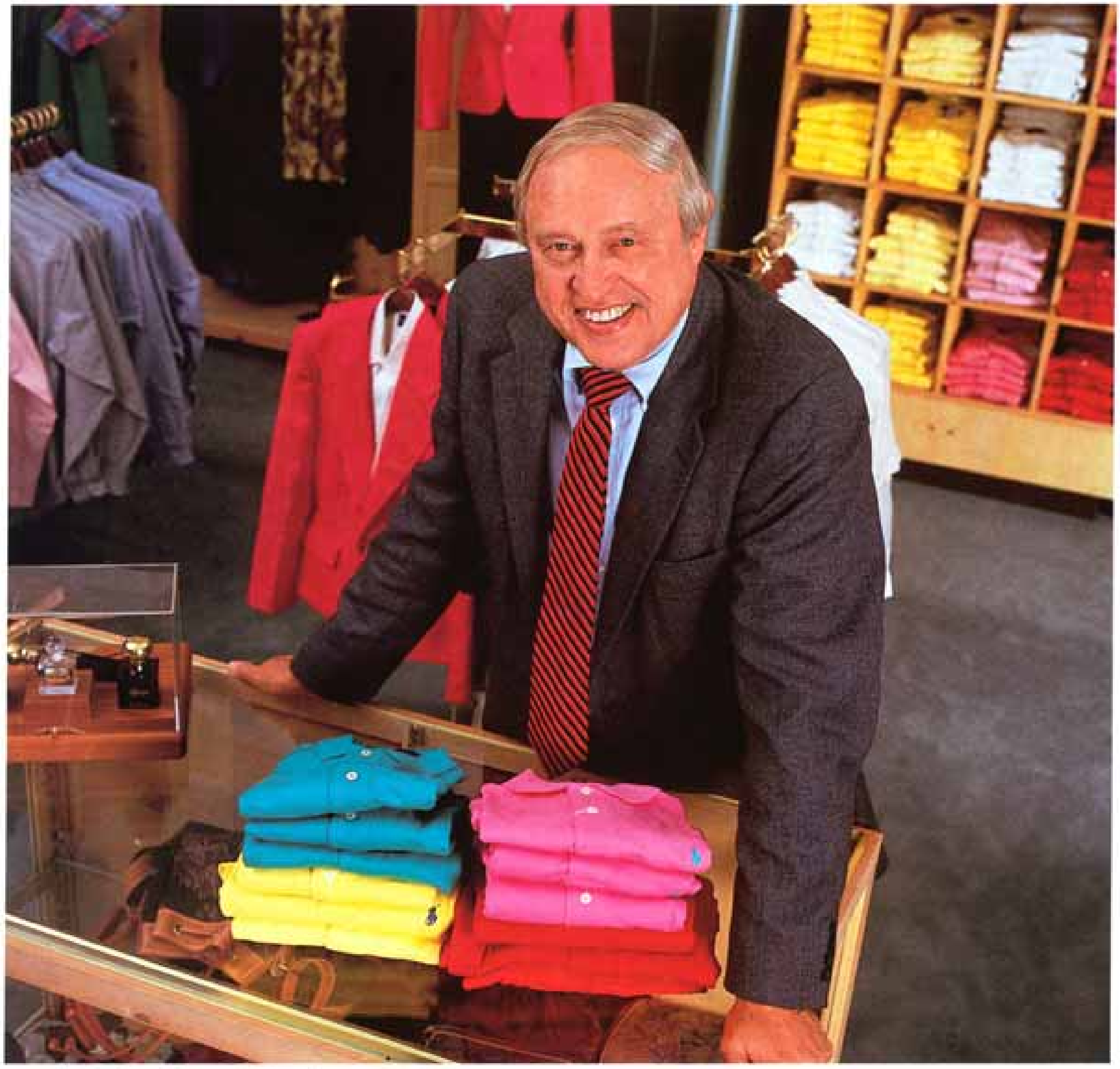
He received a graduate degree in retailing from the University of Pittsburgh and took an administrative position with Peterson's Department Store in Davenport, Iowa. In 1958 he accepted an offer from Dayton Hudson Corporation, the national retailing giant which includes Target, Mervyn's, Dayton Hudson, and Lechmere stores. He and Betty and their three sons moved to Minneapolis, Dayton Hudson's home base. After working his way up through the ranks, he became Chairman of the Board of Dayton Hudson. He recently retired to Sanibel Island,

Bill Andres — *"Making the customer your top priority is essential to success in retailing. Orientation to the customer is one of Lowe's strongest characteristics. That translates as quality products and quality service. Nobody serves customers in Lowe's markets quite the way Lowe's does."*

Florida, and was elected to Lowe's Board of Directors in 1986. He also serves on the Board of Directors of Exxon Corporation.

John M. Belk was born in Charlotte, North Carolina. His father was the founder of the Belk organization, which now comprises more than 360 department stores throughout the Southeast. John grew up in Charlotte and played basketball for nearby Davidson College, where he received a baccalaureate in economics in 1943.

He was an infantry lieutenant in World War II, and was recalled to active duty in Korea. He came home to assume responsibilities within the Belk organization. He married his wife, Claudia, and became one of his hometown's most active citizens. In 1969 he was elected Mayor of the City of Charlotte, and he served four terms to the end of 1977, holding the office longer than anyone in the city's 200-year history.



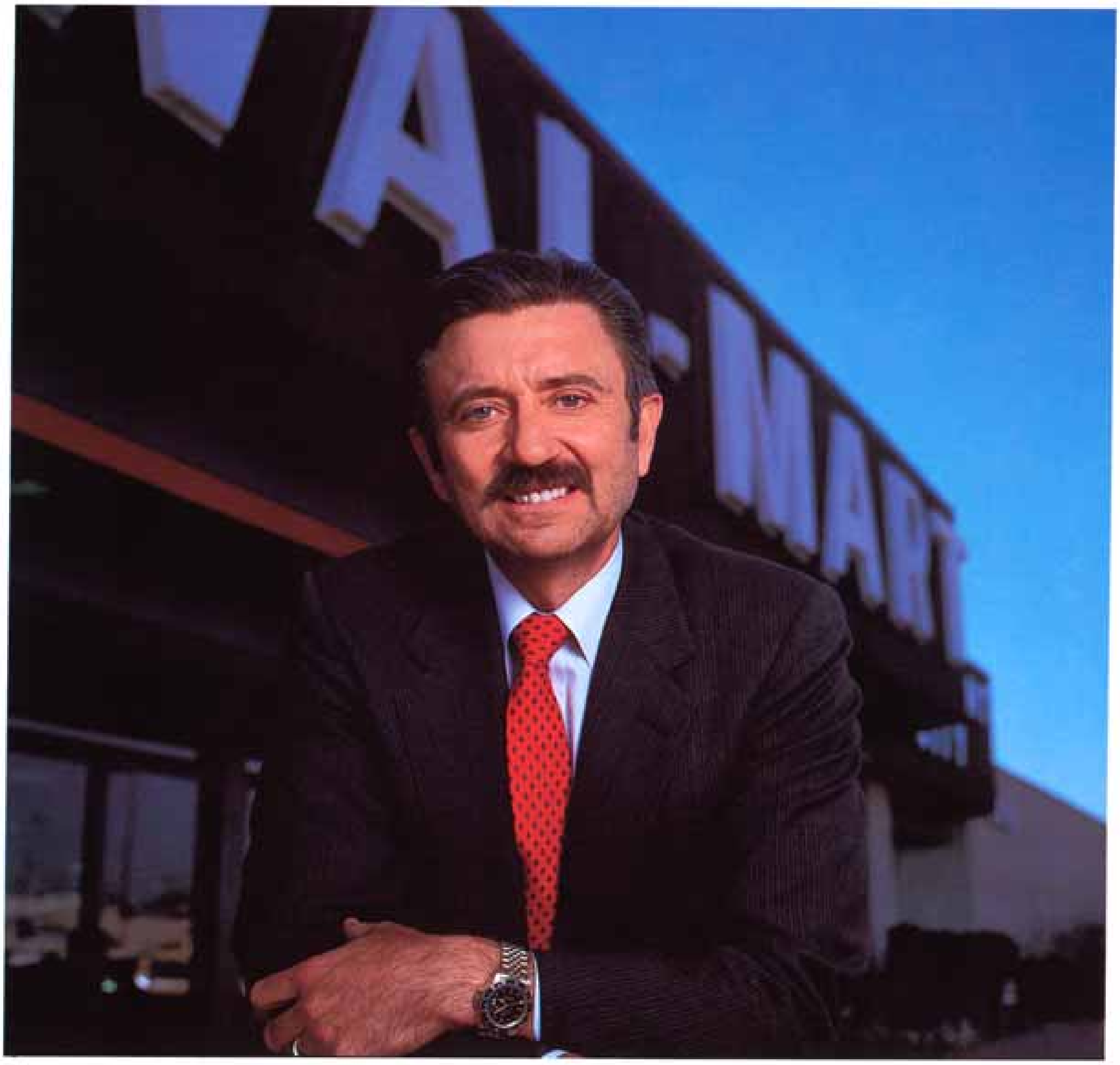
John Belk — *"You know, Belk began as a piece goods store in a small town — Monroe, North Carolina. That was in 1888. Now we're getting ready to celebrate our hundredth year in retailing.*

"If you want long-term success you've got to have good people. Belk had good people, and still does. So does Lowe's. They're smart and they're energetic; that's why they've done as well as they have."

He is Chairman of the Board of Belk Store Services and President of Belk Brothers Company. In addition to serving on Lowe's Board, he is a director of Wachovia Corporation, Southern Bell, and Southern Radio Corporation, among others. He is also an Eagle Scout who has been active in scouting all his life, and he is currently serving as Vice President of the National Council of Boy Scouts of America.

Jack C. Shewmaker was born in Buffalo, Missouri and graduated from Buffalo High School, where he played on the basketball team. He went on to play ball at Georgia Technical Institute before returning home in 1958 to marry his high school sweetheart, Melba June Prosser. They have three children, Daniel, Shari, and Emily.

Jack worked for Kroger and for Coast-to-Coast Stores before joining Wal-Mart in 1970. Starting off as a district manager, he was promoted several times and eventually became President and Chief Operating Officer, then Vice Chairman and Chief Financial



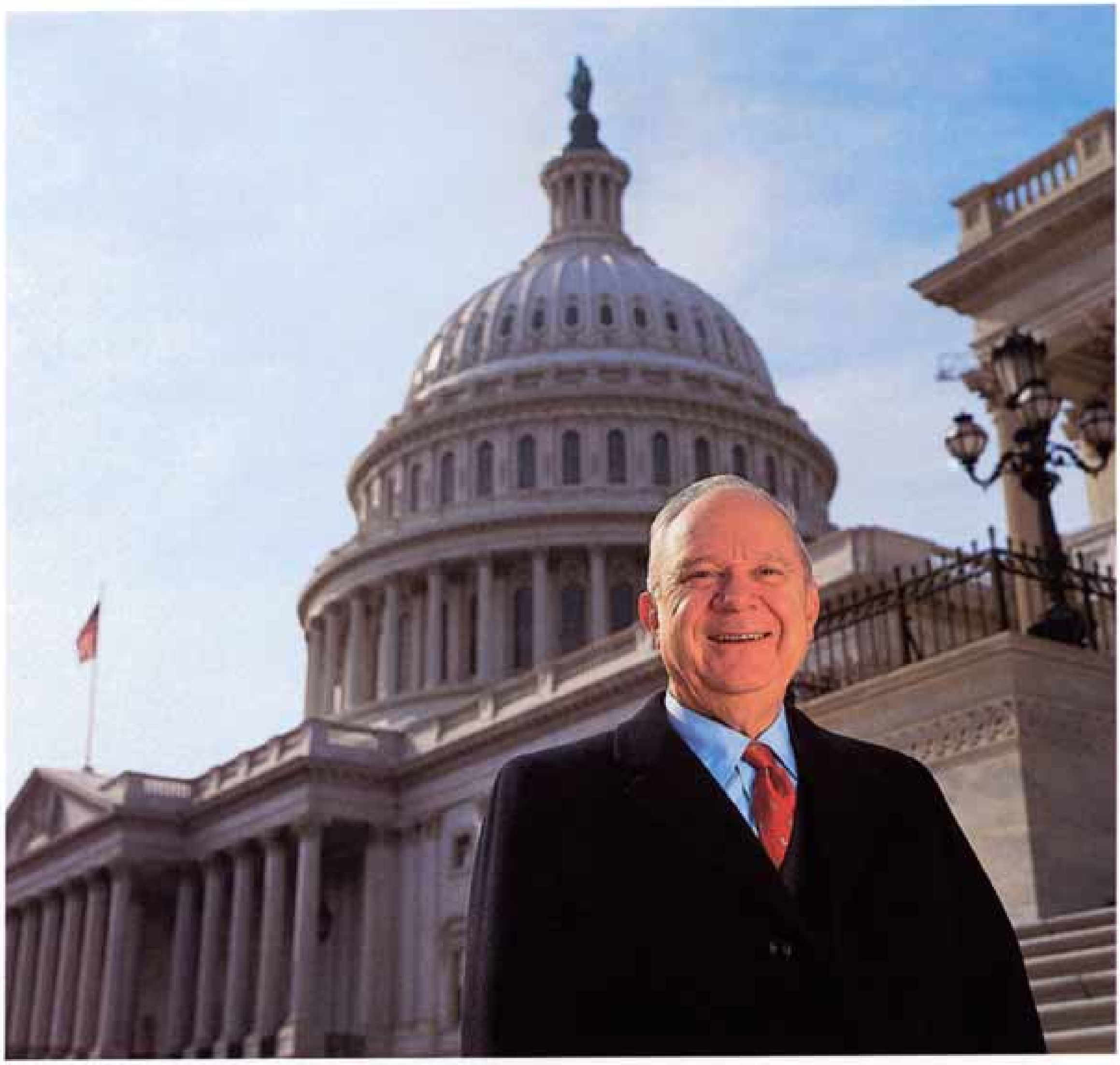
Jack Shewmaker — *"The important thing is to have a group of people who are willing to work hard together for a common goal, and to have fun doing it. Occasionally they will make mistakes, but they'll learn from them and go on."*

Officer. He is a member of the Wal-Mart Executive Committee, and was appointed to Wal-Mart's Board of Directors in 1977.

He and Melba own and operate Jac's Ranch, one of northwest Arkansas' largest cattle operations dealing in registered Angus and Polled Hereford breeding stock. The ranch has produced several champions and has won considerable recognition since its inception in 1983.

Russell B. Long was born in Shreveport, Louisiana and attended public schools in Shreveport, Baton Rouge, and New Orleans. His father, Huey P. Long, was Louisiana's Governor and then a U.S. Senator before his death when Russell was seventeen. Russell was president of the student body at Louisiana State University, where he received his bachelor's degree in 1939. He went on to law school, and was admitted to the Louisiana Bar in 1942.

As a Naval officer he took part in the World War II invasions of Africa, Italy, and France. He returned



Russell Long — *"I am delighted to be associated with Lowe's. Their years of success with Employee Stock Ownership is nationally known, and at my invitation, Lowe's Chairman testified on Capitol Hill on five occasions, supporting the concept. Also, it's great to have Lowe's stores both in Washington and Baton Rouge."*

home to practice law, and was elected to the U.S. Senate one day before his thirtieth birthday in 1948. On Capitol Hill he became known for his keen knowledge of Senate rules, his sense of humor, and his ability to win debates. He served on the Senate Finance Committee for 34 years, and was chairman for the better part of two decades. Among his legislative accomplishments are the landmark 1972 and 1976 federal revenue-sharing laws and the 1975, '77, and '78 tax cuts. He also became the leading Congressional champion of Employee Stock Ownership Plans.

He retired from the Senate in January 1987, having served for 38 years. He is now a partner in the law firm of Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey, working out of Washington and Baton Rouge.

He is married to Carolyn Bason Long, a North Carolinian from Yanceyville. They met when she was working on Capitol Hill for Senator Sam Ervin.

Sharon Johnson, Lowe's store manager, Fort Myers, Florida —

"I've worked for Lowe's since 1969, and I've been a store manager for two years now. There's plenty of excitement in my job: no two days are exactly alike, and every day brings new challenges. Both our retail customers and our contractor customers are always involved in interesting projects, and I like driving by a project and knowing that our products and our service are an important part of the result. I really take pride in that.

"My first job with Lowe's was in a 6,700-square-foot store where I often sold items out of catalogues because we didn't have the floor space to stock a very broad selection. Now, as manager of a 27,000-square-foot store, I really appreciate the advantages of being able to show customers how a product looks, feels, and operates. With Lowe's expanded product offering, the hands-on experience is even more important.

"In the following pages you'll read more about our retail and contractor customers, our markets, our product mix, and our plans to grow into the future. Welcome to our Lowe's stores."

Customer Analysis

Last year we compared Lowe's position in our industry to the uniqueness of an apple among oranges. That individuality describes and defines Lowe's in every aspect of our business, because our trading area, our product mix, and our customer franchise are unlike anyone else's. We believe that to be one of our greatest strengths.

Our market researchers collect and analyze a wide variety of data to monitor the nuances of our complex marketplace. Their findings help us position Lowe's for maximum responsiveness and flexibility in an industry where the needs, preferences, and buying habits of the consumer are constantly changing.

Our Retail Customers

Now more than ever, Lowe's retail customers are the dominant force behind our continued success in the marketplace. Our annual customer count per store has increased almost 150% since 1980, and in 1986 it grew to an average 125,000 customers per store, an 8% increase over 1985. This remarkable growth is a tribute to the success of our new large stores and our retrofitting program, which have expanded our retail base and made a broader product assortment available to more customers in more markets.

Lowe's intensive development of our retail business was adroitly timed to catch the wave of do-it-yourself consumerism which first began to swell during the highly inflationary Seventies. Although in this decade inflation has shrunk considerably as a factor in household budgeting, it has been replaced by other incentives for do-it-yourselfers. Homes built during the Seventies are now beginning to need maintenance, and demand for repairs and improvements will increase as home ownership climbs toward new highs. As seen in the following chart, current estimates predict that the do-it-yourself (DIY) market will continue to grow strongly in 1987.

Lowe's share of the national DIY market

	DIY market ($ billions)	Lowe's retail sales ($ millions)	Lowe's national market share
1977	$37.6	$ 250	.7%
1978	42.4	324	.8
1979	47.4	393	.8
1980	51.4	420	.8
1981	53.3	461	.9
1982	54.3	571	1.1
1983	61.0	724	1.2
1984	68.8	881	1.3
1985	76.0	1,100	1.4
1986	82.0	1,263	1.5
1987e	$88.0	$1,460	1.7%

Source: *The D.I.Y Consumer Market, 1985 Reference Guide*, The DIY Research Institute

The biggest segment of the buying public (and consequently, of course, the most closely scrutinized) is the baby boom generation. Consumers who are now between the ages of 25 and 44 will constitute 45% of the population by 1990. As the data file on adult baby boomers grows, many observers will no doubt be relieved to note that the flower children didn't grow up to live in trees after all, but settled down and bought homes made of lumber instead — remarkably like their parents.

Consumer buying behavior tends to vary according to some generalized life-cycle stages. Baby boomers currently fall within three of these stages, and their behavior is following the patterns closely. Newlyweds (age 25-29) buy cars, appliances, and their first furniture. They constitute roughly 11% of American households, but will decrease slightly to 10% over the next few years.

People in the "Full Nest, Phase I" stage are 30 to 34 years old. They buy homes and major appliances like washers and dryers, and they tend to save less.

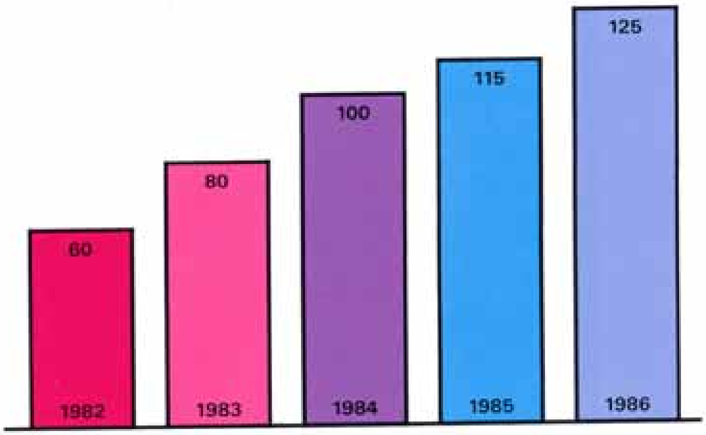
Customer purchase trends Dollars in millions	1986	1985	1984	1983	1982
Total sales	$ 2,283.5	$ 2,072.6	$1,688.7	$1,430.6	$1,034.0
Percent change from prior year	+ 10	+23	+ 18	+38	+ 16
Retail sales	**$1,263.4**	**$1,099.9**	**$ 880.9**	**$ 723.6**	**$ 570.7**
Percent change from prior year	+ 15	+25	+22	+27	+24
Percent of total	**55**	**53**	**52**	**51**	**55**
Contractor sales	**$1,020.1**	**$ 972.7**	**$ 807.8**	**$ 707.0**	**$ 463.3**
Percent change from prior year	+ 5	+20	+ 14	+53	+ 9
Percent of total	**45**	**47**	**48**	**49**	**45**

They are currently about 12% of all households and will hold that level for several years.

"Full Nest, Phase II" is the stage at which people age 35 to 44 begin to realize more of their earning potential. Although they are better off financially than they used to be, they still practice careful shopping. Their activities and their expenditures tend to be family oriented. They constitute 20% of American households now, and will increase to 23% by 1990.

It will be a while before most baby boomers reach the age at which they have enough disposable income to consider alternatives to do-it-yourself home projects. In the meantime, they are living what is known as the "Leave It To Beaver" scenario. Remember the opening of the show, where Ward, Wally, and the Beaver were shown raking leaves, pruning, and cutting the grass? Later, when the plot thickened, Ward was often interrupted in the act of fixing something around the house. The baby boomers are the Cleaver families of the Eighties and Nineties.

And what do the Cleavers want from Lowe's? We find that our average retail customer is very value-



Customer count growth

Number per store in rounded thousands

Retail Sales Growth

Dollars in millions

Chuck, Hank, Claudia and Morgan Forester

oriented, which reconfirms our commitment to offering value at Lowe's Low Prices. Retail customers also respond favorably to a product mix that meets the particular needs of their community and climate. They want fast, efficient service and knowledgeable answers to their DIY questions. This understanding has been the cornerstone of the design goals for our new and retrofitted stores. In response to research findings, we have provided better customer-service areas and increased self-serve capabilities. We also developed the TLC (Team Lowe's Commitment) program to emphasize our top priority — customer service.

Claudia and Chuck Forester are retail customers at our store in North Wilkesboro, North Carolina. They are young professionals with two children, two station wagons, and a two-story brick house with a generous yard. What do they like about Lowe's?

"I'm not what I'd call extremely handy," says Chuck, "so I value the advice I get from Lowe's salespeople. They help me figure out everything I need to finish a project, whether I'm doing some painting or installing closet shelving.

"Creativity in Lowe's displays attracts do-it-yourself decorators like Claudia and me," Chuck continues. "The bathroom and kitchen settings are very appealing, and are good for generating ideas."

"We bought our television and VCR at Lowe's," Claudia adds. "With consumer goods as well as build-

Carl and Diane Bailey

ing supplies, it's nice to know that if you have a problem with something, you can go back to the store and find the same salesperson still willing to help you."

Since they place a high value on their time and have a very modest opinion of their own home improvement skills, Chuck and Claudia bought materials from Lowe's for their deck and their newly remodeled kitchen, then hired professional contractors to do the work. This places them in a growing group of Lowe's retail customers who are finding new ways to use Lowe's array of customer services. We call them buy-it-yourselfers (BIY).

Our Contractor Customers

In last year's analysis of the residential construction market, we declared the thrills-and-chills roller-coaster of national housing starts to have stabilized. Now we're happy to say that we were right, and that stability remains our forecast for the future.

Affordability of housing is no longer the major obstacle that it was in the late Seventies and early Eighties. One contributing factor is increased disposable personal income, which reached almost $3 trillion in 1986. Mortgage interest rates finished 1986 at their lowest levels since 1979. As a result of these factors, the percentage of disposable personal income committed to pay interest on new homes is merely 1.2%, the second lowest in a decade.

The following chart shows that Lowe's contractor sales per housing start are rising steadily in this stable market.

Lowe's contractor sales per U.S. housing start

	Total U.S. private housing starts (in millions)	Lowe's contractor sales ($ millions)	Lowe's contractor sales per start
1977	1.987	$ 412	$207
1978	2.020	469	232
1979	1.745	512	293
1980	1.292	464	359
1981	1.084	427	394
1982	1.062	463	436
1983	1.703	707	415
1984	1.750	808	462
1985	1.742	973	558
1986	1.807	1,020	564
1987e	1.650	$1,160	$703

Source: U.S. Department of Commerce

How does the maturing baby boom generation affect prospects for new home construction? Lowe's main area of construction involvement is single family home building. Baby boomers will continue to form new households and buy new single family dwellings for several years to come. This trend will raise home ownership to its highest percentage levels in recent years, and by 1990 more than two thirds of American families will be living in a home they own. Then, as the baby boomers get a little older, they will be "trading up" into larger homes. These larger homes are more likely to include customized features, and will create not only an opportunity to sell more building materials but also higher margin items at the same time.

Lowe's relationship with our contractor customers in residential construction is a true partnership-in-interest, because we both give top priority to satisfying the demands of the new home buyer. Lowe's must anticipate the needs and tastes of the home buyer, providing the contractor with appropriate products for the construction and fixturing of a home for the Eighties, whether it's a first home or the dream house of a lifetime.

As the new construction market matures into the 1990's, Lowe's goal will be to give our contractor customers an edge in their competitive marketplace by offering services that will help them minimize their labor costs and implement time-saving construction

Growth of Contractor Sales

Dollars in millions

practices. As recognition of our partnership-in-interest spreads, the real pros will reciprocate by giving Lowe's an ever-increasing market share.

Carl A. Bailey II is an upscale residential contractor working in Cape Coral, Florida, near Fort Myers. Carl has recently scored a major success by designing, building, and selling two houses in the $450,000 to $550,000 range on the Caloosahatchee Riverfront. The interiors were decorated by his wife, Diane, who is an interior designer. Carl and Diane bought many of their materials through the Lowe's store managed by Sharon Johnson (see page 17).

"At our level of home construction, everything is either high-tech or high-touch," says Carl. "There's no place for mediocrity. We want the best for our customers because otherwise we can't compete.

"We buy all our lumber, windows, doors, trim, and locks through Lowe's because Sharon Johnson's commitment to service and quality matches our own," Carl adds. "Whenever we needed something that Sharon didn't ordinarily stock, she ordered it and made sure it was delivered in time to meet our deadlines. Now we're getting ready to build twenty-five more houses of similar quality, and we'll be doing considerable business with Lowe's.

"My father is a general contractor in Warrenton, Virginia, and I got my first nail pouch when I was five years old. I remember my father buying from Lowe's when I was a kid, and now I find it's a great supplier for me."

Our Competition

Just as athletes study game tapes of the teams they're going up against, we study the moves of Lowe's competitors in our fragmented but sophisticated marketplace. It's a study that demands vigilance, since in our league the franchises come and go at a startling rate.

The Top 10 building supply giants

	1986		1976
Rank		Rank	
1	**Lowe's**	1	Sears
2	Kmart	2	Montgomery Ward
3	Wickes	3	Wickes
4	Payless Cashways	4	Evans Products
5	Evans Products	5	Kmart
6	Home Depot	6	J.C. Penney
7	84 Lumber	7	**Lowe's**
8	Home Club	8	National Building Centers
9	Hechinger Company	9	Diamond International
10	Sutherland Lumber	10	Vornando

Source: *Building Supply Home Centers*

According to *Building Supply Home Centers* magazine, the list of the top ten giants in our industry has changed considerably in the past year and even more radically in the last ten.

The 1987 list is missing two names that had been included for many of the last ten years. One company has returned to the list under a different name, but the other is no longer in the business. Since 1977 all but three of the names have changed. Some have disappeared through mergers and acquisitions, while in other cases the retailer no longer competes in the building supply or hardware markets. Perhaps the single biggest cause of change since 1977 has been the emergence of building materials retailing both as a more dynamic and as a more competitive growth segment of the retailing industry.

Every member of the 1987 top ten group is either a pure building materials retailer or has a specialty division devoted exclusively to those products. The implications of this competitive environment are far-reaching: with all their efforts concentrated on building materials, our competitors have already begun to use their status as giants to develop strategies to augment their market share through programs and formats targeted at the consumer.

Lowe's is among the very elite few of the giants who have not only survived but prospered from 1977 to 1987. In the past decade we have battled our way up through the rankings from a position near the bottom to the top of the list. We have been the defending champions for three years now, but our attitude is far from defensive. In our game, the team that wins is the one that can create the most loyalty among the people in the stands. The best way for Lowe's to become a giant of the Nineties is to continue making our customers into loyal fans, and vice versa.

Product Analysis

By the end of 1986, the average five-year compound growth rate for Lowe's merchandise categories had risen to 21%, up from 19% at the end of 1985. Since our company and our sales are constantly growing, every year a single percentage point represents a larger dollar amount. Considered this way, the increase over last year's increase becomes even more impressive.

Following is a discussion of sales trends in Lowe's nine major product categories.

Structural lumber: *dimensional lumber, framing, studs, joists, posts, boards, and treated lumber.*

In terms of relative gains, lumber was the third fastest growing category in 1986, ending the year with a 15% increase over 1985 sales. For the third straight year, lumber held at 18% of Lowe's total sales.

Building commodities and millwork: *roofing, gypsum, insulation, cement, masonry, plywood, siding, nails, polyethylene, doors, windows and moldings, door and window hardware.*

Gypsum and roofing prices experienced significant deflation in 1986, and those commodities held down results for the category as a whole. The decline in gypsum prices was due to deregulation in the trucking industry, which made pricing more competitive. Deflation in roofing materials was linked to the falling price of oil.

Home decorating and illumination: *paint, paneling, floor coverings, wall coverings, window coverings, cabinet hardware, light fixtures, electrical fittings, switchgear, bulbs, and chimes.*

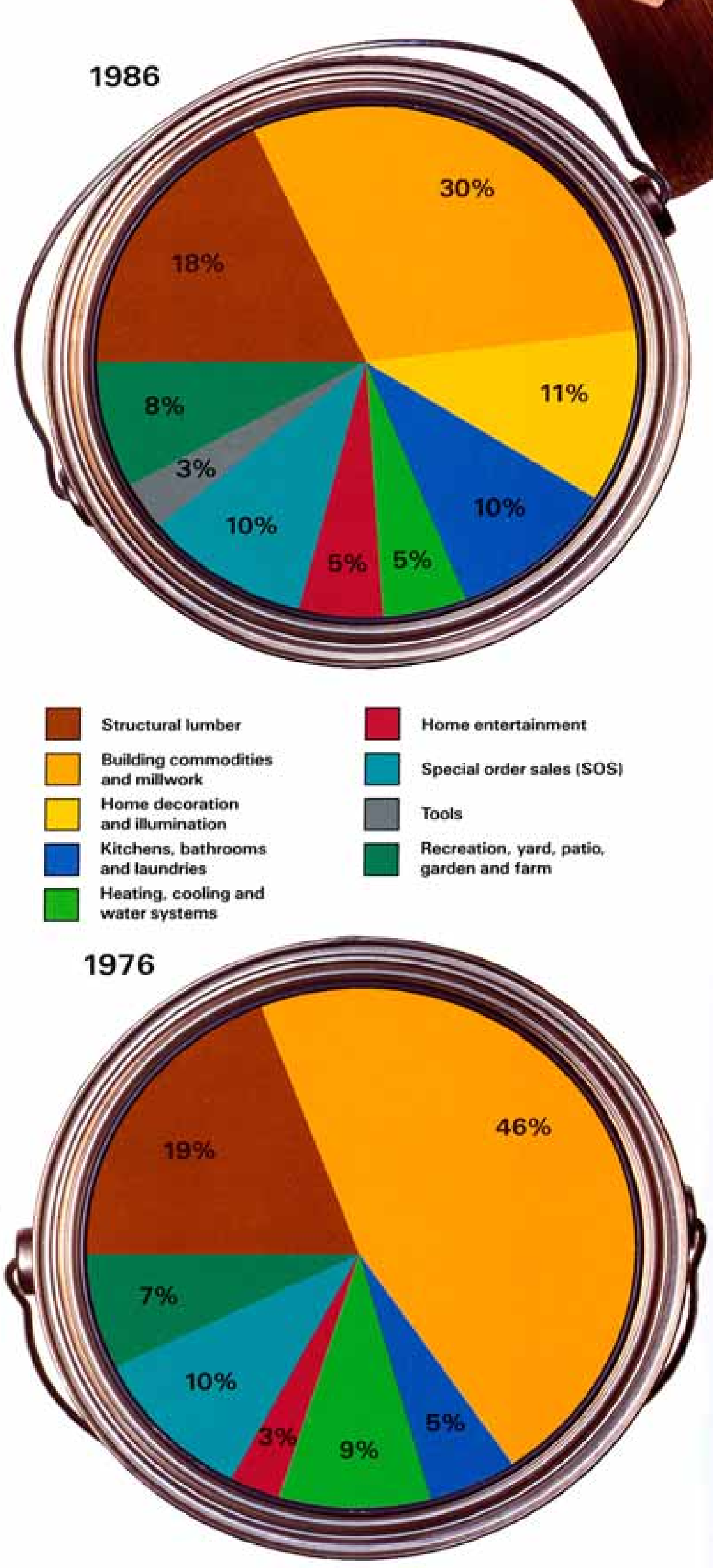
This category includes some traditional building and home improvement offerings as well as some high-margin items that we are currently emphasizing. In 1986, for the third straight year, this category represented 11% of total sales. But we expect that percentage to increase as we reallocate sales floor space to increase our margin. For example, we are moving rolls of vinyl floor coverings to our warehouses, leaving only samples on the sales floor. We are expanding our lines of light fixtures and ready-to-assemble furniture because these items represent increased margin potential.

Kitchens, bathrooms and laundries: *refrigerators, dishwashers, freezers, ovens, microwaves, sinks, kitchen cabinets and counters, disposals, trash compactors, medicine cabinets and vanities, plumbing fixtures, tileboard, and washers and dryers.*

Sales in this category increased $24 million in 1986, ending the year at 10% of total sales, the level held for two years before the slight decline to 9% in 1985.

Merchandise Sales Trends

Percent of total sales by product category



Heating, cooling, and water systems: *water heaters, pipe fittings, pumps and tanks, room air conditioners, ceiling fans, central heating and cooling units, fireplaces and accessories.*

This group realized a 6% increase of $6 million in sales for 1986, to hold steady at 5% of total sales.

Home entertainment: *stereo equipment, color and black-and-white televisions, video equipment, radios, telephones, and communication products.*

What a dynamic group! In spite of continued deflation in consumer electronics and new competition, sales in home entertainment for 1986 increased 37% over 1985's record, finishing the year as 5% of our total sales for the first time ever.

Recreation, yard, patio, garden and farm: *bicycles, wheel goods, lawn mowers, tillers, gym sets, storage buildings, lawn care products, residential and farm fence, outdoor furniture, and metal roofing.*

In 1986 this category held its 1985 level of 8% of total sales, which was a good job in view of the climatic extremes that afflicted Lowe's heartland and discouraged lawn and garden projects during the '86 growing season.

Tools: *power and hand tools, and accessories.*

This was the second fastest growing category in terms of percentages, gaining 16% over 1985 sales to hold its place at 3% of total sales.

Special order sales: *merchandise not regularly inventoried.*

Specifics of this category vary from year-to-year, but as a group these sales hover around 10% of sales.

Merchandise sales trends
Dollars in millions

			1986		1985		1984		1983		Base year 1981	
	Total sales 5-year CGR	Change from 1985	Total sales	%	Total sales	%	Total sales	%	Total sales	%	Total sales	%
Category												
1. Structural lumber	+ 22%	+ 15%	$ 419	18	$ 364	18	$ 303	18	$ 270	19	$ 157	18
2. Building commodities and millwork	+ 17	+ 5	698	30	664	32	567	33	493	34	316	36
3. Home decorating and illumination	+ 24	+ 11	265	11	239	11	183	11	149	10	92	10
4. Kitchens, bathrooms and laundries	+ 19	+ 12	221	10	197	9	170	10	142	10	93	10
5. Heating, cooling and water systems	+ 12	+ 6	110	5	104	5	93	6	85	6	62	7
6. Home entertainment	+ 36	+ 37	107	5	78	4	59	3	51	4	23	3
7. Recreation, yard, patio, garden and farm	+ 26	+ 9	177	8	163	8	117	7	86	6	56	6
8. Tools	+ 36	+ 16	65	3	56	3	36	2	25	2	14	2
9. Special order sales (SOS)	+ 24	+ 6	221	10	208	10	161	10	129	9	75	8
Totals	**+21%**	**+10%**	**$2,283**	**100**	**$2,073**	**100**	**$1,689**	**100**	**$1,430**	**100**	**$888**	**100**

Stores and Expansion

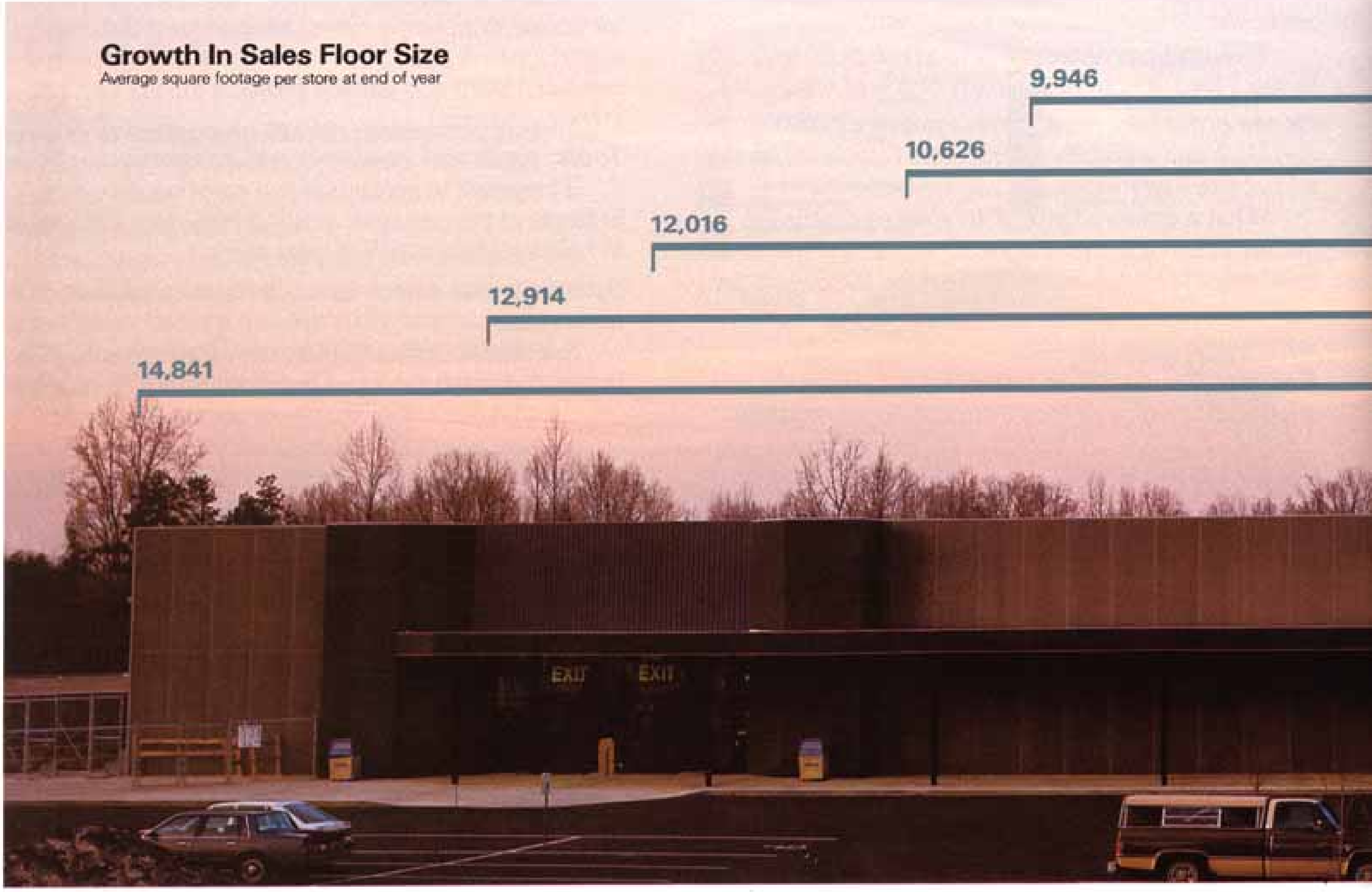
In 1986 we passed a landmark in Lowe's company history and approached a major expansion goal. The landmark was the opening of our 300th Lowe's store, an appropriate way to commemorate our 40th year in business. The goal is the completion of our 5 + 10 expansion plan, the four-year program initiated in 1983 to double our size from 2.5 to 5 million square feet through a combination of new stores and added floor space.

Our 1986 expansion schedule had called for eighteen new stores, six relocations, and fourteen retrofits totaling 753,000 square feet of added retail space, a 21% increase over 1985. We accomplished that, then went on to close three smaller stores and open three larger stores, so the total of all the changes was a net gain exceeding 22% in retail sales space.

By opening those stores ahead of schedule, not only did we get a jump on our 1987 expansion plan, but we also gave ourselves more months of sales in those stores to help offset expansion costs. The expenses for the three added stores did fall into 1986, but the benefits will also be felt sooner. With the completion of the twelve remaining retrofits and one relocation scheduled for 1987, we will end the year with more than five million square feet of sales space.

As Dwight Pardue, Lowe's Senior Executive Vice President for Real Estate, has observed, "In retailing, if you're not growing, you're shrinking." Lowe's still has a lot of growing to do, but with the 5 + 10 = 20 plan nearing completion, it became clear that our next expansion program should focus its emphasis on a slightly different type of growth potential. In Lowe's traditional, small-town markets there are 118 stores that received the RSVP treatment back in 1980 and '81 and have not been updated since then. Those stores have been some of our best performers, but 1980 is beginning to seem like a long time ago, especially since Lowe's has been expanding so dynamically in the intervening years. Now we see those smaller, mature stores as an opportunity for cost-efficient expansion in markets where we are already solidly established.

Phoenix is an expansion program designed specifically to address the renovation and expansion needs of those stores. According to classical mythology,



Sales floor size and productivity

Dollars in thousands, except sales per square foot

	1986	1985	1984	1983	1982
1. Stores open at end of year	300	282	248	238	235
2. Weighted average stores open during year[1]	291.4	273.3	240.5	235.6	232.2
Average sales floor size					
3. Total sales floor square footage, end of year	4,452,161	3,641,762	2,980,000	2,529,040	2,337,351
4. Average sales floor size, end of year[2]	**14,841**	**12,914**	**12,016**	**10,626**	**9,946**
5. Weighted average sales floor square footage during year[3]	4,043,904	3,406,684	2,722,701	2,423,382	2,281,249
Sales results					
6. Total sales	$2,283,480	$2,072,569	$1,688,738	$1,430,576	$1,034,032
7. Retail sales	1,263,411	1,099,933	880,924	723,585	570,744
8. Contractor sales	1,020,069	972,636	807,814	706,991	463,288
Sales per square foot					
9. Total sales per square foot[4]	565	608	620	590	453
10. Retail sales per square foot[5]	**312**	**323**	**324**	**299**	**250**
Average store sales					
11. Total sales per average store[6]	7,836	7,584	7,022	6,072	4,453
12. Retail sales per average store[7]	4,336	4,025	3,663	3,071	2,458
13. Contractor sales per average store[8]	$ 3,500	$ 3,559	$ 3,359	$ 3,001	$ 1,995

[1] Stores open at beginning of year, plus stores opened and closed during year computed by adding total store months of operation for new stores and closed stores and dividing by 12.

[2] Line 3 divided by line 1.

[3] Line 4 current year, plus line 4 prior year, divided by 2, multiplied by line 2.

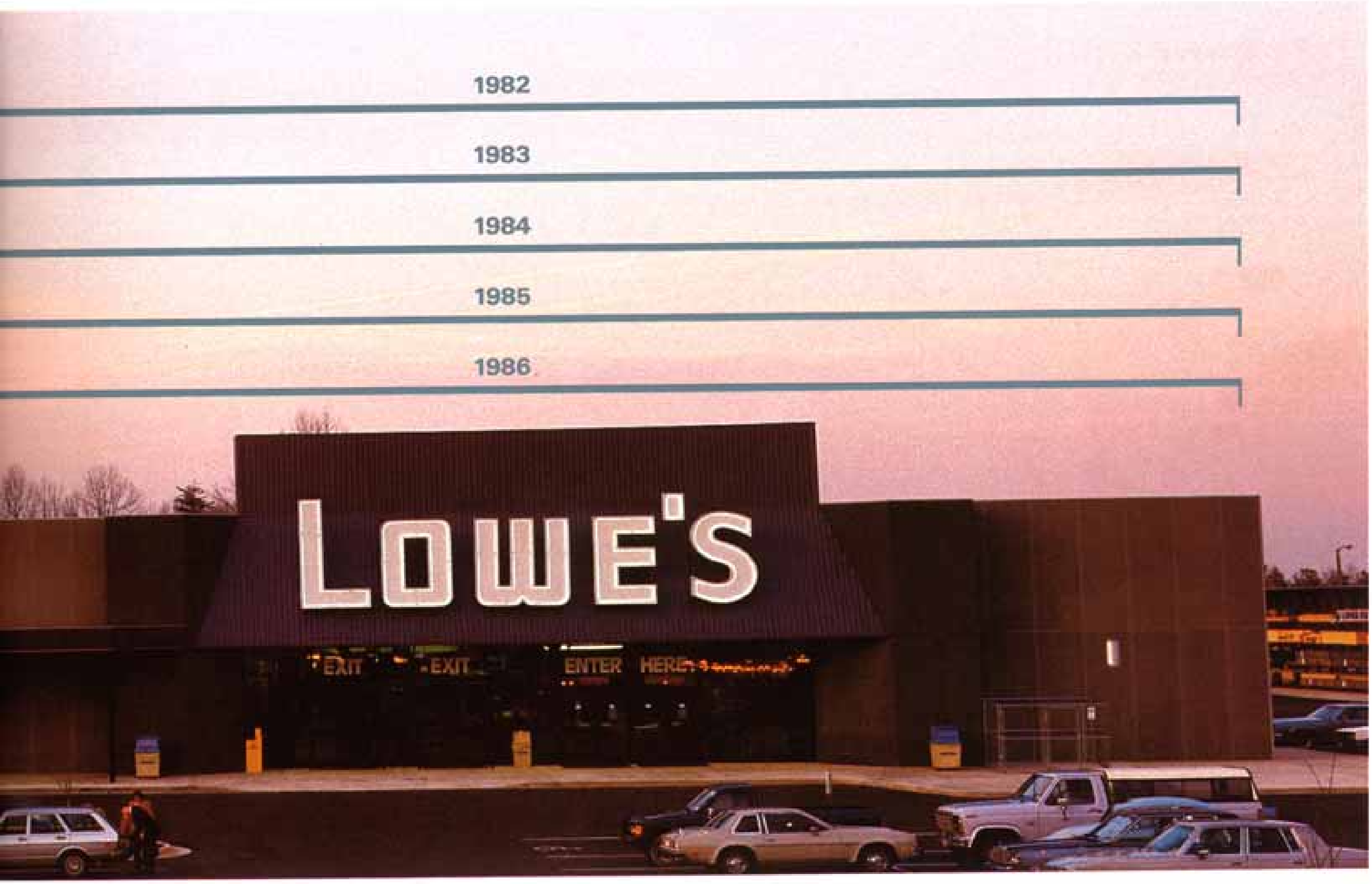
[4] Line 6 divided by line 5.

[5] Line 7 divided by line 5.

[6] Line 6 divided by line 2.

[7] Line 7 divided by line 2.

[8] Line 8 divided by line 2.



the phoenix was a bird that was reborn in spectacular new plumage from the ashes of its former life. Through the Phoenix program we will be able to create essentially new stores for our loyal customers, increasing retail space by an average of 5,000 square feet at a fraction of the cost of retrofitting, and without major disruption of normal business.

Architecturally, Phoenix adds floor space by incorporating the area formerly occupied by the loading dock and inventory storage. Once a curtain wall is hung, construction can proceed without disturbing the sales floor. Phoenix treatments can be completed in just three to four months, and cost approximately $450,000, including product gondolas and lighting fixtures for the new area. Compared with retrofitting, which costs roughly $1.2 million (not including loss of sales due to construction), Phoenix is a very economical way to increase business in a third of our stores.

The Phoenix prototype program has already begun, but will really hit its stride in 1988. Meanwhile, in the first half of 1987 virtually all of our smaller, mature stores are getting a quick boost to their appearance (and their business) from our "pre-Phoenix" package, which is designed to update their floor layout and their interior graphics.

We've had retrofits and super-retrofits; now we also have Phoenix, pre-Phoenix, and super-Phoenix (which will add roughly 7,000 square feet of retail space). With their many differences, all these procedures have a common goal: to help Lowe's grow efficiently from a small chain of smaller stores to a large chain of larger stores.

When we began our 5 + 10 program in 1983, a majority of Lowe's stores were 10,000 square feet or less. For most of a decade, during the Seventies, our new store prototype had been 11,000 square feet. Then at the beginning of the Eighties it briefly got even smaller. Now we have three new store prototypes: 20,625 square feet, 26,400 square feet, and 33,000 square feet. The three sizes are needed because some markets are not ready to support our largest stores, but can be built for easy retrofitting when the market grows.

Growth in number of stores

Our targeted expansion for 1987 includes 20 new stores (of which several are already open), one relocation, and twelve retrofits, including two Phoenix jobs and one super-Phoenix. By 1990, more than a hundred stores will have been enlarged through the Phoenix plan or by retrofitting, and more than half of Lowe's stores will be 20,000 square feet or larger.

The equation for our ruling philosophy of expansion is now 10 + X = Lowe's 1990. The 10% is growth to be accomplished by Phoenix and retrofits in our existing stores, while the X represents opportunities to grow by new units in new markets.

The increased profitability that is the incentive behind our aggressive expansion will be increasingly evident as Lowe's grows into its new clothes. Experience has shown that productivity per square foot of sales floor increases over a three to four year period following major expansion. Maturity in retailing, as in life, comes with time.

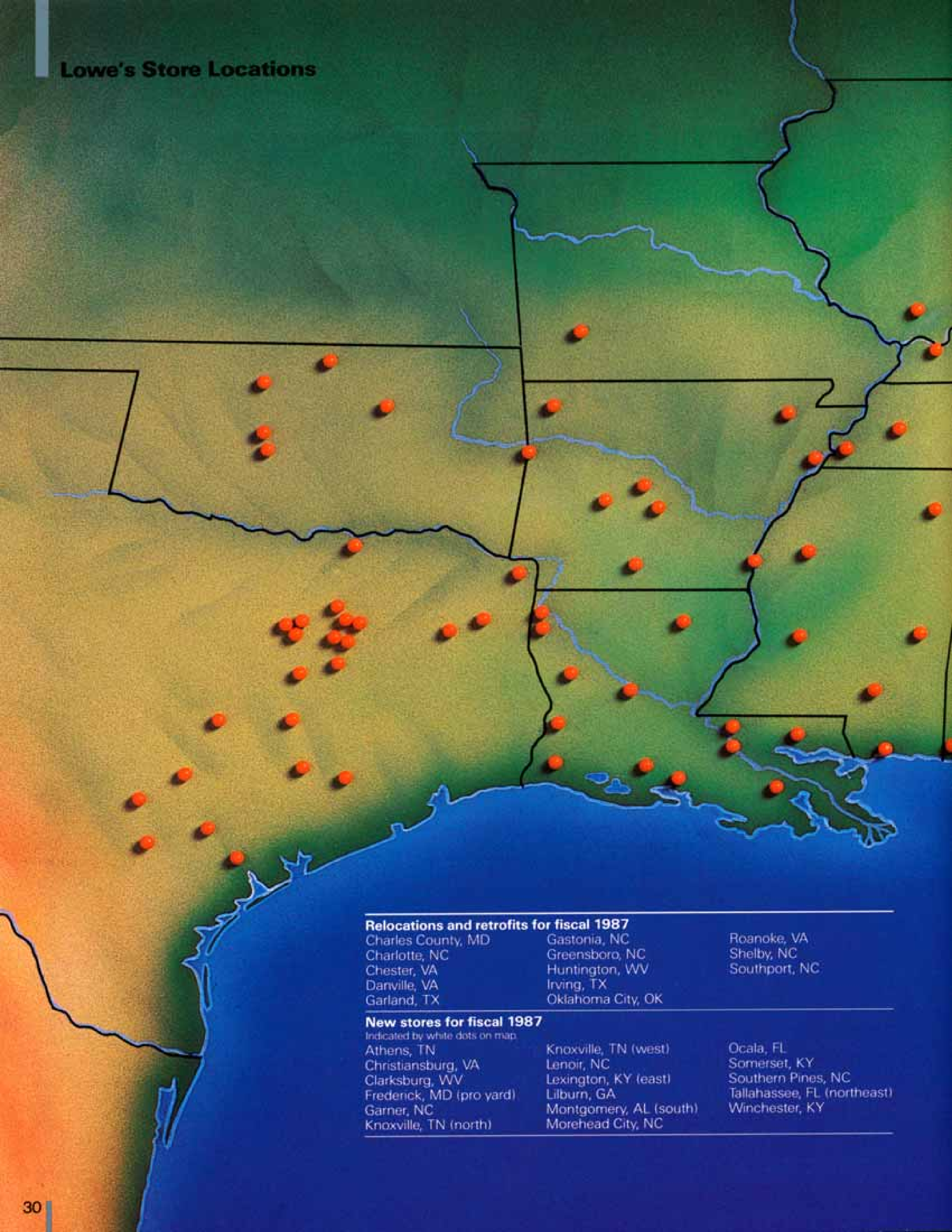
Sales analysis: comparable vs new stores
Dollars in millions

	1986	1985	1984	1983	1982
Stores open at end of year	300	282	248	238	235
Percent change total sales	**+10**	**+23**	**+18**	**+38**	**+16**
Total sales	$2,283.5	$2,072.6	$1,688.7	$1,430.6	$1,034.0
Number of comparable stores	281	248	238	235	229
Percent change comparable store sales	**+ 6**	**+10**	**+17**	**+38**	**+15**
Sales of comparable stores	$2,187.1	$1,857.4	$1,672.0	$1,428.1	$1,020.9
Sales of comparable stores previous year*	$2,055.1	$1,688.7	$1,426.8	$1,034.0	$ 888.0
Number of new stores	21	38	10	5	6
Sales of new stores	$ 96.4	$ 215.2	$ 16.7	$ 2.5	$ 13.1

*The company has closed thirteen stores since Fiscal 1978: one each in May, 1979; September, 1979; January, 1980; June, 1980; two in January, 1984; four in January, 1986; one in October 1986, and two in January 1987.


Lumber To Go
OOD
BETTER
BEST

Lowe's Store Locations



Relocations and retrofits for fiscal 1987

- Charles County, MD
- Charlotte, NC
- Chester, VA
- Danville, VA
- Garland, TX
- Gastonia, NC
- Greensboro, NC
- Huntington, WV
- Irving, TX
- Oklahoma City, OK
- Roanoke, VA
- Shelby, NC
- Southport, NC

New stores for fiscal 1987

Indicated by white dots on map

- Athens, TN
- Christiansburg, VA
- Clarksburg, WV
- Frederick, MD (pro yard)
- Garner, NC
- Knoxville, TN (north)
- Knoxville, TN (west)
- Lenoir, NC
- Lexington, KY (east)
- Lilburn, GA
- Montgomery, AL (south)
- Morehead City, NC
- Ocala, FL
- Somerset, KY
- Southern Pines, NC
- Tallahassee, FL (northeast)
- Winchester, KY

State	Stores
Alabama	12
Arkansas	8
Delaware	2
Florida	20
Georgia	25
Illinois	1
Indiana	5
Kentucky	14
Louisiana	13
Maryland	7
Mississippi	7
Missouri	1
North Carolina	58
Ohio	7
Oklahoma	5
Pennsylvania	7
South Carolina	24
Tennessee	20
Texas	23
Virginia	31
West Virginia	10
21 States	**300**


WHIRLPOOL 30" ELECTRIC RANGE
$ 609.00
$ 28.21

Financial Report

Management's Responsibility for Financial Reporting

Lowe's management is responsible for the preparation, as well as the integrity and objectivity, of the accompanying financial statements. These financial statements have been prepared in conformity with generally accepted accounting principles, and include certain amounts which represent our best estimates and judgments.

Lowe's maintains internal systems to assist in fulfilling our responsibility for financial reporting. These include an Internal Audit Department which reports directly to the Audit Committee of our Board of Directors. We view the purpose of internal auditing as independent examination and evaluation of company activities in areas such as compliance with policy, procedures, and law; the safeguarding of assets; the efficient use of resources; and the accomplishment of stated objectives and goals.

The Audit Committee of the Board of Directors is comprised of three outside directors. It meets with the company's senior financial personnel, internal auditors, and independent accountants, reports its findings to the Board of Directors and makes a recommendation of independent accountants.

The independent accountants review our systems of internal accounting control and examine Lowe's financial statements according to generally accepted auditing standards. Their report, which follows, provides an independent opinion on the fairness of our presentation of the statements.

Report of Independent Certified Public Accountants

To the Board of Directors and Shareholders
Lowe's Companies, Inc.

We have examined the consolidated balance sheets of Lowe's Companies, Inc. and subsidiary companies as of January 31, 1987, 1986 and 1985, and the related consolidated statements of current and retained earnings and of changes in financial position for each of the three fiscal years in the period ended January 31, 1987. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, such consolidated financial statements present fairly the consolidated financial position of Lowe's Companies, Inc. and subsidiary companies at January 31, 1987, 1986 and 1985, and the consolidated results of their operations and the changes in their financial position for each of the three fiscal years in the period ended January 31, 1987, in conformity with generally accepted accounting principles applied on a consistent basis.

Deloitte Haskins & Sells
Charlotte, North Carolina
March 16, 1987

Consolidated Statements of Changes in Financial Position

Lowe's Companies, Inc. and subsidiary companies
Dollars in thousands

Fiscal years end on January 31 of following year	Fiscal 1986	Fiscal 1985	Fiscal 1984
Funds Provided:			
Earnings before extraordinary item	$ 55,104	$ 59,714	$ 61,443
Charges not requiring funds:			
Depreciation	30,474	21,759	14,805
Deferred income taxes	5,165	2,386	3,443
Funds from operations before extraordinary item	**90,743**	**83,859**	**79,691**
Extraordinary item net of tax	(2,885)	—	—
Funds from operations	**87,858**	**83,859**	**79,691**
Long-term debt borrowings	9,556	100,908	48,944
Disposals of fixed assets	4,294	1,684	990
Sale of capital stock	83,039	—	—
Stock issued to ESOP	11,598	18,776	—
Tax benefit of ESOP dividend	1,039	721	—
Stock options exercised	917	13	—
Total funds provided	**$198,301**	**$205,961**	**$129,625**
Funds Applied:			
Cash dividends	$ 15,597	$ 13,199	$ 11,600
Fixed assets acquired	139,385	136,809	69,794
Current maturities and repayment of long-term debt	40,488	9,487	8,347
Other	(3,823)	6,438	5,674
Stock retirement	54	—	—
Total funds applied	**191,701**	**165,933**	**95,415**
Increase in working capital	**$ 6,600**	**$ 40,028**	**$ 34,210**
Changes in Working Capital Components: ( ) = Decrease in working capital			
Accounts receivable — net	$ (8,910)	$ 30,284	$ 2,661
Merchandise inventory	54,992	64,875	43,168
Other current assets	3,329	4,134	(986)
Current maturities of long-term debt	(1,229)	(1,590)	(1,225)
Accounts payable	4,808	(43,065)	(14,588)
Employee retirement plans	(746)	(2,236)	(2,697)
Accrued salaries and wages	(744)	1,394	(990)
Other current liabilities	(7,723)	(16,754)	(1,088)
Working capital changes before cash*	**43,777**	**37,042**	**24,255**
Increase (decrease) in cash*	**(37,177)**	**2,986**	**9,955**
Cash,* beginning of year	**87,190**	**84,204**	**74,249**
Cash,* end of year	**$ 50,013**	**$ 87,190**	**$ 84,204**

*Cash and short-term investments.

See accompanying notes to consolidated financial statements.

Management Analysis: Lowe's Financial Strategies

Funds Strategy

Our statements of changes in Lowe's financial position identify the operations and activities that were sources or uses of the company's funds. They also give us an opportunity to analyze trends and discuss strategies.

Prior to the extraordinary item, earnings dropped from $60 million to $55 million in 1986; funds from operations, before the extraordinary item, realized an 8% increase to finish the year at $91 million, up from $84 million in 1985. The increase is attributable to a 40% rise in depreciation, a noncash charge.

Some of Lowe's major sources of funds shifted emphasis in 1986, reflecting a change in strategy. For instance, Lowe's long-term debt issuance decreased to $10 million from $101 million in 1985 and $49 million in 1984. Instead of incurring more long-term debt, we chose to raise money through an issuance of common stock that netted the company $83 million. Lowe's total long-term debt now stands at $163 million.

The relationship between Lowe's major funds sources can be seen in Chart 1.

For the second straight year, Lowe's declared a dividend increase of 4¢ per share over the previous year. Cash dividends for 1986 were 40¢ per share, compared with 36¢ in 1985 and 32¢ in 1984. Including the effect of the issuance of common stock in 1986, cash dividends increased by $2.4 million or 18% over the prior year.

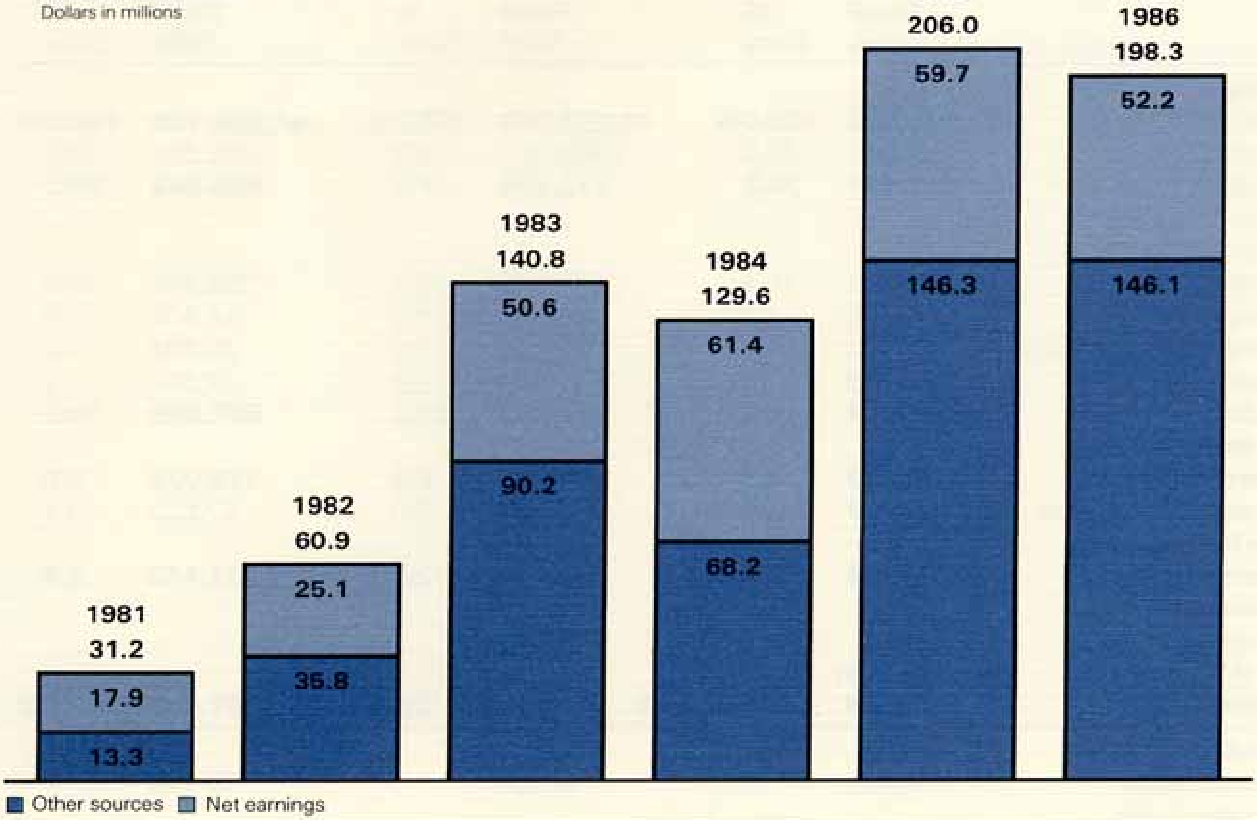
Lowe's channeled more than $139 million into acquisitions of property and equipment in 1986. This investment reflects our long-range commitment as a growth retailer by continuing our store expansion program.

The extraordinary item is the cost (net of taxes) of the early retirement of $30 million of debt. The debt retirement itself is combined on this statement with other long-term debt and capital lease payments, for a total of $40 million.

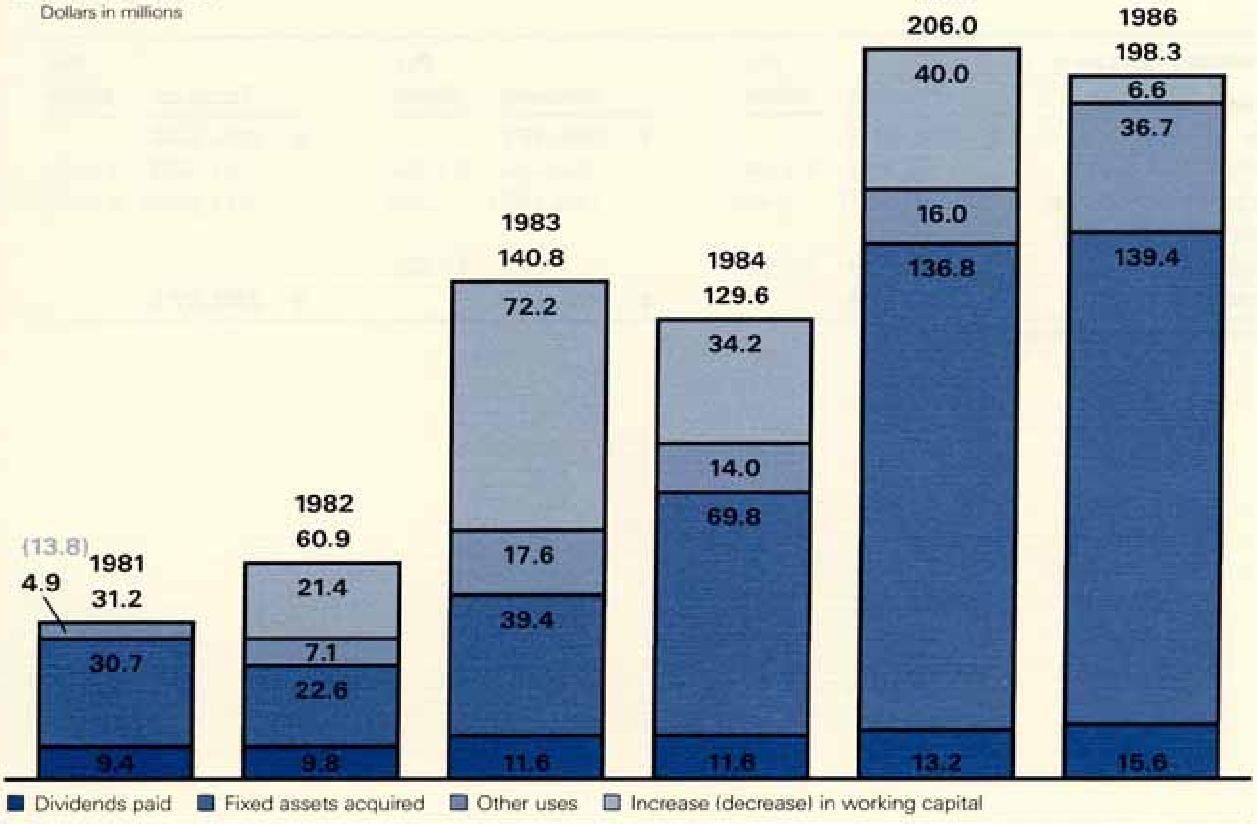
Working capital components are the dynamic elements of current assets and liabilities which are employed daily to generate sales and profits. The management of these assets in terms of their profitability and turnover is critical to Lowe's success and is reviewed in detail in the balance sheet management section.

Uses of funds are illustrated in Chart 2.

1. Sources of funds



2. Uses of funds



Consolidated Statements of Current and Retained Earnings

Lowe's Companies, Inc. and subsidiary companies
Dollars in thousands except per share data

Fiscal years end on January 31 of following year	Fiscal 1986	% Sales	Fiscal 1985	% Sales	Fiscal 1984	% Sales
Current Earnings						
Net sales	**$2,283,480**	**100.0%**	**$2,072,569**	**100.0%**	**$1,688,738**	**100.0%**
Cost of sales	1,724,370	75.5	1,560,373	75.3	1,262,394	74.8
Gross margin	**559,110**	**24.5**	**512,196**	**24.7**	**426,344**	**25.2**
Expenses:						
Selling, general and administrative	382,812	16.8	343,346	16.6	269,347	16.0
Depreciation	30,474	1.3	21,759	1.0	14,805	.9
Employee retirement plans (Note 7)	23,950	1.1	22,719	1.0	20,802	1.2
Interest (Note 12)	13,748	.6	11,507	.6	2,314	.1
Total expenses	**450,984**	**19.8**	**399,331**	**19.2**	**307,268**	**18.2**
Pre-tax earnings before extraordinary item	**108,126**	**4.7**	**112,865**	**5.5**	**119,076**	**7.0**
Income tax provision (Note 6)	53,022	2.3	53,151	2.6	57,633	3.4
Earnings before extraordinary item	**55,104**	**2.4**	**59,714**	**2.9**	**61,443**	**3.6**
Extraordinary item:						
Debt retirement net of taxes of $2,798 (Note 5)	(2,885)	(.1)	—		—	
Net earnings	**$ 52,219**	**2.3%**	**$ 59,714**	**2.9%**	**$ 61,443**	**3.6%**
Shares outstanding — weighted average	39,029		36,509		36,248	
Earnings per share:						
Before extraordinary item	**$ 1.41**		**$ 1.64**		**$ 1.70**	
Effect of extraordinary item	(.07)		—		—	
Earnings per share	**$ 1.34**		**$ 1.64**		**$ 1.70**	

Retained Earnings (Notes 5 and 8)	Amount	Per share	Amount	Per share	Amount	Per share
Balance at beginning of year	**$ 306,613**		**$ 259,377**		**$ 209,534**	
Net earnings	52,219	$ 1.34	59,714	$ 1.64	61,443	$ 1.70
Cash dividends (Notes 5 and 8)	(15,597)	(.40)	(13,199)	(.36)	(11,600)	$ (.32)
Tax benefit of ESOP dividend (Note 6)	1,039	$ .03	721	$ .02	—	
Balance at end of year	**$ 344,274**		**$ 306,613**		**$ 259,377**	

See accompanying notes to consolidated financial statements.

Management Analysis: Lowe's Financial Strategies

Earnings Statement

In 1986 Lowe's increased retail sales to 55% of total company sales, compared with 53% in 1985 and 52% in 1984. Lowe's retail business grew 15% in 1986, while contractor sales increased 5% to give us a net of 10% sales growth. Looking back over the past two years, we can observe the changing impact on sales of our acquisition from Boise Cascade. Results from those stores were a net contributor of 8% of our increase in 1985. Without the acquisition, total sales would have been up 15% instead of 23%. In 1986, excluding those stores, sales were up by 13%. For a more detailed analysis of our customer sales trends, see page 18.

While our 1986 gross margin increased by $47 million, it declined slightly as a percent of sales. One reason was too much broadly targeted promotional advertising. In our enthusiasm to attract customers into our big new Lowe's stores, we hurt our margin at smaller stores by exposing too large a portion of our product selection through promotional sales.

Another important component of the gross margin decline is inventory shrinkage, which increased from .63% of sales in 1985 to .72% in 1986. We believe that the increase is attributable to the disruption of business connected with store relocations and retrofits, increased self-service consumer sales, and unusual inventory losses in our Texas and Oklahoma stores. These losses were a part of integrating the stores acquired from Boise Cascade into our Lowe's system. Discontinued merchandise, for example, is one such loss. Even so, at three quarters of one percent our shrinkage is considerably lower than retailers generally experience.

An adjustment from FIFO to LIFO margin reveals the net effect of inflation or deflation on the cost of inventory. In 1986 the adjustment was a credit of .1% of sales, compared with credits of .2% of sales in 1985 and 1984. In 1985 the credit was due to deflation in framing and structural lumber as well as electronics. In 1986 there was actually some inflation in framing and structural lumber, but this was offset by deflation in the areas of gypsum, roofing, and some other building-related materials, as well as electronics.

The Financial Accounting Standards Board has waived its former requirement for the disclosure of supplemental information detailing the effects of changing prices. Lowe's has not experienced inflation as a major economic influence since 1983.

Selling, general, and administrative expenses increased $39 million in 1986, following an increase of $74 million in 1985. When SG&A is considered as a percentage of sales, the 1986 increase of .3% can be explained by expansion costs, our property tax expense, and increased costs of casualty insurance.

Although the major costs of expansion projects are capitalized, grand opening costs and new employee salaries are expensed as they occur. Such costs incurred in expanding sales floor square footage by more than 22% outpaced the benefits of the company sales increase of 10%.

During 1986 Lowe's obtained permission from the IRS to accelerate property tax deductions without increasing actual payments. Our property tax decision, which beneficially affected cash flow, had a negative effect of 3¢ per share on earnings.

Due to unfavorable conditions in the insurance industry, in 1986 Lowe's experienced an increase of $4.8 million in casualty insurance costs. The negative impact on earnings was 6¢ per share.

SG&A was reduced by one nonrecurring credit in 1986. A number of years ago, an antitrust suit was filed against several plywood manufacturers. In 1986 Lowe's recognized $4.9 million as our share of the settlement. The settlement reduced the 1986 SG&A total.

Depreciation increased 40% in 1986, compared with a 47% increase in 1985. Depreciation is related to Lowe's fixed assets, which rose 29% in 1986 and 46% in 1985. There is a variable lag time between acquisition of property and the increase in depreciation. By compounding the change for 1985 and 1986 in both depreciation and net property, we arrive at a measurement of the relationship between the two. Depreciation reflects a compound growth rate of 43%, while growth in net property was 45% for the same two-year period.

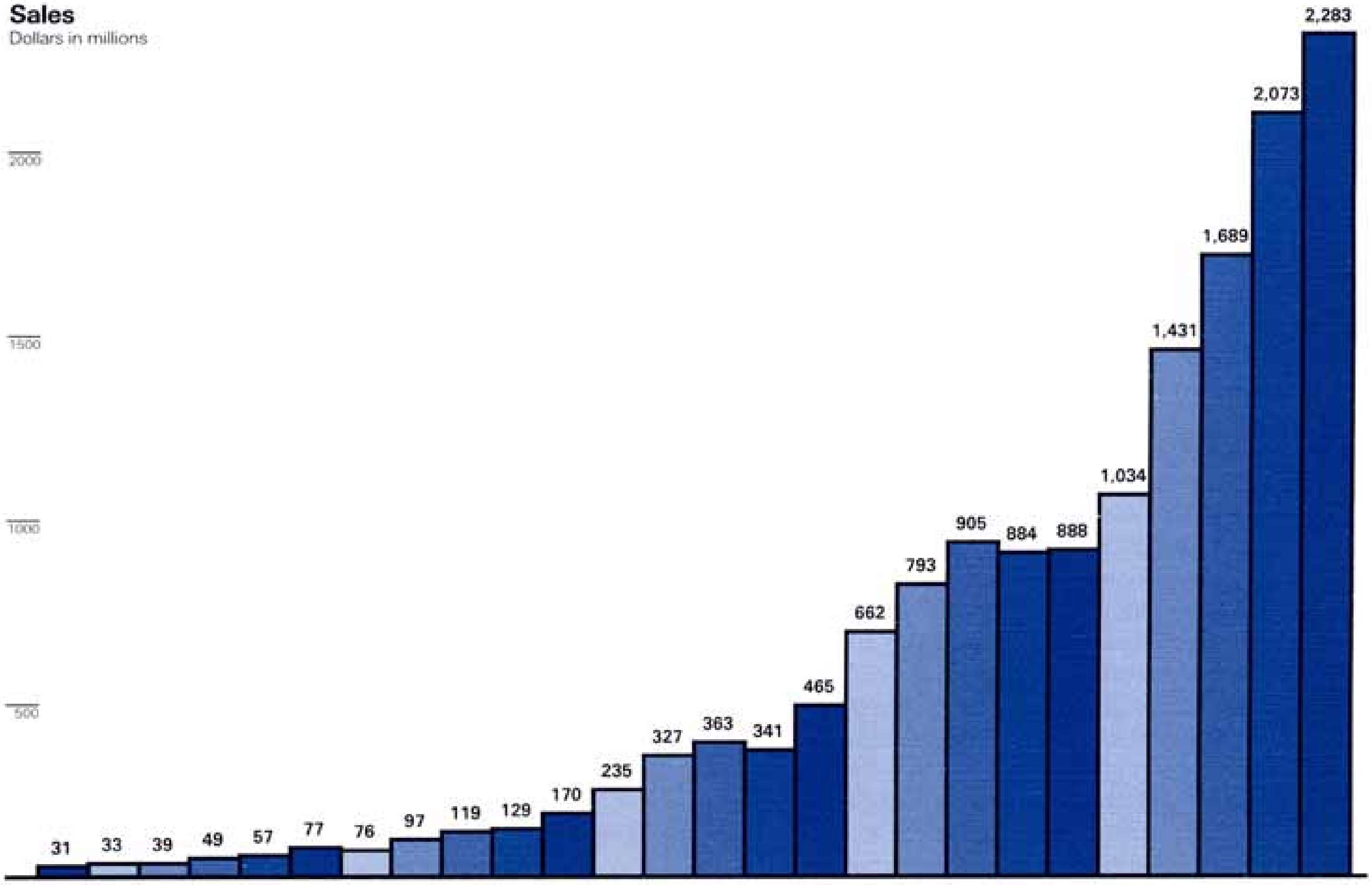
Contributions to the Employee Stock Ownership Plan as a percentage of eligible employee compensation were reduced to 13% in 1986, from 14% in 1985 and 15% in 1984. The cost of the employee retirement plans rose because of the increase in the number of our employees.

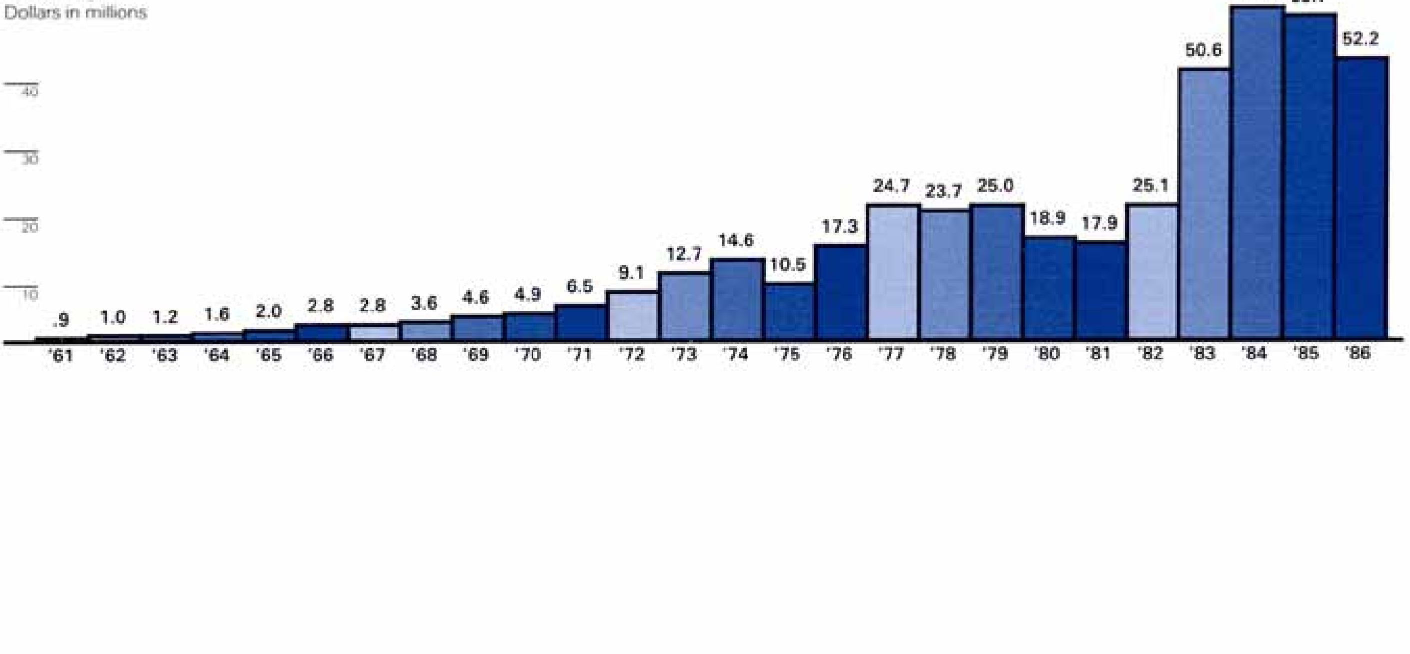
The increase of $2.2 million in interest expense in 1986 over 1985, reflects an increase in average debt outstanding during the year as a result of issuing $75 million of 11.5% notes on April 1, 1985. Lowe's accelerated the retirement of $30 million of our 11.5% notes in 1986, incurring $5.7 million of early retirement costs which decreased earnings by 7¢ per share.

Lowe's effective income tax rate rose in 1986 principally as a result of the loss of investment tax credits affecting earnings by 7¢ per share.

A Quarter Century Perspective

On the occasion of our silver anniversary as a public company we offer the following visual summary of Lowe's first twenty-five years as expressed in sales and earnings. Fiscal years from 1961 to 1976 ended on July 31; thereafter fiscal years ended on January 31.





Consolidated Balance Sheets

Lowe's Companies, Inc. and subsidiary companies
Dollars in thousands

	January 31,					
	1987	%	1986	%	1985	%
Assets						
Current assets:						
Cash and short-term investments (Note 12)	$ 50,013	5.2%	$ 87,190	10.2%	$ 84,204	13.3%
Accounts receivable — net (Note 12)	118,693	12.2	127,603	14.9	97,319	15.3
Merchandise inventory (Note 2)	368,135	38.0	313,143	36.6	248,268	39.2
Other current assets	10,042	1.0	6,713	.7	2,579	.4
Total current assets	**546,883**	**56.4**	**534,649**	**62.4**	**432,370**	**68.2**
Property, less accumulated depreciation (Notes 3 and 5)	413,220	42.6	308,603	36.0	195,237	30.8
Other assets	9,116	1.0	12,939	1.6	6,501	1.0
Total assets	**$969,219**	**100.0%**	**$856,191**	**100.0%**	**$634,108**	**100.0%**
Liabilities and Shareholders' Equity						
Current liabilities:						
Current maturities of long-term debt (Note 5)	$ 9,902	1.0%	$ 8,673	1.0%	$ 7,083	1.1%
Accounts payable	163,260	16.8	168,068	19.6	125,003	19.7
Employee retirement plans (Note 7)	22,971	2.4	22,225	2.6	19,989	3.2
Accrued salaries and wages	14,002	1.4	13,258	1.5	14,652	2.3
Other current liabilities	47,168	4.9	39,445	4.7	22,691	3.6
Total current liabilities	**257,303**	**26.5**	**251,669**	**29.4**	**189,418**	**29.9**
Long-term debt, excluding current maturities (Note 5)	152,977	15.8	183,909	21.5	92,488	14.6
Deferred income taxes (Note 6)	18,405	1.9	13,240	1.5	10,854	1.7
Total liabilities	**428,685**	**44.2**	**448,818**	**52.4**	**292,760**	**46.2**
Commitments, contingencies and litigation (Note 11)	—		—		—	
Shareholders' equity (Note 8)						
Common stock — $.50 par value; issued and outstanding: 1987 39,624,025 1986 37,082,448 1985 36,248,475	19,812	2.0	18,541	2.2	18,124	2.9
Capital in excess of par	176,448	18.2	82,219	9.6	63,847	10.1
Retained earnings	344,274	35.6	306,613	35.8	259,377	40.8
Total shareholders' equity	**540,534**	**55.8**	**407,373**	**47.6**	**341,348**	**53.8**
Total liabilities and shareholders' equity	**$969,219**	**100.0%**	**$856,191**	**100.0%**	**$634,108**	**100.0%**

See accompanying notes to consolidated financial statements.

Management Analysis: Lowe's Financial Strategies

Balance Sheet Management

Lowe's balance sheet management focuses on two basic financial strategies: the first is the structural balance of various asset components, while the second concerns the financing of these assets through an appropriate mix of equity, debt, and accounts payable. In reviewing 1986, these two basic financial strategies should be viewed as coexisting under the umbrella of our strategic growth plan.

First, on the asset side, a large portion of our assets is invested in items that "turn" around sales. Specifically, cash is invested in inventory which turns into accounts receivable, which then converts back into cash in the never-ending life cycle of business. As a group, these items have decreased from 68% of total assets in fiscal 1984 to 55% by the end of fiscal 1986. Meanwhile, our net fixed assets (that is, net of accumulated depreciation) have increased from 31% to 43% of total assets during the same period.

Inventory is Lowe's single most important asset because it is the raw material of our profitability. Therefore, we give continuing attention to its proper management. Since 1978, the inventory represented on the balance sheet has been valued using the LIFO method of accounting. However, the FIFO method better represents the current market value of the inventory, so we use FIFO for some of our internal inventory calculations. Lowe's total merchandise inventory registered a 48% increase for the two years 1984 to 1986. Yet in spite of that increase, Lowe's FIFO inventory turns (cost of sales divided by average inventory) declined only slightly over the same period, from 4.6 in 1984 and 1985 to 4.4 in 1986.

Lowe's credit offerings are a competitive advantage in the contractor sales marketplace, and accounts receivable are generated by sales to professional contractors. In 1986, due solely to an 8% drop in contractor sales in the fourth quarter, receivables finished the year down 7%. Accounts receivable turns (contractor customer sales divided by average accounts receivable) were 8.3 times for 1986. Days receivable for 1986 (ending net accounts receivable divided by the average daily sales level for the preceding 92 days) were 52 days for the third straight year.

We ended 1986 with $50 million in cash and short-term investments, down from $87 million in 1985. But that number alone is not indicative of success or failure in cash management, just as the number of coins in a millionaire's pocket is not indicative of his net worth. Strategically, in 1986 we used our cash to help finance our expansion instead of making short-term investments. For information on the interest earned from cash management, see Note 12.

Net fixed assets, which increased 112% from 1984 to 1986, represent the infrastructure for Lowe's investment in growth strategy. In 1986, fixed assets were acquired at a cost of $139 million, a further increase over 1985's $137 million. That's a compound investment of $276 million for those two years, an investment greater than the fixed asset base of $195 million with which we began 1985.

The second major balance sheet strategy involves the structuring and management of liabilities and shareholders' equity, which finance total assets. The most important components are shareholders' equity, accounts payable, and long-term debt.

From 1984 to 1985, our debt increased from 16% to 22% of total assets because in 1985 we borrowed $101 million to help finance our growth. Accordingly, equity dropped in 1985 from 54% to 48% as a percentage of total assets. In 1986 we subtracted debt and added equity, finishing the year with equity representing 56% of our total assets while debt has dropped back to 17%.

Over the last two years, equity has increased by $199 million, reaching $541 million on January 31, 1987. This increase resulted from $112 million in earnings, paying $29 million in dividends, and generating $114 million by issuing new equity (see Note 8).

With outstanding debt of $193 million at the start of 1986, we subsequently added $10 million and retired $40 million, of which $30 million was our repurchase of public notes paying 11.5% and $10 million was normal payment on the principal of other long-term debts. On January 31, 1987 our debt stood at $163 million. Of $9.9 million in current long-term debt maturities, $3.4 million represents capital leases and $6.5 million other notes.

The accounts payable balance is determined principally by inventory levels, payment terms upon purchase, and purchasing trends. Consequently, it fluctuates as a percent of inventory and as a source of financing. The days payable (ending accounts payable balances divided by the average daily purchases) on January 31, 1987, 1986, and 1985 were 33, 38, and 35 days respectively.

The remaining liabilities, which have funded 10% of Lowe's assets for the past three years, represent various obligations including current and deferred income taxes, other current liabilities and accruals, and employee benefits. During 1984, no short-term borrowings were required; a limited amount did occur during 1985 and 1986.

The "commitments, contingencies, and litigations" line of our balance sheet refers to outstanding purchase commitments. Lowe's is committed to invest approximately $21 million for land, buildings, and construction of store facilities, and $9 million for equipment, including computer systems and point-of-sales registers for our stores.

We hope that this discussion of our balance sheet will give shareholders a better understanding of the components of balance sheet management.

Notes to Consolidated Financial Statements

Lowe's Companies, Inc. and subsidiary companies
Fiscal years ended January 31, 1987, 1986 and 1985

Note 1, Summary of Significant Accounting Policies:

The Company is a specialty retailer of building materials and related products for home improvement and home construction markets serving both the do-it-yourself retail customer and the contractor. Below are those policies considered particularly significant.

Subsidiaries and principles of consolidation — The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly owned. All material intercompany accounts and transactions have been eliminated.

Short-term investments — The Company has a cash management program which provides for the investment of excess cash balances in short-term instruments which generally mature within 30 days. These investments are stated at cost which approximates market. Interest is accrued when earned.

Accounts receivable — Allowance for doubtful accounts is based on historical experience coupled with a review of existing receivables. Installment receivables arising from consumer sales are sold, without recourse, to an outside finance company.

Merchandise inventory — Inventory is stated at the lower of cost or market. Cost is determined using the last-in, first-out (LIFO) method.

Property and depreciation — Property is recorded at cost. Costs associated with major additions are capitalized and depreciated. Upon disposal, cost of properties and related accumulated depreciation are removed from the accounts with gains and losses reflected in earnings.

The provision for depreciation is based generally on accelerated methods for assets placed in service before January 1, 1981; subsequent additions are depreciated on the straight-line method.

Leases — Assets under capital leases are amortized in accordance with the Company's normal depreciation policy for owned assets. The charge to earnings resulting from amortization of these assets is included in depreciation expense in the consolidated financial statements.

Income taxes — Income taxes are provided on pre-tax earnings as reported in the consolidated financial statements. Deferred income taxes result from timing differences between pre-tax earnings reported in the consolidated financial statements and taxable income. Investment tax credits were accounted for as a reduction of income tax expense in the year in which the credits were utilized (the flow-through method). In October 1986, the investment tax credit allowances were legislatively repealed retroactive to January 1, 1986.

Employee retirement plans — Since 1957 the Company has maintained benefit plans for its employees as described in Note 7. The plans are funded annually.

Interest costs — Interest costs associated with new store construction are capitalized and charged to earnings over the lives of the related assets.

Earnings per share — Earnings per share are calculated on the weighted average shares of common stock and dilutive common stock equivalents outstanding each year.

Reclassification — Certain amounts in Fiscal 1985 and Fiscal 1984 have been reclassified to conform with the Fiscal 1986 classification.

Note 2, Merchandise Inventory:

The Company uses the LIFO method to determine inventory costs. If the first-in, first-out (FIFO) method had been used, inventories would have been $21.8 million, $24.7 million and $28.2 million higher at January 31, 1987, 1986 and 1985, respectively. Under FIFO, net earnings would have decreased $1.5 million or 4 cents per share in Fiscal 1986, $1.7 million or 5 cents per share in Fiscal 1985, and $1.3 million or 4 cents per share in Fiscal 1984.

Note 3, Property and Accumulated Depreciation:

Property is summarized below by major classes with estimated lives in years as follows: buildings, 20 to 30; store and office equipment, 3 to 10; and leasehold improvements, generally over the remaining life of the lease.

Net property includes $22.4 million, $16.8 million, and $13.9 million in assets under capital leases for Fiscal 1986, 1985 and 1984 respectively.

	January 31,		
	1987	1986	1985
Dollars in thousands			
Cost:			
Land	$ 77,595	$ 61,402	$ 36,610
Buildings	258,559	189,408	120,109
Store and office equipment	165,838	131,202	98,603
Leasehold improvements	28,097	27,959	25,233
Total cost	**530,089**	**409,971**	**280,555**
Accumulated depreciation	(116,869)	(101,368)	(85,318)
Net property (Note 10)	**$413,220**	**$308,603**	**$195,237**

Note 4, Short-Term Borrowings and Lines of Credit:

The Company has agreements with a group of banks which provide for short-term unsecured borrowings of up to $50 million with interest at the lower of prime or bank transaction rate, none of which was outstanding at January 31, 1987, 1986 or 1985.

In addition, a bank has extended to the Company a $50 million line of credit for the purpose of issuing letters of credit and bankers' acceptances.

There was no short-term borrowing during Fiscal 1984. The following relates to aggregate short-term borrowing from banks in Fiscal 1985 and 1986:

	Fiscal 1986	**Fiscal 1985**
Dollars in thousands		
Maximum amount outstanding at any month-end	$15,000	$29,900
Average amount outstanding (based on weighted daily average)	$ 2,973	$ 1,475
Weighted average interest rate (ratio of actual interest expense to average amount outstanding)	6.6%	9.3%

Note 5, Long-Term Debt:

Debt category	**Interest rates January 31, 1987**	**Year of maturity**	**January 31,** **1987**	**1986**	**1985**
Dollars in thousands					
Secured debt[1]**:**					
Insurance company notes	6.75% to 9%	1998	$ 15,795	$ 17,624	$ 20,391
Bank notes	7% to 12%	1994	493	832	822
Industrial revenue bonds	7% to 10.625%	2014	2,720	2,865	900
Industrial revenue bonds	64% to 70% of prime	1998	7,007	7,799	8,535
Other notes	2.0% to 10%	2004	1,395	1,652	25
Unsecured debt:					
Insurance company[2]	8.25% to 12.75%	1994	38,100	40,200	42,300
Industrial revenue bonds	62% to 63% of prime	2000	17,245	17,400	12,000
Industrial revenue bonds[3]	5.4%	2005	11,700	11,700	—
Unsecured notes	11.5%	1995	44,843	74,707	—
Capital leases (Note 10)	**6.1% to 14.6%**	**2018**	**23,581**	**17,803**	**14,598**
Total long-term debt			**162,879**	**192,582**	**99,571**
Less current maturities			**9,902**	**8,673**	**7,083**
Long-term debt, excluding current maturities			**$152,977**	**$183,909**	**$92,488**

The Company, in a public offering on April 1, 1985, issued $75 million of 11.5% unsecured notes at a discount of .426%. The discount and issuance costs are being amortized over the life of the indebtedness. In January 1987, the Company accelerated the retirement of $30 million of this debt and, as a result, incurred $5.7 million of early retirement costs which reduced Fiscal 1986 earnings by 7 cents per share. These early retirement costs are shown net of related income tax effects as an extraordinary item in the accompanying consolidated statement of current and retained earnings for Fiscal 1986. The remaining notes may be redeemed in whole or in part, without penalty, by the Company at any time after April 1, 1992 at the principal amount and accrued interest to the date fixed for redemption. The notes are governed by an indenture which, among other things, places certain restrictions on the issuance or guarantee of additional indebtedness.

Debt maturities, exclusive of capital leases (see Note 10), for the next five fiscal years are as follows (in millions): 1987 — $6.5; 1988 — $7.0; 1989 — $7.4; 1990 — $5.8; 1991 — $6.0.

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[1] Real properties pledged as collateral for secured debt had net book values, in millions, at January 31, 1987, as follows: Insurance company notes — $43.7; Bank notes — $1.9; Industrial revenue bonds — $11.5; and Other notes — $8.4. In addition, $4.4 million of unexpended industrial revenue bond proceeds are included in other assets in the accompanying financial statements and are restricted for acquisition of capital assets or repayment of the debt.

[2] The insurance company loans require that certain financial conditions be maintained, restrict other borrowings, and limit the payment of dividends. After giving effect to the most restrictive provisions, approximately $131.4 million of consolidated retained earnings is available for payment of dividends.

[3] The Company issued notes to secure $11.7 million of Floating Rate Monthly Demand Industrial Revenue Bonds in Fiscal 1985. The interest rates are tied to an Interest Index based on comparable securities traded at par and other pertinent financial market rates. The Bonds can be converted to a fixed interest rate based on a Fixed Interest Index at the Company's option and with certain restrictions.

Note 6, Income Taxes:

	Fiscal 1986		Fiscal 1985		Fiscal 1984	
Fiscal years end on January 31 of following year	**Amount**	**%**	**Amount**	**%**	**Amount**	**%**
Dollars in thousands	**Statutory rate reconciliation**					
Before extraordinary item:						
Income before income taxes	**$108,126**	**100.0%**	**$112,865**	**100.0%**	**$119,076**	**100.0%**
Federal income tax at statutory rate	49,738	46.0	51,918	46.0	54,775	46.0
State income taxes — net of federal tax benefit	3,739	3.4	3,674	3.3	3,803	3.2
Investment tax credits	(306)	(.3)	(2,552)	(2.3)	(1,513)	(1.3)
Other	(149)	(.1)	111	.1	568	.5
Total tax provision before extraordinary item	**53,022**	**49.0**	**53,151**	**47.1**	**57,633**	**48.4**
Extraordinary item	(2,798)	49.2	—	—	—	—
Total income tax provision	**$ 50,224**	**49.0%**	**$ 53,151**	**47.1%**	**$ 57,633**	**48.4%**
	Components of income tax provision					
Before extraordinary item:						
Current						
Federal	$ 41,517	82.7%	$ 44,325	83.4%	$ 47,489	82.4%
State	6,340	12.6	6,440	12.1	6,701	11.6
Total current	**47,857**	**95.3**	**50,765**	**95.5**	**54,190**	**94.0**
Deferred						
Federal	4,582	9.1	2,023	3.8	3,102	5.4
State	583	1.2	363	.7	341	.6
Total deferred	**5,165**	**10.3**	**2,386**	**4.5**	**3,443**	**6.0**
Total tax provision before extraordinary item	**53,022**	**105.6**	**53,151**	**100.0**	**57,633**	**100.0**
Extraordinary item:						
Current	(2,798)	(5.6)	—	—	—	—
Total tax provision	**$ 50,224**	**100.0%**	**$ 53,151**	**100.0%**	**$ 57,633**	**100.0%**

Income tax benefits of $1,039 thousand (Fiscal 1986) and $721 thousand (Fiscal 1985) related to ESOP dividend deductions have been credited directly to retained earnings and, accordingly, have not been reflected as an offset to the income tax provision in the consolidated statements of current and retained earnings. Deferred income taxes arise principally from the different treatment of depreciation and certain insurance costs for financial reporting and income tax purposes.

The Company's consolidated federal tax returns for Fiscal 1981 and 1982 have been examined by the Internal Revenue Service. The federal tax returns for Fiscal 1983 and 1984 are currently under examination. Examinations are considered routine for companies of Lowe's size. None of the Internal Revenue Service's proposed adjustments would materially affect the Company's consolidated financial statements.

As a result of the Tax Reform Act of 1986, the investment tax credit was repealed, subject to certain transition provisions, retroactive to January 1, 1986.

Note 7, Employee Retirement Plans:

Lowe's Companies Profit-Sharing Plan and Trust held approximately 4% of the outstanding shares of the Company at January 31, 1987. Contributions to this plan were discontinued effective December 31, 1977, and accounts of plan members became fully vested at that time.

The Board of Directors approved an Employee Stock Ownership Plan (ESOP) effective January 1, 1978. The Company's contribution to the ESOP is approved annually by the Board of Directors. For Fiscal 1986, 1985 and 1984, respectively, the Board authorized contributions of 13%, 14% and 15% of eligible compensation. In addition, the ESOP included a tax credit employee stock ownership plan which was fully funded by federal income tax credits of $592 thousand, $586 thousand and $585 thousand in Fiscal 1986, 1985, and 1984 respectively. This credit was legislatively repealed as of January 1, 1987. On October 10, 1985, the Company issued 833,373 common shares with an aggregate market value of $18.8 million to the ESOP as part of the Company's Fiscal 1984 contribution. On May 15, 1986, the Company issued 300,000 shares of common stock with an aggregate market value of $11.6 million to the ESOP as part of the Company's Fiscal 1985 contribution (Note 8). At January 31, 1987, the Employee Stock Ownership Trust held approximately 18% of the outstanding stock of the Company and was its largest shareholder.

An Employee Savings and Investment Plan was established during Fiscal 1984. Annually, the Board of Directors approves contributions to this plan based upon a matching formula applied to employee contributions. The annual cost for this plan ranged from $1.3 to $1.7 million during Fiscal 1984, 1985 and 1986.

Note 8, Shareholders' Equity:

Authorized shares of common stock were 120 million at January 31, 1987 and 1986, and 60 million at January 31, 1985.

On April 25, 1986, the Company sold 2.2 million shares of common stock. The net proceeds of $83 million were added to the general funds of the Company and were used to finance the land, buildings, and equipment for new and existing stores and to fund working capital.

Transactions affecting the shareholders' equity section of the consolidated balance sheets are summarized as follows:

In thousands	Shares	Dollars in thousands			Shareholders' equity
	Issued and outstanding	**Common stock**	**Capital in excess of par value**	**Retained earnings**	**Total equity**
Balance Jan. 31, 1984	**36,248**	**$18,124**	**$ 63,847**	**$209,534**	**$291,505**
Net earnings	—	—	—	61,443	61,443
Cash dividends	—	—	—	(11,600)	(11,600)
Balance Jan. 31, 1985	**36,248**	**18,124**	**63,847**	**259,377**	**341,348**
Shares issued to ESOP	833	417	18,359	—	18,776
Net earnings	—	—	—	59,714	59,714
Cash dividends	—	—	—	(13,199)	(13,199)
Tax benefit of ESOP dividend deduction	—	—	—	721	721
Stock options exercised (Note 9)	1	—	13	—	13
Balance Jan. 31, 1986	**37,082**	**18,541**	**82,219**	**306,613**	**407,373**
Sale of stock	2,200	1,100	81,939	—	83,039
Shares issued to ESOP	300	150	11,448	—	11,598
Net earnings	—	—	—	52,219	52,219
Cash dividends	—	—	—	(15,597)	(15,597)
Tax benefit of ESOP dividend deduction	—	—	—	1,039	1,039
Stock options exercised (Note 9)	43	22	895	—	917
Shares retired	(1)	(1)	(53)	—	(54)
Balance Jan. 31, 1987	**39,624**	**$19,812**	**$176,448**	**$344,274**	**$540,534**

The Company has 5 million authorized shares of preferred stock (no par), none of which have been issued. The preferred stock may be issued by the Board of Directors (without action by the stockholders) in one or more series, having such voting rights, dividend and liquidation preference and such conversion and other rights as may be designated by the Board of Directors at the time of issuance of the preferred shares.

Note 9, Stock Options:

During Fiscal 1985, shareholders approved a stock option plan under which incentive or non-qualified stock options may be granted to key employees of the Company; one million common shares were reserved for option purposes. Options granted are exercisable from date of grant through 1991.

Option information is summarized as follows:

		Option price	
Dollars in thousands, except per share data	**Shares**	**Per share**	**Total**
Granted during Fiscal 1985	**219,650**	**$21.375 to $23.375**	**$4,697**
Exercised	600	21.375	13
Outstanding January 31, 1986	**219,050**	**21.375 to 23.375**	**4,684**
Cancelled or expired	12,850	21.375	275
Exercised	42,890	21.375	917
Outstanding January 31, 1987	**163,310**	**$21.375 to $23.375**	**$3,492**

Note 10, Leases:

The future minimum rental payments required under capital and operating leases having initial or remaining noncancelable lease terms in excess of one year are summarized as follows:

	Operating leases		Capital leases		
Fiscal year	**Real estate**	**Equipment**	**Real estate**	**Equipment**	**Total**
Dollars in thousands					
1987	$ 3,413	$ 1,159	$ 1,066	$ 4,557	$ 10,195
1988	2,660	613	1,066	3,657	7,996
1989	2,382	210	1,066	3,326	6,984
1990	2,152	49	1,066	3,066	6,333
1991	1,913	—	1,066	2,127	5,106
Later years	6,881	—	23,867	1,531	32,279
Total minimum lease payments	**$19,401**	**$2,031**	**$29,197**	**$18,264**	**$68,893**
Total minimum capital lease payments			$ 47,461		
Less amount representing interest			23,880		
Present value of minimum lease payments			23,581		
Less current maturities			3,412		
Present value of minimum lease payments, less current maturities			**$20,169**		

Rental expenses for real estate and equipment were $6.8 million, $6.6 milion, and $6.0 million in Fiscal 1986, 1985, and 1984 respectively.

Note 11, Commitments, Contingencies and Litigation:

The Company had purchase commitments at January 31, 1987 of approximately $20.8 million for land, buildings and construction of facilities, and $8.8 million for equipment.

The Company is defendant in various lawsuits incurred in the normal course of business. There is no material litigation pending not covered by insurance.

Note 12, Other Information:

The allowance for doubtful accounts, which is netted with accounts receivable in the consolidated balance sheets, is summarized as follows:

Year ended January 31,	1987	1986	1985
Dollars in thousands			
Allowance for doubtful accounts:			
Balance beginning of year	$ 4,531	$ 4,162	$ 4,047
Additions charged to expenses	5,135	4,594	2,964
Deductions for accounts charged off	(5,339)	(4,225)	(2,849)
Balance end of year	**$ 4,327**	**$ 4,531**	**$ 4,162**

Interest expense is comprised of the following:

Year ended January 31,	1987	1986	1985
Dollars in thousands			
Long-term debt	$ 19,691	$ 17,138	$ 6,049
Short-term debt	202	137	—
Amortization of loan costs	158	122	30
Short-term interest income	(2,634)	(2,711)	(2,765)
Interest capitalized	(3,669)	(3,179)	(1,000)
Net interest expense	**$13,748**	**$11,507**	**$ 2,314**

Cash and short-term investments are comprised of the following:

As of January 31,	1987	1986	1985
Dollars in thousands			
Cash	$ 6,525	$ 5,884	$ 1,740
Short-term investments	43,488	81,306	82,464
Total	**$50,013**	**$87,190**	**$84,204**

Advertising expenses were $34.5, $33.0 and $26.2 million for Fiscal 1986, 1985 and 1984, respectively.

Selected Financial Data

Lowe's Companies, Inc. and subsidiary companies
Dollars in thousands, except per share data

Fiscal years end on January 31 of following year	1986	1985	1984	1983	1982
Selected income statement data:					
Net sales	$2,283,480	$2,072,569	$1,688,738	$1,430,576	$1,034,032
Earnings before extraordinary item	55,104	59,714	61,443	50,615	25,131
Extraordinary item:					
Debt retirement net of taxes of $2,798	(2,885)	—	—	—	—
Net earnings	52,219	59,714	61,443	50,615	25,131
Earnings per common share*					
Before extraordinary item	1.41	1.64	1.70	1.40	.75
After extraordinary item	$ 1.34	$ 1.64	$ 1.70	$ 1.40	$ .75
Selected balance sheet data:					
Total assets	$ 969,219	$ 856,191	$ 634,108	$ 519,637	$ 393,500
Long-term debt, including current maturities	$ 162,879	$ 192,582	$ 99,571	$ 57,749	$ 61,864

Selected quarterly data**

Three months ended	January 31	October 31	July 31	April 30
Fiscal 1986				
Net sales	$497,368	$594,275	$657,845	$533,992
Gross margin	124,849	144,756	159,752	129,753
Earnings before extraordinary item	10,053	12,416	21,251	11,384
Net earnings	7,168	12,416	21,251	11,384
Earnings per share before extraordinary item	.25	.31	.54	.31
Earnings per share*	.18	.31	.54	.31
Fiscal 1985				
Net sales	475,572	549,031	595,636	452,330
Gross margin	120,010	132,552	148,312	111,322
Net earnings	11,318	15,588	20,920	11,888
Earnings per share*	.31	.43	.58	.33
Fiscal 1984				
Net sales	375,858	447,702	484,880	380,298
Gross margin	98,960	112,785	120,358	94,241
Net earnings	10,505	17,665	20,543	12,730
Earnings per share*	$ .29	$ .49	$ .57	$ .35

*Retroactive effect has been given to the five-for-three stock split in the form of a dividend payable to shareholders of record on April 14, 1983.

****LIFO Adjustment**

Fiscal 1986 — The total LIFO effect for the year was a credit of $3.0 million. The Company had previously charged $.6 million against earnings through the first nine months, resulting in a fourth quarter credit of $3.6 million.

Fiscal 1985 — The total LIFO effect for the year was a credit of $3.4 million. The Company had no charge against earnings through the first nine months, resulting in a fourth quarter credit of $3.4 million.

Plywood Antitrust Litigation

In Fiscal 1986 the fourth quarter included $4.9 million income (before income taxes) from the settlement of a class action suit against several plywood manufacturers.

Property Tax Adjustment

In Fiscal 1986 the Company obtained permission from the IRS to accelerate its property tax expenses, without increasing actual property tax payments. This afforded the Company an additional deduction in Fiscal 1986 of $2.5 million, of which $1.4 million was charged to the fourth quarter and $1.1 million to the third quarter. This created positive cash flow as a result of the additional tax deduction at the 46% federal income tax rate, which was particularly timely in view of the reduced 1987 tax rates under the Tax Reform Act of 1986.

Profitability Model

Fiscal 1986 figures*
Dollars in millions

Sales, profit assets, equity	Organization (Stock symbol)	Sales	Profit	Beginning assets	Ending assets	Beginning shareholders' equity	Ending shareholders' equity
	Lowe's (LOW)	**$ 2,283.5**	**$ 52.2**	**$ 856.2**	**$ 969.2**	**$ 407.4**	**$ 540.5**
	Dayton Hudson (DH)	9,260.0	255.0	4,417.5	5,282.0	1,947.4	2,179.5
	Home Depot (HD)	1,011.5	23.9	380.2	394.7	89.1	163.0
	Payless Cashways (PCI)	1,525.6	42.4	605.8	709.4	332.9	369.8
	Toys R Us (TOY)	2,445.0	152.2	1,226.0	1,523.0	714.7	901.0
	Wal-Mart (WMT)	$11,909.1	$450.1	$3,103.6	$4,049.1	$1,277.7	$1,690.5

ROE calculation		Asset[1] turnover	×	Return[2] on sales	=	Return[3] on assets	×	Leverage[4] factor	=	Return[5] on equity
	Lowe's (LOW)	**2.67**		**2.29%**		**6.11%**		**2.10**		**12.83%**
	Dayton Hudson (DH)	2.10		2.75		5.78		2.27		13.12
	Home Depot (HD)	2.66		2.36		6.28		4.27		26.82
	Payless Cashways (PCI)	2.52		2.78		7.01		1.82		12.76
	Toys R Us (TOY)	1.99		6.23		12.40		1.72		21.33
	Wal-Mart (WMT)	3.84		3.78%		14.52%		2.43		35.28%

Employees		Number[6] of employees	Sales[7] per employee	Profit[8] per employee
	Lowe's (LOW)	**14,783**	**$154,468**	**$3,531**
	Dayton Hudson (DH)	120,000	77,167	2,125
	Home Depot (HD)	7,000	144,500	3,414
	Payless Cashways (PCI)	13,685	111,480	3,098
	Toys R Us (TOY)	22,000	111,136	6,918
	Wal-Mart (WMT)	141,000	$ 84,462	$ 3,192

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*Lowe's year ended 1/31. Dayton Hudson ended 1/31, Home Depot ended 2/1 and Payless ended 11/29. Toys ended 2/1 and Wal-Mart ended 1/31.

[1] Total sales divided by beginning assets

[2] Total profit divided by total sales

[3] Total profit divided by beginning assets

[4] Beginning assets divided by beginning equity

[5] Total profit divided by beginning equity

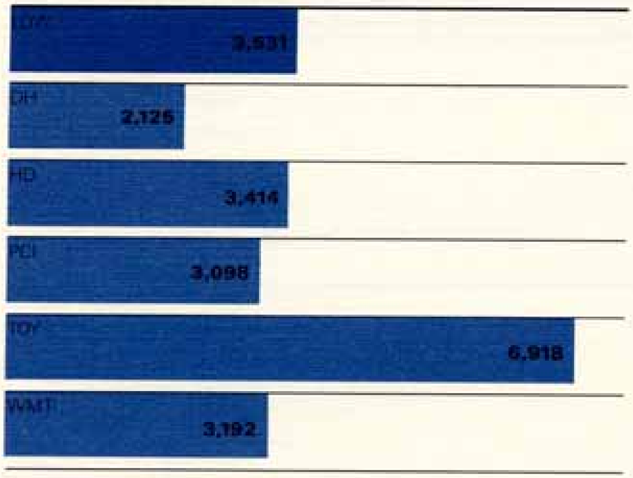
[6] At year-end

[7] Total sales divided by number of employees

[8] Total profit divided by number of employees

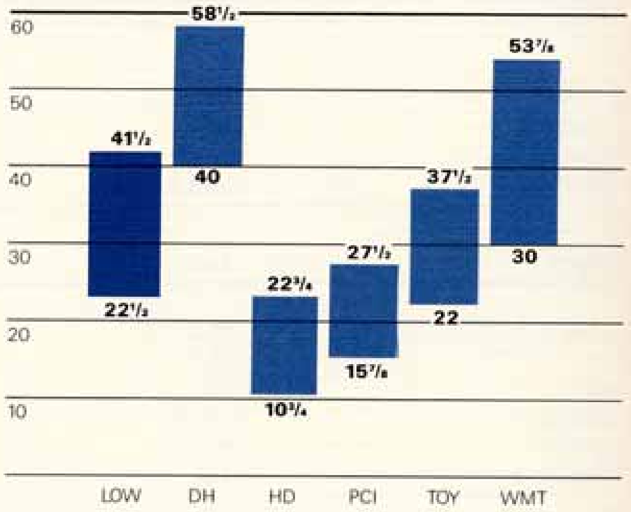
Profit per employee

Dollars



Stock price range

52-week low to high ending on January 30, 1987



LOW Lowe's
DH Dayton-Hudson
HD Home Depot
PCI Payless Cashways
TOY Toys R Us
WMT Wal-Mart

Stock Performance

Lowe's quarterly stock price range and cash dividend payment*

	Fiscal 1986			Fiscal 1985			Fiscal 1984		
	High	**Low**	**Dividend**	**High**	**Low**	**Dividend**	**High**	**Low**	**Dividend**
1st quarter	$41 3/8	$27 3/4	$.10	$30	$25 5/8	$.09	$21 3/4	$17 5/8	$.08
2nd quarter	41 1/2	29 1/4	.10	31 1/8	24	.09	22 1/8	16 1/4	.08
3rd quarter	30 1/8	22 1/2	.10	25 7/8	20 3/4	.09	24 1/2	17 1/4	.08
4th quarter	$30 5/8	$24 1/2	$.10	$28 5/8	$22	$.09	$29 5/8	$23 1/8	$.08

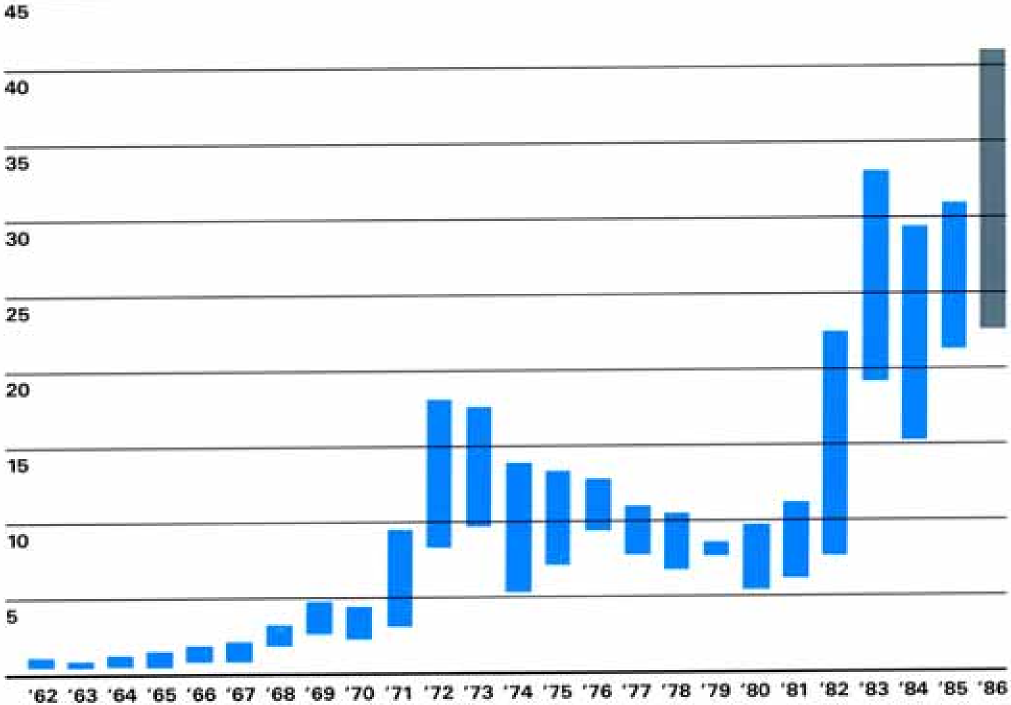
*As restated for a five-for-three split to shareholders of record April 14, 1983.
Source: *Dow Jones News Service*

Monthly stock price and trading volume

	Fiscal 1986			Fiscal 1985		
	High	**Low**	**Shares traded**	**High**	**Low**	**Shares traded**
February	$36 1/2	$27 3/4	3,244,600	$30	$27	1,638,600
March	41 3/8	34 5/8	3,635,800	29 1/4	26 3/8	1,393,100
April	40 1/4	35 3/4	2,874,100	27	25 5/8	732,200
May	41 1/2	35 7/8	2,002,300	31 1/8	26 1/8	1,620,400
June	40 3/4	33 3/4	2,962,300	29 1/4	24	2,067,500
July	36 1/4	29 1/4	3,328,700	29 1/4	24 1/2	1,545,500
August	29 7/8	26 1/2	3,231,000	25 7/8	22 1/2	1,393,100
September	28 1/2	23 1/8	2,762,000	24 1/4	21	1,060,100
October	30 1/8	22 1/2	4,015,000	23	20 3/4	1,521,600
November	30 5/8	24 1/2	3,540,100	25 3/4	22	2,059,700
December	29 1/8	25 1/4	2,923,300	25 7/8	22 3/8	2,742,600
January	$29 5/8	$25 5/8	3,677,200	$28 5/8	$24 1/8	2,995,300

Source: *Dow Jones News Service*

High–low stock price*
Dollars, adjusted for all stock splits



*Based on fiscal years, prior to '73 year-end July 31.
Source: *Monthly Market Statistics Report*, New York Stock Exchange; *The Wall Street Journal*

Quarterly Review of Performance

Earnings statements

Dollars in thousands

				Fiscal 1986				Fiscal 1985
Three months ended	1/31/87	10/31/86	7/31/86	4/30/86	1/31/86	10/31/85	7/31/85	4/30/85
Net sales	**$497,368**	**$594,275**	**$657,845**	**$533,992**	**$475,572**	**$549,031**	**$595,636**	**$452,330**
FIFO gross margin	121,225	144,756	160,122	130,047	116,565	131,052	148,500	112,634
LIFO credit (charge)	3,624	—	(370)	(294)	3,445	1,500	(188)	(1,312)
LIFO gross margin	**124,849**	**144,756**	**159,752**	**129,753**	**120,010**	**132,552**	**148,312**	**111,322**
Expenses:								
S, G & A	87,957	101,269	101,767	91,819	85,242	87,993	92,818	77,293
Depreciation	8,853	7,897	7,201	6,523	6,430	5,538	5,590	4,201
Employee retirement plans	5,066	5,764	6,719	6,401	5,089	5,941	5,895	5,794
Interest (Note 12)	3,713	3,396	3,114	3,525	2,488	3,345	3,926	1,748
Total expenses	**105,589**	**118,326**	**118,801**	**108,268**	**99,249**	**102,817**	**108,229**	**89,036**
Pre-tax earnings*	19,260	26,430	40,951	21,485	20,761	29,735	40,083	22,286
Income tax provision*	9,207	14,014	19,700	10,101	9,443	14,147	19,163	10,398
Net earnings	**10,053**	**12,416**	**21,251**	**11,384**	**11,318**	**15,588**	**20,920**	**11,888**
Earnings per share*	**.25**	**.31**	**.54**	**.31**	**.31**	**.43**	**.58**	**.33**
Earnings per share after extraordinary item	**$ .18**	**$ .31**	**$ .54**	**$ .31**	**$ .31**	**$ .43**	**$ .58**	**$ .33**

Earnings statement changes

Percent change from same quarter prior year; to nearest tenth percent

				Fiscal 1986				Fiscal 1985
Three months ended	1/31/87	10/31/86	7/31/86	4/30/86	1/31/86	10/31/85	7/31/85	4/30/85
Net sales	**4.6%**	**8.2%**	**10.4%**	**18.1%**	**26.5%**	**22.6%**	**22.8%**	**18.9%**
FIFO gross margin	4.0	10.5	7.8	15.5	21.1	17.9	23.2	17.8
LIFO credit (charge)	5.2	(100.0)	96.8	(77.6)	28.3	6.3	(6.0)	(6.4)
LIFO gross margin	**4.0**	**9.2**	**7.7**	**16.6**	**21.3**	**17.5**	**23.2**	**18.1**
Expenses:								
S, G & A	3.2	15.1	9.6	18.8	26.9	26.7	30.4	25.6
Depreciation	37.7	42.6	28.8	55.3	35.1	60.5	64.4	31.5
Employee retirement plans	(.5)	(3.0)	14.0	10.5	2.3	13.0	.5	23.0
Interest (Note 12)	49.2	1.5	(20.7)	101.7	301.3	483.8	599.8	212.1
Total expenses	**6.4**	**15.1**	**9.8**	**21.6**	**28.0**	**30.6**	**33.6**	**27.2**
Pre-tax earnings*	(7.2)	(11.1)	2.2	(3.6)	(3.1)	(12.7)	1.9	(8.1)
Income tax provision*	(2.5)	(.9)	2.8	(2.9)	(13.5)	(13.7)	1.9	(9.8)
Net earnings*	**(11.2)%**	**(20.3)%**	**1.6%**	**(4.2)%**	**7.7%**	**(11.8)%**	**1.8%**	**(6.6)%**

*Percentage change denotes increase (decrease) in expenses.

Earnings statement analysis

Percent total sales to nearest hundredth; income tax is percent of pre-tax earnings

				Fiscal 1986				Fiscal 1985
Three months ended	1/31/87	10/31/86	7/31/86	4/30/86	1/31/86	10/31/85	7/31/85	4/30/85
Net sales	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**
FIFO gross margin	24.37	24.36	24.34	24.36	24.51	23.87	24.93	24.90
LIFO credit (charge)	.73	—	(.06)	(.06)	.72	.27	(.03)	(.29)
LIFO gross margin	**25.10**	**24.36**	**24.28**	**24.30**	**25.23**	**24.14**	**24.90**	**24.61**
Expenses:								
S, G & A	17.68	17.04	15.47	17.20	17.92	16.02	15.58	17.08
Depreciation	1.78	1.33	1.09	1.22	1.35	1.01	.94	.93
Employee retirement plans	1.02	.97	1.02	1.20	1.07	1.08	.99	1.28
Interest (Note 12)	.75	.57	.47	.66	.52	.61	.66	.39
Total expenses	**21.23**	**19.91**	**18.05**	**20.28**	**20.86**	**18.72**	**18.17**	**19.68**
Pre-tax earnings*	3.87	4.45	6.23	4.02	4.37	5.42	6.73	4.93
Income tax provision*	47.80	53.02	48.11	47.01	45.48	47.58	47.81	46.66
Net earnings*	**2.02%**	**2.09%**	**3.23%**	**2.13%**	**2.38%**	**2.84%**	**3.51%**	**2.63%**

*Before Extraordinary Item

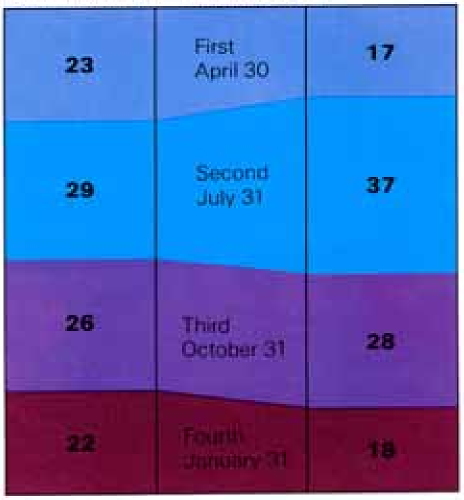
In January 1987, the Company accelerated the retirement of $30 million of its 11.5% notes and, as a result, incurred $5.7 million of early retirement costs. This item reduced the income tax provision by $2.8 million, net earnings by $2.9 million and earnings per share by 7 cents.

Customer sales profile
Dollars in millions, rounded totals

	Fiscal 1986			Fiscal 1985		
	Change	Sales	% Total	Change	Sales	% Total
1st Quarter						
RC[1]	+ 17%	$ 288.8	54%	+ 33%	$ 246.4	54%
CC[2]	+ 19	245.2	46	+ 6	205.9	46
Totals	**+ 18**	**534.0**	**100**	**+ 19**	**452.3**	**100**
2nd Quarter						
RC	+ 14	367.2	56	+ 24	320.9	54
CC	+ 6	290.6	44	+ 21	274.7	46
Totals	**+ 10**	**657.8**	**100**	**+ 23**	**595.6**	**100**
3rd Quarter						
RC	+ 12	319.6	54	+ 22	284.3	52
CC	+ 4	274.7	46	+ 24	264.7	48
Totals	**+ 8**	**594.3**	**100**	**+ 23**	**549.0**	**100**
4th Quarter						
RC	+ 16	287.8	58	+ 22	248.2	52
CC	− 8	209.6	42	+ 32	227.3	48
Totals	**+ 5%**	**$497.3**	**100%**	**+ 27%**	**$475.6**	**100%**

[1] RC: sales to retail customers (cash or non-recourse credit).
[2] CC: sales to contractor customers (Lowe's-extended credit).

1981 - 1986 sales and earnings
Percent of total year — a six-year average



Store sales profile
Dollars in millions, rounded totals

	Fiscal 1986					Fiscal 1985				
	Change	Sales	% Total	Stores	Per store average	Change	Sales	% Total	Stores	Per store average
1st Quarter										
Comparable stores[1]	**+ 8%**	**$483.4**	**91%**	**254**	**$1.9**	**+ 11%**	**$422.1**	**93%**	**238**	**$1.8**
New stores[2]		50.6	9	35	1.4		30.2	7	37	.8
Total stores reporting[3]	**+ 18**	**534.0**	**100**	**289**	**1.8**	**+ 19**	**452.3**	**100**	**275**	**1.6**
Less closed stores[4]							(4.5)		(4)	
Comparable stores[5]							**447.8**		**271**	
2nd Quarter										
Comparable stores	**+ 5**	**622.3**	**95**	**274**	**2.3**	**+ 9**	**527.2**	**89**	**241**	**2.2**
New stores		35.5	5	18	2.0		68.4	11	37	1.8
Total stores reporting	**+ 10**	**657.8**	**100**	**292**	**2.3**	**+ 23**	**595.6**	**100**	**278**	**2.1**
Less closed stores							(5.0)		(4)	
Comparable stores							**590.6**		**274**	
3rd Quarter										
Comparable stores	**+ 3**	**559.9**	**94**	**276**	**2.0**	**+ 8**	**483.4**	**88**	**242**	**2.0**
New stores		34.4	6	21	1.6		65.6	12	38	1.7
Total stores reporting	**+ 8**	**594.3**	**100**	**297**	**2.0**	**+ 23**	**549.0**	**100**	**280**	**2.0**
Less closed stores							(3.9)		(4)	
Comparable stores							**545.1**		**276**	
4th Quarter										
Comparable stores	**—**	**469.1**	**94**	**281**	**1.7**	**+ 13**	**424.7**	**89**	**248**	**1.7**
New stores		28.2	6	21	1.3		50.9	11	38	1.3
Total stores reporting	**+ 5%**	**$497.3**	**100%**	**302**	**$1.6**	**+ 27%**	**475.6**	**100%**	**286**	**$1.7**
Less closed stores							(4.2)		(5)	
Comparable stores							**$471.4**		**281**	

[1] Comparable stores: stores which have been open for one year or more at the end of the quarter.
[2] New stores: stores which have been open for less than a year at the end of the quarter.
[3] Total stores reporting: total stores reporting sales for the period.
[4] Closed stores: stores closed after the end of the period. Sales of closed stores must be subtracted in order to make the sales base comparable. An adjustment was not made for one store closed in the last week of the third quarter and two stores closed in the fourth quarter of fiscal 1986.
[5] Comparable stores (future): stores still open one year after the reporting period, i.e., those that are "comparable" to the next year's comparable stores.

Directors and Officers

Left to right, seated: William H. McElwee, Sr., Leonard G. Herring, Robert L. Strickland, Petro Kulynych, Gordon E. Cadwgan; standing: Jack C. Shewmaker, John M. Belk, Russell B. Long, Robert G. Schwartz, William A. Andres.

William A. Andres
Director since 1986, age 60
Member of Stock Option Committee of the Board.

Dayton Hudson Corporation (Retail Chain), Minneapolis, Minn. — Chairman of the Board 1976–1985 (retired September, 1985); Chairman of the Executive Committee 1976–1985; Chief Executive Officer 1976–1983; Director, Jostens, Inc., Minneapolis, Minn., since 1985; Director, Exxon Corporation, New York, N.Y., since 1981; Director, Scott Paper Company, Philadelphia, Penn.; Director, The St. Paul Companies, St. Paul, Minn.; Director, International Multifoods, Inc., Minneapolis, Minn.; Director, Hannaford Bros., Scarborough, Maine, since 1986.

John M. Belk
Director since 1986, age 67
Member of Audit Committee of the Board.

Chairman of the Board, Belk Stores Services, Inc. (Retail Chain), Charlotte, N.C., since 1980; Director, Wachovia Corporation, Winston-Salem, N.C., since 1958; Director, First Wachovia Corporation, Winston-Salem, N.C., since 1985; Director, Coca-Cola Bottling Company Consolidated, Charlotte, N.C., since 1972; Director, Southern Radio Corp., Charlotte, N.C., since 1963; Director, National Distillers & Chemical Corp., New York, N.Y., since 1983; Director, Southern Bell, Atlanta, Ga.; Member, American Management Association; Member, World Business Council; Member, The Conference Board; Member, American Retail Federation; Member, National Retail Merchants Association; Member, Board of Trustees, Davidson College; Member, Board of Visitors, Johnson C. Smith University.

Gordon E. Cadwgan
Director since 1961, age 73
Chairman of Audit Committee, Member of Compensation Committee, Member of Stock Option Committee and Member of Special Committee of the Board.

Trustee and Financial Consultant; affiliated with Tucker, Anthony & R.L. Day, Inc., Boston, Mass., since 1979; Director, Bevis Industries, Inc., Providence, R.I.; Director and Member Executive Committee, Third Century Fund, Inc., Providence, R.I.; Fellow Emeritus, Brown University.

Leonard G. Herring
Director since 1956, age 59
President and Chief Executive Officer since 1978, Member of Special Committee of the Board.

Director, First Union Corporation, Charlotte, N.C., since 1986; Director, Northwestern Financial Corporation, North Wilkesboro, N.C., 1969–1985; Director, First Brands Corporation, Danbury, Conn., since February, 1987; Trustee, Pfeiffer College; Member, North Carolina Business Council of Management and Development, Inc.; Member, Executive Committee, Hardware Home Improvement Industry Council, The City of Hope National Medical Center.

Petro Kulynych
Director since 1952, age 65
Chairman of Stock Option Committee of the Board; Managing Director, 1978–1983 (retired December, 1983).

Director, North Wilkesboro Federal Savings & Loan Association, North Wilkesboro, N.C., since 1974; Director, North Carolina Council on Economic Education, Greensboro, N.C.; Member, Medical Center Board of Visitors, Bowman Gray School of Medicine, Wake Forest University, North Carolina Baptist Hospital, Inc.; Chairman and Commissioner, Wilkes Airport Authority; Director, Carolina Motor Club, Inc.; Trustee, Wake Forest University.

William H. McElwee, Sr.
Director since 1961, age 79
Managing Director and General Counsel since 1980; Member of Compensation Committee and Member of Special Committee of the Board.

Partner, McElwee, McElwee, Cannon & Warden (Attorneys-at-Law), North Wilkesboro, N.C.; Member Emeritus, North Carolina Board of Law Examiners; Trustee, Davis Hospital Endowment Fund; Member of Local Board, North Carolina National Bank; Member of the Board, Legal Advisors of the Southeastern Legal Foundation, Inc.; Fellow, American College of Trial Lawyers.

Robert G. Schwartz
Director since 1973, age 59
Chairman of Compensation Committee, Member of Audit Committee and Member of Stock Option Committee of the Board.

Metropolitan Life Insurance Company, New York, N.Y. — Chairman of the Board since 1983; Chairman of the Investment Committee since 1980; Vice Chairman of the Board and Director, 1980–1983; Director, Potlatch Corporation, San Francisco, Cal., since 1973; Director, Kaiser Cement Corporation, Oakland, Cal., since 1977; Director, State Street Research and Management Company, Boston, Mass., since 1983; Director, Communications Satellite Corporation, Washington, D.C., since 1986; Director, Mobil Corporation, New York, N.Y., since 1987; Trustee, Committee for Economic Development; Trustee, Greater New York Councils Boy Scouts of America; Chairman, Investment Advisory Committee, Christopher's, Inc.

Jack C. Shewmaker
Director since 1985, age 49
Member of Compensation Committee of the Board.
Wal-Mart Stores, Inc. (Discount Retail Chain), Bentonville, Ark. — Vice Chairman of the Board and Chief Financial Officer since 1984; Director since 1977; Member of Executive Committee; President and Chief Operating Officer, 1978–1984; National Mass Retailing Institute — Director; Member of Executive Committee; Member of Convention Committee; Member, Board of Trustees, Drury College.

Robert L. Strickland
Director since 1961, age 56
Chairman of the Board since 1978. Chairman of Special Committee of the Board.
Director, Revelstoke Companies, Ltd., Calgary, Alberta, Canada, since 1976; Director, Summit Communications, Winston-Salem, N.C., since 1987; Director and Past Chairman, Do-It-Yourself Research Institute, Chicago, Ill.; Director, The Home Center Institute, Indianapolis, Ind.; Director and Past Chairman, The Employee Stock Ownership Assn., Washington, D.C.; Director, Council of Better Business Bureaus, Inc., Washington, D.C.; Director, The Committee of Publicly Owned Companies, New York, N.Y.; Board of Visitors, Babcock Graduate School of Management, Wake Forest University; Board of Advisors, Fuqua School of Business, Duke University; Member, Executive Committee, Hardware Home Improvement Industry Council, The City of Hope National Medical Center.

Director Nominee

Russell B. Long
Director Nominee, age 68
Partner, Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey (Attorneys-at-Law), Washington, D.C., since 1987; Director, Metropolitan Life Insurance Company, New York, N.Y., since 1987; Director, The New York Stock Exchange, New York, N.Y., since 1987; Director, Louisiana Land & Exploration Co., New Orleans, La., since 1987; Director, Kelso and Company, Newport Beach, Cal., since 1987; United States Senator, 1948–1987; Member, Senate Finance Committee, 1952–1987; Member, Joint Committee of Taxation, 1961–1987; Member, Senate Committee on Commerce, Science, and Transportation, 1966–1986; Member, Senate Select Committee on Ethics, 1985–1986; Member, Senate Finance Subcommittees on Health, Pensions and Investment Policy, and Social Security and Income Maintenance Programs, 1985–1986.

Company Officers

Richard D. Elledge
Vice President (Chief Accounting Officer), Secretary

Wendell R. Emerine
Executive Vice President

Leonard G. Herring
President and Chief Executive Officer

Arnold N. Lakey
Vice President, Credit

William H. McElwee, Sr.
Managing Director and General Counsel

W. Nathan Mitchell
Assistant Secretary

Dwight E. Pardue, Sr.
Senior Executive Vice President, Real Estate

William F. Reins
Assistant Treasurer

Leslie G. Shell, III
Controller

Robert L. Strickland
Chairman of the Board

Harry B. Underwood, II
Senior Vice President, Finance and Treasurer

John W. Vining, Jr.
Vice President, Administration

William C. Warden, Jr.
Assistant Secretary

Results of 1985 Shareholder Survey and Shareholder Analysis

Which sections of the Lowe's 1985 annual report did you read?	
All of the report	57%
Letter to shareholders	37
The art and science of retailing	20
Saying sooth about the home center industry	16
Here's looking at us, 1985 in review	30
Here's looking at them, our industry and our competition	28
Financial report	35
Other	5%

Ratings of the quality of the annual report sections (5-point scale), 5 = outstanding:	
All of the report	4.4
Letters to shareholders	4.3
The art and science of retailing	4.1
Saying sooth about the home center industry	4.0
Here's looking at us, 1985 in review	4.4
Here's looking at them, our industry and our competition	4.3
Financial report	4.4
Other	4.3
Overall rating on 5-point scale:	4.4
Status of respondent as a shareholder:	Yes — 84%, No — 16%

As a present or potential shareholder, what is or would be your primary reason for holding or buying Lowe's stock?	
Price appreciation	66%
Dividend income	2
Both	30
Other	2%

If you own stock, which category best describes your ownership interest?	
Individual	
Shareholder of record	51%
Street name	36
Employee stock ownership participant	17
Analyst for company owning Lowe's stock	2
Money manager for company owning Lowe's stock	5%

Which of the following do you consider the most important criteria regarding dividends?	
Annual dividend growth	52%
Yield on original investment	34
Not interested in dividends	11
Dividend never reduced	3%

How did you first become aware of Lowe's?	
Employee or store	26%
Stockbroker	17
Other	16
Investment publication	12
News articles	12
Annual reports	10
Shareholder	6
This is my first exposure	1%

From which of the following groups does your primary interest stem?	
Individual investor	50%
Employee	17
Stockbroker	8
Security analyst	8
Retired or former employee	8
Financial media	6
Financial advisor	5
Other	4
Supplier	3
Investment club	2
Trade magazine	2
Financial institution	1%
Are you male or female?	Male — 82%, Female — 18%

In which age group would you be listed?	
Under 30	9%
30-40	19
41-50	16
51-65	29
Over 65	27%

Which of the following most closely describes your present occupation?	
Executive, administrator, manager	35%
Retired	25
Doctor/lawyer	14
Sales	10
Clerical	5
Homemaker	5
Technician	2
Laborer	2
Machine operator	1
Transportation	1
Protective service	—
Precision laborer	—%

State	**Holders**	**Shares**
Alabama*	109	12,237
Alaska	5	1,380
Arizona	15	2,308
Arkansas*	25	331,124
California	97	229,087
Colorado	11	3,047
Connecticut	47	25,757
Delaware*	37	13,850
District of Columbia	13	17,077
Florida*	223	120,010
Georgia*	231	142,796
Hawaii	1	11
Idaho	3	340
Illinois*	115	1,118,861
Indiana*	42	10,765
Iowa	3	601
Kansas	14	2,247
Kentucky*	92	17,697
Louisiana*	85	6,765
Maine	10	4,318
Maryland*	135	102,049
Massachusetts	90	101,667
Michigan	45	16,733
Minnesota	25	32,643
Mississippi*	64	12,448
Missouri*	40	13,913
Montana	1	30
Nebraska	7	33,709
New Hampshire	6	985
New Jersey	94	30,965
New Mexico	3	474
New York	144	23,214,927
North Carolina*	2,685	4,165,243
Ohio*	107	79,247
Oklahoma*	11	15,690
Oregon	10	6,167
Pennsylvania*	105	203,617
Rhode Island	67	78,107
South Carolina*	312	114,074
South Dakota	1	1
Tennessee*	200	93,567
Texas*	82	15,094
Utah	2	1,075
Vermont	2	2,683
Virginia*	502	385,797
Washington	8	914
West Virginia*	71	15,095
Wisconsin	24	3,894
Canada	12	10,841
International[1]	19	23,260
Shareholders of record[2]	**6,052**	**30,835,187**
Employees in profit-sharing trust[2]	—	1,724,161
Employees in stock ownership plan and trust[2]	12,246	7,064,677
Total shareholders[3]	**18,298**	**39,624,025**

* Indicates state with Lowe's store.

[1] Does not include international holdings in New York-based street-name accounts.

[2] In computing shareholders of record, the two trusts are counted as one shareholder each.

[3] Total shareholders does not include 1,353 employees in the profit-sharing trust, as they are also ESOP participants.

Investor Information

Dividend declaration dates

Usually the middle of each quarter to shareholders of record approximately the middle of April, July, October and January.

Dividend payment dates

Usually the last of April, July, October and January.

Dividend disbursing agent

Wachovia Bank & Trust Co., NA
Box 3001
Winston-Salem, NC 27102-3001
Information contact:
Bill Kepley
(919) 770-6190

Dividend reinvesting agent

Wachovia Bank & Trust Co., NA
Box 3001
Winston-Salem, NC 27102-3001
Information contact:
Deborah Keaton
(919) 770-4402

Dividend policy

Lowe's has paid a cash dividend each quarter since becoming a public company in 1961.

Lowe's telephone

(919) 651-4000

Lowe's telex

510-922-5737

Lowe's mailing address

Box 1111
North Wilkesboro, NC 28656-0001

Lowe's street address

State Highway 268 East (Elkin Highway)
North Wilkesboro, NC 28659-1111

Shareholder services

Shareholders' and security analysts' inquiries should be directed to:
W. Cliff Oxford
(919) 651-4631

or Clarissa A. Story
(919) 651-4254

Lowe's Companies, Inc.
Box 1111
North Wilkesboro, NC 28656-0001
(919) 651-4000
Telex 510-922-5737

Annual meeting date

May 29, 1987 at 10:00 a.m.
Lowe's Corporate Offices
State Highway 268 East (Elkin Highway)
North Wilkesboro, NC

Stock transfer agents

Wachovia Bank & Trust Co., NA
Box 3001
Winston-Salem, NC 27102-3001
Information contact:
Vicki Decker
(919) 770-5822

Morgan Shareholder Services Trust Co.
30 West Broadway
New York, NY 10015
Information contact:
Sadie Griffo
(212) 587-6349

Stock registrars

Wachovia Bank & Trust Co., NA
Box 3001
Winston-Salem, NC 27102-3001

The Chase Manhattan Bank
1 Chase Manhattan Plaza
New York, NY 10005

Lowe's common stock

Ticker symbol: LOW
Listed:
New York Stock Exchange
20 Broad Street
New York, NY 10005

Pacific Stock Exchange
301 Pine Street
San Francisco, CA 94104

The Stock Exchange (London)
Old Broad Street
London, EC2N1HP England

General counsel

McElwee, McElwee, Cannon & Warden
906 B Street Rear
North Wilkesboro, NC 28659
(919) 838-1111

Certified public accountants

Deloitte Haskins & Sells
2000 First Citizens Bank Plaza
Charlotte, NC 28202
(704) 372-3560

Disclosure policy

Lowe's Companies, Inc., for more than 25 years, has maintained a policy of complete and free disclosure of all information needed by investors to determine whether they should buy, sell or hold Lowe's stock. The company seeks new and fresh ways of presenting financial and other information about itself to better inform the investor.

Lowe's Store Evolution
25-Year Review

Supplemental Information
25-Year Review

	LIFO accounting				
		5-year performance			
Fiscal years end January 31 of following calendar year except fiscal years prior to 1978 which ended July 31.	5-Year CGR	Fiscal 1986	Fiscal 1985	Fiscal 1984	Fiscal 1983
Stores and people					
1 Number of stores	5.6%	300	282	248	238
2 Square footage	14.8	4,452,161	3,641,762	2,980,000	2,529,040
3 Number of employees	19.8	14,783	13,317	10,727	8,715
4 Customers served (thousands)	24.9%	36,346	31,477	23,938	18,889
5 Average customer purchase		$62.83	$65.84	$70.55	$75.74
Comparative income statement (thousands)					
6 Total sales	**20.8%**	**$2,283,480**	**$2,072,569**	**$1,688,738**	**$1,430,576**
7 LIFO credit (charge)	NM	2,960	3,445	2,686	(5,684)
8 Pre-tax earnings before extraordinary item	26.6	108,126	112,865	119,076	96,891
9 Taxes on income	28.1	53,022	53,151	57,633	46,276
10 Extraordinary item net of tax	NM	(2,885)	—	—	—
11 Net earnings	**23.9**	**52,219**	**59,714**	**61,443**	**50,615**
12 Cash flow before extraordinary item [1]	26.2	90,743	83,859	79,691	66,575
13 Cash dividends paid	10.7	15,597	13,199	11,600	11,600
14 Earnings retained	34.0%	$ 36,622	$ 46,515	$ 49,843	$ 39,015
Dollars per share (weighted average number of shares)					
15 Sales	16.5%	$58.51	$56.77	$46.59	$39.53
16 Earnings	**19.5**	**1.34**	**1.64**	**1.70**	**1.40**
17 Funds from operations before extraordinary item [1]	21.8	2.33	2.30	2.20	1.84
18 Cash dividends	**6.6**	**.40**	**.36**	**.32**	**.32**
19 Earnings retained	29.3	.94	1.27	1.38	1.08
20 Shareholders' equity	20.5%	$13.85	$11.16	$ 9.42	$ 8.05
Strategic profit model [2]					
21 Asset turnover (sales per asset dollar)		$ 2.67	$ 3.26	$ 3.24	$ 3.64
22 Return on sales (net earnings as percent of sales)		× 2.29%	× 2.88%	× 3.64%	× 3.54%
23 Return on assets		= 6.11%	= 9.39%	=11.79%	=12.89%
24 Leverage factor (asset dollars per equity dollar)		× 2.10	× 1.86	× 1.79	× 1.98
25 Return on shareholders' equity		=12.83%	=17.47%	=21.10%	=25.52%
Comparative balance sheet (thousands)					
26 Total current assets	22.9%	$ 546,883	$ 534,649	$ 432,370	$ 377,572
27 Cash and short-term investments	9.3	50,013	87,190	84,204	74,249
28 Accounts receivable — net	19.8	118,693	127,603	97,319	94,658
29 Inventories (lower of cost or market)	26.5	368,135	313,143	248,268	205,100
30 Other current assets	43.3	10,042	6,713	2,579	3,565
31 Fixed assets	30.2	413,220	308,603	195,237	141,238
32 Other assets	77.3	9,116	12,939	6,501	827
33 Total assets	**25.9**	**969,219**	**856,191**	**634,108**	**519,637**
34 Total current liabilities	26.3	257,303	251,669	189,418	168,830
35 Accounts payable	27.8	163,260	168,068	125,003	110,415
36 Other current liabilities	23.9	94,043	83,601	64,415	58,415
37 Long-term debt (excluding current portion)	25.6	152,977	183,909	92,488	51,891
38 Total liabilities	**27.1**	**428,685**	**448,818**	**292,760**	**228,132**
39 Shareholders' equity	**25.0%**	**$540,534**	**$407,373**	**$341,348**	**$291,505**
40 Equity divided by long-term debt (excluding current portion)		3.53	2.22	3.69	5.62
41 Year-end leverage factor: assets divided by equity		1.79	2.10	1.86	1.79
Shareholders and shares					
42 Shareholders of record, year-end		6,052	6,253	6,372	5,928
43 Shares outstanding, year-end (thousands) [3]		39,624	37,082	36,248	36,248
Stock price range during year [4]					
44 High (adjusted for stock splits)		$41.38	$31.13	$29.63	$32.75
45 Low (adjusted for stock splits)		$22.50	$20.88	$16.25	$18.45
Price earnings ratio					
46 High		31	19	17	23
47 Low		17	13	10	13

					FIFO accounting		
Fiscal 1982	Base Year Fiscal 1981	Fiscal 1980	Fiscal 1979	Fiscal 1978	Fiscal 1977	Fiscal 1976	Fiscal 1975
235	229	214	209	199	175	150	130
2,337,351	2,232,008	1,998,239	1,931,419	1,817,000	1,570,000	1,330,000	1,209,000
7,080	6,003	5,950	5,804	5,809	5,274	4,378	3,574
15,075	11,973	11,376	11,024	10,013	8,224	7,033	5,702
$68.59	$74.17	$77.67	$82.02	$79.20	$72.27	$66.12	$59.78
$1,034,032	**$888,042**	**$883,614**	**$904,651**	**$793,125**	**$594,358**	**$465,052**	**$340,882**
(1,626)	(920)	(6,686)	(7,484)	(8,466)	—	—	—
47,525	33,226	36,277	47,331	45,865	42,487	34,295	20,811
22,394	15,367	17,386	22,376	22,141	21,056	16,984	10,319
—	—	—	—	—	—	—	—
25,131	**17,859**	**18,891**	**24,955**	**23,724**	**21,431**	**17,311**	**10,492**
39,794	28,381	29,211	35,019	32,437	27,643	22,288	14,669
9,800	9,376	7,813	6,511	5,209	2,735	1,272	1,171
$ 15,331	$ 8,483	$ 11,078	$ 18,444	$ 18,515	$ 18,696	$ 16,039	$ 9,321
$31.02	$27.28	$27.14	$27.79	$24.36	$18.26	$14.29	$10.47
.75	**.55**	**.58**	**.77**	**.73**	**.66**	**.53**	**.32**
1.19	.87	.90	1.08	1.00	.85	.68	.45
.29	**.29**	**.24**	**.20**	**.16**	**.08**	**.04**	**.04**
.46	.26	.34	.57	.57	.57	.49	.29
$ 5.96	$ 5.45	$ 5.19	$ 4.89	$ 4.32	$ 3.47	$ 2.90	$ 2.40
$ 3.37	$ 2.94	$ 2.95	$ 3.35	$ 3.28	$ 3.00	$ 3.01	$ 2.26
× 2.43%	× 2.01%	× 2.14%	× 2.76%	× 2.99%	× 3.61%	× 3.72%	× 3.08%
= 8.19%	= 5.91%	= 6.31%	= 9.25%	= 9.81%	=10.83%	=11.22%	= 6.96%
× 1.73	× 1.79	× 1.90	× 1.92	× 1.98	× 2.10	× 1.97	× 2.24
=14.17%	=10.58%	=11.99%	=17.76%	=19.42%	=22.74%	=22.12%	=15.60%
$ 271,535	$ 195,370	$ 209,756	$ 210,913	$ 189,228	$ 186,198	$ 146,448	$ 108,784
25,341	32,070	15,567	22,959	9,363	13,324	15,620	11,574
75,388	48,107	68,172	66,442	66,836	76,162	52,322	38,533
167,535	113,529	125,104	118,511	111,248	96,164	77,963	58,223
3,271	1,664	913	3,001	1,781	548	544	454
121,406	110,673	91,399	88,695	80,096	60,210	50,434	45,127
559	521	573	291	371	401	859	452
393,500	**306,564**	**301,728**	**299,899**	**269,695**	**246,809**	**197,741**	**154,363**
134,999	80,199	80,781	84,690	64,081	87,709	66,705	42,964
90,580	47,959	52,003	45,567	44,833	60,324	42,942	29,727
44,419	32,240	28,778	25,245	10,694	27,385	23,764	13,236
56,233	48,864	51,929	56,112	64,961	46,244	36,664	33,156
194,717	**129,063**	**132,710**	**140,802**	**129,042**	**133,953**	**103,370**	**76,120**
$198,783	**$177,501**	**$169,018**	**$159,097**	**$140,653**	**$112,857**	**$ 94,371**	**$ 78,243**
3.53	3.63	3.25	2.84	2.17	2.44	2.57	2.36
1.98	1.73	1.79	1.89	1.92	2.19	2.10	1.97
5,144	5,415	4,620	5,147	4,750	4,588	3,846	3,755
33,333	32,555	32,555	32,555	32,555	32,555	32,555	32,555
$22.35	$11.36	$ 9.95	$ 8.20	$10.40	$13.10	$13.73	$12.40
$ 7.65	$ 6.30	$ 5.35	$ 6.50	$ 6.60	$ 8.70	$10.60	$ 5.33
30	21	17	11	14	20	26	39
10	11	9	8	9	13	20	17

Fiscal 1974	Fiscal 1973	Fiscal 1972	Fiscal 1971	Fiscal 1970	Fiscal 1969	Fiscal 1968	Fiscal 1967	Line #
116	100	86	75	64	58	53	44	1
1,046,000	832,000	635,000	489,000	379,653	316,000	294,678	263,317	2
3,598	3,296	2,630	2,071	1,670	1,450	1,223	1,017	3
5,321	4,717	3,820	3,194	2,729	2,290	2,034	1,755	4
$68.12	$69.29	$61.40	$53.13	$47.09	$51.98	$47.70	$43.14	5
$362,453	**$326,846**	**$234,556**	**$169,723**	**$128,491**	**$119,053**	**$97,031**	**$75,695**	**6**
—	—	—	—	—	—	—	—	7
29,287	25,393	18,143	13,027	9,938	9,514	7,202	5,151	8
14,670	12,665	9,022	6,479	5,068	4,906	3,609	2,381	9
—	—	—	—	—	—	—	—	10
14,617	**12,728**	**9,121**	**6,548**	**4,870**	**4,608**	**3,593**	**2,770**	**11**
18,075	15,519	11,416	8,174	6,091	5,559	4,419	3,564	12
1,045	1,017	946	907	844	780	756	661	13
$ 13,572	$ 11,711	$ 8,174	$ 5,641	$ 4,026	$ 3,828	$ 2,837	$ 2,109	14
$11.22	$10.27	$ 7.40	$ 5.38	$ 4.07	$ 3.77	$ 3.08	$ 2.45	15
.45	**.40**	**.29**	**.21**	**.15**	**.15**	**.11**	**.09**	**16**
.56	.49	.36	.26	.19	.18	.14	.12	17
.03	**.03**	**.03**	**.03**	**.03**	**.02**	**.02**	**.02**	**18**
.42	.37	.26	.18	.13	.12	.09	.07	19
$ 2.08	$ 1.63	$ 1.24	$ .97	$ .79	$ .66	$ .54	$ .45	20
$ 2.88	$ 3.65	$ 3.40	$ 3.43	$ 3.09	$ 3.37	$ 3.24	$ 2.65	21
× 4.03%	× 3.89%	× 3.89%	× 3.86%	× 3.79%	× 3.87%	× 3.70%	× 3.66%	22
=11.63%	=14.22%	=13.20%	=13.25%	=11.72%	=13.03%	=11.98%	= 9.70%	23
× 2.43	× 2.28	× 2.26	× 1.99	× 1.99	× 2.08	× 2.15	× 2.42	24
=28.23%	=32.42%	=29.81%	=26.31%	=23.34%	=27.07%	=25.76%	=23.49%	25
$ 111,943	$ 96,391	$ 70,110	$ 54,911	$ 38,878	$ 33,433	$ 28,617	$ 24,164	26
12,986	7,859	7,802	6,304	4,658	4,640	4,129	4,814	27
36,850	37,603	27,440	20,944	14,887	14,559	11,880	9,675	28
61,775	50,639	34,475	27,332	19,040	14,183	12,475	9,532	29
331	290	393	331	293	51	133	143	30
38,552	29,238	19,330	14,087	10,390	7,918	6,546	5,729	31
140	85	45	88	148	209	205	99	32
150,634	**125,714**	**89,485**	**69,086**	**49,416**	**41,560**	**35,368**	**29,992**	**33**
50,228	55,694	40,217	31,198	21,212	18,505	14,911	12,503	34
32,640	36,101	27,684	21,999	15,178	10,997	9,703	8,425	35
17,588	19,593	12,533	9,199	6,034	7,508	5,208	4,078	36
33,158	18,238	10,014	7,296	3,315	2,192	3,434	3,527	37
83,386	**73,932**	**50,231**	**38,494**	**24,527**	**20,697**	**18,346**	**16,033**	**38**
$ 67,248	**$ 51,782**	**$ 39,254**	**$ 30,592**	**$ 24,889**	**$ 20,863**	**$ 17,022**	**$ 13,959**	**39**
2.03	2.84	3.92	4.19	7.51	9.52	4.95	3.95	40
2.24	2.43	2.28	2.26	1.99	1.99	2.08	2.15	41
3,698	3,704	3,038	2,463	2,117	1,916	1,976	2,154	42
32,293	31,828	31,708	31,573	31,558	31,550	31,523	30,938	43
$16.27	$19.20	$17.70	$ 9.30	$ 4.63	$ 4.86	$ 3.36	$ 1.55	44
$ 8.73	$12.47	$ 8.00	$ 3.33	$ 2.47	$ 2.93	$ 1.55	$ .69	45
36	48	61	44	31	32	31	17	46
19	31	28	16	16	20	14	8	47

Fiscal 1966	Fiscal 1965	Fiscal 1964	Fiscal 1963	Fiscal 1962	Fiscal 1961
39	35	28	22	18	15
231,217	199,537	141,970	103,220	88,580	71,680
891	762	636	555	491	399
1,636	1,284	1,141	883	703	651
$47.10	$44.44	$42.66	$44.20	$46.52	$47.85
$77,043	**$57,044**	**$48,680**	**$39,012**	**$32,716**	**$31,128**
—	—	—	—	—	—
5,286	3,942	3,086	2,438	2,054	1,890
2,496	1,896	1,518	1,233	1,034	956
—	—	—	—	—	—
2,790	**2,046**	**1,568**	**1,205**	**1,020**	**934**
3,339	2,351	1,765	1,356	1,145	1,067
616	519	460	411	402	102
$ 2,174	$ 1,527	$ 1,108	$ 794	$ 618	$ 832
$ 2.50	$ 1.87	$ 1.63	$ 1.32	$ 1.09	$ 1.04
.09	**.07**	**.05**	**.04**	**.03**	**.03**
.11	.08	.06	.05	.04	.04
.02	**.02**	**.02**	**.01**	**.01**	**.03**
.07	.05	.04	.03	.02	.03
$ .38	$ .31	$ .26	$ .21	$ .19	$ .17
$ 3.34	$ 3.20	$ 3.11	$ 2.98	$ 2.76	$ 3.32
× 3.62%	× 3.59%	× 3.22%	× 3.09%	× 3.12%	× 3.00%
= 12.09%	= 11.49%	= 10.03%	= 9.20%	= 8.62%	= 9.96%
× 2.43	× 2.31	× 2.47	× 2.31	× 2.34	× 2.57
= 29.40%	= 26.55%	= 24.78%	= 21.28%	= 20.23%	= 25.60%
$ 23,396	$ 19,187	$ 15,350	$ 13,976	$ 11,702	$ 9,305
3,024	3,801	3,374	2,735	1,956	1,299
9,310	7,165	5,586	4,968	3,769	3,108
10,931	8,156	6,337	6,214	5,868	4,801
131	65	53	59	109	97
5,058	3,832	2,381	1,531	1,261	1,229
105	77	73	123	134	1,301
28,559	**23,096**	**17,804**	**15,630**	**13,097**	**11,835**
13,630	11,213	7,454	7,123	5,696	4,922
9,496	7,913	5,149	5,036	4,255	3,187
4,134	3,300	2,305	2,087	1,441	1,735
3,127	2,377	2,615	2,139	1,680	1,791
16,765	**13,606**	**10,097**	**9,304**	**7,435**	**6,792**
$11,794	**$ 9,490**	**$ 7,707**	**$ 6,326**	**$ 5,662**	**$ 5,043**
3.77	3.99	2.95	2.95	3.37	2.81
2.42	2.43	2.31	2.47	2.31	2.35
1,985	1,871	1,967	2,034	2,047	—
30,793	30,458	29,798	29,640	30,000	30,000
$ 1.38	$ 1.02	$ .74	$ .42	$ .62	—
$ .87	$ .63	$ .37	$ .30	$ .31	—
15	15	15	11	21	—
10	9	7	8	10	—

Stock splits and stock dividends since 1960

- ■ A 100% stock dividend, effective April 5, 1966, (which had the net effect of a 2-for-1 stock split).
- ■ A 2-for-1 stock split, effective November 18, 1969.
- ■ A 50% stock dividend, effective November 30, 1971, (which had the net effect of a 3-for-2 stock split).
- ■ A 33⅓% stock dividend, effective July 25, 1972, (which had the net effect of a 4-for-3 stock split).
- ■ A 50% stock dividend, effective June 2, 1976, (which had the net effect of a 3-for-2 stock split).
- ■ A 3-for-2 stock split, effective November 2, 1981.
- ■ A 5-for-3 stock split, effective April 29, 1983.

Explanatory notes

[1] Cash flow (funds from operations) is defined as the total of net earnings plus depreciation and deferred income taxes.

[2] See page 46 for explanation of computational method.

[3] Variation in the outstanding shares is a result of the following:
1963 — Treasury Stock purchase
February 2, 1982 — 778,018 common shares issued to ESOP.
February 8, 1983 — 2.917 million common shares sold in public issuance.
October 10, 1985 — 833,373 common shares issued to ESOP.
April 25, 1986 — 2.2 million common shares sold in public issuance.
May 15, 1986 — 300,000 common shares issued to ESOP.
— Ongoing employee option transactions.

[4] Stock price sources:
Dow Jones News Service;
The Wall Street Journal

NM = not meaningful
CGR = compound growth rate

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Credits

Primary: All Lowe's people
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Lowe's 1986 Annual Report Survey

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Attention: Corporate Relations Department

Comments:

Lowe's 21st Annual Shareholder Survey

Dear Investor:

Thanks for reading the Lowe's 1986 Annual Report. Please take a few minutes to tell us what you thought of it by answering the following questions. Your opinions are important to us and they help us improve our ability to serve you.

When you've completed the survey please drop it in the mail, postage is prepaid!

1. When reading annual reports, different people have different informational needs. Please check all the sections of this report you read by placing a mark on the line next to the title of the section.

___ All of the Report
___ Letter to Shareholders
___ Lowe's Investors Want to Know
___ Board of Directors Feature
___ Customer Analysis
___ Product Analysis
___ Stores and Expansion
___ Financial Report
___ Other

2. Next we'd like for you to rate the annual report sections you read. When making your judgements, please consider the overall quality, understandability and readability of the sections you read.

	Low				High
All of the Report	1	2	3	4	5
Letter to Shareholders	1	2	3	4	5
Lowe's Investors Want to Know	1	2	3	4	5
Board of Directors Feature	1	2	3	4	5
Customer Analysis	1	2	3	4	5
Product Analysis	1	2	3	4	5
Stores and Expansion	1	2	3	4	5
Financial Report	1	2	3	4	5
Other	1	2	3	4	5

Summing it up

3. In general, please rate the overall Lowe's 1986 Annual Report by circling the number below which best describes your overall impression.

	Low				High
Overall, I feel the 1986 annual report is a	1	2	3	4	5

Now we'd like to ask a few questions about you. This information will be invaluable as we begin to analyze your answers to the previous questions.

4. Are you currently a Lowe's shareholder?

___ Yes ___ No

5. As a present or potential shareholder what is or would be your primary reason for holding or buying Lowe's stock.

___ Long term profit on original investment or for capital appreciation
___ Dividend income
___ Both capital appreciation and dividend income
___ Other (please state) ______________________________

6. When you say that you own Lowe's stock does that mean you as an individual or you as the organization with which you are associated? Please check the box below that best describes your ownership interest in Lowe's.

___ I personally own the stock in my own name and have the certificates.
___ I personally own the stock through — and the certificates are in — an employee stock plan.
___ I personally own the stock, however, my broker keeps the certificates.
___ The company I am associated with owns Lowe's stock, and I am the analyst following the company.
___ The company I am associated with owns Lowe's stock, and I am a money manager.

7. Regarding dividends, which of the following do you consider to be most important?

___ Dividend growth on an annual basis
___ Yield on my original investment
___ Dividend never reduced
___ Not interested in dividends

8. How did you *first* become aware of Lowe's? Please answer only one.

___ Through my stockbroker
___ Through a Lowe's employee or store
___ Through a Lowe's shareholder
___ By reading previous annual reports
___ Newspaper or magazine article
___ Investment publication
___ This is my first exposure to Lowe's
___ Other ______________________________

9. From which of the following groups does your interest in Lowe's stem?

___ Security analyst
___ Financial advisor
___ Employee
___ Individual investor
___ Stockbroker
___ Retired or former employee
___ Trade media
___ Investment club
___ Financial media
___ Financial institution
___ Supplier
___ Other __________

10. Are you a male ______ or a female ______ ?

11. In what age group would you be listed?

___ Under 30
___ 30-40
___ 41-50
___ 51-65
___ Over 65

12. Please check the line which most closely describes your present occupation.

___ Executive, administrator, manager
___ Handler, helper, laborer
___ Protective service
___ Precision production
___ Technician or related support
___ Sales occupation
___ Administrative support/clerical
___ Machine operator, assembler or inspector
___ Transportation and material moving occupations
___ Professional specialty/doctor, lawyer, etc.
___ Retired
___ Homemaker

13. How long have you been a Lowe's shareholder?

___ Less than a year
___ 1 - 2 years
___ 3 - 5 years
___ 6 - 10 years
___ More than ten years

Thanks again for reading the '86 Lowe's Report and especially for answering these questions.

Your name ______________________________

Your address ______________________________

City ______________ State __________ Zip __________