

Holiday Retail Outlook

December 2014



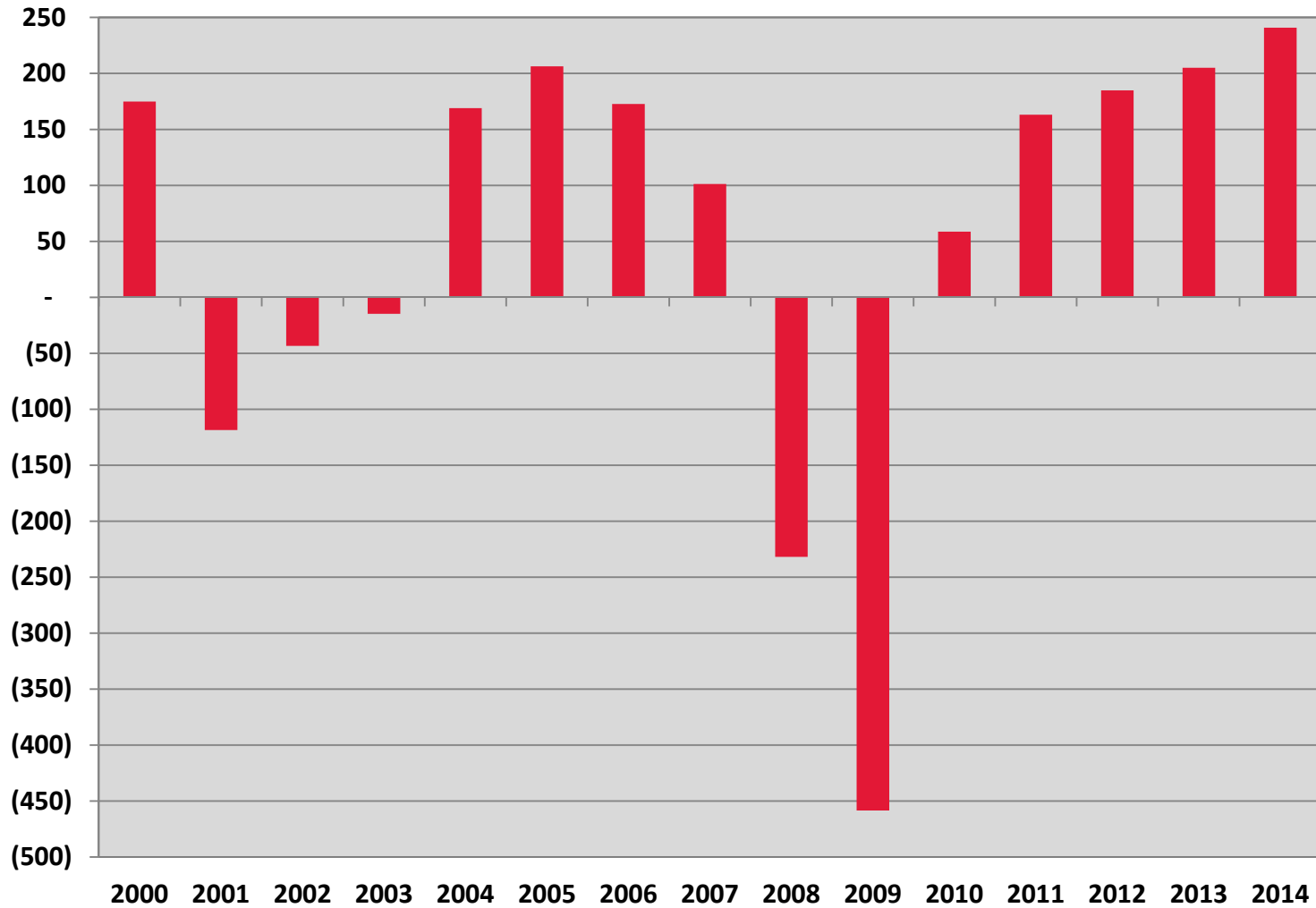
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Where Do We Stand Heading into 2015?

- ▶ **U.S. now fully into employment expansion and accelerating**
- ▶ **GDP growth rate nearing 3%, job growth averaging nearly 250K per month and unemployment now below 6%**
- ▶ **Budget deal takes another government shutdown off the table for 2015**
- ▶ **Federal Reserve is done with balance sheet expansion and likely to start raise short rates in 2015**
- ▶ **Household net worth now well above pre-crisis level and broad household deleveraging has ended**
- ▶ **Housing recovery slow but continuing. Need for replacement consumption revealing itself in durables (e.g. automobiles)**
- ▶ **U.S. income distribution at historically unbalanced levels with lower income households having smallest share of income since WWII**

Strongest Job Growth This Century

AVERAGE MONTHLY CHANGE IN TOTAL EMPLOYMENT (000'S)



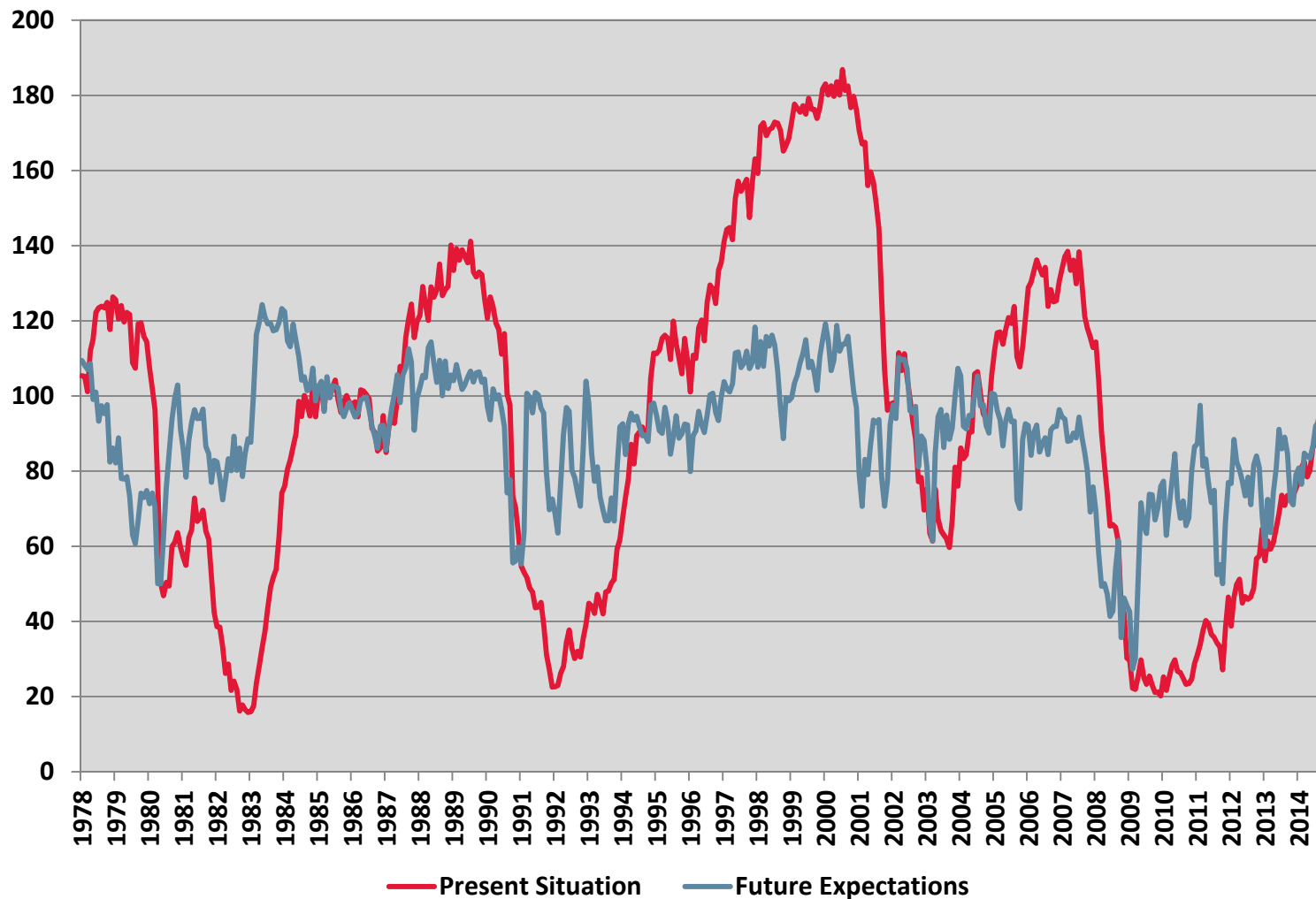
U.S. employment moved above pre-crisis peaks during the first half of 2014

Job growth has now accelerated – greater than any year this century

Source: BLS, Moody's Analytics

Consumer Sentiment Returns to Normal

CONSUMER CONFIDENCE INDEX



Consumers feeling better about the current situation but still far below pre-crisis readings

Expectations about the future remain volatile but close to pre-crisis levels

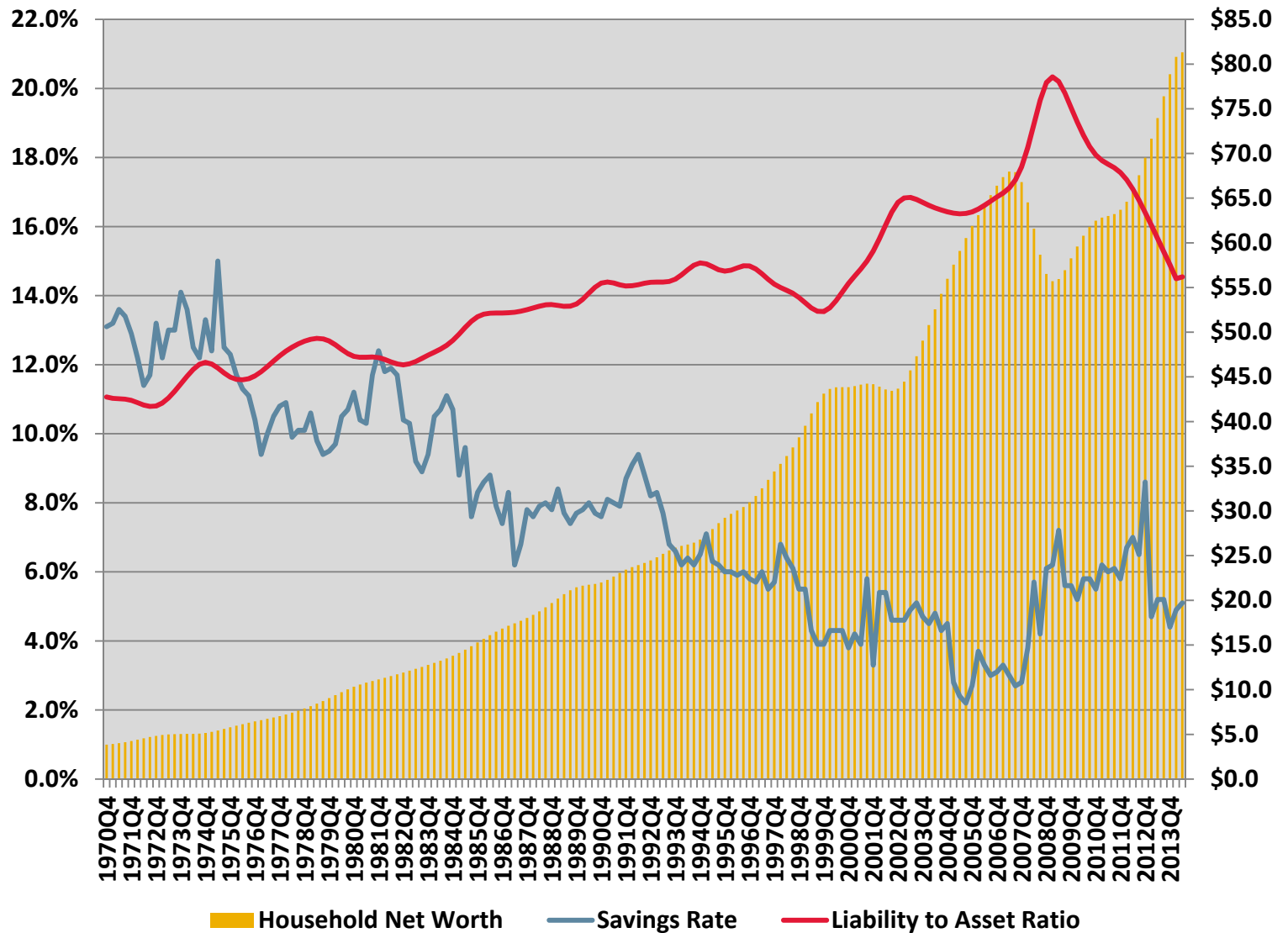
Source: Conference Board

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Household De-Leveraging Has Ended

Household debt to liability ratio now back to pre-recession level and beginning to rise again

Household net worth \$15 trillion above pre-crisis peak



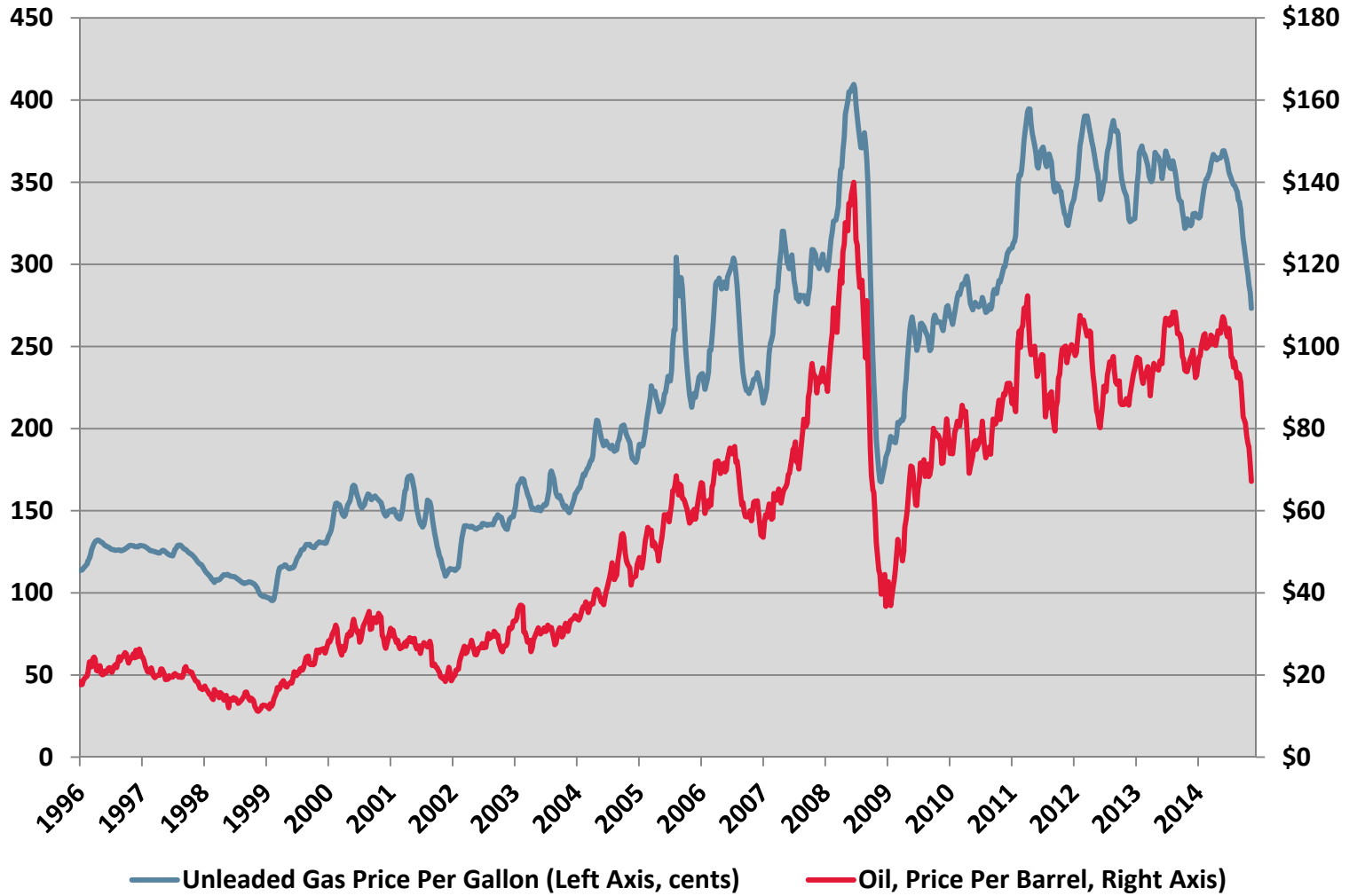
Source: Federal Reserve

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What's Next for Oil and Gas?

Every one cent drop in gasoline prices equals about \$1 billion of potential spending on something else

WEEKLY GAS AND OIL PRICES



Source: U.S. Energy Information Agency

Retail Sales Growth

(Year-Over-Year Through November)

	2009	2010	2011	2012	2013	2014
Total	1.8%	6.7%	7.1%	4.3%	3.6%	4.9%
Total ex Motor Vehicles & Parts	1.3%	5.1%	6.8%	3.2%	1.9%	3.9%
Motor Vehicles & Parts	3.7%	13.6%	8.3%	8.4%	10.1%	8.6%
Furniture & Home Furnishings Stores	-7.5%	1.5%	4.6%	3.2%	7.1%	2.1%
Electronics & Appliance Stores	-5.4%	-2.0%	5.5%	0.7%	1.6%	6.9%
Building Materials & Garden Stores	-9.3%	4.9%	6.1%	5.0%	3.6%	7.8%
Grocery Stores	0.9%	2.9%	4.8%	2.7%	1.7%	3.8%
Gasoline Stations	14.3%	7.1%	16.5%	2.8%	-4.7%	-2.1%
General Merchandise Stores	-0.8%	4.7%	2.9%	1.5%	1.2%	2.6%
Department Stores	-5.4%	1.7%	-3.1%	-4.8%	-3.1%	-1.1%
Food Service & Drinking Stores	-0.8%	4.8%	6.6%	5.0%	4.3%	6.7%
E-Commerce (Q3/Q3 %CHG)¹	2.6%	14.8%	14.6%	17.4%	17.8%	16.2%

Source: Commerce Dept

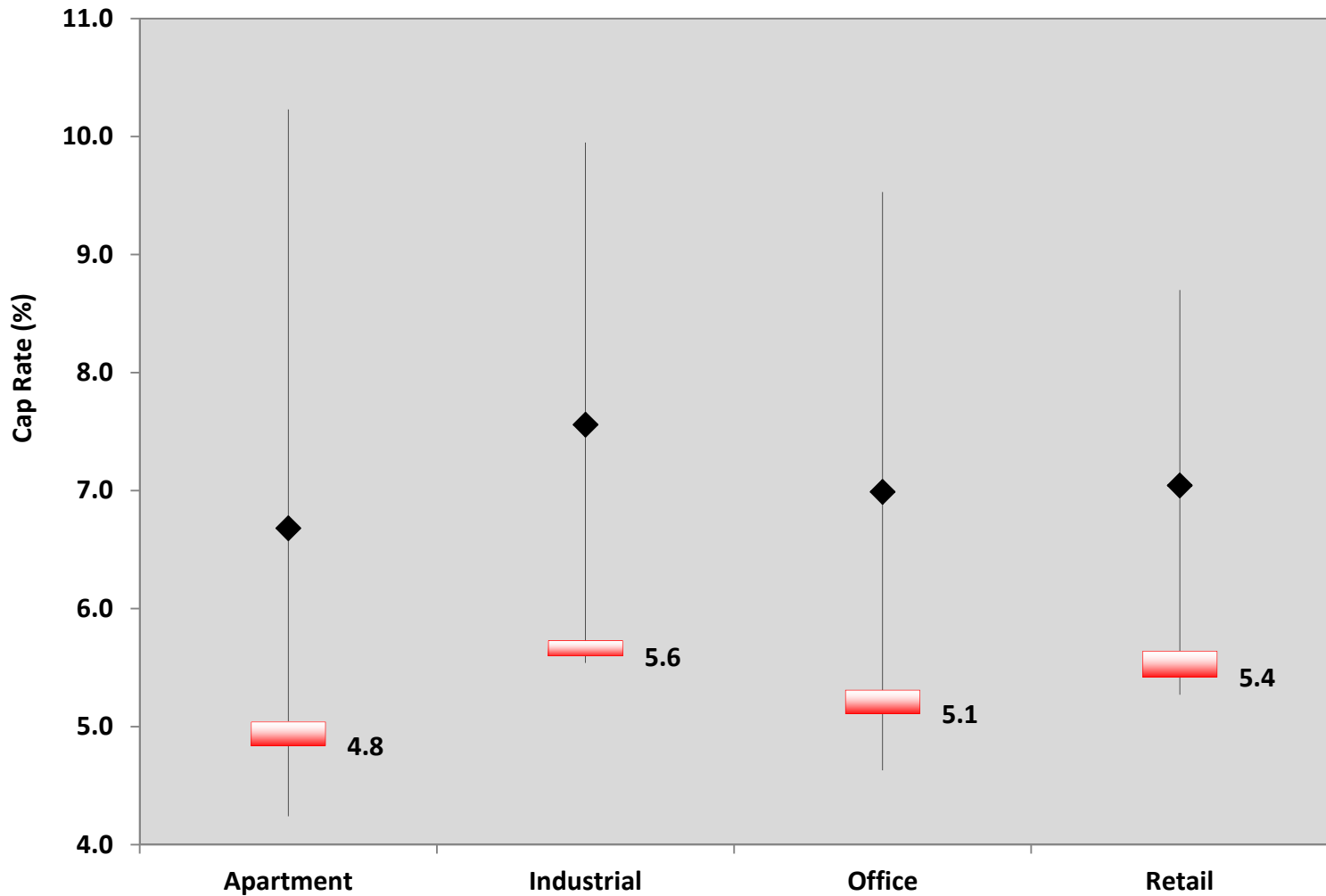
¹Quarterly data through September 2014 percent change Q3/Q3

Property Yields Near All-Time Lows

Near-term cap rate expansion will be limited by strong capital in-flows

Property yield spreads expected to compress through 2016 as Treasury yields rise

HISTORICAL CAP RATE RANGE (%)



Source: AEW Research, NCREIF

AEW U.S. Real Estate Market Outlook

Holiday Retail Outlook 2014

- ▶ Retail Real Estate – The Big Picture
 - Retail Real Estate – Center by Center

- ▶ Holiday Retail 2014 – The “New Reality” Year 6 AL
 - Thanksgiving – Black Friday – Cyber Monday 2014
 - Omni-channel and Supply Chain
 - If the economy is improving and retail sales are up, why is store traffic down?
 - E-Commerce is more profitable than bricks-and-mortar, Right?

- ▶ Holiday 2014 Retail Tour

- ▶ U.S. Income Distribution

U.S. Shopping Center Industry Growth by Center Type 1980-2014

	1980	1985	1990	1995	2000	2005	2010	2014
Total Shopping Center GLA (SF, MM)	3,103	3,734	4,675	5,248	5,963	6,763	7,434	7,517
Trailing 5 year CAGR	4.8%	3.8%	4.6%	2.3%	2.6%	2.5%	1.9%	0.3%
Regional Malls (number)	723	849	985	1,044	1,113	1,176	1,232	1,240
% Retail GLA	21.9%	21.0%	19.3%	18.2%	17.2%	16.1%	15.3%	15.2%
Total GLA (SF, Million)	680	784	902	955	1,026	1,089	1,137	1,143
Trailing 5 year CAGR	6.3%	2.9%	2.8%	1.1%	1.4%	1.2%	0.9%	0.1%
N'Hood/Community (number)	18,733	22,937	28,734	31,526	34,955	38,618	41,641	42,036
% Retail GLA	57.6%	58.7%	60.0%	59.7%	58.6%	57.5%	56.3%	56.3%
Total GLA (SF, Million)	1,787	2,192	2,805	3,133	3,494	3,889	4,185	4,232
Trailing 5 year CAGR	4.7%	4.2%	5.1%	2.2%	2.2%	2.2%	1.5%	0.3%
Power Centers (number)	398	468	658	947	1,375	1,823	2,219	2,249
% Retail GLA	5.4%	5.3%	5.9%	7.7%	10.0%	11.8%	13.1%	13.1%
Total GLA (SF, Million)	168	198	276	404	596	798	974	985
Trailing 5 year CAGR	2.6%	3.4%	6.9%	7.9%	8.1%	6.0%	4.1%	0.3%
Lifestyle Centers (number)	79	96	127	141	179	275	416	432
% Retail GLA	0.8%	0.8%	0.8%	0.8%	1.0%	1.4%	1.9%	1.9%
Total GLA (SF, Million)	25	30	37	42	60	95	141	143
Trailing 5 year CAGR	2.3%	3.8%	4.6%	2.3%	7.3%	9.7%	8.3%	0.3%

*Source: ICSC, CoStar

AEW Research Conference Call: Holiday Retail Outlook

Retail Real Estate 2014 – The Big Picture

- ▶ **Dramatic reduction in new supply – now and for the foreseeable future**
 - Total US Shopping Center GLA grew at annual rate of 0.3% over the last four years, well below the 4.2% annual growth rates experienced in the ‘80s and the 2.3% annual growth rates experienced from 1990 to 2010
 - Minimal new development driven by outlets, specialty grocers, middle-market chain restaurants, and a handful of larger format value apparel, sporting goods, and beauty concepts, focused primarily on in-fill opportunities in established retail nodes
 - ▶ Relatively mature business overall, particularly for national anchor tenants with extensive footprints – few, if any, of the usual suspects have unit growth plans sufficient to drive substantial new center development
- ▶ **The lack of new development, however, “masks” significant redevelopment and repositioning activity that has taken hold as stronger retailers recover from the Great Recession and weaker retailers shed unproductive stores, freeing up existing real estate**
 - Retail center leasing is akin to running a huge department store with 100% leased departments – daily mission is to drive sales and traffic by strategically replacing weak vendors in declining categories with strong vendors in established or emerging categories – typically at lease expiration or sooner
 - ▶ With notable, well-publicized exceptions, retailers took heed of the lessons of the Great Recession, cut back unit expansion, shored up their balance sheets and dramatically improved operating efficiency by making overdue investments in their supply chain and inventory management capabilities – leverage “comp” is now achieved at a 1-2% same store sales gain
 - ▶ Those retailers who heeded the call have been selectively adding new stores, renovating productive existing units and closing underperformers, seeking to strike the right balance from a profit and sales standpoint between their profitable “bricks-and-mortar” business with their lower margin online business as they adapt an “Omni-channel” operating model

Retail Real Estate 2014 – The Big Picture

- Focus is securing the real estate that best aligns with their customer profile and operating strategy
- Lack of new competition eases pressure to match overly tenant-friendly lease concessions
- ▶ **Net operating income steadily increasing, along with quality of rent roll**
 - Lack of new supply driving occupancy gains in existing centers – many shopping centers nearing record occupancy levels
 - While many cite sluggish sales growth as an NOI headwind, they have the beneficial near-term effect of limiting new development, arguably hastening the departure of weaker retailers, and placing a premium on freed up space in established centers
 - Growth from increasing occupancy and redevelopments is not linear or instantaneous – replacing obsolete stores and completing redevelopments in existing centers require careful coordination of lease expirations, opening schedules and construction phasing
- ▶ **Retail real estate cash flows, as a result, are becoming more bond-like – steadily growing, diversified income streams from a healthier rent roll support higher “bond rating”**
 - Globally low equity yields and interest rates, combined with the gradual return of the CMBS market have driven cap rates lower and valuations higher, in some cases reaching historic levels
 - Scarcity of product further drives up values as investors lack replacement investments in the sector

Retail Real Estate 2014 – The Big Picture

- ▶ **E-Commerce threat to bricks-and-mortar slowly morphing into the opportunity of the omni-channel reality**
 - Stand-alone e-commerce focused on low margin commodities
 - Retailers developing effective omni-channel capabilities as their customers rapidly adapt mobile technology
 - ▶ Key goal is driving profitable sales by allowing the customer to shop wherever, however and whenever they please
 - ▶ Avoid the “race to the bottom” on pricing and profit margins by striking the right balance between a profitable, established store based distribution system and a low-margin, highly price sensitive online channel.
 - ▶ Variety of options – buy online/pick-up in store, buy in-store/deliver to home, etc. - being offered to both encourage store visits and to maximize stores’ role in maintaining an efficient delivery system

Retail Real Estate – Center by Center

Grocery Anchored

- ▶ As in other sectors, growth of new centers has slowed dramatically
- ▶ Major supermarket chains investing significantly in store upgrades – adding organics and natural food offerings to differentiate themselves from Wal*Mart at the low end and Whole Foods and the Fresh Market at the high end – while continuing to leverage highly-efficient supply chains to manage margin pressure from inflation in proteins (beef, fish, poultry and pork) and dairy products
- ▶ Wal*Mart threat remains but at a reduced level as slower store growth, combined with growing demand for organics and a solid competitive response by larger regional chains, has maintained a positive balance
- ▶ Whole Foods, Fresh Market and Trader Joe’s continue to aggressively open new stores, finding growing acceptance as appreciation for higher quality organic and natural foods grow – the foodie revolution is in full swing
- ▶ Occupancy levels steadily rising in existing centers – anchor boxes are at historic high occupancies helping to drive still soft mom and pop demand into existing centers
- ▶ Dollar Stores continue to be the fastest growing sector in retail – significant continuing growth in store count and profitability as struggling families trade down; expanding their selections of convenience and frozen foods, acting as demand driver for centers in more moderate trade areas

Power Centers

- ▶ While shift to online sales was commonly viewed as major threat, majority of the major box stores well-positioned to prosper in current market
- ▶ Cyclical shift to home improvement (Home Depot/Lowe’s), combined with the continued success of off-price branded apparel retailers (T.J.Maxx/Ross) largely offsets headwinds from the rationalizations taking place in office supply and book stores

Retail Real Estate – Center by Center

- ▶ While shift to online sales is commonly viewed as a major threat in the office supply, book and music businesses, hardgoods big box retailers have introduced omni-channel strategies, most notably buy online/pick-up in store options, that have been quickly embraced by customers
- ▶ Best Buy's embrace of omni-channel, notably store upgrades to include vendor operated specialty departments, chainwide roll-out of order online/pick-up in store and deliver from store capabilities, has been positively received by the customer
- ▶ The "Power Village" trend continues, driven by growth in both the organic/fresh food sector and in the moderate sit-down restaurant sector. Incorporating higher-end grocers, sit-down and counter serve restaurants drives additional shopping trips and provides additional leasing upside

"A-Malls"

- ▶ The better continue to get better – while sales growth has recently slowed, only a handful of new regional malls have been built in the last several years, driving up occupancy levels, improving rents as leases rollover and generating attractive new redevelopment and repositioning opportunities
- ▶ True A malls typically serve densely populated, high income trade areas with strong barriers to entry, first-rate anchors and a steadily growing and improving mix of better merchants and restaurants
- ▶ With no meaningful supply – either from malls or lifestyle centers – on the horizon, higher potential rents and lack of competition increasingly support renovations, redevelopments and expansions that previously did not pencil, enabling the top-tier malls to add compelling new uses, increase market share and further reinforce their market dominance

Retail Real Estate – Center by Center

- ▶ The better retailers - and department stores – in top-tier malls have embraced omni-channel retailing, ensuring that these centers will continue to feature the most updated flagship stores that make full use of the most current retailing technology
- ▶ The recent uptick in mall renovations, store remodels and new store additions have substantially updated and improved the look and feel of most better malls following the hunker down years of the recession.
- ▶ Mall REITs have aggressively sold off their lower productivity centers to improve portfolio-level operating metrics and refocus their leasing and redevelopment skills on smaller portfolios of higher quality assets.

“B-Malls”

- ▶ Solid interest in B/C malls from investors searching for yield, combined with the gradual return of the CMBS market, has accelerated the transfer of a significant number of these assets from several large REITs to a handful of new companies focused solely on these opportunities – just in time?
- ▶ While A malls typically dominate larger, higher income trade areas, B malls typically serve submarkets in those trade areas or smaller, separate markets where they are the “only game in town”
 - B malls typically anchored by JC Penney, Sears and one to two smaller regional chains, and a moderate mix of national and regional specialty tenants
 - While operating to high standards, the B malls typically experienced greater declines in sales, occupancy and tenancy during the Great Recession than the A malls
 - New ownership aims to upgrade and improve these centers through repositioning strategies that typically include extensive renovations, select new tenant additions, and a concentrated leasing effort, while taking advantage of opportunities to recapture and redevelop anchor stores

Retail Real Estate – Center by Center

- ▶ Successful turnarounds by JC Penney and a rationalization of Sears’ extensive footprint would be significant positives for B centers – JC Penney has made significant progress on its turnaround while Sears has recently announced several initiatives that suggest a more focused approach to rightsizing their operation

Lifestyle Centers

- ▶ Development of new centers has all but ceased
- ▶ Well-located, well-conceived centers with strong specialty tenancy and complimentary dining and food uses have performed well and command premium pricing in the marketplace – many of those that fall short of these characteristics continue to decline as falling sales and occupancies trigger co-tenancy provisions
- ▶ While there is some renewed investor interest in repositioning more challenged lifestyle centers – typically by converting to outlet uses or adding restaurant and specialty grocers – many reside in the shadows of larger, more established centers

Outlet Centers

- ▶ Outlet center business has changed dramatically since the first wave of centers was developed in the early 90’s
 - ownership of new generation outlet centers is highly concentrated among established outlet center developers partnered with one of the major Mall REITs
 - The outlet store model has largely transitioned from the traditional clearance, out-of-season and irregular business to predominantly branded made for outlet product.
- ▶ As a result, outlet centers now offer complete assortments of value-priced fashion merchandise, basics and accessories – less of a treasure hunt than in the early days

Retail Real Estate – Center by Center

- ▶ Many specialty retailers view outlet as an additional distribution channel – with new development taking place closer to established full price stores, maintaining brand integrity and pricing power between outlet and full price stores is a significant concern
 - While many claim that different customers shop outlet stores compared to full line mall stores, many shoppers beg to differ

Quotes From The Front

Retail Real Estate

- ▶ **“...we have positioned ourselves to be an owner of retail hubs which are the A malls and flagship urban locations. The reason is we live in an omni-channel world, you want to own the hubs, the flagship locations, because that is where the retailers will show their entire offering of merchandise, the entire depth, and if they can fully integrate the online and bricks-and-mortar venues, then brick-and-mortar will be the point of distribution as well. When you own the best real estate, you’re going to have the right tenants with the right product.” (GGP)**
- ▶ **“...the rent growth in the great centers is the recycling of the bottom 25% to 30% of the producers in any given center out of the centers as you remerchandise the centers constantly and bringing in retailers that are going to do better than the mall average.” (Macerich)**
- ▶ **“There are a few people it is scaring away, but we’re still seeing plenty of people that would love to get the Sears back and say, can we get more of these back, that’s better because it’s the redevelopment and upside opportunity, so it cuts both ways.” (CBL)**
- ▶ **“We crossed the 400-store mark yesterday, expect to pass 500 stores in fiscal 2017, and over the longer term see demand for 1,200 Whole Foods Market stores in the United States alone. Our new stores are delivering higher-than-projected sales and operating results, and our current 114-store pipeline is projected to reach cumulatively positive EVA before our five-year hurdle. (Whole Foods Market)**
- ▶ **“...as you know, our brick-and-mortar business makes so much money that we want to balance where we make our investments.” (TJX)**

Reported Same Store Sales (\$ per square foot) Regional Mall REITs

	2005	2006	2007	2008	2009	2010	2011	2012	2013	RTM 2014
General Growth*	\$437	\$453	\$462	\$438	\$406	\$446	\$505	\$545	\$564	\$565
Macerich	\$417	\$452	\$467	\$441	\$407	\$433	\$489	\$517	\$562	\$571
Simon**	\$450	\$476	\$491	\$470	\$433	\$494	\$536	\$568	\$582	\$613
Taubman	\$508	\$539	\$555	\$533	\$498	\$564	\$641	\$688	\$721	\$807

Green=Prior Peak Sales Year

*GGP Sales post 2011 reflect Rouse spin-off

**Simon Sales after 2010 Include Outlet Centers

Holiday Retail Outlook – The “New Reality” – Year 6 “After Lehman”

- ▶ **While overall economic fundamentals continue to slowly improve, with solid employment growth and steady improvements in housing values and home sales, 2013 and 2014 have proven to be challenging years for top line retail sales and bottom-line operating profits**
 - Cyclical shift in spending towards big-ticket durable items, including cars, appliances and home improvements, as well as increased spending on mobile devices took significant market share from apparel and other discretionary purchases
 - Exceptionally bad weather in early 2014, particularly in the northeast, led to lost sales that were not fully recaptured
 - While most hardgoods merchants were able to move up or reroute deliveries, specialty apparel players who rely on a steady flow of new, seasonal product felt the effects of West Coast dock disputes with moderately delayed shipments and higher delivery costs
 - The teen apparel business continues to struggle as teens reject the vertically-integrated “Logo” look in favor of more individualized basics - at same time teen population and spending power has declined from its 2007 peak, smartphones and dining out now capture a larger share of their limited spend, and the overall teen sector is arguably overstored
 - Mobile traffic to retailer websites grew significantly as the introduction of more powerful wireless networks dramatically increased the speed and reliability of mobile based web searches while increasingly versatile apps added “bells and whistles” to the omni-channel shopping experience
 - Store traffic across the board declined noticeably in the third quarter of 2013 and has yet to recover
 - ▶ Partly reflects consumer anxiety, more browsing being done on mobile devices and a shift in spend to big-ticket durables
 - ▶ While many observers point to ecommerce as the main culprit, a far more significant concern is the majority of consumers continue to struggle with stagnant wages, higher living expenses and modest household wealth, limiting “share of wallet” available for discretionary purchases

Holiday Retail Outlook – The “New Reality” – Year 6 “After Lehman”

- Comparatively strong performers have been off-price branded apparel merchants (T.J.Maxx and Ross), home improvement chains (Lowe’s and Home Depot) and jewelry stores (Signet)
- ▶ **Despite these continued headwinds, retailers have significantly improved their business models, increasing operational efficiency, reducing debt, strategically managing inventories and rolling out increasingly powerful new omni-channel capabilities**
 - With the notable exception of the teen sector, Sears and a handful of others, retailers have refocused their capital spending on renovating their existing stores, selectively adding new stores and adding the “back of house” IT and shipping capabilities they need to fully integrate their store into this omni-channel networks
 - Retailer balance sheets have improved dramatically since the “dark days” of the Great Recession – most major retailers using free cash to buy back shares, strengthen their supply chains and reinvest in their stores
 - Improved operational efficiency enables retailers to leverage operating expenses with lower comparable sales gains – from 3-5% gains prior to 2009 to 1-2% today
 - Outside of organic/natural food specialty grocers like Whole Foods and Fresh Market, and a handful of moderate sit-down restaurant chains, new store growth is measured – the major new players that are steadily expanding in the U.S. – H&M, Zara, Uniglo and Primark – are all value-oriented apparel retailers with a long history of serving income constrained consumers overseas
- ▶ **Retail industry focused on restoring operating margins, generating increased ROIC and finding the most profitable balance between their bricks-and-mortar, outlet, online and catalogue categories**
 - Return to over-emphasis on unit growth and footprint expansion not happening unless and until the middle income consumer begins to spend again – which no one expects to see soon

Holiday Retail Outlook – The “New Reality” – Year 6 “After Lehman”

- ▶ Overall retail industry is surprisingly healthy and poised to weather continued volatility for the near future – while all stand to benefit significantly if and when economic prospects for middle income consumers, millennials in particular, improve, no one is expecting any such rebound soon:
- ▶ “While traffic continues to be challenging, we’re focusing on controlling what we can control, refining our merchandise execution, maintaining focus on inventory levels and expense management, developing an integrated e-commerce platform for our customers and driving efficiency improvements.” (Ascena)
- ▶ “...the levers remain the same and our mission is to get the most out of what we can control.” (Footlocker)
- ▶ “...we’d rather be in a position of planning for a continued...difficult core customer economy. It’s still very choppy out there, if you look at consumer sentiments in our price point and in our core middle American consumer. So we’d rather stay a little conservative and pessimistic and work hard on growing our business...and if the headwinds surprise us we will get there sooner...but we’re not counting on it.” (BJ’s Restaurants)

Quotes From The Front

New Reality Year 6 AL

- ▶ **“We’ve seen all the reports that despite the fact consumer confidence is increasing, consumer spending is still flat. And it is not clear when this will change. Moderate wage growth and a desire to increase savings are certainly at play here.” (J C Penney)**
- ▶ **“...the reality is, we do have a consumer who is still stressed out there as we’re seeing it...it’s still...a difficult environment out there, competitive environment, a consumer who is very judicious on what she does, she is looking for fashion, she is looking for value, she wants to get something that she feels good about.” (Bon-Ton)**
- ▶ **“...I think customers are choosing to spend their disposable dollars in different ways and that’s part of the reason why we’re not more optimistic about the lower gas prices.” (Macy’s)**
- ▶ **“Stores are first-of-the-month ready. When the customer has money in their pocket and they’re ready to shop, we want to be ready with the product. We think of the first of the month as 12 additional holidays and we prepare them as such.” (Dollar Tree)**
- ▶ **“...we achieved these gains in a very challenging climate for apparel retail, especially the ongoing difficult and volatile macroeconomic backdrop that continues to especially pressure the low to moderate income customer.” (Ross Stores)**
- ▶ **“I think we’re swimming upstream a little bit given the that this customer is a bit challenged, and as we saw last week in the industry, forget tween, they’re looking for those great deals and not looking to spend a lot of money, at least not on apparel.” (Ascena)**



Quotes From The Front

New Reality Year 6 AL

- ▶ **“We’re very focused on trying to get this business back to a double-digit operating income business, but frankly it’s going to take a little bit of time, and I don’t know if we’ll see that over the next couple of years.” (Express)**
- ▶ **“As we leverage...integrated retail...we will continue to right-size, redeploy and highlight the value of our assets, including our substantial real estate portfolio, as we transition from an asset-intensive, store focused retailer to an asset-light, integrated retailer.” (Sears)**
- ▶ **“...we had a ship that came in with 18,000 containers on it, of which we had 26. Trying to get your 26 out of 18,000 containers in the backed up port is like finding a needle in a haystack.” (Chico’s)**

Thanksgiving-Black Friday - Cyber Monday 2014

- ▶ **This years' Thanksgiving – Black Friday – Cyber Monday shopping period left many observers scrambling for explanations as sales reportedly dropped over 10% compared to 2013, store traffic was noticeably light and many retailers resorted to aggressive, store-wide 50% off promotions to clear product. In many ways these results reflect the continuation of trends observed in prior years, namely:**
 - With modestly encouraging back-to-school results (up 2.6%), many apparel retailers maintained strong buys, when traffic slowed in October they repeated the pattern of launching early promotions and sales, which pragmatic, value-conscious customers, armed with their mobile phone apps, took as a sign to wait for better deals – as a result, sales usually concentrated during the Thanksgiving period were spread out through the month and the sales that did occur were at steep discounts
 - The Thanksgiving shopping season is 85% self-gifting as shoppers wait for the best deals and mark downs before buying apparel
- ▶ **Mobile traffic over the Thanksgiving Holiday set new records – over 50% of website traffic on Thanksgiving was generated by smartphones and tablets as shoppers aggressively browsed competing websites to find the best deals**
 - Regardless, mobile conversion rates remain low(2.4% to 3.3%) indicating customers use their smartphones “on the fly” to search for deals and buy in store or on their desktops
 - Online sales growth was lighter over the Thanksgiving Holiday than in previous years, with gains of 14.3%, 9.5% and 8.5% on Thanksgiving, Black Friday and Cyber Monday, respectively
 - Aside from the significant increase in mobile traffic, overall website metrics remained reasonably consistent – abandonment rates range from 68-75%, conversion rates remain low at 3.3% to 5.2%
- ▶ **Overall average online order values fell in 2014 by approximately 4%**

E-Commerce - Black Friday/Cyber Monday

E-Commerce Metrics - 2014/2013

U.S. Sales*

	Thanksgiving 2014	Black Friday 2014	Black Friday 2014 vs. 2013	Cyber Monday 2014	Cyber Monday 2014 VS. 2013
Total U.S. Sales Increase Year Over Year	14.3%		9.5%		8.5%
Transaction Metrics:					
Items/Order	4.30	3.97	3.9%	4.08%	(0.5%)
Average Order Value	\$125.25	\$129.37	(4.4%)	\$124.21	(3.5%)
Conversion Metrics:					
Conversion Rate	3.3%	4.0%	2.1%	5.2%	3.6%
New Visitor Conversion Rate	2.5%	3.2%	2.6%	4.1%	2.5%
Shopping Cart Sessions	12.1%	13.2%	8.9%	15.1%	6.7%
Shopping Cart Abandonment Rate	75.8%	72.4%	2.0%	68.4%	1.4%
Session Traffic Metrics:					
Average Session Length	8.13	8.26	(5.9%)	8.28	(5.4%)
Bounce Rate	32.4%	31.4%	2.9%	30.8%	4.3%
Browsing Sessions	46.1%	47.6%	0.6%	49.4%	2.2%
Page Views Per Session	8.3	8.37	2.3%	8.40	0.0%
Mobile Metrics:					
Mobile % of Sales	32.3%	27.9%	28.2%	22.0%	27.6%
Mobile % of Site Traffic	52.1%	49.6%	25.0%	41.2%	30.1%
Mobile Bounce Rate	34.7%	34.8%	(0.5%)	35.1%	1.5%
Mobile Conversion Rate	2.4%	2.6%	7.3%	3.3%	4.8%
Smartphone Traffic	NA	34.7%	NA	28.5%	NA
Tablet Traffic	NA	14.6%	NA	12.5%	NA

*Sales from 800 U.S. Retail websites
Source: IBM Digital Analytics Benchmark



Quotes From The Front

Thanksgiving 2014

- ▶ **“...standing out there in some of the big competitors out there on Friday morning was pretty stunning at 9:00 in the morning not to see one customer at the cash register. So traffic, it was certainly down. There’s no question about it...I’ll be the first to say, as a retailer of 35 years, the industry made a bad move by...extending hours on Thursday and so on. We’ve taken the wind out of what was once a sense of urgency. I mean, there were no lines out there at any retailer at 4 or 5 or 6 AM on Friday.” (Big Lots)**
- ▶ **“...traffic got much more spread out. It’s no longer noses to the windows of the store waiting for the gates to open, as much as it had been in the past.” (Genesco)**
- ▶ **“...the more fashion-oriented customer was shopping earlier in November. Clearly a more needs-oriented customer shops during Black Friday.” (Aeropostale)**

Omni-channel and Supply Chain

- ▶ **Omni-channel – Brick-and-mortar retail’s response to eCommerce, rapid adaptation of increasingly powerful mobile devices, and a cautious, pragmatic and increasingly price- and time- sensitive consumer, combining a long overdue overhaul of inefficient supply chain and inventory management systems with an online presence that allows customers to shop whenever they want using which ever “store” – bricks-and-mortar, mobile app or website - they find most convenient**
- ▶ **Ultimately, omni-channel is a classic “pull” inventory system, in which customers pull the items they want out of a retailers’ inventory, as opposed to the classic “push” system in which retailers push standard quantities of goods out to stores and use price and promotions to clear if they overstock**
 - Pull system has promise of preserving IMU margins but immensely more complex and difficult to operate
 - Push systems very efficient at getting goods to stores, but if goods don’t sell the ensuing clearance sales kill margins
- ▶ **Three key steps in buying process – browsing/research, buying, and delivery – all of which are opportunities to better serve customers and make the sale, but all of which are also opportunities to preserve or sacrifice margin**
 - The buying process increasingly starts with browsing on a mobile device – searching for product, comparing prices, and availability - with subsequent research, buying and delivery steps executed through a combination of channels –a trip to the store, a session on the retailers’ mobile app, or on your desktop online
 - Throughout the shopping trip, the retailer must have the “back of house” supply chain, inventory management and order fulfillment systems in place to seamlessly and flawlessly serve the customer as they move between channels – the legacy “silo” inventory systems used for catalogue operations and centralized warehouse based ordering systems are no longer viable.

Omni-channel and Supply Chain

- ▶ **Overall goal is to satisfy customers, drive repeat business, and maximize sales AND profits**
- ▶ **Obviously, seamless omni-channel capabilities are no longer a “coming feature” for most retailers – new mobile devices utilizing 4G/LTE technology can quickly and easily download massive amounts of data at the same time retailers are building increasing powerful and robust websites that allow shoppers to view their entire inventory regardless of which distribution channel it resides in, select from a variety of payment and delivery options, and maintain a record of the transaction for future suggestions or special offers**
- ▶ **While online sales continue to grow at a double digit pace – albeit from a small base - retailers are clearly using their omni-channel capabilities to drive store traffic after the initial browsing session**
 - Over 90% of retail sales are made in traditional bricks-and-mortar stores with well-established profit metrics backed up by increasingly efficient supply chains and inventory management systems – moving product through stores is typically the most profitable avenue for most purchases
 - Aside from search, mobile apps and customized e-mail blasts keep shoppers up-to-date on new products, special offers and in-store events that drive make productive and successful store visits – while traffic levels are down, conversion rates and average ticket in stores are up
 - Outside of several outliers (teens), store fleet “rationalizing” has largely run its course – retailer CapEx dollars disproportionately allocated to store remodels to enhance the in-store experience (as exemplified by the pretty pictures on its website) and install the latest IT, inventory management, fulfillment and shipping capabilities necessary to operate their omni-channel platforms.

Omni-channel and Supply Chain

- ▶ **Key “back-of-house” enhancements include:**
 - Buy online, ship to store, pick-up in store (and buy a bunch of other things while you’re there...)
 - Buy online, ship to home – higher delivery costs
 - Buy in store, ship to home – nirvana if they buy enough to offset shipping costs
 - Sourcing across inventory platforms – find closest product – in nearby store, distribution center or central warehouse – and ship to customer’s preferred pick-up point – keep inventory from going stale, inventory turns, lower shipping costs
- ▶ **Bottom-line – a well-designed, well executed customer-centric omni-channel retail capability is a critical component of any successful bricks and mortar retail business model**

Quotes From The Front

Omni-channel and Supply Chain

- ▶ **“Customers all over the world are integrating how they shop. They don’t see the same lines of separation some of us might focus on and this is a great opportunity for Wal-Mart.” (Wal-Mart)**
- ▶ **“...traffic to the website increased notably in the third quarter, particularly traffic from mobile devices. This is a trend we’ve seen over the last several quarters and is understandable given teens’ fascination with their mobile phones...Not only can customers go online to check availability for product and sizes before making a trip to the store, but they can also access store inventory when shopping online and place orders for merchandise in the distribution center or in other stores, if the store they are in does not have the merchandise they want.” (Genesco)**
- ▶ **“...we believe that [the website is] the front door to our brand and it’s critical we get that brand right.” (Vera Bradley)**
- ▶ **“...omni-channel customers spend 3 times more than a store-only customer and they visit our stores or online 2.5 more times per month than store-only customers. Quite simply, omni-channel customers are more loyal...Gone are the days when she plans a shopping trip. When she wants to shop she pulls out her mobile device and she starts shopping, or starts researching. We know that our customers are researching a lot before they come into the store.” (JC Penney)**
- ▶ **“...in an omni-channel world...it’s all about serving customers in multiple contact points.” (Zumiez)**

Quotes From The Front Omni-channel and Supply Chain

- ▶ **“...in an omni-channel world...it’s all about serving customers in multiple contact points.”
(Zumiez)**
- ▶ **“...all of our existing stores and new stores feature ship-from-store capabilities, allowing us to connect to online shoppers with inventory in our stores. Our new stores enhance our distribution network as new stores can be used to fulfill eCommerce orders. We continue to optimize our ship-from-store fulfillment to improve inventory returns, reduce shipping costs, and accelerate merchandise delivery to our customers. As we open stores in new markets, we’ve also seen our eCommerce business, although off a small base, increase by over 50%.”
(Dick’s Sporting Goods)**
- ▶ **“Interconnected retail also requires us to rethink space allocation within our stores. Almost 40% of our online orders are picked up in the store, using our buy online/pick-up in store and buy online/ship to store capabilities. This year we are installing dedicated storage bays in 550 stores to improve the customer experience.” (Home Depot)**

If the Economy is Improving and Retail Sales Overall are Up, Why is Store Traffic Down?

- ▶ **Overall shift in spending towards big ticket durable goods – autos, home appliances and building supplies – crowds out limited spend available for apparel and non-durables, especially for the vast majority of consumers on tight budgets**
 - Long deferred purchases as recession stretched the replacement cycle – average age of US auto at historic high
 - modest rebound in housing prices and home sales – replace outdated appliances, paint and carpet
 - smart phones squeezing out apparel spend amongst teens – an iphone with data plan substitutes for a full fall wardrobe
 - ▶ Apple store in mall does more business than the average Sears or JC Penney combined
- ▶ **Browsing and product search has increasingly moved online, especially mobile**
 - Mobile traffic up dramatically but conversion remains low - store traffic is down, but conversion rates are up
 - shoppers browse, research and search for the best deals online, buying standardized commodity goods with clicks and specialized goods in stores – cuts out the “browsing” trip
 - retailer websites continue to improve, with increased content, high resolution photos, easy search functions, and customer preferences, at same time that mobile technology – notably the recent roll-out of 4G/LTE networks (“Fourth Generation/Long Term Evolution”) - dramatically increases band width and download speeds with retailer developed apps enabling customers to quickly locate, compare and transact, whether the sale takes place online or instore
- ▶ **Moderate to lower income consumers carefully watching budgets and avoid store trips that could lead to unplanned impulse purchases**

If the Economy is Improving and Retail Sales Overall are Up, Why is Store Traffic Down?

- Particularly troublesome with regards to Millennials – while they visit malls more frequently than any other age group, a significant proportion live at home, have comparatively low incomes and came of age during the worst years of the Great Recession, making them cautious, extremely pragmatic shoppers
 - ▶ As seen over Thanksgiving, use mobile to find the best deals and only buy when store is 50% off
 - ▶ In many ways, retailers push mobile apps to keep them top of mind with reluctant customers, so when the urge or need to shop arises, they are only a click away – even though online sales are less profitable than bricks-and-mortar sales
- ▶ **Fashion cycle has been horrendous – more color and excitement in home appliances than in apparel – a sea of sameness that does little to drive customers to stores looking for the latest “must have” fashion**
 - Partly reflects tenor of the times and merchants unwilling to take chances on fashion that does not sell, especially given the lessons of the Great Recession

What's on your Kid's Holiday List?

2014 Holidays Preferred

iPhone 6 with large display	\$400
One Year data plan (\$50/mth)	<u>\$600</u>
Total (One Gift!)	\$1,000

2014 Holidays – Alternative from Abercrombie & Fitch

Down Jacket (on Sale - \$180.00)	\$180
4 Pairs of Jeans (on Sale - \$50/Pair)	\$200
4 Flannel Shirts (on Sale - \$50/Shirt)	\$200
2 Cotton Sweaters (on Sale - \$50 each)	\$100
10 Boxer Shorts (on sale - \$13.20)	\$132
20 Pairs of socks (on sale - \$8 each)	\$160
1 Pair Sleep Pants (on sale - \$20 each)	\$ 20
Burger and medium fries	<u>\$ 8</u>
Total	\$1,000

Quotes From The Front Store Traffic

- ▶ **“...as we see the customer getting engaged in home and home improvement, their confidence in both local and national housing market, and the value of their homes, improve, we...see them...continue to get engaged in taking on discretionary projects. Today, most of these are still in the smaller projects, which we label as \$500 or less, but we did see an uptick versus the same quarter last year and a willingness to take on larger projects, which we think bodes well going forward as we continue to see home values continue to improve and consumer finances continue to improve.” (Lowe’s)**
- ▶ **“...our own research is that this girl is really crying out for a smartphone or an ipad...to a much greater extent than she was...two or three years ago...with this earlier adoption of...consumer electronics to this customer...is taking dollars away from her spending on apparel.” (Ascena)**
- ▶ **“...we have a perspective on how traffic to the mall can be down and how comps can be up. And it basically speaks to how people shop and there is a large swath of people who do their window shopping...all of their browsing, all of their research online. And so, a lot of traffic fall off in our view are people who aren’t just walking to the mall to figure out what they might want to buy down the road. They are walking to the mall with more purpose to buy, hence conversion of the people walking into the mall is higher...as you can imagine every kid glued to their smartphone does a better job of figuring out what they want to buy by the time they get to the mall. So that would explain the broad mall pattern of lower traffic, higher conversion.” (Genesco)**
- ▶ **“Our core customer is still struggling. Low income is not getting the jobs like higher income folks are. In fact, some of the data we even question as so many people have dropped out of the job market.” (Family Dollar)**

E-Commerce is More Profitable than Bricks-and-Mortar, Right?

- ▶ **If and when Amazon provides the details, we'll probably learn that e-commerce, by and large, is a relatively low margin business...**
 - Amazon and eBay combined represent 40% of the \$265 billion in online sales – Amazon does not disclose margins by business and eBay is a transaction facilitator, not a true retailer
 - Amazon dominates commodity business – big insight was customers are willing to buy basic commodities – like books – online without checking them out first; less willing to do so with larger ticket, more specialized discretionary purchases
 - Amazon's biggest competitors? Wal*Mart and Target
- ▶ **The nature of the product sold online, price transparency and free shipping on single items – a "race to the bottom"?**
 - Online search facilitates rapid, almost instantaneous price discovery on comparable items – typically lower margin products
 - price match bots from Amazon – and others – continually adjusting prices to meet competition – almost always down
 - shoppers seek out best overall deal – price, shipping costs, sales tax and delivery time – leave many abandoned shopping carts in their wake and then get special offers to come back for a second look at what they abandoned...
 - free delivery becoming the norm (>60% of all purchases) – delivering small number of packages to multiple, different, addresses is far more expensive and inefficient than delivering many packages to an established store network
 - as a result, profit margins are reduced every step of the way – low margin commodity product, price matching, free delivery

E-Commerce is More Profitable than Bricks-and-Mortar, Right?

- ▶ **Bricks-and-Mortar stores – “we’ve worked too hard regaining margins to now give it back by mimicking Amazon”**
 - Operating profit ranges from upper single digits for basics to low-to-high teens for specialty retailers
 - Overall margins fell dramatically during the recession as customer spending ground to a halt and retailers resorted to aggressive promotions and deep discounting to clear out unsold inventory
 - While operating margins have slowly improved, few retailers have regained the margins they enjoyed pre-recession – and all are keenly focused, as are their shareholders, on steadily growing profitability
 - Customers routinely prefer to buy more specialized, discretionary goods from retailers with a physical store – validate product quality, fit and look, handle returns, provide advice on complementary products and provide a wider range of customer services
 - As a result, retailers primarily use online channel for clearance items, special sizes, extended product offerings, and slow moving special order items – preserving higher store margins while using the lower margin online channel to sell lower margin product
- ▶ **Evolving Omni-channel capabilities seek to combine the benefits of the online world – easy search and research – with the benefits of bricks-and-mortar – product validation, add-on purchases, personalized service and more efficient delivery through an established distribution network – end goal is to make the most profitable sale and that is usually in the store**
 - Balancing act between the channels – online and in store – same as that faced in the catalogue era

E-Commerce is More Profitable than Bricks-and-Mortar, Right?

- ▶ **Online landscape gradually changing as “Amazon tax” legislation, which requires online retailers to collect state sales tax, is adapted by an increasing number of states**
 - While consumers overall are sensitive to price and sales taxes, online shoppers are especially sensitive and shop online for large purchases to avoid paying sales tax.
 - ▶ Recent research by the National Bureau of Economic Research found that the value of products (net of sales tax) purchased on Amazon declined 9.5% following the introduction of the tax and the frequency of purchases – number of transactions per week – fell 4.2%
 - ▶ The effect was more pronounced for larger purchases – spending fell 15.5% for purchases over \$150 and declined 23.8% for purchases greater than \$300
 - ▶ Households substituted away from Amazon, with competing retailers experiencing a 19.8% increase in purchases in their online channel and a 2% increase in their bricks-and-mortar channel – again the effects were more pronounced with larger purchases
- ▶ **Ironically, low search cost of online shopping facilitated customer migration from Amazon to alternative outlets**

Quotes From The Front

E-Commerce Profitability

- ▶ **“Q: the free shipping program...is it profit accretive?”**
- ▶ **A:...it’s not accretive...[but]...we know it’s the number one frustration with our guests and the number one reason for abandoned carts...[dotcom] on margin, it’s definitely dilutive...if for no other reason than the shipping expense. And I think as it continues to grow, that will put margin pressure on the P&L...as that business grows it will be margin dilutive. But as we increase penetration of ship-from-store and pickup in store, that significantly not only improves our guest experience but also significantly improves our P&L” (Target)**
- ▶ **“...we’re in the middle of building the e-commerce business from the ground up and...when you think about what happened over the holiday and on cyber Monday, it’s probably going to be an interesting thing to see...because, as you well know, most people don’t make any money on e-commerce...[and]...some of those guys actually called...out...how tough it is just [to] get the breakeven. And then when you pile free shipping on top of it, with no limit? As you increase your penetration of e-commerce, [you] put...huge, huge margin pressure on you.” (Big Lots)**
- ▶ **“What we don’t see ourselves as is being the entity that’s going to deliver two different boxes of kids’ cereal to your doorstep at seven in the morning.” (Costco)**
- ▶ **“When we get a customer in, we can start with an item and build a wardrobe. That’s harder and harder to do online, and even while she may come into the store, having browsed on her iPad at home...we still, when she’s in the store, have the ability to build that outfit. To not only sell her the bottom but to put it together with a terrific top and add jewelry to compete the outfit. (Chico’s)**
- ▶ **“...omni-channel initiatives are not all about driving online sales.” (GAP)**

Holiday 2014 Retail Tour

- ▶ **Four dimensional tour – venue, retail segment, performance since 2006, and customer base**
 - Venue and retail segment
 - ▶ Apparel in the mall – teen, family, women’s and department store
 - ▶ Power center across the street – mass merchant, off-price apparel, home improvement and CE
 - ▶ Warehouse clubs and dollar stores
 - Summary performance metrics
 - ▶ Net sales, gross margin and operating income
 - ▶ Number of stores, comparable sales and percent of sales from DTC channel
 - Historic performance through three retail “eras” since 2006
 - ▶ 2006-2007 – end of the “Go-Go” years – high margins, store growth fueled by home appreciation
 - ▶ 2008-2010 – the “OMG” years – bottom falls out of housing market, debt crisis ensues, massive unemployment and the Great Recession is on – retailers hoard cash, clear inventories and re-work business models
 - ▶ 2011-Present – Hunker Down – re-engineer business model to lower leverage point, lower leverage and “control what we can” as consumer remains cautious and extremely price and value sensitive; improve supply chain, selectively introduce omni-channel capabilities while preserving margins; wait for growth to resume – someday
 - Customer Base
 - ▶ Mall – middle to upper income boomers, millennials and their kids
 - ▶ Power Center – lower to middle income families
 - ▶ Warehouse/Dollar Store – lower to middle with many receiving some form of government assistance

Holiday 2014 Retail Tour

▶ Key Takeaways

- Profit margins fell drastically during recession, and while most have recovered somewhat, overall margins appear to have ratcheted down permanently – where many specialty retailers generated operating margins in the high teens/low twenties prior to 2008, they now focus on achieving low to mid teen level operating margins; likewise, store count growth has slowed as retailers rationalize their fleets and focus on renovations and new prototypes
 - ▶ Department store and big boxes have largely stabilized margins at slightly lower levels – again with modest unit growth
 - ▶ JC Penney slowing coming back to life
- Net sales, profit margins and store counts in off-price and dollar stores continue to grow
- Most retailers no longer report DTC sales separately – include these sales in “comparable sales” to reflect omni-channel strategies
- DTC sales for off-price, mass merchants, and warehouse stores considerably lower in comparison to specialty retail – while reporting is spotty, most report DTC sales of less the 3-5% of total sales

Holiday 2014 Retail Tour: Specialty Retailers - Teens

American Eagle Outfitters	FY 2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014E
Net Sales (\$MM)	\$2.794	\$3.055	\$2,989	\$2,967	\$2,968	\$3,120	\$3,476	\$3,306	\$3,239
Gross Margin %	47.9%	46.6%	39.3%	39.3%	39.5%	36.7%	40.0%	34.6%	35.0%
Operating Income %	21.0%	19.6%	10.1%	9.6%	10.7%	9.4%	12.4%	7.1%	5.6%
Number of Stores	911	987	1,098	1,103	1,086	1,090	1,044	1,066	1,070
Comparable Sales % change	12.0%	1.0%	(10.3%)	(3.6%)	(1.0%)	3.0%	7.0%	(6.0%)	(7.1%)
% Sales DTC	0.0%	8.0%	10.3%	11.6%	11.3%	12.3%	13.4%	N/A	N/A*

Abercrombie & Fitch	FY 2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014E
Net Sales (\$MM)	\$3,318	\$3,750	\$3,540	\$2,962	\$3,469	\$4,158	\$4,511	\$4,117	\$3,856
Gross Margin %	66.6%	67.0%	66.7%	64.6%	63.8%	61.3%	62.4%	62.6%	61.2%
Operating Income %	19.8%	19.7%	12.4%	5.1%	8.3%	5.3%	8.3%	5.4%	5.2%
Number of Stores	944	1,035	1,125	1,096	1,069	1,045	1,051	1,066	1,003
Comparable Sales % change	2.0%	(1.4%)	(13.3%)	(22.9%)	7.3%	5.0%	(1.4%)	(11.3%)	(7.8%)
% Sales DTC	6.0%	7.9%	8.6%	9.7%	11.7%	13.3%	15.5%	18.9%	22.5%

Tilly's	FY 2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014E
Net Sales (\$MM)	\$199	\$246	\$255	\$ 283	\$333	\$401	\$467	\$496	\$513
Gross Margin %	37.0%	37.2%	32.5%	30.9%	30.9%	32.2%	32.1%	30.4%	29.8%
Operating Income %	16.0%	16.0%	9.3%	7.6%	7.5%	8.7%	8.3%	6.0%	4.0%
Number of Stores	61	73	99	111	125	140	168	195	211
Comparable Sales % change	17.3%	8.7%	(12.5%)	(3.1%)	6.7%	10.7%	2.3%	(1.9%)	(4.1%)
% Sales DTC	2.0%	5.0%	6.0%	8.0%	9.9%	10.9%	11.3%	12.0%	N/A*

*DTC Sales included in Comparable Sales

Holiday 2014 Retail Tour: Specialty Retailers – Family Apparel

The Gap	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014E
Net Sales (\$MM)	\$15,923	\$15,772	\$14,526	\$14,197	\$14,664	\$14,549	\$15,651	\$16,148	\$16,517
Gross Margin %	35.5%	36.1%	37.5%	40.3%	40.2%	36.2%	39.4%	39.0%	37.9%
Operating Income %	7.7%	8.3%	10.7%	12.8%	13.4%	9.9%	12.4%	13.3%	12.5%
Number of Stores	3,131	3,167	3,149	3,095	3,068	3,038	3,095	3,164	3,257
Comparable Sales % change	(7%)	(4.0%)	(11.5%)	(3.0%)	1.0%	(4.0%)	4.8%	2.2%	(0.2%)
% Sales DTC	4.6%	5.8%	7.1%	7.9%	8.9%	10.7%	12.0%	14.0%	N/A*

Urban Outfitters	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014E
Net Sales (\$MM)	\$1,092	\$1,508	\$1,835	\$1,938	\$2,274	\$2,474	\$2,795	\$3,087	\$3,305
Gross Margin %	41.1%	38.3%	38.9%	40.6%	41.2%	34.8%	36.9%	37.6%	35.4%
Operating Income %	19.0%	14.9%	16.3%	17.5%	18.2%	11.5%	13.4%	13.8%	10.9%
Number of Stores	207	245	293	326	371	427	472	507	547
Comparable Sales % change	10.9%	5.5%	8.0%	(3.4%)	4.3%	(3.8%)	(0.8%)	6.0%	1.0%
% Sales DTC	12.0%	13.6%	14.9%	16.7%	19.1%	20.4%	23.7%	24.0%	N/A*

*DTC Sales included in Comparable Sales

Holiday 2014 Retail Tour: Specialty Retailers – Women’s Apparel

Ann Taylor	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014E
Net Sales (\$MM)	\$2,343	\$2,397	\$2,195	\$1,829	\$1,980	\$2,212	\$2,376	\$2,493	\$2,517
Gross Margin %	53.7%	52.2%	48.1%	54.4%	55.8%	54.6%	54.8%	53.9%	51.2%
Operating Income %	9.6%	6.5%	(16.9%)	1.5%	6.3%	6.8%	7.0%	6.8%	5.3%
Number of Stores	869	929	935	907	896	953	984	1,025	1,058
Comparable Sales % change	2.8%	(3.3%)	(14.8%)	(17.4%)	10.7%	6.8%	3.3%	2.3%	(2.6%)
% Sales DTC	N/A	5.0%	6.0%	6.6%	9.6%	11.2%	12.4%	12.8%	13.5%

L Brands	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014E
Net Sales (\$MM)	\$10,671	\$10,134	\$9,043	\$8,632	\$9,613	\$10,364	\$10,459	\$10,773	\$11,410
Gross Margin %	37.6%	34.6%	33.2%	35.1%	37.8%	39.1%	41.9%	41.1%	41.3%
Operating Income %	11.0%	11.0%	6.5%	9.9%	13.4%	11.9%	15.0%	16.2%	16.4%
Number of Stores	2,897	2,926	3,014	2,971	2,968	2,941	2,876	2,923	2,964
Comparable Sales % change	7.0%	(2.0%)	(9.0%)	(5.0%)	9.0%	10.0%	6.0%	2.0%	3.0%
% Sales DTC	13.3%	13.8%	16.8%	16.1%	15.6%	15.0%	17.3%	16.4%	15.9%

Holiday 2014 Retail Tour: Department Stores

J.C. Penney	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014E
Net Sales (\$MM)	\$19,903	\$19,860	\$18,486	\$17,556	\$17,759	\$17,260	\$12,985	\$11,859	\$12,206
Gross Margin %	39.3%	38.6%	37.4%	39.4%	39.2%	36.0%	31.3%	29.4%	35.0%
Operating Income %	9.7%	9.5%	6.1%	3.8%	4.7%	0.0%	(10.1%)	(12.0%)	(2.0%)
Number of Stores	1033	1,067	1,093	1,108	1,106	1,112	1,117	1,094	1,063
Comparable Sales % change	4.9%	0.0%	(8.5%)	(6.3%)	2.5%	0.2%	(25.2%)	(7.4%)	3.8%
% Sales DTC	N/A	N/A	N/A	N/A	8.6%	8.8%	7.9%	9.1%	9.8%

Nordstrom	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014E
Net Sales (\$MM)	\$8,561	\$8,828	\$8,272	\$8,258	\$9,310	\$10,497	\$11,762	\$12,166	\$13,086
Gross Margin %	37.5%	37.4%	34.5%	35.5%	36.7%	37.2%	36.8%	36.4%	35.9%
Operating Income %	12.9%	13.7%	9.1%	9.7%	11.5%	11.5%	11.0%	10.8%	9.8%
Number of Stores	155	156	169	184	204	225	240	260	296
Comparable Sales % change	7.5%	3.9%	(12.4%)	(3.6%)	8.1%	7.2%	7.3%	2.5%	3.7%
% Sales DTC	5.0%	5.1%	5.8%	6.8%	7.6%	8.7%	10.8%	13.3%	15.3%

Holiday 2014 Retail Tour: Big Box Stores

Target (US Segment)	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014E
Net Sales (\$MM)	\$63,368	\$63,368	\$64,948	\$65,357	\$65,787	\$68,466	\$71,960	\$71,279	\$72,230
Gross Margin %	30.3%	30.2%	29.8%	30.5%	30.5%	30.1%	29.7%	29.8%	29.3%
Operating Income %	8.5%	8.3%	6.8%	7.1%	8.0%	7.8%	7.3%	5.3%	5.0%
Number of Stores	1,488	1,591	1,682	1,740	1,750	1,763	1,778	1,793	1,797
Comparable Sales % change	4.8%	3.0%	(2.9%)	(2.5%)	2.1%	3.0%	2.7%	0.4%	0.8%
% Sales DTC	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Ross Stores	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014E
Net Sales (\$MM)	\$5,570	\$5,975	\$6,486	\$7,184	\$7,866	\$8,608	\$9,721	\$10,230	\$10,913
Gross Margin %	22.5%	22.7%	23.6%	25.8%	27.2%	27.5%	27.9%	28.0%	28.1%
Operating Income %	7.0%	7.0%	7.6%	10.1%	11.5%	12.4%	13.1%	13.1%	13.3%
Number of Stores	797	890	945	995	1,042	1,103	1,181	1,276	1,373
Comparable Sales % change	4.0%	1.0%	2.0%	6.0%	5.0%	5.0%	6.0%	3.0%	2.0%
% Sales DTC	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Holiday 2014 Retail Tour: Big Box Stores

Home Depot	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014E
Net Sales (\$MM)	\$79,022	\$77,349	\$71,288	\$66,176	\$67,997	\$70,395	\$74,754	\$78,812	\$82,715
Gross Margin %	33.6%	33.6%	33.7%	33.9%	34.3%	34.5%	34.6%	34.8%	34.8%
Operating Income %	11.2%	9.4%	6.2%	7.3%	8.6%	9.5%	10.4%	11.6%	12.5%
Number of Stores	2,147	2,234	2,274	2,244	2,248	2,252	2,246	2,263	2,269
Comparable Sales % change	(2.8%)	(6.7%)	(8.7%)	(6.6%)	2.9%	3.4%	4.6%	6.9%	4.8%
% Sales DTC	N/A	N/A	N/A	N/A	N/A	1.8%	2.4%	3.5%	N/A*

Best Buy - Domestic	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014E
Net Sales (\$MM)	\$27,380	\$31,031	\$33,328	\$35,070	\$37,314	\$37,070	\$37,615	\$35,831	\$35,711
Gross Margin %	24.8%	24.5%	24.5%	24.6%	24.2%	25.1%	24.4%	23.1%	22.1%
Operating Income %	6.1%	6.0%	6.0%	5.0%	5.6%	5.5%	4.9%	3.2%	3.5%
Number of Stores	774	873	971	1,107	1,192	1,317	1,503	1,495	1,473
Comparable Sales % change	5.1%	4.1%	1.9%	(1.3%)	1.7%	(3.0%)	(1.6%)	(0.4%)	0.4%
% Sales DTC	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A*

*DTC Sales included in Comparable Sales

Holiday 2014 Retail Tour: Warehouse/Dollar Stores

Costco	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014E
Net Sales (\$MM)	\$63,545	\$58,963	\$70,977	\$69,892	\$76,255	\$87,048	\$ 97,062	\$110,212	\$117,106
Gross Margin %	10.6%	10.6%	10.5%	10.8%	10.8%	10.7%	10.6%	10.7%	10.7%
Operating Income %	2.8%	2.7%	2.7%	2.6%	2.7%	2.7%	2.8%	2.9%	2.9%
Number of Stores	518	487	543	558	572	592	608	664	695
Comparable Sales % change	5.2%	7.5%	8.2%	(3.7%)	6.9%	9.8%	6.8%	4.2%	3.9%
% Sales DTC	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Dollar General	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014E
Net Sales (\$MM)	\$9,170	\$9,495	\$10,458	\$11,796	\$13,035	\$14,807	\$16,022	\$17,504	\$18,907
Gross Margin %	25.8%	27.8%	29.3%	31.3%	32.0%	31.7%	31.7%	31.1%	30.7%
Operating Income %	2.7%	2.7%	5.6%	8.1%	9.8%	10.1%	10.3%	9.9%	9.5%
Number of Stores	8,229	8,194	8,362	8,828	9,372	9,837	10,506	11,132	11,787
Comparable Sales % change	3.3%	2.1%	9.0%	9.5%	4.9%	6.0%	4.7%	3.3%	2.9%
% Sales DTC	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

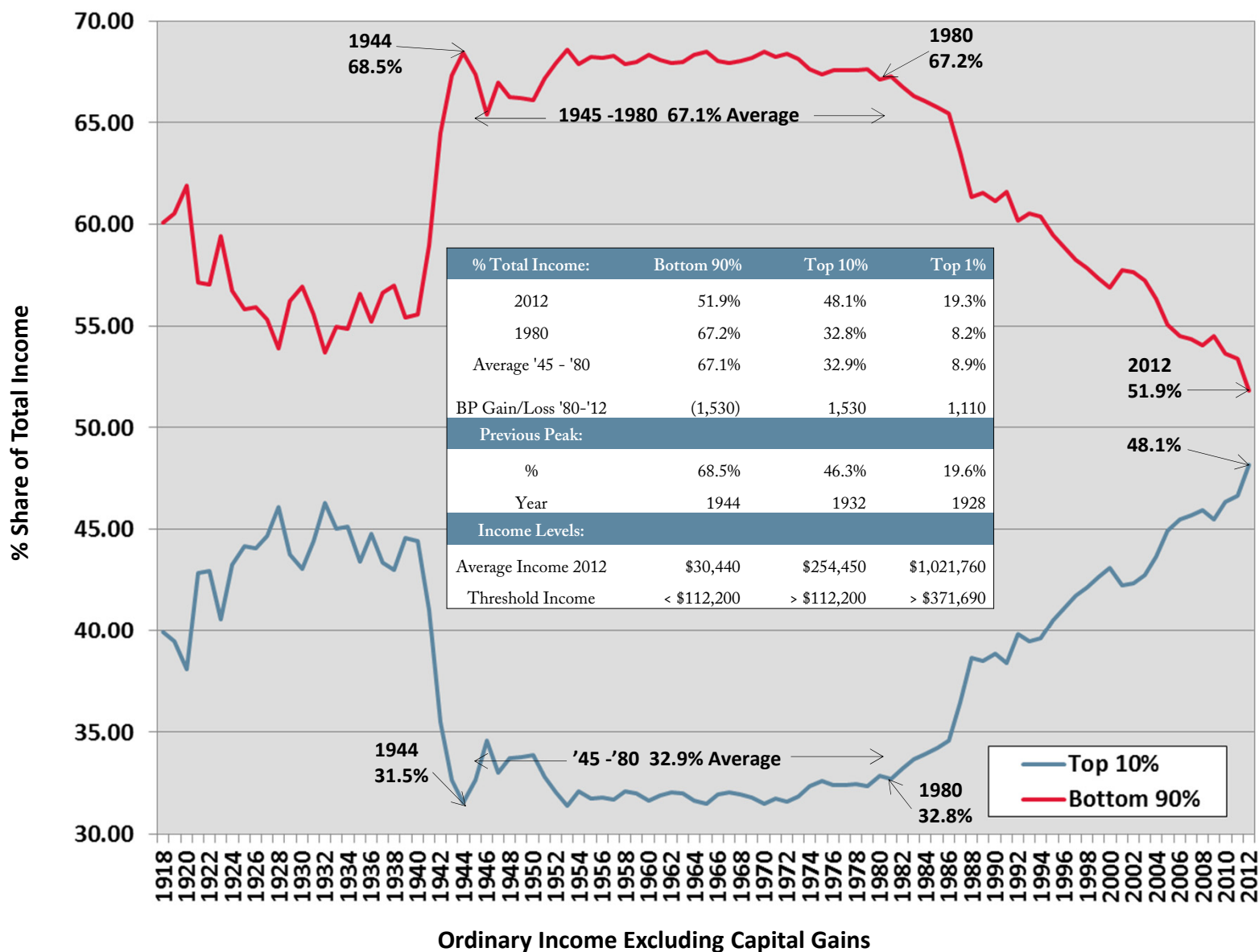
U.S. Income Distribution

- ▶ **Income inequality in the U.S. has been steadily growing since the 1970's**
- ▶ **Following a brief pause during the depths of the Great Recession, income equality has accelerated to the point where Janet Yellen, Chair of the Federal Reserve Bank, noted in an October 2014 conference that “income and wealth inequality are near their highest levels in the past hundred years” and that the “past few decades of widening inequality can be summed up as significant income and wealth gains for those at the very top and stagnant living standards for the majority”**
 - From 1944 to 1980, roughly 2/3rds of annual income (excluding capital gains) accrued to the bottom 90% of taxpayers while the remaining 1/3 accrued to the top 10%
 - Since 1980, the income share accruing to the bottom 90% has dropped to just over 50% while the share accruing to the top 10% has increased to nearly 50%
 - Income has become even further concentrated in the top 1%, increasing from 8.2% of income in 1980 to over 19% in 2012
 - Recent analysis by the Federal Reserve found that families in the middle to upper income brackets (between 40% and 90%) saw little change in average real incomes since the end of the recession in 2010 and thus had failed to recover the losses suffered between 2007 and 2010 – at the same time families at the very top of the income distribution saw widespread gains
- ▶ **Improving average household income and net worth is masking the effects of substantial income disparity as the vast majority of American shoppers are not benefitting from the recovery – not a new event as their fortunes have been in decline for quite sometime**
- ▶ **In this context, the slowdown in retail sales and lack of new shopping center construction reflects what many retailers have known - and reacted to – for some time: the middle income consumer is increasingly budget constrained with limited spending power for discretionary purchases and non-essentials**

U.S. Income Distribution

- Not surprisingly the “Golden Age” of mall development took place in the midst of the 1945-1980 time period when the middle class enjoyed a steady and significant share of national income – fueled both by the baby boom and suburbanization
- The next wave of retail development – big box, lower margin power centers - followed in the 90s as income disparity grew, income growth slowed and customer focus on value increased – largely out of necessity
- As witnessed this Thanksgiving, budget constrained consumers used their mobile apps to aggressively seek out the best deals – all low margin transactions for retailers – and opted to forego the purchase if the deals weren’t attractive enough
- ▶ **Suspect that most retailers are aware of this dynamic – after all, they see more of America at the cash register everyday than most people see in a lifetime – and as such, without wage growth for the middle class, we should not expect a “break-out” in retail sales or new center construction outside of more affluent markets for the foreseeable future**

U.S. Income Distribution 1918-2012

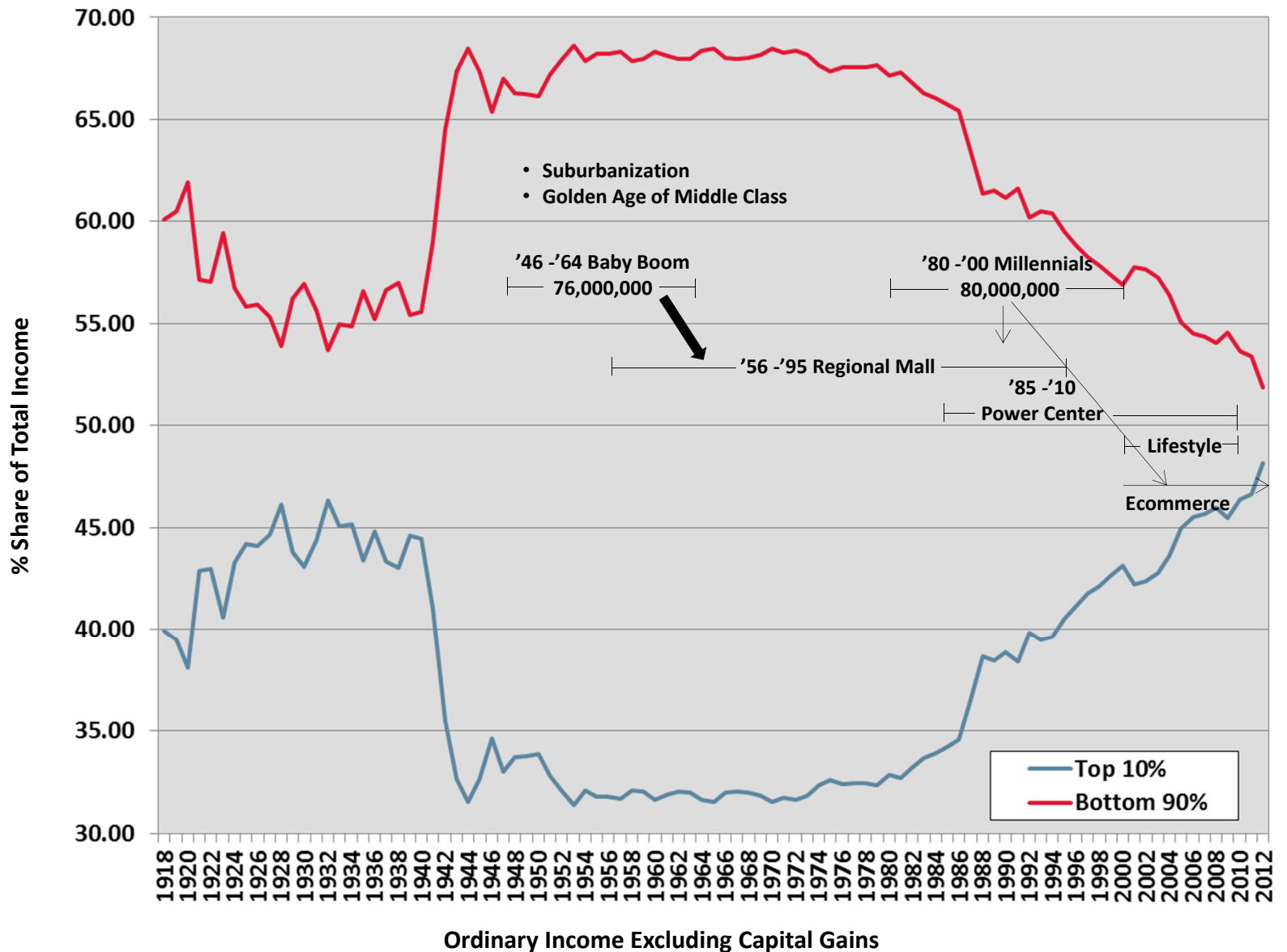


Source: World Top Incomes Database

AEW Research Conference Call: Holiday Retail Outlook

U.S. Income Distribution 1918-2012

Shopping Center Development Trends 1946-2012



Source: World Top Incomes Database

AEW Research Conference Call: Holiday Retail Outlook

Quotes From The Front

U.S. Income Distribution

- ▶ **“By some estimates, income and wealth inequality are near their highest levels in the past hundred years, much higher than the average during that time span and probably higher than for much of American history before then. It is no secret that the past few decades of widening inequality can be summed up as significant income and wealth gains for those at the very top and stagnant standards for the majority. “ (Janet Yellen)**
- ▶ **“...did rising inequality contribute in an important way to the unsustainable increase in household leverage that triggered the collapse in consumer demand and the Great Recession? Has the rise in inequality become a drag on demand growth since the Great Recession that has held back recovery? Our answer to both questions is yes.” (Cynammom/Fazzari – “Inequality, the Great Recession and Slow Recovery”)**
- ▶ **“So it is true that rich people can spend more money than middle class people, but there’s this upper limit on what we can spend...My family can afford to go out to eat more than most American families, but not more than 3 times a day. We can’t go out 3,000 times a day....My family...owns a pillow company, and the pillow business is tougher because fewer and fewer people can afford to buy pillows. I may earn a thousand times the median wage, but I can’t sleep on a thousand pillows. We need everyone to be able to afford a pillow every year..to have a successful pillow business, and concentrating wealth at the top essentially creates a death spiral of falling demand.” (Nick Hanauer)**
- ▶ **“The Economic Policy Institute has found that the Walton wealth was larger than the wealth of the bottom 40 percent of all American families combined in 2010.” (Joseph Stiglitz)**

Biographical Information



MICHAEL J. ACTON, CFA, *Managing Director, AEW Research*

Michael J. Acton, CFA, is Director of Research for AEW Capital Management, L.P. with responsibility for directing the activities of AEW Research, the firm’s highly regarded in-house research group. Mike joined the firm in 1990 and has nearly 30 years of experience as an economic analyst and forecaster and is a standing member of the firm’s Investment Committee and Management Committee. The resources of AEW Research are an integral part of AEW’s investment process and Mike works closely with senior professionals in all areas of the firm to develop investment strategies that match clients’ risk/reward objectives with market opportunities. Mike is also a member of the firm’s Compliance Committee and Risk Management Committee. Prior to joining AEW, he was with DRI/McGraw-Hill where he managed the Metropolitan Area Forecasting Service. He is a graduate of Bates College (B.A.) and a CFA charterholder.



RONALD M. PASTORE, *Director, AEW Direct Investment Group*

Ron is the Senior Retail Portfolio Manager in AEW’s Direct Investment Group. In this capacity he oversees AEW’s retail portfolio with particular emphasis on super regional malls, urban specialty centers and retail-oriented mixed-use projects. Ron brings to his position over 30 years of real estate experience, including extensive experience managing joint ventures, complex redevelopment projects, financings and dispositions at both the asset and portfolio level. He served as managing partner for separate ventures that owned historic Union Station in Washington D.C. and Woodfield Mall in Chicago, and currently serves in a similar capacity for Arden Fair Mall in Sacramento, California. He previously served on the partnership committee of the Taubman Realty Group and was a key player in the restructuring of the Taubman UPREIT in 1998. Ron recently advised an AEW client on the redevelopment of a downtown property holding in Salt Lake City into City Creek Center - a 20-acre, open-air mixed use project anchored by Nordstrom and Macy’s, featuring 300,000 square feet of specialty retail and 450 housing units. City Creek Center opened in March 2012 and received the International Property Award for “Best Retail Development, USA”. Ron joined AEW in 1993 from Himmel/MKDG, where he was responsible for retail asset management, development planning and joint venture structuring. Prior to Himmel/MKDG, he was a consulting city planner responsible for financing and managing infrastructure improvement and downtown revitalization projects in New England. He is a member of the International Council of Shopping Centers (ICSC). Ron is a graduate of Bowdoin College (B.A.), Harvard University’s Kennedy School of Government (Masters in City and Regional Planning) and MIT’s Sloan School (M.B.A.).

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