AEW

HOLIDAY RETAIL OUTLOOK

DECEMBER 2017

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LOOKING BACK AND LOOKING FORWARD

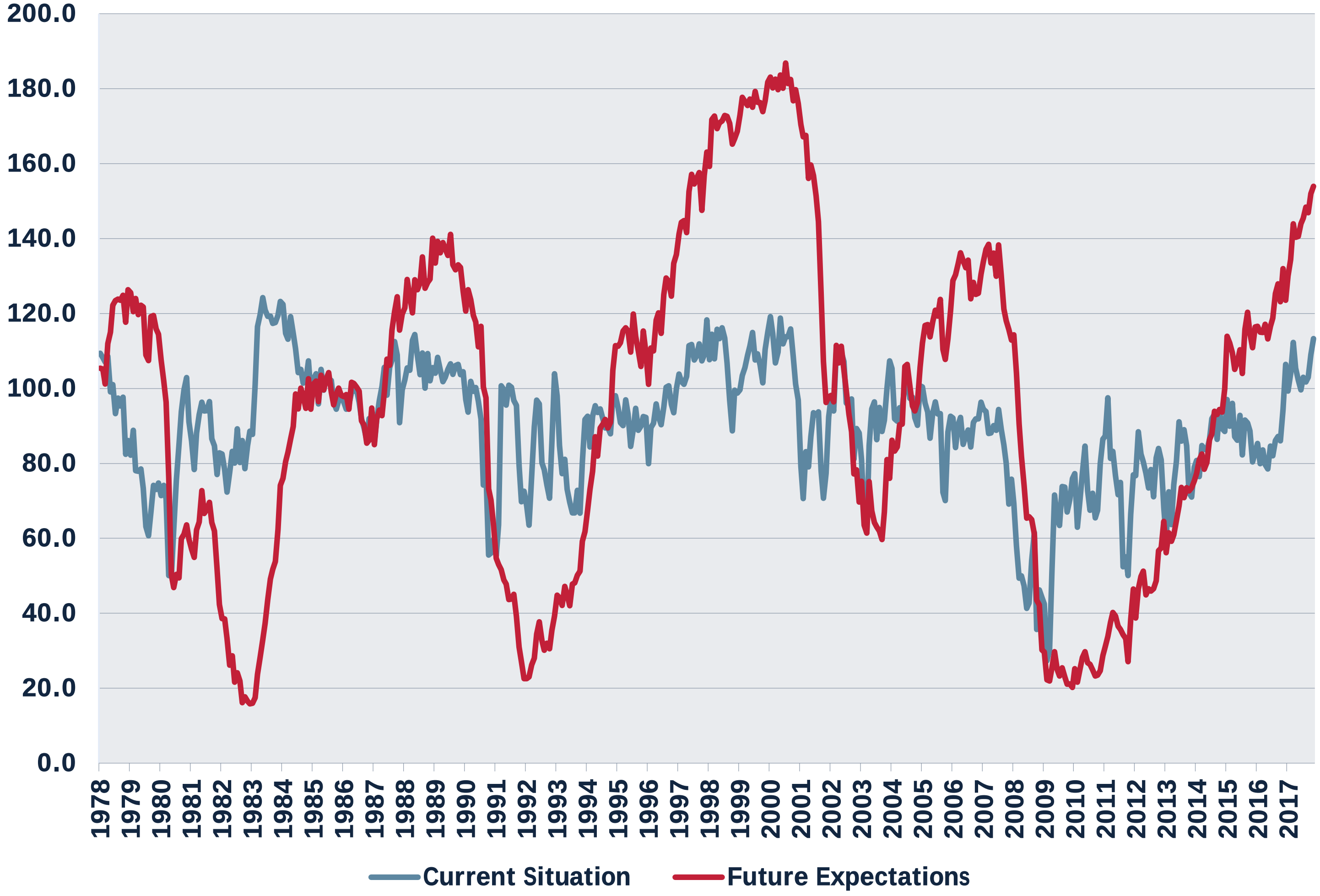
Consumer confidence now back to pre-crisis levels	✓ now above
U.S. has added 15 million jobs since 2010	✓ now >17 million
Unemployment rate now well below 5%	✓ now 4.1%
New claims for unemployment insurance at lowest levels since early 1970s	✓ still true
Number of open jobs at highest level ever recorded	✓ still true
Wage growth accelerating	✓ still true
Stock market at record highs	✓ still true
Markets now pricing in higher growth and inflation ahead, mostly due to expectations of tax cuts/reform	✓ still true
Federal Reserve has more room to normalize policy	✓ still true

U.S. GDP growth has been slightly stronger in 2017 compared with 2016

U.S. employment growth continues to slow as the labor market approaches full employment

CONSUMER CONFIDENCE SURGING

CONSUMER CONFIDENCE INDEX (1985=100)



Source: Conference Board

Consumer and business confidence rising in response to very low unemployment, booming stock market and anticipation of tax cuts

WHICH COMPANIES WILL BENEFIT THE MOST FROM TAX CUTS?

CURRENT EFFECTIVE TAX RATE

TICKER	COMPANY	TAX RATE
PHM	Pulte	40%
CVS	CVS	40
WFM	Whole Foods	39
BBY	Best Buy	38
CAH	Cardinal Health	38
TWC	Time Warner	38
CMG	Chipotle	38
GPS	GAP	38
CSX	CSX	37
WMT	Wal-Mart	30

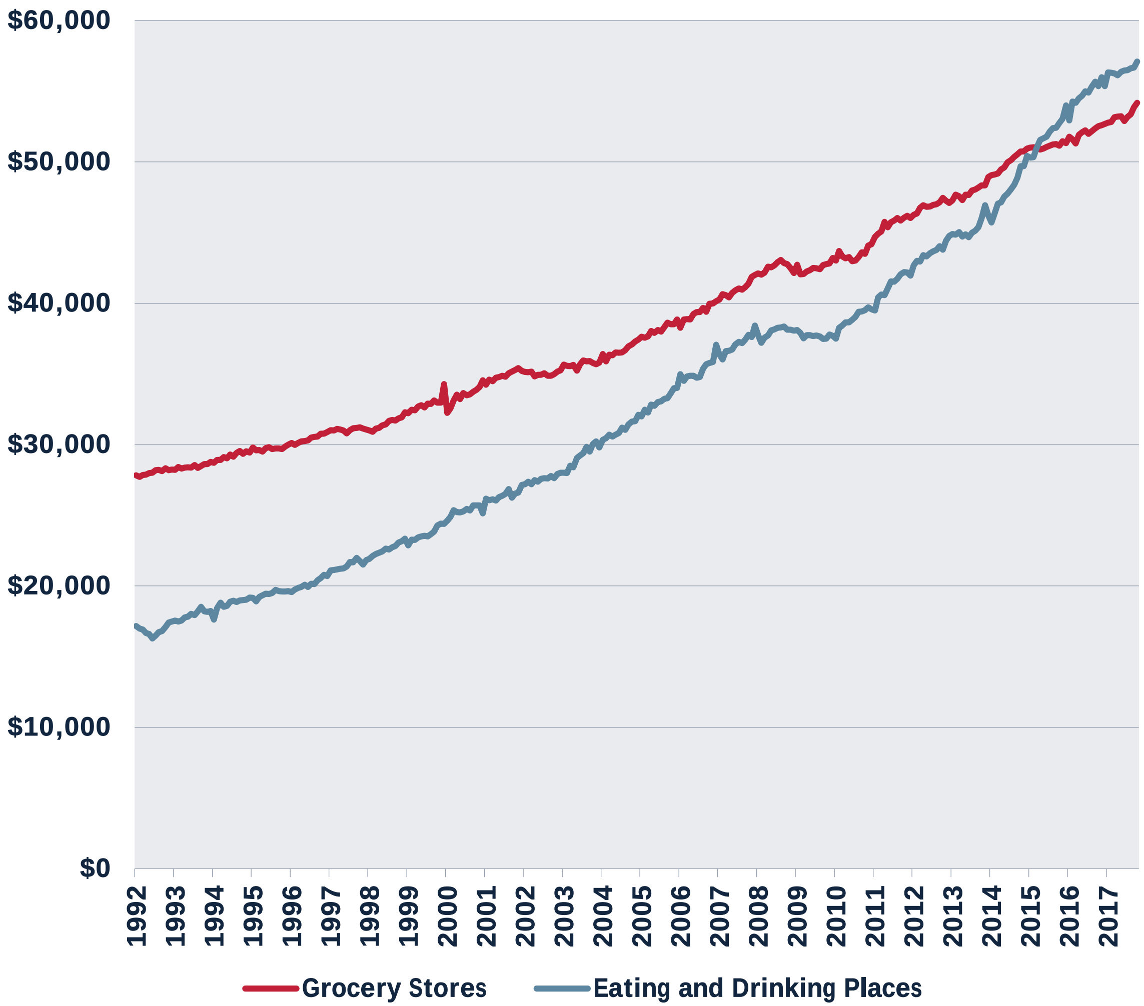
TICKER	COMPANY	TAX RATE
EBAY	eBay	19%
PCLN	Priceline	18
ABT	Abbott Laboratories	18
MRK	Merck	17
GOOGL	Alphabet	17
GILD	Gilead Sciences	16
VRX	Valeant	17
NFLX	Netflix	14
LLY	Eli Lilly	14
AMGN	Amgen	13

- Corporate tax rate to be cut to 20%
- Cut will benefit companies directly in proportion to how much of their revenue is domestic

Source: Cornerstone Macro

AMERICANS NOW SPEND MORE ON FOOD AWAY FROM HOME

RETAIL SALES (MILLIONS)

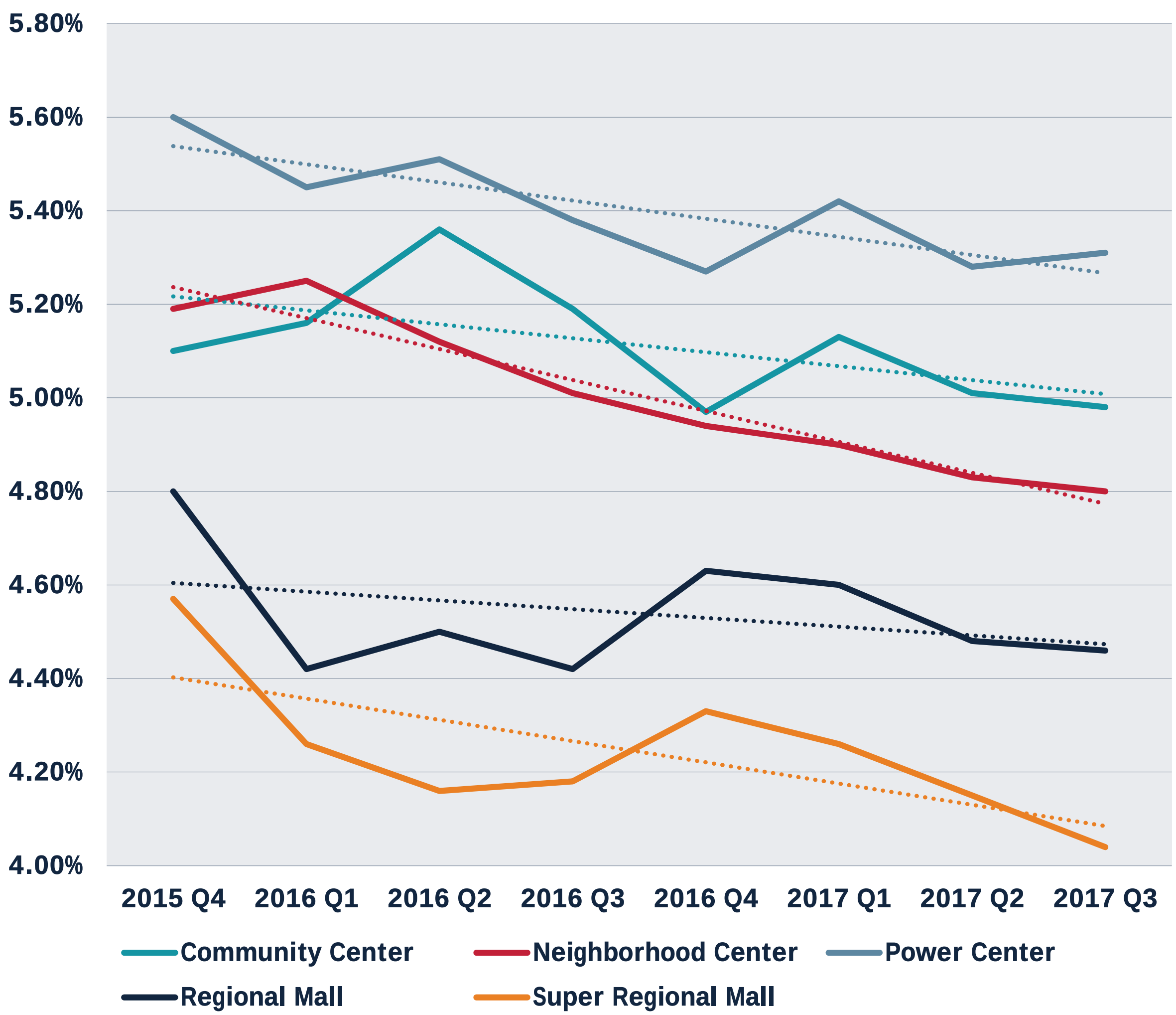


Source: Commerce Department

- Americans eat out more often than they cook for the first time in history
- Casual restaurant business at or near saturation point in many markets given skittish demand
- Most major chains pausing new unit growth to revamp menu value and rethink service models to absorb wage increases
- Grocers took notice years ago – more prepared/to go options

HOW MUCH LOWER CAN WE GO?

AVERAGE CARRYING VALUE RETAIL CAP RATES

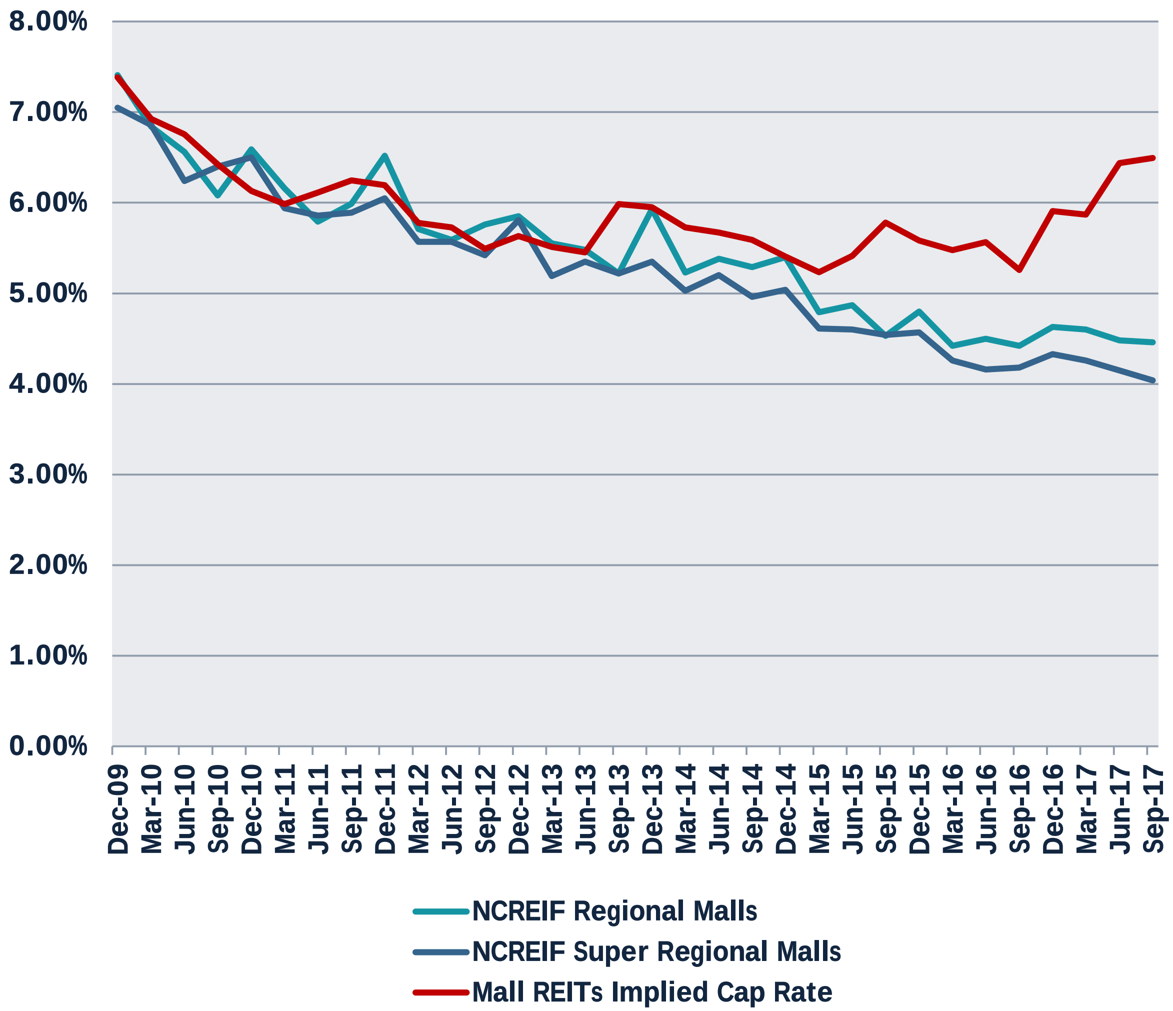


Source: NCREIF 2017 Q3

- Wide yield spread across retail categories
- Super-regional mall yields near 4%
- Disconnect between retail REIT values and private market values since mid ’15
- Spread between A/B+ properties and “all the rest” have widened as well

HOW MUCH LOWER CAN WE GO?

MALL CAP RATES



Source: NCREIF 2017 Q3

- Public market cap rates began to rise following store closure announcements by Macy's and J.C. Penney
- Super-regional mall yields near 4%
- Recent GGP/Brookfield and Westfield/Rodamco news first significant M&A activity on "A" mall side in years

ESTIMATED U.S. RETAIL SALES BY KIND OF BUSINESS - YTD NOVEMBER 2016

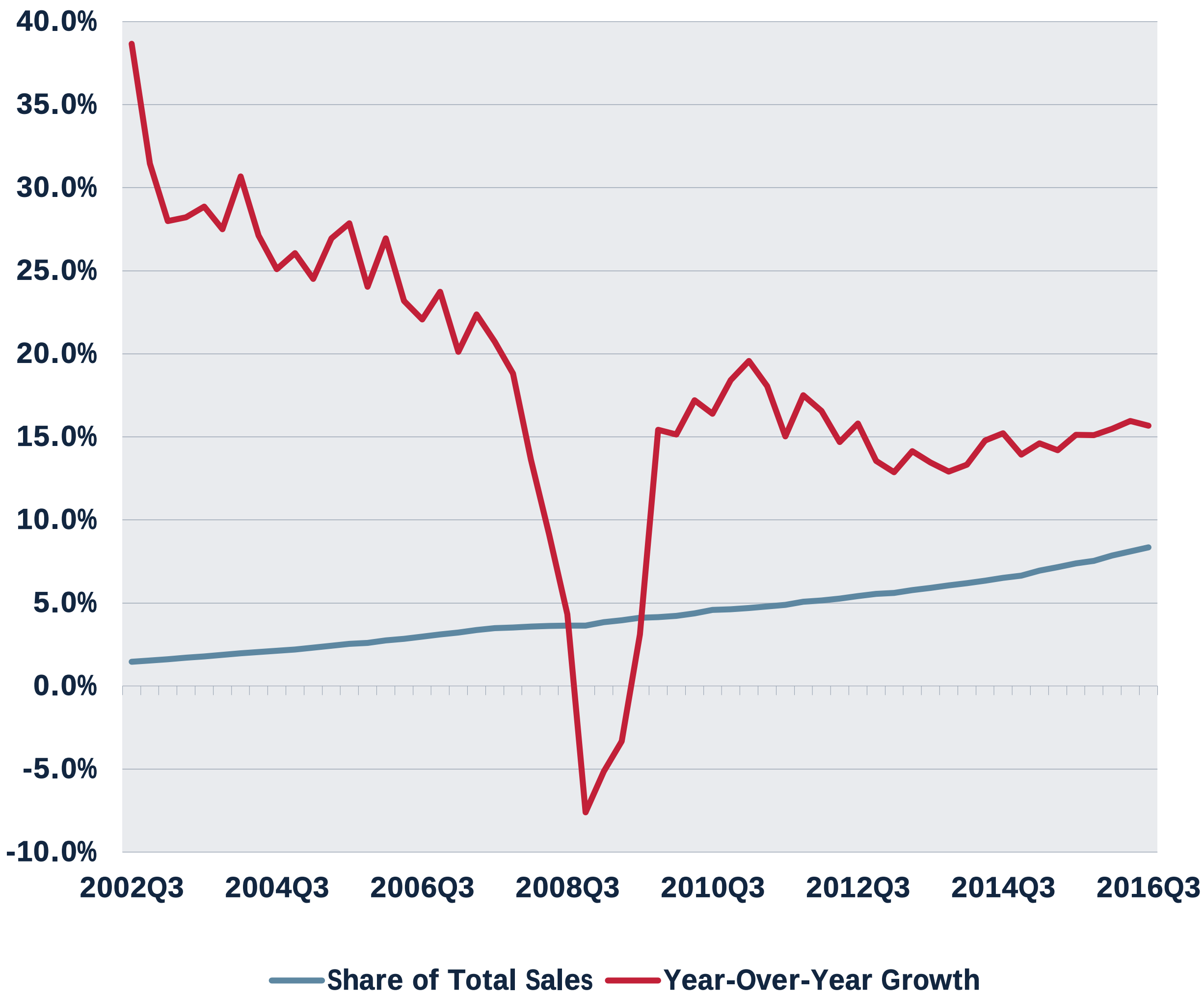
	SALES $MM	% TOTAL SALES	% TOTAL SALES EX. - AUTO	% CHANGE VS. 2016
RETAIL & FOOD TOTAL	**5,191,445**	**100.0%**		**4.2%**
Autos	1,086,633	20.9%		4.5%
Retail ex. Auto	**4,104,812**	**79.1%**	**100.0%**	**4.4%**
NECESSITY RETAIL				
Food & Beverage Stores	651,538	12.6%	15.9%	2.3%
Restaurants & Bars	618,978	11.9%	15.1%	2.7%
Gasoline Stations	417,034	8.0%	10.2%	8.8%
GAFO				
Furniture & Home Furnishings	**104,141**	**2.0%**	**2.5%**	**4.6%**
Electronics & Appliances	**85,342**	**1.6%**	**2.1%**	**-0.3%**
Clothing & Accessories	**226,292**	**4.4%**	**5.5%**	**1.1%**
Sporting, Hobby, Book & Music	**74,081**	**1.4%**	**1.8%**	**-3.6%**
General Merchandise	**612,315**	**11.8%**	**14.9%**	**2.1%**
– *Department Stores*	*130,404*	*2.5%*	*3.2%*	*-2.0%*
GAFO	**1,102,171**	**21.2%**	**26.9%**	**1.5%**
OTHER				
Health & Personal care	300,353	5.8%	7.3%	0.6%
Building Materials	349,819	6.7%	8.5%	8.2%
Misc. Store Retailers	117,365	2.3%	2.9%	3.1%
Non-Store Retailers	547,554	10.5%	13.3%	10.2%

Source: U.S. Census Bureau

- America’s Shopping List – solid gains vs. 2016
- $5.2 trillion of annual sales through November – 75% of U.S. Economy
- Necessities – Food, Auto & Gas – account for over 50%
- Discretionary – “GAFO” – sales account for less than 25% but most of the headlines
- Cyclical shift to autos and home improvement crowd out more discretionary apparel spend
- Food faces deflation, restaurants confront volatile traffic

E-COMMERCE SALES

SHARE OF TOTAL SALES AND YEAR-OVER-YEAR GROWTH



Source: Commerce Department

- Growth in e-commerce sales has stabilized at roughly 15% per year over the past six years
- Total e-commerce sales now account for nearly 10% of total retail sales
- Dominated by Amazon and E-Bay – low margin commodity focus – with retail omni-channel comprising remainder
- Amazon = no profit margin - $7.2B net shipping cost in ’16
- Retailers balance low-margin on-line (shipping & returns) and higher margin store channels
- Mobile drives omni-channel – most sales start with mobile search, replacing traditional browsing

RETAIL 2017

Apocalypse, Armageddon or Evolution?

Spike in store closures – over 6,000 and counting – almost universally blamed on e-commerce

- Common fallacy – with record low unemployment, solid job growth, recent income gains and the stock market setting records daily, poor sales and store closures must be due to e-commerce and the shift to online shopping…right?

***Well…not really…*the popular explanation completely ignores three far more powerful long-term demand-side trends that drove retail in the past, and will continue to drive it in the future, namely:**

- Increasing income inequality since the early 80s has saddled the vast majority of American consumers with stagnant wages and tight household budgets leaving little for discretionary spending
- The aging of the Baby Boomers who drove retail development in the 80s and 90s, and the long-delayed passing of the retail "spending baton" to the much larger Millennial generation, which is poised to "break out" of their apartments or their parents' homes, form independent households and enter a new cycle of spending…just like the Boomers before them
- Increasing geographic inequality as small- and mid-size communities benefitted from the decentralization of manufacturing after WWII are left behind as manufacturing declines and new knowledge-based activities require a more highly-educated workforce concentrated in fewer, larger metro areas that dominate the media – this trend is further deepened by declining household mobility – Americans move less than ever before

In this context, recent closures are more reflective of the long-term effects of these trends often compounded by poor decisions that retailers, and their investors, made in the past, notably crushing debt burdens stemming from LBOs that left no room for error, aging concepts that failed to remain relevant to a changing customer base or invest in more efficient operations, and aging store fleets in older, declining markets

RETAIL 2017

Apocalypse, Armageddon or Evolution?

***Regardless, e-commerce is not irrelevant* – two key factors overlooked:**

- Mobile has become the primary link between customers and retailers
- Pure play e-commerce destroys margins, both by design (Amazon strategy) and in practice - expensive shipping, fulfillment, and return processing to support shift from traditional, more efficient “push” inventory to far more expensive “pull” inventory models

Finally, media seems to believe retailers don’t react to these e-commerce threats…well, they do, and have been responding aggressively…it’s called “omnichannel”, a phrase that may well be forgotten in a few years

Despite the negative sentiment, retailers had a surprisingly upbeat fall with cautious optimism heading into the final Holiday Season – *despite three hurricanes, constant political turmoil and continuing economic anxiety:*

- Weather matters – last 3+ years have seen unusually warm weather well into early December which decimates high-margin cold weather apparel sales as customers increasingly buy close to need
- After a near disaster last year, retailers have done a much better job keeping inventories under control and avoiding constant discounts
- Encouraging signs of new fashion trends selling at near full price
- Spending on home goods has increased as housing market recovers, Millennials gradually form independent households and folks rebuild after the hurricanes
- Soft spots include restaurants (budgets and volatile emotions) and middle market concepts
- Value and deep discount remains strong

RETAIL 2017

Apocalypse, Armageddon or Evolution?

Future outlook depends on two critical demand factors **- resumption of meaningful income growth for the majority of Americans AND the household formation, spending and geographic impacts of the pending great Millennial migration:**

- Millennials – many in the media confuse presence with preference – is current presence in apartments in metros or home with Mom and Dad a preference? Lifecycle theory and Baby Boom experience says no
- If Millennial migration into the "virtually universal process of leaving home to set up independent" households even partially follows Boomer experience, the suburbs, and the retail serving them, will benefit dramatically given the sheer numbers, while cities could benefit from the "boomer-ang" as Boomers downsize from suburban locales and find city living more attractive

Apocalypse, Armageddon or Evolution?

"Whereas the demographic pipeline pumped young adults into cities at full volume, the normal turnover and outflow was clogged by older peers who lacked the job and housing opportunities to advance to the next stages of their employment and housing careers. Millennial presence was amplified in cities because the drain was plugged, but now we can anticipate an amplified outflow of those who had been pent up."

"…we might expect that previously stalled progress through the life cycle will at least partly resume…The Millennials are currently poised at the threshold of housing independence, many residing with their parents in the suburbs and others in central neighborhoods of urban areas. In the next five years, when the larger cohorts of Millennials have moved into their 30s, and given continued recovery in the housing market, their residence will likely progress to a different stage, and likely in different neighborhoods."

Dowell Myers - "Peak Millennials: Three Reinforcing Cycles That Amplify the Rise and Fall of Urban Concentration by Millennials"

U.S. SHOPPING CENTER INDUSTRY
Growth by Center Type 1980-2016

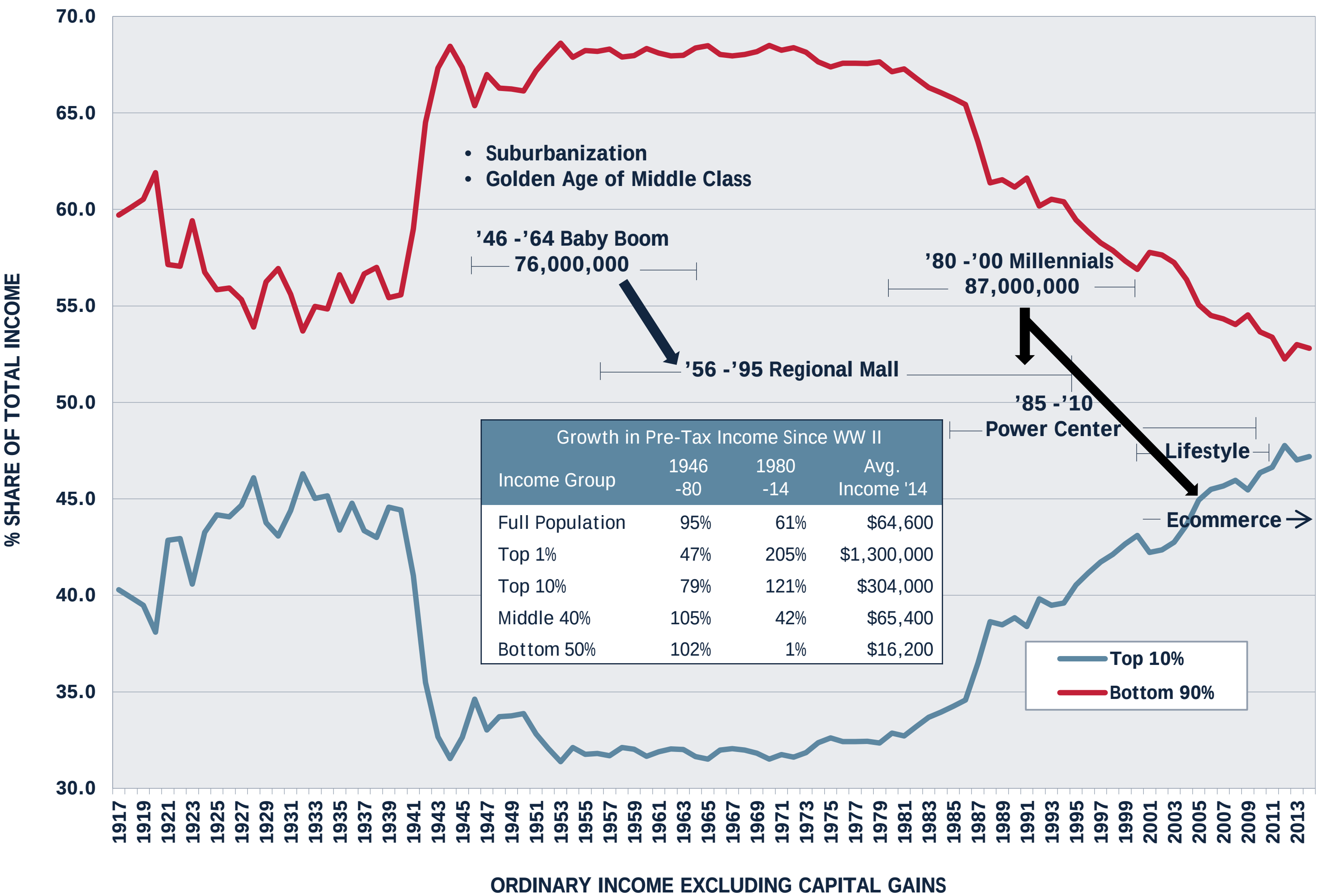
	1980	1985	1990	1995	2000	2005	2010	2016*
Total Shopping Center GLA (SF, MM)	3,087	3,717	4,650	5,224	5,939	6,740	7,412	7,582
Trailing 5-Year CAGR	4.8%	3.8%	4.6%	2.4%	2.6%	2.6%	1.9%	0.4%
REGIONAL MALLS (NUMBER)	713	839	972	1,032	1,102	1,166	1,205	1,222
% Retail GLA	21.8%	21.0%	19.3%	18.2%	17.2%	16.1%	15.2%	14.9%
Total GLA (SF, Million)	672	778	894	950	1,020	1,085	1,124	1,133
Trailing 5-Year CAGR	6.2%	3.0%	2.8%	1.2%	1.4%	1.2%	0.7%	0.1%
N'HOOD/COMMUNITY (NUMBER)	18,625	22,822	28,586	31,369	34,789	38,455	41,508	42,318
% Retail GLA	57.7%	58.7%	60.1%	59.7%	58.7%	57.6%	56.3%	56.3%
Total GLA (SF, Million)	1,780	2,184	2,793	3,120	3,488	3,881	4,175	4,266
Trailing 5-Year CAGR	4.8%	4.2%	5.0%	2.2%	2.3%	2.2%	1.5%	0.4%
POWER CENTERS (NUMBER)	394	460	647	933	1,360	1,810	2,190	2,252
% Retail GLA	5.4%	5.2%	5.8%	7.7%	9.9%	11.7%	13.0%	13.0%
Total GLA (SF, Million)	166	194	271	400	588	791	961	986
Trailing 5-Year CAGR	2.7%	3.1%	6.9%	8.1%	8.0%	6.1%	4.0%	0.4%
LIFESTYLE CENTERS (NUMBER)	80	100	132	145	184	277	435	485
% Retail GLA	0.9%	0.9%	0.9%	0.9%	1.0%	1.4%	2.0%	2.1%
Total GLA (SF, Million)	27	32	41	45	59	94	147	163
Trailing 5-Year CAGR	2.7%	3.8%	5.0%	2.1%	5.5%	9.7%	9.3%	1.7%
OUTLET CENTERS (NUMBER)	44	73	150	233	271	290	323	363
% Retail GLA	0.9%	1.6%	3.1%	5.1%	5.9%	6.0%	6.7%	7.5%
Total GLA (SF, Million)	6	12	28	48	61	66	75	86
Trailing 5-Year CAGR	4.1%	15.2%	17.4%	11.7%	4.7%	1.6%	2.8%	2.1%

*Trailing growth rates for 6-year period ended 2016
*Source: ICSC, CoStar

- Supply side response to consumer driven demand – underlying demographic drivers of value and location often ignored
- 4.5% annual supply growth pre '90 slowed to 2.5% over the next 20 years and stopped after Great Recession
- Pre-'80 growth reflected suburban middle-class expansion; Boomers and growing WLFPR on budgets drove 1980-2005; "great hand-off" of the "spending baton" to Millennials now in progress
- Necessity follows population and rooftops; Discretionary mirrors disposable income, HH budgets and life cycles
- Steady shift from higher margin malls to lower margin big boxes/off-price to no-margin online
- Over-retailed = built for demand that never appeared or demand that disappeared

U.S. INCOME DISTRIBUTION 1917-2014

Shopping Center Development Trends 1946-2014



Growth in Pre-Tax Income Since WW II

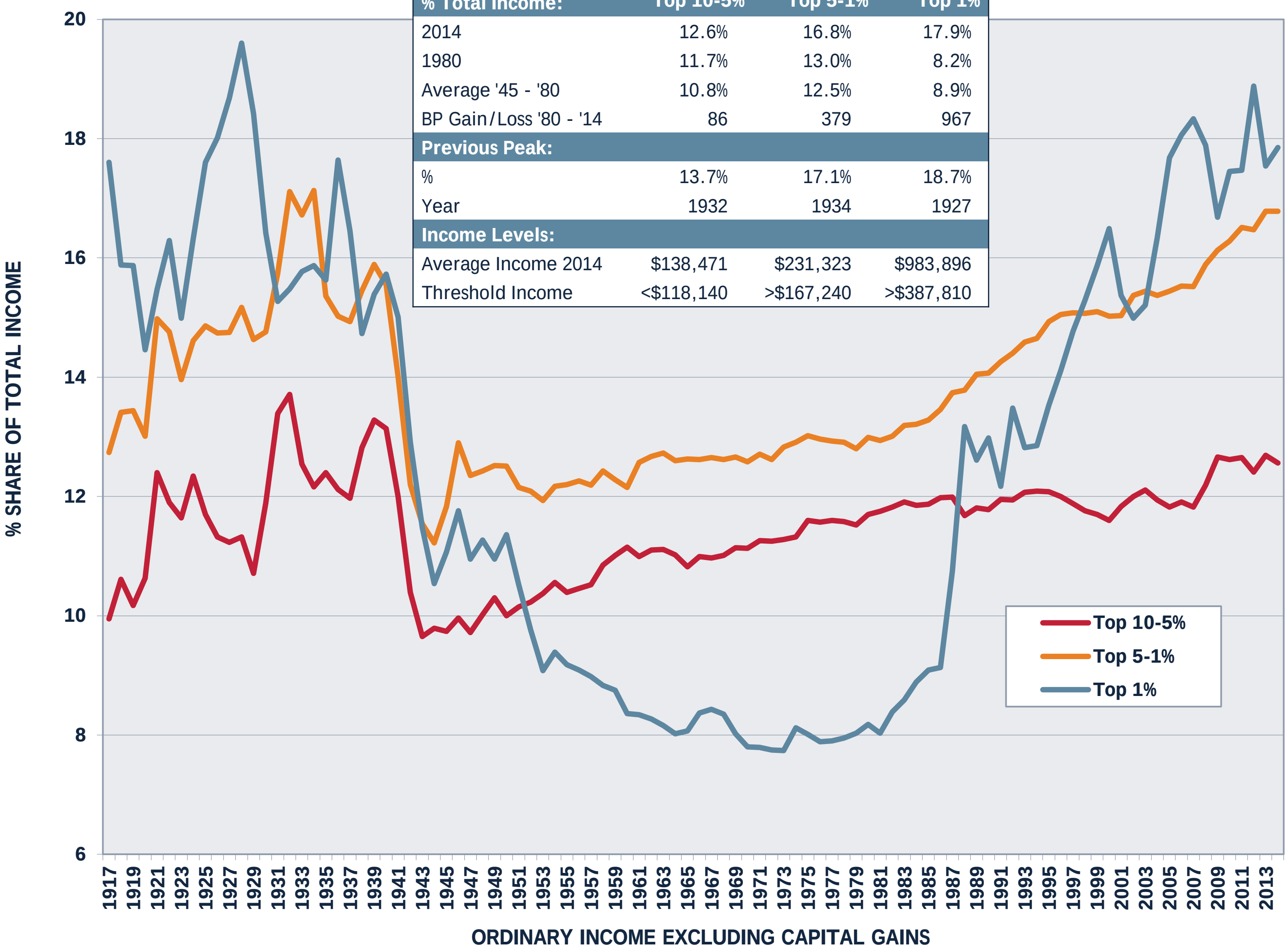
Income Group	1946 -80	1980 -14	Avg. Income '14
Full Population	95%	61%	$64,600
Top 1%	47%	205%	$1,300,000
Top 10%	79%	121%	$304,000
Middle 40%	105%	42%	$65,400
Bottom 50%	102%	1%	$16,200

Source: The World Wealth and Income Database

- Since 1980, 15% of national income shifted from bottom 90% of earners to top 10%
- From 1945-1980, 2/3rds of national income went to the lower 90%, as their incomes doubled
- Since 1980, the lower 90% share of national income has fallen to 52% while incomes have stagnated – at the same time, the top 10% share increased to 48% and their incomes more than doubled
- Pre-'80 multiplier effect and Baby Boom drove 4%+ annual retail space growth; post '80 lost multiplier effect and Boomers drove value retail and boxes
- Women's labor force participation rate increased from 37% in 1948 to 60% in 1999; over 1 million new entrants annually from '80 to '99; currently at 250K/annum

U.S. INCOME DISTRIBUTION - THE TOP 10%

% Total Income:	Top 10-5%	Top 5-1%	Top 1%
2014	12.6%	16.8%	17.9%
1980	11.7%	13.0%	8.2%
Average '45 - '80	10.8%	12.5%	8.9%
BP Gain/Loss '80 - '14	86	379	967
Previous Peak:			
%	13.7%	17.1%	18.7%
Year	1932	1934	1927
Income Levels:			
Average Income 2014	$138,471	$231,323	$983,896
Threshold Income	<$118,140	>$167,240	>$387,810



Source: The World Wealth and Income Database

- While vast majority of consumers experienced stagnant wage growth since 1980, incomes for top 1% have tripled and their share of income has increased from 8% to 18%
- Given significant and growing income disparity, average income and wage growth statistics mask the significant income and budget issues faced by the vast majority of consumers

THE FAMILY BUDGET*

What Does a "Decent Yet Modest" Standard of Living Cost?

	NEW YORK		MILWAUKEE		HOUSTON		GRAND RAPIDS	
	$/MONTH	% INCOME	$/MONTH	% INCOME	$/MONTH	% INCOME	$/MONTH	% INCOME
Housing	$1,440	17.5%	$812	12.8%	$926	18.3%	$740	14.2%
Food	$782	9.5%	$782	12.3%	$782	15.5%	$782	15.0%
Child Care	$2,011	24.4%	$1,530	24.1%	$835	16.5%	$1,029	19.8%
Transportation	$583	7.1%	$608	9.6%	$583	11.5%	$620	11.9%
Health Care	$1,061	12.9%	$990	15.6%	$694	13.7%	$726	13.9%
Other Necessities**	$1,073	13.0%	$770	12.1%	$825	16.3%	$735	14.1%
Taxes	$1,277	15.5%	$850	13.4%	$407	8.1%	$577	11.1%
Monthly Budget	$8,227	100.0%	$6,342	100.0%	$5,052	100.0%	$5,209	100.0%
Annual Income	$98,724		$76,104		$60,624		$62,508	
Median Family Income	$63,740		$63,740		$63,740		$63,740	
Median - Decent SOL Gap	-35.4%		-16.2%		5.1%		2.0%	
SMSA Median Family Income	$59,265		$56,157		$51,046		$49,728	
Median - Decent SOL Gap	-40.0%		-26.2%		-15.8%		-20.4%	

*Assumes Two Parent, Two Child Family
**Necessities - apparel, entertainment, personal care expenses and household supplies & furnishings
Source: Economic Policy Institute - Family Budget Calculator
BLS - Consumer Expenditure Survey

U.S. INCOME DISTRIBUTION – THE LOST MULTIPLIER EFFECT

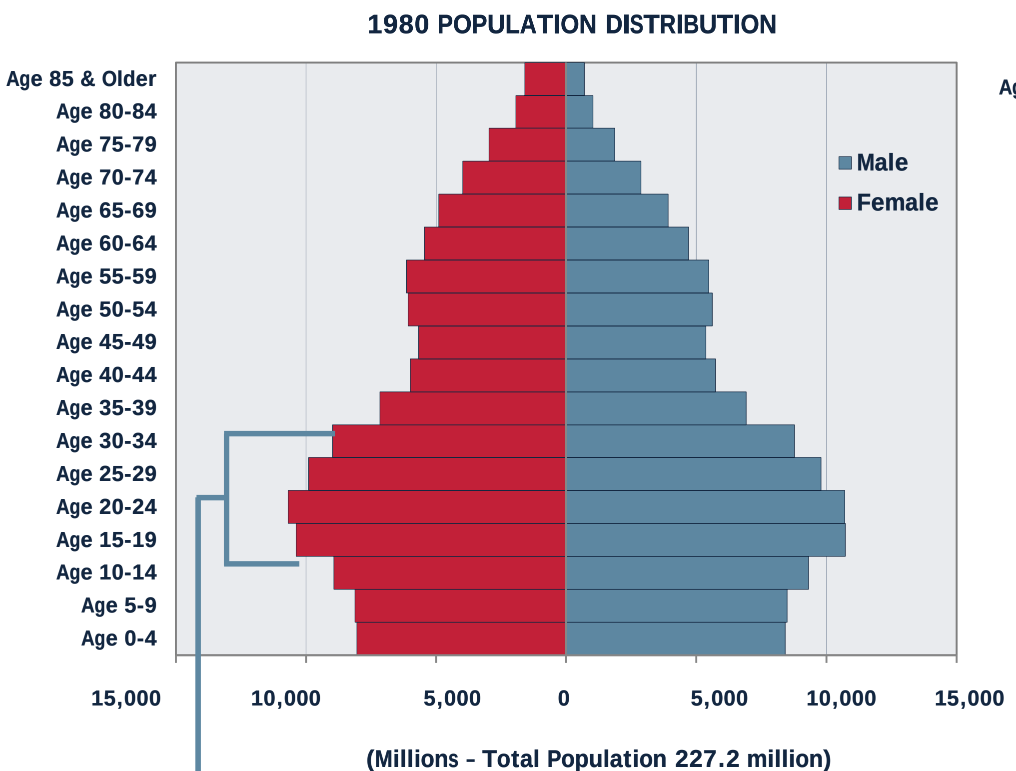
Quotes from the Front

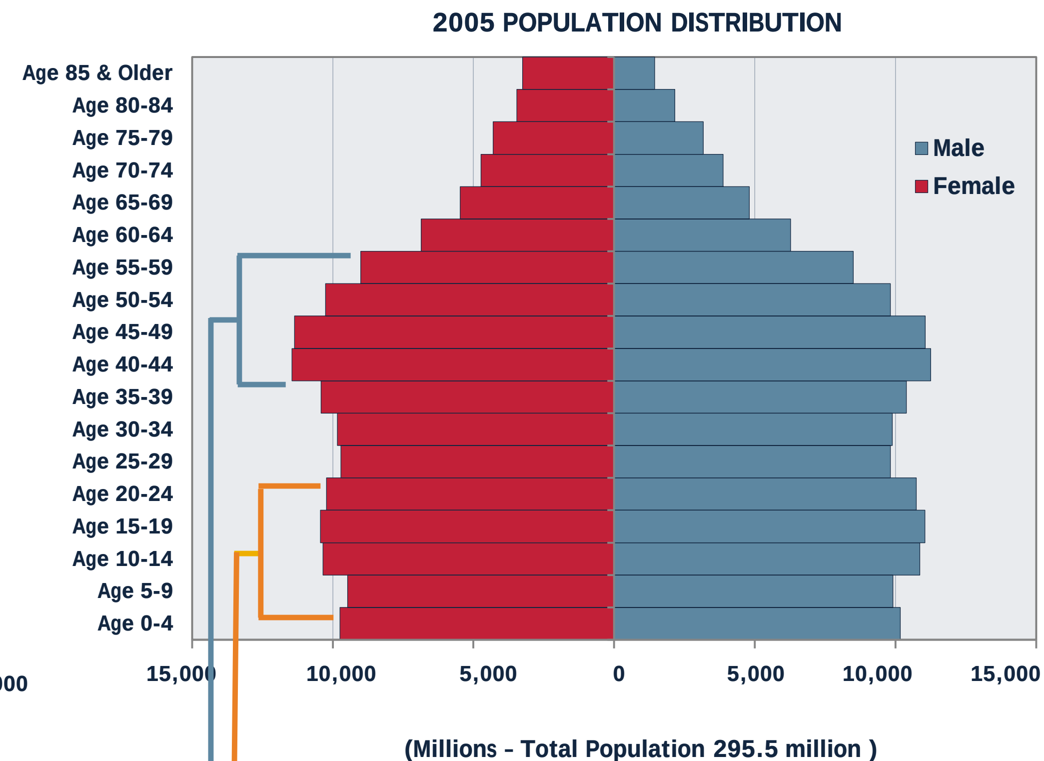
"So it is true that rich people can spend more money than middle class people, but there's this upper limit on what they can spend…My family can afford to go out to eat more than most American families, but not more than three times a day. We can't go out 3,000 times a day. My family owns a pillow company, and the pillow business is tougher because fewer and fewer people can afford to buy pillows. I earn a thousand times the minimum wage, but I can't sleep on a thousand pillows. We need everyone to succeed to be able to afford a pillow every year to have a successful pillow business. Concentrating wealth at the top essentially creates a death spiral of falling demand." ~ ***Nick Hanauer***

"The economy is continuing to create more of our core customer…we are putting stores today [in areas] that perhaps five years ago were just on the cusp of probably not being our demographic and now it has turned to being our demographic." ~ ***Dollar General***

POPULATION COHORT PYRAMID

1980-2005 – Boomers Power Through Their Prime Spending Years





Baby Boomers - 79.9 million; 15-34 yrs. old; 35% of population

- Front edge (late 20's/early 30's) early career, buying homes & starting families
  - Entering prime spending years
- Back edge (late teens/early 20's) finishing school, living at home
  - 15% +/- taking on student debt
  - Younger group hanging out at the mall
- Over next 25 years Boomers drive suburbanization and housing construction as they leave cities to raise families…shopping every step of the way

Baby Boomers - 84.7 million; 40-59 yrs. old; 28% of population

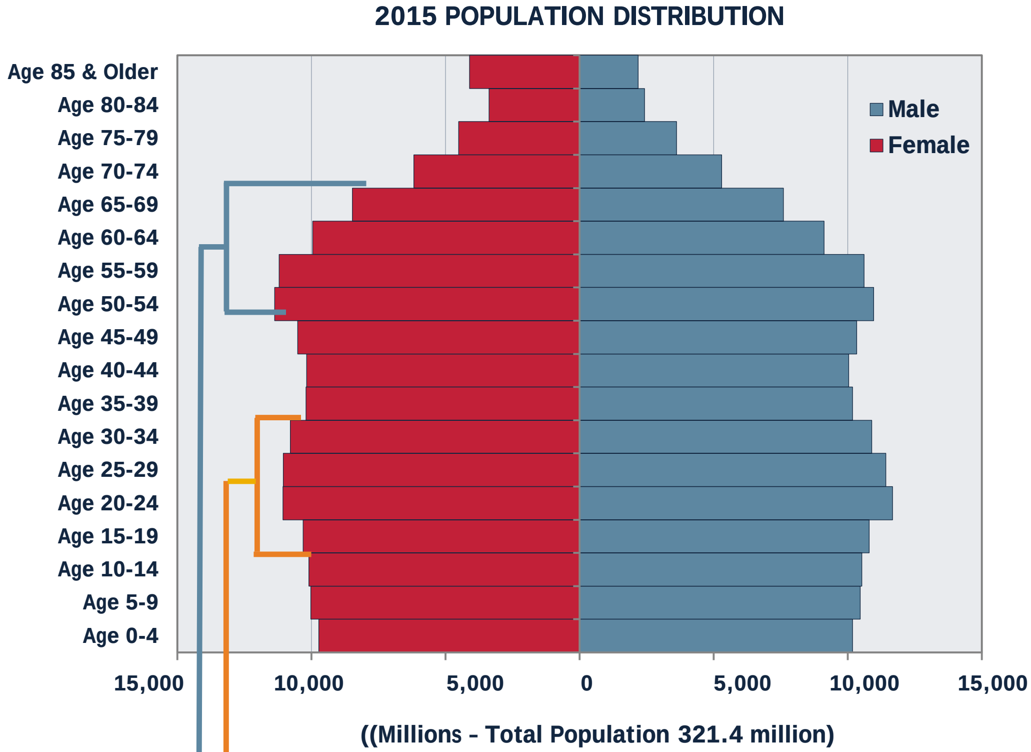
- Peak earning, spending & savings years
- Established households that are increasingly less mobile
- Thin on retirement savings, many use debt to maintain lifestyles

Millennials - 83 million; 5-24 yrs. old; 28% of population

- Front edge finishing school, taking on student debt
- Back-end hanging out with friends at the mall driving teen apparel sales
- iPhone has not been introduced yet

POPULATION COHORT PYRAMID

2015-2025 – Millennials Take the Spending Baton…Gradually

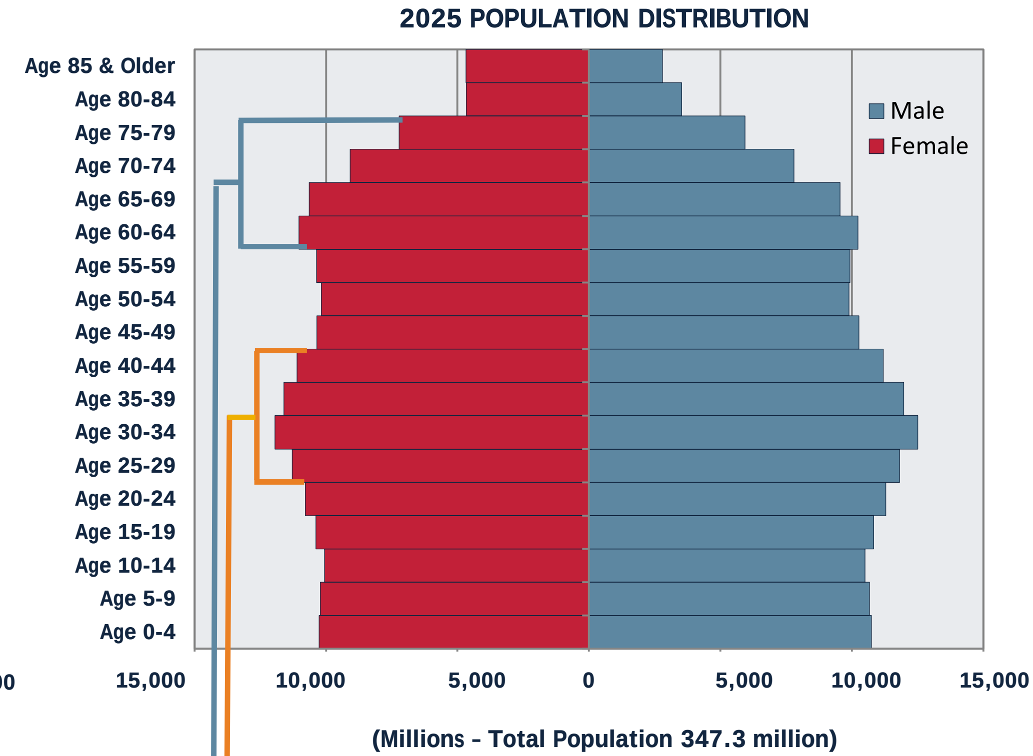


Baby Boomers - 79.3 million; 50-69 yrs. old; 25% of population

- Major hurt from recession for vast majority
- Front Edge - working retirement?
- Back-End - should be peak earning years - rebuild incomes, support families, looming retirement

Millennials - 88 million; 15-35 yrs. old; 27.5% of population

- Front Edge - early careers, home ownership and HH formation slowed by lower incomes, housing shortage and $1.3+ trillion in student loan debt
- Middle - renting in cities or at home - preference or presence?
- Back End - finishing school, taking on debt, sleeping with iPhone



Baby Boomers - 71.5 million; 60-79 yrs. old; 20.5% of population

- Retirement – working or otherwise for front edge, looming for back-end
- Aging in Place or Moving On?

Millennials - 93.4 million; 25-44 yrs. old; 27% of population

- Front Edge - peak earning, spending and homeownership years; having families and spending on kids and home, assuming career growth and paid off student debt
- Middle - looking for first home, most likely in suburbs
- Back-End - finishing school, early careers, student loan debt

CRYSTAL BALL FOR RETAILERS

Knowledge economy = greater concentration of growth in fewer, larger cities, while the Millennial migration promises to redirect housing and consumption towards their immediate suburbs

We know how many Millennials are powering through the economy - if their incomes, lifestyle choices and spending habits mirror the Boomers, retail is in for continued growth

Turmoil in fashion as spending baton is passed = room for new players

The Millennial migration to households, careers and possibly homeownership means the potential market will continue to grow for new players and present an opportunity for legacy brands to refine their offerings and message to attract new customers – turnarounds at Kors, Coach, Gap and Abercrombie??

Value dominance will continue

With market share increasingly concentrated – bifurcating into deep discount/dollar/rural and off-price/brand suburban/urban – TJX, Ross, Burlington Coat, Costco and Dollar Stores (Dollar General, Dollar Tree and Five Below)

Big box has largely been rationalized to best players

Walmart, Target, Home Depot, Lowes, Best Buy – highly-efficient cash generating machines with established store bases in significant future home and family "equipping" businesses that will continue growing

CRYSTAL BALL FOR RETAILERS

DEPARTMENT STORES

Will continue to selectively shed unproductive stores in declining or stagnant legacy markets; reduce footprint where oversized in strong markets and redevelop/repurpose surplus space to higher and better uses – residential oriented mixed-use certainly on the menu – while refocusing investments in profitable locations, notably focused on omnichannel, elevated brand presentations and service

RESTAURANTS

Casual sector currently appears to be at saturation point – pick carefully – both a supply and demand concern with business model adjustments to balance lower priced value offerings and higher service demands with higher labor costs; regardless, everyone loves to eat on a budget and foodie revolution is here to stay

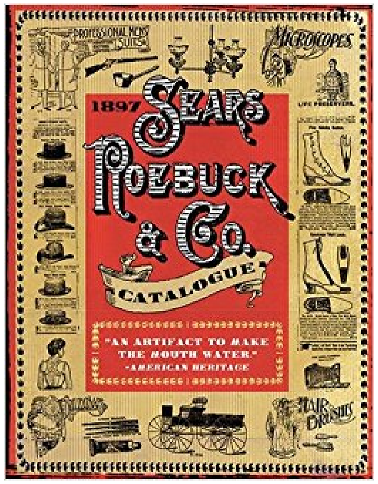
ONLINE

If/when Amazon needs to make money, expect major shift towards AWS as an online platform for brands/retailers without the scale or financial resources to replicate their online marketing and fulfillment muscle - not to mention their customer database - but will compete head-on with Walmart to do so; at same time omnichannel investments and refinements will accelerate across the retail industry over next 3-5 years, with store and online channels seamlessly fused to the point where we can hopefully retire the term "omnichannel"…the customer already has!!

SEARS - LAST CENTURIES' AMAZON??

Early 1890s	Railroad stationmaster Richard Sears sells shipment of rejected watches to fellow stationmasters, enlists them as agents, and makes $5,000 along the way
1895	Sears hires watchmaker Alvah Roebuck and Julius Rosenwald (Steve Jobs) and establishes a mail-order business with 80 people in four buildings in Chicago's rail yards and launches the Sears catalogue
1905	Sears outgrows original facility and moves to massive new 2 million square foot facility housing over 9,500 employees in the middle of Chicago's rail yards – the Age of the Supply Chain comes to Chicago
1925	Sears opens first freestanding store near Chicago HQs
1932	Opens Chicago Flagship store in 1932, its 381st store, following rail lines throughout the Midwest
1947	Total sales exceed $4 billion – roughly 5% of all US general merchandise sales
1963	Surpasses A&P to become world's largest retailer – by 1973 grows to 840 stores, 12 catalogue plants and sales of over $11 billion as company rides wave of suburbanization and mall development
1989	After soliciting bids from numerous locales, Sears accepts over $200 million in state and local incentives to relocate its HQ from downtown Chicago to Hoffman Estates
1993	After numerous failed forays into unrelated businesses, Sears stops publishing big book, merchandise building demolished…losing market share to big boxes, decline capped by K-Mart acquisition
1994	Amazon starts as a pure play online retailer selling books…and some watches?
2015	Amazon opens first store in Seattle…several miles from its headquarters
2017	Amazon solicits and receives 238 proposals from cities eager to help pay for its second HQ

QUOTES FROM RETAILERS PAST…AND RETAILERS PRESENT



*"It is the policy of our house to supply the consumer everything on which we can save him money, goods that can be delivered to your door anywhere in the United States for less than they can be procured from your local dealer; and although our line covers about everything the consumer uses, there's scarcely an article but what will admit of a savings of at least 15%, and from that to 75%, to say nothing of the fact that our goods are as a rule of a higher grade than those carried by the average retailer or catalogue house, and we earnestly believe a careful comparison will convince you that we can furnish you more and better goods for your dollar than you can obtain from any other establishment in the United States…[W]e are able by reason of our enormous output of goods to make contracts with representative manufacturers and importers for such large quantities of merchandise that we can secure the lowest possible prices****. To this we add the smallest percentage of profit possible**, and through the medium of catalogue offer the goods to our customers, and on our economic-one-small-profit plan, direct from manufacturer to consumer, a large percentage of the merchandise we handle is owned by the purchaser at less than local dealers can buy in quantities."* ***~ Sears Catalogue 1897***

Available at amazon

"We'll continue to invest in video content. We'll continue to invest in fulfillment space to handle higher and higher paid unit volumes and shipped unit volumes. We'll continue to invest in getting faster and faster shipping methods for our customers. We believe that's working. ***As far as long long-term operating margins, I can't forecast that right now." ~ Amazon 2017***

IF NOT THE GRIM REAPER, WHAT ARE THE KEY EFFECTS OF E-COMMERCE?

Shoppers do not see same bright line between online shopping and brick-and-mortar retail – it's all shopping and the cheaper and more convenient it is the better.

Retailers face three major evolutionary challenges - and opportunities - brought about by the digital revolution and e-commerce:

- Mobile has taken over – smartphone is preferred communication channel between customers and brands, with many shopping trips starting with mobile search and incorporating smartphone at multiple points along the journey
  - Continual pressure to upgrade apps – quicker loads, more intuitive search, better graphics and easy ordering
  - Requires seamless back-up between channels – smartphone link to store, delivery and pick-up critical as customer channel surfs
  - Frictionless – make the progression from impulse to purchase quick and easy
  - Powerful marketing and outreach tool – major competitive advantage for those who master it
- Omnichannel model creates margin headwinds
  - Each online order is a special order – far more expensive than a traditional replenishment model
  - Delivery and return processing very expensive, particularly when competitive standard is free-shipping and unlimited returns – both UPS and FedEx benefit!!
  - In-store pick-up, shipping and return handling far more efficient, with attachment opportunities, but still require staff, storage space and seamless coordination between inventory channels

IF NOT THE GRIM REAPER, WHAT ARE THE KEY EFFECTS OF E-COMMERCE?

- New Economy Model focuses on disruptive vision, sales growth and market share, not profitability.
  - Eerie echo of the previous “grow at all costs” dot.com boom, which did not end well
  - Significant price-cutting to gain share, along with free shipping, effectively pulling margin from brands and transferring the resulting savings to customers – at-best, a break-even model that other retailers cannot copy
  - Algorithms vs. brands - algorithms mine data to anticipate behavior and find cheapest product – brands build relationships with margin – who does Alexa work for??

AMAZON VS. WALMART

Changing View of What the Future Holds

- Amazon buys Whole Foods, Walmart buys Bonobos; Amazon promotes AWS as online platform for retailers and brands, Walmart creates Lord & Taylor flagship online store – what's going on here?
- Recent skirmishes in the ongoing battle for retail dominance, with both starting from vastly different places – pure play online with specialized fulfillment capabilities favored by more upscale metro consumers vs. extensive suburban and rural store base with unmatched, highly-efficient supply chain favored by more moderate and lower income consumers
  - Both contestants moving to a hybrid omnichannel competitive strategy to compete in all distribution channels while expanding customer base outside of their established markets
  - Walmart – bonobos checks all the "boxes" for areas Walmart needs to improve – hybrid operation, younger, more upscale clientele, and centralized inventory system that minimizes in-store inventory while creating replenishment
  - Amazon – Whole Foods checks boxes on selling perishables vs. commodities and the reality of home delivery while actually owning a profitable retail business
- Where does it lead? Amazon shifting more towards the AWS platform business serving a variety of brands – profitably – with a stable of key retail holdings driving its store-based distribution channel? Walmart building platform business, adopting best online practices from Amazon and others, to lever its physical supply chain strength across more brands with more affluent customers??
- Stay Tuned – Walmart just had one of its best quarters in recent memory and clearly out to re-establish dominance

WHY DO STORES CLOSE?

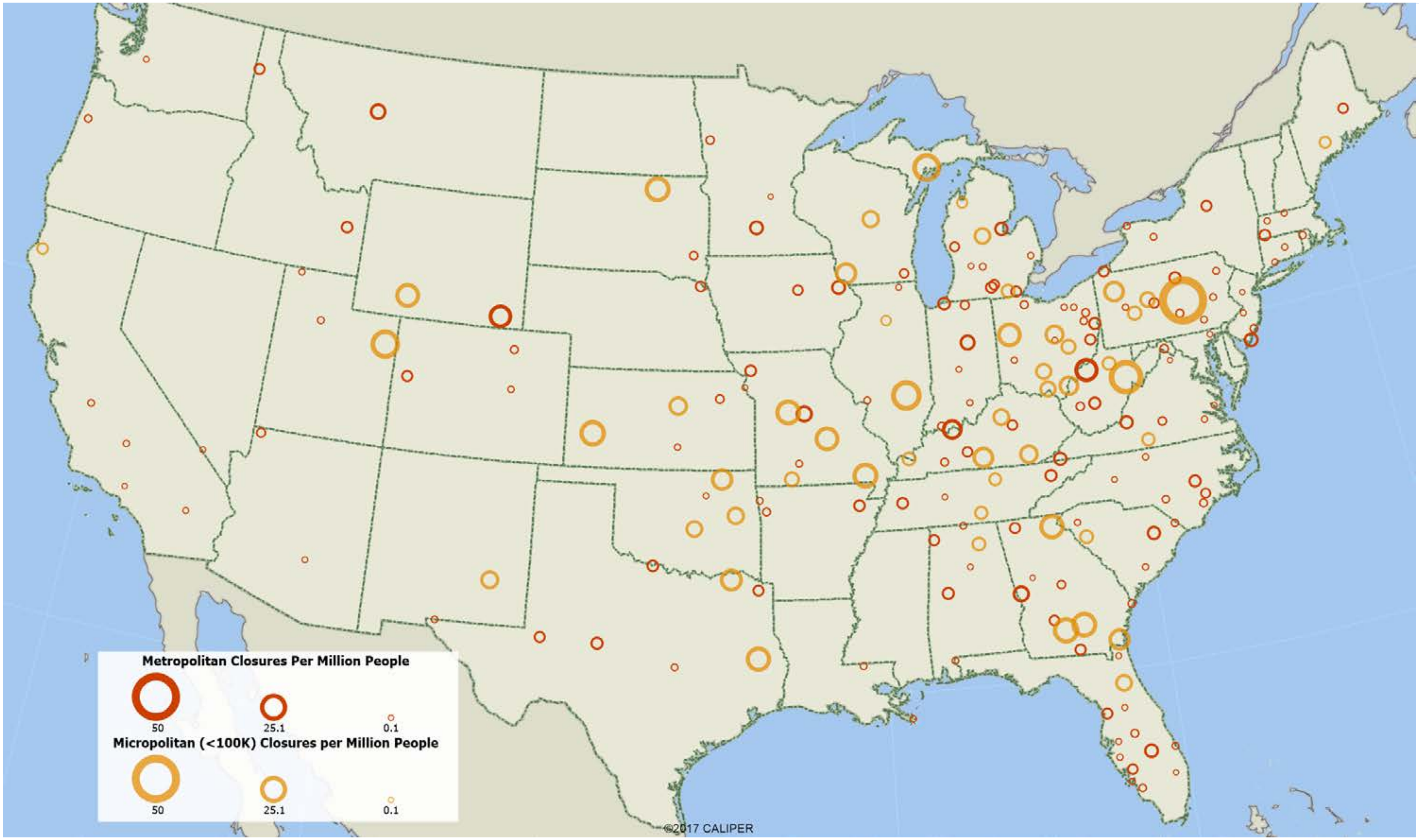
Lost in the hysteria is any remotely thoughtful analysis of why stores close – easier to blame it on e-commerce?

Against a backdrop of strained household budgets that limit spend regardless of retail channel, four key factors to consider:

GEOGRAPHY	Location matters – where are the stores closing? Majority of '17 closures in smaller, more economically challenged communities
BALANCE SHEET	Bankruptcies and resulting closures almost universally related to over-leveraged balance sheet, often debt assumed to finance acquisition with new owners cashing out and effectively issuing a "put" option on the remaining operation – risky model that destroyed Campeau in the 80s
IRRELEVANT CONCEPT	Obsolete product; target demographics' needs have changed and concept has not evolved accordingly; or competition offers better value that resonates with target customers with more efficient business model/operation
OPERATIONAL CHALLENGES	Poor sourcing, inventory control, indifferent service and other operational miscues that disappoint customer, destroy margin and leave retailer vulnerable to more efficient competitors that please their customers

K-MART AND SEARS

2017 Store Closure Announcements



Source: 2017 Caliper

WHAT'S ON YOUR MILLENNIAL'S HOLIDAY LIST?

2017 Holiday Preferred

iPhone X 256GB	$1,149
One Year Data Plan ($50/mth)	$600
Total (One Gift!)	$1,749

2017 Holiday - Guys' Wardrobe from A&F	
Down Filled Parka	$160
4 Heathered Oxford Shirts ($58/shirt)	$232
4 Signature Fit Flannel Shirts ($34.80/shirt)	$139
4 Iconic V-Neck Sweaters ($29/sweater)	$116
4 Long Sleeve Waffle Henleys ($38/shirt)	$232
5 Kenan Straight Jeans ($35.20/pair)	$163
2 Pair Eastland Lumber Up Boots ($130/pair)	$260
2 Pair Converse High Tops ($85/pair)	$170
6 Pair Boxer Briefs ($12/pair)	$72
9 Pair Casual Crew Socks ($6/pair)	$54
2 Pair Classic Sleep Pants ($28.80/pair)	$58
4 One-Inch Leather Belts ($22.80/belt)	$91
1 Starbucks Tall Dark Roast Coffee	$2
Total - 48 Items	$1,749

2017 Holiday - Gals' Wardrobe from H&M	
2 Short Wool-Blend Coats ($129/coat)	$258
1 Down Jacket	$198
5 Oversized Denim Shirts ($34.99/shirt)	$175
4 Plaid Flannel Shirts ($24.99/shirt)	$100
5 Cable-Knit Sweaters ($34.99/sweater)	$175
4 Hooded Sweatshirts ($24.99/shirt)	$100
6 Straight Regular Jeans ($39.99/pair)	$240
2 Pair Ankle Boots ($39.99/boot)	$80
1 Pair Premium Suede Boots	$129
5 - 3 packs Hipster Briefs ($14.99/pack)	$75
10 Pair Merino Wool-Blend Socks ($6.50/pair)	$65
4 Pair Flannel Pajamas ($34.99/pair)	$140
2 Starbucks Vente Lattes ($7/cup)	$14
Total - 51 Items	$1,749

APPENDIX

Retailers Respond
Holiday Retail Tour
Quotes from the Front
- *Current Retail Environment*
- *Omnichannel Retail*
- *Stores*
- *Performance and Strategy*

RETAILERS RESPOND – THE KEY CHALLENGES AND RESPONSES

- **Frugal, budget constrained consumer, the vast majority, has less discretionary spend, buys closer to need, hunts for deals on their smartphones, closes wallet in a flash, and has other needs – home, auto, medical bills and debt – that come first; most use additional cash to pay bills**
  - Off-price and deep value – TJX, Ross, Dollar Stores – dramatic, highly profitable growth, with treasure hunt atmosphere and minimal online, outside of BOPUS
- **No-margin online competitor with seemingly endless funding challenging all facets of traditional retail model – pricing, marketing, fulfillment, delivery – that automatically becomes the media darling of any business it enters into, no matter how small, unprofitable or silly**
  - New economy mantra – forget profits, they only stymie innovation, sell a vision of a disruptive data driven, online business that grows sales and market share by undercutting existing competitors on price and free delivery while using algorithms derived from proprietary data collected from customers to anticipate purchases and leverage the supply chain
    - As demonstrated by recent closures, not aware of any "traditional" retailer that can continue investing in facilities and systems, not make or even forecast meaningful profits, and stay in business – online 2000-2002 dot.com version didn't end well
- **Respond with Omni-channel - watch, test and verify which online capabilities customers demand - let others lose money throwing online spaghetti at the consumer - skip up the learning curve, and decisively invest in the proven online search and fulfillment features that resonate while leveraging existing store base and supply chain to generate profitable sales**
  - Multiple fulfillment options - notably buy on line pick up in store; buy online ship to home or work; and reserve in store – and return options
    - Shipping costs and online returns absolutely kill profit margins – only UPS and FedEx benefit (20-30% of online traffic is returns)
    - All store visits to pick up or return on-line purchases are opportunities to interact with customers, sell additional goods – attachment rates range from 20% - 50% - and save money on return processing and shipping
    - Requires significant changes in inventory management – need to integrate all facets to work together – far more difficult to accomplish than it seems

RETAILERS RESPOND – THE KEY CHALLENGES AND RESPONSES

- Mantra – reduce friction between channels – shopping trip now incorporates both online and physical channels as customer flips back and forth between online and in-store and expects retailer to track the journey and transaction trail seamlessly
  - Shoppers don't distinguish between channels – it's all shopping with journey driven by customer preference and retailers' service capabilities
- Outside of off-price and dollar stores, nearly all retailers have adapted and continue to test new omnichannel capabilities – while results vary, usually based on the nature of the goods sold and associated shopper preferences, all find that shoppers who buy online and in stores purchase 2-3X times more than those who shop just one channel
  - Stores clearly drive online sales in a given market – physical presence establishes brand and product quality, expands fulfillment options and handles returns and exchanges; store closures, in turn, hurt online sales

- **Mobile – tipping point reached in 2012, when over 50% of Americans owned a smartphone for first time, has accelerated as larger screens, more powerful apps and borderline obsessive use has made them the principal line of communication with many retailers and brands**
  - First interaction with retailer or a brand is usually on a smartphone; intuitive, informative apps encourage further discovery and store visits, and take advantage of the fact that many shoppers are glued to their phones
  - Continually refine mobile apps and websites to allow easy access to the retailers' entire inventory, and make research product, order placement and fulfillment selections seamless with no "friction" between online or store channels
  - Key concern - current teen and preteen "iGen" shoppers do not remember a time before the internet or online shopping; the smartphone has radically changed every aspect of their lives from their social interactions to their mental health, something to be watched carefully
- **Declining Store Traffic – poorly understood phenomena that is portrayed, wrongly, by popular press as mass shift to online; bottom line, while online is certainly a factor, in many ways replacing the catalogue business of old, the shopper and the shopping trip has changed, and many of the factors currently reducing store traffic appear to be reversing themselves**
  - Shopping trip itself has changed – browsing and research happens more on mobile device, less physical visits – reflects time pressure – but higher conversion rates and bigger baskets

RETAILERS RESPOND – THE KEY CHALLENGES AND RESPONSES

- Income constrained consumers on a tight budget limit anything other than required shopping, stay out of malls to avoid temptation
- Big cohort – millennials – cooped up in cities or home with mom & dad, not where the malls are – when log jam breaks millennials expected to return to past household formation and migration patterns that favor the suburbs and retail spending
- In a dramatic change since 2012 – the mobile tipping point - "iGen" teens and pre-teens spend less time "hanging out" with friends and more time alone at home glued to their smartphones – trend is more pronounced among young girls that traditionally hung out at the mall, a key customer group given that 67%+ of shoppers historically are women.
- Response includes integrating stores into fulfillment, improving merchandise assortments with better inventory flow to maintain "fresh" look and avoid stock-outs, renovate to aligning online brand perception with in-store reality and vastly improve service – make the trip worthwhile!!

HOLIDAY 2017 RETAIL TOUR

- **After disappointing 2016 results and hysterical headlines thus far in 2017, third quarter 2017 earnings and sales results were positive for most retailers despite 3 major hurricanes, and unsettling political turmoil - cooler weather, better inventory control and glimmering signs of better fashion drove modest margin and EPS improvements**
  - S&P Specialty retailer index up nearly 18% since August 2017 lows
- **Following '08/'09 meltdown, retailers have steadily re-engineered their business models with laser focus on operational improvements to protect and rebuild profit margins without the benefit of sustained topline growth in a world enamored with no-margin online competitors**
  - Industry mantra is "control the controllable" and reduce SG&A leverage point to low 1-3% comp sales gains versus the 4-5%+ thresholds in the past
  - If and when topline growth resumes – the "spending baton handoff" – re-engineered retailers poised for outsize profit growth
  - Granular focus on profit margin the norm for retailers but oddly absent for pure play online retail – will Blue Apron experience raise new concerns?
- **Most controllable category is inventory - amount, quality, location and flow - with revamped and updated physical store fleets, omnichannel capabilities, and financial structure close behind**
  - Keep inventory growth below sales growth, reduce store inventory, and dramatically increase flow of in-demand product - understock and "chase" what is selling rather than mark-down clearance
    - Consumers buy closer to need – have to respond quickly to slow inflow of poorly selling goods and chase after hot items
  - Increasing role of real time data-analytics and advanced supply-chain management – read demand in real time and move inventory accordingly – huge logistics investment
  - mobile is king - direct path to the pocketbook and wallet starts on a smartphone screen – continually refine apps to make cross channel shopping trip seamless and intuitive
  - Balance higher margin stores with lower margin online – best to educate and converse with customer online and transact in store
  - Continue to edit and update store fleet, right size box to please customers while handling more fulfillment, and, for those in transition – keep lease terms flexible

HOLIDAY 2017 RETAIL TOUR

- Continue to edit and update store fleet, right size box to please customers while handling more fulfillment, and, for those in transition – keep lease terms flexible
- Avoid debt at all costs – cash flow for investing in systems, refurbishing stores and, increasingly, buying back stock

- **High operational bar leaves no room for error for retailers on the cusp - those with crushing debt, outdated stores in declining markets, inefficient supply chains or outdated concepts - as demonstrated by the widespread store closures and bankruptcies that have dominated the news in 2017 - don't last long**

HOLIDAY 2017 RETAIL TOUR:

Specialty Retailers – Teens

American Eagle Outfitters	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Net Sales ($MM)	$3.055	$2,989	$2,967	$2,968	$3,120	$3,476	$3,306	$3,283	$3,522	$3,610
Gross Margin %	46.6%	39.3%	39.3%	39.5%	36.7%	40.0%	33.7%	35.2%	37.0%	37.9%
Operating Income %	19.6%	10.1%	9.6%	10.7%	9.4%	12.4%	4.3%	4.7%	9.1%	9.8%
Number of Stores	987	1,098	1,103	1,086	1,090	1,044	1,066	1,056	1,047	1,050
% Comp Sales	1.0%	(10.3%)	(3.6%)	(1.0%)	3.0%	7.0%	(6.0%)	(5.0%)	7.0%	3.0%
% Sales DTC	8.0%	10.3%	11.6%	11.3%	12.3%	13.4%	N/A*	N/A*	N/A*	N/A*

Abercrombie & Fitch	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Net Sales ($MM)	$3,750	$3,540	$2,962	$3,469	$4,158	$4,511	$4,117	$3,744	$3,519	$3,327
Gross Margin %	67.0%	66.7%	64.6%	63.8%	61.3%	62.4%	62.6%	61.8%	61.3%	61.0%
Operating Income %	19.7%	12.4%	5.1%	8.3%	5.3%	8.3%	5.4%	5.1%	3.9%	0.5%
Number of Stores	1,035	1,125	1,096	1,069	1,045	1,051	1,066	969	932	898
% Comp Sales	(1.4%)	(13.3%)	(22.9%)	7.3%	5.0%	(1.4%)	(11.3%)	(8.0%)	(2.7%)	(4.9%)
% Sales DTC	7.9%	8.6%	9.7%	11.7%	13.3%	15.5%	18.9%	22.2%	24.0%	25.0%

Tilly's	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Net Sales ($MM)	$246	$255	$ 283	$333	$401	$467	$496	$518	$551	$569
Gross Margin %	37.2%	32.5%	30.9%	30.9%	32.2%	32.1%	30.4%	30.0%	30.4%	29.6%
Operating Income %	16.0%	9.3%	7.6%	7.5%	8.7%	8.3%	6.0%	4.5%	3.3%	3.4%
Number of Stores	73	99	111	125	140	168	195	212	224	223
% Comp Sales	8.7%	(12.5%)	(3.1%)	6.7%	10.7%	2.3%	(1.9%)	(2.8%)	1.2%	0.5%
% Sales DTC	5.0%	6.0%	8.0%	9.9%	10.9%	11.3%	12.0%	11.3%	12.5%	11.3%

*Sales from online channels included in store sales

- On schedule, teen retailers feel the pinch as their prime demographic ebbs – fewer teens, more constrained budgets, and iPhone the only "must have" fashion
- Teen behavior has changed – less hanging out with friends at the mall, more time with smartphone at home
- Field has consolidated and downsized, remaining retailers take advantage, gaining market share with steady sales growth, better profitability and aggressive omnichannel strategies – DTC sales 10-25% of total
- AEO – noticeable pickup in store traffic, 19 consecutive quarters of record denim sales, Aerie concept on fire – sales up 19% - new store format rolling out
- Abercrombie – turning the corner led by Hollister, downsizing A&F fleet with fewer, smaller stores in new prototype
- Tilly's – steady, consistent growth based on constantly shifting offer of branded apparel

HOLIDAY 2017 RETAIL TOUR:

Specialty Retailers – Family Apparel

The Gap	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Net Sales ($MM)	$15,772	$14,526	$14,197	$14,664	$14,549	$15,651	$16,148	$16,435	$15,797	$15,516
Gross Margin %	36.1%	37.5%	40.3%	40.2%	36.2%	39.4%	39.0%	38.3%	36.2%	36.3%
Operating Income %	8.3%	10.7%	12.8%	13.4%	9.9%	12.4%	13.3%	12.7%	9.6%	7.7%
Number of Stores	3,167	3,149	3,095	3,068	3,038	3,095	3,164	3,280	3,275	3,200
% Comp Sales	(4.0%)	(11.5%)	(3.0%)	1.0%	(4.0%)	4.8%	2.2%	0.0%	(4.0%)	(2.0%)
% Sales DTC	5.8%	7.1%	7.9%	8.9%	10.7%	12.0%	14.0%	15.2%	N/A*	N/A*

Urban Outfitters	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Net Sales ($MM)	$1,508	$1,835	$1,938	$2,274	$2,474	$2,795	$3,087	$3,323	$3,446	$3,546
Gross Margin %	38.3%	38.9%	40.6%	41.2%	34.8%	36.9%	37.6%	35.4%	34.9%	35.1%
Operating Income %	14.9%	16.3%	17.5%	18.2%	11.5%	13.4%	13.8%	11.0%	10.3%	9.5%
Number of Stores	245	293	326	371	427	472	507	544	572	594
% Comp Sales	5.5%	8.0%	(3.4%)	4.3%	(3.8%)	(0.8%)	6.0%	2.0%	2.0%	1.0%
% Sales DTC	13.6%	14.9%	16.7%	19.1%	20.4%	23.7%	24.0%	N/A*	N/A*	N/A*

*Sales from online channels included in store sales

- Specialty retailers crafting balance between low-profit online and higher profit store channels – established store distribution networks more efficient than online, with shipping, returns, clearance and lack of "attachment" sales driving profitability gap
- Gap, arguably the casual clothier of the boomer, striving to play similar role with millennials – Old Navy growth on value, Banana focus on career casual, Gap resizing in the middle, and Athleta riding athleisure boom
- Urban Outfitters – straddling the boomer/millennial divide between namesake, Anthro and Free People, with growing DTC business challenging profits

HOLIDAY 2017 RETAIL TOUR:

Specialty Retailers – Women's Apparel

Chico's*	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Net Sales ($MM)	$1,714	$1,582	$1,713	$1,905	$2,196	$2,581	$2,586	$2,675	$2,642	$2,476
Gross Margin %	56.5%	51.8%	56.0%	56.1%	55.8%	56.2%	54.8%	53.3%	54.1%	38.2%
Operating Income %	7.1%	(2.5%)	6.3%	9.3%	10.1%	11.1%	5.5%	4.3%	(0.5%)	5.7%
Number of Stores	1,038	1,076	1,080	1,151	1,256	1,357	1,472	1,547	1,518	1,501
% Comp Sales	(8.1%)	(14.5%)	7.6%	8.3%	8.2%	7.2%	(1.8%)	0.0%	(1.5%)	(3.7%)
% Sales DTC	4.3%	4.5%	5.8%	7.2%	NR	NR	NR	NR	NR	NR

L Brands	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Net Sales ($MM)	$10,134	$9,043	$8,632	$9,613	$10,364	$10,459	$10,773	$11,454	$12,154	$12,552
Gross Margin %	34.6%	33.2%	35.1%	37.8%	39.1%	41.9%	41.1%	42.0%	42.8%	40.8%
Operating Income %	11.0%	6.5%	9.9%	13.4%	11.9%	15.0%	16.2%	17.1%	18.0%	15.9%
Number of Stores	2,926	3,014	2,971	2,968	2,941	2,876	2,923	2,969	3,005	3,074
% Comp Sales	(2.0%)	(9.0%)	(5.0%)	9.0%	10.0%	6.0%	1.0%	4.0%	5.0%	1.0%
% Sales DTC	13.8%	16.8%	16.1%	15.6%	15.0%	17.3%	16.4%	15.8%	15.8%	16.2%

*Chico's results FY2016 reflect divestiture of Boston Proper

- Women's labor force participation rates have declined – between '78 and '99 over 1 million women entered the labor force annually, fueling the dramatic growth of women's apparel chains; since 2008, new entrants have slowed to less than 250,000 per year
- Women's apparel retailers contending with transition from boomer to younger customer, while facing competition from department stores and off-price
- Social media has shortened fashion lifecycle – fashion misses can be immediate
- Chico's in turnaround mode, correcting fashion misses while ramping up Soma business and repositioning WHBM
- L Brands – Victoria's Secret. Pink and Bath and Body – remains one of most successful concepts in retail – while swimwear exit hurt VS sales, Pink is a coveted younger brand, with all concepts executing solid business both in-store and online

HOLIDAY 2017 RETAIL TOUR:

Department Stores

J.C. Penney	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Net Sales ($MM)	$19,860	$18,486	$17,556	$17,759	$17,260	$12,985	$11,859	$12,257	$12,625	$12,547
Gross Margin %	38.6%	37.4%	39.4%	39.2%	36.0%	31.3%	29.4%	34.8%	36.0%	35.7%
Operating Income %	9.5%	6.1%	3.8%	4.7%	0.0%	(7.7%)	(10.5%)	(2.1%)	(0.7%)	3.1%
Number of Stores	1,067	1,093	1,108	1,106	1,112	1,117	1,094	1,062	1,021	1,013
% Comp Sales	0.0%	(8.5%)	(6.3%)	2.5%	0.2%	(25.2%)	(7.4%)	4.4%	4.5%	0.0%
% Sales DTC	N/A	N/A	N/A	8.6%	8.8%	7.9%	9.1%	10.0%	11.2%	11.9%

Nordstrom	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Net Sales ($MM)	$8,828	$8,272	$8,258	$9,310	$10,497	$11,762	$12,166	$13,110	$14,095	$14,498
Gross Margin %	37.4%	34.5%	35.5%	36.7%	37.2%	36.8%	36.4%	35.9%	35.0%	34.9%
Operating Income %	13.7%	9.1%	9.7%	11.5%	11.5%	11.0%	10.8%	9.8%	7.8%	5.6%
Number of Stores	156	169	184	204	225	240	260	292	323	349
% Comp Sales	3.9%	(12.4%)	(3.6%)	8.1%	7.2%	7.3%	2.5%	4.0%	2.7%	(0.4%)
% Sales DTC	5.1%	5.8%	6.8%	7.6%	8.7%	10.8%	13.3%	15.2%	19.7%	22.2%

- Department store expansion rode the mid-century suburbanization wave; many older stores in declining markets bypassed by concentrated growth in larger metro areas
- Closures interpreted as death of concept vs. decline of the markets they originally served – check the closure locations!
- Department stores responded to big box, value competition by shedding categories to focus on apparel and home, driving sales with endless promotions; now adding off-price concepts – Rack and Backstage – and aggressively expanding online presence
- J.C. Penney returning to value roots, with strengths in private label apparel, home treatments and recently added-appliances following disastrous '12/'13 upscale attempt – turnaround in progress with encouraging results
- Nordstrom in balancing act between high margin full price business and low margin Rack and online channels; attempted to go private for more flexibility
- Closure of obsolete older Sears, K-Mart and Macy's stores long overdue

HOLIDAY 2017 RETAIL TOUR:

Big Box Stores

Target (US Segment)	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Net Sales ($MM)	$63,368	$64,948	$65,357	$65,787	$68,466	$71,960	$71,279	$72,618	$73,785	$69,495
Gross Margin %	30.2%	29.8%	30.5%	30.5%	30.1%	29.7%	29.8%	29.4%	29.5%	29.7%
Operating Income %	8.3%	6.8%	7.1%	8.0%	7.8%	7.3%	5.7%	6.2%	7.5%	7.2%
Number of Stores	1,591	1,682	1,740	1,750	1,763	1,778	1,793	1,790	1,792	1,802
% Comp Sales	3.0%	(2.9%)	(2.5%)	2.1%	3.0%	2.7%	(0.4%)	1.3%	2.1%	(0.5%)
% Sales DTC	N/A	N/A	N/A	N/A	N/A	N/A	N/A	2.6%	3.4%	4.4%

Ross Stores	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Net Sales ($MM)	$5,975	$6,486	$7,184	$7,866	$8,608	$9,721	$10,230	$11,042	$11,940	$12,867
Gross Margin %	22.7%	23.6%	25.8%	27.2%	27.5%	27.9%	28.0%	28.1%	28.2%	28.7%
Operating Income %	7.0%	7.6%	10.1%	11.5%	12.4%	13.1%	13.1%	13.5%	13.6%	13.9%
Number of Stores	890	945	995	1,042	1,103	1,181	1,276	1,362	1,446	1,533
% Comp Sales	1.0%	2.0%	6.0%	5.0%	5.0%	6.0%	3.0%	3.3%	4.0%	4.0%
% Sales DTC*	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM

*Online sales not meaningful – less than 1%

- Value/off-price retail flourishing – Ross, TJX, Costco and Dollar Stores increasing overall sales and store counts while maintaining or improving profit margins with little or no online presence
- Mass merchants – Walmart and Target – caught in middle, maintaining margin despite flat sales in broad merchandise categories duplicated by others in store and online
- Walmart issuing direct challenge to Amazon, leveraging the buying power of its massive, highly efficient supply chain, its physical store distribution network, and lock on moderate income HHs to directly compete on price while significantly beefing up its online presence and fulfillment platform – has been watching and learning…stay tuned

HOLIDAY 2017 RETAIL TOUR:

Big Box Stores

Home Depot	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Net Sales ($MM)	$77,349	$71,288	$66,176	$67,997	$70,395	$74,754	$78,812	$83,176	$88,519	$94,595
Gross Margin %	33.6%	33.7%	33.9%	34.3%	34.5%	34.6%	34.8%	34.1%	34.2%	34.2%
Operating Income %	9.4%	6.2%	7.3%	8.6%	9.5%	10.4%	11.6%	12.6%	13.3%	14.2%
Number of Stores	2,234	2,274	2,244	2,248	2,252	2,246	2,263	2,269	2,274	2,278
% Comp Sales	(6.7%)	(8.7%)	(6.6%)	2.9%	3.4%	4.6%	6.9%	5.4%	5.6%	5.6%
% Sales DTC	N/A	N/A	N/A	N/A	1.8%	2.4%	3.5%	4.5%	5.3%	5.9%

Best Buy - Domestic	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Net Sales ($MM)	$31,031	$33,328	$35,070	$37,314	$37,070	$37,615	$35,831	$36,055	$36,365	$36,248
Gross Margin %	24.5%	24.5%	24.6%	24.2%	25.1%	24.4%	22.5%	22.4%	23.3%	23.9%
Operating Income %	6.0%	6.0%	5.0%	5.6%	5.5%	4.9%	2.9%	4.0%	4.4%	4.9%
Number of Stores	873	971	1,107	1,192	1,317	1,503	1,495	1,448	1,416	1,363
% Comp Sales	4.1%	1.9%	(1.3%)	1.7%	(3.0%)	(1.6%)	(0.4%)	1.0%	0.5%	0.3%
% Sales DTC*	N/A	N/A	N/A	N/A	N/A	7.2%	8.5%	9.8%	11.0%	13.4%

- Big boxes – mature business dominated by 2-3 highly efficient operators in each category, generating significant cash flow and aggressively buying back stock while driving increased sales through established store networks profitably leveraged with new omnichannel capabilities
- Focus on home is a significant, lasting sales driver - as housing markets recover and homeowners take on delayed improvement projects, replace appliances and add connected home technologies, significant portion of big box world positioned to prosper further
- With a brief pause in 2009, Home Depot has grown sales by over $17 billion over last 10 years…while only adding 44 stores and steadily increasing margin

HOLIDAY 2017 RETAIL TOUR:

Warehouse/Dollar Stores

Costco	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Net Sales ($MM)	$70,977	$69,892	$76,255	$87,048	$97,062	$102,870	$110,212	$113,666	$116,073	$126,172
Gross Margin %	10.5%	10.8%	10.8%	10.7%	10.6%	10.6%	10.7%	11.1%	11.3%	11.3%
Operating Income %	2.7%	2.6%	2.7%	2.7%	2.8%	2.9%	2.9%	3.2%	3.2%	3.3%
Number of Stores	543	558	572	592	608	634	663	686	715	741
% Comp Sales	8.2%	(3.7%)	6.9%	9.8%	6.8%	5.5%	4.2%	1.0%	0.0%	4.0%
% Sales DTC	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM

Dollar General	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Net Sales ($MM)	$9,495	$10,458	$11,796	$13,035	$14,807	$16,022	$17,504	$18,910	$20,369	$21,987
Gross Margin %	27.8%	29.3%	31.3%	32.0%	31.7%	31.7%	31.1%	30.7%	31.0%	30.8%
Operating Income %	2.7%	5.6%	8.1%	9.8%	10.1%	10.3%	10.0%	9.4%	9.5%	9.4%
Number of Stores	8,194	8,362	8,828	9,372	9,837	10,506	11,132	11,789	12,483	13,320
% Comp Sales	2.1%	9.0%	9.5%	4.9%	6.0%	4.7%	3.3%	2.8%	2.8%	0.9%
% Sales DTC*	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM

*Online sales not meaningful – less than 1%

- Category is home to some of the fastest growing, least noticed, sectors in retail
- Reflecting the worldwide need for value, Costco's sales have grown $55 billion over last 10 years with gradually increasing margins; reflecting the erosion in more rural markets, Dollar General has more than doubled its sales to nearly $22 billion since 2007 while more than tripling its operating margin, swallowing up Family Dollar along the way
- Dollar General adding close to 800 stores per year while renovating a similar number to include refrigerators for consumables; Dollar Tree and Five Below experiencing similar store, sales and profit growth
- Costco and Dollar Stores coming at deep discount business from opposite ends – Costco in more urban areas serving more affluent members making periodic visits, Dollar Stores increasingly serving daily shopping needs of customers in more rural, lower income areas
- New Dollar Stores are the first new stores many smaller communities have seen in years; spreading into new markets that formally did not shop Dollar Stores.

QUOTES FROM THE FRONT

Retailers on the Current Retail Environment

"The big improvement we have seen has been in our U.S. business. We have seen a strong start to the…holiday season with improvements in both traffic and sales trends. Comps for Calvin Klein…are trending up mid-single digits and Tommy Hilfiger…comps are trending up high single digits quarter to date." ***~PVH***

"The improvement in our business in October, most notable in our retail channel, was driven by healthy traffic increases in stores, our direct business also rebounded but was not as strong as our retail business." ***~J.Jill***

"Our digital sales continued to be strong, and we also saw a pickup in stores with traffic outpacing them all. We showed improved sales trends as the quarter progressed with fewer promotions. As a result, we saw meaningful sequential improvements in our third quarter margins compared to the first and second quarters…we have a great opportunity in today's environment to gain market share " ~American Eagle

"…we're trying to skate where the puck is going to be. We don't like where the puck is right now." ~Genesco

"…and what's going on in food, it started…somewhere around 18-24 months ago, you started seeing some real pressure on pricing. Obviously, everyone is…wondering about the Amazon purchase of Whole Foods and Walmart has really gotten more aggressive duking everything out against them…it's an industry thing of duking it out for market share using price as the driver." ***~Big Lots***

"…you guys know their numbers. I mean, everybody knows. They get a free pass when it comes to one side of the question, okay? That's kind of a difficult model for guys like us." ***~Big Lots***

"Operating income decreased 40% to $347 million in the third quarter, compared with operating income of $575 million in third quarter 2016. Operating income includes $21 million from Whole Foods market." ***~Amazon***

QUOTES FROM THE FRONT

Retailers on the Current Retail Environment

"I think the fears are people feel that one or multiple people are going to bring prices down pretty significantly in the industry, and I think from what we're seeing is, people have been fairly responsible in managing the business, and…as deflation is dissipating we're seeing a lot more discipline from the retailers who are doing well around pricing. Certainly when somebody gets upside-down and starts running negative traffic…they may be irresponsible for some period of time, but that tends to be short-lived and doesn't work." ***~Sprouts***

"…we're not in an environment where we can tolerate execution-related issues and we had several this past quarter." ***~Ascena Retail***

"The retail landscape is experiencing unprecedented disruption, characterized by increasingly commoditized transactions and short term focus. But disruption also equates to enormous opportunity, and Lululemon is at the forefront of unlocking the future of what defines a new era of human connection and a powerful evolution of retail." ***~Lululemon***

"…we were very pleased with the improvement in traffic across both brands and we did see nice traffic gains, particularly in our stores channel, which is an important place for us to begin to see productivity improvement." ***~Abercrombie & Fitch***

"E-commerce is not going to eliminate the retailing sector of the country. It's about 10% right now. It's certainly growing to grow as a percentage…But I think you see the purchase by Amazon of Whole Foods, they want to be in the grocery business. Groceries are heavy, hard to handle and people like to come and see the produce and so forth. I've been in the grocery business twice…and I have to tell you it is one of the toughest businesses in the world with very low margins and very, very good competitors. I think you're going to see e-tailers become more brick –and-mortar. And I think you're going to see brick-and-mortar become more e-tailers…So all of this is not quite as pristine as a lot of people would like to think." ***~FedEx***

"…a lot of it really is making sure that the engagement which we know is going to begin digitally is intriguing to the consumer, and it helps move them through their journey into a physical space…to make their purchase." ***~Footlocker***

QUOTES FROM THE FRONT

Retailers on the Current Retail Environment

"…The second emerging trend across all brands was a revival in customer interest in fashion apparel. Quite simply, fashion is back and it is selling…the customer demands more newness and fashion trends have quicker adoption rates and shorter life cycles because of social media…Based on the positive response to our current fashion offerings combined with our improved ability to execute looks more quickly, I'm optimistic that our merchants will be able to deliver compelling fashion through the holiday season…" ***~Urban Outfitters***

"It was warm through like the last week of October and then when it got cold, it was like turn on a light switch and all of a sudden we started to sell-through nicely. And you remember from last year, it didn't get cold early enough and the whole market got promotional and we joined in." ***~Genesco***

"…our core guests are actually going to the mall as frequently as they were before…some of the economically focused guests might have pulled back a little bit, and that also might be where some of the mall traffic has been down." ***~Cheesecake Factory***

"I think there's a customer that still is under pressure. Rents continue to rise, healthcare continues to rise; we have to be right on when they have money in their pocket. We call it thrive and survive. So certainly at the beginning of the month, for our most needy customers, we need to be ready in store with the basics, and at the end of the month…give them a reason to shop…when they're trying to stretch their budget." ***~Dollar Tree***

"…in the third quarter it was unseasonably warm through big parts of the country until late, and that had a negative impact on our results, as it got as little cooler at the very end, it improved some…we look at that stuff really closely. We have a lot of data to mine over the history of how this has all worked out to try to ensure we're allocating and flowing merchandise with the appropriate timing…so the weather's out of our control, but we're prepared for it. And we do benefit from the changing seasons and when that cold weather comes along for sure." ***~Nordstrom***

"This year, based on feedback from our members, we are also bringing back the beloved and iconic Sears Wish Book, bringing members all of their favorite gifts in one place. We reinvented the Wish Book for 2017, reclaiming its place as the definitive source for thousands of gift options for every member of the family." ***~Sears Holdings***

QUOTES FROM THE FRONT

Retailers on the Current Retail Environment

"…there is a major negative sentiment that we all know about retail, about our sector and about our company…what creates this negative sentiment? Well, to a great extent it is social media. Social media that is driven by folks that have somewhat of a contrarian, a conflict of interest. Maybe they're shorting stocks, maybe they're a hedge fund. And of course every time a retailer goes broke it's always blamed on e-commerce…In fact, the reason the tenants tend to fail is because the brand has become irrelevant. They may over-levered and yes, to some extent digital commerce may have accelerated their debt…in our portfolio, the companies that have gone broke over the last couple of years averaged about $250 per square foot. And they pay rents that are about 40% to 50% below the average rent…" ***~ Macerich***

"…the retailers are certainly using the sentiment that's out there to try to drive their costs [down] through renewals. So there is a little bit more friction on renewals." ***~ Macerich***

"Brands themselves are looking at a rapidly evolving retail landscape. They don't have confidence yet in their physical channels. And when they look at the deconstruction of retail, they have to think about where are we going to be in three years and who is going to sell for us. And I think…there's going to be a couple of big digital or omni-channel portals in the world, and we'd be one of them. So, frankly, brands that we had a very tough time approaching and having a conversation about selling on eBay a year ago, it's now a very different conversation." ***~ eBay***

"…we do well under any tax code. But with excess cash…we want to strike the right balance, pay a competitive dividend and continue to repurchase shares with the excess cash flow…while protecting our investment grade rating." ***~ Dollar General***

"…as tax reform stands presently…it's definitely going to be positive to us both from an EPS and free cash flow…perspective…I don't know that it really changes our capital allocation strategies. First and foremost, we look to invest in our business when those investments are going to drive a significantly higher rate of return than our weighted average capital. And then secondly, we have always and we will continue to…provide returns to shareholders." ***~ American Eagle***

QUOTES FROM THE FRONT

Retailers on Omnichannel Retail

"…60% of our dot-com sales are currently picked up in store, with 40% of those customers buying incremental product when they arrive to pick up their item. Another 10% to 15% is delivered from store, with the remaining 25% to 30% being parcel. So for us, that tells a great story of the role of the store in the omnichannel environment and how our customers continue to utilize our stores for fulfillment options in our omnichannel strategy." ***~Lowe's***

"…we're excited that we're able to recognize demand in one channel and fulfill it in another in a more and more seamless matter as we develop these [omnichannel] capabilities." ***~Lululemon***

"…there's absolutely no question that omni sales are positively or negatively impacted based on the scale of the physical environments you have. And that's why…we feel so strongly about our store base." ***~Kohl's***

"…we love the fact that our e-commerce growth is picking up…we're agnostic about it from a bottom line profit perspective, but we're really positive about it as it relates to customer engagement…folks that are like 90% of our loyalty members that are omni-channel…by far are the best guests in terms of spending almost 3 times the amount of somebody who's only shopping store, but she's also shopping more in-store than before…we actually know that when we build stores, the e-commerce business also grows with it, they are actually complementary, not stealing from each other." ***~Ulta Beauty***

"I'll just say that returns represent 20% to 30% of all the goods transported through e-commerce." ***~FedEx***

"…there is a lot of white space for additional brick and mortar [Aerie] stores. But what I've found is where we open a brick-and-mortar store…it tends to drive digital demand at 1.5 times the store's sales. So it's clearly a driver of digital sales and demand and performance." ***~American Eagle***

"We think it is important to drive our business regardless of where our customers choose to shop. It's the reality of our business today." ***~Abercrombie & Fitch***

QUOTES FROM THE FRONT

Retailers on Omnichannel Retail

"I'm not even sure I like the word omni-channel any more. I actually prefer, I think, channelless or integrated retail as a way of thinking about what we're doing as a model…I don't think the customers views this as I'm shopping on the web or I'm shopping in stores. There's no omni-channel to them, they're just shopping. That's what they do, starting online, getting into stores, going into stores, finishing online whatever way they would like to do it." ***~Zumiez***

"And further on stores, it is apparent that the growing number of online returns are becoming a pain point for e-tailers evidenced by recent alliances formed with brick-and-mortar partners for drop-off of returns…most of the online sales that end up being returned at Journey's or brought to a physical store rather than being shipped back, providing with an opportunity to convert the return to a sale once these customers are in our stores." ***~Genesco***

"Digital is perhaps the first gateway to the band. As we know, customers inform themselves primarily through digital even before they push the doors of our stores." ***~Burberry***

"…we believe that today the number one place that a consumer engages with your brand usually initially is online and usually through your own website. And they may not ultimately transact there because certainly brick-and-mortar stores are very important, and we believe in brick-and-mortar, and we believe that the consumer will shop in multiple places for their merchandise. But what we need to remain committed to as a company is our own digital flagships and that being the cornerstone of how we're engaging with the customer." ***~Michael Kors***

"…digital is here to stay and personalization is really the key to success, and that even pure play online retailers are going to want a physical manifestation of their brand. And so, as we look at the digital spend, we look at how do we really leverage our physical assets and then leverage the fact that we have shared inventory and inventory visibility today." ***~Chico's***

QUOTES FROM THE FRONT

Retailers on Omnichannel Retail

"We've also been investing quite heavily in reducing customer friction, simplifying our check-out, looking at ways to improve our payment options, so all those things take investments. On the supply chain side, we've really been focused on reducing the amount of cancellations, which allows for more topline growth and better customer experience and then improving our split shipments, which also improves our cost and it's a better customer experience." ***~Nordstrom***

"Our agreement to create a Lord & Taylor flagship on Walmart.com significantly extends the reach of this business. And we know that all of our banners have meaningful runway to continue growing their online presence." ***~Hudson's Bay Co.***

"As far as the…influence of Walmart on Lord & Taylor, we do not believe that our Lord & Taylor customer will have a negative impact on our existing Lord & Taylor stores because of our association with Walmart…we own the product, we're buying it, we're planning it, we're marketing it. This is just…another Lord & Taylor flagship store that happens to be located at Walmart.com." ***~Hudson's Bay Co.***

"…we are absolutely unequivocally under-reporting sales. We can only give you what we get from the retailers, but we've done enough work to know that there is an issue there…I am absolutely convinced that our productivity is much higher than what's been reported, even though the lease requires them to do so…let's face it, the market rewards an online sale more importantly than it does a brick-and-mortar…so retailers would prefer an online sale…regardless of the profitability." ***~Simon Property Group***

QUOTES FROM THE FRONT

Retailers on Stores

"New stores typically account for over 80% of our annual growth and growing the store base remains our highest priority…our new stores continue delivering strong performance across both new and existing markets in urban, suburban and semi-rural settings…The class of 2017 is generating very strong profitability, with average first year volumes that we believe are on track to exceed $2 million. That would make this our strongest class yet." ***~Five Below***

"…we don't have stores that are unprofitable…so if we closed a bunch of stores we make a lot less money." ***~Dick's***

"All we know is, is that our brick and mortar is strong, as strong as it's ever been and trending in the right direction from there." ***~Costco***

"…we are managing our fleet to a very short and agile term of 1.8 years, so it gives us the ability to relook at all of these properties very constantly. Our negotiations with landlords have been very straightforward against our high hurdle of both our EBITDA hurdle, our working capital hurdle, our transfer hurdle and the landlords have been pretty straightforward, and they work with us to get to the right outcomes with these locations, so we're fairly positive about our outcome." ***~Ascena Retail***

"Our mature store base, which are stores that are over 5 years old and have not been remodeled or relocated, continues to deliver the best same-store sales growth that we've seen in four years." ***~Dollar General***

"Our traffic has outpaced what we've seen as industry statistics. And we're really put a concerted effort into driving traffic, primarily starting with in-store events, which have been very successful for us in bringing brand awareness in new markets for us…but we're very sensitive to the fact that it is very difficult for everybody in terms of driving traffic to the stores. We own the stores and you can sit back and do nothing about it or try to do something about it. And what we've done so far has worked." ***~Tilly's***

QUOTES FROM THE FRONT

Retailers on Stores

"Our fleet optimization program continues to generate significant financial benefits. We have closed 156 stores… [and]…we are expanding our expected store closures to 300 doors by 2020. Key elements of the strategy have been; one a sales transfer in excess of 20%; two, our ability to successfully negotiate rent reductions for a significant portion of our expiring leases; and three, lease flexibility, with the majority of the lease renewals being short term deals, resulting in reducing our average lease term to less than three years." ***~Children's Place***

"…this is a delicate dance that we're doing with our landlords, and there's a fair amount of negotiation going on right now…we're up to our eyeballs right now in the midst of what is a really constructive dialogue…" ***~The Gap***

"Where possible, we will actively reposition the existing floorspace for use by partners such as WeWork, Topshop, Sephora and foodhalls to maximize productivity and drive additional in key customer segments to HBC stores…similarly, we will exit space when it is prudent to do so. In addition to the lease of the Lord & Taylor building, we recently sold two Lord & Taylor leases back to their landlords, generating proceeds of $23 million." ***~Hudson's Bay Co***

"Trends emerge and spread much faster in our more connected world and customers expect to be able to experience brands on a much more frequent and more personalized basis…we believe brick and mortar is critical to successfully executing our customer centric growth policy. Therefore we continue to selectively open stores in each of our geographic regions with the goal of achieving the optimal number of locations required to reach our customers and provide them with a superior level of service they expect from Zumiez." ***~Zumiez***

"What is really happening because we're in the A malls is they're getting reinvestment dollars, and it's really been happening for three or four years now…so, every year…it's 10 to 15 of these locations that these mall owners are refurbishing...in the long term it's certainly a positive because that is definitely going to benefit those properties and benefit us." ***~Cheesecake Factory***

QUOTES FROM THE FRONT

Retailers on Stores

"But I think over time we are going to want to get some space back from the department stores and we may get some space back, but it's all going to be on the margin. They don't pay any rent even at places where they pay rent. So the opportunity to re-tenant those buildings on an accretive basis is pretty significant for us. And to the extent they they're not investing in their store and we are investing in the mall, there is a disconnect to the consumer that…potentially we can modify…by having a better of different use." ***~Simon Property Group***

QUOTES FROM THE FRONT

Retailers on Performance and Strategy

"We believe we operate in one the most attractive sectors in retail. Our unique strengths include more than 14,000 convenient small box stores with strong economics that allow us to serve an underserved customer who shops our stores differently than other sectors of retail. With an average basket of about five items and an average ticket of approximately $12, our stores and product mix are streamlined to help make the shopping trip convenient for our customers." ***~ Dollar General***

"We've had an increase in our merchandising margin…the components of merchandise margin are working in our favor. Inventories are better managed. Inventories are leaner. Inventories are more relevant because receipts are coming closer to sales…and then. Of course, working against us is the headwind of shipping and fulfillment." ***~ Kohl's***

"Walmart U.S. had a strong quarter with comp sales growth of 2.7% led by a traffic increase of 1.5%…we estimate hurricane-related impacts benefitted comps by 30 to 50 basis points. On a two-year stacked basis, comp sales were up 3.9% and comp traffic increased 2.2%. This is the strongest quarterly and two-year stacked comp performance in more than eight years." ***~ Walmart***

"…liquidating their goods for some retailers online is…way more tedious than it is for them to sell the goods to somebody like us where we can ship it and sell it invisibly across 2,200 stores. And they get to hang with other brands in a very…conducive atmosphere that's…a benefit to them in terms of their image and their brand…so we have been finding [that] the brands are realizing that they're better off liquidating with us than trying to liquidate on their own off their websites." ***~ TJX***

"…supply has never been better…the shift to online…is actually a benefit to us in terms of product availability. We are finding that brands would rather clear product by selling to us and let us invisibly sell their clearance goods through our stores rather than run clearance sales on their websites that might damage their brand integrity." ***~ Burlington Coat Factory***

QUOTES FROM THE FRONT

Retailers on Performance and Strategy

"So, in summary, despite three major hurricanes, Gymboree's bankruptcy and clearance liquidations in several hundred of their stores, [and] record-breaking October heat across most of the country, we still delivered an outstanding quarter of 5.1% comp on top of a 4.6% comp from last year, and an 80 basis point increase in adjusted operating margin." **~ Children's Place**

"Our first priority remains investing in new stores, where we continue to see great returns, and the necessary infrastructure to support our store growth. Our second priority is to return cash to shareholders." **~ Dollar General**

"…more and more retailers are evolving their business model to compete with pure-play e-tailers, and we see this as an opportunity to provide even better value for our customers, whether it's fulfilling from store or a DC…there are opportunities for retailers to provide unique value to their customers by leveraging their infrastructure …with the services we provide." **~ FedEx**

"We started this year with a very healthy business, one that generates lots of cash. We made a decision to ramp up the investments of that cash in both capital and operating margin to speed up our progress…Our ultimate goal is to build a supply chain that can reliably deliver any item in our network to all but the most remote areas in the US in two days or less, with most items delivered in one day." **~ Target**

"We want to manage our inventory because that's really the only piece that we can control… [w]e can't control what others do in the marketplace. We occasionally react to it, but our markdown strategy is based on our being competitive in the marketplace, making sure we move through the product that we need to on a given season, so that we can enter the next season with the ability to flow in the best goods possible and chase goods if needed. The marketplace is competitive. The marketplace is driven by markdowns." **~ Footlocker**

"So, better utilization of our own supply chain to make sure that all of our inventory is available and accessible to our consumers, and that we can deliver it to them as quickly and efficiently as possible." **~ Footlocker**

QUOTES FROM THE FRONT

Retailers on Performance and Strategy

"…if you look at the first half of 2017, we had carry over from a very tough four quarter in sales last year. And we were out of parity. We had too much inventory for the demand generated online and in our stores. So there was a lot of liquidation that was going on. We really entered the third quarter in a good inventory position…and we're in a very good position right now…with an available checkbook, we're able to react to those things that are tested, that are known, that are giving us higher margin because the sell-throughs are better when it comes in." ***~ Macy's***

"…in any retail business it's obviously critical to have the best merchandise and good values. It's particularly true in an off-price business. And having plans that were now, in hindsight, too aggressive, caused our teams to have to pull back a little bit. And so we weren't in the market as aggressively as we would like to have been to ensure that we have the right freshness and flow and again corresponding values." ***~ Nordstrom***

"I think we would all agree that this is one of the most dynamic times in the history of retail. And one of the things we talk a lot about here at J.C. Penney is that you can't run a traditional business with a traditional structure in an environment that is dynamically changing…J.C. Penney was buying the same way that they were buying 20 years ago. Our merchandising structure was virtually the same structure that we had 20 years ago…and I learned a long time ago that good leadership can't overcome bad structure. And…we're competing against ecommerce companies that don't have chief merchants, don't even have category merchants. They're just moving fast with data. We think merchandising is important….but we should be more nimble, agile decision-making based on merchant instincts and data without having this hierarchy that slowed things down." ***~ J.C. Penney***

"If you talk to 100 retailers today, 99.5 of them will talk about speed. This dominates the boardroom…In the old days…the supply chain was optimized by costs. Every single year, our customer would come to Asia and say, I want a cheaper product, I want a cheaper product. That conversation has almost stopped completely. Cost is almost a given…the conversation now really revolves around speed…to increase the velocity of the customers' supply chain and to meet the growing consumer and changing consumer expectation, driven by e-commerce and disruption." ***~ Li & Fung***

QUESTIONS?

Please feel free to contact Mike or Ron regarding any of the information contained herein

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Michael J. Acton, CFA®
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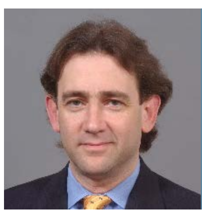
Michael J. Acton, CFA, is Director of Research for AEW Capital Management, L.P. with responsibility for directing the activities of AEW Research, the firm's highly regarded in-house research group. Mike joined the firm in 1990 and has more than 30 years of experience as an economic analyst and forecaster 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 charter holder.



DIRECTOR
RONALD M. PASTORE
AEW DIRECT INVESTMENT GROUP

Ronald M. Pastore 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. Ron 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, Ron 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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