AEW

Holiday Retail Outlook

DECEMBER 2018

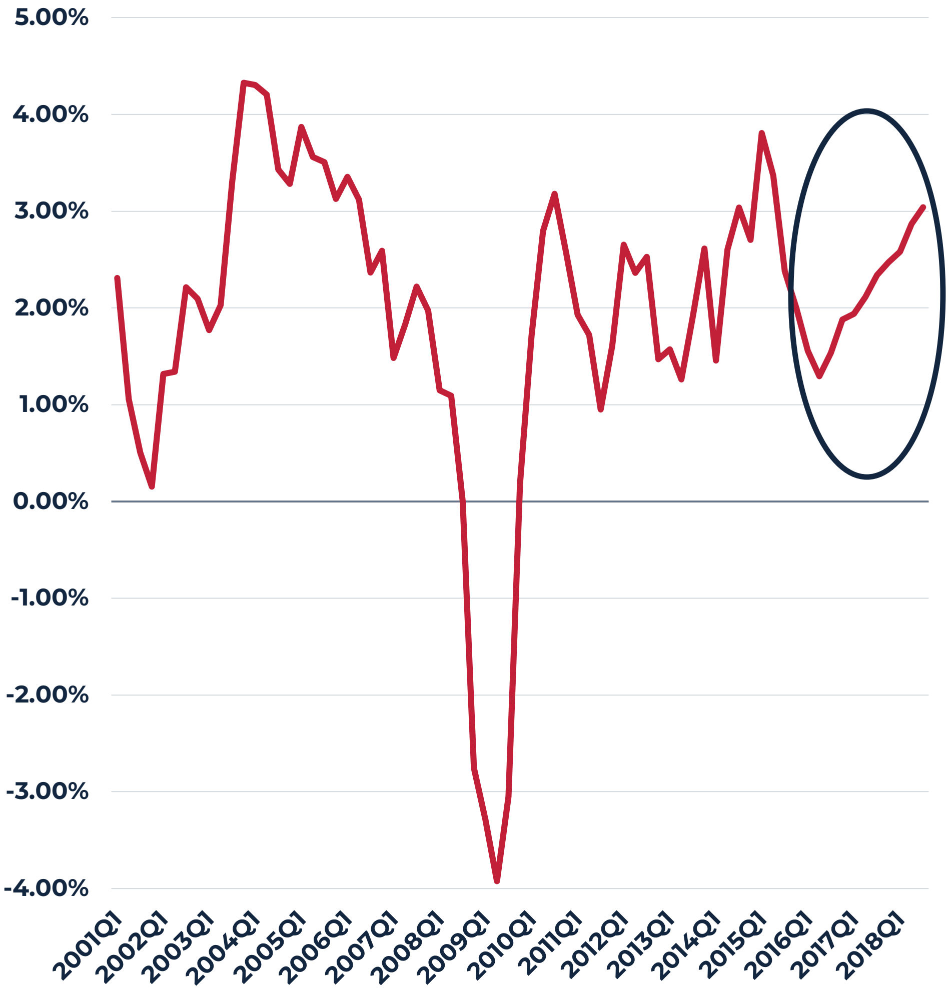
If the Consumer Isn’t Happy Now, Not Sure If They Ever Will Be

- Consumer confidence **above pre-crisis levels**
- U.S. has added **20 million jobs since 2010**
- Unemployment rate at **lowest level in 50 years (3.7%)**
- New claims for **unemployment insurance at lowest levels since 1969**
- Number of **open jobs at highest level ever recorded** – one million more open jobs than unemployed people
- Wage growth accelerating
- Federal Reserve indicating perhaps **slower increase in interest rates in 2019 and beyond**

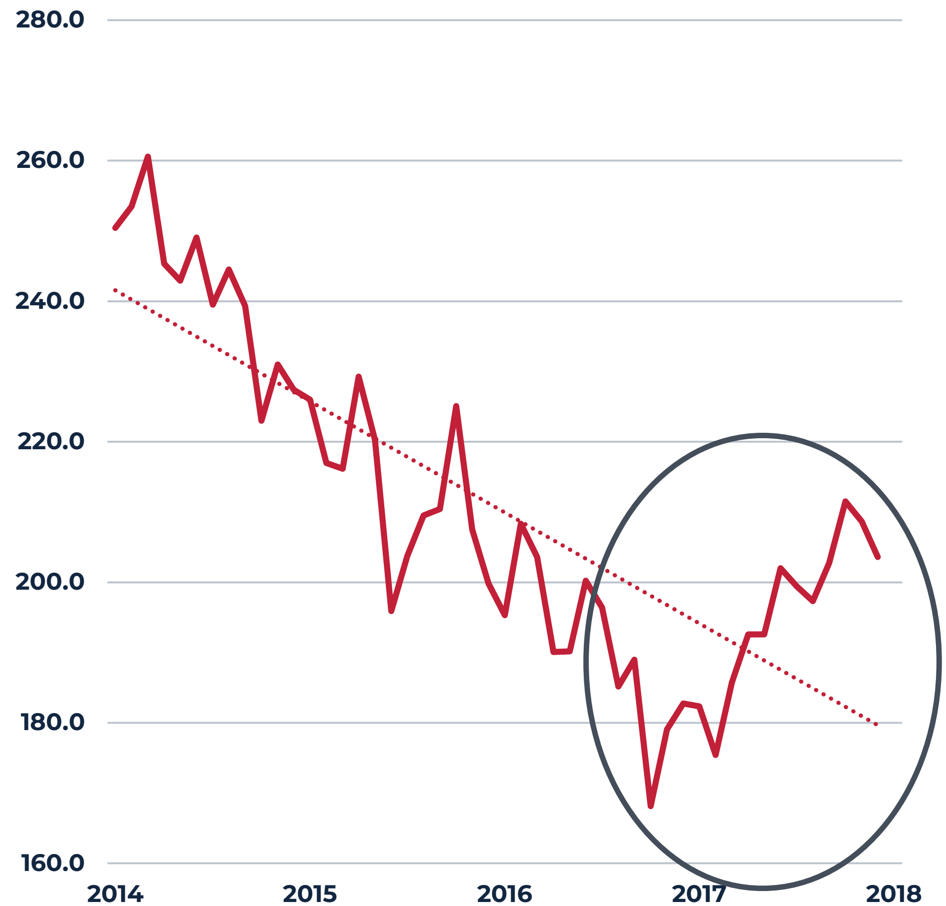
- **U.S. GDP growth accelerated to 3% during 2018**
- **Employment growth also accelerated; may be hitting a wall in terms of labor availability**

Growth Has Accelerated!

YEAR-OVER-YEAR GROWTH IN REAL GDP

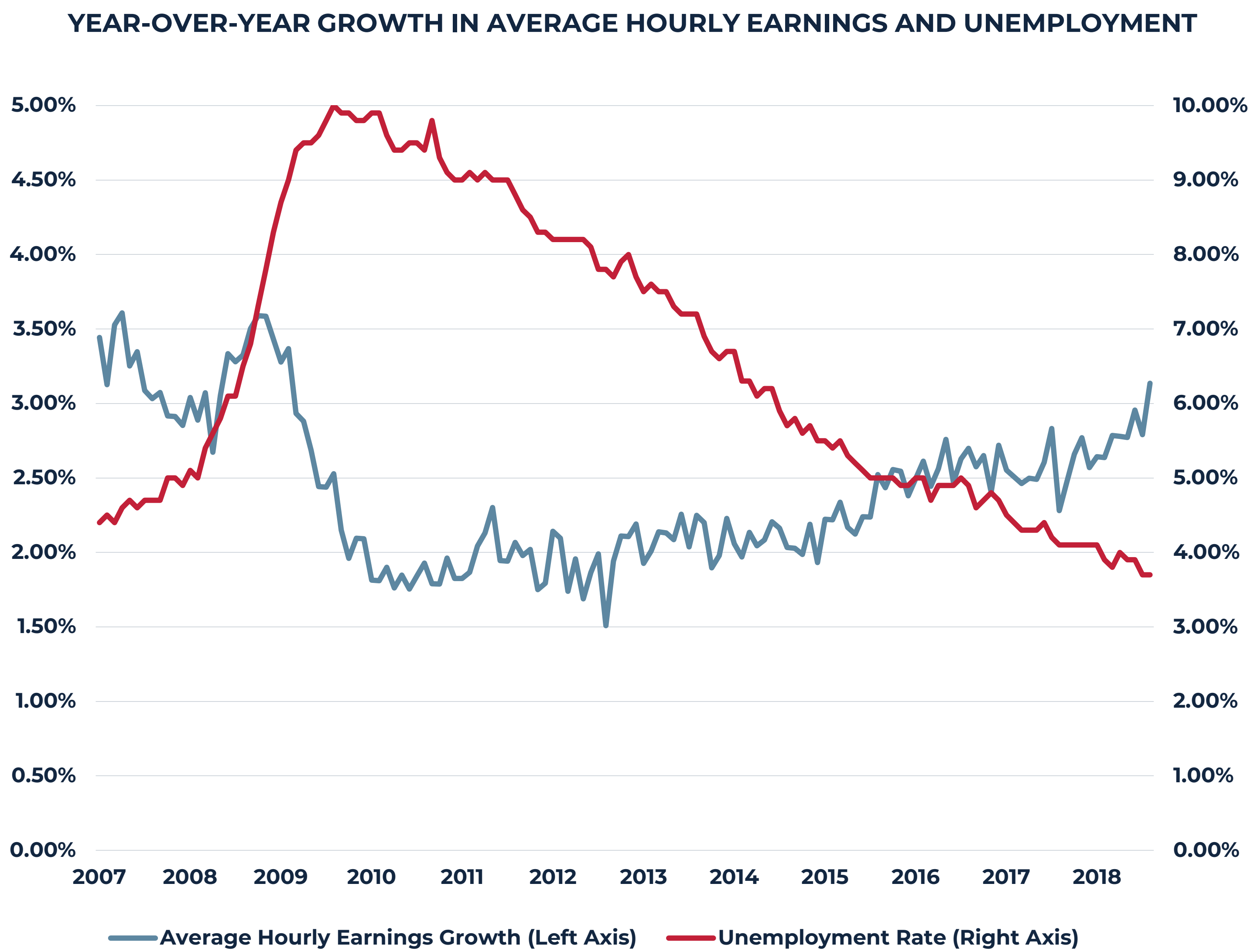


AVERAGE MONTHLY JOB GAIN OVER PRIOR 12 MONTHS



Source: Bureau of Labor Statistics and NIPA

Wage Growth Finally Picking Up



Source: Bureau of Labor Statistics

U.S. wage growth continues to accelerate in response to low and falling unemployment

YTD NOVEMBER 2018

Estimated U.S. Retail Sales by Kind of Business

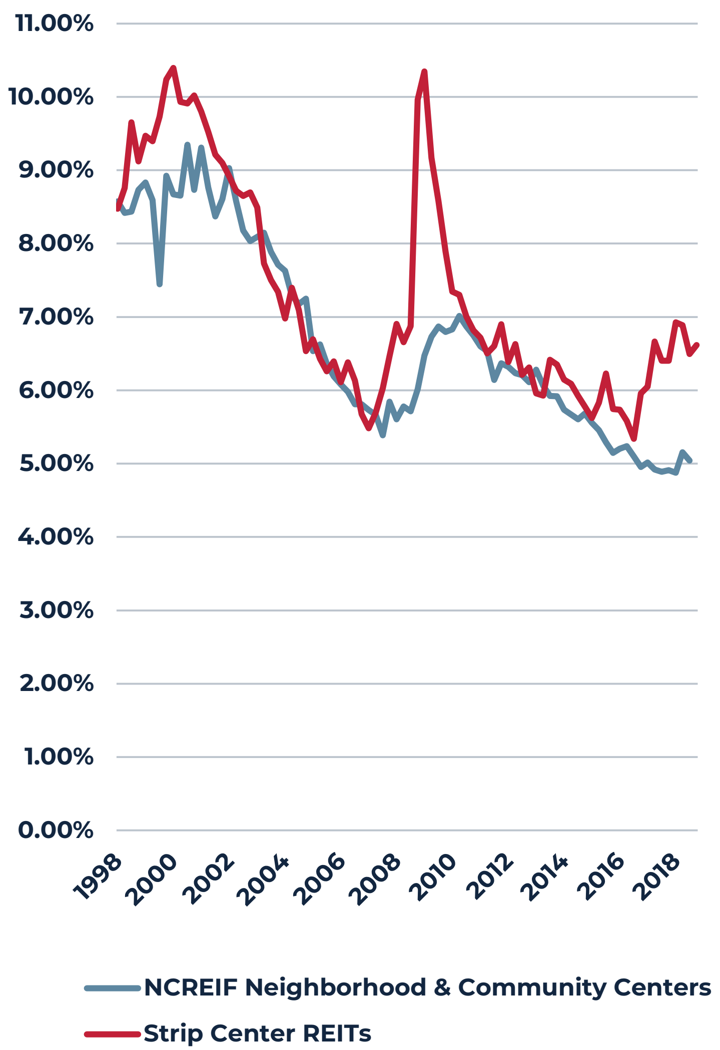
	SALES $MM	% TOTAL SALES	% TOTAL SALES EX. - AUTO	% CHANGE VS. 2017
RETAIL & FOOD TOTAL	**5,466,415**	**100.00%**		**5.3%**
Autos	1,124,160	20.56%		2.9%
Retail ex. Auto	**4,342,255**	**79.44%**	**100.00%**	**6.0%**
NECESSITY RETAIL				
Food & Beverage Stores	675,038	12.3%	15.5%	3.7%
Food Service/Drinking Places	655,550	12.0%	15.1%	6.2%
Gasoline Stations	476,655	8.7%	11.0%	14.4%
GAFO				
Furniture & Home Furnishings	110,095	2.0%	2.5%	4.1%
Electronics & Appliances	87,352	1.6%	2.0%	2.9%
Clothing & Accessories	238,777	4.4%	5.5%	4.9%
Sporting, Hobby, Book & Music	69,546	1.3%	1.6%	-4.0%
General Merchandise	634,038	11.6%	14.6%	3.5%
– Department Stores	*128,264*	2.3%	3.0%	*-0.4%*
GAFO	**1,139,808**	**20.9%**	**26.2%**	**3.4%**
OTHER				
Health & Personal care	313,614	5.7%	7.2%	3.8%
Building Materials	361,372	6.6%	8.3%	3.9%
Misc. Store Retailers	118,792	2.2%	2.7%	4.1%
Non-Store Retailers	601,426	11.0%	13.9%	10.4%

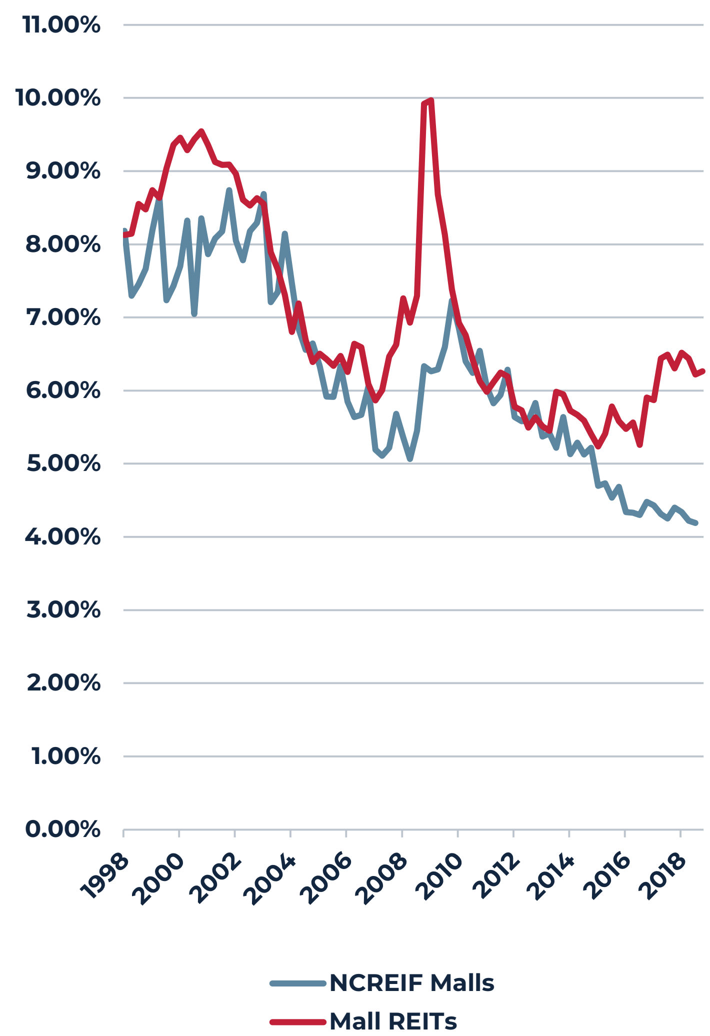
Source: U.S. Census Bureau

- **Excluding autos, America's shopping list registered a solid 6% gain through Nov., after recording a 4.4% increase in 2017**
- **$5.5 trillion of annual sales through Nov. – 75% of U.S. economy**
- **Necessities – Food, Auto & Gas – account for over 50%**
- **Discretionary – "GAFO" – sales account for about 25% but most of the headlines**
- **Non-store sales continue at 10% growth pace**
- **Restaurants and grocers benefit from strong demand as consumer confidence improves**
- **Following years of flat sales – apparel, mass merchants and department stores register gains – despite demise of Sears and BonTon**

MISPRICED ASSETS?

Public Market vs. Private Market Pricing





- **Retail property valued at yields 150-200 bps higher in the public market**
- **Broader equity markets concerned about retail performance past current market peak**
- **Mall sector bifurcated into scarce "A" centers serving higher income trade areas and the balance of the sector serving more moderate customers**
- **Significant industry overhang from Sears, BonTon and Toys 'R Us closures, along with eCommerce creates uncertainty for all but best retail properties**

Source: Bureau of Labor Statistics

The Big Reset

After a difficult 2017, and the well-publicized Sears and Toys 'R Us bankruptcies, holiday 2018 is shaping up to be one of the best seasons in years for retailers

- **Following strong back-to-school and Black Friday/Cyber Monday results, overall holiday sales are expected to increase anywhere from 4.5% to 5.5%, as consumers benefit from strong job growth, modest wage gains, buoyant confidence levels and lower gas prices – oh, and the cold, relatively dry weather also helped!**
  - Retailers that “answered the call” after the Great Recession and re-engineered their business models delivered solid sales, modest traffic gains and stable profit margins with positive overall earnings despite headwinds from higher freight, wage and delivery costs
  - While applauding the topline results, analysts focused on any signs of margin pressure or merchandise miscues, reflecting growing market anxiety as the recovery enters its late stages, geo-political issues mount and investors wonder “what’s next” on a number of fronts
  - Value retailers posted consistently strong sales, with a number of specialty retailers and department stores reporting promising results indicating that a gradual turn around in the apparel sector is finally underway
  - The big mass merchants – WalMart and Target – reported their strongest comparable store sales and traffic gains in years as their competitive response to online retail gains traction after years of flat results

The Big Reset

- **In many ways, 2018 should be remembered as a major turning point for the retail industry as it responds and adapts to new technology, significant demographic shifts, and seismic changes in the economic landscape that have collectively concentrated job growth in a short list of "superstar" cities, left the rest of the country with more limited prospects, and rewarded those retailers with an efficient, technically adept, customer-centric business model**
  - The trade areas, and consumers, that retail was built to serve back in the 80s and 90s are completely different today, and following the pivotal 2008 "wake-up" call of the Great Recession, retailers have been forced to rapidly adapt – or go out of business
  - Those who have made the investments and refined their operating models for the "new world" have dramatically transformed their businesses and will continue to adapt and – hopefully – deliver profitable growth
- **The demise of Sears represents the end of a storied 125-year retail icon, a major "reset" milestone that reflects the cumulative effect of these trends - the future re-use of the sites that Sears, K-Mart and Toy 'R Us are leaving behind will address a completely different set of market factors that vary widely from market to market**
  - While re-use of a subset of these sites represents a significant opportunity, investors have largely adopted a "wait and see" approach given the wide variety of potential redevelopment scenarios, capital requirements, timing and ultimate investment returns – there are few easy-to-model cookie cutter strategies
  - Mall operators and Seritage have been at the forefront of the coming redevelopment wave – while most welcome the opportunity to convert chronically underperforming stores and their associated sites into higher and better uses, articulating strategies that satisfy investor concerns remains a challenge

The Big Reset

The "reset" retail business model incorporates the following key improvements:

- **Customer facing store, mobile app, personal service and fulfillment enhancements – basically all the items retailers shed during the Big Box era that today's customer – driven by the power of mobile and intense competition – demand**
- **Less visible but powerful BOH improvements in all aspects of supply chain, inventory management, fulfillment capabilities and merchandise planning – essentially converting an old "push" retail model into a hybrid "pull" retail model, able to quickly read and accurately react to changing demand, locate, pack and deliver inventory no matter where it resides to a customer's home or nearby store on short order, and seamlessly integrate distribution channels**
  - Notably, the shopping trip has changed completely, and now includes mobile search, desktop ordering, pick-up in store or delivery to home – all for a pair of socks; retailers must seamlessly track customers across all channels, collecting valuable "intent heavy" customer data along the way
- **Striking the proper balance between traditional store, online and omnichannel capabilities, notably handling delivery and fulfillment demands, to consistently meet consumer expectations profitably**
  - The role of the "store" and the definition of a "sale" has changed as the line between online and bricks-and-mortar retail has blurred beyond recognition
- **A low debt or debt free balance sheet with CAPEX spending on store upgrades, IT, inventory and supply chain enhancements, and product development**
- **Focus on maintaining brand integrity while pursuing profitable sales as opposed to sales at all costs**

The Big Reset

This "reset" – which was commonly called the "Retail Apocalypse" last year – has been driven by three 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 that has left the vast majority of American consumers with stagnant wages and tight household budgets leaving little room 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**
  - Important to note that the smaller "Gen X" cohort is significantly smaller than either the Boomers or the Millennials – as a result, their passage through the peak spending years has not generated the same level of total sales as the Boomers before them
- **Dramatically increased geographic inequality as small- and mid-size communities benefitted from the decentralization of manufacturing after WWII are left behind as manufacturing employment declines and new, knowledge-based jobs require a highly-educated workforce, concentrate in fewer, larger metro areas - a trend that is further reinforced by declining household mobility as Americans move far less than ever before**
  - Amazon's decision to locate its twin new headquarters in New York City and Washington D.C. aptly reflects this dynamic

The Big Reset

In this context, the wave of closures in 2017 and the demise of Sears and Toys 'R Us reflect the long-term effects of these demand-side trends compounded by poor decisions that many retailers, and their investors, made in the past - notably crushing debt burdens from LBOs, aging concepts that failed to remain relevant to a changing customer base, or invest in more efficient operations, with aging store fleets in older, declining markets.

The future outlook for the more efficient "reset" retail world 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.**
  - Many also question whether millennials will spend like previous generations when they begin to form households…after spending their formative years in malls driving teen apparel sales why is this even a question?
- **If Millennials follow the "virtually universal process of leaving home to set up independent" households, the suburbs, and the retail serving them, will benefit dramatically – the cities they exit could benefit from the "boomer-ang" as their Boomer parents downsize and find city living more attractive**

Current Retail Conditions

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 low-price strategy) and in practice (expensive shipping, fulfillment and return processing)

The 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"

- Seamlessly integrate mobile-based shopping with store-based fulfillment to reduce transactional friction, preserve margins, encourage add-on sales, and engage with the shopper no matter when they shop or which channel they use

Despite the negative sentiment, retailers have reported upbeat results:

- Majority of retailers reported solid sales gains with increased store traffic and upbeat earnings
- Industry expects strong 2018 Holiday Season – forecasts range from 4.5% to 5.5%
- Encouraging signs of new fashion selling at full price – reading and responding to trends quickly with some of the first notable apparel sale increases in years
- Industry clearly finding balance between lower profit online and higher profit store channels
- More efficient and adaptable retailers maintain margins despite headwinds caused by higher freight costs, wage pressure and the prospect of tariffs on Chinese imports
- Value and deep discounts remain strong

As of June 30, 2018.
Source: AEW Research; Image Source: Shopify

Current Retail Conditions

Mobile – The Primary Link

- **iPhone introduced 2007 – by 2012, 50% of people over 18 own a smartphone – ownership is now over 75%, with 90% of 18-49 year-olds – all key customers**
  - Smartphone over 50% of website visits, taking lead over desktop (38%) and tablet (11%)
  - Conversion rates remain low – smartphone less than 2%, while desktop less than 5% - both well below in-store rates which range from 30% for discretionary purchases and closer to 90% for necessities
  - Mobile session page views average just less than 6 pages versus nearly 9 for desktop and tablet – very quick to exit site if page load is slow – high "bounce" rates
- **Role of mobile and the retailer app/website**
  - Browse/research on phone – validate/fulfill in store
  - Seamless movement across channel platforms – phone/desktop/store/website - as customer moves between channels on the same shopping trip
  - Data analytics back it up – but convenience to some is privacy infringement to others, especially in EU where privacy laws strictly protect consumer rights, and recent hacking and social media manipulation puts issues on radar in U.S.
    - Use of retailer and customer data gathered from online platforms gaining attention of anti-trust regulators – which brand will Alexa recommend? Who has access to the data? Where and how is it collected?
    - Browsing across devices generates tons of "intent-heavy" data – pages viewed, items researched, shopping carts loaded and discarded, not to mention when customer shops – data savvy retailers' dream!

Current Retail Conditions

Mobile – The Primary Link

- **Mobile is the retailers' 24/7 marketing and advertising tool – feed the impulse!**
  - Apps must be easy to navigate, with fast page downloads, easy checkout, order/delivery status tracking and seamless connection to other personal devices – phone/tablet/desktop/store
  - Requires integrated inventory search and fulfill capabilities on retailer side – make entire inventory accessible to customer 24/7
  - Seamless. Frictionless – after years of taking service out of retail, customer demanding/expecting retailer to provide exceptional service in all channels, including delivery
- **Delivery and fulfillment both opportunities for share and challenges to profits – free shipping drives sales but fulfillment – both shipping and returns – chews up margins**
  - High return rates for shoes and apparel – does drive store traffic but kills margins
  - Clear increase in online sales where retailers open physical stores in new market areas

Current Retail Conditions

TURMOIL IN FASHION AS SPENDING BATON IS PASSED

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

VALUE DOMINANCE WILL CONTINUE

With market share increasingly concentrated and bifurcated into deep discount dollar stores in more rural areas and off-price, branded merchants in suburbs and urban areas

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 will continue growing

DEPARTMENT STORES

Will continue to shed unproductive stores in declining markets; reduce footprint in strong markets and redevelop/repurpose surplus space to higher and better uses – including residential oriented mixed-use

RESTAURANTS

Casual sector has both supply and demand concerns balancing lower-priced value offerings and higher-service demands with higher labor costs; everyone loves to eat on a budget and foodie revolution is here to stay

ONLINE

Major shift towards Amazon Web Services as an online platform for brands/retailers without the scale or financial resources to replicate; refinements will accelerate across the retail industry over next 3-5 years, with store and online channels seamlessly fused

As of June 30, 2018.
Source: AEW Research; Image Source: Shopify
The information and opinions presented above have been prepared internally and/or obtained from sources which AEW believes to be reliable, however AEW does not guarantee the accuracy, adequacy, or completeness of such information. Opinions expressed reflect prevailing market conditions at the time this material was completed and are subject to change.

Sears' Bankruptcy

Editorial Credit: QualityHD / Shutterstock.com

- Not surprisingly, Sears filed for bankruptcy protection on October 15, 2018, capping off years of decline as its K-Mart division continued to flounder in the face of stiff competition from the likes of Walmart and Target, and its flagship Sears stores failed to respond to the onslaught of box retailers, including the likes of Home Depot, Best Buy, TJMaxx, Target, Walmart and others that replicated its offerings and captured the market share Sears once dominated
- The majority owner, Ed Lampert, has submitted a bid to acquire substantially all the assets of Sears, including 505 "go forward" stores, including 267 Sears stores and 238 K-Mart locations, that would form the core of a new retail operation – or ultimately be liquidated – auction set for mid-January 2019
- Overall bankruptcy is quite complicated and contentious given the complex financial maneuvers and asset sales Lampert engineered over the years to keep the chain afloat and protect his sizable investment – expect fair amount of noise about self-dealing, asset stripping and arcane CDS and inter-company bond arrangements
- Big picture is by the end of 2018, Sears will have closed over 1,640 Sears and K-Mart stores since 2011, representing over 75% of its store base in 7 years
  - Initial wave of closures dominated by old K-Mart locations – 2/3 of the chain was closed by 2017 and 80% will have closed by year-end 2018
  - The more recent wave of closures has focused on more valuable Sears locations, with over 63% of its stores closing in the last 3 years
  - Throughout the last 5 years, Sears has actively sought to monetize its owned stores through direct sales and sale-leaseback arrangements with Seritage and various developers

Sears' Bankruptcy

Editorial Credit: JRRieger / Shutterstock.com

- Typical Sears location includes a 160,000 freestanding store and 10-15 acres of parking – infill development sites in established retail locations with varying levels of interest from replacement tenants and developers
  - In most cases, site is encumbered with REA, zoning and other use restrictions that must be addressed to redevelop outside the existing footprint, expand building area and maximize value
  - Seritage and several mall developers have been at the forefront of redeveloping and/or re-tenanting the Sears boxes – thus far, "in the box" uses include off-price apparel retailers, entertainment, theaters, restaurant and fitness uses
  - More extensive redevelopments are in the planning stages for sites in prime locations, with a handful of high profile projects underway
  - While investment returns, timeframes and capital requirements are uncertain, redeveloping the high quality locations into higher and better uses, possibly including residential, office, or hospitality present a long-awaited opportunity to replace a chronically underperforming anchor with vibrant new uses that generate significantly higher rent and traffic

U.S. SHOPPING CENTER INDUSTRY

Growth by Center Type 1980-2018

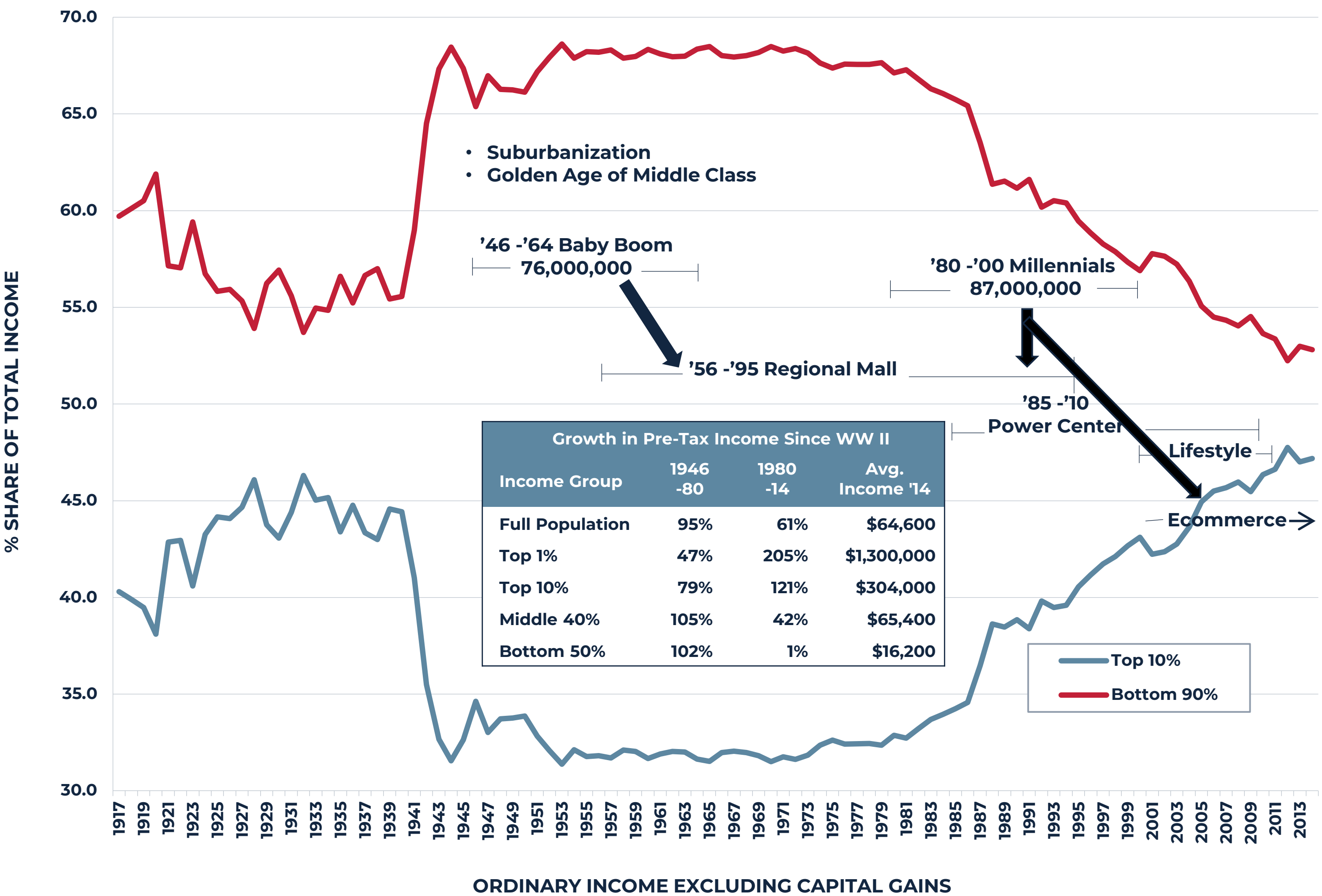
	1980	1985	1990	1995	2000	2005	2010	2015	2018
Total Shopping Center GLA (SF, MM)	3,087	3,717	4,650	5,224	5,939	6,740	7,447	7,614	7,685
Trailing Period CAGR	4.8%	3.8%	4.6%	2.4%	2.6%	2.6%	2.0%	0.4%	0.3%
REGIONAL MALLS (NUMBER)	713	839	972	1,032	1,102	1,166	1,182	1,194	1,202
% Retail GLA	21.8%	20.9%	19.2%	18.2%	17.2%	16.1%	15.0%	14.8%	14.7%
Total GLA (SF, Million)	672	778	894	950	1,020	1,085	1,116	1,126	1,130
Trailing Period CAGR	6.2%	3.0%	2.8%	1.2%	1.4%	1.2%	0.6%	0.2%	0.1%
N'HOOD/COMMUNITY (NUMBER)	18,625	22,822	28,586	31,369	34,789	38,455	41,494	42,211	42,557
% Retail GLA	57.7%	58.7%	60.1%	59.7%	58.7%	57.6%	56.2%	56.1%	56.1%
Total GLA (SF, Million)	1,780	2,184	2,793	3,120	3,488	3,881	4,188	4,272	4,309
Trailing Period CAGR	4.8%	4.2%	5.0%	2.2%	2.3%	2.2%	1.5%	0.4%	0.3%
POWER CENTERS (NUMBER)	394	460	647	933	1,360	1,810	2,199	2,263	2,287
% Retail GLA	5.4%	5.2%	5.8%	7.7%	9.9%	11.7%	13.1%	13.2%	13.2%
Total GLA (SF, Million)	166	194	271	400	588	791	979	1,007	1,018
Trailing 5-Year CAGR	2.7%	3.1%	6.9%	8.1%	8.0%	6.1%	4.4%	0.6%	0.3%
LIFESTYLE CENTERS (NUMBER)	80	100	132	145	184	277	452	501	524
% Retail GLA	0.9%	0.9%	0.9%	0.9%	1.0%	1.4%	2.1%	2.3%	2.3%
Total GLA (SF, Million)	27	32	41	45	59	94	155	172	180
Trailing Period CAGR	2.7%	3.8%	5.0%	2.1%	5.5%	9.7%	10.5%	2.1%	1.5%
OUTLET CENTERS (NUMBER)	44	73	150	233	271	290	320	361	375
% Retail GLA	0.2%	0.3%	0.6%	0.9%	1.0%	1.0%	1.0%	1.2%	1.2%
Total GLA (SF, Million)	6	12	28	48	61	66	76	88	92
Trailing Period CAGR	4.1%	15.2%	17.4%	11.7%	4.7%	1.6%	3.0%	2.9%	1.4%

*Trailing growth rate for 3 year period ended 2018
*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 came to an abrupt halt after the 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 = redundant and/or obsolete retail 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

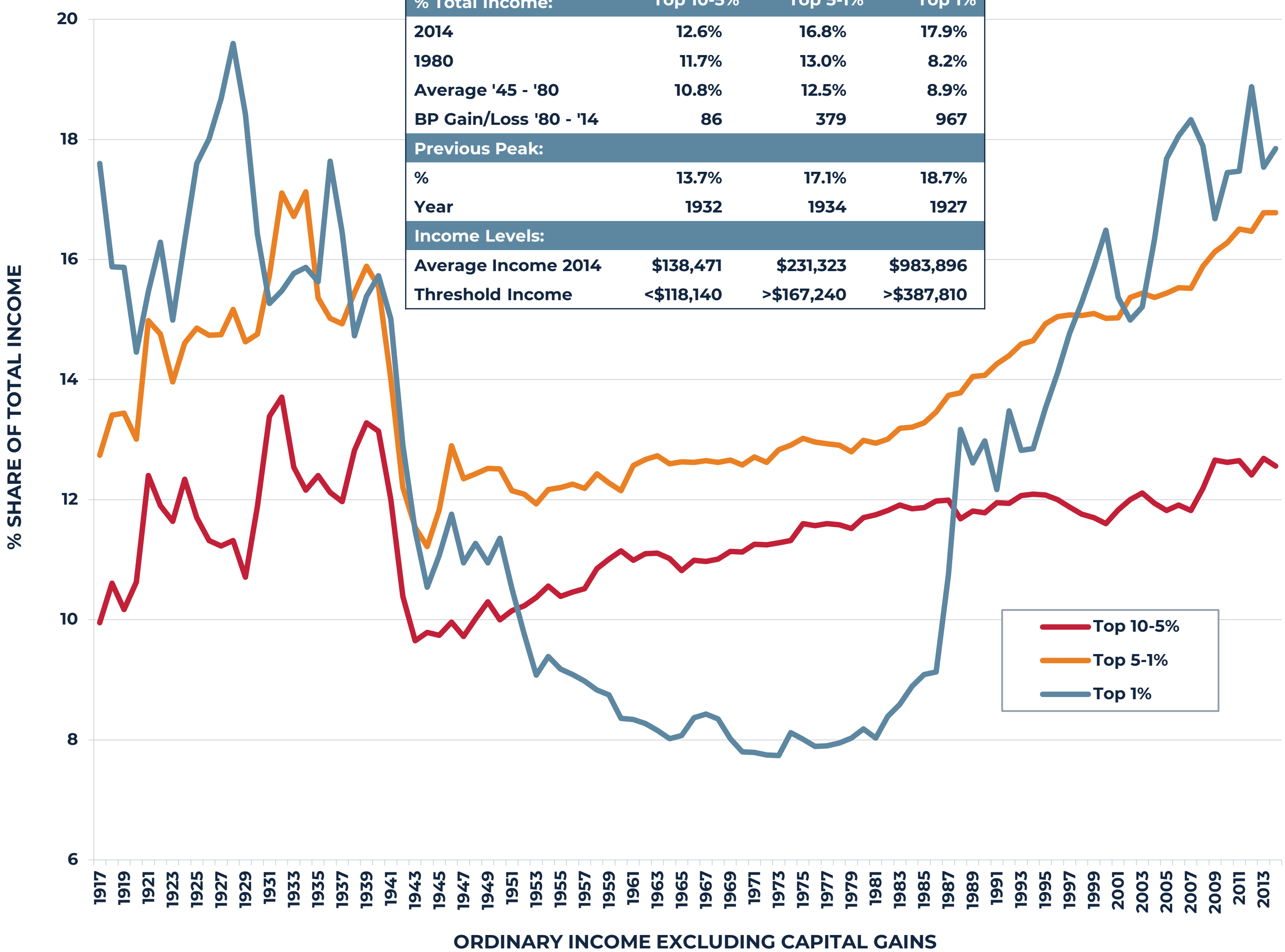
Income Group	1946 -80	1980 -14	Avg. Income '14
Full Population	95%	61%	$64,600
Top 1%	47%	205%	$1,300,000
Top 10%	79%	121%	$304,000
Middle 40%	105%	42%	$65,400
Bottom 50%	102%	1%	$16,200

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, 2/3 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

% 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



- **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**

Source: The World Wealth and Income Database

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

The Lost Multiplier Effect

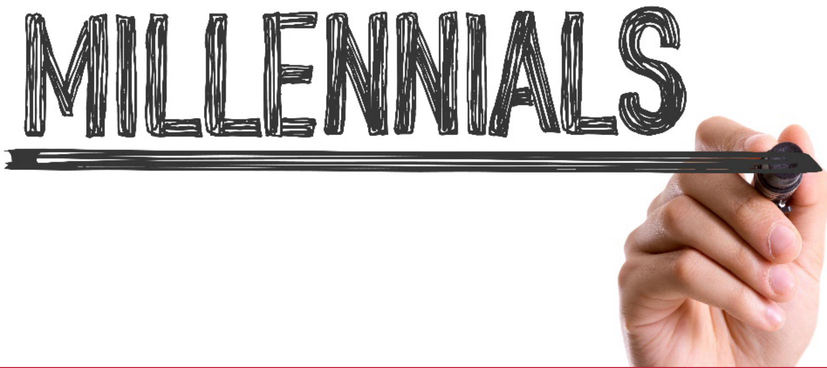
"So it is true that rich people can spend more money than middle class people, but there's this upper limit on what they can spend…My family can afford to go out to eat more than most American families, but not more than three times a day. We can't go out 3,000 times a day. My family owns a pillow company, 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

DOLLAR GENERAL®

"While the economy appears to be doing well, we know that our core customer is always challenged. With concerns about health care, inflation, rent expenses, and fluctuating gas prices, we know she remains very concerned about her budget. Our customers are at the center of everything we do, and we remain committed to serving them with the everyday low prices they have come to know and appreciate from Dollar General." **~ DOLLAR GENERAL**

Retail Outlook 2020+



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

FUTURE OUTLOOK DEPENDS ON TWO CRITICAL DEMAND FACTORS

Knowledge Economy = Greater Concentration of Growth in Fewer, Larger Cities and Their Immediate Suburbs

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"

AND

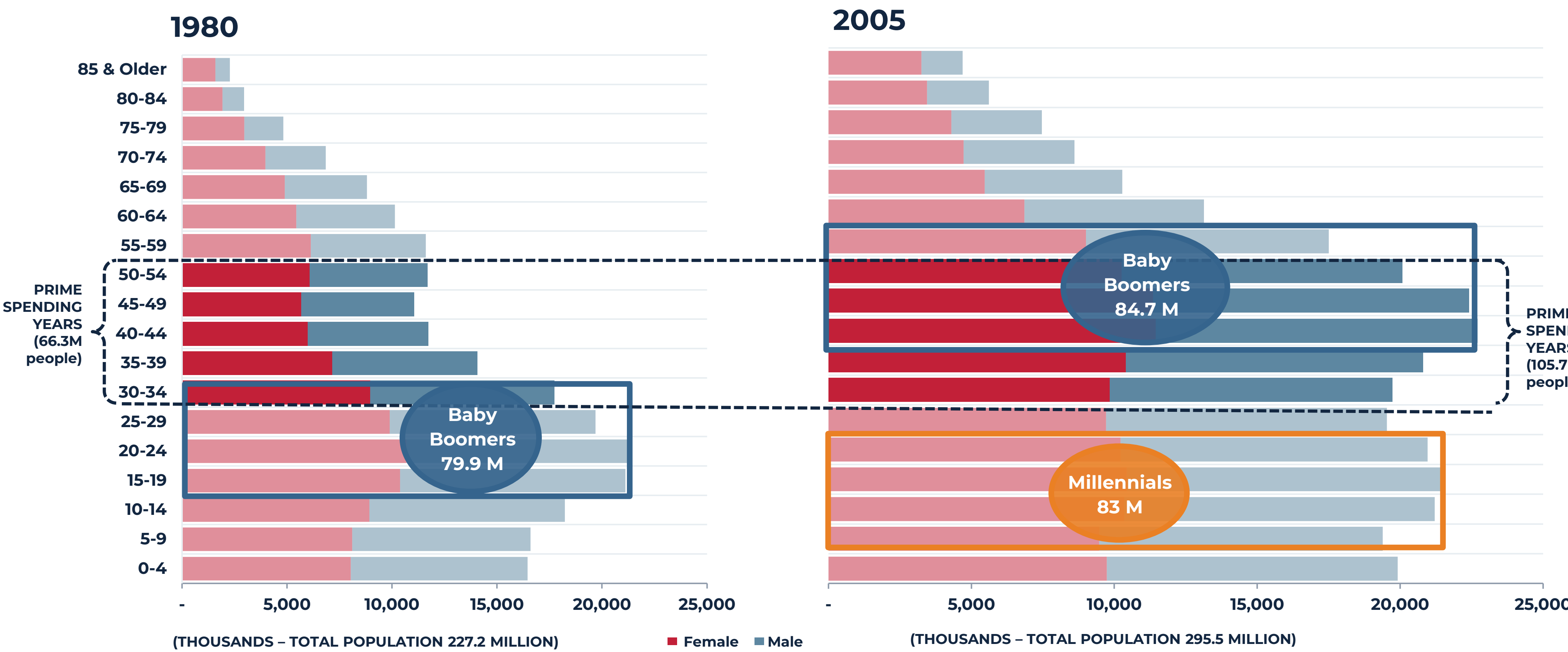
The Household Formation: Spending and Geographic Impacts of the Pending Great Millennial Migration

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

Source: AEW Research

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**

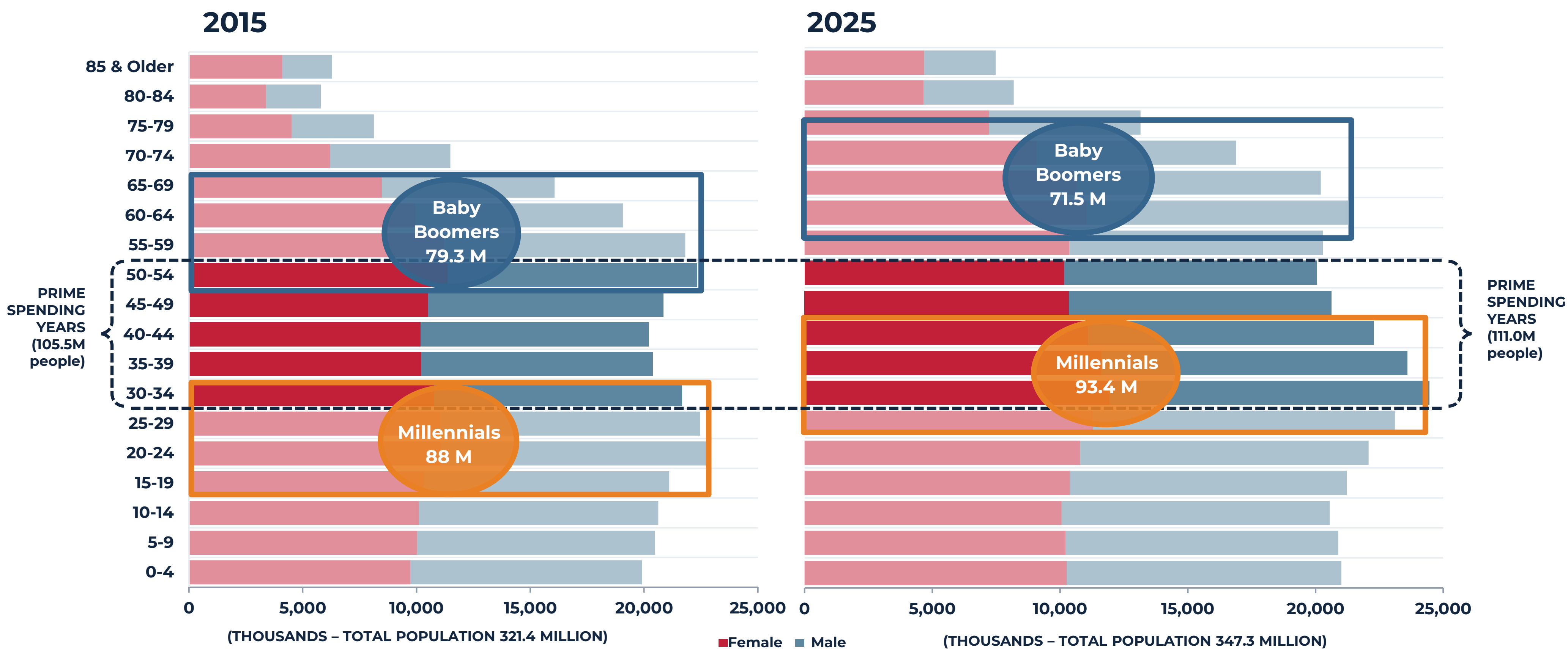
Millennials
83 million

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

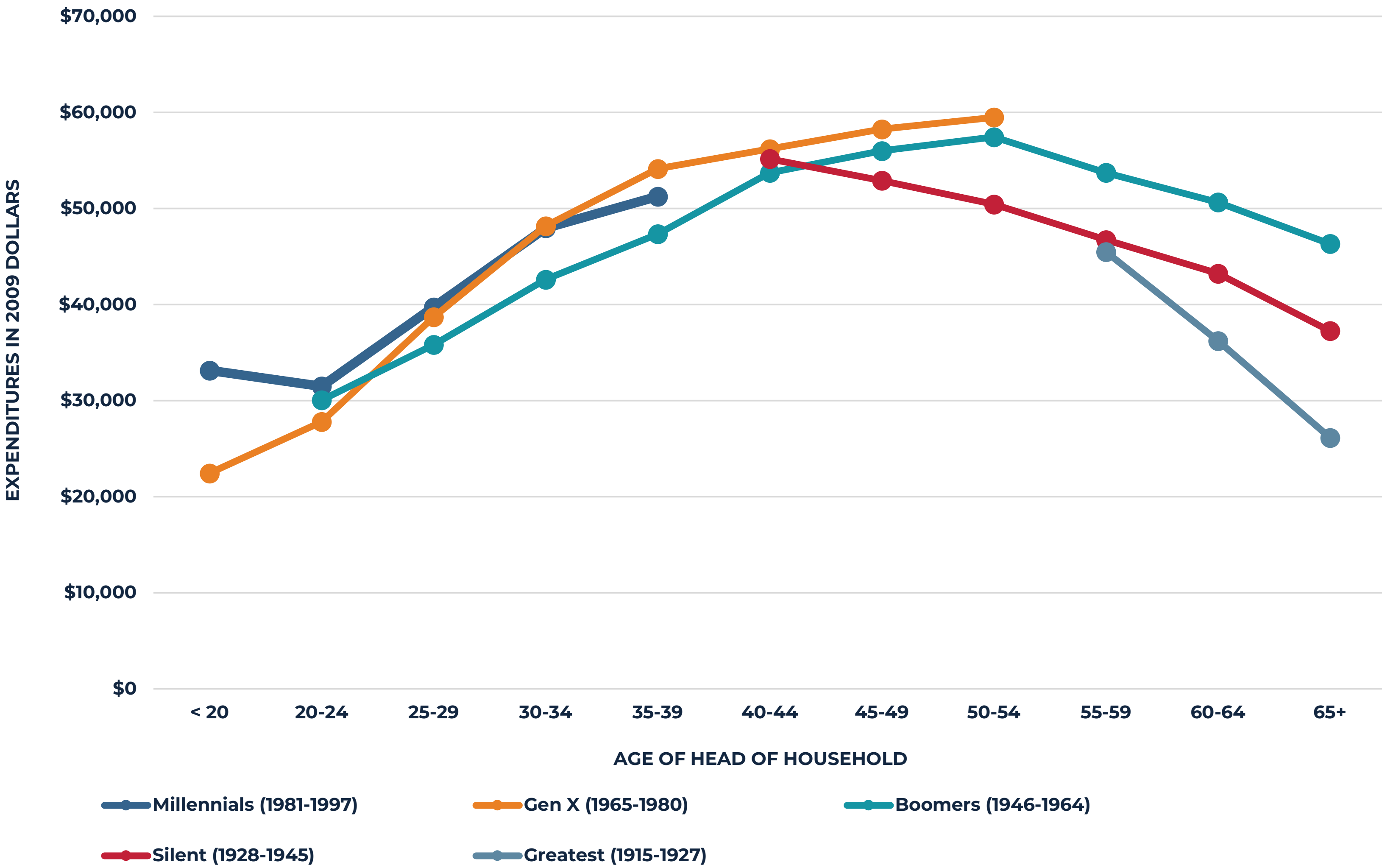
2015-2025 – MILLENNIALS TAKE THE SPENDING BATON



2015	
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

2025	
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

Real Average Annual Expenditures Per Household by Age and Generation

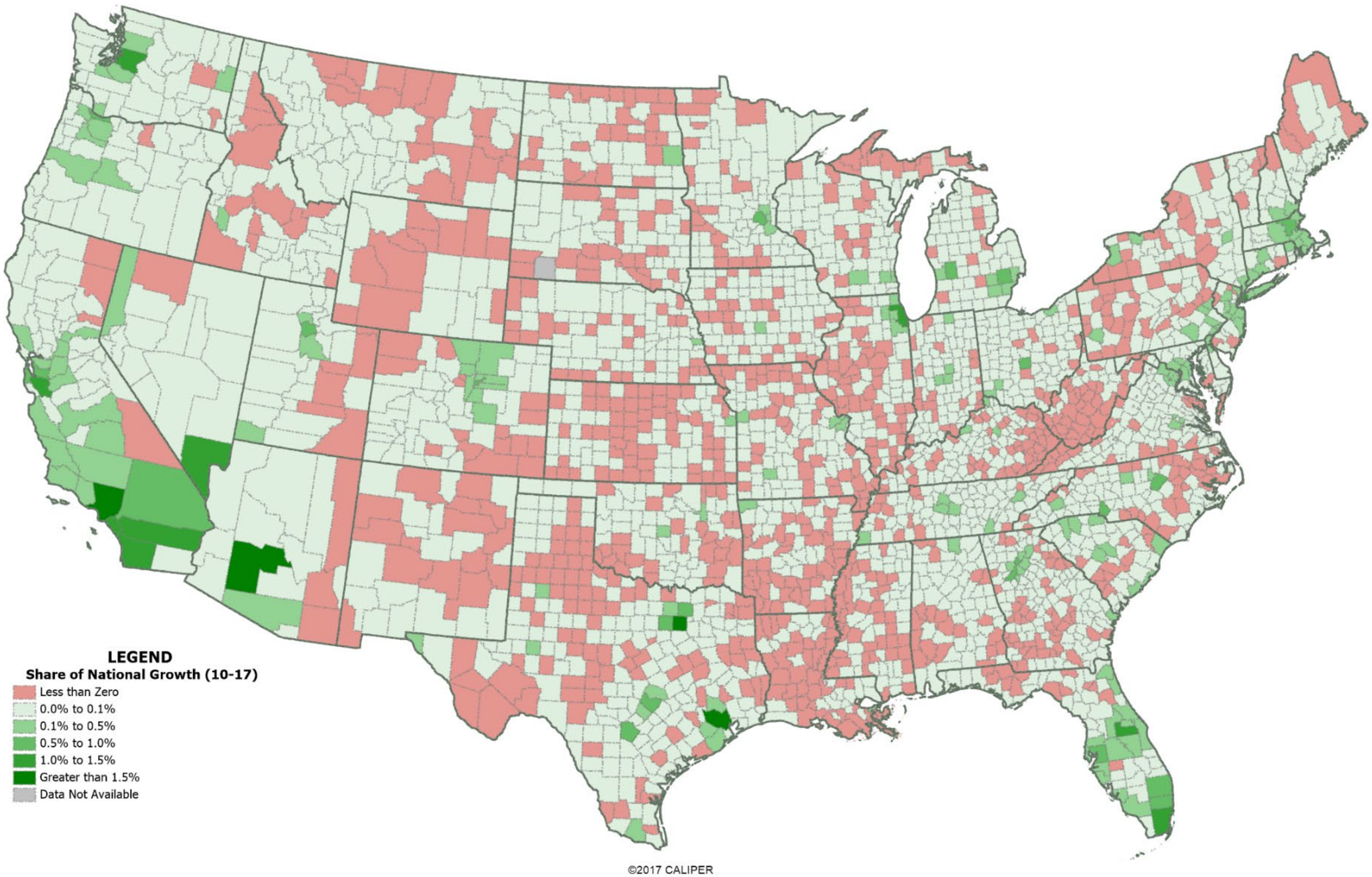


Contrary to media reports, spending profiles for Boomers, GenXers and Millennials are quite similar, with emerging Millennial households actually spending more than Boomer households at the same age

Sources: Kurz, Christopher, Geng Li, and Daniel J. Vine (2018). "Are Millennials Different?," Finance and Economics Discussion Series 2018-080. Washington: Board of Governors of the Federal Reserve System, https://doi.org/10.17016/FEDS.2018.080; Data from Consumer Expenditure Surveys (1986 – 2016), BLS. PCE price index is from the Bureau of Economic Analysis

2010-2017

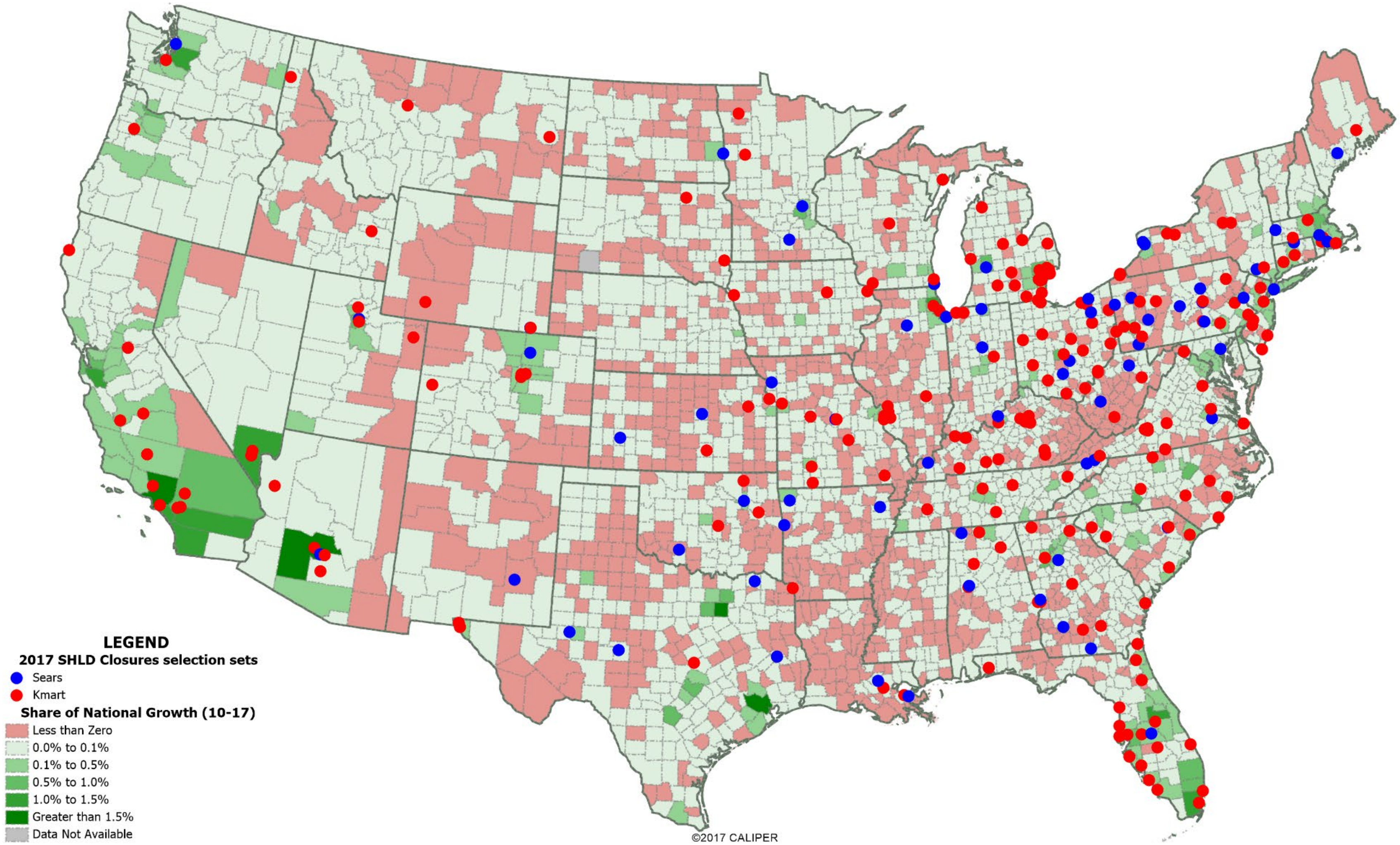
Share of National Job Growth by County



Following WWII, the share of jobs in large metropolitan areas declined as growth spread to smaller cities. This trend ended in the early 1980s largely due to the decline in marketing and the rise of knowledge intensive service industries. Between 2010 and 2017, a handful of large metropolitan areas generated over two-thirds of total output growth and 73% of employment gains.

Source: Quarterly Census of Employment and Wages, BLS

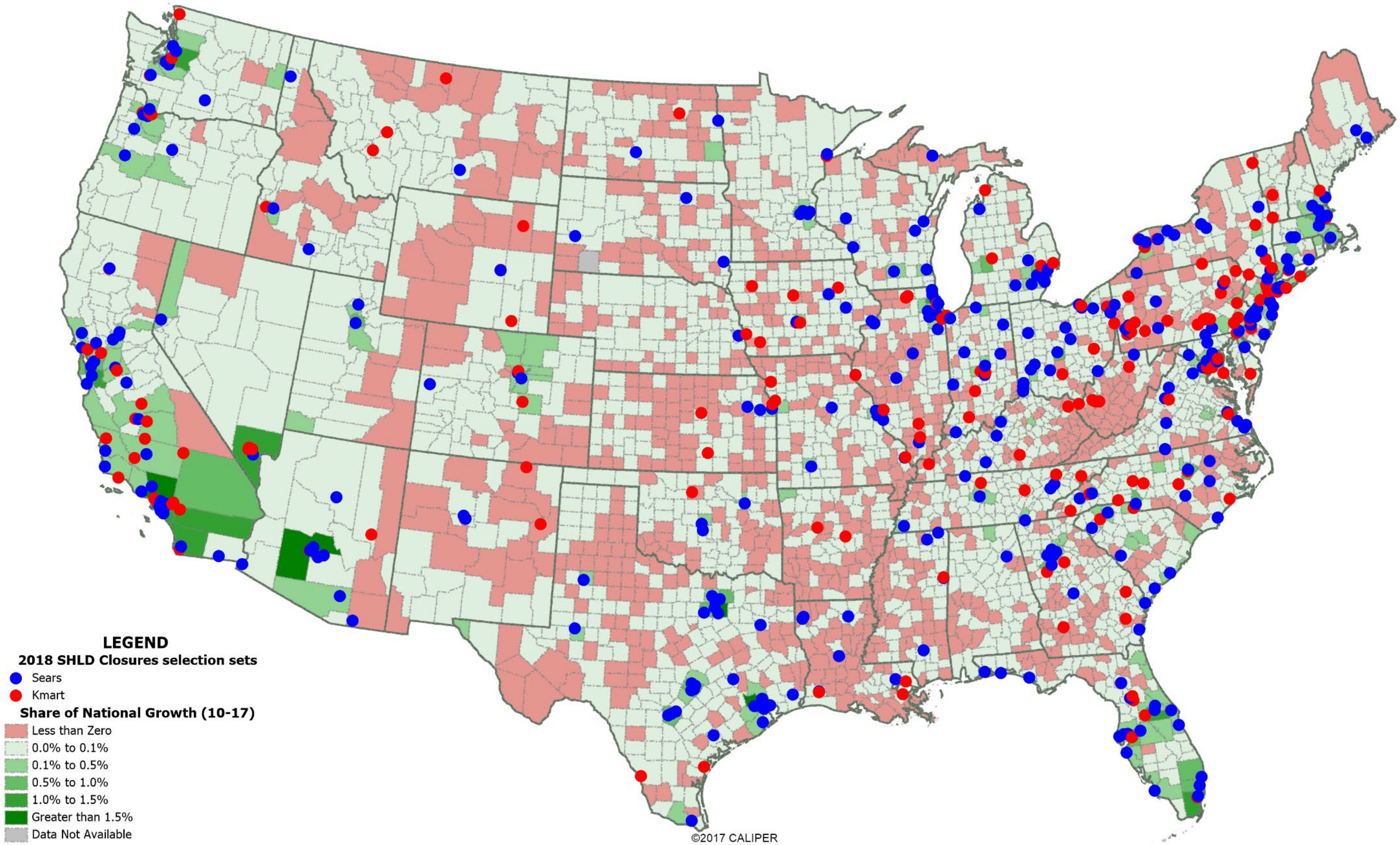
Job Growth Share with 2017 Sears/K-Mart Closings



The 2017 K-Mart and Sears closures were largely concentrated in areas with stagnant or declining job growth. K-Mart was disproportionately affected as it had already lost significant market share to Walmart, Target and other more efficient mass merchants. By the end of 2017, nearly two-thirds of the entire K-Mart fleet had closed in just 5 years – current "go forward" plan in front of the bankruptcy court will reduce the 2011 count by over 80%. Sears closures were likewise concentrated in struggling markets.

Source: Sears Holdings

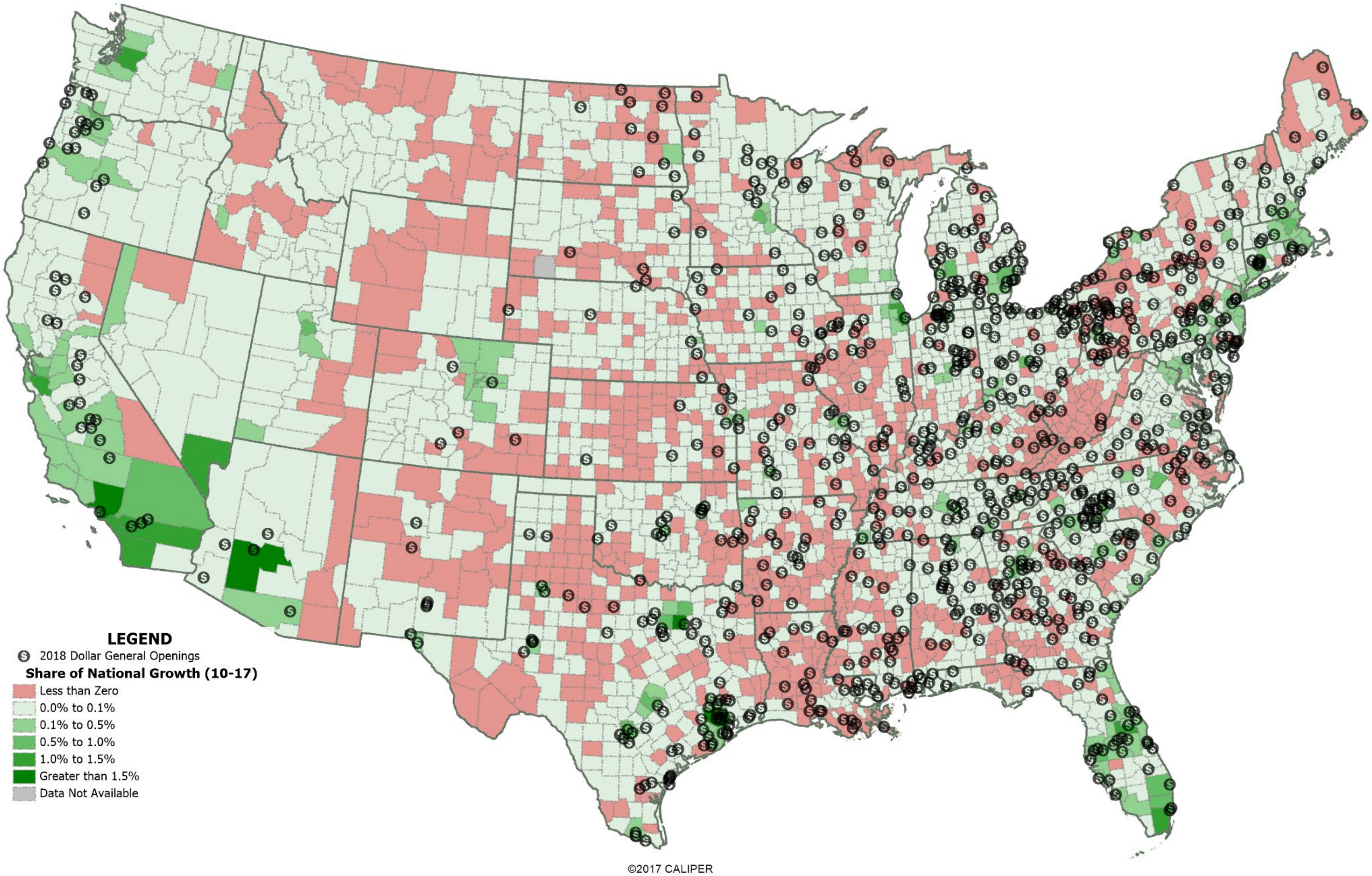
Job Growth Share with 2018 Sears/K-Mart Closings



Facing a liquidity crunch with a looming debt payment, Sears stepped up store closures, aggressively marketing locations in both struggling and vibrant markets to raise cash. By year-end 2018, Sears will have cut its store count in half over the last 18 months and by 70% since 2011. Following its October bankruptcy filing, Sears submitted a bid to acquire the remaining 505 Sears and K-Mart stores to continue operating with just one-quarter the size of its 2011 fleet.

Source: Creditntell

Job Growth Share with 2018 Dollar General Openings



Dollar General has opened nearly 4,700 stores since 2011 – at the same time Sears closed 75% of its K-Mart and Sears locations. In 2019, the chain expects to open 975 new stores, remodel and add coolers to nearly 1,000 existing stores and explore possible urban opportunities as it continues to blanket rural America.

Source: ThinkNum

SEARS Last Centuries' Amazon??

Late 1880's	Railroad stationmaster Richard Sears sells rejected shipment of watches to fellow stationmasters and makes $5,000
1895	Sears hires watch-maker Alvah Roebuck and Julius Rosenwald, establishes a mail-order business in Chicago's rail yards, launches the Sears catalogue and rides the railroads and U.S. Postal Service to create a retail behemoth
1905	Sears outgrows original facility and opens massive new 2 million square foot facility with over 9,500 employees in Chicago's rail yards – distributes 20 million catalogues, using rural delivery to reach all of America
1925	Sears opens first freestanding store near Chicago HQs – more Americans now live in cities than rural areas
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	Became world's largest retailer, growing to 840 stores, 12 catalogue plants and sales of over $11 billion by 1973, riding the twin waves of suburbanization and mall development
1989	After conducting nationwide competition, Sears receives 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 and demolishes old headquarters
1994	Amazon starts as a pure play online retailer selling books...and maybe 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
2018	Sears files for Chapter 11 Bankruptcy following years of sales declines and operating losses after hedge-fund led 2005 K-Mart merger, closes over 75% of its stores from 2011 to 2018
2018	Amazon announces the winners for its second headquarters – Washington DC and New York City – after collecting reams of sensitive data and confidential tax abatement and incentive proposals from hundreds of municipalities

What Was Bezos Saying??

"Amazon is not too big to fail. In fact, I predict one day Amazon will fail. Amazon will go bankrupt. If you look at large companies, their lifespans tend to be 30-plus years, not a hundred plus years." **~ JEFF BEZOS – Q&A RESPONSE AS RELATED TO CNBC NOVEMBER 2018**

"Certainly, Amazon looks unassailable in its current form. So did every retailer that became the biggest dog on retail's porch. They were all innovative. They all pushed the boundaries on pricing, sourcing, marketing, regulation, employment, expansion and tax breaks. They all ultimately lost their way. Sears is the latest chapter in that story. And probably not the last." **~ NEW YORK TIMES EDITORIAL BOARD "HOW SEARS WAS THE AMAZON OF ITS DAY" OCTOBER 2018**

"It's a fact that we're a large company. It's reasonable for large institutions of any kind, whether it be companies or governments to be scrutinized…[the best way to respond to scrutiny] is to conduct ourselves in such a way that when we are scrutinized we will pass with flying colors…Facebook is not the same as Google, and Apple is not the same as Amazon. I don't want to fight this kind of big tech impression – I want to just talk about Amazon." **~ JEFF BEZOS – Q&A RESPONSE AS RELATED TO CNBC MARCH 2018**

"Starting in 2011, the FTC pursued an investigation into Google, partly in response to allegations that the company uses its dominance as a search engine to cement its advantage and exclude rivals in other lines of business. While the FTC closed the investigation without bringing any charges, leaks later revealed that FTC staff had concluded that Google abused its power." **~ LINA KHAN – "AMAZON'S ANTITRUST PARADOX" YALE LAW JOURNAL**

What Was Bezos Saying??

"Although Amazon has clocked staggering growth, it generates meager profits, choosing to price below-cost and expand widely instead. Through this strategy, the company has positioned itself at the center of e-commerce and now serves as essential infrastructure for a host of other businesses that depend upon it. Elements of the firm's structure and conduct pose anticompetitive concerns – yet it has escaped antitrust scrutiny." **~ LINA KHAN – "AMAZON'S ANTITRUST PARADOX" YALE LAW JOURNAL 2017**

"You can't really be a high-volume seller online without being on Amazon, but sellers are very aware of the fact that Amazon is also their primary competitor." **~ LOTEN AND JANOFSKY, "SELLERS NEED AMAZON, BUT AT WHAT COST?" WSJ JANUARY 2015**

"…the current framework in antitrust…is unequipped to capture the architecture of market power in the modern economy…[F]irst, the economies of platform markets create incentives for a company to pursue growth over profits, a strategy that investors have rewarded. Under these conditions predatory pricing becomes highly rational – even as existing doctrine treats it as irrational and therefore implausible. Second, online platforms serve as critical intermediaries, integrating across business lines positions these platforms to control the essential infrastructure on which their rivals depend. This dual role also enables a platform to exploit information collected on companies using its services to undermine them as competitors." **~ LINA KHAN – "AMAZON'S ANTITRUST PARADOX" YALE LAW JOURNAL 2017**

So…who does Alexa REALLY work for?

Why Do Stores Close?

Lost in last years' hysteria was any remotely thoughtful analysis of why stores close – it was much easier to blame it all on ecommerce.

In 2018, the demise of Sears, K-Mart and Toys' R Us - stores that many grew up, only to witness their slow and steady decline - suggested that ecommerce was a late addition to the wrecking crew; the damage had been done years ago.

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

GEOGRAPHY

BALANCE SHEET

IRRELEVANT CONCEPT

OPERATIONAL CHALLENGES

Why Do Stores Close?

GEOGRAPHY

Location matters – where are the stores closing? Majority of closures hit smaller, more economically challenged communities, the ones that Sears, K-Mart and Toys dominated in their heyday

BALANCE SHEET

Bankruptcies and resulting closures almost universally related to over-leveraged balance sheets, often debt financed acquisitions with new owners cashing out and issuing a "put" option on the remaining operation – risky model that destroyed Campeau in the 80s brought back to do more of the same for Toys, K-Mart and Sears

Staggering debt loads left little free cash to invest in updated supply chains, store upgrades (and closures), compelling new products and the omnichannel capabilities necessary to compete; investors banked on the strength of brands and value of real estate without reinvesting in the core business that made these assets valuable in the first place

IRRELEVANT CONCEPT

Obsolete product and services; target customer's needs have changed and concept has not evolved accordingly; competition offers better value and service proposition that target customers favor, with more efficient business model/operation that consistently generates operating profits

Big box retail effectively eviscerated Sears key business lines, replicating Sears with newer, more efficient boxes from the likes of Home Depot, Best Buy, TJMaxx, and others that offered similar or better product at lower prices

OPERATIONAL CHALLENGES

Poor sourcing, inventory control, indifferent service and other operational miscues that disappoint customers, destroy margins and leave retailers vulnerable to more efficient competitors that please their customers

K-Mart had already lost this battle with Walmart and Target; Sears got distracted with Allstate Insurance, Dean Witter and Discover before a short-resurgence with "The Softer Side of Sears"...and then got distracted again

What’s on Your Millennial’s Holiday List?

2018 HOLIDAY PREFERRED	
iPhone XS 256GB	**$1,249**
One Year Data Plan ($50/mth)	**$600**
Total (One Gift!)	**$1,849**

2018 HOLIDAY - GUYS' WARDROBE FROM A&F	
Ultra Parka	$196
Sherpa Lined Full-Zip Jacket	$49
6 Signature Fit Oxford Shirts ($29/shirt)	$174
4 Signature Fit Flannel Shirts ($23.20/shirt)	$93
4 Iconic V-Neck Sweaters ($29/sweater)	$116
5 Kennan Straight Chinos ($40.80/pair)	$204
5 Kennan Straight Jeans ($39/pair)	$195
2 Pair Clarks Desert Boots ($140/pair)	$280
2 Pair Sperry Boat Shoes ($98/pair)	$196
9 Pair Boxer Briefs ($12/pair)	$108
12 Pair Casual Crew Socks ($6/pair)	$72
2 Pair Classic Sleep Pants ($28.80/pair)	$58
4 One-Inch Leather Belts ($26.60/belt)	$106
1 Starbucks Tall Dark Roast Coffee	$2
Total - 56 Items	**$1,849**

2018 HOLIDAY - GALS' WARDROBE FROM H&M	
2 Short Wool-Blend Coats ($119/coat)	$238
1 Padded Parka with Hood	$80
1 Long Down Jacket	$149
5 Denim Shirts ($24.99/Shirt)	$125
5 Plaid Flannel Shirts ($24.99/shirt)	$125
4 Cable-Knit Sweaters ($49.99/Sweater)	$200
4 Hooded Sweatshirts ($24.99/Shirt)	$100
6 Straight Jeans ($49.99/pair)	$300
2 Pair Lined Chelsea Boots ($49.99/boot)	$100
2 Pair Premium Suede Boots ($69.99/boot)	$140
6 - 3 packs Hipster Briefs ($14.99/pack)	$90
10 Pair Wool-Blend Socks ($6.50/pair)	$65
4 Pair Flannel Pajamas ($29.99/pair)	$120
2 Starbucks Vente Lattes ($8.50/cup)	$17
Total - 66 Items	**$1,849**

Appendix

Retailers Respond

Holiday Retail Tour

Quotes from the Front

- *Current Retail Environment*
- *Omnichannel Retail*
- *Mobile and Supply Chain*
- *Performance and Strategy*
- *Sears and Redevelopment*

AEW

The Key Challenges and Responses

- **Recent job growth and improving consumer confidence aside, the vast majority of consumers have not enjoyed a meaningful pay raise in years and remain frugal and budget constrained**
  - Buys closer to need, hunts for deals at Ross or the Dollar Store, closes wallet in a flash, and has other needs – rising rent, auto loans, medical bills and credit card debt – that come first; most use additional cash to pay bills
  - Not surprisingly, branded off-price and deep value – TJX, Ross, Burlington and Dollar Stores – have benefited, supporting profitable growth with minimal online presence
- **Non-profit massive online competitor with endless investor support challenging all facets of traditional retail model – pricing, marketing, fulfillment, delivery – automatically becoming media darling of any business it pursues, no matter how small, unprofitable or silly**
  - New economy mantra – ignore profits - they only stymie innovation – and sell a vision of a disruptive, data driven online business platform that grows sales and market share by undercutting competitors on price and delivery while using data mined from "customers" to anticipate purchases, evaluate potential business opportunities and compete with their own business service and fulfillment customers
    - As demonstrated by recent store closures, no "traditional" retailer can continue investing in facilities and systems without earning or even forecasting meaningful profits, and stay in business – online 2000-2002 dot.com version didn't end well
  - Some chinks in armor, however, as data privacy, anti-competitive behavior and hacking issues all warrant a more thoughtful and critical examination of the data driven online business platform model – is anti-trust far away?

RETAILERS RESPOND

The Key Challenges and Responses

- **Retailers respond with Omni-channel – watch, test and verify which online capabilities their customers demand and actually use - let others lose money experimenting with drones - skip up the learning curve, and target investment in online search, browsing and fulfillment capabilities that satisfy customer while leveraging store base and supply chain to generate profitable sales**
  - Symbiotic relationship between stores and online – online sales from given market area typically surge when a store opens in that market – likewise, online sales fall when stores close
  - Multiple fulfillment – BOPUS; BOSIS; and reserve in store – and return options to satisfy customer and protect margin
    - Shipping costs and online returns kill profit margins – only UPS and FedEx benefit (20-30% of online purchases are returned)
    - 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 inventory management changes – far more difficult to keep shelves stocked, manage purchase pick-up from online buyers and ship merchandise from existing stores than it seems
  - New mantra – reduce friction between channels – shopping trip now incorporates multiple online (mobile to desktop to tablet to mobile) and physical channels as customer flips back and forth between channels, fully expecting retailer to seamlessly track the journey and transaction trail
    - Shoppers don't distinguish between channels – it's all shopping with journey driven by customer preference and retailers' service capabilities
    - Cross channel shopping also a treasure trove of data for retailer – when, where and how customers browse, place orders and take delivery

The Key Challenges and Responses

- 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

- **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 obsessive use make them the first line of communication with retailers and brands**
  - Shopping trip often starts with smartphone; intuitive, informative apps encourage further discovery and store visits, taking advantage of the fact that many shoppers are glued to their phones – slow page load times are not tolerated
  - Continually improve and refine mobile apps and websites to allow easy access to the retailers' entire inventory, make search, order placement and fulfillment 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; while online in many ways replaced the catalogue business, the shopper and the shopping trip has changed, and many of the factors currently reducing store traffic may be reversing themselves**
  - Shopping trip has changed – browsing and research happens first on mobile device, less physical visits – reflects impulse and time pressure – but higher conversion rates and bigger baskets in stores

The Key Challenges and Responses

- Income constrained consumers on a tight budget stay out of malls to avoid temptation
- Big cohort – millennials – cooped up in cities or home with mom & dad, not where the malls are – as millennials age, establish careers and form independent households, expect both increased "home equipping" spending and steady migration to suburbs
- 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.

▪ **Overall retailer response includes renovating stores to align in store presentation with online brand perception, vastly improved – and technically enabled – personal service, improved merchandise with faster inventory flow to maintain "fresh" look and avoid stock-outs, and seamless fulfillment across channels – make the trip worthwhile!!**

Holiday 2018 Retail Tour

- **After two years of disappointing results, saturation coverage of the "retail apocalypse", continued geo-political uncertainty, and long anticipated bankruptcy filings – and store closing announcements – by Sears, Bon Ton and Toys 'R Us, retailers by and large posted some of the strongest top line sales and earnings results in years, with many setting quarterly records for comparable sale and traffic increases**
  - Solid top line results were driven by strong job growth, improving consumer confidence, the return of cold, dry weather in the early fall and on-target fashion that supported a solid recovery in apparel sales
  - Majority of retailers re-affirmed or increased their annual earnings guidance – significantly in several instances – as strong top line sales levered more efficient operating platforms, including less profitable on-line businesses, despite significant headwinds from higher freight, delivery and fulfillment costs, wage pressures, uncertainty surrounding tariffs on products from China, two significant hurricanes, and aggressive on-line competition
  - Comparable quarterly results were also pressured by the 2018 retail calendar, which has one less week than last year, that shifted strong 2018 back-to-school results back into the second quarter while adding a relatively quiet week in early November to the third quarter – combined with inventory build-up to avoid possible tariffs and capitalize on strong expected holiday demand, the calendar shift pressured reported operating results

- **Holiday 2018 is expected to be the strongest for retailers in years, with sales forecasts ranging from 4.5% to 5.5% gains**
  - While prepared to encounter typical promotional pressure, specialty and off-price apparel retailers, select department stores, mass merchants and restaurants are expected to outperform
  - Sears and Bon Ton store closures and going out of business sales a short term issue with most competitors focused on gaining the future sales and customers lost by these chains
  - Black Friday and Cyber Monday sales were strong, and the early Thanksgiving results in the longest possible shopping season until Christmas

Holiday 2018 Retail Tour

- **However, while quick to applaud top line results and positive earnings surprises, investors remained cautious and hyper sensitive to any signs - margin pressure, higher inventories, increasing labor, freight and fulfillment costs – that the recovery has run its course and recession is around the corner**
  - Overall industry has clearly transitioned from profit growth fueled by store expansion into a more rationalized industry focused on profitable sales growth, efficient operating platforms that leverage earnings from even modest sales gains, solid balance sheets and sustainable, growing market share
  - Store closing in last 5 years, combined with little new supply and the demise of Sears and BonTon has reduced retail space overhang while winnowing out weak, over-levered and poorly operated retailers
- **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 sustained topline growth in a competitive environment increasingly susceptible to no-margin online competitors**
  - Industry mantra remains “control the controllable”, reduce leverage point on fixed and variable costs to modest 1-3% comp sales gains versus the 4-5%+ thresholds in the past, get debt off the balance sheet and right size the store fleet
  - When topline growth resumes – the “spending baton handoff” – re-engineered retailers poised for outsize profit growth
  - While granular focus on profit margins and leverage are the norm for retailers, they were oddly absent for pure play online retailers until recently – clear shift towards acknowledging on-line channel is less profitable and requires similar operational discipline to succeed long term

Holiday 2018 Retail Tour

- **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 and react accurately and quickly
  - Mobile is king – 24/7 marketing site and direct path to the pocketbook – many of today's shopping trips start on a smartphone – continually refine apps to keep customer engaged and make today's cross channel shopping trip seamless and fast
  - Balance higher margin stores with lower margin online – converse with customer online, confirm and fulfill in store
  - Edit and update store fleet, right size and improve box to please customer, handle online fulfillment, and, for those in transition – keep lease terms flexible
  - Avoid debt – use operating cash flow, and cash freed up by recent corporate tax cuts, to invest in systems, refurbish stores and, buy 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 demise of Sears and K-Mart – don't last long**

Specialty Retailers – Teens

American Eagle Outfitters	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
Net Sales ($MM)	$3.055	$2,989	$2,967	$2,968	$3,120	$3,476	$3,306	$3,283	$3,522	$3,610	$3,796
Gross Margin %	46.6%	39.3%	39.3%	39.5%	36.7%	40.0%	33.7%	35.2%	37.0%	37.9%	36.1%
Operating Income %	19.6%	10.1%	9.6%	10.7%	9.4%	12.4%	4.3%	4.7%	9.1%	9.2%	8.0%
Number of Stores	987	1,098	1,103	1,086	1,090	1,044	1,066	1,056	1,047	1,050	1,047
% Comp Sales	1.0%	(10.3%)	(3.6%)	(1.0%)	3.0%	7.0%	(6.0%)	(5.0%)	7.0%	3.0%	4.0%
% Sales DTC	8.0%	10.3%	11.6%	11.3%	12.3%	13.4%	N/A*	N/A*	N/A*	N/A*	N/A*

Abercrombie & Fitch	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
Net Sales ($MM)	$3,750	$3,540	$2,962	$3,469	$4,158	$4,511	$4,117	$3,744	$3,519	$3,327	$3,493
Gross Margin %	67.0%	66.7%	64.6%	63.8%	61.3%	62.4%	62.6%	61.8%	61.3%	61.0%	59.7%
Operating Income %	19.7%	12.4%	5.1%	8.3%	5.3%	8.3%	5.4%	5.1%	3.9%	0.5%	2.0%
Number of Stores	1,035	1,125	1,096	1,069	1,045	1,051	1,066	969	932	898	868
% Comp Sales	(1.4%)	(13.3%)	(22.9%)	7.3%	5.0%	(1.4%)	(11.3%)	(8.0%)	(2.7%)	(4.9%)	3.0%
% Sales DTC	7.9%	8.6%	9.7%	11.7%	13.3%	15.5%	18.9%	22.2%	24.0%	25.0%	28.0%

Tilly's	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
Net Sales ($MM)	$246	$255	$ 283	$333	$401	$467	$496	$518	$551	$569	$577
Gross Margin %	37.2%	32.5%	30.9%	30.9%	32.2%	32.1%	30.4%	30.0%	30.4%	29.6%	30.4%
Operating Income %	16.0%	9.3%	7.6%	7.5%	8.7%	8.3%	6.0%	4.5%	3.3%	3.4%	4.2%
Number of Stores	73	99	111	125	140	168	195	212	224	223	219
% Comp Sales	8.7%	(12.5%)	(3.1%)	6.7%	10.7%	2.3%	(1.9%)	(2.8%)	1.2%	0.5%	1.0%
% Sales DTC	5.0%	6.0%	8.0%	9.9%	10.9%	11.3%	12.0%	11.3%	12.5%	13.4%	13.1%

*Sales from online channels included in store sales

- Teen retailers adjust as their prime demographic ebbs – fewer teens, more constrained budgets, and iPhone the only "must have" fashion
- Changing teen behavior – less hanging out at the mall, more time browsing and texting with smartphone at home
- Overall teen sector has consolidated and downsized, remaining retailers now growing sales, taking share from lapsed competitors and department stores, launching powerful apps, and improving store profitability while aggressively pursuing omnichannel strategies – DTC sales 15-25% of total
- AEO – noticeable pickup in store traffic, record sales with 4 consecutive years of positive comps & record denim sales, Aerie concept on fire – sales up over 30% - rolling out 60-70 new stores
- Abercrombie – solid turnaround led by Hollister, "rightsized" A&F fleet with smaller new prototype stores and rationalized Euro fleet
- Tilly's – steady, consistent growth with constantly shifting branded apparel offering – store sales growth strongest since 2012

Specialty Retailers – Family Apparel

The Gap	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
Net Sales ($MM)	$15,772	$14,526	$14,197	$14,664	$14,549	$15,651	$16,148	$16,435	$15,797	$15,516	$15,855
Gross Margin %	36.1%	37.5%	40.3%	40.2%	36.2%	39.4%	39.0%	38.3%	36.2%	36.3%	38.3%
Operating Income %	8.3%	10.7%	12.8%	13.4%	9.9%	12.4%	13.3%	12.7%	9.6%	7.7%	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	3,165
% Comp Sales	(4.0%)	(11.5%)	(3.0%)	1.0%	(4.0%)	4.8%	2.2%	0.0%	(4.0%)	(2.0%)	3.0%
% Sales DTC	5.8%	7.1%	7.9%	8.9%	10.7%	12.0%	14.0%	15.2%	N/A*	N/A*	N/A*

Urban Outfitters	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
Net Sales ($MM)	$1,508	$1,835	$1,938	$2,274	$2,474	$2,795	$3,087	$3,323	$3,446	$3,546	$3,616
Gross Margin %	38.3%	38.9%	40.6%	41.2%	34.8%	36.9%	37.6%	35.4%	34.9%	35.1%	32.5%
Operating Income %	14.9%	16.3%	17.5%	18.2%	11.5%	13.4%	13.8%	11.0%	10.3%	9.5%	7.2%
Number of Stores	245	293	326	371	427	472	507	544	572	594	603
% Comp Sales	5.5%	8.0%	(3.4%)	4.3%	(3.8%)	(0.8%)	6.0%	2.0%	2.0%	1.0%	0.0%
% Sales DTC	13.6%	14.9%	16.7%	19.1%	20.4%	23.7%	24.0%	N/A*	N/A*	N/A*	N/A*

*Sales from online channels included in store sales

- Specialty apparel sales and margins pressured by twin challenges of balancing low-profit online and higher profit store channels while competing with branded off-price and fast fashion – at same time, customer is changing, more selective and younger
- Those with strong fashion, “addressable” customer base, efficient supply chain, inventory and omnichannel capabilities, and solid balance sheets have advantage as they move from reliance on boomer and x’er to millennials
- Gap, the former clothier of the boomer, striving to attract millennials with a smaller, updated fleet (and outlets), solid Old Navy growth on value, Banana with career casual niche, and Athleta riding high on athleisure boom – focus on profitability not growth
- Urban Outfitters – straddling the boomer/millennial divide between namesake, Anthro and Free People, with growing DTC business challenging profits; better fashion read in 2018 improving sales and margins

Specialty Retailers – Women's Apparel

Chico's*	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
Net Sales ($MM)	$1,714	$1,582	$1,713	$1,905	$2,196	$2,581	$2,586	$2,675	$2,642	$2,476	$2,282
Gross Margin %	56.5%	51.8%	56.0%	56.1%	55.8%	43.4%	40.3%	38.4%	38.6%	38.2%	37.9%
Operating Income %	7.1%	(2.5%)	6.3%	9.3%	10.1%	11.1%	5.5%	4.3%	(0.5%)	5.7%	6.4%
Number of Stores	1,038	1,076	1,080	1,151	1,256	1,357	1,472	1,547	1,518	1,501	1,460
% Comp Sales	(8.1%)	(14.5%)	7.6%	8.3%	8.2%	7.2%	(1.8%)	0.0%	(1.5%)	(3.7%)	7.7%
% Sales DTC	4.3%	4.5%	5.8%	7.2%	NR	NR	NR	NR	NR	NR	NR

L Brands	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
Net Sales ($MM)	$10,134	$9,043	$8,632	$9,613	$10,364	$10,459	$10,773	$11,454	$12,154	$12,574	$12,632
Gross Margin %	34.6%	33.2%	35.1%	37.8%	39.1%	41.9%	41.1%	42.0%	42.8%	40.8%	39.3%
Operating Income %	11.0%	6.5%	9.9%	13.4%	11.9%	15.0%	16.2%	17.1%	18.0%	15.9%	13.7%
Number of Stores	2,926	3,014	2,971	2,968	2,941	2,876	2,923	2,969	3,005	3,074	3,075
% Comp Sales	(2.0%)	(9.0%)	(5.0%)	9.0%	10.0%	6.0%	1.0%	4.0%	5.0%	1.0%	4.0%
% Sales DTC	13.8%	16.8%	16.1%	15.6%	15.0%	17.3%	16.4%	15.8%	15.8%	16.2%	16.4%

*Chico's results FY2016 reflect divestiture of Boston Proper; Gross margin post FY2012 reflects change in accounting methodology

- 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 – without quick "reads" and adjustments, fashion misses can inflict enduring pain
- Chico's remains in turnaround mode, repeated fashion misses hurt core Chico's and WHBM while Soma business continues to grow
- L Brands – uncharacteristic fashion and merchandising mistakes at Victoria's Secret and Pink – arguably two of the most successful concepts in retail – have raised questions about future fashion direction despite coveted brand equity – new brand heads in place

Department Stores

J.C. Penney	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
Net Sales ($MM)	$19,860	$18,486	$17,556	$17,759	$17,260	$12,985	$11,859	$12,257	$12,625	$12,547	$12,506
Gross Margin %	38.6%	37.4%	39.4%	39.2%	36.0%	31.3%	29.4%	34.8%	36.0%	35.7%	34.6%
Operating Income %	9.5%	6.1%	3.8%	4.7%	0.0%	(7.7%)	(10.5%)	(2.1%)	(0.7%)	3.1%	0.9%
Number of Stores	1,067	1,093	1,108	1,106	1,112	1,117	1,094	1,062	1,021	1,013	872
% Comp Sales	0.0%	(8.5%)	(6.3%)	2.5%	0.2%	(25.2%)	(7.4%)	4.4%	4.5%	0.0%	0.1%
% Sales DTC	N/A	N/A	N/A	8.6%	8.8%	7.9%	9.1%	10.0%	11.2%	11.9%	NR

Nordstrom	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
Net Sales ($MM)	$8,828	$8,272	$8,258	$9,310	$10,497	$11,762	$12,166	$13,110	$14,095	$14,498	$15.137
Gross Margin %	37.4%	34.5%	35.5%	36.7%	37.2%	36.8%	36.4%	35.9%	35.0%	34.9%	34.7%
Operating Income %	13.7%	9.1%	9.7%	11.5%	11.5%	11.0%	10.8%	9.8%	7.8%	5.6%	6.1%
Number of Stores	156	169	184	204	225	240	260	292	323	349	366
% Comp Sales	3.9%	(12.4%)	(3.6%)	8.1%	7.2%	7.3%	2.5%	4.0%	2.7%	(0.4%)	0.8%
% Sales DTC	5.1%	5.8%	6.8%	7.6%	8.7%	10.8%	13.3%	15.2%	19.7%	22.2%	25.0%

- Department store expansion rode the mid-century suburbanization wave; older legacy chains in declining markets left behind while remaining chains focus resources on rationalized fleets serving fewer, larger metropolitan 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 back to value roots, focused on strengths in private label apparel, housewares, and recently added-appliances following disastrous '12/'13 upscale attempt – new CEO aggressively clearing and resetting offering with focus on gaining share left by BonTon and Sears
- Nordstrom balancing higher margin full price business and low margin Rack and online channels (DTC is 25% of sales) with aggressive customer centric strategy; attempt to go private did not pan out
- Closure of obsolete older Sears, K-Mart and BonTon stores long overdue – fair amount of market share up for grabs after closure sales are complete

Big Box Stores

Target (US Segment)	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
Net Sales ($MM)	$63,368	$64,948	$65,357	$65,787	$68,466	$71,960	$71,279	$72,618	$73,785	$69,495	$71,879
Gross Margin %	30.2%	29.8%	30.5%	30.5%	30.1%	29.7%	29.8%	29.4%	29.2%	29.3%	28.9%
Operating Income %	8.3%	6.8%	7.1%	8.0%	7.8%	7.3%	5.7%	6.2%	6.9%	7.1%	6.0%
Number of Stores	1,591	1,682	1,740	1,750	1,763	1,778	1,793	1,790	1,792	1,802	1,822
% Comp Sales	3.0%	(2.9%)	(2.5%)	2.1%	3.0%	2.7%	(0.4%)	1.3%	2.1%	(0.5%)	1.3%
% Sales DTC	N/A	N/A	N/A	N/A	N/A	N/A	N/A	2.6%	3.4%	4.4%	5.5%

Ross Stores	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
Net Sales ($MM)	$5,975	$6,486	$7,184	$7,866	$8,608	$9,721	$10,230	$11,042	$11,940	$12,867	$14,135
Gross Margin %	22.7%	23.6%	25.8%	27.2%	27.5%	27.9%	28.0%	28.1%	28.2%	28.7%	29.0%
Operating Income %	7.0%	7.6%	10.1%	11.5%	12.4%	13.1%	13.1%	13.5%	13.6%	13.9%	14.4%
Number of Stores	890	945	995	1,042	1,103	1,181	1,276	1,362	1,446	1,533	1,622
% Comp Sales	1.0%	2.0%	6.0%	5.0%	5.0%	6.0%	3.0%	3.3%	4.0%	4.0%	4.0%
% Sales DTC*	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM

*Online sales not meaningful – less than 1%

- Value/off-price retail flourishing – Ross, TJX, Burlington, Costco and Dollar Stores increasing overall sales and store counts while maintaining or improving profit margins with little or no online presence – concerns about product availability over blown as these retailers have become established, and profitable distribution channels for numerous brands
- Mass merchants – Walmart and Target – benefitting from strong economy as both reported significant sale and traffic gains in '18 despite flat margins as higher freight and fulfillment costs cut into profits – Target reported its highest store traffic and sales increases in 10 years while Walmart reported best 2 year comp sale "stack" over the same time
- Both Walmart and Target directly challenging Amazon by leveraging buying power of their extensive, highly efficient supply chains, physical store distribution networks, and solid repeat grocery and replenishment business from their moderate income suburban and rural shoppers – to directly compete on price while significantly beefing up their online presence and in-store fulfillment platforms...stay tuned

Big Box Stores

Home Depot	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
Net Sales ($MM)	$77,349	$71,288	$66,176	$67,997	$70,395	$74,754	$78,812	$83,176	$88,519	$94,595	$100,904
Gross Margin %	33.6%	33.7%	33.9%	34.3%	34.5%	34.6%	34.8%	34.1%	34.2%	34.2%	34.0%
Operating Income %	9.4%	6.2%	7.3%	8.6%	9.5%	10.4%	11.6%	12.6%	13.3%	14.2%	14.5%
Number of Stores	2,234	2,274	2,244	2,248	2,252	2,246	2,263	2,269	2,274	2,278	2,284
% Comp Sales	(6.7%)	(8.7%)	(6.6%)	2.9%	3.4%	4.6%	6.9%	5.4%	5.6%	5.6%	6.8%
% Sales DTC	N/A	N/A	N/A	N/A	1.8%	2.4%	3.5%	4.5%	5.3%	5.9%	6.7%

Best Buy - Domestic	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
Net Sales ($MM)	$31,031	$33,328	$35,070	$37,314	$37,070	$37,615	$35,831	$36,055	$36,365	$36,248	$38,662
Gross Margin %	24.5%	24.5%	24.6%	24.2%	25.1%	24.4%	22.5%	22.4%	23.3%	23.9%	23.4%
Operating Income %	6.0%	6.0%	5.0%	5.6%	5.5%	4.9%	2.9%	4.0%	4.4%	4.9%	4.5%
Number of Stores	873	971	1,107	1,192	1,317	1,503	1,495	1,448	1,416	1,363	1,293
% Comp Sales	4.1%	1.9%	(1.3%)	1.7%	(3.0%)	(1.6%)	(0.4%)	1.0%	0.5%	0.3%	5.6%
% Sales DTC*	N/A	N/A	N/A	N/A	N/A	7.2%	8.5%	9.8%	11.0%	13.4%	15.5%

- **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 expanded omnichannel capabilities**
- **Focus on home is a significant, lasting sales driver - as housing values recover and homeowners take on delayed improvement projects, replace appliances and add connected home technologies, "home equipping" portion of big box world positioned to prosper further**
- **With a brief pause in 2009, Home Depot has grown sales by over $23 billion over last 10 years...while adding only 50 stores and steadily increasing operating margins, and continues to aggressively buyback stock - $8 billion in 2018**
- **Best Buy continues to expand market share and improve profitability by focusing on connected home, expert service and solid omnichannel strategy despite competing in market dominated by highly promotional new product launches**

Warehouse/Dollar Stores

Costco	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
Net Sales ($MM)	$70,977	$69,892	$76,255	$87,048	$97,062	$102,870	$110,212	$113,666	$116,073	$126,172	$138,434
Gross Margin %	10.5%	10.8%	10.8%	10.7%	10.6%	10.6%	10.7%	11.1%	11.3%	11.3%	11.0%
Operating Income %	2.7%	2.6%	2.7%	2.7%	2.8%	2.9%	2.9%	3.2%	3.2%	3.3%	3.2%
Number of Stores	543	558	572	592	608	634	663	686	715	741	762
% Comp Sales	8.2%	(3.7%)	6.9%	9.8%	6.8%	5.5%	4.2%	1.0%	0.0%	4.0%	9.0%
% Sales DTC	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM

Dollar General	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017
Net Sales ($MM)	$9,495	$10,458	$11,796	$13,035	$14,807	$16,022	$17,504	$18,910	$20,369	$21,987	$23,471
Gross Margin %	27.8%	29.3%	31.3%	32.0%	31.7%	31.7%	31.1%	30.7%	31.0%	30.8%	30.8%
Operating Income %	2.7%	5.6%	8.1%	9.8%	10.1%	10.3%	10.0%	9.4%	9.5%	9.4%	8,6%
Number of Stores	8,194	8,362	8,828	9,372	9,837	10,506	11,132	11,789	12,483	13,320	14,534
% Comp Sales	2.1%	9.0%	9.5%	4.9%	6.0%	4.7%	3.3%	2.8%	2.8%	0.9%	2.7%
% Sales DTC*	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM	NM

*Online sales not meaningful – less than 1%

- Category is home to the fastest growing, least noticed, sector in retail – dollar stores
- Reflecting the worldwide need for value, Costco's sales have grown over $66 billion since 2007 with gradually increasing margins; reflecting the erosion in more rural markets, Dollar General has more than doubled its sales to over $23 billion since 2007 while tripling its operating margin
- Dollar General adding over 950 stores per year while renovating a similar number and adding 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; while focused on rural areas, expect Dollar Stores to target underserved urban communities in coming years

Quotes From The Front

"Boston has won so many championships out of the last 15 years that it's getting to be expected. So, you don't get as big a jump out of Boston as we once did."

DICK'S SPORTING GOODS

QUOTES FROM THE FRONT

Retailers on the current retail environment

"...as you get into the fall assortment, having the weather turn cold and ideally being relatively dry gets people into stores and gets people to start shopping for seasonal items...the general trends we see from the long-term forecast would suggest that they're going to be positive, which is relatively cool and relatively dry through most of the cold parts of country, which should support the business." (Gap)

"While the economy appears to be doing well, we know that our core customer is always challenged. With concerns about health care, inflation, rent expenses, and fluctuating gas prices, we know she remains very concerned about her budget. Our customers are at the center of everything we do, and we remain committed to serving them with the everyday low prices they have come to know and appreciate from Dollar General." (Dollar General)

"Where we're seeing the improvement in margins is around our traditional core competency, which is women's apparel and having a more accurate call on the fashion which has led to better sell-through and fewer markdowns. What has allowed us to do that? First of all, demand, because the economy is better and the fashion change, the demand for women's apparel and men's apparel as well has gone up. And then secondly, the brands have developed their speed to market capabilities...that give them a shot at being more accurate." (Urban Outfitters)

"With the increasingly blurred lines between retail channels, we have moved toward a channel-less world in which the empowered customer isn't focused on going into a store or buying online but rather transacting with the trusted retailer...when we open stores, we see massive web growth." (Zumiez)

"We've not seen anything per se going on in China that would give us any concern that we're not going to be treated well or we're going to be treated better...we've been working to reduce our exposure to China for many, many years. And where you see us now at 11% for our U.S. imports, we can lever that down if need be, or we can maintain." (VF Corp)

QUOTES FROM THE FRONT

Retailers on the current retail environment

"We like the trend that's going on in the mall. If you look at ShopperTrak information, and you look at traffic into apparel and accessory stores this year, it has finally flattened out roughly versus last year, versus four years of significant decline on top of decline. So, there's something going on in the marketplace, where people are saying, I'm willing to go back to the store." (Genesco)

"The mood is definitely changing…18-24 months ago, we met with retailers all the time, and the conversations revolved around traffic being down in the malls and online shopping killing the mall business, but fast forward 18, 24 months…these conversations are much different. The tenants are talking about their products and they're talking about the services they are providing…[t]he ones that are performing today took the last couple of years to really reinvent themselves, to figure out the revised shopping patterns and to figure out the new customer which is the millennial and the Gen Z. And in doing so, they are performing much better." (Macerich)

"But what we've seen, which is actually encouraging, is that the in-line sales are actually getting the benefit of the department store closures. And we're also seeing some of the other department stores pick that business up…maybe our industry got just too carried away with having all these big department store boxes." (Simon)

"So, you've got these regional malls that draw a lot of customers. And at the same time that we are really changing the chemistry and the content and experiences in these buildings, so are all our mall developers in these malls. And so what you see them doing is they're remixing their square footage. They're pulling out more apparel and accessories. They're adding more entertainment and food and beverage. They're making these more destinations. We're doing the same thing within our buildings." (Macy's)

"…consumer confidence is at an all-time high. People are feeling good. However, I don't think this is a tide where all the boats are rising. I think well-positioned brands that are executing are performing really well…moving forward, the biggest challenge in the industry is going to be the war for talent. Brands that can hire, train and retain frontline employees to bring their brands to life are going to win and the dynamics within the industry are changing dramatically." (Darden)

QUOTES FROM THE FRONT

Retailers on the current retail environment

"I think this fourth quarter will be as fiercely competitive as it's been in the past. So in terms of pricing, my expectation would be is that there will still be tremendous promotions, and that's what people would use to drive the business…obviously there's more money in the economy and so one would expect that consumers would be spending. But it remains to be seen." (Ross Stores)

"The recent performance of our U.S. footwear business highlights the importance of brick-and-mortar retail and executing a successful multi-channel strategy. In addition to our results, results from many of our industry peers paint a similar picture. They also show a growing divergence between companies that have invested in building the necessary physical and digital infrastructures to compete and win in today's consumer environment and those that have not." (Genesco)

"…let me just start by…making the statement that…Macerich is not alone in stating that they have plans to develop plans for Sears boxes and we all know this is something that has been a long time coming, and…you're getting back boxes which are in some of the most productive centers in the country. So I guess I'm a little disappointed that…there's a lack of definition as to how many of these boxes are going to…new anchors that will be added…that have wanted to get in for a long time and didn't have space available versus…boxes [that] can be…redeveloped at a much higher cost but theoretically at a much higher return." (Analyst BTIG)

"Obviously, our digital business is increasing pretty dramatically…our mom is a millennial customer and really focused on digital…[B]ut certainly, on the brick-and-mortar side, there is a lot of opportunity as well. 60% of our business still comes from malls. And as we detailed on previous calls, most of the stores we're in – about 90% of them – are in thriving fully-tenanted A and B malls. So we have a lot of competitors that are struggling in those malls, be they department stores or…specialty stores. Not every competitor is created equal, but there is a lot of kids share out there." (Children's Place)

"We've got 10,000 distribution points of distribution in communities all across the country. We envision a hub and spoke concept where as we've talked about the concept stores or some have referred to them as health hubs. So from a bricks-and-mortar perspective, I think we have the assets to create that local presence in communities across the country." (CVS)

QUOTES FROM THE FRONT

Retailers on the current retail environment

"...there are a number of things driving freight cost this year: very tight capacity, higher rates driven by trucker and driver shortages. The improved economy is obviously impacting capacity regulations around electronically monitoring drivers. And then diesel costs aren't helping that; they're up 20% year-over-year in the third quarter which is at 3 year highs." (Ross Stores)

"But freight, in general, I think is the driver shortage that's out there and the pressure we're seeing from that, we expect freight to continue to be up." (Dollar Tree)

"One of the things that is super important to us, as always, is country migration as about 50% of our product in ready-to-wear is made in China, we're continuing to look at new countries to produce, specifically in sweaters and in denim in Bangladesh, to really offset what could possibly be tariffs in apparel...we've gone from 65% of our products coming from China down to 50%." (RTW RetailWinds)

"...if you look at imports for apparel and accessories from China into the United States, the last statistic I saw, it's a bit of a moving target, is about 40% of imports for the U.S. market come from China. We are, as a company, we are below 20% of our production for North America. For U.S., it's about 17%, 18%. And we're constantly adjusting that. If you were to look at us three years ago, we would have been over 40%...So...if the administration makes a decision, we're going to raise all tariffs, we're going to do 25% and we're all going to do it on January 1, we got a problem in the short term in that there's no time to react." (PVH)

"...in working with our customers largely in Asia right now, we are seeing some movement in decisions around where they're actually manufacturing and moving supply chains in anticipation of what January may bring." (UPS)

"...the other thing I think people are making a mistake with is like trying to rush out of China, to rush to other countries. They're like, good luck with that. China is the biggest, most sophisticated manufacturing country in the world. There's no one close. Other countries are doing things better, but you can't shift all this business to Vietnam. You can't shift all this business to these little small countries without massive dislocation risk to your business." (Restoration Hardware)

QUOTES FROM THE FRONT

Retailers on the current retail environment

"…the brands are more [directly] competitive. Amazon…is…clearly our number one competitor…but I think the brand as competitors is a bit overblown as it relates to us and a few other key retailers, because the brands are very helpful in trying to drive our online business…we share information…and there is a real partnership there." (Dick's Sporting Goods)

"Amazon is a longstanding customer of ours. However, no one customer represents more than 3% of our revenues and Amazon is not our largest customer. Now Amazon and other customers of ours have certain elements of their logistics in-sourced to deal with capacity issues as well as inventory management. And while there has been significant media interest in what Amazon is doing to expand their in-source delivery capability, this should not be confused as competition with FedEx. The global infrastructure, the technology, the capabilities, knowledge that's needed to compete in our business is quite extraordinary, and we have built that up over 40-plus years." (FedEx)

"With regard to labor, we will absorb another California minimum wage increase as well as additional minimum wage pressures in other states, and continued wage pressure due to historically low levels of unemployment. We continue to expect wage increases in the mid-4% range for hourly positions, which is consistent with 2018. Therefore, going into 2019, I would expect that labor will be difficult cost to leverage for both us and the industry." (BJ's Restaurants)

"…we feel really good about the takeout business. The growth we think is significantly incremental…if you're not getting those take-out dollars, they're going to move to somebody else who offers the takeout option. So the desire for today's consumer across the demographics to find convenience and to spend a little more time at home is undeniable." (Brinker)

"We continue to test with the third-party delivery services…we're learning the business as it starts to mature. But for us there's significant hurdles that we still have to work through. We're not sure that it enhances our brands. We're concerned about how it is executed. We're concerned if it can create incremental growth at scale. We're not happy with the economics." (Darden)

QUOTES FROM THE FRONT

Retailers on the current retail environment

"My understanding is there is a little extra backup in China, in Shanghai, but not a heck of a lot there. And part of that is, every extra container that was out there, merchants like Costco were filling them to bring in things in anticipation of certain tariffs going to 25% on January 1. Can I interest you in some patio furniture?" (Costco)

"The tenant pool which clearly shrunk in the 2016, 2017 period is now starting to grow again with all these very interesting tenants. And where do they want to be? They want to be in the best asset, and that's what we have." (Taubman)

QUOTES FROM THE FRONT

Retailers on Omnichannel Retail, Mobile and Supply Chain

"[BOPUS] is the customer choice. As a customer focused, customer obsessed company, we're not going to try to make the decision for the customer…there's a unique benefit of picking up in-store. You can get it in less than an hour, so speed is pretty great knowing that 30% of the U.S. population lives within 15 minutes of a Best Buy store." (Best Buy)

"We have a young customer, they're digitally native, they're practically born with a screen in their hand. They just don't get more connected and we need to make sure we're providing them an experience that delivers on their expectations and beats their expectations…" (Footlocker)

"The consumer, as we all know, wants their product how they want it, when they want it and deliver it the way they want it…we've been very focused on improving our speed and…our goal is to get to the vast majority of our customers within two days. To do that, we just need to make sure that we have the right inventory in the right place around the country. We're leveraging our entire store network and we're building these many fulfillment centers…so we can take the speed question off the table." (Dick's Sporting Goods)

"…retail turbulence has been further challenged by the implementation of new privacy and data protection regulation commonly referred to as GDPR, which, as with many companies with European operations, has significantly reduced our database of guests and severely inhibited our ability to collect new subscribers or directly communicate marketing messages to guests…" (Build-A-Bear)

"…when it comes to [cost] mitigation, we are just continuing to learn through our data where best those orders are fulfilled. And in an omni world, when you have your choice of coming directly from the distribution center, directly from the closest store location or from the store location where the product is in-stock, what is the best financial return for the customer to deliver that product and we're working through all of that now." (Chico's)

QUOTES FROM THE FRONT

Retailers on Omnichannel Retail, Mobile and Supply Chain

"In terms of mobile, that's been a key driver of our eCommerce trends…Faster load times, more curated shopping experience, more personalized pages. And…we think that the combination of a strong eCommerce experience with our store footprint creates a competitive advantage of omnichannel because we know that customers have an integrated shopping journey. They're back and forth between mobile and an in-store experience before they make their purchases." (Signet)

"…there's no question that speed-to-market has helped us not only stay lean on the inventory side, but being more on target with the inventory we do bring in. Of course, the closer you can get, the more accurate you can be because you'll have more information to make the call." (Urban Outfitters)

"Yes, there can be cannibalization between online stores but it can also complement [regular stores]. And we see the more and more integrated we get, we get the possibility to increase online sales in our physical stores and drive physical store sales through the online store. So we believe very much in this fully integrated model that we are rolling out to all markets now." (H&M)

"…the outsized growth of our digital business has caused low levels and stock-outs of e-commerce inventory and has forced us to make brick-and-mortar inventory available to our digital customers online in order to meet their demand. Our capability to fulfill online orders from the store inventory was tested during various points of the year." (Children's Place)

"…we are continuing our dialogue with Amazon. We are very clear on the four key principles for us to participate in pure play business. They haven't changed, right: brand building presentation; pricing integrity; making sure that no non-authorized third-party sellers or counterfeit products are available on the site; and working with the partner on access to consumer data." Ralph Lauren

QUOTES FROM THE FRONT

Retailers on Omnichannel Retail, Mobile and Supply Chain

"...bulk of what we've done this year is back to fixing the fundamentals and basics of digital...It's not just e-commerce. It's not just mobile growth, which obviously has potential, but also the connection of these elements to our in-store associates. So if you look at Saks, part of its success is giving our associates tools that really enable them to serve customers in better ways and find products for them and get them to them as quickly as possible." (Hudson's Bay)

"...a lot of retailers are moving their inventory closer and closer to customers, they've been doing that for many years now. It's important to note that for us at FedEx, especially FedEx Ground, that the average package at ground, whether it's B2B or B2C, is between 64%, 65% delivered in two days or less for us today." (FedEx)

QUOTES FROM THE FRONT

Retailers on Stores

"…we're more interested in going into power centers, strip centers overall, but we have taken advantage of some of the Sears closures where we'll take a piece of a building and somebody else will take another piece of the building…I think K-Mart is probably more of an opportunity for us because they're in very good locations…there's just a lot of opportunity out there for real estate." (Burlington Stores)

"…what you have seen us do over the last several years…is building a more agile model to be able execute a retail brick-and-mortar strategy tailored to each market in the most effective manner. And what we're seeing on these co-located and experiential stores is more a next chapter in our retail journey, where we're going to be able to create exciting space for us to introduce new product categories powerfully, and well as create new in-store experiences for our guests." (Lululemon)

"We are a mall-based retailer. We have to find ways to win in the mall, clearly some of our competitors are demonstrating solid results in the mall and we do see certain mall locations that are frankly outperforming off-mall locations, so I think…we've got to be able to do both." (JC Penney)

"…we think there's a tremendous amount of runway still to open up stores in the continental U.S. So, again, a little bit more driven toward the rural communities, but yet over time, we believe that opening more and more stores in metro is the right thing to do." (Dollar General)

"What's happened over the last year with the going out of business of a key store has given us an opportunity to bid on choice real estate that really fits our model in a nice way." (Big Lots)

"We get more favorable lease terms in terms of duration of the lease as well as significant reductions to the previous lease that we had in place…we can leverage B&O [buying and occupancy] at flat to negative low-single-digit comps." (Express) "

QUOTES FROM THE FRONT

Retailers on Stores

"The shape of our comps is very positive in the sense that brick and mortar has found its legs again. For the past two years or so, we've been calling out the fact that comps that tilt too heavily digital are dilutive, simply because there's more variable cost in the digital business, and its more of a fixed cost business with small box retailing in particular. So, the fact that we are seeing some really nice brick and mortar gains, if we can sustain that, that's a plus. It makes the sales increase that much more effective on the bottom line." (Genesco)

"We continue to have a lot of lease flexibility with 60% of our U.S. leases expiring by the end of 2020. That flexibility has allowed us to do a number of things. It allows us to continually evaluate our fleet. It does allow us to negotiate with landlords on stores that are maybe non-performing or underperforming economically. We have had some successful negotiations…[w]e are very focused on driving productivity and the tools that we have at our disposal include not just store closures but right-sizes and investments that we're making to improve the experience, and we've seen those investments pay off in terms of productivity." (Abercrombie & Fitch)

"…the availability and opportunistic situation is very strong right now and we're taking advantage of it. We're just being careful on being too oriented toward a specific number of how many stores we want to open. We're going to stay pretty opportunistic. The environment's yielding a fair amount of real estate." (TJX)

"…we've never liked being out of town and trying to drag people to us. So we will look for busy malls. I think it's particularly important that we don't rush in the States because there is greater uncertainty about the malls now and in the future. I'd rather err on the side of caution there." (Primark)

"…given the ongoing traffic challenges and changing consumer shopping patterns, we have been in the process of evolving via more tourist type locations where today's families with younger children prefer to go shopping and for entertainment while maintaining our real estate opportunity with a systematic process of securing short-term favorable lease extensions in select malls." (Build-A-Bear)

QUOTES FROM THE FRONT

Retailers on Performance and Strategy

"...we believe that this year will establish a sustainable benchmark for our operating margin rate over the longer term, as we achieve a balancing point between the rate pressure and opportunities of operating an omni-channel retail business." (Target)

"...what I'm telling you and what I want everyone to hear is this is not a growth story, this is a contract to improve overall profitability and return on invested capital story." (Gap)

"...the lever point is still mid-single digits, but we do look for these investments [in technology] to pay off...on the marketing side it is an advantage to have greater technological capabilities because it allows you to be really thoughtful about your marketing efforts and measure the return on it. Both what you do digitally and the ability to connect digital with driving traffic into the store, you can measure back to specific marketing events." (Footlocker)

"We had another strong quarter of execution and we're off to a solid start for the fourth quarter. We remain on track to deliver improved results this year, including top-line growth, gross profit rate expansion and operating expense leverage for 2018. We continue to focus on transforming our operating model to deliver the best customer experience in a rapidly evolving retail environment." (Abercrombie & Fitch)

"...there's lots of stuff going on here, guys, and I think we're less worried about was gross margin 5 or 10 basis points different than it could have been. It could have been a lot better than what we did. We don't like at it that way. We look at what we can do to drive our business, and we still want to make money. We still think long term we're creating a stronger and more loyal company." (Costco)

"The biggest evolution you've seen in our stores...is trying to have people understand what a connected home...can do for them. The growth opportunity for us is not driven specifically by a particular product launch, it's driven by the opportunity to expand the relationship with the customer." (Best Buy)

QUOTES FROM THE FRONT

Retailers on Performance and Strategy

"…our traffic has been up for eight quarters in a row…the other is we've been able to drive positive traffic to the store without giving the store away, which is consistent with what we've done really for the past three years, we haven't run this give the store away, BOGO, whatever, the whole store." (Tilly's)

"As we look across the landscape, it's becoming clear that those of us who have the resources to invest and the ability to adapt quickly are seeing the benefit in our traffic, sales and financial performance. For us, it's a vivid reminder of the benefit of maintaining a strong balance sheet and sound operations, while also maintaining a relentless focus on our guests and their expectations." (Target)

"I'd like to think about what's the addressable market space by category, by price points for our brands…I do believe that the specialty space that Gap occupied when we had close to 1,100 stores in North America that that space has contracted somewhat. And some of that has gone to value, some of it may have gone to premium. Part of rightsizing the fleet and frankly walking away from some significant amount of unprofitable top line is recognizing the size of the market that Gap can play in." (Gap)

"…with the tax savings we got, we wanted to reinvest. We want to reinvest to give better service in our stores. I think we're very proud when you walk in the malls and you look at the condition of the stores and you look at the merchandise displays, I think we're the number one looking store in the malls today. We're one of the few retailers that didn't cut back on service, we've improved our services…Because at the end of the day, the customer today expects everything. They expect a great on-line experience as well as in-store experience." (American Eagle)

"…we want to appeal to a wide range of customers and that applies to demographics, income levels. That applies to fashion desire. So in other words, we don't want to have all our mixes in one direction. We don't want to represent – unlike many retailers that will specialize, go after one demographic or one type of customer – we want to trade broadly and have as many customers as possible." (TJX)

QUOTES FROM THE FRONT

Retailers on Performance and Strategy

"With the barriers between the physical and digital worlds coming down, and increasing speed at which individuals communicate, trend cycles are rotating faster than ever before. The same holds true for the pace at which demand for emerging brands can go from local to global in nature. In this type of environment where consumers can access so much information, a new level of transparency in retail is being created that drives out inefficiencies within the market and forcing consolidation in the industry." (Zumiez)

"…with much more competition, we want to make sure we're focusing our dollars on people who look more like those best customers of ours…a partnership with weight watchers is a great example of what we believe are more high affinity customers who have certain dietary preferences…we want to avoid spending a lot of money on customers who are likely not to be highly engaged and maybe come in and out pretty quickly because we believe that's not a great business, a sustainable business going forward." (Blue Apron)

"…we continue to see good traction with brands and we continue to evolve our brand experience so brands have a comfortable place to sit within the eBay marketplace. And the number of brands continues to grow because brands want choice. They want to sell on a marketplace that now has 177 million customers and doesn't compete with them." (eBay)

"Q: so…even if you continue this rate of sales growth, expense leverage should continue to be modest? A: Well, we'll see. I mean, we never want to predict where it's going to go. We are clearly a top line company…I think I'm beating around the bush because, A, we can't really tell you where and when. We feel good about building to accommodate even more growth in e-commerce and on the delivery side. And we know that we'll see some of those costs associated with that to come down as a percentage of those sales. But we're not going to tell you when. It'll take some time." (Costco)

QUOTES FROM THE FRONT

Retailers on Sears and Redevelopment

"At Kings Plaza in Brooklyn during the third quarter, we had the grand opening of the $100 million redevelopment...where we recaptured the Sears box that was doing under $30 million in sales...[and]...significantly improved the overall tenant mix of the center with the addition of Primark, JCPenney, Burlington and Zara...[that] in total are expected to do over $100 million in annual sales." (Macerich)

"...we're putting Sears in our rearview mirror...we think it is a unique opportunity. We're going to redevelop this. We're going to generate positive momentum with the properties due to this. We're going to reinvest in the communities. We're going to be able to drive traffic out of now from this box. Put all of that aside, we're going to be able to make money on this...obviously, we're planning for the ultimate unfortunate demise of Sears, and we're ready for it. We have the balance sheet and the capital with the intellectual and human resources to deal with these sets of events." (Simon)

"...at CoolSprings Galleria in Nashville [the] year after we replaced Sears we had an 18% increase in sales for the entire center. We were able to add Cheesecake Factory and more recently California Pizza Kitchen to the mall...[i]t really helped the property and it helped the area where Sears was. We're doing roughly five times the amount of business and sales out of that box than what Sears was doing." (CBL)

"What we're not clear on is when we're going to get these assets back...so until we know the ultimate outcome we're not going to get too specific on exactly what we're going to do." (Macerich)

"...when we get back one of these department store boxes, it's more than just 150,000 to 200,000 feet, it's anywhere from 10 to 18 acres adjacent to some of the best real estate in the United States. We are very focused on what we can do with those 18 acres. And you are going to see an accelerating amount of activity in a number of our properties." (Simon)

"If there's 125 malls in GGP, ideally where we'd like to be over some reasonable time period is down to maybe 100 of them we think have the best long-term outlook to them. And in each case, all of 100, we think that some element of mixed-use is in their future...effectively turning them into mini-cities is really how to future proof all of these assets." (Brookfield)

QUOTES FROM THE FRONT

Retailers on Sears and Redevelopment

“No question the closing of these boxes is disruptive in the short-term, but because of the prime real estate they occupy, I am 100% confident that this also represents a once-in-a-generation opportunity to transform our properties from traditional enclosed malls to suburban town centers that include fashion, value, dining, entertainment, fitness, service and other mixed uses such as hotels, residential and office – the type of properties that today’s customer desires.” (CBL)

“We will no longer be a traditional enclosed mall company, instead we will be a company with a portfolio of retail-focused suburban town center mixed-use properties that are dominant in their markets.” (CBL)

Questions?

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

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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.).