# Company Participants

- Chen Grazutis, Apparel and Footwear Analyst, Bloomberg Intelligence
- Jitendra Waral, Internet & Consumer Electronics Analyst, Bloomberg Intelligence
- Joshua Wright, Economist, Bloomberg Intelligence
- Michael Halen, Food and Restaurants Analyst, Bloomberg Intelligence
- Poonam Goyal, Senior Retail Analyst, Bloomberg Intelligence
- Seema Shah, Consumer Discretionary Analyst, Bloomberg Intelligence

# Presentation

## Chen Grazutis {BIO 16090672 <GO>}

Good morning everyone and thank you for joining us today for this Bloomberg Intelligence Preview for the 2015 Holiday Shopping Season. My name is Chen Grazutis, and I'm the Apparel and Footwear Analyst here at Bloomberg Intelligence. With me today on the line are Poonam Goyal, which is our Senior Retail Analyst, and Seema Shah, Michael Halen and Jitendra Waral, who cover consumer names in a variety of sectors from Internet retailers to jewelry and home improvement. We also have Josh Wright on the line with us, who is our BI Economists.

Before we begin, a few housekeeping notes. Today's presentation will be recorded and available for playback. At the bottom of the slide window, you will notice that you can adjust volume and maximize your screen. We recommend you maximize your screen for best quality. Feel free to ask questions using the Q&A panel to the right of the slide. We will address questions at the conclusion of the presentation. A copy of the slide will be distributed via email following the presentation and additional questions can be sent to bievents@bloomberg.net.

For those of you, who are not that familiar with what we do here in BI, I'll provide a quick intro. Bloomberg Intelligence provides unique analysis and context on industries, companies and government, litigation, economic and credit factors that impact businesses, all integrated within the Bloomberg professional service. BI coverage spans over 130 industries and 4,000 companies globally, we produce data-driven research powered by our own datasets and over 300 third-party data providers. Our analysts average over 20 years of buy and sell side research experience. We are neutral. BI Research does not provide buy or sell recommendations, we give our clients the information they need to make knowledgeable investment decisions.

Terminal users can explore Bloomberg Intelligence by typing BI Go in the command line.

And with that, let me turn it over to Poonam to give us a quick overview of the topic in hand. Poonam?

## Poonam Goyal {BIO 16489913 <GO>}

Thanks, Chen. So the largest shopping season of the year Christmas is just around the corner, less than 40 days to Christmas and Black Friday week begins next week. How will the season shape out? Will shoppers shop and will retailers make their topline estimates without jeopardizing margins? We, the Bloomberg Intelligence consumer team see sales growth over last year levels, some margins may remain pressured. Sales should materialize from higher consumer confidence and extra selling day between Thanksgiving and Christmas and the rise in online shopping, retailers' optimism for sales is also evident in increased holiday hiring.

Margins still may come under pressure from rising freight costs, a warmer winter that may prevent till this cold weather apparel, increased payroll costs and higher promotions as retailers battle each other for market share gains. So what happened last year in holiday? Last year holiday sales advanced 4%, according to the NRF. This year's estimate spanned from 3.3% at the ICSC or the International Council of Shopping Centers to 5.7% by eMarketer, NRF is at the middle at around 3.7% growth. Much of the increase in holiday sales that we are seeing from these estimates is expected to come from rising ecommerce sales, which eMarketer expects to grow 14% over last year.

Risks to attaining these stats or these sales forecast may include a risk of the US government shutdown, any economic or job growth hiccup, a steeper deceleration in tourism if the dollar continues to get stronger.

I'll turn it over to Josh to give a little insight on to the consumer outlook.

## Joshua Wright {BIO 17944409 <GO>}

Hello. Stepping back to the macro perspective, focusing on the domestic outlook, there have been some signs of deceleration in consumer spending recently if you look at the September personal consumption expenditures reports and the October retail sales report. But despite that, our view is that the fundamentals of the US consumer remain quite solid. So we're just going to go over a couple of those factors and some of the recent trends.

The first slide, you can see here the real consumer spending has remained above 3%, now not quite as high as what we saw in -- on average in 2014. It's still higher than most of what we saw over the prior five years and certainly above what the five-year average was.

Compared to what we've seen over the last couple of decades in this larger historical perspective, this kind of growth is unspectacular but it's still quite solid and it's not hard to identify some of the reasons why that might be gas and energy prices have remained low, consumer balance sheets have improved greatly since the time of the great recession with new foreclosures down sharply, mortgage delinquencies down, home equity restored and while there are some concerns about student loans and auto loans. Overall, the consumer appears to be in much better financial shape.

Turning to the next slide, you can see that going forward; one of the key drivers of the consumer behavior is likely to be job growth. And here, the recent results have been pretty encouraging. It's tempting to tribute the recent deceleration in consumer spending to the soft patch we had in August and September job growth, but October was certainly very reassuring to see the sharp rebound in nonfarm payrolls. And along with jobs themselves, you can see that aggregate income has been rising and that income is going to be what will drive the actual spending by consumers.

The other thing that is notable about the jobs outlook is that the performance there seems to be driving, what's going on in consumer sentiment. So although consumer sentiment like job growth has come down a little bit from the highs [ph] seen at the end of 2014 and early 2015, it's still quite solid. And in the latest report of University of Michigan Survey, there were some interesting details suggesting that most of the recent improvement after the soft patch in August and September had come from the bottom two-thirds of the income distribution, which is interesting because that's the portion of the population that is much more exposed to the labor market in terms of what drives their consumption behavior relative to the top third of the income distribution, which is more exposed to financial markets.

So that's the fact that (inaudible) have rebounded, supports the idea that these lower end consumers are going to continue spending pretty well and that seems to be a positive for discount retailers, such as Wal-Mart, Target and Dollar Stores.

So going forward, we expect that in the macro perspective, it's really going to be about the jobs numbers because the -- we don't expect there is necessarily going to be great movement in upwards in equities (inaudible) hikes.

## Chen Grazutis {BIO 16090672 <GO>}

Thanks, Josh. So one of the biggest issues we are following in the last few months were the strengthening of the US dollar versus foreign currencies, in particular we were following the Euro and the Chinese Yuan and the movement there. Now, a lot have been said already about brands and global brands that has significant amount of their revenue come outside of the US, over there you still -- obviously because of the strengthening of the dollar, when you translate those sales numbers into US dollars, you probably going to get some unit growth and that was accounted for by analysts and investors.

Another issue is threatening of the US dollar, it's obviously the tourism, and how it impacts tourism, specifically coming into the US, when the dollar gets stronger, obviously, it's harder for tourists to come here, it's more expensive for them. Now we have to keep in mind that in terms of looking at the full-year, fourth quarter is not the highest in terms of visitors coming into the US. That happens usually around summertime and the number of tourists coming into the US. But the fourth quarter is still -- has a significant number of visitors coming here and shopping in retail stores.

The American numbers, we don't have them as of late, but we do have some numbers on the Chinese side, and if you look at the third quarter, number that came out, Chinese tourism into the US was down 12% and that's the first decline that I've seen in a very long time. So we can expect the same trend with European tourism as well.

And what it does, if you're a retailer and you have a exposure to the metro cities in the US where you have outlets in a lot of tourist destinations, retailers like big department stores or specialty apparel and Tiffany's, those kind of retailers has exposure to those big tourism destination and you can expect much lower traffic during this time of holiday and as a result of lower sales. We are expecting this challenging trend going into the fourth quarter, maybe continue in the first quarter and it definitely becomes as a negative and it's been said last week that some of the department stores are negative to traffic and negative to sales.

Switching a little bit and talk about timing of the holidays this year. Usually -- historically, we look at the number of days between Black Friday and Christmas, -- I'm sorry, -- just in terms of the timing of the holidays, looking how many days we have Black Friday and Christmas, and last year we had 27 days, this day -- this year we have 28 days. So we see a little bit of tailwind there in terms of the number of days, you have one extra selling day, which can be looked as a positive for retailers.

But a couple of caveats there. First of all, Christmas this year falls on a Friday, which can be looked as a little bit of a negative, it takes the urgency out of the prior weekend to the holiday and kind of lift the last few days before Christmas being regular business weekdays. So that's a little bit of a negative. On top of that, last year we had Hanukkah and Christmas very close to each other, which created this momentum going into the last week before Christmas, we don't have that catalyst this year, Hanukkah falls much earlier in December 6th, which creates somewhat of a wall between those two kind of large holidays in terms of shopping.

So all in all, one extra selling day, which is a positive, partially offset by a Christmas falling on a Friday and Hanukkah being a little bit separated from Christmas.

And with that, I just want to move to Seema to talk about Black Friday itself.

## Seema Shah {BIO 18919310 <GO>}

Hi, thank you. Black Friday remained the biggest spending day of the holiday season, but lately, in recent years it's important that it has been declining overall within the holiday season, with the growth of e-commerce and as promotions are beginning earlier and lasting longer. Overall, since the recession, the retail market has been more promotional and consumers have been spreading out their holiday shopping throughout the year, with over 14% of their consumers beginning their holiday shopping before Halloween, according to the NRF.

So, as more and more people, I think through today, I think over 56% of people have already begun or more than halfway completed with their holiday shopping. So, all

Black Friday remains very important, it's not the only day to get a deal or to get a discount and particularly with the growth of e-commerce, people can shop whenever they want and when it's most convenient. And 2014 Black Friday sales declined 1.6%, though the whole weekend sales were up 90 basis points according to MasterCard and a lot of this was driven by retailers being open on Thanksgiving Day itself, which is a new phenomenon in the last three to five years, and last year Thanksgiving Day sales were up 3.3%.

## Chen Grazutis {BIO 16090672 <GO>}

Thanks Seema. Just jumping on weather a little bit. Well, a lot of people said, the weather this year and how -- it's warmer than usual. It is well documented in the media this year, as we have a strong El Nino, which usually is characterized by a warmer and drier weather in the Northern part of the country versus little bit colder and wetter when you talk about the Southern part of the country. And so far, we've seen this -- what was expected before the season played out pretty accurately, September and October with much warmer in the US than the normal levels, and so far, we have a mild November. What it does to inventories when you have -- if you are a retailer with a large exposure to apparel merchandise, you have most of your inventory sits on the floor starting in September. If the weather is not cooperating in September and October, you might be pressed to start discounting this inventory and move it, as you approach the holiday.

In addition, a lot of the retailers have orders already set up for some of the weather related merchandise for November and December. So you might be able to postpone it or even cancel it, which can hurt further up the supply chain. And that's what we kind of seeing right now and last week if you follow the department stores earnings call, some of them attribute the weather as a big impact to their inventory pick up and slower sales. Obviously, it's really hard to predict the weather, but it seems like so far this trend has been holding up and it's warmer than usual. So definitely a negative there.

There is one positive, there is silver lining that I would like to mention, if you are a retailer to have the smaller exposure to apparel, you might be better off. If you're talking about Discounters, if you're talking about Dollar Store's, or even jewelry, I'd say, furniture, or warmer and dry weather, that might motivate shoppers to go out and actually shop at physical stores as supposed to sitting in home and shop online, while it's snowing outside. So if there is a silver lining that might be hit. It still going to hurt, if you're a retailer, that sells a lot of apparel, it's definitely a negative. So that's a little bit about the weather.

I'm going to shoot it back to Seema to get us over to some stats [ph].

## Seema Shah {BIO 18919310 <GO>}

So I just wanted to talk a little bit about toys this year. Toys along with clothing and fashion accessories will be our top three categories for holiday this year. Hi-tech toys include maybe a smart teddy bear from Metal [ph] or Star Wars product, particularly items such as a lightsaber, any other Star Wars theme to merchandise. Other top toys this year maybe LEGO [ph] and video games.

So far through September of this year, US toys sales have been up over 7% and its projected to end the year up 6% year-over-year according to NPD. The toy industry has been relatively stagnant recently around 21 billion, so this is a huge opportunity for the industry. Star Wars in particular will be driving a lot of the sales and expected to drive up to 1 billion in toy sales according to Jim Silver of TTPM.

So toys are very important and the strong growth in toys will be a boon to struggling retailer toys arrest, as well as other retailers with a large toy presence such as Wal-Mart, Target and Amazon. Other beneficiaries maybe someone like Hasbro, who is the maker of the Star Wars-themed toys.

I just wanted to jump in a little bit about give you more detail on commerce. While there has been a lot of discussion as to how large total holiday sales will be this year, there's no dispute in the importance of e-commerce. According to eMarketer as Poonam mentioned, e-commerce sales will we up almost 13% to $18 billion this year with penetration increasing to 9%. Online sales continued to be driven by convenience, larger product assortments and mobile shopping.

As smartphone penetration has increased to over 70% in the US and screen sizes of phones have increased, making them a little bit closer to tablet size, mobile commerce has continued to grow as more convenient and easier for people to shop online. M-commerce should grow 32% in 2015 and may be up to 25% of US e-commerce transactions by the end of 2016.

I'm going to pass it over to my colleague Jitendra; he's going to talk a little bit more about social media commerce. Jitendra?

## Jitendra Waral {BIO 15423976 <GO>}

Thanks, Seema. I'll briefly touch on the social media, Amazon and mobile commerce with the holiday season in context. Social media will play a prominent role this holiday season but the buy buttons that Twitter and Facebook are pitching may take some time to gain traction with consumers. Most of social media use for this holiday season will be product research and discovery as a Deloitte's survey, you see on the screen indicates, where shoppers -- because shoppers regard quick and free shipping as the shop criteria for their online purchase decision.

So competitive threats to likes of Amazon from social media companies may be lower in the near-term until the logistics issues are resolved. Only 9% of US Internet users are expected to shop online directly on social media sites this holiday season according to an eMarketer survey, so that should give you some indication of what the near-term impact from social media would be. But for e-commerce giants, the outlook seems more optimistic than retailers with three key factors helping Amazon's core business.

So number one, prime subscriber growth with free trials during the holiday season may help raise their prime install base. Number two, this Fulfillment by Amazon program, or FBA, its expanding Amazon selection and channeling those products of the prime consumers, who spent significantly more. FBA may expand selection under the prime umbrella this holiday season and that also helps drive sales.

To put things in context, Amazon's total e-commerce market share in the US has surpassed 30% over the trailing 12 months. And this is being helped by its third-party unit sales and mostly by the FBA program. A survey by EYTM [ph] Research for prime members in the US, show that 45% of US prime members place order on Amazon a few times a month, about 20% at least once a week. So that sort of gives us some context about why this holiday season is going to be so important for Amazon to push its prime installed base.

Moving on to mobile. Mobile will play a significant role this holiday season, with usage surging and -- but the apps are going to play a very critical role. Apps account for about 58% for mobile commerce transactions today, a number which should rise with concerns about ad blockers coming up, because apps are less susceptible for ad blockers to change the user experience. Structurally consumers are spending more time with an app, so if your experience within apps are hindered, the sales might get impacted, smartphone users are spending 86% of their time in apps according to Flurry Analytics report. So apps are going to be very critical.

So three things to keep in mind this holiday season, social media risks to e-commerce giants maybe limited on logistics concerns, prime subscriber growth will be the focus for Amazon, it should benefit from its FBA program and apps are going to be very critical for sales as mobile commerce continues to rise.

I'll turn it over to Seema to talk a bit more about ad blockers and its impact.

## Seema Shah {BIO 18919310 <GO>}

Thank you. I just wanted to continue a little bit more what Jitendra said, about the use of ad blocking technology, which is essentially a technology on a browser or an app that filters, changes or removes an ad from the webpage.

Use of ad blockers is at 48% in the US for 2Q according to Adobe. Overtime as penetration of this type of technology grows; retailers could be negatively affected as their ability to advertise and promote their merchandise may be hindered. This will probably hurt their ability to drive market share and businesses whose online presence is funded by advertising will also be negatively affected.

Thus far, ad blocking penetration on mobile has been limited, but longer term, this is a negative to retailers as Jitendra said, such as Bed Bath & Beyond, Pier 1, Williams-Sonoma, Target, and Macy's and others that are depended on online and omnichannel strategies to compete with players such as Amazon. Especially critical as consumers are expected to complete 46% of their shopping -- a holiday shopping online this year, up 200 basis points from last year according to the NRF.

Poonam, I'm just going to turn it over to you now to talk about holiday hiring.

## Poonam Goyal {BIO 16489913 <GO>}

Thanks. So, we've heard a lot about mobile, tablet and online sales contributing to holiday sales this year, but what we now focus on is a brick and mortar part of it mostly, which is, our retailers are staffed to meet the growing demand for both online sales and in-store sales?

And if you look at this slide here, you can see that most retailers are staffing more personnel for the holiday season this year than last year with the exception of Toys "R" Us and JCPenney. On average excluding those two, there will be a 13% increase in seasonal hiring. But what's more important on this slide, if you focus your attention to the last column, as the percent of change in average employee versus last year and you can see here that we have an increase of 30% cold [ph] which is pretty significant and it's a combination of what we think to be more online sales, so staffing -- employees, not only at the stores, but also at the distribution centers and since stores have now mostly rolled out by online pickup in-store, they do need to also fulfill demand by hiring more people there and recently you probably have seen Target's new launch of Curbside, which also demand associates to be staffed to fulfill orders for any drive-ups that may come up.

So the optimism is definitely there for holiday hiring and that suggests the holiday sales should increase over last year, but with Penney's and with Toys "R" Us, I think just cost-cutting initiatives are probably holding them back from hiring more seasonal employees.

## Seema Shah {BIO 18919310 <GO>}

And I just wanted to talk a little bit more about the delivery option and how that affects online. As e-commerce penetration is rising, delivery choices are increasingly critical part of consumers' decision-making process. Their ability to buy online or pickup in-store, receive free shipping is driving 47% of consumers' decisions as to where to shop online this year.

As free shipping is the key driver of online traffic, particularly for millennials, who are focused on same day delivery. Retailers must offer these incentives to drive traffic to their sites and convert sales, often at the expense of gross margin. This holiday, many retailers are offering free shipping on all purchases, including Target and Best Buy, though the largest retail Wal-Mart has maintained its free shipping over -- on purchases only over $50, and instead its pushing consumers to buy online and pick up in the store, which will hopefully for the them drive incremental or impulse purchases and save on gross margin. But overall, many retailers are finding that the free shipping is necessary to drive traffic but it comes at a cost to them on the margin line.

And then Poonam is going to talk a little bit more about some of these other expenses that retailers are facing.

## Poonam Goyal {BIO 16489913 <GO>}

Yes. So, Seema talked about just increased online shipping that retailers are offering by offering it for free. But it comes at a cost and it will hurt retailers' margins. We saw that UPS and FedEx are both boosting holiday hiring, which suggest that there will be increased packages being shipped. But if you look at the next -- if you look at it, FedEx plans to add up to 55,000 employees for the season, and UPS is adding twice that 95,000 seasonal workers. So that's a lot of people delivering packages and until we have grown we'll probably continue to see more seasonal workers hired by UPS and FedEx to meet this growing or the surge in demand for online packages as it save consumers time to go to the store and really just helps get the package to them more conveniently.

For FedEx and UPS, if you look at the next slide have also raised their rates. So they continued to increase rates for about -- at least two to three years now about 5% each and that's pretty significant for retailers to absorb. So I don't think they'll be able to offset it, since they're offering free shipping for most orders and -- or at a low minimum at $50 or $100. So it definitely will hit their bottom line, FedEx raised (technical difficulty) by 4.9% and ground packages and so did UPS and that will continue to happen, especially as cost increase per them to staff, these workers and there is still a trucker shortage in the US.

So they are paying premium wages to these truckers who are driving the packages to the consumers and (technical difficulty) need to hurt retailers margins as they continue to pay more, they continue to ship more, we probably will continue to see gross margins being pressured and that's in the holiday season, and probably through 2016.

I'll now pass it over to Mr. Chen [ph] to talk about just teen exposure.

## Michael Halen {BIO 18797919 <GO>}

Hi. Thanks, Poonam. Yeah. Among the linear problems US department stores are facing, including some of the ones we've spoken about like weather, the slowdown in tour spending and most importantly, the excess of inventory that they have going into 4Q, exposure to oil producing regions may be another one. Oils had drastic decline. Over the last year, it has caused oil producers to cut back on spending and there has been some talk that Texas's economy is diversified, but restaurants with exposure to Texas or Louisiana and Oklahoma, including Brinker, Del Frisco's, Buffalo Wild Wings and Texas Roadhouse have all cited weakness in the September end quarter.

So the department stores with the most exposure would be stage stores with 38% of their stores in the region and Dillard's, who reported a 4% same-store sales decline this morning, with 28% of their stores in the region. In terms of the department chain, smart (inaudible) store chains with less exposure, Nordstrom's only has about 7% of their stores in the regions and Kohl's just about 9%.

# Questions And Answers

## A - Chen Grazutis {BIO 16090672 <GO>}

Thanks, Mike. We'll give a minute here to kind of line up some questions to the speakers. We have one, that we got during this presentation. And I think I'm going to let Poonam answer this one, I think it's kind of relevant to her coverage.

Some of the recent retailers have reported 3Q earnings show up an uptick in inventory levels in 3Q. How do you see this plays out during the holiday season and even beyond that going into 2016? So a question about inventory levels going forward. Poonam?

## A - Poonam Goyal {BIO 16489913 <GO>}

Thanks, Chen. So, we obviously don't want to see an inventory built heading into holiday. Retailers are obviously going to be promotional on the current inventory that they have planned and now they only have more to add to it. So it's definitely a negative for the holiday season and if holiday demand doesn't exceed current targets of mid-single-digits, then we're probably going to see excess of inventory into 2016, which then will hurt 1Q margins as well. So it's a negative in total, 4Q probably worse than 1Q.

And if they can't pull orders back, which at this point, with just making sure they don't have shipment delays or anything. Retailers probably have most of their holiday inventory in stores and are just playing catch up. This inventory average [ph] is going to hurt their margins and it could probably result in more promotions earlier than we would expect if the weather continues to be warm and retailers continue to pile inventories.

## A - Chen Grazutis {BIO 16090672 <GO>}

Thanks, Poonam. We did get another one that I think is also relevant to you. This question is about rising payrolls. Do you see it going forward continuing and some of the impact to retailers about payroll?

## A - Poonam Goyal {BIO 16489913 <GO>}

Yeah. I definitely think once again that's also a negative impact. And we saw it just a few months ago with Wal-Mart, when they took down their guidance, how big effect increased payroll can have on the retailers. We are seeing retailers pay more to their associates, offer more benefits, and while that's good for morale, while that's good for getting more experienced hires and for employee retention and so forth it does hit the bottom line.

And we're going to see no difference this holiday, especially because retailers are also adding seasonal hires. Those seasonal hires typically get paid more and with the spread now narrowing between permanent workers and seasonal workers, they probably would have to increase their pay as well and that will be a drag to the bottom line in 4Q and will be a drag as long as the retailer continues to raise the payroll and doesn't cycle past that increase, which from the ones that have announced it, like Wal-Mart won't until 2017.

## A - Chen Grazutis {BIO 16090672 <GO>}

Okay. With that, we don't have -- if we don't have any other questions, we'll wrap it up. We did hear that with some technical difficulties to hear some of the presenters. I just want to make sure that you know that we will e-mail the presentation to everybody who actually attended the webinar, so no worries about that. Thank you for joining us today. We're happy to have you and we'll see you next time. Thanks and have a great day.