Debunking the Retail Apocalypse Webinar – IHL Group

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[Kelly Sayre – Retail/CPG Analyst – IHL Group] Welcome to the IHL group webinar Debunking the Retail Apocalypse. A great deal has been made in the press recently about retailers closing stores. What is often lacking in these stories is the other side of the coin in that a large number of retailers that are actually opening stores. So, our webinar today will address the reasons for the negative narrative and present the evidence that shows the retail apocalypse headline is off base. In fact, although retail is rapidly changing, it is growing and it is quite healthy. The slides are a subset of the report
called “Debunking the Retail Apocalypse” which you can find under the research and advisory tab at our website which is http://www.ihlservices.com/.

Our panelists today are Greg Buzek, President of IHL Group and Lee Holman Vice President of
Research and Product Development.

Let’s get started here by thanking our sponsors. Without them we would not have been able to undertake the giant effort needed to complete this research. Specifically thank you to our Title sponsors AT&T, Fujitsu, Cayan and Aptos as well as our Gold level sponsors Adspace and Level 10. We truly thank you.

Today you will have the opportunity to ask questions throughout the webinar interface. Simply click on the questions tab in the sidebar of the webinar. We encourage you to ask your questions throughout the webinar and we will try to address all the questions during the Q&A period later in the call. Without further delay, let me turn it over to Greg Buzek, President of IHL group

[Greg Buzek – President – IHL Group] Thanks everyone for joining today. I don't want to presume that everybody knows about IHL and who we are. With webinars such as this, the attendance is quite a bit larger than normal. IHL is a boutique analyst firm that focuses on the retail, hospitality and CPG market. We help retailers and hospitality companies make better IT decisions through a managed RFP process. We have syndicated research and data services as well. One that will be focused on quite heavily here will be our Sophia Data Service which has over 7,000 retail and CPG companies and the systems they use. Then we have your typical advisory programs and then we do custom research. So that's IHL in a nutshell.

Now to the research. I want to start off today looking at what is the background for this negative narrative that's out there, what's driving that, what got us to this point and then what are the major things that are happening in the marketplace today that have built up this retail apocalypse narrative that is out there. The first thing is to rightly view the data that's out there.

Retailers are closing stores every year and it's actually very wise for retailers to close underperforming stores very, very quickly. One of the mantras since the Great Recession has been- learn to fail quickly. If you had a bad store in a bad market, close that store quickly- that's quite normal. I think the biggest thing that happened this year is it's the first year in a while that the Fung data on global retail and technology data went negative; where the closings actually eclipsed the openings. Fung are friends of ours and they do a terrific job on what they cover but they really only focus on some specific areas and not the entire area of retail. Unfortunately, without some kind of definition around the data, what happens is the areas they focus on are the areas that have had the most negative news. They focus heavily on apparel, department stores, and then Super Centers and warehouse clubs. They don't go as deep in food and drug, mass merchants, and some of these big categories that are growing very, very fast. They cover it but not to a very deep level and they do not cover the convenience stores, fast food, or restaurant areas that most vendors in the market and particularly the US Census covers as retail sales. They have excellent research on large public and private companies in those core focus areas and they've been doing these announcements for opening and closings for years so they've become sort of like the proxy for retail. Unfortunately, it's not as wide of a view of retail so what's happened is, absence of any further data, the press used this data to project all of retail and unfortunately that's not a true view. Here's the latest data that they had. The press has focused heavily on the store closures, which are up 178 percent, and in most stories, you won't even find the data on store openings which is the 3300 store openings. Once again, these are in those core fashion segments, department store segments, and super center warehouse segments for the most part or large public companies.

One of the other things that's been happening since the Great Recession is we've had cheap money. Whenever you have interest rates that are historically low, it creates an environment among public companies, as well as private equity companies, to expand, expand, expand. We as an industry are guilty for expanding at the expense of customer service in many cases. There have been many of these chains where private equity got involved and said “Hey- it works at a hundred stores, let's put it to five hundred stores” and the next thing you know, that retailer is out over their skis. They didn't focus on the customer, they focused on the expansion, and the net result was any pebble in the road caused them to go off the rails. We're going to see that when we get into the unique retailers that we're talking about today.

Next- we are tremendously over stored right now in the United States and that's been part of the issue. We actually have 10 times the space per capita than Germany which is pretty extraordinary. In the United States, because of cheap money and because of the availability of land, property developers have been developing malls at a rate four times the actual population growth since 1975. This has caused an over expansion of properties, making it extremely easy for retailers who wanted to expand, to go into those properties. In many cases you had one mall and less than five miles away you had a whole new mall being produced. That is a big reason why we got to this narrative and we've got empty mall space today. We simply have too much shopping space for all the retailers to fill.

Then we have the rise in fast fashion; Zara, H&M, Forever 21. Not only have then been expanding and stores expanding
in the United States, but they've been changing the model when it comes to fashion. Instead of buying outfits that you wear for a year or more, you've got outfits you're going to wear three, four, or five times that are changing very, very quickly. The lead time has gone from idea to shelf in nine months down to 21 days and because of that, it has completely disrupted the fashion side of the retail business; particularly hurting not only the apparel retailers but also department stores and their clothing.

Shifting our focus specifically to department stores and drug stores in particular, we have the impact of the cosmetics and the beauty market going out to separate stores. Companies like Sephora Ulta Beauty, Lush, Body Shop are opening individual stores instead of being sections of department stores. Those are big, big changes that have affected the margins and the traffic within department stores.

Now let's talk about the consumer and what's really going on today in the marketplace on a macro level. Since 1996, the overall inflation rate has been about 55% on consumer services and goods. In comparison, the inflation rate on all of these necessities- childcare, healthcare, food and beverage, and housing *surpassed* that 55% inflation rate. Anyone who has a child in college knows college tuitions and textbooks have been driven up significantly. If you look at the household income diagram, you start to see what's really been happening in terms of income growth since 1996. It's a totally different picture when you look things by quintile. The household incomes in the lowest 20% quintile only grew 44.9%. The second quintile only grew 54.7% at a median income rate. The third quintile grew 60.2%. So, we have 50% of the US population that has not been able to keep up with inflation on key necessities. That's a big part of what's going on with the change in retail that's happening. To go further into that, let's look at the middle class. The chart on the left shows us what the middle-class percent of the population was from 1971 to 2015. The middle class was 61% of the population in 1971 and is now only 50% of the population in 2015. When it comes to shopping, you look at the right diagram and see the middle-class controlled 62% of the wealth in 1970 but only 43% of the wealth in 2015. Most of those properties and most of those malls were built in areas that were originally designed for middle-class housing and that's caused issues as well.

Finally, we've got debt. Particularly student loan debt and auto debt that have been driving up significantly since 2008. Student-led, student loan debt has gone up over a 105% so consumers are being squeezed, particularly consumers in the middle class, so those who used to shop at department stores and specialty stores are now looking to off-price retailers. Retailers like TJ Maxx and Ross Stores, fast fashion like Zara, etc. and then buying cosmetics and beauty from those separate stores instead of going into department stores. When you look at what fuels this narrative, you've got low interest rates, the fast fashion, the stand-alone cosmetics, smaller middle class, the rise of online-which we really haven't even gotten into yet, and incomplete data that's been out there in terms of the overall area of retail.

So, what's really happening? Let's talk about what's really happening in retail. The reality is retail sales are up. Retail sales are up $121.6 billion dollars in the US through the first seven months of 2017. Now let's put that in perspective; $121.6 billion dollars is the equivalent of the annual retail trade of the Netherlands. That's our growth. We are growing quite well but it is not all the same segments. C-stores and mass merchants are doing outstanding. Your home groups, your home furniture stores are doing great. They're up $14 billion dollars in DIY and furniture sales. Men's clothing is doing well and toys is actually doing very well year to date. What’s not doing so well is department stores and soft goods. That's the area we're seeing struggle. What's interesting though, and you'll see this when Lee starts getting into the deeper data, apparel sales are relatively flat. We've got a lot of stores that have announced closings in this area but the sales are flat and that signifies to me some bad business models more than weakness in the overall industry or a weakness in spending among consumers in those categories.

Appliances, sporting goods, and office supplies-those are down and those are the areas that are specifically being affected by online sales and Amazon. When you get into appliances, we had several retailers go out of business. We also saw that in electronics and sporting goods. Those lowered the actual overall market for sales because those stores were not there. Online is up 11% for the year, its 29% of the total retail growth but it's still only 8.3% of the total retail market in North America. Around that, Amazon's about $9 billion dollars of that total ($121.6 billion dollars) so they're getting a lot of blame and a lot of people saying “hey, Amazon's a big part of this problem” but it's unfounded. Retail overall is growing very well; the shift is occurring because of these other issues.

I want to give you a little bit of background on this study and what we're doing and then I'll turn it over to Lee. We used our Sofia data service and started with over 2,700 retailers that are listed in Sofia. Then, we narrowed that down to companies who are parents and banners in segments that match the US census for retail trade. What we mean by that is you have a company like Kroger (a parent company) in our system but we also have Kroger stores in our system. We didn't want to double count those things. We had to narrow and cut those lists down. Next, we focused only on companies that had 50 or more stores in those banners which got us to a subset of 1,803 companies in 10 retail segments. Then the way we looked at it was net opens and closed for that chain only. For instance, all retailers are closing stores, most retailers are opening stores so we didn't try to count- they opened 10 and closed 2, we only counted the +8 net difference for that particular retailer. If it was a net positive, we counted that. If it was a net negative, we counted that.

We left out a lot of stuff to be purposely conservative in what we're doing. We focused on retailers with 50 or more stores only, we did not include the mom-and-pop growth area. This is kind of important because in 1990 Walmart had three super centers, by the year 2000 they had over 1500 super centers and in the meantime, two million mom-and-pop stores went away. What's happening with Amazon is Amazon has grown. They've increased the number of mom-and-pop stores. We're not counting those here because those mom-and-pop stores have a storefront but they now have access to everybody that's an Amazon Prime member; as a result- it’s actually helping them by selling through Amazon. We also do not include pure-play showroom stores. The Amazon stores, their bookstores and the other stores they have (excluding Whole Foods of course) for this. We don't include those stores in our count. Anybody that's a pure-play e-commerce company that started opening up stores, like Warby Parker and those folks, we did not include in here unless they had gotten to 50 stores or more.

Finally, it does not include foreign retailers that are operating here in the United States unless they have 50 or more stores in the United States. We were purposely conservative in this study. Getting to the bottom line, the actual results- what we found through this research is we had 14,248 opens, 10,168 closures among 1,803 retailers. This is the breakout by segments. Department stores and specialty soft goods were the only two negative groups. All these other areas were growing. So, we have a net opening of 4,080 stores. I'm going to show you one more slide because some of you are probably sitting there going, "hey- what are restaurants doing in there?" and the answer to that question is two-fold. Number one, the U.S. census on retail trade is actually the U.S. census on retail trade and food service. That's how the data is presented there and number two, this is how vendors (which is how we make our money) have traditionally organized their businesses. They go after the retail and hospitality segments as a combined segment. If you want to get nit-picky and get to the individual numbers, we've got the core retail segments as a +1,326 stores and restaurants segments +2,754 stores-and that's for 2017. All indications from the research that we did across these 1,800 stores is in 2018, things are going to accelerate. In fact, we just got word today that the GDP grew at a 3% annual rate for the first time in quite a while. Things are very, very positive; not only economically, but also in retail alone. With that I'm going to turn it over to Lee Holman.

[Lee Holman – VP Research and Product Development – IHL Group] All right great, thanks Greg. Good afternoon everybody, it's a pleasure being here with you. Before we get too deep into the data, let me just reiterate a couple of things that Greg mentioned. At IHL, we look at retail and we look at hospitality so typically in our verbiage we don't use words like vertical too often because it tends to get confusing; especially when we're having conversations with vendors that are cross industry types. In our parlance, we talk about segments and that's what you see on the left-hand side of the screen. Superstores, warehouse clubs, convenience stores and so forth and this is one of the manners in which we take data from the retail industry and break it down into more manageable pieces. Another way that we do it, as Greg talked about, is we have the Kroger company listed as a parent company but underneath them would be a various number of banners such as Kroger, Roundy's, QFC and so forth and they reside in the food/grocery segment. As Greg also mentioned, they've got convenience stores like Tom Thumb and Turkey Hill, they've also got specialty retailers under the Kroger parent company like Fred Meijer jewelry stores. They're there in the specialty groups. Basically, what we did for the data that Greg described in the previous slide is we took each of those segments, and we broke it down according to the number of banners that were opening stores, the number of banners that were closing stores, and we kind of ignored those that were staying flat for the year. We presented the data this way so that you can see there's a whole lot more green on this slide than there is red and when you break down the numbers, what you find is that for every banner that's closing stores this year, 2.7 banners are opening stores. This is a confirmation of what Greg said earlier; retail is pretty healthy.

In this slide, we take the exact same data and run the ratios for you. In the case of Superstores, they had no banners that were closing stores so the denominator explodes off to infinity. We cut it short to keep it on the screen. The way you read this chart is that in Food and Grocery, for every banner that's closing stores, there are 4.9 banners that are opening stores. That's how you read each and every one of those segments. You'll see department stores down at the bottom which is the only segment that does not have a ratio higher than 1.0. Now that's a problem- obviously something's going on there because we saw earlier that that's one of the two segments that's closing stores that has a net negative for 2017 in terms of number of stores. The segment right above that is specialty softgoods; it too has a low number 1.3, but they're closing 3,000 stores or so this year. When we look at this and have a grasp of what's going on, we see there are some very large retailers, in these segments, that are closing lots of stores. There's also some retailers in these segments that are growing very rapidly and we'll see some of that evidence in just a minute.

Here is a chart that might look a little familiar to you. It's similar to some of the numbers that Fung data has shown and basically what we've got is Dollar General at the top and that's a huge number; 1,290 store opens. That's the number they had in their 10K and in their first 10Q of this year, they had already opened 396 stores. They're well on their way to reaching that 1,290. I think their next 10Q comes out in a couple of days so it'll be interesting to see what the data says in that report. The Dollar Tree, also in the mass merchant category, is opening 650 stores. These are some really big numbers and that's why you'll see a lot of green for these guys. Moving down the chart just a little bit, you'll see Aldi- where we are showing 200 opens. I believe the Fung data actually shows 400 for the year. The information we captured concerning their growth indicated that they were going to open 400 stores by the end of 2018. We simply went ahead and split it in two and gave half to 2017 and the other half to 2018. That's why there's only 200 there for Aldi. You see O'Reilly and AutoZone, two auto aftermarket retailers in the specialty hardgoods segment, both of these retailers have been growing their store footprint by leaps and bounds over the last handful of years especially through M&A activity where they buy up a smaller player and they rebrand the stores. Interesting thing about these retailers right now is most of their retail sales come from local machine shops, mechanic shops, and auto dealers. It's not so much the walk-in customer that that drives their sales. Another interesting thing is the fact that while they're growing their store footprint so big, you'll see in a few slides, their sales have actually declined in the first seven months of this year. We'll get to that in a little bit. Moving a little further down the chart, you see Sally Beauty and Ulta. Greg mentioned these guys a little bit earlier and we'll see a chart in just a little bit that describes some of the dynamics involved in what's going on with them. Lidl is showing up the third one from the bottom. This is the only retailer on this screen that had zero stores in the country at the beginning of the year but they've announced that they're planning on opening a hundred stores this year so It'll be interesting to see what the rest of the year looks like for them. All told, these 16 retailers have 4,162 new stores. That's a 30% to 40% of the total that we saw from Greg slide earlier.

This next slide shows the data that is the source of some of the heartache that we had in the first part of this year. Basically, what you see is the top (or well maybe it's the bottom retailers) in terms of store closings. It goes without saying that if you look at the total number, 4,929 stores closed, that's almost half of all the store closings that we counted in this effort; just these 16 retailers. If you look at the some of the names, it's not too much of a stretch to say that some of these guys should have been closing stores throughout the past decade but they chose not to. Let's take a little closer look at the second, third, fourth, fifth, and sixth entries, Payless down to The Limited, those are all specialty softgoods retailers. All the stores between those two brands equals 1,500 stores that are closing. That's pretty much the cause of the red marks that are against them and the negative numbers for their store counts for this year. You'll also see a couple of department store retailers in this list and they're closing 340 stores between them. Actually, let me say this and reiterate what Greg said earlier. It's not necessarily a bad thing for retailers to close stores. In fact, it's healthy for them to assess the performance of each and every store in their chain, and make whatever changes are necessary. If it means closing a store and moving to a different location, that's great because those resources get repurposed. If it means investing more in the store, to drive traffic to the store, to increase the sales in the store, and therefore increase the performance, that's also an option.

On this slide, we're looking at restaurants in the same vein as we did the pure retail just a few moments ago. Let me say this- the data on this slide and the next one is what I would consider just a little bit softer than the data that's found in the retailer's and that's only there's such a heavy franchise mentality associated with restaurants. So, these are these are the top level, parent company kind of companies and underneath they've got dozens of franchisees that are sometimes working at cross-purposes amongst themselves in terms of store growth or store decline. A lot of names that you see on the left are very familiar names. Some of them have been in the news recently and not for good reasons necessarily. I will give one shout out to Chick Fil-a. Full disclosure, my family loves Chick Fil-a. We love the food, we love the service, and as an analyst, I absolutely love the way they manage the company. Keep in mind they are open 86% of the amount of time that the rest of these guys are open.

Here's the flip side of the story for restaurants. This is the first time I can recall Subway closing this many stores in the course of a year. You look at that number and think it’s huge but when you realize they've got approx. 23,000 stores in the states, then that percentage is way down there. Starbucks is closing 379 stores and that has a lot to do with their to Teavana banner. We're not real sure how that's going to turn out for the rest of the year but I think that number is going to change somewhat. Some of the others in that list, Burger King and McDonald's, both closing 100 or 110 stores. There’s some aspect of this pertaining to what I just talked about. It's healthy for some of these brands to close stores on an annual basis, depending on their performance. One of the things that you'll notice in the previous sheet; there's a lot of fast food in the growth chart and a whole heck of a lot more table service restaurants in the decline side of the equation.

Now- here's where we get into a little bit deeper dive on data for some of these segments. In the case of drugs and cosmetics, the NAICS code for drug stores includes drug stores and pharmacies as a separate code, and cosmetics and vitamins as a separate code. So, we separated out that growth of 345 according to those NAICS codes and what we find is that the drug stores and pharmacies are actually closing 77 stores this year while the cosmetics and vitamin stores, the companies Greg talked about- the Ulta's, the Sally Beauties, the Sephora, are growing leaps and bounds. In fact, 422 stores increased this year and they're showing a sales increase of 4% up through the first seven months of this year. That's having a huge impact on drug stores and department stores. Anybody that has spent any time wandering around some of the department stores, especially around the holidays, can see that the traffic around the cosmetic stores is
considerably less than it once was.

On this slide, we're looking at general merchandise. We're talking about department stores and mass merchants and supercenters. Let's deal with the supercenters first; 82 opens is not a big spectacular number compared to some of the others, but this is still significant growth and the 2% sales growth you see is a consistency that happening there with those particular retailers. Looking at mass merchants, those numbers are up in a big way mainly because of the retailers we saw on previous slides. It's the simple fact that you've got Dollar General and Dollar Tree growing so many stores. What's also included here is the number of Walmart's, the original discount format stores, that are closing as they are being reopened or repurposed for Super Centers. When we look at department stores, the only red numbers on the whole sheet here (and it's a tough situation for them), they're facing competition online and they're facing competition from the specialty retailers we've already talked about, the cosmetics and the personal care type of situation. Department stores are really having a tough go and we consider the fact that a lot of them are anchor stores in malls. It becomes a ripple effect because if one of these retailers goes out of business or closes a store in a mall, it has an impact throughout the mall for every other retailer that's present.

Taking a look at soft goods- we mentioned earlier about the fast fashion and we'll get to that in just a moment. Soft goods in the NAICS codes are broken down by clothing and then under clothing there's men's clothing, there's women's clothing, there's children's clothing, there's family clothing, and so forth. Rolled-up, clothing is down 2,300 stores this year and that's despite the men's clothing growing. They're going in the opposite direction. Shoe stores are also having a tough go here and part of that has to do with Payless. They're closing 700 stores and that's a really big deal for them. Some of the stores that are closing in the clothing arena- Rue 21 and Ascena are closing 400 each, Gymboree is 350, The Limited was 250, and Children's Place was 172. In those five retailers, 1,572 stores closed all by themselves. Again, some big chains closing lots of stores. Jewelry is doing fairly well, a nice 2.6% growth over the year with 138 more stores this year. Then we get to fast fashion- understand clothing, shoes, and jewelry all have separate NAICS codes in the federal docket. Fast fashion does not. What's included in fast fashion is also up here in clothing. The fast fashion includes your H&M and Zara the retailers Greg mentioned earlier. These retailers are showing a growth of 62 stores if we exclude Rue 21, because Rue 21 is actually going through the very thing that Greg talk about in terms of easy money, fast expansion, and so forth. Rue 21 is closing 400 stores this year. The killer though is what you see on the right-hand side of the graph. Clothing is down 1.1% this year, shoes are down .9%, but fast fashion is going up 6 to 7% and that's our estimate- that's not a number that came from the Census Bureau.

When we get to the next slide, hard goods, we see the same effect in Auto Parts that we talked about earlier. Auto Zone and O'Reilly opening lots of stores but their sales are declining. Part of this has to do with the announcement Amazon made in the early part of the year saying they were really going to go after auto parts. Now- I don't know if they were referring to the retailer's themselves or just bigger sales of auto parts on their site. That's open for debate. You can see that DIY is up 6.8% in terms of sales and opening an additional 347 stores- people are investing in their homes. They're remodeling, they're expanding, and they're doing the kinds of things that you know we've been trained to do through the years by investing in our own personal infrastructure. Furniture is the same idea, they're not seeing quite as much growth, but still healthy at 3.8% for the year. Sporting goods- now this is where it really gets interesting because remember last year when Sports Authority vanished? There were 260 stores or something that closed up shop overnight. Running the numbers this year, we see a total of +4 stores which basically means that the store footprint isn't going to change very much at all for the year, but their sales are down +8% for the first 7 months this year. That's a tough spot to recover from. Now, having said that, there are certain sporting goods retailers that are doing fairly well but the competition online is pretty heavy. A Spalding basketball is Spalding basketball; so, if you can get it delivered for free in two days and it's comparable what you see in the store, why not? Book stores are having a tough time mainly because of one retailer and that's Family Christian book stores. They closed 240 stores this year but book sales are actually up a little bit. Taking a look at electronics- this one is the area that's really been hammered by the closings of RadioShack, Game Stop, and HH Gregg. There's a lot of stores closed due to those three retailers and again pretty heavy competition coming online from the likes of Amazon and Walmart. When you can order a 65-inch TV and have it delivered for free or even have it installed for next to nothing, that's a remarkable deal and something that's tough for bricks and mortar retailers to deal with.

The final slide- we're talking about restaurants and fast food restaurants. There was huge growth with 2,000 extra stores opening this year, sales are up 3.2%. Americans love to eat out, food away from home continues to be a heavy part of our budget and bar restaurants are also growing. I'm not quite sure why only a third of the number of fast food is growing, if that's mainly because certain restaurants in that segment have had to close stores over the past couple years. Still, we see sales are up about 4% and that's a decent number. Having said that you need to understand that in the bar restaurant category, drinking establishments sales are up 16% this year alone. We went back and looked at the data from early October of last year and I'm hard pressed to understand what happened in that time frame so I don't know if it was celebratory or commiseration kind of drinking but these are the numbers that we see here in the data and with that let me pass it back to Greg.

[Greg Buzek – President – IHL Group] So going forward, what do retailers need to do to effectively compete? We're going to outline six specific things.

First, retailers have to transform the customer experience. The customer experience in most retail environments today is horrible. You go online, they treat you like a king or a queen. They know what you like, your preferences, and they have specific offers. When you go into most retailers today, the associates could hardly care less that you even walked in the door. You're not getting specific offers for how you are as a shopper. Loyalty systems are not put together for consumers and yet you have to transform that customer experience. Consumers are spending on experiences and on their homes. Live sporting events, live concerts and those type of things are up sharply in terms of business, but what is of utmost importance is people want to be entertained and they want to have a good experience and you have to transform that customer experience.

Now related to that, a big part of the problem with the customer experiences is out of stocks. Overall, the industry as a whole, struggles with out of stocks. Consumers will experience out of stocks, one in four trips to a store. If you want-go to one of our reports for more detailed data. We have a report called “We Lost Australia” which is a worldwide view of the cost of over stocks and out of stocks which is actually a $1.1 trillion dollar problem. But more importantly for retail survival is understanding this- I used to *have* to shop, now I have to *want* to shop and I only have a 50 to 75% chance that your store has what I want to buy. If I don't need it immediately, at that time, I can go online and get it shipped to me in two days. That is a big problem. Technology such as RFID is key so you can know that if a lady comes in for a size 12 black cocktail dress and it’s not on the rack, you know it's in the dressing room, not out of stock. RFID is a key technology getting to a single view of your inventory across the chain, it can save the sale, it has the ability to attack this out of stock problem and convert your customers when they come to your stores.

Third, and we've got a couple of these lines in red here so we'll go in deeper. Decoupling the IT spending from previous year’s revenue. Traditionally, retailers have only done 1 to 2% of revenue spent on IT budgets. That was before Amazon. Amazon spent $15.1 billion dollars last year on R&D and innovation. Retailers cannot expect to compete effectively against Amazon, Walmart, Kroger, Target, and some of these other retailers who are spending a huge amount of money on IT transformation, if they're not willing to decouple their IT spending to previous year revenue.

Next, leverage the cloud as a head start and we're not going to go into a whole bunch of detail but you could leverage the cloud not only as a full replacement of certain systems, but also to be a hybrid cloud that provides the interface to make your on-premises systems work together to provide that single view of the customer and single view of your inventory that can be used to improve the customer experience.

Fifth, embrace mobility. I’m going to show some data here in a second that explains why that's so critical.

Lastly, learn from the leaders and what the leaders are doing. Our leading retailers today are spending up to five times more on IT than the laggards. This is a study we did in January. It shows the folks (about 30%) that are in the leader category on the left and in blue. Then we have the middle category (about 28%) that were average and the rest were in the below average retailers. Those in the far right, the purple categories of both graphs- these are the people that when Amazon grows, are just going to get eaten up.

It's not going to be the retailers that are over here in the blue, these are the people that are investing heavily in systems and I'll show some specific things that the leaders are doing differently as we go forward.

Next, embracing mobility. The leaders are those that are growing more than 5% a year in sales. They are 250% more likely to be using mobile devices for their associates and the impact of that usage is they're enjoying a 70% higher sales increase than others. What that means is if the average sales increase is 4%, they're enjoying 70% higher than 4% on that so basically 7%, a little less than 7% growth. That is significant. Simply by having mobile devices for your associates so they can do their jobs while they're moving around the store. They can assist customers as well as mobile point-of-sale, being able to complete the transaction completely on a mobile device. The leaders are 150% more likely to be doing that and they're enjoying 90% higher sales because of that capability. Now we're going to have a session, a video with Kelly that will go over how you do this right. You can't just throw mobile in and expect it to work. There are certain things you have to do correctly to make that work. Psychologically with the customers, training with the associates, but also the fact that you've got to do some specific things technologically that allow you to hit these levels. We'll be doing that in a video that's coming out here in a couple weeks. What the leaders are doing differently with that 8.8% growth rate is they're prioritizing IT transformation at a 135% higher priority than the average retailers. They're focusing on lowering the supply chain cost at a 145% higher priority. They are focusing associate training and tools at a 194% higher rate. Looking at inventory visibility and prioritizing that 55% higher and then the clienteling and assisted selling- 26% higher investment in priority than the average retailers. I can't overemphasize the importance of the IT transformation, the lowering of supply chain costs, and the associate training. Those three are critical to what IT can do to help improve the customer experience.

Our final slide here reminds you that you don't have to beat Amazon or beat Walmart or beat Target or beat Kroger. You simply have to out invest and out execute your competitors. The weakest competitors within your segments. Fortunately, the failure rate of some large retailers who are not willing to transform themselves, leaves such a gap that the players and the smaller upstarts that are growing like crazy can simply vacuum that up. However, the gap is bigger than what any one retailer can vacuum up and that includes Amazon. So as retailers drop out of a marketplace or close stores because of either bad management, a bad business model, over expansion- whatever the cause may be or competition, that gap is bigger than any one player. Those who are willing to invest in that technology are going to be the ones that are going to not only survive they're going to thrive because the market has already been primed and they just need to come in. It's kind of like lead generation. You've already primed the pump for customers to buy the products and then a retailer got out of the marketplace so it's more for everybody else. With that I'm going to turn it back over to Kelly for Q&A.

[Kelly Sayre – Retail/CPG Analyst – IHL Group] Thank you. As a reminder, you can still submit questions through the interface on the sidebar.

From Michael Lehman:

“Do your studies indicate that Specialty Retail appears to be growing faster than traditional, mainstream retailers? In theory, Specialty Retail is smaller, with smaller budgets, but greater touchpoints with the end customer?”

[Greg] I want to make sure I understand the question-specialty retail overall, I wouldn't say it's growing faster or greater than the others in there. What you've got is you've got smaller retailers that are growing faster because if you've got 50 stores and you add one you've literally gone up a more than if you had 500 and added one. The fact that that growth percentage is higher. Also, there is the fact that we have a benefit with the smaller retailer since they don't have a legacy system. The same way if you read “The World is Flat” by Thomas Friedman, we learned about technology and how third world or upcoming countries didn't have to deal with plain old telephone lines when it came to the internet, they could go to straight wireless or they could go to fiber right away because they didn't have the “old” technology. Many of these small, up-and-coming guys don’t have to deal with legacy, they can do everything in the cloud and don't have to deal with that so that also allows them to expand much faster because they don't take on a capital expense for IT systems and other things as well.

[Kelly] I'll go and take a question for Lee.

“Some of our systems are cloud enabled, mostly infrastructure systems, what retail specific systems would you prioritize for the cloud?”

[Lee] That's a great question because there's some retailers that simply said “ok, put everything in the cloud” and boom they're done. Basically, the jumpstart that Greg talked about earlier, the key thing you want to keep in mind is you want to get a unified view of your customer. You also want to have a unified view of the order as it progresses through the enterprise, as well as the inventory that is associated with that order. These are the two key things that you really need to have when you're talking about your cloud enablement and being able to jumpstart the enterprise. The thing that's really interesting is the thing that retailers need to keep in mind. Putting something into the cloud in such a manner makes the cloud solution much stickier. That's a good thing for vendors obviously, but it's something that retailers need to keep in mind because if you get to the point where you're not willing to do this anymore- it gets turned off and it’s instant. As opposed to having legacy systems in place.

[Kelly] I'm going to go right over to another question that pertains to unified commerce.

From Ken Silay:
“Are those retailers that are opening stores taking the opportunity to open those stores with new technology to enable omnichannel or just using legacy systems?”

[Greg] I think it varies on the particular retailer that's opening the stores and where they are with things. There are some who are using those open stores to be the new launching pad for things and then there are others that are just opening stores with their systems in place. The challenge of making a change while you're opening new stores is on the one hand, it's great- you can experiment and you can play with the new technology and keep it isolated. The downside is you then are managing multiple systems as you go through there. So that's one of the reasons why you see somebody like a Home Depot or one of those guys, roll out all their point-of-sale systems in six months across 1,500 stores. Because it's easier for them to manage one solution and roll it out than it is to have multiple solutions that are in place. Whereas a grocery store, because it's margins are so low, may take three years to open up half as many stores with new technology. If they make a switch, they've got to manage multiple systems for that period of time. Which means every system that touches that point-of-sale system has to be managed twice. Every update needs to be managed twice. EMV has to be managed twice. So, it really varies based on the retailer and where they are in the IT maturity curve for key technologies.

[Kelly] I have a question here from Marc. He has a couple questions actually.

From Marc Millstein:
“Given the growth of online sales at most retailers, wouldn't one expect to see more store closings as part of rationalization and smarter business models?”

[Greg] You may and but you may also see these stores actually move to being warehouses and fulfillment centers for online purchases. What's the one advantage that many of the retailers have over Amazon and other ecommerce retailers is proximity to the customers. That's the primary reason I believe that Amazon bought Wholefoods. It was to actually get closer to that last mile delivery for their products that are bought online. Not so much to just get into the grocery business that's there. So, retailers have to make a decision as to whether or not they're going to fulfill online orders locally from their stores, or what we're seeing in Europe is they have dark stores. Dark stores are stores that are completely set up as retail stores but they're not open to the customer. They're just there for shipping locally. It’s ship from stores, we have dark stores, and then fulfillment houses. Sections of the warehouse or specific warehouses that are designed specifically as fulfillment for online. I think you're going to see a mix of all those depending on the segment and where this may be.
[Lee] You can't ignore the aspect of returns there as well.

[Kelly] We have another question coming in from Shelley Bosler:

“Are you seeing retailers using technology to eliminate employees or reallocating them to customer facing activities. Are they just trying to “shrink to greatness” with their labor force?”

[Greg] No actually I do not see that happening at the store level. We're seeing a bit of automation happening
particularly in the UPC based businesses that are out there- so your grocery stores, your Supercenters, your warehouse
clubs, your mass merchants- at their DC's a lot of automation, artificial intelligence, robotics there. At the
store level, what we're seeing is technology being deployed to free up labor, not necessarily reduce the labor,
but to do things. One of the studies that we did Shelley, earlier this year, is we looked at 30 different technologies.
Kelly's been doing a video series on the technologies that move the sales needle and one of those technologies was a shift from store, or click and collect, and we asked

retailers- are any of you making money on that yet and the answer was no. The opportunity is there to make a huge dent in labor hours but I'm a firm believer that RFID technology is the key thing that allows ship from store and click and collect to actually work for a couple reasons. One, the return on investment is really, really quick with some of the new technologies coming out. Two, it frees up a lot of labor and that labor can now go do the click and collect, and they can go out and meet customer orders, and do those sorts of things. Historically, when retailers reduced labor out of their stores, when they take labor out of their stores, they begin to fail. A perfect example is self-checkout. Self-checkout was ideal for removing labor from the particular thing because you would take four checkout lanes and condense it to one person in most cases. In some cases, you would do up to 16 lanes down to one person. The retailers that simply removed labor, like Kmart, they failed miserably at self-checkout. Those who took their best cashiers to train customers how to use self-checkout and then took those other employees and put them in other areas that were profit centers- because let's face it, a cashier's job in a grocery store is not to upsell when somebody comes through but to process as fast as possible. Those retailers like Kroger, that moved those people to prepared foods, moved those to taste testers around the store, actually increased their margins dramatically when they deployed self-checkout because they didn't reduce the labor in the store. Retailers could do that- it's foolhardy in my opinion because the data over time has shown that they fail.

[Kelly] Let's go a question for Lee.

"There was a report that a shopping mall Ohio is being transformed into Amazon Fulfillment Center. Do you see this trend continuing?"

[Lee] Short answer- yes. I mean, they're the types of things that we were talking about earlier. The shopping malls within five miles of each other and then you get a brand-new build, all that kind of thing. Those things are going to have to be repurposed somehow, whether it's a sales effort by the owner of the mall or whether it's an entrepreneur that comes in and says hey I want to do this in your mall, what do you think? Can we give it a try? It's kind of like what happens with the Olympics. When a host city hosts the Olympics, they build all these new infrastructures and buildings and facilities and so forth and then the crowds come and the games happen and then the crowds leave. What do you do with this brand-new gymnasium? You know you're not going to have games in it every single night so I think malls are going to have to rethink how they view the properties that they own. Whether its fulfillment houses, whether it's you know, residential type situations. Long story short, malls are going to have to work real hard to not only figure out how they populate the empty spaces that are going to show up, but also, they've got to do a better job of working with the retailers that are still there. One of the things we've talked about is the fact that there are so many retailers that complain about the Internet service they get in a shopping mall. But they're dependent upon the property manager for that and in order to do the kinds of things they want to do with the cloud, they simply can't get enough bandwidth. So, malls need to do a better job of relating to the retailers that they already have in place, and then do a better job of bringing somebody in that can supplement what's going on there.

[Kelly] Great, great. Well we still have questions coming in but unfortunately, we need to wrap this up so that will conclude our webinar for today. For those of you who asked questions that we didn't get to, we will have one of the panelists reach out to you with those answers and thank you all again for taking time out of your day to join us, we really appreciate it.