FOR MEMBERS ONLY

RETAIL CONDITIONS REPORT

SPRING 2018

SO FAR, SO GOOD…FROM "CAUTIOUSLY OPTIMISTIC" TO CONFIDENT

After Long Winter, Sales "Spring" in May

The following results are from an RCC survey of large and mid-size members concerning their experience in the spring and month of May to date. The survey was conducted during the period May 22-25, 2018. A total of 44 retailers operating approximately 9,500 stores participated.

OVERVIEW

Despite a winter that seemed never ending, retailers have seen sales in the first part of 2018 grow modestly, and in accordance with plans. Margins have remained stable and inventories under control. As has been the case for more than two years, traffic continues to decline at many retail stores as customers shift to online. Other indicators of consumer behaviour remain steady. Respondents are confident they will achieve their 2018 targets.

Spring & May 2018

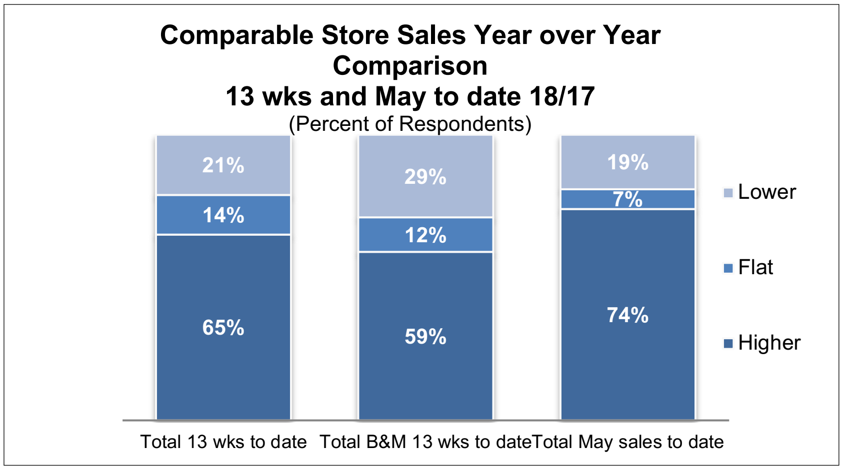
- 65 percent of respondents said **spring** sales were higher. Average increase for all respondents was 2.1 percent.
- 59 percent of respondents said **spring** bricks and mortar (B & M) sales were higher. Average increase for all respondents was 0.8 percent.
- 74 percent of respondents say sales were higher for **May**. Average increase for all respondents was 4.5 percent.
- 58 percent say **spring** margin rates were higher; 65 percent had an increase in margin dollars.
- 40 percent reported higher inventory levels in the **spring;** 37 percent had faster turns.
- 65 percent said **spring** traffic counts were lower; 80 percent said conversion was higher.
- 52 percent said **spring** transactions are higher.
- Average ticket, basket, and unit retail were generally positive in **the spring**.

The next edition of this report will look at summer and early back-to-school results. The special focus will be on measuring what portion of online sales are returned.

SALES

RCC asked respondents to compare spring and May same store sales to 2017.

- Average sales increase, total company sales stronger than **spring 2017**, excluding one outlier: **4.2%**
- Average sales decline, sales weaker than **spring 2017,** excluding one outlier: **-3.7%**
- Average total company **spring** sales change, excluding two outliers: **2.1%**
- Average B & M sales increase, sales stronger than **spring 2017**, excluding one outlier: **3.6%**



- Average B & M sales decline, sales weaker than **spring 2017,** excluding one outlier: **-4.4%**
- Average B & M **spring** sales change, excluding two outliers: **0.8%**
- Average sales increase, sales stronger than **May 2017**, excluding one outlier: **6.1%**
- Average sales decline, weaker than **May 2017**, excluding three outliers: **-2.4%**
- Average **May** sales change, excluding four outliers: **4.5%.**

The first part of 2018 has unrolled largely as expected by members. Most categories experienced modest **sales** growth. The one wild card has been the unusually long and cold winter, which froze sales of seasonal items for the months of March and April. April in particular was a tough month. However, as soon as it was no longer dangerous to go outside, customers quickly and eagerly returned to shopping. In the words of one member, "May saved our bacon". The rise in gas prices has affected retailers selling to lower income Canadians. As one member notes, their customer lives from one paycheque to the next, and every cent that goes into the tank is one cent less that comes to their store. Many report e-commerce sales are playing a significant role in boosting the overall top line. The slower growth rate reported for bricks and mortar only highlights how important online sales have become to the top line.

British Columbia continues to enjoy solid sales growth, and the softness noted in earlier reports appears to have diminished. For an increasing number of respondents, **Alberta** is experiencing growth and several say this strength has spread from Calgary to Edmonton. Members are puzzled by the poor sales results in **Saskatchewan** and **Manitoba**. One member suggests the dry spring is affecting the farming community. **Ontario** is generally a positive market for most. However the pace of growth has declined from 2017. This may reflect the fact many retailers have fully recovered sales lost in recent years and incremental growth is proving more difficult to achieve. Once again, **Quebec** presents a fragmented picture. For some, the market is one of their strongest while it is a weak spot for others. And still no one, including Quebec-based members, has a satisfying explanation for what is happening. There is a similar mixed picture in the **Atlantic Provinces**, with some members enjoying solid sales while others say it is a soft region. Again, there is no apparent pattern or explanation for the differing experiences.

The data in the table does not show any meaningful growth in online commerce, but there is a consensus among respondents that this channel continues to grow in its importance – both for the top and bottom lines.

Holiday 2018 Online Sales as a Percentage of Total Company Sales
(% of Respondents)

	No Online	Alcohol Retailers	< 3 %	3 - 5 %	5 - 10 %	10 - 20 %	>20 %
% of Respondents	14%	11%	18%	20%	20%	11%	5%

RCC COMMENT

Weather is so often the go-to explanation for sales, to the point where it can be seen as a feeble excuse. But not this time. There is validity to retailer complaints this spring that a very long cold winter affected sales of seasonal merchandise. The truth of this point is underlined by the way sales rebounded in May when winter finally released its grip.

The movement of Easter to an early date shifted sales between March and April. This is one of the reasons RCC asks for sales performance for the 13 weeks leading up to the report, as this will capture Easter sales regardless of when they occur.

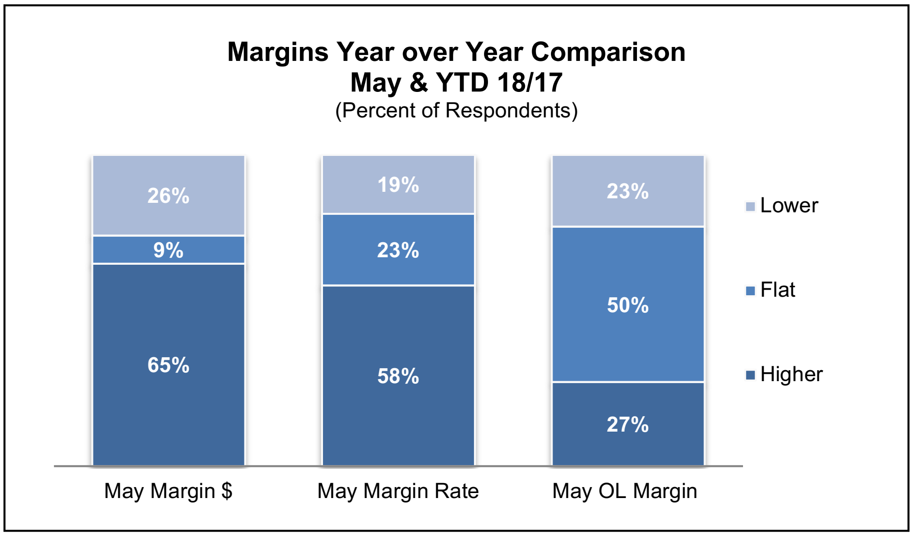
As the online channel grows in importance, retailers are anxious to get clear insight into what portion of the retail market is now served through this channel. Not surprising, this is difficult to know with any precision, although Statistics Canada has started a series to track e-retail. The most recent report from the agency pegs online sales as comprising 2.6 percent of retail sales. RCC's Retail Fast Facts analysis, which strips out automotive and gasoline sales takes that percentage to closer to 5%. However, this still likely understates the degree of penetration by online sales. According to the advice from RCC's consulting economist, Paul Jacobson, Statistics Canada does not treat operators of several platforms with a ".ca" suffix as Canadian retailers even though they may only ship to Canadian addresses. These retailers operate out of foreign jurisdictions and ship the product at retail prices to Canada for fulfilment through their own or third-party logistics operations. They collect and remit Canadian retail taxes as appropriate. However, because the retail service margin is produced abroad, they are not treated as retailers. The Statistics Canada numbers also do not include purchases from foreign sites made by consumers.

Spare a thought for your local alcohol retailer who is preparing for the legal sale of cannabis. In addition to all the new regulatory structure they must invent/deal with, they are wrestling with how the arrival of this competing product will affect alcohol sales. For the fall *Retail Conditions Report,* RCC will consult with alcohol retailers on how to make sense of their data – because right now we have no foggy clue!

MARGINS AND INVENTORIES

Despite the impact of a cold spring on sales, few retailers decided to deviate from their pricing plans and offer deeper discounts. Several note the arrival of warmer weather has perked up sales without the need for margin-busting promotions. **Inventories** which had begun to back up in April are also quickly coming into line with plans.

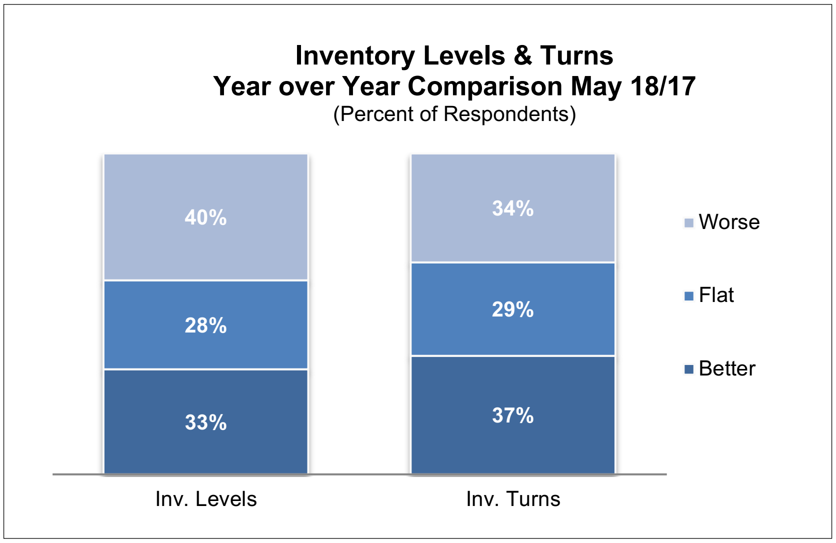
In the February Outlook report, members speculated retailers would make attempts to raise prices where they thought it might be possible. However, most respondents this time say they see little sign of it happening.



MARGINS AND INVENTORIES

Some members report the changes in their **online margins** are gradually coming into line with store margins. This reflects the maturation of the channel and the increasing tendency of the customer to shop the website in the same way as they shop the store. Online margins still tend to be lower than for stores.

The data do not reflect it, but there is a high level of confidence about **inventory levels and turns**. Respondents expect they will be able to sell through their spring inventories at planned margins. With sales now growing steadily for more than a year, additional inventory is needed to support the sales.



RCC COMMENT

After the solid performance of 2017, some commentators were forecasting a year of strong growth. Retailers were not so sure and tempered their buying plans. So far, 2018 has conformed with their milder expectations. Growth has continued, but slower than in 2017. Having planned correctly for this, retailers are reaping the benefits of steady margins and inventories that are in line with sales.

For the first time in years, few respondents mentioned the exchange rate of the Canadian dollar. The relative stability of the dollar is most welcome, allowing retailers to place the exchange rate further down their list of worries.

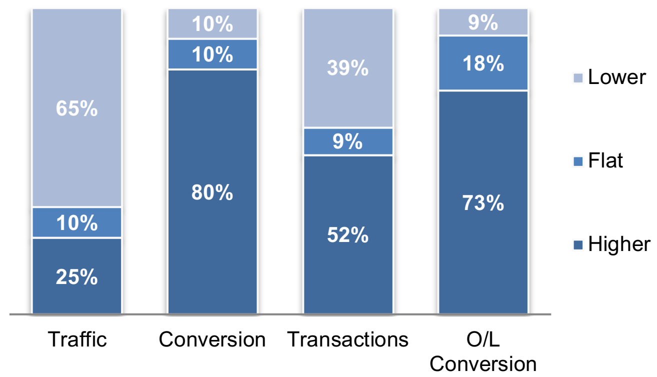
CUSTOMER BEHAVIOUR

Readers are reminded once again that the data for customer behaviour are based on a smaller number of respondents; 20 for the traffic data, 22 for online conversion and only eight for cart abandonment.

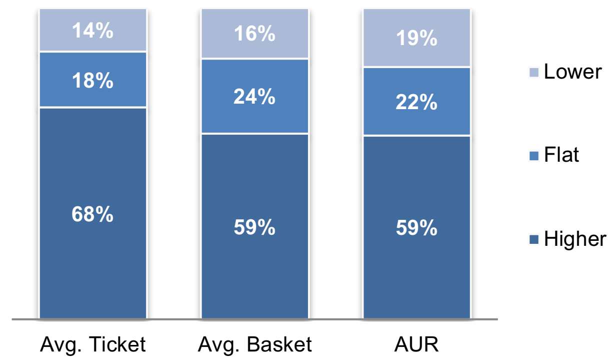
The big story continues to be the steady decline in footfall, a trend that has lasted more than two years. Retailers are becoming inured to the steadily dropping traffic counts. As one member notes, “The drop in traffic is unavoidable.” But as another points out, this is not defeatism. “It is a recognition of our reality, and we just have to learn to operate within that new reality.” Many members count transactions also report their traffic is clearly off from last year even if the number of transactions has risen. Conversion rates are up for most respondents, as is the average amount spent per transaction, but many say these are not sufficient to offset the impact of the decline in traffic on store sales. The other data for customer behaviour reflect the steady confidence of the customer. They reinforce the impression that soft sales in March and April do not reflect a loss of confidence.

The increase in online conversion rates of a majority of members is a sign of retailers’ growing success at understanding and serving their online customers. Respondents note an improved website elicits a rapid positive response from visitors, and equally, a poorly performing website is quickly punished. The results for cart abandonment are too small to make report. Members are paying increased attention to cart abandonment but there is some debate about what the results mean.

Customer Behaviour
Year over Year Comparison May 18/17
(Percent of Respondents)



Transaction Profile
Year-over-Year Comparison May 18/17
(Percent of Respondents)



RCC COMMENT

The increase in the cost of gasoline has had a mixed impact on traffic. For some, it has meant fewer trips as customers consolidate their shopping into a more efficient pattern. This phenomenon occurs for most categories, with the exception of luxury. But there is another impact. Retailers operating in smaller towns notice higher gas prices are inducing shoppers to stay in town and shop local more often, foregoing trips to the city that may be a couple of hours and many dollars-worth of gas away.

Online conversion and cart abandonment are two metrics RCC has introduced only recently, and there is still some learning taking place. It would appear they may not tell us much about the confidence or shopping patterns of customers. Rather, they may provide a measure of how well retail websites are meeting customer expectations, at least in relation to online sales. The bigger challenge will be how to stretch beyond these metrics to measure how well the online and bricks and mortar channels integrate to provide the seamless service customers already expect.

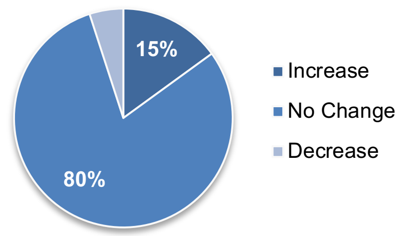
So what does a change in the rate at which website shopping carts are abandoned mean anyway? A decline in the portion of carts abandoned should be good news, right? Perhaps not. A member with a very successful online business suggests carts that are filled and then abandoned show the shopper has a stronger attachment to the banner and the merchandise than a casual browser. The visitor liked the merchandise enough to pick it up, as they would in a store. This customer has a higher likelihood of returning to look at the item or items they chose and buying on a subsequent visit. The conventional view is retailers are always striving to improve conversion, and an abandoned website cart is hard evidence of a failure to convert. What explains this difference of view? Part of the reason may lie in the category a retailer serves. Apparel retailers are familiar with a customer taking multiple items into the change room and buying some or none – testing different combinations and looks. Some say this cycle can be repeated more than once before a buy decision is made. This "trying on" phenomenon does not exist in many other categories. For now, RCC will continue to ask about cart abandonment and seek continuing education from members.

Some members have suggested RCC should start to track average ticket, basket and average unit retail for the website. They argue the channel is large and mature enough to make these data informative. At the risk of taking up even more of the Finance Department's time, RCC will try out these questions in the fall report.

OUTLOOK

With the year starting as expected, it is not surprising most retailers are sticking with their plan. Many point out they made a conscious decision to order carefully - even conservatively. They prefer to protect margins and the bottom line even if it means foregoing some sales. The retailers looking to buy less for the upcoming seasons say it has more to do with internal company-specific factors than an assessment about how confident customers will be during the fall and holiday seasons. Unique company circumstances are also the principal reason why some are planning to increase their buy.

Fall and Holiday Buying Plans
(Percent of Respondents, May 18)



RCC COMMENT

The results and comments from members are remarkable from one perspective. For the first time in many reports, there was not a single respondent who used the phrase "cautiously optimistic". After a solid 2017 and a steady entry into the current sales year retailers, are actually confident. Confident the market will continue to grow moderately, confident their plans are appropriate for the conditions, and confident they can achieve their targets. It's been a long time coming.

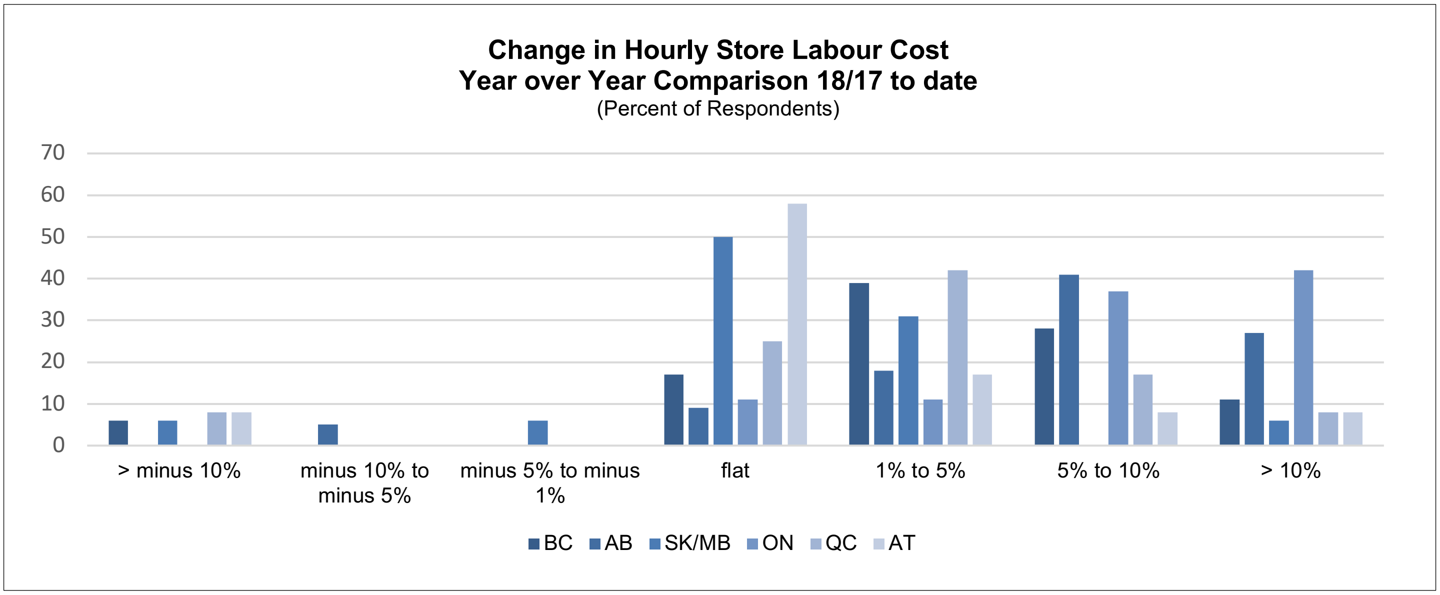
Who knows? It may be time to break out the sparkling wine. (Let's hold the vintage champagne until the holiday season is safely and successfully over.)

SPECIAL FOCUS – MANAGING LABOUR COSTS

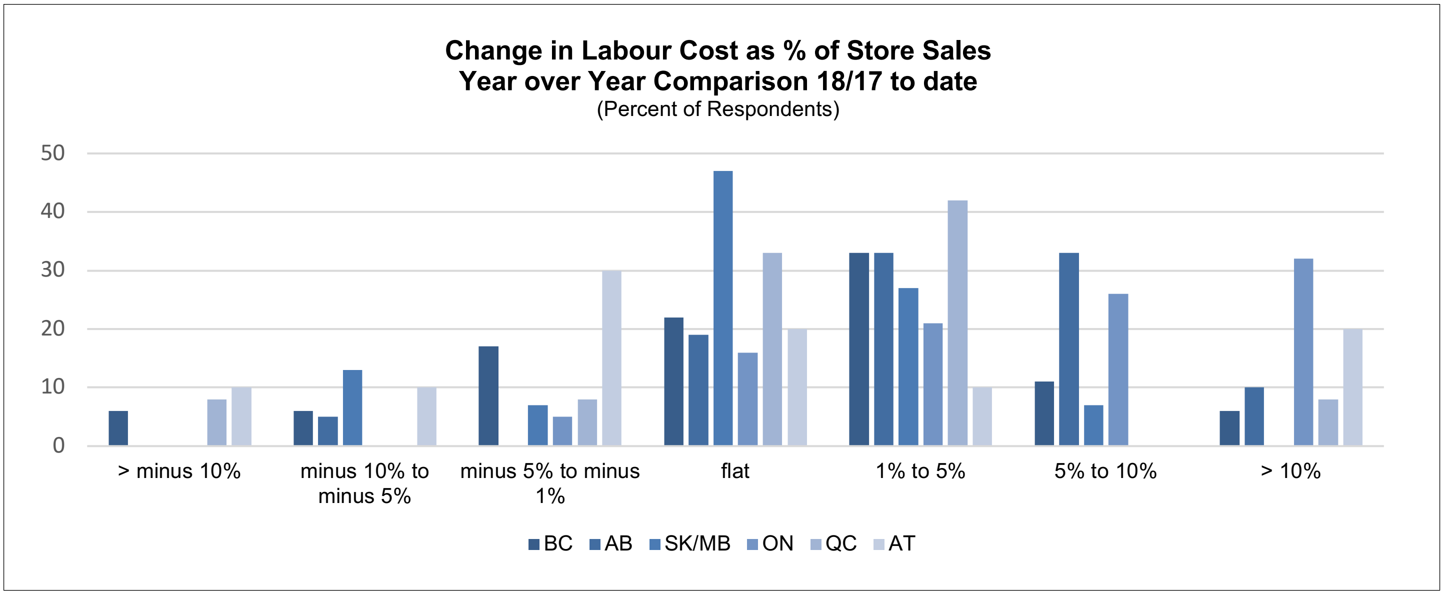
Only 22 members provided data for the two questions in this section. The smaller sample means readers should treat the results with an extra degree of caution. This is also RCC's first attempt at tracking the effect of minimum wage changes and both RCC and respondents are learning how to do it in a way that provides useful information to the trade.

RCC asked members if they had reduced hours in order to accommodate the mandated rise in labour costs. A solid majority, 59 percent, say they have not done so. However, many are aggressively looking for ways to make the hours worked more efficient and productive, and examining retail automation such as expanded self-checkout programs. Those with smaller format stores point out that they cannot go below the irreducible minimum of one person in the store.

The increase in **store labour costs** (see first chart below) is a simple measure of how the average hourly cost of running a store has changed in the first part of 2018 compared to 2017. It does not indicate how the change was achieved, and there are a number of ways it can be done. What the results do show is that retailers have been able to attenuate some of the impact of the increase in compensation, so the bottom line has not borne the full weight of the increase. Nonetheless, the October 2017 change in Alberta pushed up labour costs in that province substantially. The largest impact was in Ontario, where almost 80 percent respondents report increases in store labour costs of five percent or more.



The change in **labour costs as a percentage of store sales** provides some insight into how well retailers have been able to improve the labour efficiency of their stores. The results suggest there has been some improvement. However, the general increase of sales as a result of a healthy economy also helps. The impact of the minimum wage increase in Ontario stands out. The results showing a fifth of Atlantic retailers have experienced a large increase in the ratio appears to be an anomaly caused by the small number of respondents.



RCC COMMENT

The results above are RCC's first attempt at measuring how retailers have managed their way through substantial increases in labour costs in some provinces.

It is important to remember that the impacts and retailer adjustments are all still short term in nature. Many retailers have taken a significant hit on the bottom line to cover the higher store HR costs. One has to wonder how long this can be continued. The expectation on the part of many is that additional cost savings and improvements to productivity will help pay for the higher pay rates. If these efforts fall short, eventually the retailer will not be able to eat the additional costs. At some point they will have to be passed on, at least in part, in higher prices. RCC will return to this topic in the spring 2019 report. By that time retailers will have had a year of experience in most provinces where minimum wages were increased.

The February Outlook report identified a long list of initiatives retailers were undertaking to accommodate the higher labour costs. The responses for this report confirm that retailers have indeed worked very hard and taken some short term hits to protect their employees. Hours have been reduced only as a last resort.

RCC ASKED RETAILERS: "WHAT KEEPS YOU AWAKE AT NIGHT?"

Even if the steady drop in store traffic is unavoidable, retail execs are worrying about it and especially the implications for the company's future. Many members are pondering how the structure, business model, and strategy of the company must be changed as the online channel grows and becomes more closely integrated with the stores. As one member said, "That's why we have eyes in the front of our head – so we look forward, not back".

The sharp increase in store labour costs in some provinces is also causing restless nights. Members know the full effects of the changes have not yet worked their way through. They also anticipate other provinces following the pattern and raising minimum wages in their jurisdictions.

The election campaign in Ontario is being closely watched by many retail executives. They are aware that the policies of the next government could have a major impact on consumer confidence in their largest market, comprising close to 40 percent of all sales.

RCC thanks our members who generously contribute time, information and insight!

RCC produces the *Retail Conditions Report* four times a year. The next *Retail Conditions Report* will be conducted in September 2018. If you would like to participate, please contact Peter Woolford (see contact information below) or reply to this email with your contact information. We value your input. All information is kept strictly confidential and we do not reveal the names of the companies surveyed.

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