RCC RETAIL COUNCIL OF CANADA CCCD CONSEIL CANADIEN DU COMMERCE DE DÉTAIL

RETAIL CONDITIONS REPORT

Published: Feb 2019

Outlook 2019

It's Déjà vu All Over Again

2019 is looking a lot like 2018 with a forecast for stable growth in a changing industry

The following results are from an RCC survey of large and mid-size members, their expectations for 2019 and their experiences of the holiday season and into the first quarter of the year. The survey was conducted during the period of February 11 – 15, 2019 representing a healthy cross section of formats and geographies.

OVERVIEW

Overall, retailers experienced a decent, slightly unremarkable holiday season in 2018 that came in as planned for many, with nearly 60% of respondents reporting that sales were up from 2017. The season was characterized by some dramatic shifts in customer demand, behaviour and sales, with the week-to-week numbers in December remaining low for many, until just prior to Christmas. Retailers reported a strong Week 52 (i.e. Boxing Day/Week), which made the month for many. 2019 is shaping up to be another year of stable growth in the low single digits, 2.5-3.5% growth, not unlike 2018.

Retailers are mostly confident in an economy (with some regional exceptions, namely Alberta) that features relatively full employment. There are concerns about increasing interest rates eroding disposable income, the impacts on consumer confidence specifically relating to geopolitical issues (e.g. tariffs), as well as local issues (lack of affordable housing causing a tightened labour market).

Capital investment is expected to increase slightly overall. Many retailers report investments in online, re-platforming their current system. Store traffic remains a challenge, as does the amount of discounting and promotional activity in the market.

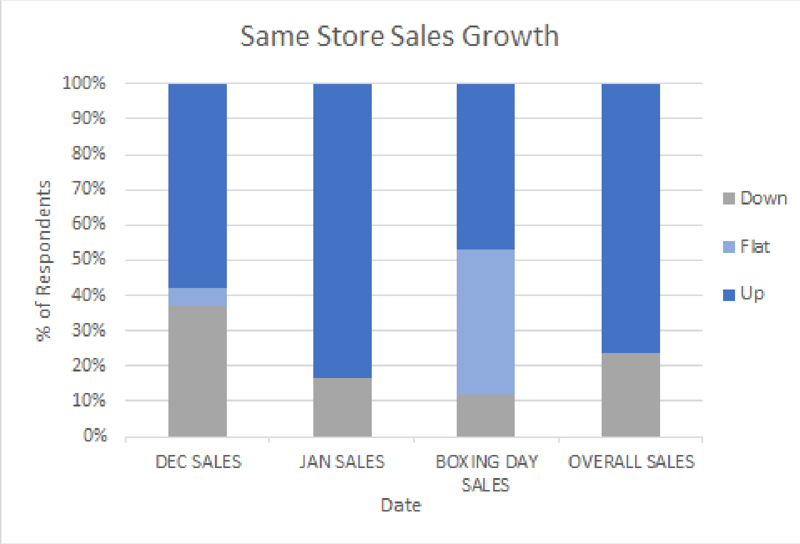
Holiday 2018 & Winter 2019

- 58% of respondents say December sales were higher than the year before, with nearly half of those saying the increase was softer than planned. Average increase for all respondents is +0.3% for the month.
- Boxing Day was just OK. 41% of respondents say flat year with the year before, 47% say up, with many of those reporting soft increases.
- That said, Boxing Week was great – 76% of respondents report up year over year, and report Week 52 saved Sales for the month of December.
- The year is off to a good start. 83% of respondents report higher sales year over year in January, with average respondent up +3.6%.

SALES

RCC asked respondents to compare sales in December, January, and for Boxing Day.

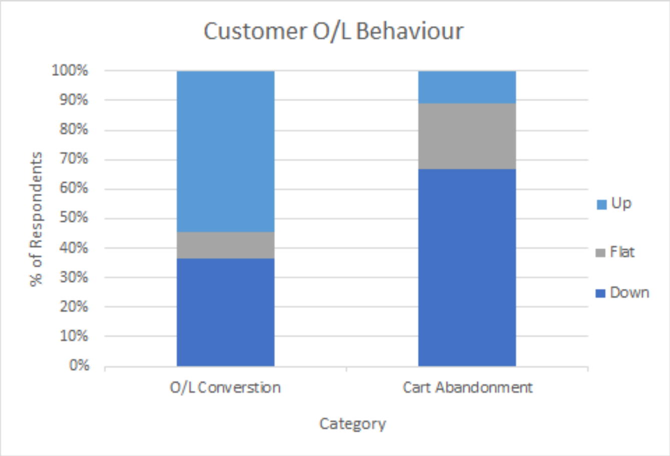
- December sales were varied; Week 52 helped some close out ahead, others say losses. On average, December was close to flat: **0.3% Up**
- Boxing day slightly up; an average of **1.4%**. While Boxing day is still high sales day, most report strong Week 52 sales.
- Companies recovered in January; off to a healthy start. Average sales increase: **2.8% Up** over last January.
- For the period Dec to Jan, **over 75%** of Retailers report same store growth

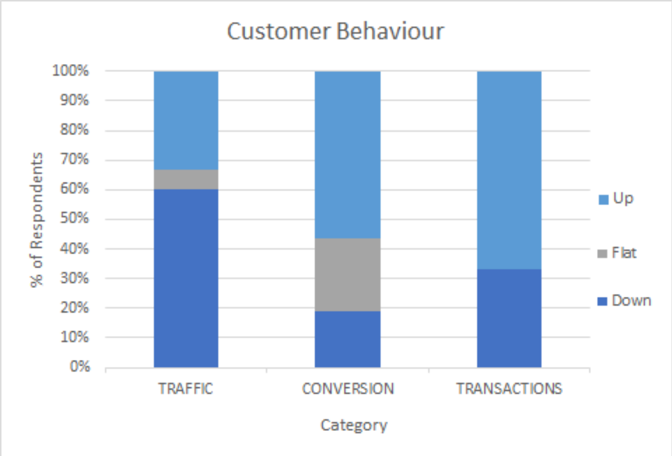


CUSTOMER BEHAVIOUR

Reaching back to the results of our prior survey and continuing in the dialogue around how the year finished, retailers felt a longer, more pronounced lull after the Black Friday/Cyber Monday shopping event. Many only felt the customer return in Week 52 for strong pre-Christmas, Boxing Day and Boxing Day Week Sales. Flat or declining store traffic is a regular focus of many conversations with retailers, and will continue to be an ongoing measurement in each Retail Conditions Report.

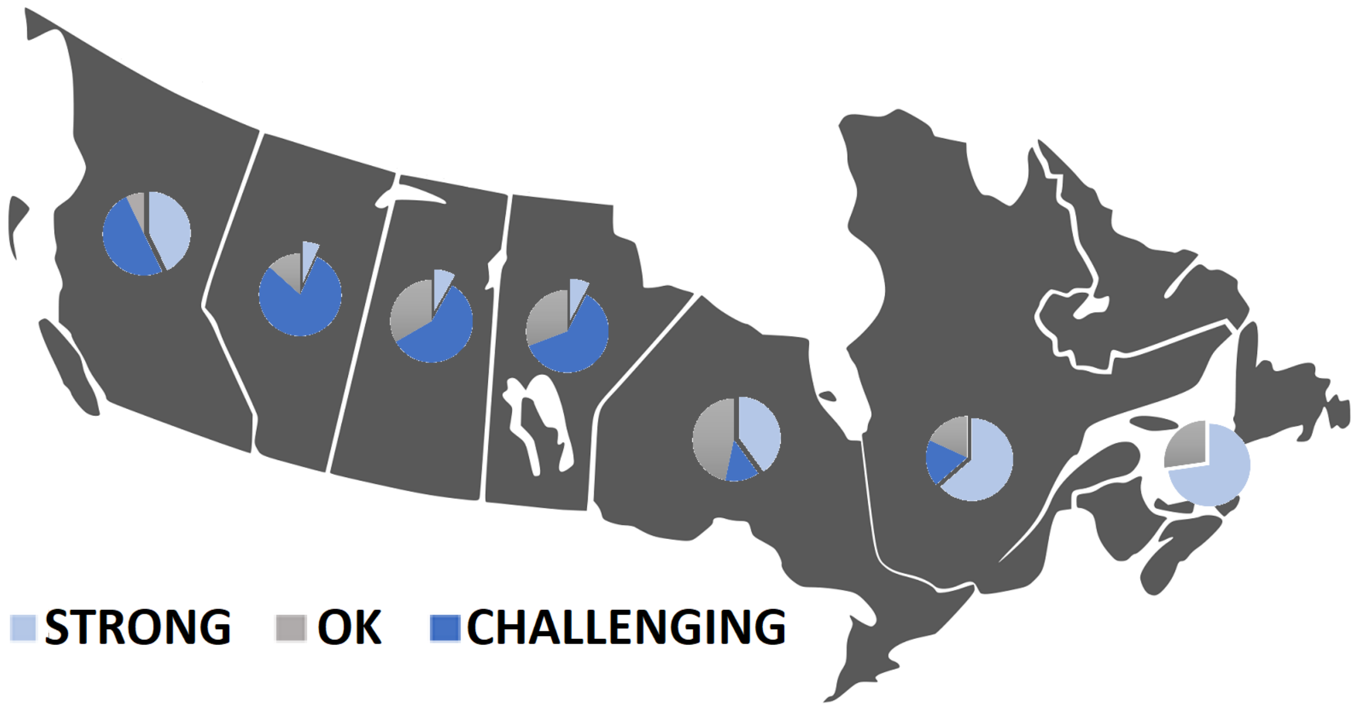
Holiday 2018 was a bit of an unusual season. As felt by many retailers, particularly those with robust eCommerce offerings, the Canada Post delivery issues generated a bit of lift in store traffic. But that was not a uniform response – for some retailers, incremental store traffic was hard to come by at any investment rate, flat to down.





RCC Factoid!

Cyber Monday was co-created by Scott Silverman of the NRF/Shop.org. It was created to help brick-and-mortar retailers and pure-play dotcom retailers raise awareness of online shopping, as well as to raise funds for a scholarship named after Shop.org Vice President of Research Ray Greenly, who lost his battle with cancer in 2005.



From Sea to Shining Sea: Results by Region

Growth in **British Columbia** now seems hard to come by, and the high cost of living has resulted in challenges finding and keeping labour. Several members also mentioned dips in sales in Vancouver and drew a more or less direct line to geopolitical problems between Canada and China that have caused the Chinese customer to shop elsewhere.

Alberta continues to be the most challenging province for most with the downturn in their resource-driven economy. In the Prairie Provinces, both **Manitoba** and **Saskatchewan** demonstrated some strength for most members, and this is proving resilient.

Ontario is stable, solid even – though not spectacular for most. With the size of the market, these results are considered a good thing. **Quebec** for many now represents a highlight in the nation, with strong YOY growth. Recent seasonally unadjusted sales from Statistics Canada are approaching a trend of something like 6% YOY growth in Montreal, and 4% YOY growth in the Province as a whole.

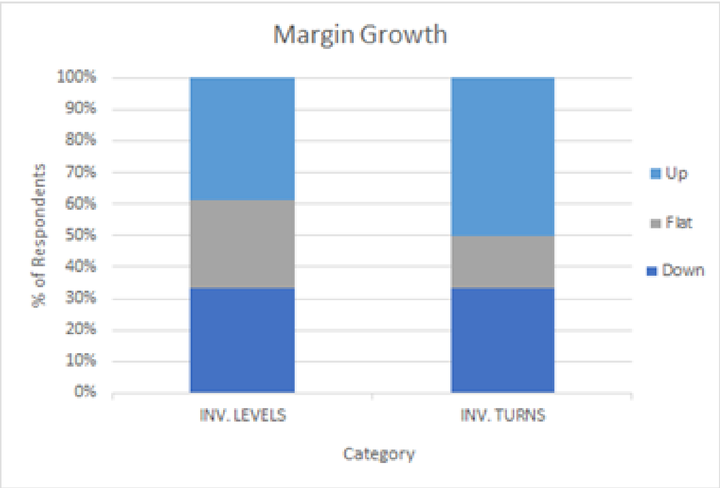
For most, the **Atlantic Provinces** are surprisingly robust, reporting solid gains. One retailer mentioned the interesting upside of labour mobility and the Alberta market. As the Alberta oil and gas industry reduces its workforce, people move back to the East Coast and bring with them their purchasing power accumulated over the past several years of full employment.

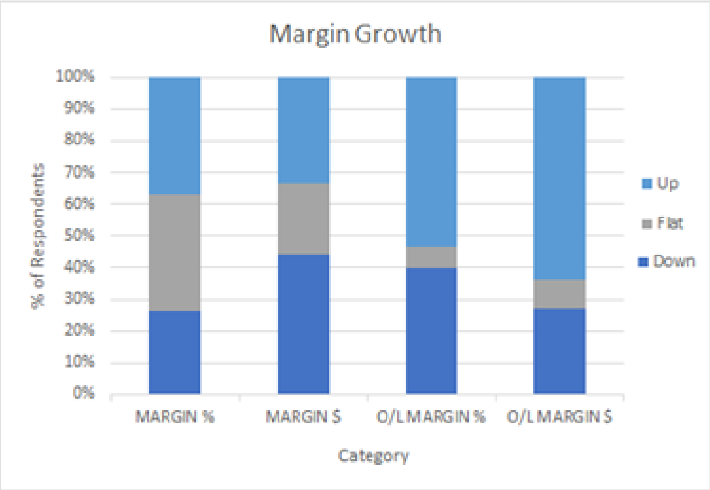
RCC Factoid!

In January 2019, a new set of laws governing eCommerce in China took effect. There are two important considerations of note for retailers in Canada. For those on the brand side with their own product lines, or who export to China, consumers can now spend up to 5,000 Yuan ($976CDN) on a single transaction and pay no import taxes. This likely means more direct online shopping and less turning to alternative marketplaces for Chinese consumers. For retailers who may be benefiting from Chinese consumers shopping in Canada and then re-selling those goods online in China (so-called Daigou agents), new licencing and business laws mean more red tape and cost for the Daigou agents. This may result in less sales in Canada.

MARGINS AND INVENTORIES

Inventory levels and turns were a mixed basket coming out of December and January. For retailers who had higher inventory levels coming out of December (39% of respondents), most reported that they managed to bring levels mostly back in line for January. Over the period of December and January, most reported margins holding or slightly up (74% of respondents). Major growth continues to be felt in the online space, though online sales continue to represent a smaller portion of total sales.





SPECIAL FOCUS: CANADA POST STRIKE

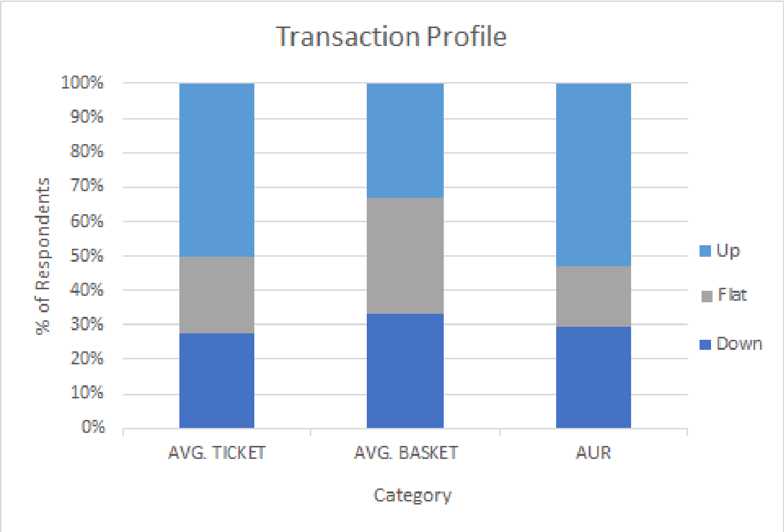
For the second time in two years, Canada Post service was disrupted across the nation during Q4 of 2018. Impacts of the Canada Post labour disruption amongst the members we spoke to ranged from a relative non-event for some (though they all thought there was a general dampening effect) to a downright business disaster for others. What was the difference?

For some retailers, they simply did not have extensive eCommerce businesses, or their commodity type (e.g. big-ticket appliances) was such that Canada Post was not their service provider; so, there was no direct impact. For others, they had already switched providers, or had worked through a back-up plan with alternative suppliers. In the latter case, the hit to their business was in the EBITDA, as they had to absorb what often are higher shipping costs than budgeted. In addition to the many cycles spent adjusting systems and processes in anticipation of possible service disruption, this meant time much better spent working on solutions and delivering value for their customers. Lastly, due to the sudden demands on alternative carriers, there was a limit as to how many packages that could be accepted into their systems. This was also the case for retailers who used couriers for deliveries of merchandise to the store networks.

For some retailers the postal dispute impacted flyer distribution, or direct marketing campaigns. Programs that arrived late didn't deliver the sales objectives.

There is concern that the disruption over the holiday season put a dent in online business that did not always translate into store traffic and resulted in lost, not deferred sales. Retailers expressed much frustration that there seems to be no end in sight – that in another four years, we could very well be in the same place. RCC will continue to discuss several issues with Canada Post, including the importance of labour stability, its rates across Canada, across the Canada/US border, and in from Asia in order to increase competitiveness. RCC, on behalf of members, is also taking a deeper look at how Canada Post will be collecting border duties, particularly once USMCA is ratified and put into force.

- In December and January, half of respondents reported increases to the average ticket, with those that did provide numbers generally reporting the increases were in the 1% to 5% range.
- AUR was up, with 58% of respondents reporting that metric increased over the period.



RCC Factoid!

In 2019, Black Friday moves out six entire days to November 29, the latest BF/CM in the calendar since 2013! This leaves only 26 shopping days between BF/CM and Christmas in 2019 versus 32 shopping days in 2018.

Special Focus: The Great Debate, Take Two

While we touched on Black Friday + Cyber Monday (BF/CM), in our last Retail Conditions report we felt the topic is worth revisiting. A decade ago, the adoption of Black Friday was primarily a defensive move by retailers in Canada. It was a time when the dollar was at par, and Canadians were streaming across the border to shop.

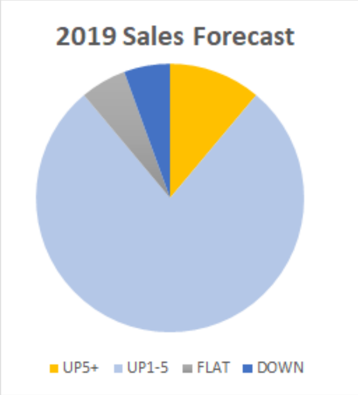
Fast forward to 2018, where Black Friday and its companion event Cyber Monday are major retail holidays in Canada. The RCC/Leger Holiday 2018 survey (retailcouncil.org/holiday-shopping) tells us that amongst the more than 2,000 Canadians polled, 40% indicated they were going to shop on Black Friday versus 35% on Boxing Day.

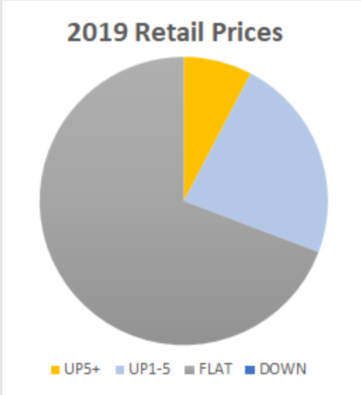
The challenge with all this is three-fold: consumers in November are shopping more or less fresh merchandise brought in for the holiday season, not a blend of excess and purpose-bought promotional buys as they are Boxing Day. Second, it would seem consumers are holding back purchases during November, and then holding off *again* after the event. The confidence retailers felt in being able to manage this cycle was somewhat dented in 2018.

Finally, the pre-Black Friday events are happening earlier and with deeper discounts. Looking south where the BF/CM holiday originated, it might be fair to say that while the event is massive with 165 Million Americans shopping over the course of the weekend, the event itself has lost some of its momentum. Sales in the U.S. market now start super early and super aggressively. In fact, the 2018 results show a slight declining participation on BF/CM: Holiday purchasing was slightly down year-over-year for the weekend, according to the NRF. If there are any lessons to be taken from the U.S. market, this promotional behaviour is a race to the bottom.

Interested in hearing more? Listen to a fun debate on the merits of Black Friday between former Retail Conditions scribe Peter Woolford and current Retail Conditions co-scribe Michael LeBlanc here: retailcouncil.org/podcast-9, and an interview with Peter Woolford looking back on decades of change in the retail industry here: retailcouncil.org/inverview-woolford.

OUTLOOK 2019





Retailers expect 2019 to be a rerun of 2018, with 78% anticipating growth between 1% and 5% for the year. Most retailers expressed that forecasts between 2% and 3.5%. With those looking to grow by more than 5% outweighing those projecting flat or sales decreases, the average estimate given works out to 3.8%

67% of retailers surveyed experienced increased Merchandise Prices. That said, retailers are conscious of how price sensitive their consumers are, with 69% seeking to hold retail prices flat, year over year.

Capital investment outlook 2019

Capital expenditures were forecasted to be stronger in 2019. The focus for capital investments for 2019 is largely in three areas:

1. Optimizing, or entirely refreshing, their online platforms
2. Investing in their store fleet by either refreshing the format or support mechanisms for associates to help increase sales conversions in-store
3. Investing in supply chain and upgrading distribution capabilities – investments that improve productivity back-of-the-house

The Voice of Retail™ podcast

The Voice of Retail™ is a weekly podcast hosted by retail pioneer and veteran Michael LeBlanc, produced in conjunction with Retail Council of Canada.

On a weekly basis, along with expert commentary and interviews, we take listeners through a curated look at the top retail stories in Canadian, U.S. and International retail.

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

We've heard a wide variety of issues that are keeping retailers awake when thinking about the year ahead. Here are several general themes:

- **Implications of Geopolitical Uncertainty**

By their nature, retailers are both optimistic and realistic at the same time. This applies to their perspectives around the many geopolitical issues that are impacting on business in 2019. Trade & tariffs changes and activist local governments all impact the value of the U.S. dollar.

- **Consumer confidence and discretionary spending**

In the face of interest rate increases, economic growth challenges in the West and the cost of living in Canada's major cities, retailers are concerned about the relative strength of consumer confidence, and the impact on their ability to spend on discretionary goods if interest rates continue to creep up.

- **Competition**

While it is often said that competition is like oxygen for retailers, the environment is getting highly charged with more and more international retailers entering Canada. In fact, CBRE reality ranked Canada in a 2018 survey as the seventh top destination in the world for international retailers, plus you have pure-play retailers also fighting for essentially the same customer dollars. While eCommerce growth is at or close to double digit, overall retail growth is in the low single digits, so it's a fight for market share.

- **Infrastructure Capacity**

Effective, efficient retail still means moving large amounts of goods efficiently and effectively from overseas to Canada and then across our vast nation. Members are worried about the "pinch-points" in the supply chain – from shipping container capacity to rail capacity, to the availability of truck drivers and warehouse workers.

- **Labour Costs**

While the Ontario government has both held the minimum wage increase for 2019-2020 as well as repealed Bill 198, the Albert government moved their rate to $15. Other provinces (e.g. Quebec) continue to increase their minimum rates, albeit slower. Yet, in some ways, the fiscal damage has already been done as the "knock-on" effect of managers demanding pay increases to create distance between themselves and minimum wage workers is well in motion for 2019.

Feedback, Special Thanks & One Big Ask

RCC asked members to help us assess the Retail Conditions Report. Is it a still-relevant body of work, and if so, could we do anything to improve its ability to lend insight to action?

Three key observations about the feedback we received:
1. Continue producing the report, largely in the same format and with the same timing/process release schedule
2. Continue to expand the reach/breadth of Retail Conditions by adding to its participants
3. Continue to explore key issues such as store traffic metrics, retail technology and other trend issues

Thanks to everyone who took the time to provide feedback.

RCC and the current authors would like to express their thanks and gratitude to the many retailers that are new to and continue their participation in the brief, one-to-one phone interviews that form the body of knowledge for this report. If you are reading this and would like to participate, please contact mleblanc@retailcouncil.org directly. As always, our conversation is highly confidential, brief, and we hope it also provides value and insight with an early preview to the analysis that we develop for every report. Importantly, while many trends reveal themselves in the first dozen or so interviews, the more participants we speak with means deeper and richer insights that we can convey to the entire industry.