FOR MEMBERS ONLY

RETAIL CONDITIONS REPORT

Holiday 2018

SANTA'S MOBILE LIST KEEPS GROWING

SALES OK, MARGINS & INVENTORIES SOLID, TRAFFIC SOFT

The following results are from an RCC survey of large and mid-size members concerning their experience in the fall and holiday season and expectations for 2019. The survey was conducted during the period December 3 - 7, 2018. A total of 41 retailers operating approximately 7,200 stores participated.

OVERVIEW

The holiday may not quite live up to retailer plans, but most are comfortable with what promises to be an OK season. Online commerce is by far the main, if not the only, source of growth, and mobile phones are emerging as the device of choice for both surfing and transacting on retailer sites. The big promotional events that bracket the season continue to grow in importance. Margins and inventories are performing as expected. Store traffic continues its multi-year decline.

Fall & Holiday 2018

- 63 percent of respondents say **fall** sales were higher. Average change for all respondents is +1.6 percent.
- 78 percent of respondents say sales were higher for **Black Friday / Cyber Monday**. Average change for all respondents is +5.4 percent.
- 50 percent of respondents say sales were higher for **the last week of November**. Average change for all respondents is -1.4 percent.
- 41 percent say **fall** margin rates were higher; 72 percent had an increase in margin dollars.
- 53 percent report higher inventory levels in **fall** and 49 percent had slower turns.
- 86 percent say **fall** traffic counts are lower and 67 percent say conversion is higher.
- 67 percent say **fall** transactions are higher.
- Average ticket, basket, and unit retail are generally positive in the **fall**. Ticket and AUR are boosted by price appreciation.

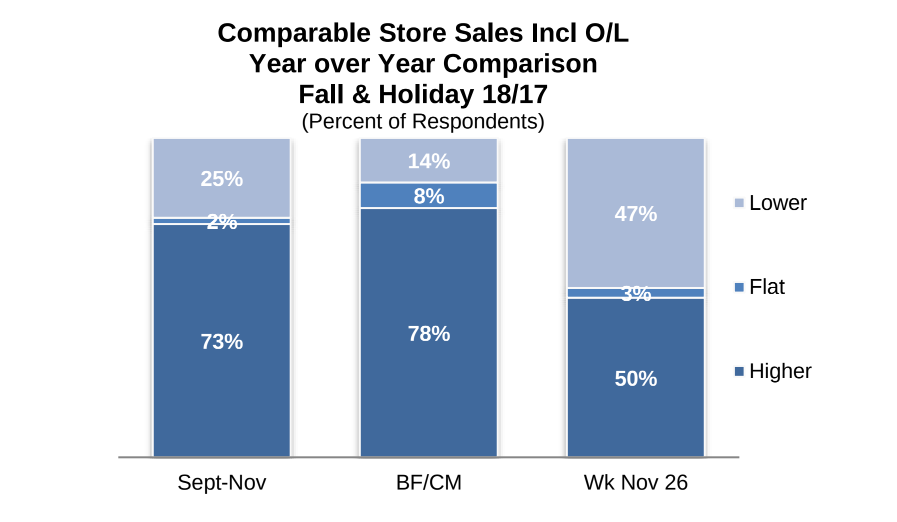
A Personal Message from Peter Woolford

After 17 great years, this is my last *Retail Conditions Report*. The members who participate have been thanked directly, but their contribution should be acknowledged publicly. Without their knowledge, insight, and leadership this report simply would not exist. Thank you for being great supporters of the report, RCC, and the trade. From the very start, RCC President Diane J. Brisebois gave me the freedom and encouragement to develop and grow the report. I am grateful for her belief in me and the report. And last but not least my thanks to the RCC staffers and my wife, Jean, who helped in the production of the report. They made me look good.

SALES

RCC asked respondents to compare sales in fall, Black Friday/Cyber Monday, and the last week of November to 2017.

- Average sales increase, sales stronger than last **fall**: **3.1%**
- Average sales decline, sales weaker than last **fall**: **-3.0%** excluding one outlier.
- Average **fall** sales change, all respondents: **1.6%** excluding one outlier.
- Average sales increase, sales stronger than **BF/CM** 2017: **7.9%** excluding one outlier.
- Average sales decline, sales weaker than **BF/CM** 2017: **-4.8%**



- Average **BF/CM** sales change, all respondents: **5.4%** excluding one outlier.
- Average sales increase, **W/O November 26** sales stronger than last year: **3.2%**
- Average sales decline, **W/O November 26** sales weaker than last year: **-5.7%** excluding one outlier.
- Average **W/O November 26** sales change, all respondents: **-1.4%** excluding one outlier.

The holiday season appears to be evolving as planned, although most expect to fall short of their sales targets. Interestingly, the strong comps of 2017 are not cited as a reason. Retailers anticipated a slowing economy, planned for it, and are not overly concerned the decline has been slightly greater than forecast. The end of season will see comparable store sales including web sales growth in the low single digits. Most if not all of this comes from the online channel, with stores flat or showing marginal increases. Some have experienced store sales declines.

The trend toward a bimodal holiday season – Black Friday/Cyber Monday and Boxing Week - continues to expand. The former is now a much larger event for many retailers. Strong sales during this promotional period were immediately followed by a desert of much slower sales and declines in the rest of the following week. The promotion is now effectively a four-day weekend event in both channels, and many members anticipate it will continue to expand further back into November. As in previous years, many saw sales soften in the first part of November as customers waited for the promotions. Some retailers experienced softer sales in October; some attribute this to a dip in consumer confidence that month.

Results by region are more diverse this time, with some reporting more consistency across Canada, while others see regional differences. The slow-down in **British Columbia** has become more widespread, with the majority of members saying it is now one of their weaker regions. The softness occurs in all parts of the province. **Alberta** continues to be the softest retail market. The consensus is the small signs of recovery seen earlier in the year have disappeared, and many expect 2019 to be a tough year. Members say **Saskatchewan** sales are also soft, a consequence of weakness in oil and gas. **Manitoba**, too, is reported as soft, although no specific factors are mentioned. **Ontario** is a solid market for most. The September Statistics Canada data for **Quebec** show strong growth, but the experience of members is mixed, with members reporting sales experience varying from soft to strong. The province continues to be a puzzle for retailers. **Atlantic Canada** also has varied results.

The online channel continues to grow dynamically. The growth rates are too widely diverse for an average to be meaningful, but almost all retailers report double digit increases. This includes retailers that already have substantial online business. It isn't just those with a very small base on which it is easy to post dramatic growth rates.

The impact of the postal dispute was more nuanced and diverse than portrayed in the general media. A substantial portion of respondents say they have seen relatively little impact on online sales. Others believe site visits and transactions were affected. Almost all say there has been no impact on total company sales. Certainly, there have been delays in delivery, and some retailers switched to higher cost options. Some report the other delivery services have struggled to handle the surge in additional business. The problems centre around slower and less reliable delivery dates. Calls to retailer help desks enquiring about the non-arrival of orders have risen substantially. It would appear the problem is worse in smaller urban centres and rural Canada than in metropolitan cities. Most are confident they will be able to deliver online orders made by the previously-set deadline before the holiday. Those that use direct mail advertising, especially flyers, say their programs were significantly compromised. The options for delivery are few and higher cost.

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	10%	15%	20%	5%	25%	13%	13%

RCC COMMENT

The notion of a tipping point has been over-worked, but retail has clearly passed through one with this year's Black Friday / Cyber Monday. If retailers ever had any doubt about the strength of the shift to online, this season has laid them to rest. Even with the disruption in the postal system, customers continue to shift *en masse* away from stores and toward online. Retailers are now operating in an environment where this channel is, and will be for the foreseeable future, the source of growth. Whether growing organically or by taking market share, the tool for doing it is the website. What is worrisome is that the site is increasingly accessed via the mobile phone, but as reported below, more than half the respondents could not provide data on the portion of visits and transactions done by mobile and tablet. If what gets measured gets done, these data should be on every screen in the C-suite, of equal importance to the traditional key performance indicators.

What's happening in Alberta? The economic indicators portray an economy that is really struggling. Yes, retail sales are soft too, but less than one would think given the amount of distress in the oil patch. One member who has seen this movie before, notes there is a six to nine month lag before consumer behaviour changes in response to a downturn in economic conditions.

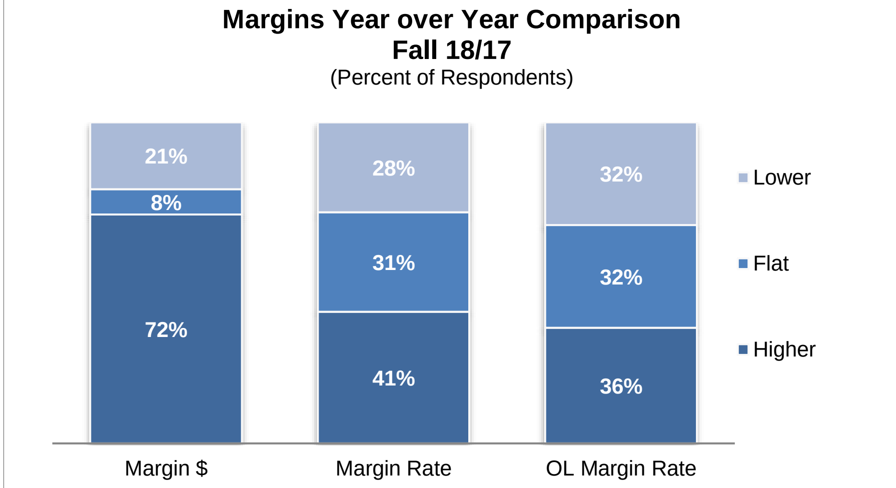
In the outlook edition of this report, many retailers said they were cautious when setting sales targets for 2018. The wisdom of that approach has become increasingly clear as the year has progressed. In addition to the usual years-worth of unexpected bumps and squeaks, retailers have operated in an economy that has slowed rather more than expected. Job creation in 2018 was modest until Statistics Canada delivered an early holiday gift to retailers on December 7. The agency reported a spectacular increase of 94,000 jobs in September, almost all full time.

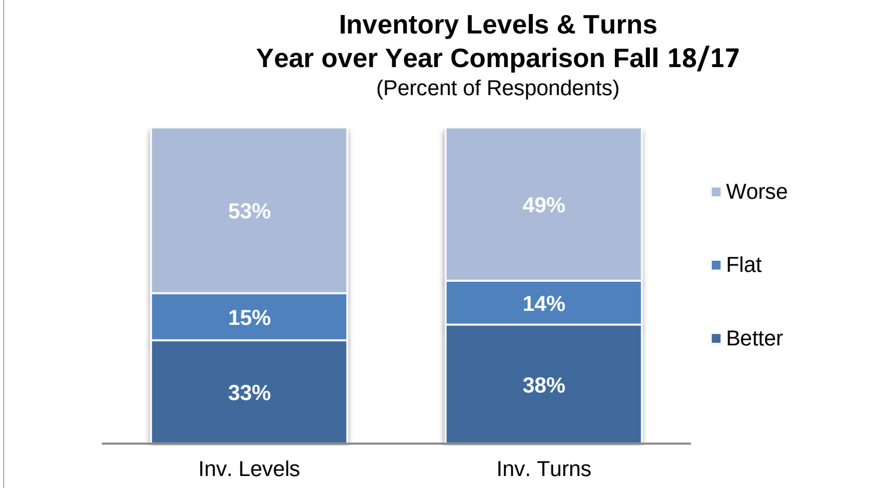
Canadian consumers pay attention to political, economic, and business developments, and apply them to their personal circumstances. They are remarkably astute analysts, but this year they have had to deal with a complex environment full of conflicting signals. A healthy but slowing economy, except for the oil patch, and a thrills-and-chills-a-minute international environment. Lots of reason for consumers to be prudent. It's hard to believe 2017 were "the good old days".

MARGINS AND INVENTORIES

Despite sales below plan, margins have held up, and almost no one is talking about offering unplanned promotions. Members note the relative stability in the exchange rate of the dollar has helped them to stick to margin plans, although many still watch the value of the dollar closely and nervously. The experience of margins in the online channel is more similar to that for bricks and mortar than previously.

The inventories graph leaves a negative impression that is at odds with what respondents say about their stocks. Inventories are fresh and well under control. Members are confident they can sell through at planned margins. Some note it has become more complex to manage inventories as the season has shifted toward bimodal surges at the start and end of the holiday. Some of those reporting higher inventory levels say they were planned. Others admit they under-ordered for the 2017 season, so this year's levels measure higher but are in fact appropriate. Very few mentioned problems with aged inventories – but they are more likely to show up January.





RCC COMMENT

Inventory results are a useful leading indicator for how the season is unfolding, as any unexpected build-up will quickly trigger a response. They offer insight into whether competitors are coming under pressure to break away from their promotional plans in order to move any emerging stock overhang. At this point there is no reason for retailers to change their tactics. And the longer they can hold to plan the better the margin results will be. Of course, the store-wide promotions at the very beginning of the season when stocks are fresh and full will already have taken a (planned) chunk out of the bottom line. There is a special place in retail hell reserved for the person who invented Black Friday. Michael Leblanc and I will debate this proposition during the webinar on Wednesday December 19.

Retailers with a large online business are struggling with the level of margin in this channel. Even when the website graduates from a clearance channel to carrying the same merchandise range as in stores, margins generally are lower, partly because of the customer's expectation delivery will be free. Currently the web business benefits from the infrastructure built and supported by the bricks and mortar stores. What happens as the store contribution of margin dollars shrinks, and the company still needs to invest? It is an axiom in retail that, “You can’t shrink your way to greatness,” so cost reductions are a short term tactic at best. Where do we go from here?

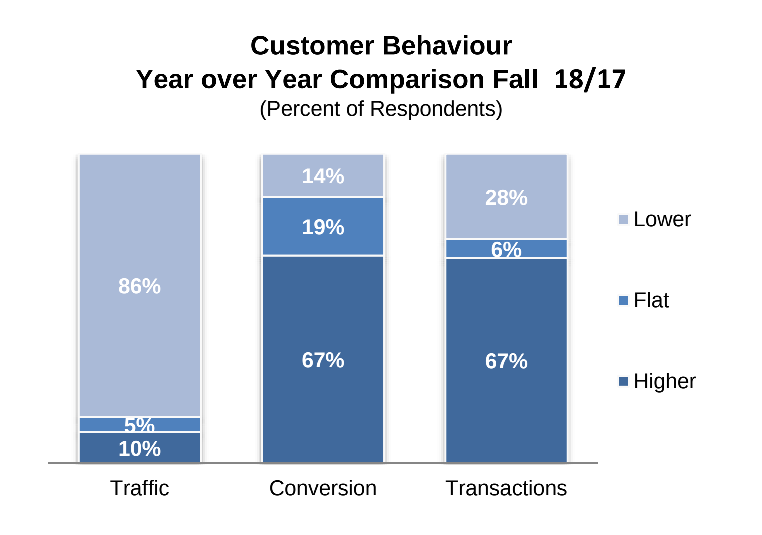
Concern about changes in the value of the Canadian dollar continues to lurk at the back of the mind for many retail executives. The sharp drop in the value of the dollar after the December interest rate decision by the Bank of Canada brought those worries back to life. It is worth noting there was no expression of concern about inflationary pressures arising from exchange rate changes.

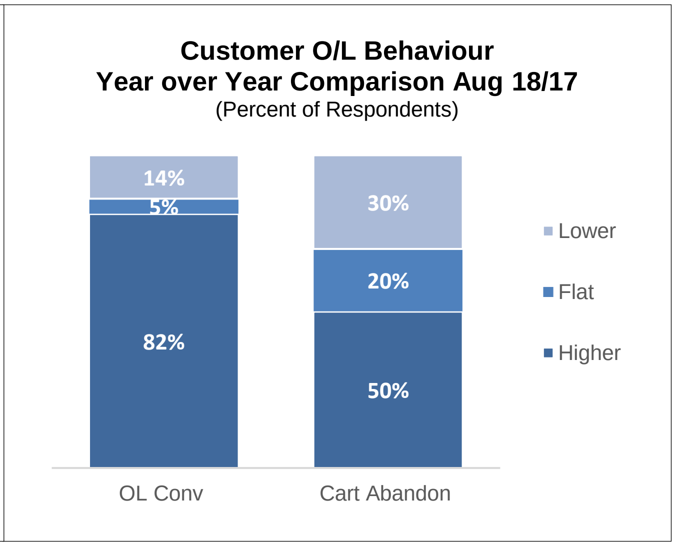
The results for these metrics add to the sense this holiday is turning out to be a rather unexciting season. After the glow of the good 2017 results, retailers might have been expected to be disappointed. But given the roller coaster the trade has been riding, unexciting sounds pretty good to many merchants. Actually, roller coaster understates the past decade; there the cars just go up and down, around, faster and slower. Maybe a shooting gallery is a more apt metaphor, with retailers able to be either the shooter or the target. Consider: as the shooter they are aiming at dozens of constantly moving targets, jostled by a crowd of other players, using a weapon that doesn’t shoot as truly as it once did. As target they are bumping their way through a market filled with other moving targets and being shot at from many different angles. The minute they make it to the side of the shooting range, they are pulled around to do it all over again.

CUSTOMER BEHAVIOUR

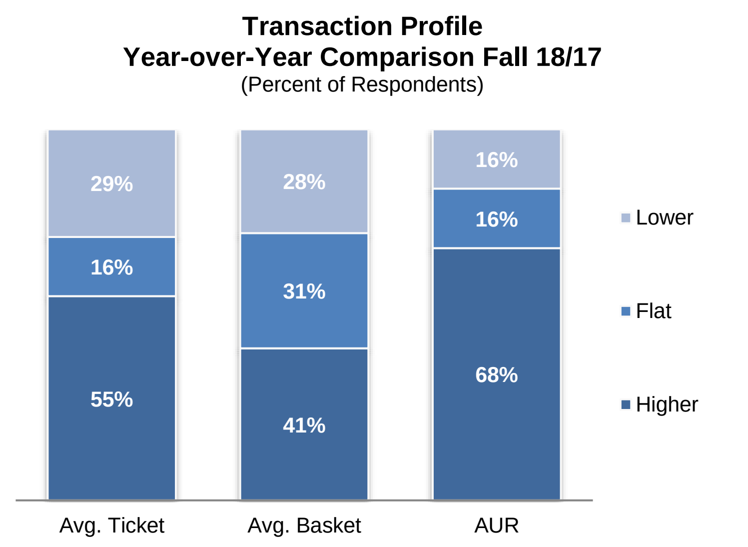
The results in this section should be read with caution because the base of respondents is small. Only 21 respondents use automated traffic counters, 18 report transactions. Store traffic continues its multi-year decline, as customers flock to the website. Some respondents saw a modest uptick in store visits as a result of customer concern about the reliability of the delivery of online orders, but they quickly agree the long term trend continues to be negative. The conversion results indicate store customers are committed buyers who have done their research and are there to close the sale. Some members argue their conversion results are a sign of their evolution toward omni-channel retailing, with the website playing an important role in driving traffic and sales to the store. The transaction results are helpful only in confirming the mild positive trend in sales.

Once again RCC has included data on online conversion and cart abandonment, even though they are not informative and have few responses (22 report conversion, 10 report cart abandonment). Hopefully, at some point these data will provide insight into customer behaviour online.





The results for average transaction value (ticket) items per transaction (basket) and average price per unit sold (average unit retail, AUR) continue to be mildly positive, showing no sign of a change in consumer confidence. Some say the average ticket and AUR have risen as a result of price increases driven by the need to pass through at least part of the increase in minimum wages.



RCC COMMENT

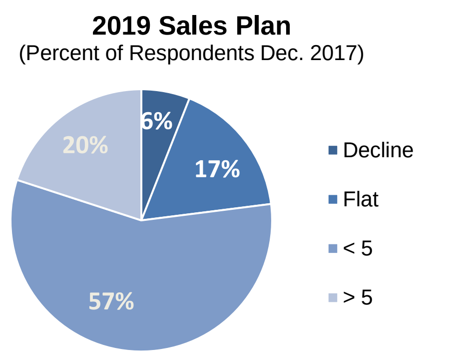
The sudden surge in traffic during the promotional event shows customers have not forsaken the store completely, but also suggests it increasingly requires an extra promotional effort to pull people away from shopping on their mobiles.

Even though relatively few members can provide the data, RCC has been tracking results for online conversion and cart abandonment as an investment toward the future. As noted in prior reports, one of the challenges is uncertainty about what the results say about customer behaviour on the website. It is likely additional data points will be needed to understand the complex interactions customers have with the website before they buy, whether online or in-store. For example, some retailers are using email addresses and loyalty programs to follow the customer from their research on the website, to interacting with a store associate, and then to a sale, either in-store or on the site.

This fall, Canadians have been beset with worrisome news: uncertainty about the trading relationship with our largest partner to the south, reports of a softening economy and slower employment growth, and heightened geopolitical tensions. We are astute scanners of the larger environment and incorporate the trends into our daily purchasing activity. It is encouraging to see that despite lots to ponder, Canadians are still prepared to shop – as long as they get a bargain.

OUTLOOK

Retailers expect 2019 to be a repeat of this year. Most are planning for very modest increases in sales, characterized by flat store sales and strong online increases. Given the generally softer margins online, this may presage lower margin rates and less growth in margin dollars. The consensus would appear to be for sales to grow roughly in the two percent range.



RCC COMMENT

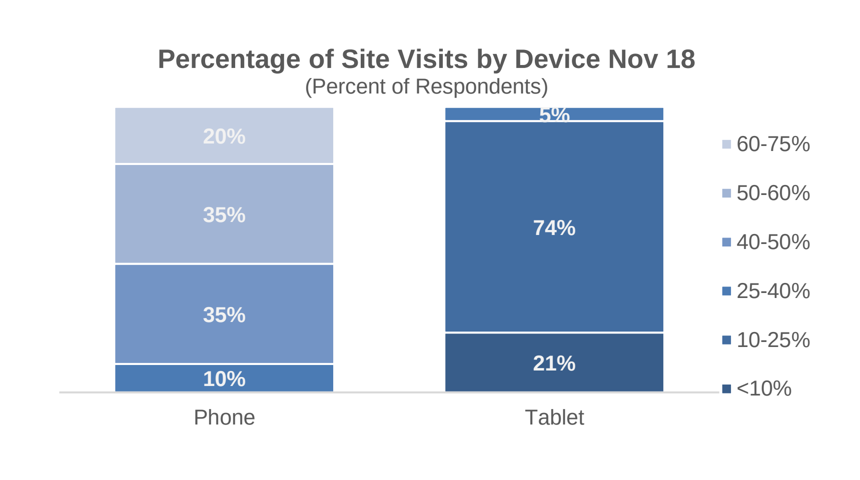
After a year of gradually softening conditions, retailers can look forward to more of the same. Economic forecasts for 2019 peg the Canadian economy as growing at a slower rate than this year. The good news is that few forecasters expect a recession. With employment likely to grow slowly next year, retailers can expect to grind out very modest sales increases. It will be a grind. Many anticipate the level of competition will only increase. If previous years' trends continue, the growth driver will be the online channel while store sales will be flat at best. This means retailers will be facing further restructuring of their business model and operations to reflect the new market realities without much support from either the top or bottom line.

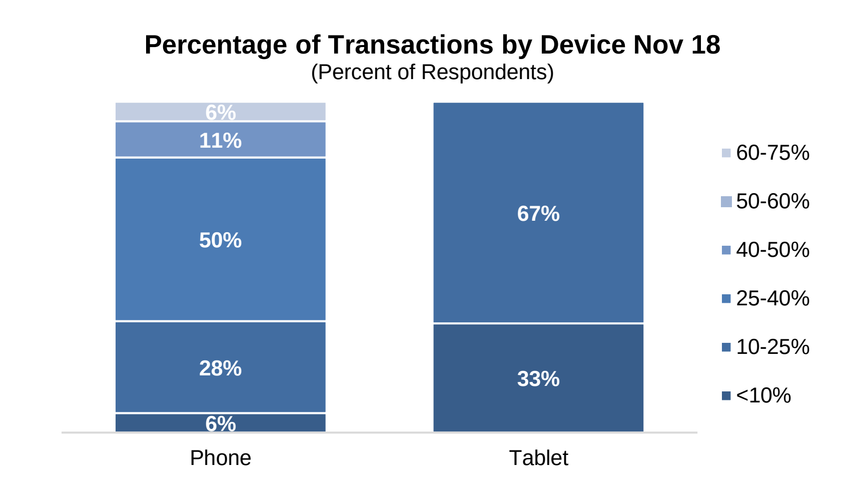
SPECIAL FOCUS: MOBILE COMMERCE

RCC was able to get results from fewer than half the respondents (18-20 retailers depending on the topic) for the questions regarding the use of mobile phones and tablets to visit and purchase on store websites. Although the number of respondents is small, discussion of the results with participants suggest they are representative of experience across the trade. They show a significant shift in customer preferences from the last time RCC explored this topic, some years ago. Mobile has emerged even more as the dominant device for site visits. As the graphs show, mobile penetration for transactions is lower than for visits, but members agree it will quickly become the preferred device for this purpose too.

Use of the tablet for online purchases was popular a few years ago. However, rapid advances in mobile phone technology and an increase in their screen size have removed the tablet's advantages and its usage for making purchases has dropped.

Most respondents now have optimized their website for all devices





RCC COMMENT

The real surprise in the results is the surge in the use of mobile phones, and the corresponding decline in the use of tablets. This is happening for both site visits and transactions. The last time RCC asked these questions, the tablet was the preferred device for transactions and a strong competitor for site visits. So what's happening? One member offered a crushing verdict on the tablet, explaining "it's just not portable enough." That is a measure of how quickly and profoundly technological advances can change customer behaviour. A tablet is now viewed as being almost as clunky as a desktop.

Is it time that retailers made a commitment to being "mobile first"? In the tech industry, a decision to put a specific technology first is a statement of a strategic commitment to place investment in that technology ahead of all others and to deliberately lead customers to that platform. What would a mobile first strategy imply for your website? In light of the results in this report, it would mean a total and continuing commitment of resources to making the website as mobile-friendly as possible. This would be pursued even if it meant underinvesting in other devices and giving their users a lesser experience. From this perspective, the limited number of company executives who know what role mobile plays on their sites is telling. The customer is shouting their preference loudly, but it not clear retailers have yet reacted to the message.

Many respondents had data on the portion of site visits and transactions without a break-out between mobile and tablets. Apart from site optimization considerations, does it matter which type of device is used? Consider anecdotal comments from some members. Store staff report customers using their mobile to compare prices and order from a lower-priced competitor while still in the store. *Ouch*. Others describe customers looking at the line-up at the cash wrap, pulling out the mobile, and jettisoning their purchases. At least the sale was saved but at a cost to the store.

RCC's answer to the question is yes. Retailers need to track mobile use obsessively and devote effort to really understanding when, where, why, and how their customer is using it.

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

Like their customers, retailers are very aware it is an uncertain world. The items in the big picture – trade disagreements, a slower economy, geopolitical tension, the exchange rate, technological change, cost and competitive pressures – intrude when retail execs are trying to get to sleep.

HR concerns pop up in two forms. First there is the difficulty of finding staff, especially at store level. This challenge is redoubled for those with stores in Vancouver. Respondents say the cost of living is so high people working in front end jobs simply cannot afford to live there. The second HR worry is the cost of labour, especially in provinces where there has been a sharp rise in the minimum wage. Some believe there has been some limited pass-through of these costs to the customer in price. Even so, the consensus is retailers cannot eat these increases over the medium term.

On behalf of all the staff at RCC,
best wishes for the holiday season and a happy and prosperous New Year

We value your input. All information is kept strictly confidential and we do not reveal the names of the companies surveyed. RCC thanks our members who generously contribute time, information, and insight.

PREPARED BY: Peter Woolford