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WEINER NOTES

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Goldman Sachs Global Retailing Conference

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I recently attended the Golden Sachs 17th Annual Global Retailing Conference. Here are my key observations:

- All the retailer executives attending the conference are cautious on the consumer outlook. However, they are not expecting the economy to get worse.
- Dot.com strategy has become a core competency and is competing for capex with real estate.
- Average Unit Retails (AUR) are continuing to trend down in many retail segments suggesting that slight deflation is still a factor.
- There is a sea-change in the assortment at Wal-mart. The experiment to reduce the assortment at Wal-mart failed and is being reversed. Huge impact on Wal-mart's competitors as this will take market share.
- While the executives presenting seem in general extremely strong, my favorites are Mickey Drexler (J Crew), Jim Sinegal (Costco) and Jim Wright (Tractor Supply)

Niche growers (note: no big-box operators)

- Tractor Supply
- Rue 21
- Urban Outfitters
- Lulu lemon
- Lumber Liquidators

JCPenney (Myron Ulman—CEO)

- Underlying economy will not be inflationary over the next 12-18 months. Inflation is an overstatement.
- Assortments are skewed to the good, not better and best. Average unit retail (AUR) is down 6-7% but increase in number of units that have offset decrease in AUR
- Macro backdrop: good lift on comps from 4Q. Consumer on pause for 2010 and 2011. Strong balance sheet to invest in renovations and new initiatives.
- Very few new stores. Not a lot of 100ksf opportunities in urban markets, and suburban markets are saturated. A few new stores only.
- Capital allocation priorities—remodels important. $1.3BN in capital a few years ago. Goal is now to shift to put capital renovations. Also merchandise initiatives. Fund peak borrowing from own balance sheet. Very unusual. JCP has a strong dividend policy.
- Ulman: JCP is a tough short-term story. But long-term potential.

Andy Weiner is a lifelong analyst of the retail and restaurant industries. For three generations, his family owned and operated Weiner's Stores, a clothing retailer throughout Texas and Louisiana. A graduate of Stanford University with an MBA from the University of Texas at Austin, Andy served as COO of Weiner's Stores for eight years. He continues to study the industry, merging trends with his experience and intuition as a private developer, broker and consultant. Andy Weiner specializes in identifying the larger forces that impact both consumers and investors–and understanding their implications for today.

J Crew (Mickey Drexler–CEO)

- Macro: concerned; world is not a feel good place. Proliferation of goods at every price point; more and more competition at every level. In terms of planning, no reason not to be conservative. Comps will come from competition. We think there is deflation: selling lower average unit retails. This is deflation. More and more people coming on-line with internet platforms.
- Drexler sleeps well at night: goes to sleep not worrying about who will be marking down goods. Also, a lot of brands are opening own stores; everyone wants to go vertical. Not alot of growth long-term
- World is not just about low price—also fun, fashion, fit. (AIW: Mickey is good). Lexa has had a very successful line.
- Shoppers love to shop; it is an olympic sport.
- AIW: Mickey is very passionate about his business; very appealing. Has built a high-integrity fashion company; men's and kids business starting. To grow , J Crew does not need to build stores to show growth. Even in the drug store business, it is all about the product. J Crew is afraid of the big rents of new stores.
- No one knows the regular price selling of any goods.

Macy's (Terry Lungren-CEO)

- Macy's is training 130,000 employees in the art of magic selling. American Rag is junior brand; and Material Girl from Madonna. 1BN internet hits on Material Girl.
- Inflation is inevitable towards end of 2011. Shipping costs, product costs, Material costs. Deflation on apparel industry has occurred for many years.
- AIW: Terry is very sharp; knows his product, brand, assortments, pricing.
- Capital: from $550MM to $800MM increase in capex–primarily in technology investing instead of real estate; will expand state-of-the-art fulfillment centers for dot-com.

Lowe's (Rob Niblock–CEO)

- Growth of new stores: metro areas and single-store markets.
- Earliest regions that went into downturn are coming out earliest: Northeast, Florida, California. Carolinas are soft.

Dot.com panel

- Panelists: GSI Commerce; yooks ($200MM in sales); Kohl's ecommerce exec; William Sonoma–Pat Connolly
- Dot com as core competency
- Stores have advantage over a pure play.
- Most people come to site so that they can buy in store.
- Basic of any retail experience is great product.
- Yooks.com seems strong
- Everyone is increasing investment in technology.
- Ipad is being used for commerce more than iphone and just in 2-3 months
- Amazon does $33BN of business; $79 yearly payment for free shipping 2 days: 33% of sales comes from this loyalty program. Yet amazon has opened up market to first line purchasers.

Radio Shack (Julian Day)

- Mobility products as key focus in the last year;
- Economics of wireless. TMobile is third carrier plus ATT and Sprint. Goal is to be authority on wireless. Since added third carrier, all three carriers are up in volume
- AIW: Julian Day seems to be too cerebral, not emotional
- Rolling out stores within Target

Kohl's (Kevin Mansel–CEO)

- Huge market share gain; transactions are up 8% and margins are up as well.
- Heavy investment in online: new 1MM sf fulfillment center, new software and in-store kiosks.
- Accelerated investment in remodels. Will have completed 30 new stores as well in 2010.
- Testing electronic signing. Reduces store payroll.
- Credit card is 50% of sales; new partner is Capitol One
- Cash balance over $2.5BN. Opportunities to invest include share buyback, dividend (timing may be right for), opportunistic growth in real estate.
- AIW: Kevin Mansel presents better than I had expected.
- Productivity opportunity in the west and in the south; obviously sales are sluggish.
- Sales psf are at $217 from a historical high of $240-$250psf. AIW:I would have thought it would have been higher.

- Last year, comp stores increased yet marketing spend went down $40MM. Want to be on the edge with social media.

Office Depot (Steve Odland–CEO, and Kevin Peters, President–North American Retail)
- AIW: Steve is sharp; business is turning around. Kevin seems OK as well.
- 80-85% of sales comes from small business; small business has been hurt in the economy.
- First national postal service rollout. WOW!!
- 15,000-18,000sf smaller footprint; higher store productivity, better shopping experience. This makes sense. 100-110 stores per year come up in lease each year, and ODP uses this opportunity to downsize. Can downsize in place via downsize, opportunity to relocate, and sometimes will pay dead rent. ODP will add 20-25 stores per year
- New Combo facility–Kiva mobile fulfillment center. Product brought to people using robots.
- Capital allocation: asset back facility that prohibits share repurchase through 2012. Priority for capex will be downsizing stores, European IT systems.
- AIW: I liked the story; a lot of upside dealing with emerging markets as well.

Costco (Jim Senegal-CEO; Richard Gilanti-CFO)
- 13 openings in 2010; 19 in 2009. Deals were harder to get done; 26-27 new opening in 2011. Will open north of 30 on a go-forward basis.
- Craig Jonak(spelling?) is the new president of the company; has run our merchandising for 7 years.
- Role of private label is potentially impacting deflation. More private label selling causes the competing brand to lower pricing. This is a major issue: deflation in products. For example, Kirkland detergent is $13.99. Same size for national brand is $21.99. Sales have increased at Costco for the Kirkland Brand and the major brand has reduced its price to $19.99.
- Self checkout for the lower volume warehouses; 75 stores; higher volume stores don't have because employees run through customers quicker. Note–stores with self-checkout will have lower sales.
- Health care insurance costs have increased due to higher penetration of users because employees weren't leaving. Now with stores growth ramping up, this negative could mitigate.
- Harder to run business today and find product for all stores; but that is why they call it work.
- Margin–focus on pricing and driving sales. Theme: we are in a deflationary environment; in other words, very competitive.
- Capital allocation: $1.5BN 5 years ago; last year $1BN. In next few years will go back to $1.4/$1.5BN. This is interesting.

Home Depot (Frank Blake–CEO; Mark Ellison–Head of Stores)
- Macro Climate: Indicators--private fixed residential investment as relates to GDP, housing turnover,
- How do you merchandise for an era of frugality? Staffing in stores–reassign staff away from higher ticket items to repair aisles–hardware, plumbing, electrical. On merchandise, more of focus on OPP (opening price points) and value areas.
- Supply Chain initiatives. From 75% direct to stores to 75% DC to stores. Allows HD to reduce safety stock.
- Merchandising initiatives: centralized planning, assortment management,
- E-commerce–the future is an interconnected store and web strategy.
- Uses marketing tool dunhumby–shopping behavior that defines a Pro customer. Significant decline in pro business in 2008 and 2009. Stabilizing at a lower level in 2010.

Saks (Steve Sadove-CEO)
- High-end consumer has come back. Customer seems OK. Purchasing at all price points: good, better, best. Strength in NYC. NYC is 20% of sales.
- Don't let a good recession go to waste: challenge merchandise mix, cost structure. Took $150MM of cost out of structure. On merchandise mix, took about 5-10 points out of best price points and put into good/better. Eventually 20% of product will be differentiated product. Local event and marketing by store: 37 new marketing managers hired.
- Don't expect to see double dip and rapid growth.
- 90% R squared correlation between stock market and state of our business. Customers based upon their attitude toward their net worth.
- Gross Margin is several hundred basis point opportunity–less promotion due to inventory more in line. Triple to double points. Back to very good level of full-price selection. Hold and flow technology–holding back 30% of the product to post-allocate. Pulled out points of distribution of less profitable lines. AIW: very positive.
- Reducing promotional cadence. Goal is to reduce the amount of promotions.
- Expense Management: 90% of associates on commission. Have closed some underperforming stores and have a few more to go. Closed stores at $125psf. Every store is unique. Plano, Texas, and Mission Viejo, Cal, have been able to get out of their leases.

- Goal is to get to 8% operating margin—when secular trend returns for luxury.
- At Off-Saks, could look at growing 3-4 stores. Feel very good about outlet sector.
- Capex: $55MM this year plus the same next year; used to be $125MM years ago. $55MM is not a lot investment. ot major remodels.

Rue 21 (Bob Fisch, Pres and CEO; Keith McDonough, CFO)

- Smaller markets is a good strategy. Good mall business in B malls. More opportunities to squeeze developers; better B malls where Rue can take over white space. 50% strips and 50% B malls—goal is to lock up rents for next 10 years. Outlet strips cost most and the malls the least; this is opposite from 10 years ago. If stores can do $900-$1.1MM, in B malls stores can be doing greater than $1.1MM without paying higher rent. Low preopening cost. 100% ROI is achievable on opening. Can open up a store in 3 months. Does not see new buildings coming up for at least 2 years. Strategy of filling existing centers. In strips Rue 21 sees 2400 opportunities and has 600 stores. In malls, has 180 stores. Don't know how long mall opportunity will remain; most likely 2 years.
- Rue Black perfume has become 1% of sales
- Speed to Market—in 2 months.
- Capex–$120k net of LL contribution (for new stores); 80%of inventory covered by accounts payable. 100% ROI is conservative.
- Store size is 4700-4800sf; sometimes get more space in mall because LL does not want to reconfigure space.
- Studying on-line presence
- 70% female; 30% male; target customer is 13-17 year old who wants to be 21; some adults who want to be 21 are our customers.
- AUR is $7 and $7.50. Average sale is $22-$24
- Sales in general next to Wal-mart are usually about 1% of sales of Wal-mart;
- Open a regular business in outlet centers—expanding the etcetera format.
- Cato is Misses business and non cutting edge of fashion
- Look at over 400 locations to get to 200 to get to 100 or 110. A lot of opportunities in Texas ; Rue has 73 stores and Wal-mart has 300 stores. Can add 150 stores in Texas. Idea: let's do Kemah!! Any opportunities in Texas than any other areas of country. Border areas now getting better. By far number one growth state.
- Outlet centers will not be a big play because outlet centers not being built; mall opportunity could be 500 stores from 180.
- Bonuses are tied to shrinkage.
- Value is here to stay!!! Higher priced store is Abercrombie
- Location strategy of Smaller Markets (50k and less) and Mid-Markets (50k-200k).
- Maurice's is more 18-35; an overlap of 10-20%; likes Children's Place, Justice, Rue, Maurice's and Dress Bard (35-50)
- President was at A and S.

Ross (Michael Sullivan—Pres and COO; John Call—SVP and CFO)

- Has cut inventory which has helped margin and turns
- Didi's has 57 locations; will be profitable this year
- Can double store base from today
- More stores are not turn-key, using second generation space
- 6-7% unit growth

Wal-mart (Bill Simon—Pres and COO of Wal-mart US)

- Listening tour: where can we be better? Spending a lot of time with Mike Duke.
- Added back regular prices and action alleys
- How will rest of year look? Back-to-school came later and in fact came in after the event.
- More transactions being paid for with government assistance. At 11pm at end of month customers fill basket and government cards get activated at midnight.
- What worked: electronics (strong assortment in hardware), process discipline and inventory management (electronic RFID tags for men's), store standards working (fast, friendly, and clean)
- What did not work? Pricing (on basket, not on every price), broad assortment (being restored), supplier partnerships, local community involvement
- Will offer full breadth of assortment. Customers will decide what we carry by what they buy. We will win in every category. Will not carry things that are not profitable. (Implication: more inventory); restoring action alleys in most of stores (80% of most stores). 80% of items for action alleys driven by Bentonville; remaining 20% chosen by managers.
- Message to suppliers: open for business and we want to sell product. We can launch a new product better than anyone. Get trial and feedback faster than anyone.

- Private Label Program–we are a house of brands. Shows our product better; wants to show as value. Less emphasis on private labels.
- Merchandise Organization Changes. Four core areas: hardlines, food, apparel and one more. John Westling will lead general merchandise. Andy Beren will lead apparel. Jacksie Clair runs food business (from Tesco), Duncan McNaughten will run consumables, wellness and dot.com business. Was at HEB and Supervalu. All four will report directly to Bill Simon. Goal is speed.
- Growth–Chicago announcement–several dozen stores over next 5 years. Urban markets. 10,000 associates and 2,000 construction jobs. Healthy mix of supercenters and smaller formats including Neighborhood formats
- Supercenters still have the best ROI.
- E-commerce. Eduardo Castro Wright runs this business. Pilot in LA and Boston–site to store. Deliver to Fedex stores for free.
- Saw loss of trips due to inability to fill basket with more limited assortment. Traffic loss was at middle and lower end of customer. Lack of assortment hurt that customer and higher gasoline prices hurt us.
- Looking forward to win in each category.
- Inventory is up 4%.
- Have seen some inflationary movement in dairy and commodities. Deflationary environment will eventually be abated.
- Urban markets: market share is very low in urban markets. Suburban and rural markets as well. Focus is on jobs. US square footage growth–will grow with multiple formats.
- Technology-able transactions. Wal-mart well positioned to deliver in that environment.
- Contribution to hunger in US–$2BN over next few years.
- What is right percent of private brands? Depends upon category. Branding private label made it look like we were bigger than we planning to be. With reduced SKU, stores looked like Wal-mart was forcing customer to private brands. (Interesting).
- Inflation in four major segments: on food side inflation in dairy and grain. In apparel could be some inflation from orient.
- Financial services. Doing very well. Adding money centers to stores.
- What was thought process over reducing assortment? Merchandise theory that if you distort growth areas and make them bigger and therefore reduce other areas, business will increase.
- We have to get better every day. EDLP, EDLC, better assortments. Progress is important: two steps forward; one step back.
- Macro–holiday will be price-competive; customers more cautious than distressed. More need-based gifts and practical gifts–things you need you will get
- Margin-flat for rest of year.

Petsmart (Bob Moran-CEO)

- Shift from a growth model to driving shareholder returns–focus on productivity of existing portfolio of $210psf–stuck for 4-5 years.
- Wave of new offerings–either private brands or exclusive offerings (like Martha Stewart and GNC)
- Macro–tiny improvements in consumer side but long slide.
- Can trade customer from better to best.
- $120-$150MM of capex per year at 2-2.5% of sales; store growth of 3-4%.
- First time that we have seen the number of households with pets have dropped from 62% to 61%. Also new household formation is down.

Tractor Supply (Jim Wright–CEO; Greg Sandfort–Pres and CMO- came from Michaels; Randy Guiler–IR)

- TSC Peaked at annual unit growth of 13%.
- Customer is cautious; postponing the deferrable.
- $120MM invested in DC in past 10 years
- 960 stores today–can get to 1800 stores.
- Lifestyle we serve–owns land, outdoor projects, animals (14 times more likely to own a horse than average American, owns dogs, an SUV and pickup truck). Small town America is conservative. The customer is very busy because they have projects. Customer is on average 49 years old, makes 15% more than average person. Eclectic mix of merchandise–dominant player of workwear, birdfeeding, pets, large animal bagged feed. Land and equipment maintenance, seasonal categories makes tall grass short and short grass tall. Gas and wood pellet business.
- 8% unit growth–70-75 stores this year; next year 80 stores.
- $3.5BN in revenue. No debt. $400MM line of credit. Dividend introduced in Jan of this year.

- Long-term EBIT target of 7.5% driven by gross margin. Four initiatives: pricing optimization, strategic sourcing, private brand (today less than 20% and could go to 25%), improved planning and allocation of seasonal goods.
- Consumables—usable and edible. Pet and animal has grown from 33% to 40% of business this year.
- AIW: The head merchant, Greg Sanfort, seems strong.
- New POS system was launched. Moved company to latest update of SAP. Been on SAP for last 10 years. Purchased Manhatten system for warehouse management. Placing automation in all DC's–conveyor systems. Price optimization system about to be announced.
- Private label–customers look for "planted tools"— if they fall off of truck going through field. Private label as a brand introduced into gaps into the assortments
- Direct Sourcing–product sourcing is now internal; product development team is in place.
- Macro backdrop–83% of people employed are less fearful today than a year ago.
- Margin trends–on the gross margin line an internal objective of 30bps of margin growth per year over the next three years.
- Growth–Feel very comfortable with 8% growth and cash on balance sheet.
- West Coast–18 stores in California today. It is a very long supply change today. Temperate, arid market with a lot of rules and regulations. Of 860 to be opened, about 290 will be Colorado and west. Will need 2 DC's one in southern Cal and other in northwest near a port. DC's will be built around 2013.
- Capital allocation–store growth followed by new DC ($45MM capex) opened next year.
- Dell's–it could take share in smaller markets. The model works very well. $2MM in second year if strong horse density. Tested smaller TSC in 5 stores (12ksf); can be profitable with $2MM. Good test. 2.5 acres. Would expand stores with high density of horses but lack of availability of 2.5 acres. Looks more like Tractor Supply.
- AIW: Jim Wright as always sharp; first time to meet Greg Sanfort–impressed. Former Pres and CMO for Michaels.

Rite Aid (John Standley-Pres and CEO; Frank Vitrano–CFO, CAO)

- Story is liquidity. Capital structure issue is behind us for 4 years. $650MM asset backed loan.
- Wellness Plus is loyalty based card program just rolled out. Earn 1 point per dollar; 25 points per script. When 500 points, 10% discount on all front end for one year; at 1000 points then 20% discount on front end for one year. This seems strong. Over 50% of front end is Wellness Plus cards. 40% pharmacy.
- Test announced with Save-alot for 10 stores announced last week. Fewer skus (13k versus 20k); more full-case pack which will drive down costs. Our store with licensed agreement from Savealot; dry grocery, deli, produce, on one side. (What is size and where can this be seen?). This is in Greenville, Alabama, area. Is this a copy of Fred's?
- Need momentum on top line. In pharmacy–71% of front-end customers do not shop pharmacy. Opportunity to market to this group with Wellness Plus. Also a larger basket size ($2 per basket) for Wellness Plus customers.
- Issues: labor, real estate, etc. Higher volume stores–shift towards health and wellness. Big immunization program. Additional services in pharmacy.
- Front-end issues: consumer is focused on value; value equation model is changing; convenience is not as importance as in the past.
- Back to school was not great for us; bought less inventory.
- Profitability of pharmacy side of business.
- What is macro backdrop? Remains tough with some small positive signs.
- What is direction of operating margin? Hopefully better. Depends upon top line.
- Capital allocation—$250MM in capex in 2010. Not a sustainable level; needs to be $500MM. Will gradually increase in capex over next couple of years. File-buys, resets, relocate existing stores.