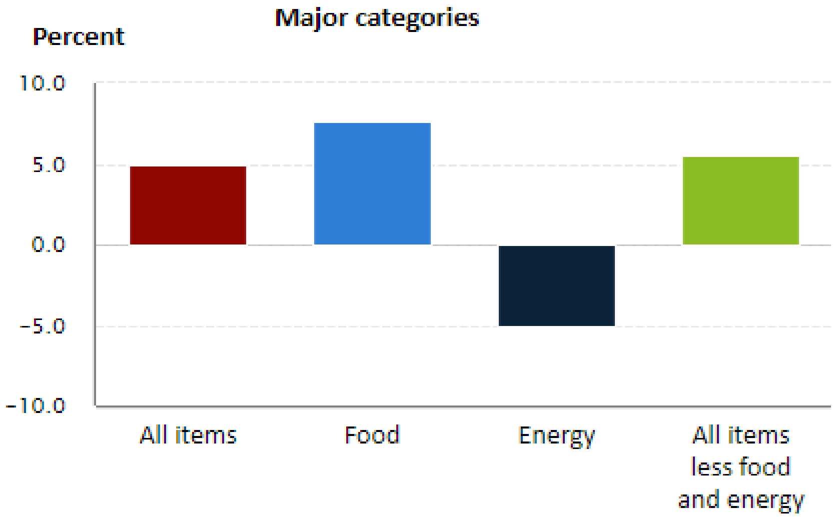
Retail Outlook: 2H23 Update

June 8, 2023

Economic Trends – Inflation

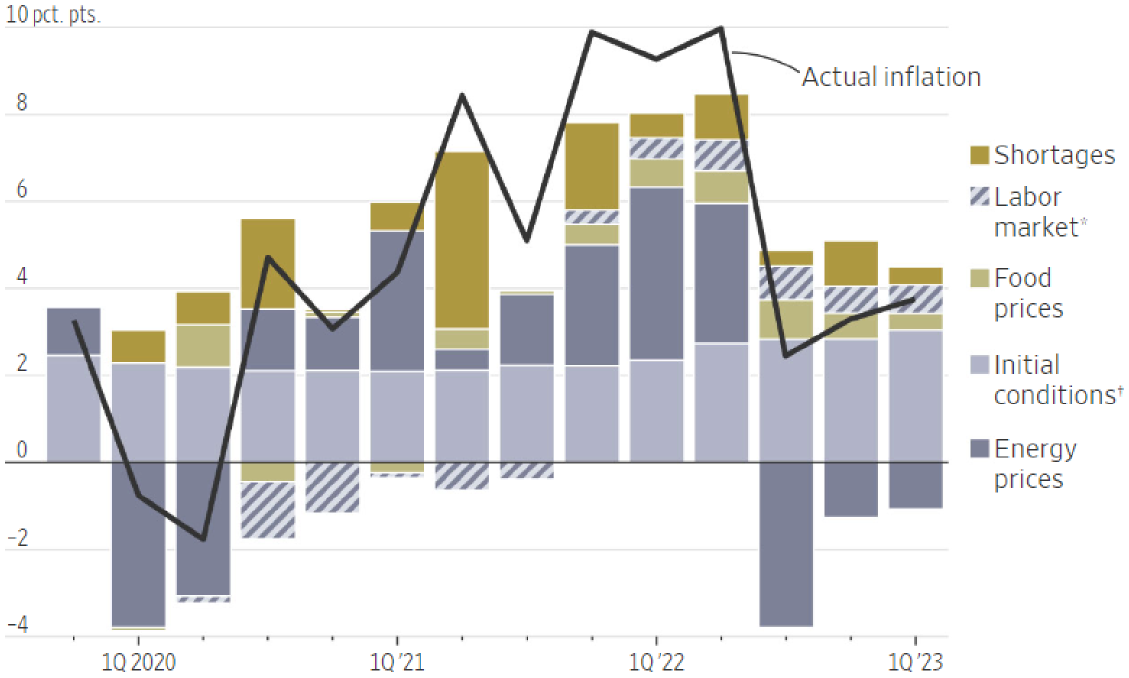
- Persistent inflation remains the headline
- Predictions: Summer 2021 – transitory; Summer 2022 - inflation retreat to 2% range by mid-2023
  - April CPI up 4.9% on top of 8.3% April 2022
  - Peaked at 9.1% in June 2022
- In 2020 Fed shifted mandate focusing on maximum employment even if inflation topped 2%
- A multi-faceted problem, that complicates Fed rate debate

12-month percentage change, Consumer Price Index, selected categories, April 2023, not seasonally adjusted



Source: U.S. Bureau of Labor Statistics.

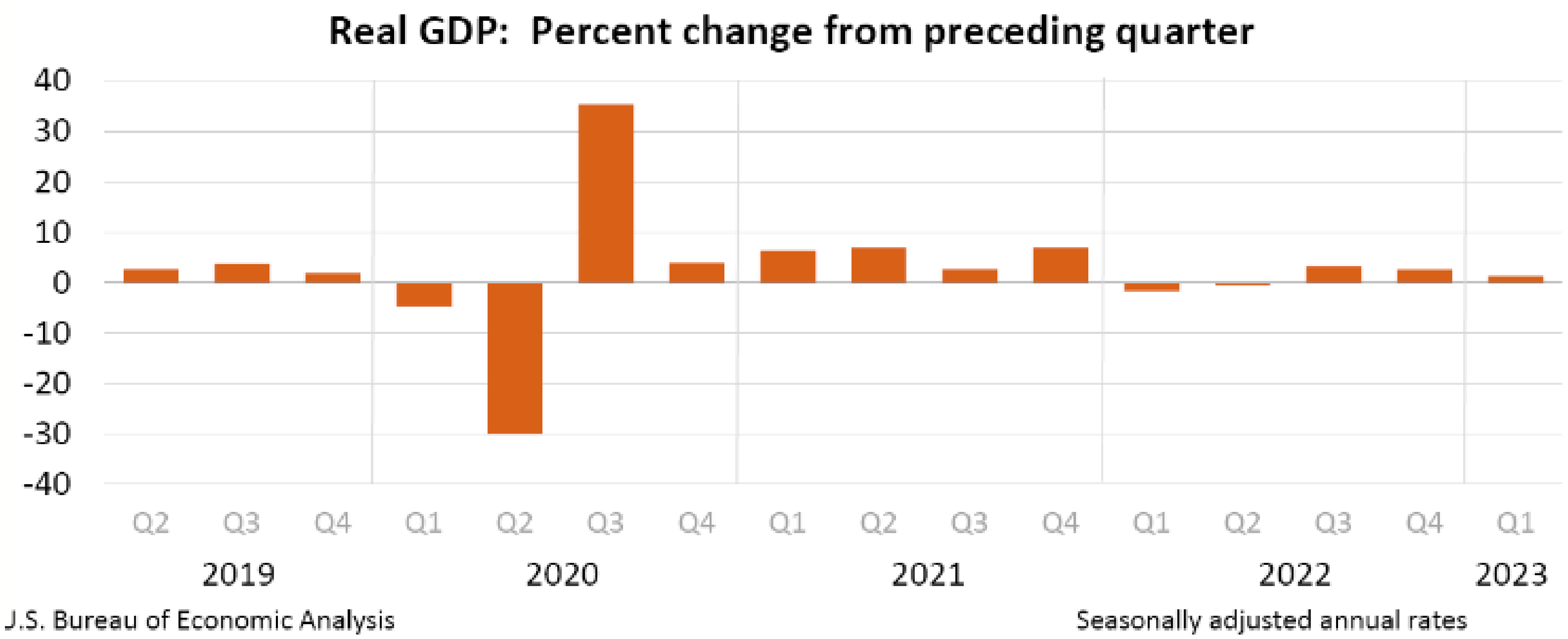
Contributions to inflation by source



*Ratio of job vacancies to unemployed
†Effect of pre-2020 data and productivity.
Note: Contributions are model estimates and don't add exactly to actual inflation.
Quarterly data, annualized.
Source: Ben Bernanke and Olivier Blanchard

Economic Trends – GDP

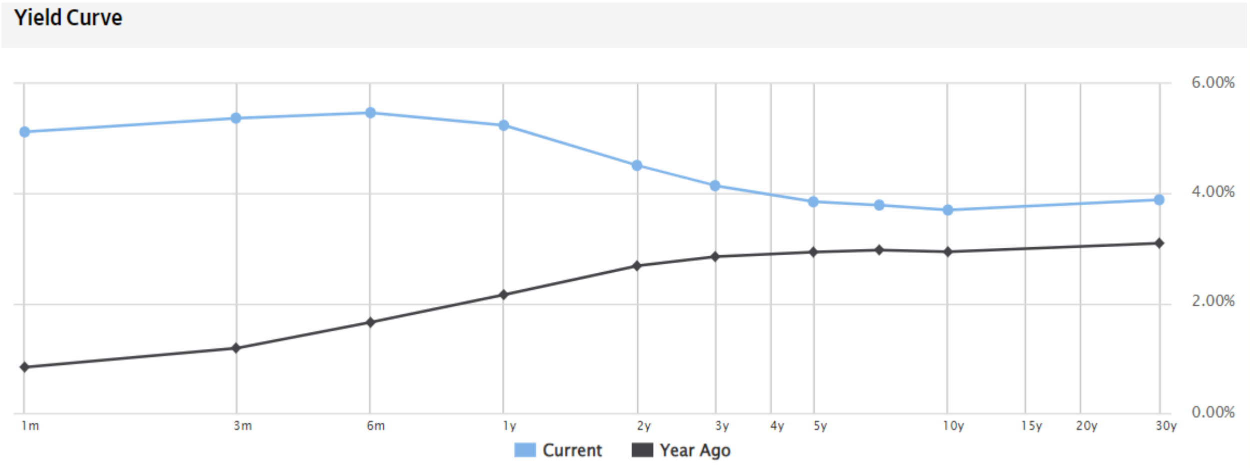
- Economy remains surprisingly resilient
- 1Q23 GDP +1.3% – consumer spending tailwind
- 4Q22 GDP +2.6%
- When will the recession hit, or has it already?
- Conference Board – CEOs expect "short and shallow" recession

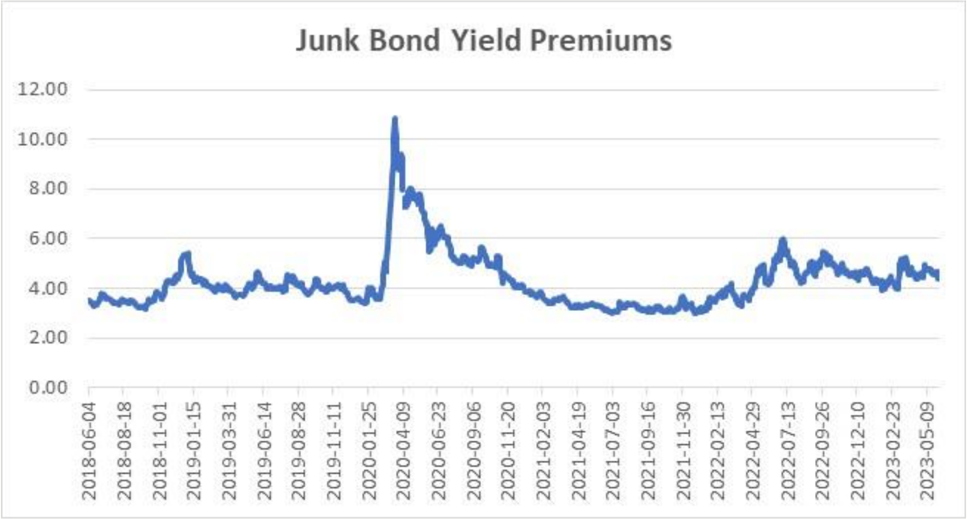


Economic Trends – Interest Rates

- Fed rate debate – further hikes or cuts by year end?
  - Latest expectations are Fed rate ~5% at end of 2023
  - Fed's job: destroy some demand and jobs
- Yield curve inverted = recession
- End of low default era?
  - Corporate bond spreads are within historical range; junk spread 400 bps to 500 bps & demand indicates low expected defaults
- Rate hikes hit small business hardest
  - More restrictive lending
  - Average rate for U.S. SBA loans reached double-digits

	YIELD/RATE %		52 WEEK		CHG IN PCT PTS	
	LAST	WK AGO	HIGH	LOW	52-WK	3-YR
Federal-Funds Rate Target	5.00 - 5.25	5.00 - 5.25	5.00 - 5.25	0.75 - 1.00	4.25	5.00
WSJ Prime Rate*	8.25	8.25	8.25	4.00	4.25	5.00
Money Market, Annual Yield	0.54	0.53	0.54	0.08	0.46	0.25
Five-Year CD, Annual Yield	2.82	2.84	2.84	0.94	1.88	2.06
30-Year Mortgage, Fixed	7.09	7.27	7.41	5.26	1.52	3.62
15-Year Mortgage, Fixed	6.54	6.65	6.65	4.62	1.79	3.70
Jumbo Mortgage, Fixed	7.13	7.31	7.44	5.19	1.53	3.61
Five-Year Adj Mortgage (ARM)	6.00	5.97	6.03	3.90	2.10	2.77
New-Car Loan, 48-Month	7.02	7.01	7.03	4.47	2.55	2.82





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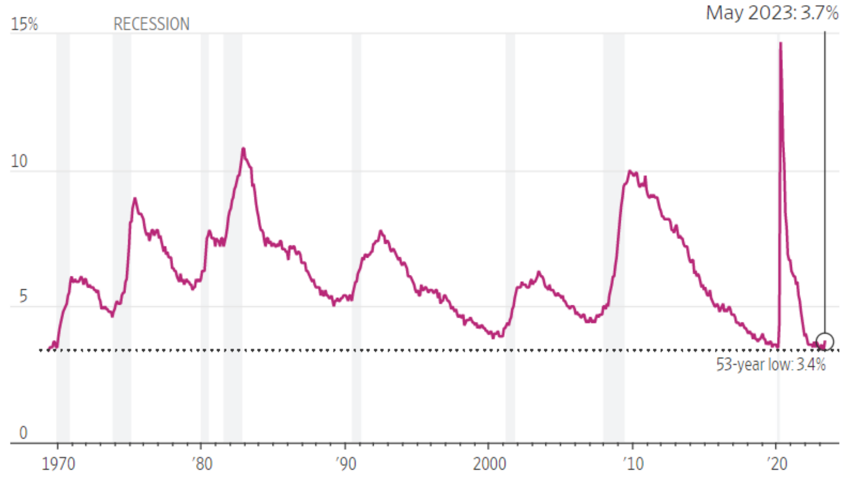
Economic Trends – Labor

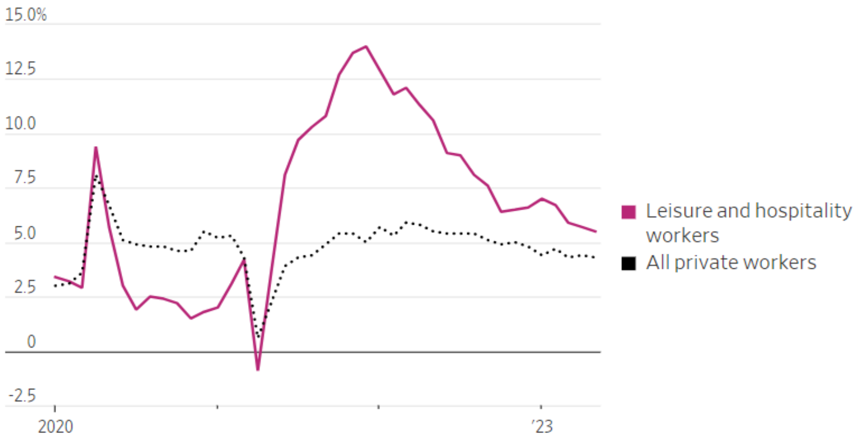
- Strong labor market complicates Fed decision making
- May saw 29th consecutive month of increased employment
  - Unemployment inched up to 3.7%, from April's 3.4% rate (53-year-low)
  - May average hourly earnings grew 4.3%
  - Job openings grew to 10.1M; ~4M job gap
- Conference Board – 75% of CEOs intend to raise wages, and 79% expect to increase or maintain staffing
  - Health care, child & elder care, restaurants & services: in-person work
- Large company cuts
- Small companies account for ~80% of all jobs

Unemployment rate



Note: Seasonally adjusted
Source: Labor Department

Hourly wages, change from a year earlier



Notes: Seasonally adjusted
Source: Labor Department

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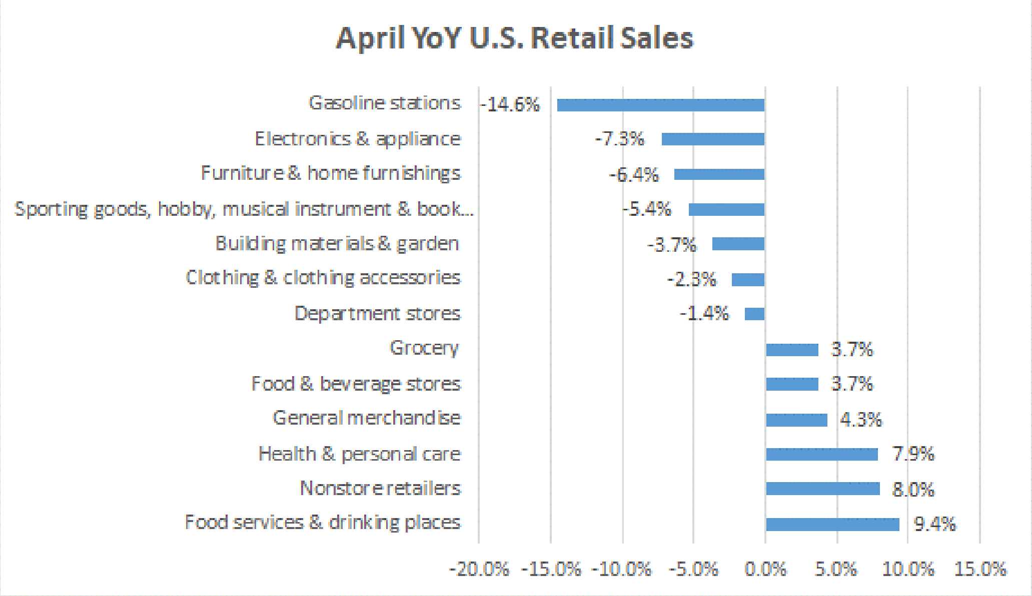
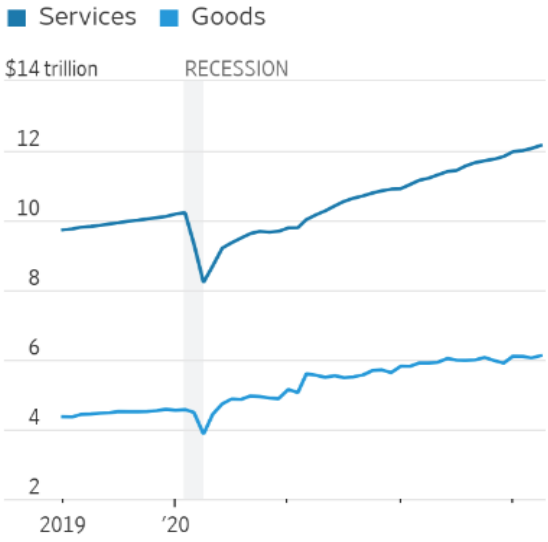
Economic Trends – Retail Consumer

- Growing uncertainty – inflation, debt ceiling, banking, commercial real estate
- Bifurcated – healthy consumer with low debt/high savings, or struggling to pay bills
- 84% expect to be as well or better off in one year; 94% concerned about rising cost of living (EY)
- Discretionary goods are a low priority; spending on services strong
- Essentials not immune
  - Trading down
- Retailers need to sharpen value offering and/or focus on cost cuts
- 1Q earnings reflect declining sequential trends – Macy's, Target, Home Depot, Walmart
- After pandemic binge, how long will consumers pullback last?
  - "2023 is a year of moderation as we digested those gains" Home Depot

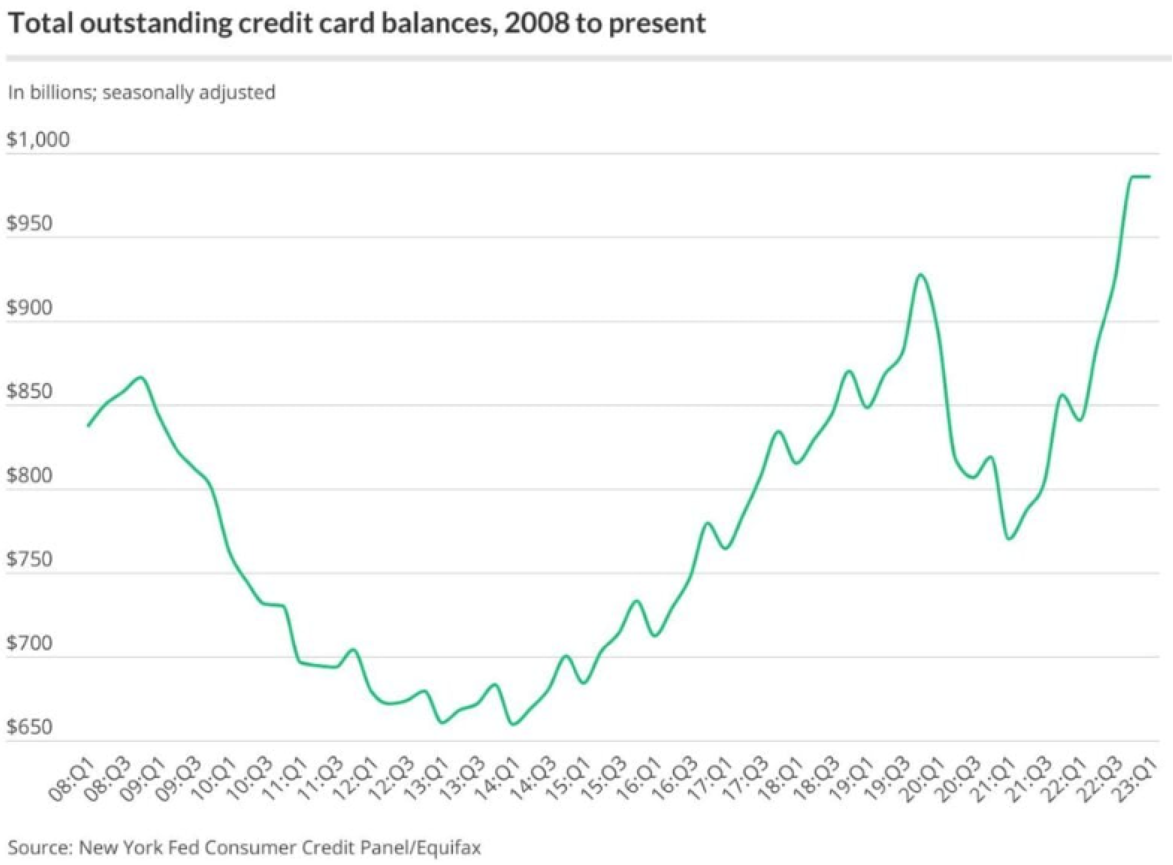




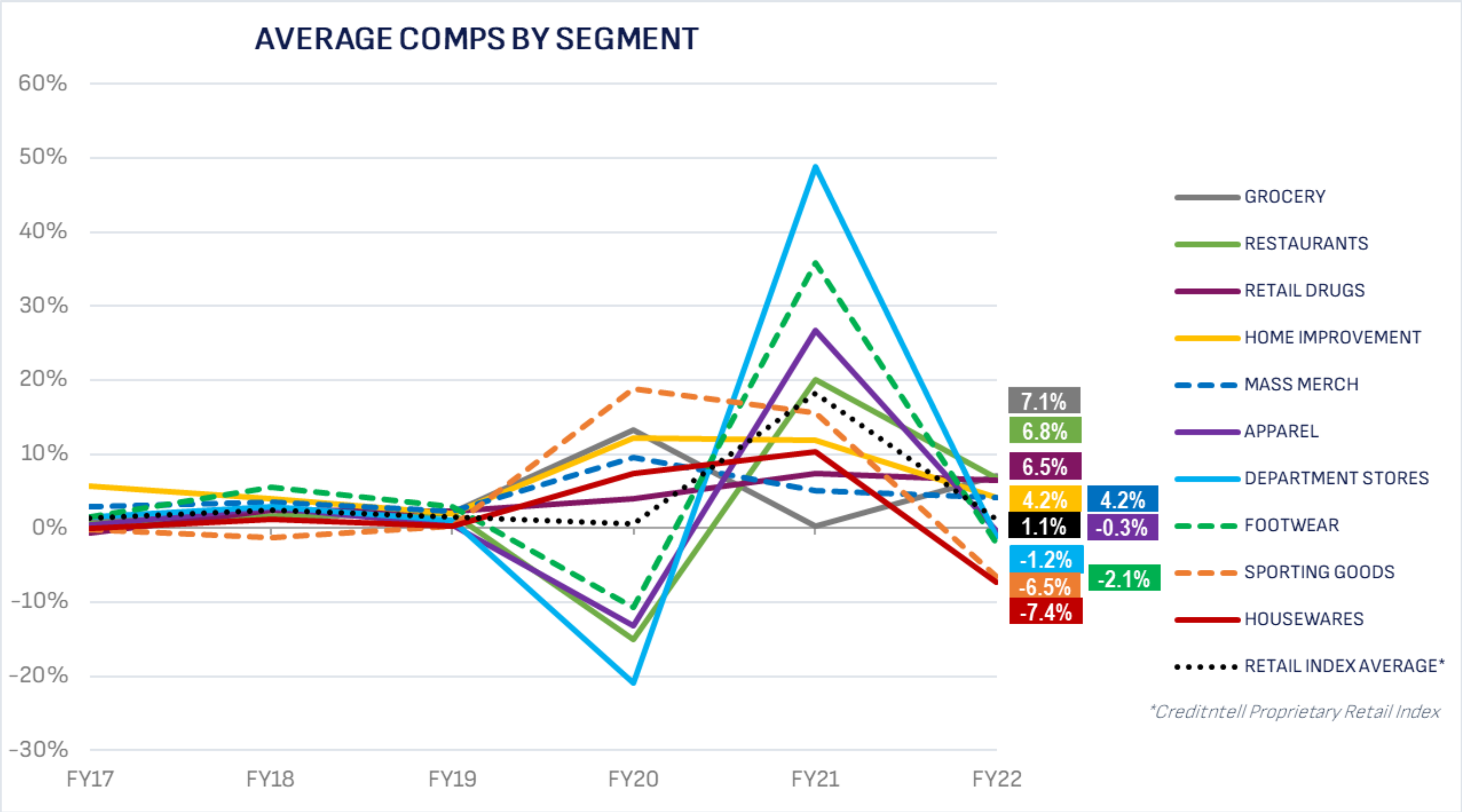
Note: Seasonally adjusted annual rates
Source: Commerce Department via St. Louis Fed

Economic Trends – Retail Consumer

- Consumers borrowing to fund spending, despite higher rates
- Credit card rates exceeding 20%
- Nearly half (46%) carry a balance (Bankrate) with average balance of ~$6,000 (Experian)
- Delinquencies back to pre-pandemic levels
- 7% mortgage rates, while home sales picking up
- Continued debt fueled spending complicates Fed decision making

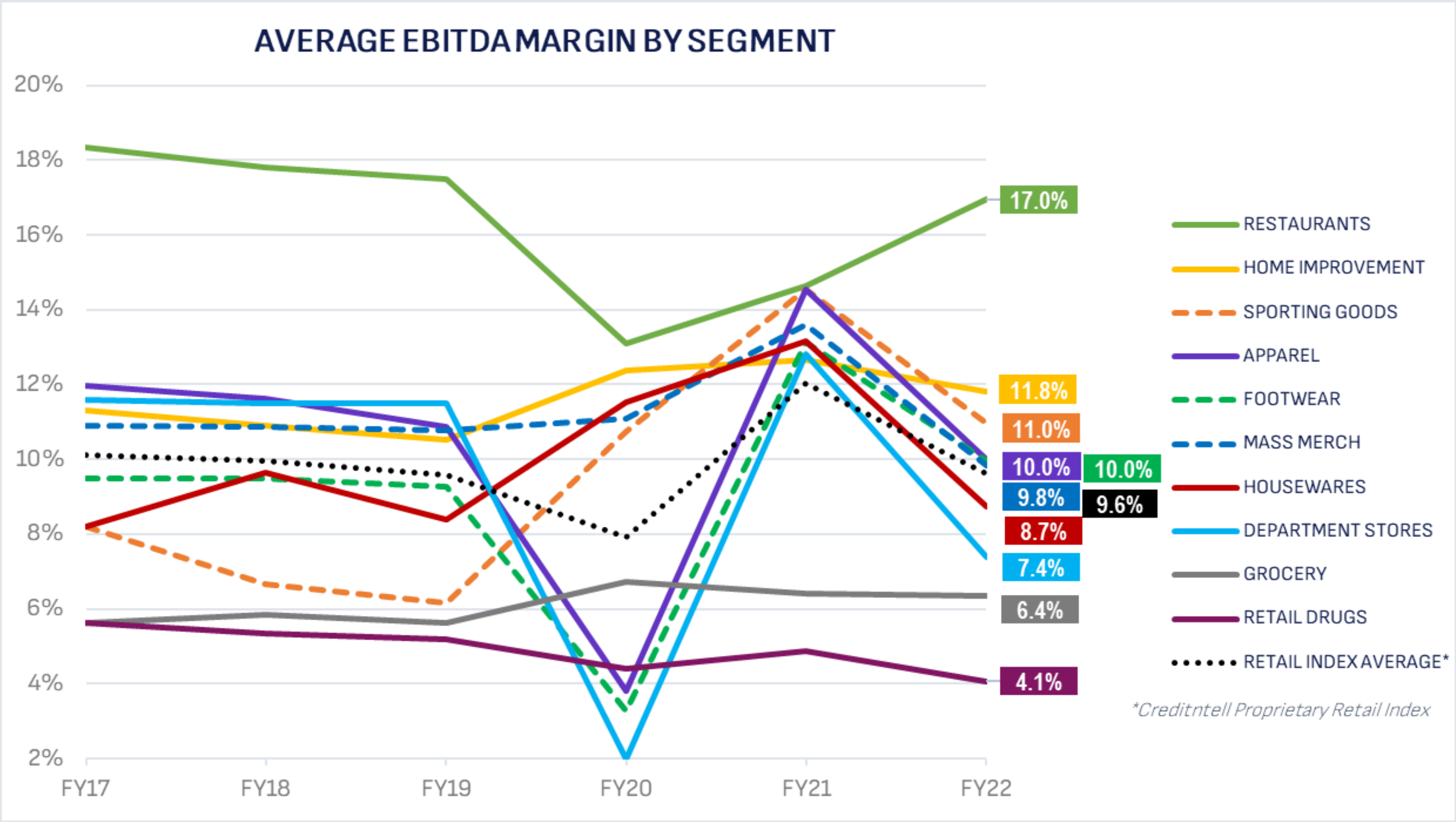


Average Comps by Segment



Segment	FY17	FY18	FY19	FY20	FY21	FY22
Grocery	1.1%	1.4%	2.1%	13.3%	0.3%	7.1%
Restaurants	0.6%	1.7%	1.9%	-15.0%	20.1%	6.8%
Retail Drugs	-0.7%	2.4%	2.3%	4.0%	7.4%	6.5%
Home Improvement	5.7%	3.9%	1.9%	12.2%	11.9%	4.2%
Mass Merch	2.8%	3.5%	2.3%	9.6%	5.0%	4.2%
Apparel	0.4%	2.7%	0.5%	-13.2%	26.7%	-0.3%
Department Stores	1.5%	2.9%	1.1%	-20.9%	48.9%	-1.2%
Footwear	1.5%	5.5%	2.9%	-10.8%	35.8%	-2.1%
Sporting Goods	-0.2%	-1.3%	0.3%	18.9%	15.6%	-6.5%
Housewares	0.0%	1.2%	0.3%	7.4%	10.3%	-7.4%
Retail Index Average*	***1.3%***	***2.4%***	***1.6%***	***0.5%***	***18.2%***	***1.1%***

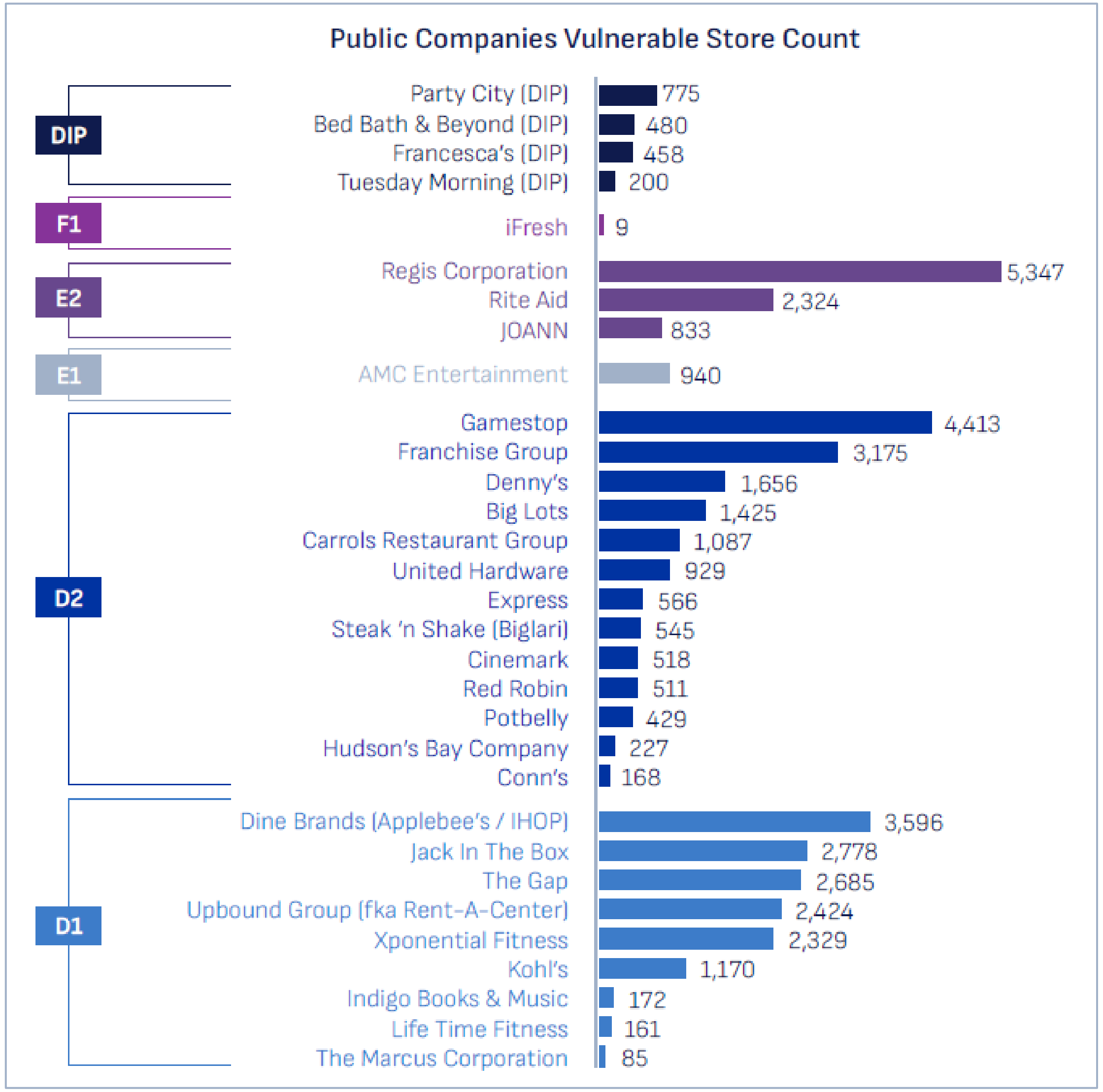
Average EBITDA Margin by Segment

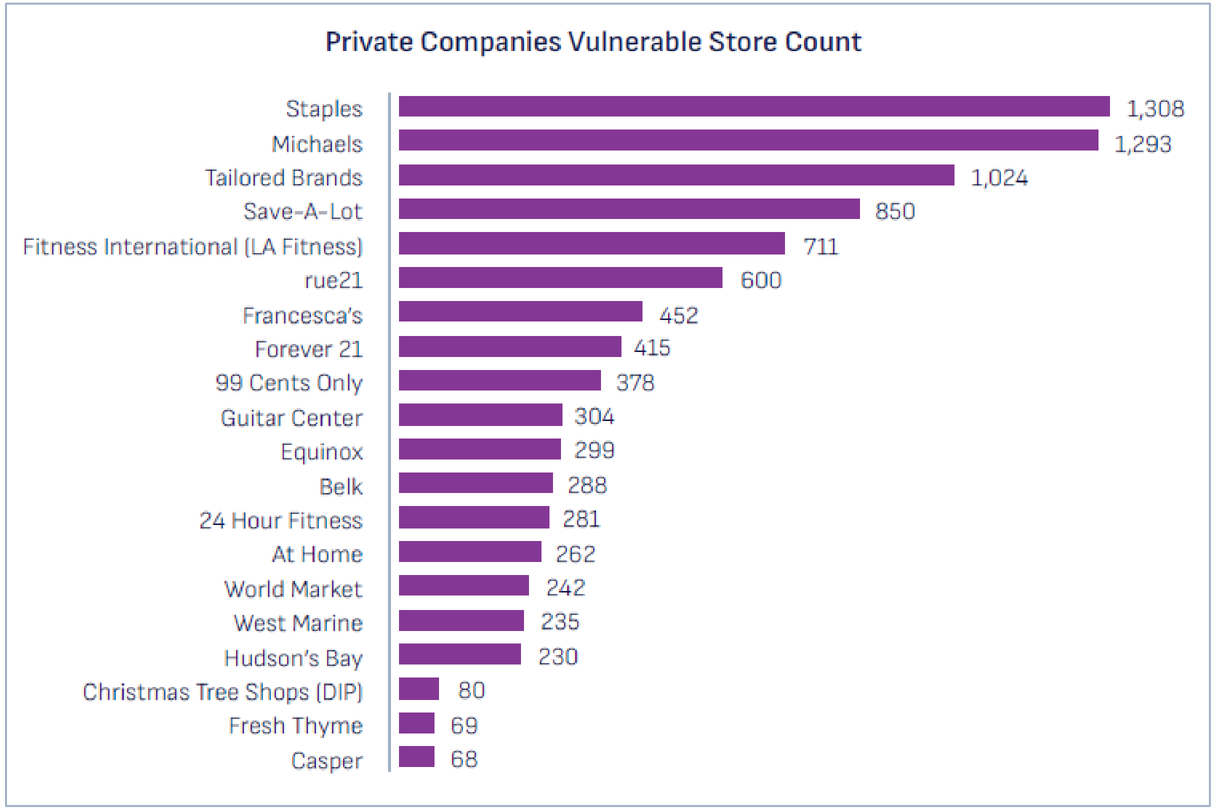


Segment	FY17	FY18	FY19	FY20	FY21	FY22
Restaurants	18.3%	17.8%	17.5%	13.1%	14.6%	17.0%
Home Improvement	11.3%	10.9%	10.5%	12.4%	12.7%	11.8%
Sporting Goods	8.2%	6.7%	6.2%	10.8%	14.5%	11.0%
Apparel	12.0%	11.6%	10.9%	3.8%	14.5%	10.0%
Footwear	9.5%	9.5%	9.3%	3.3%	13.1%	10.0%
Mass Merch	10.9%	10.9%	10.8%	11.1%	13.6%	9.8%
Housewares	8.2%	9.7%	8.4%	11.5%	13.2%	8.7%
Department Stores	11.6%	11.5%	11.5%	2.0%	12.8%	7.4%
Grocery	5.6%	5.9%	5.6%	6.7%	6.4%	6.4%
Retail Drugs	5.6%	5.3%	5.2%	4.4%	4.9%	4.1%
Retail Index Average*	***10.1%***	***10.0%***	***9.6%***	***7.9%***	***12.0%***	***9.6%***

Vulnerable Store Count

The charts below show our monitored retailers at risk of closing stores, including companies with a credit rating of D or worse (left) and private companies (right)





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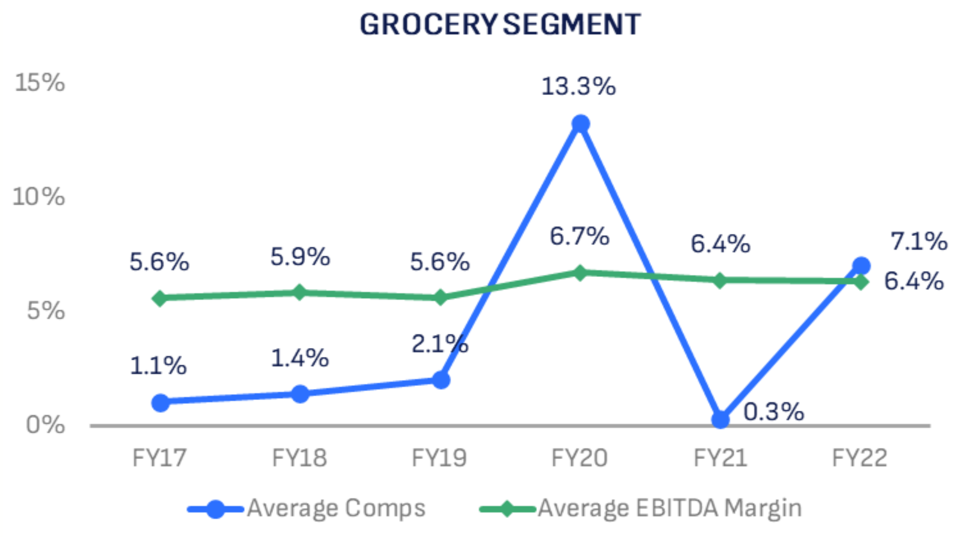
Grocery

- Solid FY22
  - Elevated inflation offset modest unit erosion
  - Comp gains masked product margin pressures
  - Profits still above pre-pandemic

- FY23 Outlook?
  - SNAP decreased $95 or more per month starting March 2023
  - Inflation elevated but lower than FY22 (up 20+% over two years)
  - Consumers increasingly price sensitive
- Shifts Occurring: Value Gaining & Chains Gaining as Winning on Value
- Continued Private Label growth
- Kroger / Albertsons merger creates M&A opportunities



*excludes BJ's Wholesale and Costco

WINNERS

Publix, ALDI, Grocery Outlet Bargain Market

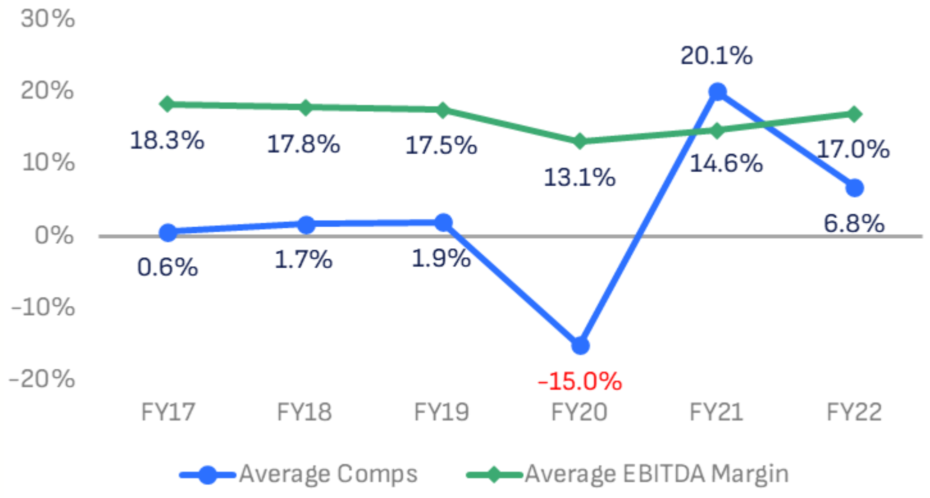
IN QUESTION

Sprouts Farmers Market, Kroger, Ocado, SpartanNash, Amazon Fresh

Restaurants

- Menu price increases still driving comp growth, with traffic continuing to decelerate.
- Many restaurants expect to slow the pace of further price increases and lean into promotions (LTO's, value menu, etc.) to hopefully bolster traffic trends and win market share
- Food Away From Home (restaurants, bars, hotels, etc.) prices now rising faster than Food at Home (grocery) prices as of March 2023, putting pressure on restaurants to be seen as a good value proposition with most customers looking to cut spending
- Commodity inflation is moderating, but restaurants are also still dealing with wage inflation and labor availability issues

RESTAURANTS SEGMENT



WINNERS

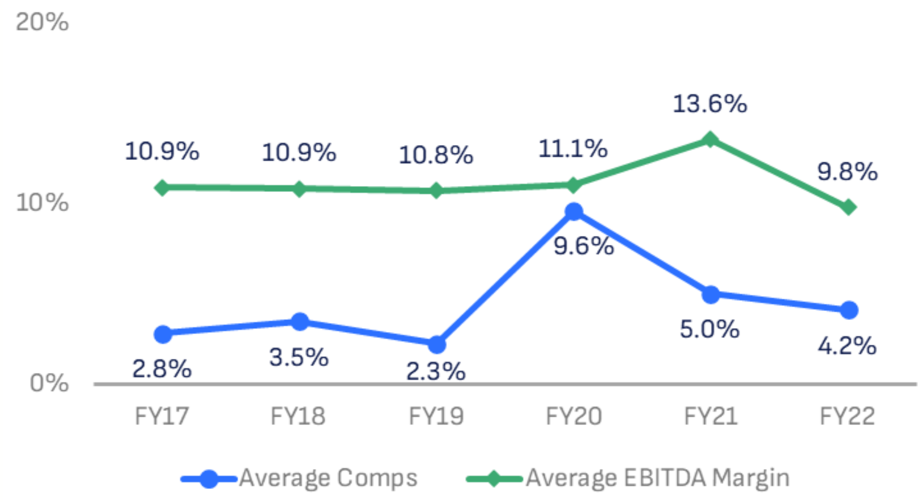
IN QUESTION

LOSERS

Mass Merchandisers

- Challenged FY22
  - Elevated inventory necessitated discounting
  - Margins retreated. Most operators below pre-pandemic levels
  - Those with higher share of consumables fared better
- FY23 Outlook?
  - Comp gains due to inflation
  - Cautious optimism; less inventory issues, lower distribution costs
- Dollar / Five Below continuing to add stores
- Target remodeling stores (175 stores)
- Big Lots is an outlier – very challenged. Took full year to clear inventory. Now eight quarters of negative comps. Rated D2. Likely more downgrades in FY23.

MASS MERCHANDISERS SEGMENT



WINNERS

Costco Wholesale

BJ's Live Generously

Walmart+

LOSERS

Big Lots!

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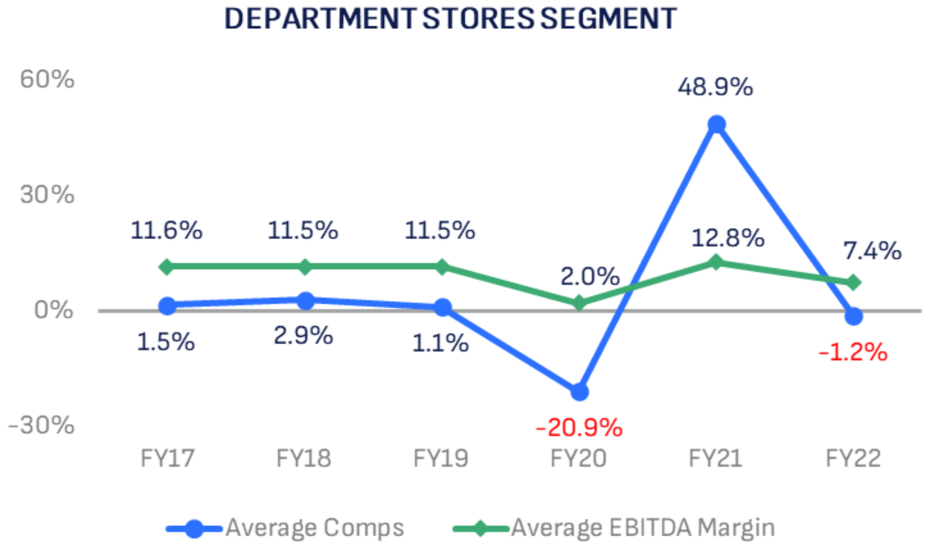
Department Stores

- FY22 inventory issues as consumer demand shifted
- FY23 outlook challenged by weakening consumer & cuts in discretionary spending
    - Sales & margins pressure
    - Trading down
- Retailers tightly managing inventory to minimize markdowns & promotions
    - Time to restock?
- Traditional banners pressured, but luxury also starting to hurt



- Casualization
- Capex focus remains on omnichannel
- Closures slowed, but little growth outside of off-price & specialty retail
- Shift to off-mall, small format & value – Market by Macy's, Bloomies
- Leadership turnover
- Shrink
- 1Q sales lower, profits mixed

WINNERS	IN QUESTION	LOSERS
TJX THE TJX COMPANIES, INC.	JCPenney	belk
ROSS DRESS FOR LESS	Burlington	KOHL'S
	macy's	

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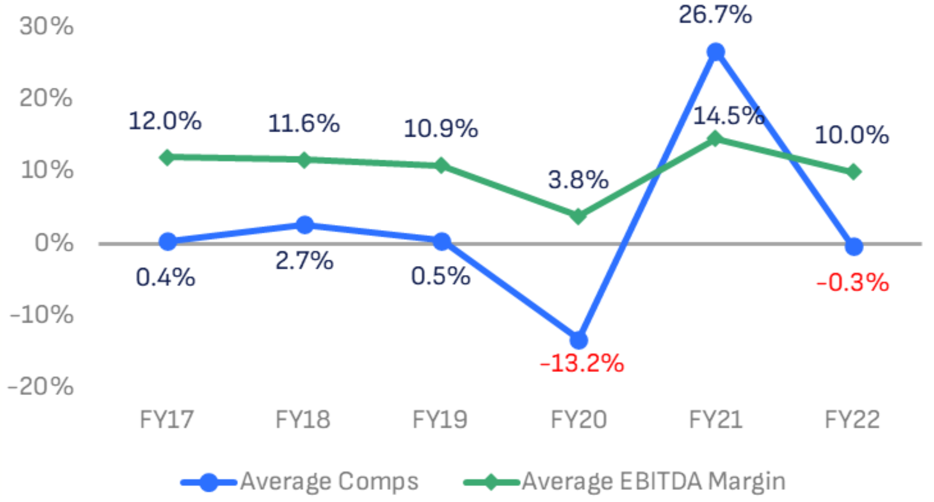
Apparel

- Sales slowing due to the decline in discretionary spending
- Although athleisure remains strong no “hot” fashion trends to drive sales
- Retailers are buying conservatively, and inventory levels are down year-over-year
- Gross margins are benefitting from significantly lower freight costs
- Shrink issues related to shoplifting
- Resale and rental trends remain strong – expected to grow 8% faster than overall apparel market
- Sector retailers are generally optimistic that sales trends will begin to improve in 4Q
- The sector remains relatively healthy from a credit perspective

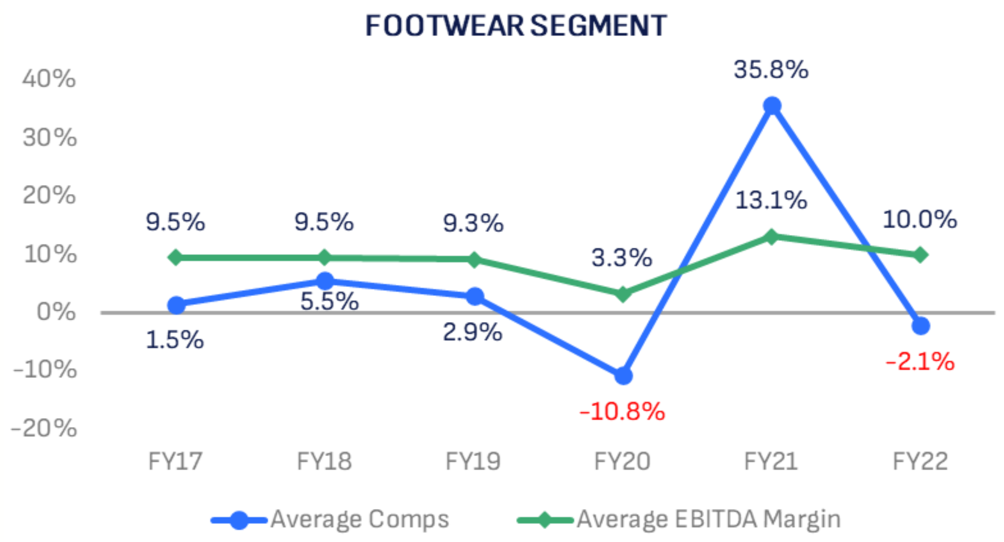
APPAREL SEGMENT



WINNERS	IN QUESTION	LOSERS
chico's lululemon Buckle	J.Jill LANDS' END	STITCH FIX THE CHILDREN'S PLACE EXPRESS VS&Co VICTORIA'S SECRET & CO.

Footwear

- Sharp drop-off in customer traffic pushing the industry to become more promotional, squeezing product margins
- Many footwear retailers have reduced FY23 guidance, now expect mid-to-high-single digit sales and comp declines
- Retailers still working on paring down inventory, will continue throughout 2023
- Operators like DSW and Famous Footwear likely to keep closing stores at a low single-digit pace, while Foot Locker will be more aggressive in closing stores through its initiative to replace 400+ mall stores with 300+ larger off-mall formats through 2026
- Other retailers still expanding, including Shoe Carnival through its Shoe Station banner and Boot Barn into the Northeast and other new markets



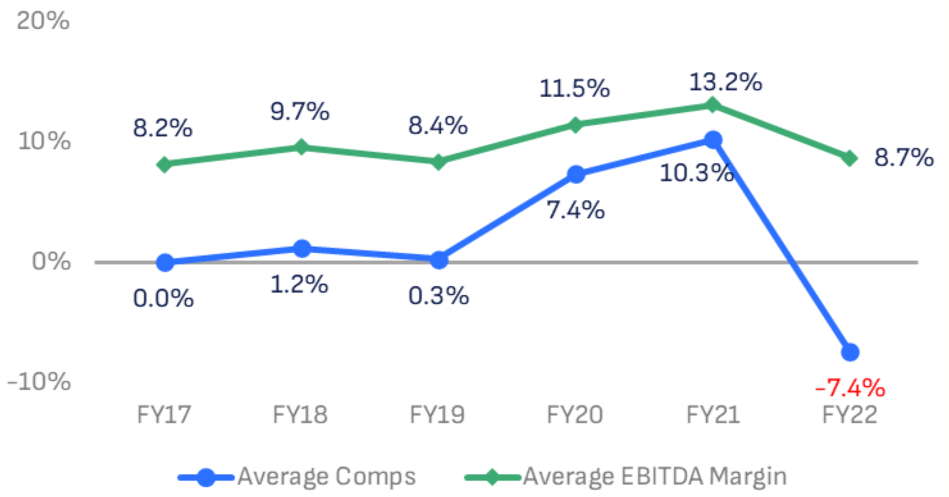
IN QUESTION

LOSERS

Home Furnishings

- Consumer pullbacks, which began in 2022, continue and steepen into 2023. The housing market also remains soft.
- Non-essential retailers are squeezed or pushed out. Bed, Bath & Beyond and Tuesday Morning formats were expendable.
- 2022 margins were decimated by supply chain/freight costs and promotions to reduce excess inventory. Freight costs have subsided substantially, which is starting to provide some relief.
- However, while freight costs improve, promotions are picking up again due to shrinking demand. Margins also impacted by elevated labor costs and cost deleveraging as outsized sales reverse direction.

HOUSEWARES & HOME FURNISHINGS SEGMENT



WINNERS	IN QUESTION	LOSERS
WILLIAMS SONOMA CALIFORNIA	wayfair	Kirkland's
HomeGoods	The Container Store	at home The Home Décor Superstore

Arts & Crafts

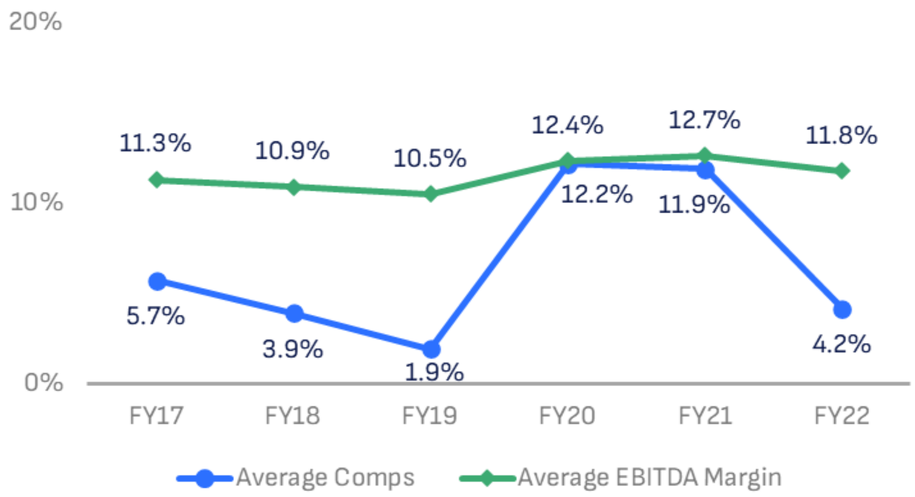
- Hobby Lobby has continued to stand out and expand. The offering from other players are largely proving not necessary or not desired at the moment.
- Party City went bankrupt due to excessive debt. Expects to emerge in June/July but still facing performance issues and now a more wary consumer.
- Michaels' performance has suffered much like JOANN's and the added LBO leverage, including $4.5B of debt, has certainly made things uncomfortable. However, its stores perform better than JOANN's and we believe has a much longer runway to enact a turnaround.
- JOANN nearly filed bankruptcy pre-COVID. It was saved by the need for mask making and hobbies during the pandemic but as the pendulum swings, performance and liquidity are under extreme duress again.

WINNERS	IN QUESTION	LOSERS
HOBBY LOBBY	Michaels Party City	JOANN

Home Improvement

- Home Depot and Lowe's both feeling the pinch from a cash strapped consumer; each reported negative comps and notable declines in traffic
- Homeowners increasingly likely to pare back or delay projects beyond necessary replacements and repairs as economic uncertainty and the threat of a recession persist
- Improvements and maintenance are projected to drop about 3% through 1Q24
- 99% of current mortgages have interest rates below current market rates
- Little incentive to sell and take on a higher rate mortgage or home equity loan, curbing the appetite for remodels
- Floors and interior painting projects are among the top home improvement projects in the U.S. and are considered a cost effective "trade down" from more extensive remodeling projects

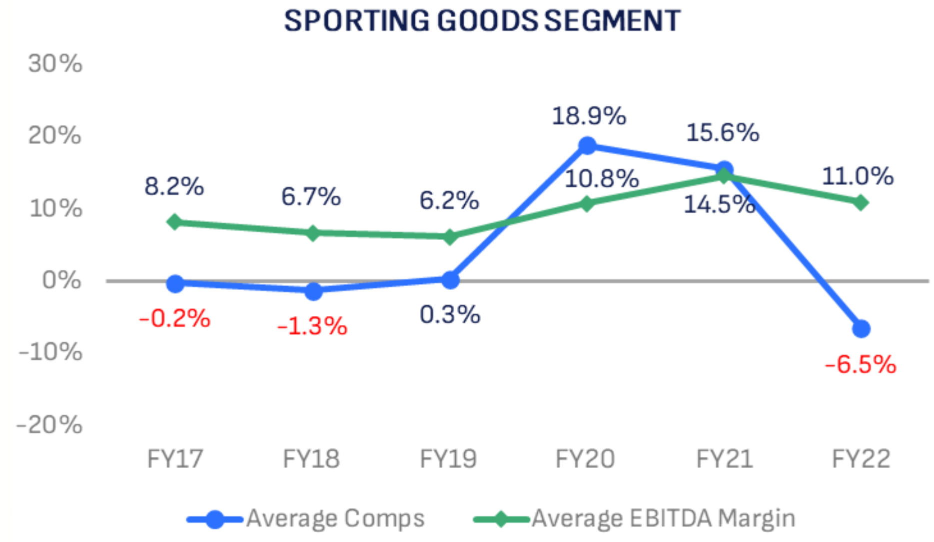
HOME IMPROVEMENT SEGMENT



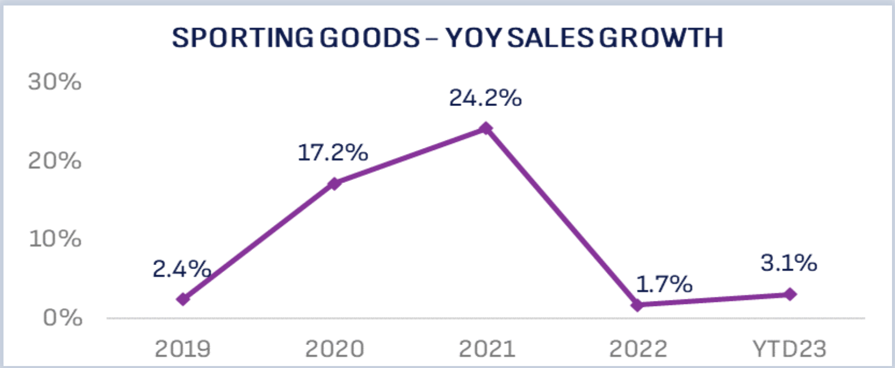
WINNERS	LOSERS
FLOOR & DECOR SHERWIN-WILLIAMS	LL Flooring

Sporting Goods

- Sporting goods retailers continued to see sales pullback in 4Q
- Any gains mostly reflect inflationary pricing as volumes fall
- Operating levels still elevated compared to pre-pandemic trends
  - Some players seeing margins fallback to pre-pandemic levels
  - More downgrades expected
- Second tier retailers that lack scale and/or exposed to more soft goods under most pressure
- Store expansion continues, but closures could start to grow
- Fragmented market – Dick's controls 8%



- Omnichannel, private label, exclusive merchandise, brands paring retail partners, DTC
- 75% of sporting goods companies plan to expand nearshoring by 2025, 8% already there (McKinsey)
- 1Q sales and earnings trending lower



WINNERS

DICK'S SPORTING GOODS
PGA TOUR SUPERSTORE

IN QUESTION

SPORTSMAN'S WAREHOUSE
Academy SPORTS+OUTDOORS
HIBBETT | CITY GEAR ESTABLISHED 1945

LOSERS

BIG 5 SPORTING GOODS
CAMPING WORLD
SIGNA SPORTS UNITED

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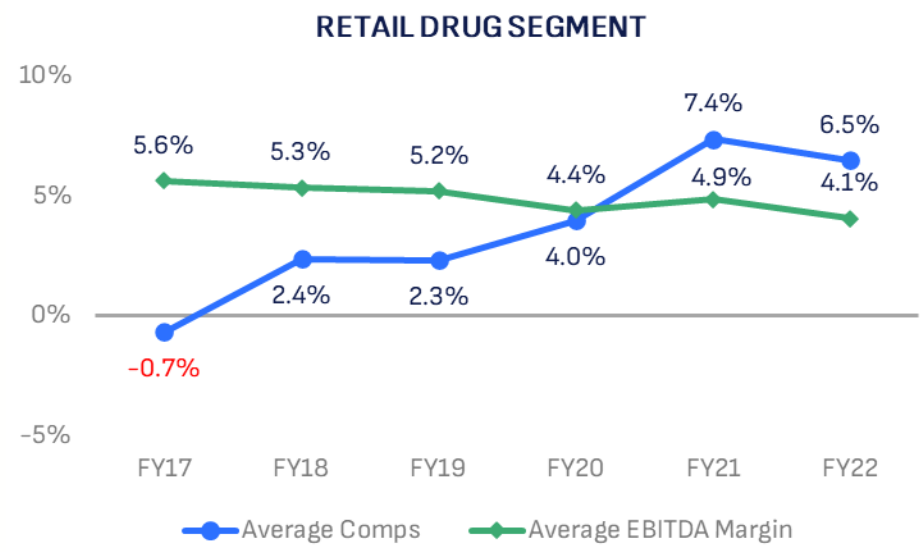
Retail Drug

- COVID headwinds
- Front-end slightly positive, despite elevated shrink
- Legacy issues: reimbursement rates, increasing online competition

- CVS & Walgreens in early stages of shift to value-based primary care
- Underperforming Rite Aid still to settle opioid litigation
- Latest quarter results showing positive sales but margin & profit pressured



WINNERS

LOSERS

THANK YOU FOR JOINING US!

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