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SECURITIES

The Sputnik Moment For Retail

Google Think Retail Conference | July 12, 2011

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Together we'll go far



Introduction: Who We Are, What We Do, and How We're Different

Wall Street “sell-side” analysts assign ratings to and publish detailed reports on publicly traded companies, advising investors which stocks to buy, hold, or sell

➤ **What sell-side analysts do**

- Analysts become experts on their sector (retail, technology, healthcare, etc), conduct extensive research on companies to understand the competitive landscape, growth strategies, capital structure, and risks, and create detailed forecasting models to predict future financial performance.
- Based on these factors as well as a company's valuation, analysts assign a Buy, Sell, Hold, or equivalent rating to covered companies – along with a price target or target range.

➤ **Our approach is unique**

- We are the only firm on the Street to combine coverage of the mass merchants and other “traditional” retailers, with the largest online retailer and largest online marketplace.
- Our emphasis is on proprietary analyses. This includes price comparisons, natural search results, and other attributes of the shopping experience that are customer facing.

Our Thesis

The Lines Between Offline and Online Retail are Blurring...

...and the influence of the Internet on retail is bigger than anyone thought it would be

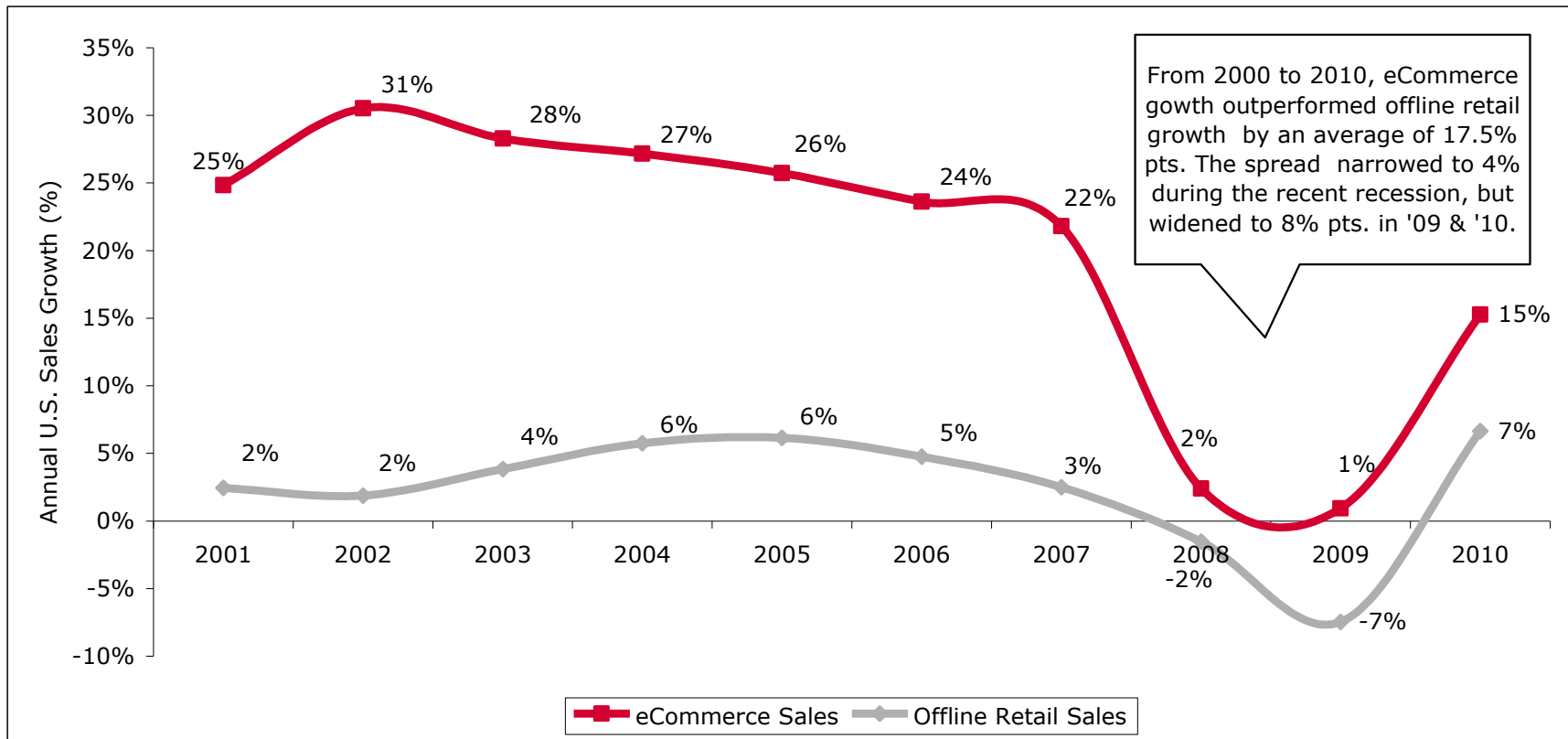
“We could not have been more wrong in our expectations of the internet,” says Alex Bolen, CEO, Oscar de la Renta after the company received an online order for an \$80,000 coat. – The Economist, 7/10

“We had our February Board of Directors meeting at Facebook, and that was an eye-opener for members of our Board.” – JC Penney 4/10

"It's clear to me the customer has evolved and changed the way they shop and we have to change with them. There's no going back," -Macy's Chief Executive Officer Terry Lundgren 9/09

eCommerce is No Longer A Blip

**eCommerce now represents over 8% of retail sales;
The spread between online and offline sales growth is widening again**



Source: U.S Census Bureau and Wells Fargo Securities, LLC estimates

We Are on the Brink of Another Acceleration in eCommerce

There are five principal reasons why eCommerce growth will accelerate, in our view

- 1) Favorable Demographics:** Internet-savvy young adults are moving into higher earnings years
- 2) Consumers are “Always Plugged In”:** Broadband availability and the proliferation of internet-enabled devices
- 3) Social Networking:** Social networking is driving time spent online and is increasingly integrated with retail
- 4) Mobile Commerce:** mCommerce works and has unique new features (it’s all about the apps)
- 5) Improved Online Experience:** Consumers are gaining comfort transacting online and the experience is more personalized and fun

Offline Retailers Are Behind And Have Not Made E-commerce a Strategic Priority

The focus is still on square footage growth

41% of companies surveyed said they intend to increase domestic store expansions in 2011, up from 25% in 2010 – KPMG.

“Due to our successful new market launches in the Mid-Atlantic market and the continued availability of quality real estate at reasonable rental rates, the company believes the time to expand aggressively remains intact.” – hhgregg management, November 2010.

“We believe we have an opportunity to open hundreds of additional locations of our current format in the United States,” –Target management, November 2010.

Offline Retailers Are Behind And Have Not Made E-commerce a Strategic Priority

Few multi-channel retailers offer a truly multi-channel experience

Retailer	Ship to Store	Same Day Ship to Store	Curbside Pick-up	Store Inventory Lookup (on website)
Wal-Mart	√	√		√
Target				√
Home Depot	√*	√*		√*
Lowe's	√	√		
Costco				
Walgreens	√	√	√*	√
Coach	√	√		√
Best Buy	√	√		√
Kohls				
Staples	√			
Gap				
Bed Bath & Beyond				√
Macy's				
Limited Brands				
Nordstrom	√	√		√
Tiffany	√ **			
J.C. Penney	√			
Sears Holdings	√	√	√*	√
Urban Outfitters				
Abercrombie & Fitch				
PetSmart				
Lululemon Athletica				
Dick's Sporting Goods				
Williams-Sonoma				
Tractor Supply	√			
Gamestop	√	√		√

* beta testing in some locations

** only in the Wall Street store

Source: Company web sites

Wells Fargo Securities Proprietary Analyses

The Sputnik Moment For Retail

A Whitepaper On eCommerce And The Disruption In Retail

Topics Covered

- Industry Themes and Drivers of eCommerce
- Proprietary Pricing, Search, and Shopping Analyses
- Key Developments in eCommerce
- Recommendations for Investors

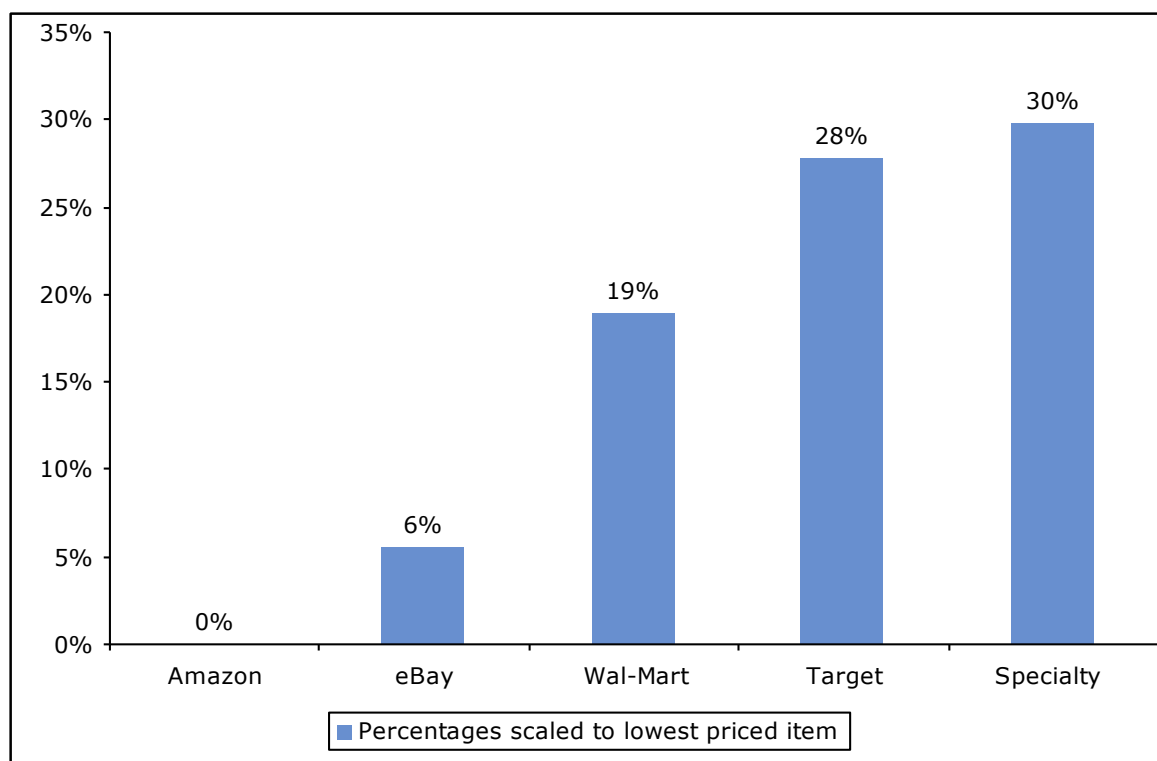


The Sputnik Moment For Retail

Amazon and eBay have a 20-30% price advantage over Target and specialty retail

- Analyzed nearly 100 identical products at Amazon, eBay, Target, Walmart and one specialty competitor, across 10 categories in retail.
- Amazon and eBay have the lowest prices in retail by a wide margin.
- Walmart's core prices are still relatively competitive, although shipping and sales tax make the comparison less favorable.
- Target and specialty aren't even close on core products or all-in prices to consumers
- The second time we ran the study, Amazon was out of stock on only 2 items, versus 5 at eBay, 15 at Target, and 16 at Walmart. Interestingly, Amazon was charging 10% more for those products.

Pricing Study Results - Core product price plus tax and free shipping

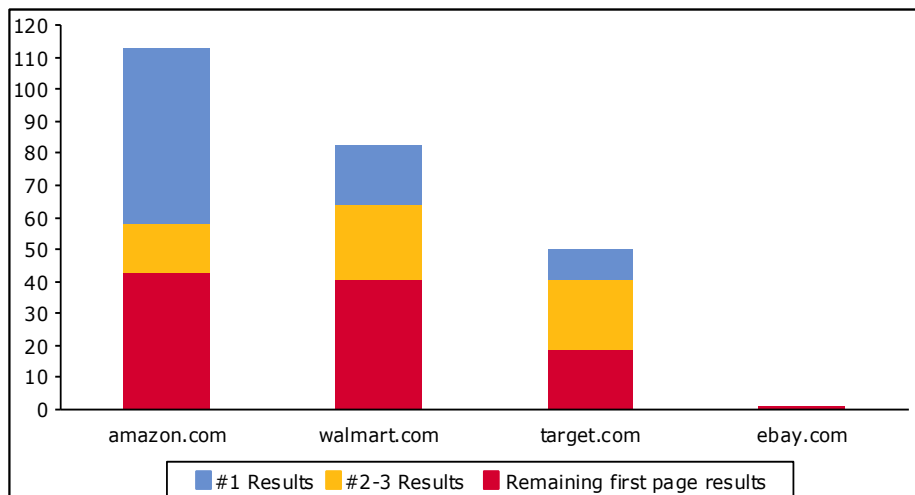


Source: Company websites (percentages are scaled to lowest priced item)

The Sputnik Moment For Retail

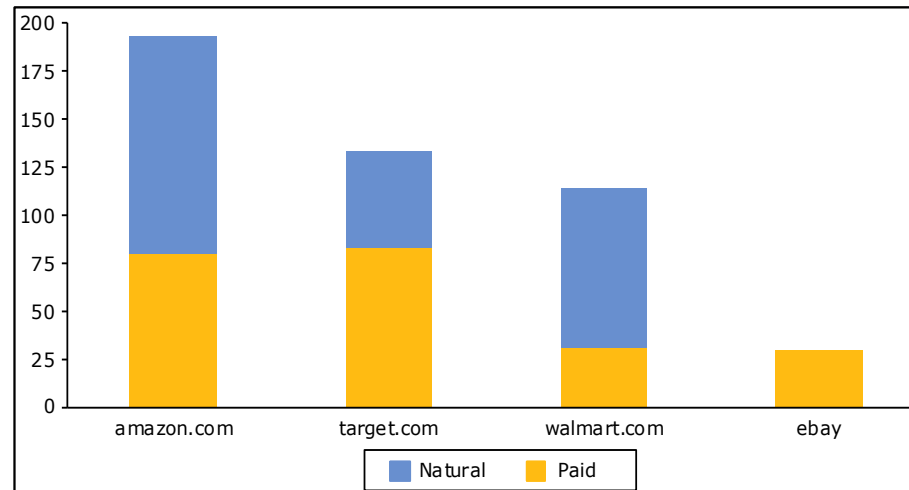
Out of nearly 100 products across 10 categories of retail, Amazon dominates in natural and total search results; eBay was absent from our results

Natural Search Results (number of occurrences on Google search page 1)



Source: Google

Total Search Results (number of occurrences on Google search page 1)



Source: Google

The Sputnik Moment For Retail

We went on a \$5,000 shopping spree across 27 web sites; Amazon dominates again

	Amazon.com	Wal-Mart	Target	eBay	Home Depot	Lowe's	Costco	Coach	Best Buy	Kohls	Staples	Gap	Bed Bath & Beyond	Macy's	
Shopping Features															
Free shipping	yes	no	yes	yes	no	no	no	no	no	no	yes	yes	no	no	
Product reviews	yes	yes	yes	no	yes	yes	yes	no	yes	yes	yes	yes	yes	yes	
Customer discussions/community forums	yes	yes	no	yes	yes	yes	no	yes	yes	no	yes	no	no	no	
Product images (number)	5	1	2	3	1	1	3	4	4	2	1	2	1	1	
Recently viewed items or searches	yes	yes	no	yes	no	no	no	no	no	no	no	no	no	no	
Ability to share product on Twitter/Facebook	yes	no	yes	yes	no	no	no	yes	yes	no	yes	no	yes	yes	
Wish list	yes	yes	yes	yes	yes	no	yes	yes	yes	no	yes	no	yes	yes	
Checkout Features															
Full account sign-up required for purchase	no	yes	no	yes	no	no	no	no	no	no	no	yes	no	no	
Automated address verification	yes	yes	yes	yes	no	no	yes	no	no	no	no	yes	no	no	
Gift wrap/message option	no	no	yes	no	no	no	no	yes	no	yes	no	yes	yes	yes	
Payment options (number)	3	4	2	3	3	2	3	2	3	2	1	2	2	2	
Private label credit card offer	yes	yes	yes	yes	yes	no	no	no	yes	no	no	no	no	no	
Bill Me Later available	no	yes	no	yes	no	no	yes	no	yes	no	no	no	no	no	
Time spent on site placing order (minutes)	4	6	4	8	5	3	8	9	5	4	3	6	4	5	
Upsell Features and Adjacencies															
"Customers who viewed x also viewed y..."	yes	yes	yes	yes	yes	yes	no	no	no	no	yes	no	no	yes	
"Frequently bought together" suggestions	yes	yes	yes	no	no	no	no	yes	no	no	yes	no	no	no	
"Similar product" suggestions	yes	no	yes	no	yes	yes	yes	no	no	yes	no	no	yes	no	
External advertisements on the site	yes	yes	yes	yes	no	no	no	no	yes	no	no	no	no	yes	
Multi-channel Features															
Ship to store	NA	yes	no	NA	no	yes	no	yes	yes	no	yes	no	no	no	
Store inventory look up	NA	yes	yes	NA	no	no	no	yes	yes	no	yes	no	yes	no	
Link to local ad/catalog	NA	yes	yes	NA	yes	yes	no	no	yes	yes	yes	no	no	yes	
Return to store	NA	yes	yes	NA	yes	yes	yes	yes	yes	yes	no	yes	yes	yes	
Customer Service															
Phone number displayed on homepage	no	no	no	no	yes	yes	no	no	yes	no	yes	no	yes	no	
Live chat	no	no	no	no	no	no	no	no	yes	no	no	no	yes	yes	
Response time from cust. service email (hours)	0	3	NA *	26	1	26	11	2	NA	3	8	18	49	18	
Telephone customer service hold time (mins)	1	3	1	NA *	1	3	2	1	1	10	2	1	1	3	
Post Purchase															
Promotional email specific to recent purchase?	no	no	no	no	no	no	no	no	no	no	no	no	no	no	
Method of delivery	USPS	Fedex	USPS	NA *	UPS	Fedex	USPS	Fedex	USPS	UPS	UPS	USPS	Fedex	UPS	
Return instructions in package	yes	yes	no	NA *	yes	yes	yes	yes	yes	yes	yes	yes	yes	Yes	
Require going online or call for return?	yes	yes	yes	NA *	no	yes	yes	no	no	no	yes	yes	no	no	
Coupon enclosed?	no	no	no	NA *	yes	no	no	no	yes	no	no	no	no	no	
Prepaid return shipping (deducted from refund)	no	yes	no	NA *	yes	no	yes	no	no	no	yes	yes	yes	yes	
Score	25	18	21	14	20	13	16	12	19	12	19	13	16	17	

Source: Company web sites, companies listed in order by market cap. Analysis is limited in scope, only one item was purchased at each retailer, company websites are subject to change.

* We never received a response from Target's customer service via email; eBay does not have telephone customer service; We never received our product from eBay.

The Sputnik Moment For Retail

Multi-channel retailers lack key features online

- Only 1 out of 27 retailers offers unconditional free shipping (Lululemon) and only 9 out of 27 offered free shipping with a minimum purchase.
- Several large multi-channel retailers made no attempt to up-sell during the purchase process, including: Best Buy, The Gap, Abercrombie & Fitch, Lululemon, and Tractor Supply.
- Only 5 out of 27 sites offered Live Chat customer service; 55% of companies do not list their toll free contact number on their home page.
- 18 out of 27 companies responded to our customer service email within 24 hours. Amazon had the fastest response at only 15 minutes after our original email, and Target never responded at all.
- Post purchase, only two companies emailed us a special offer related to recent order (Urban Outfitters and PetSmart). 8 out of 27 companies did not send any follow-up marketing emails.
- Only three companies included a coupon or promotional item in the package. Best Buy and Home Depot included in-store coupons and PetSmart included a promotional dog chew.

Monthly Web Traffic Report

Designed to provide insight into both online and offline sales trends
in various subsectors of retail

Why It's Important for All of Retail

- We believe consumers will increasingly turn to the internet before they purchase anything online or offline.
- Some studies suggest over 90% of consumers research online before making a purchase online or in a physical store (this can include product research, checking store locations and times, checking in stocks).

February 14, 2011

Equity Research



eCommerce Report: January 2011

- Our monthly eCommerce report is an analysis of web traffic data designed to provide insight into both online and offline sales trends in various subsectors of retail. Our bottom line take: Retail categories exhibited mixed traffic growth this month, with more categories decelerating than accelerating. We saw weak traffic trends in home furnishings, with yr/yr declines at several major home web properties.
- Company-Specific Changes in Trend: Companies with the strongest positive inflection in unique visitors in January include Foot Locker, Cars.com, GameStop, and Dollar Tree. Companies with the most significant negative change in trend were Bed Bath & Beyond, Crate & Barrel, Frontgate, Sur La Table, JC Penney, Home Depot, CVS, Zappos, PetSmart, and PETCO.
- Focus companies: Unique visitor growth to CarMax grew 20.5% yr/yr, relatively consistent with the past several months. Traffic appears to have accelerated in February as well, likely driven by CarMax's national Super Bowl advertisements. Google Trends shows search traffic for "CarMax" following the Super Bowl was 50% higher yr/yr. Traffic to Williams-Sonoma's web sites collectively declined slightly by 1.5% yr/yr in January, an improvement from the 5.7% decline in December. Unique visitors to Amazon.com declined slightly, down 0.7% yr/yr vs. 1.3% growth in December. However, on a 2-year stacked trend, unique visitors improved from 22.9% growth in December to 26.8% growth in January. Unique visitors to Ebay.com declined 6.2% yr/yr in January vs. down 9.5% yr/yr in December, with the 2-year trend holding relatively constant, down ~10%. Unique visitors to Walmart.com were generally flat, up 0.5% yr/yr, an improvement from down 5.7% in December. Unique visitors to Target.com declined 2.9% yr/yr, vs. down 10.8% in December.
- Category Strength and Weakness: Jewelry, Dollar Stores, Toys & Games, and Sporting Goods all experienced strength in January, with Jewelry and Toys & Games experiencing a reversal in trend from unique visitor declines in December. Home Furnishings, Broadlines, Department Stores, Home Improvement, Books & Office, Drug, Pet Retail and Pet Acquisition/Adoption categories all experienced weak web traffic in January or a recent reversal in trend.

Retail

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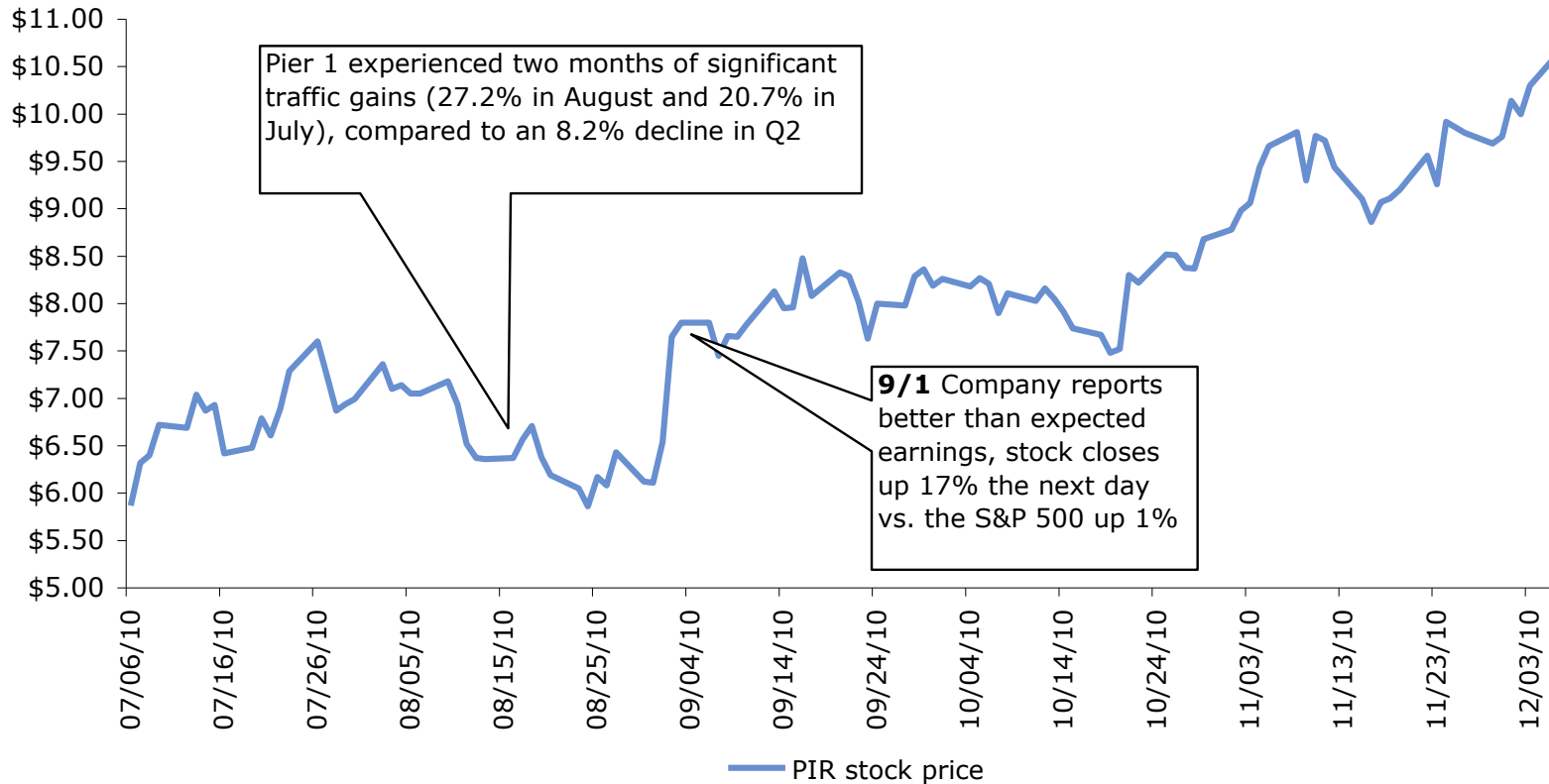
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Monthly Web Traffic Report

Can serve as a leading indicator for store traffic and monthly sales

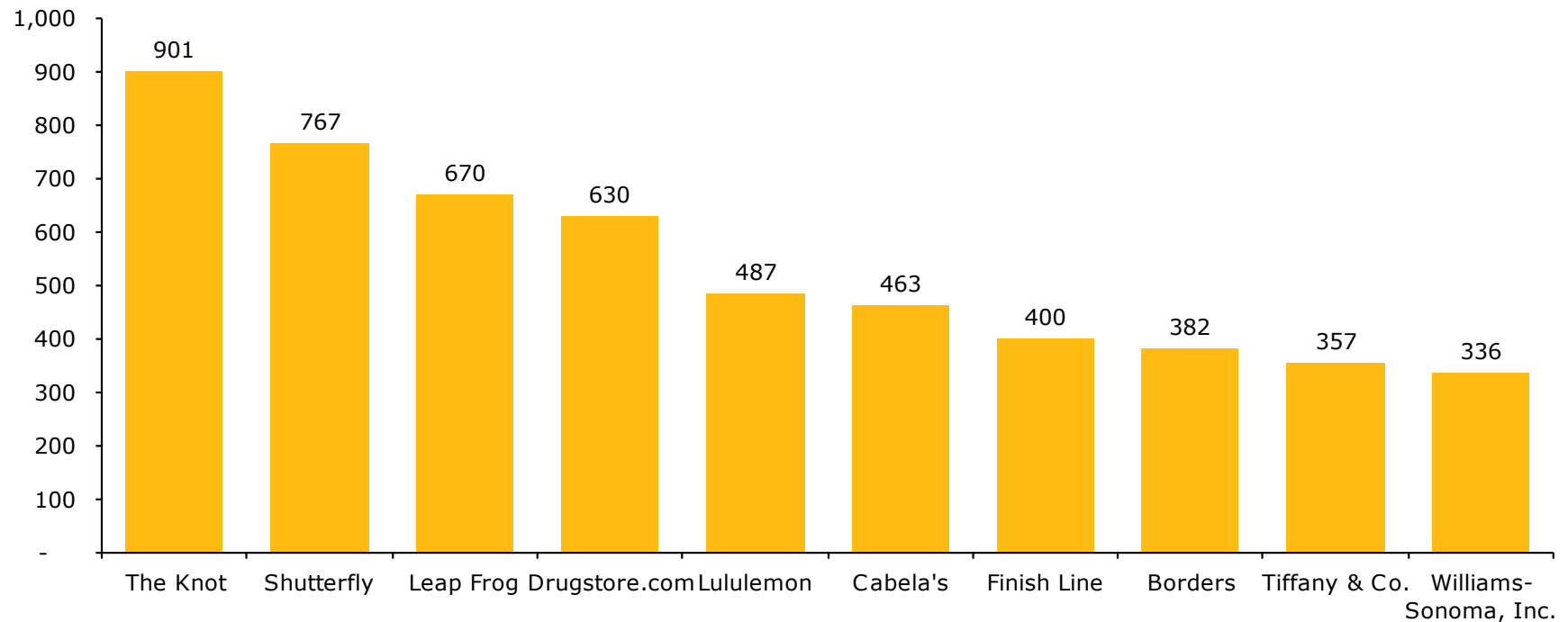
Example – Pier One Imports (PIR)



Source: FactSet, comScore, and company reports

Monthly Web Traffic Report

**Tracking Facebook fans is becoming more important with over 750mn users
(50% log on every day)**



Source: Facebook

NEW Proprietary Study: Buy Online, Pick-up in Store Analysis

We went on a follow-up shopping spree to test the in-store pick up experience

July 11, 2011

Equity Research

WELLS FARGO SECURITIES

Shopping Spree Analysis: Buy Online, Pick-Up In Store

Retail

- **Summary:** We tested "buy online, pick up in store" at the largest U.S. retailers as a follow up to the online shopping analysis in our February report, *The Sputnik Moment For Retail*. Our conclusion is that the customer experience is quite good for those retailers that offer this multi-channel functionality, although very few do. Only 13 out of the 26 largest U.S. retailers that we surveyed are taking advantage of this "last mile" attribute. We believe site to store functionality is arguably physical retail's most powerful defense against online-only retailers like Amazon, and a key tool to leverage the fixed investment in physical stores.
- **The site to store experience is quite good...** The majority of orders we placed were ready to be picked up in less than one hour, and we had an average wait time of only 3.6 minutes at the store. Gamestop and Sears were first to notify us that our orders were ready to be picked up (5 and 7 minutes after the respective orders were placed) and Staples was the last to notify us (22 hours after the order was placed).
- **...unfortunately, few retailers offer this service.** Only 13 of the 26 largest U.S. retailers offer a buy online, pick up in store feature with only 9 offering a same day pick up option. Major retailers that do not offer this service include: Target, Costco, The Gap, and Kohl's. In addition, many retailers only offer site to store on a select number of items (we found it particularly difficult to find items available for same day shipping to a store at Walmart), and Nordstrom operates the only online store that allows customers to search and shop by items available for in-store pick up.
- **Why is multi-channel integration important?** We believe consumers increasingly desire to shop in both channels as the lines between online and offline retail continue to blur. For example, Best Buy recently disclosed that 40% of all online orders are picked up in a store. Not only does site to store functionality offer additional convenience for the consumer, but it could lead to improved financial returns including faster inventory turns and reduced markdowns / higher merchandise margins.

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Proprietary Buy Online, Pick-up in Store Analysis

The buy online, pick up in store customer experience is generally quite good, but not enough retailers are currently exploiting this last mile benefit

- We estimate that only half of the 26 largest U.S retailers offer a buy online, pick up in store feature (13 out of 26)
- ...but the experience is quite good: The majority of orders we placed were ready to be picked up in less than one hour, and we had an average wait time of 3.6 minutes at the store
- Why is this important? We believe consumers increasingly want to shop in both channels as the lines between online and offline retail continue to blur. Retailers who aren't able to meet this changing demand won't get the sale, in our view.

Proprietary Buy Online, Pick-up in Store Analysis

Buy online, pick-up in store score card; How the multi-channel retailers stack up

Retailer	Time between placing order and being ready for pick up	Ability to change pick up contact person online	Sent text when order ready	Called when order ready	Emailed when order ready	Time waited in store	Signage in store for "buy online, pick up in store"
Wal-Mart	65 minutes	√	√		√	3 minutes	√
Lowe's	10 minutes			√	√	5 minutes	√
Best Buy	16 minutes	√			√	3 minutes	√
Staples	22 hours	√		√		3 minutes	
Nordstrom	34 minutes				√	4 minutes	
Sears Holdings	7 minutes	√	√		√	4.5 minutes	√
Gamestop	5 minutes				√	3 minutes	
Walgreens	55 minues	√	√		√	3 minutes	√

Source: Wells Fargo Securities, LLC

Proprietary Buy Online, Pick-up in Store Analysis

Interesting buy online, pick-up in store observations

- Walmart was the only retailer who offered shipping to a third party location (a nearby Fed Ex store).
- Nordstrom was the only retailer who allows consumers to search by items available for in-store pickup, and then make a purchase. At other retailers' sites we had to search through many products before finding a product that was eligible for in store pick up.
- Sears and Nordstrom were the only stores we had to walk through in order to get to customer service (i.e., the desk wasn't in the front of the store).
- Sears was the only store where we had to use a kiosk to bring up our order and didn't talk to a person. Sears also had a 5 minute guarantee and there was a timer that started once we swiped our credit card in the kiosk.
- Staples was the only retailer who actually shipped the product to the store we visited (came in a UPS ground box from an out of state Staples.com DC). All other retailers had the products in stock at the store.

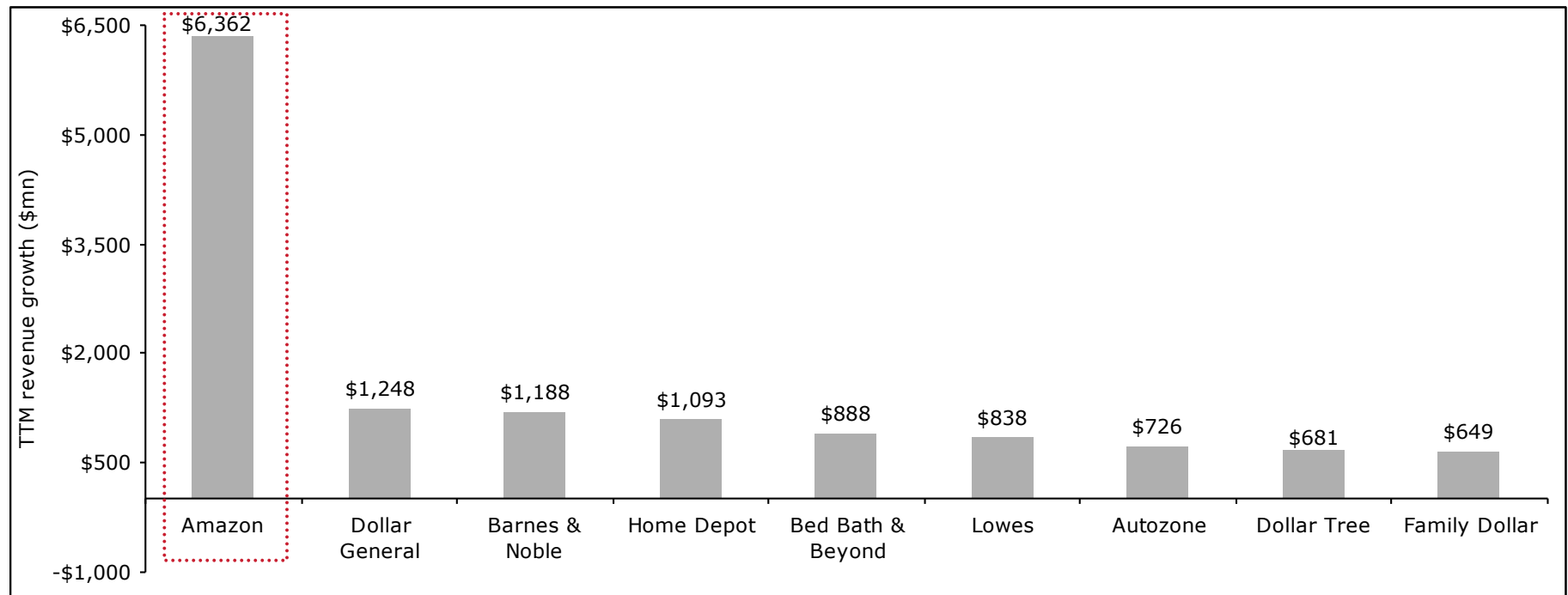
Implications for Retail

Implications: Market Share Will Continue to Shift From Physical Retail to Online

Amazon's results vs. other hardlines retailers proves the market share shift is already happening...

“Quarterly results [in the TV business] fell below our expectations...We think this was driven by a weaker overall demand environment for TVs along with slower adoption of new technologies”. – Best Buy

“...customers were budget-conscious during the back-to school season and retailers were very competitive and promotional.” – Office Max



Source: Factset, company reports – represents Amazon's North America revenue growth only

Implications: Market Share Will Continue to Shift From Physical Retail to Online

We see four major problems physical retailers are facing

1. Absolute price transparency favors online-only retailers (no sales tax helps)
2. Online retailers have a broader product assortment and are almost always in stock
3. Quick shipping makes it easier to buy one product at a time (disrupting a classic retail strategy)
4. Consumers rate customer service higher at online-only retailers

Implications: Where Investors Can Find Relative Safety

We are telling clients to invest in retailers who have prioritized eCommerce and/or have protective attributes

- Companies who have prioritized eCommerce typically have a seasoned eCommerce management team, have dedicated significant expenditure to IT, have owned fulfillment capability, and perhaps already receive a high level of web traffic.

- Protective attributes include:
 - Product mix tilted toward immediate need, or convenient “last mile” location
 - Product mix with unique customer fulfillment hurdles, including items that are heavy, fragile, or perishable,
 - Strong brand and a high percentage of exclusive or unique items,
 - A differentiated in-store experience, including events or services that drive traffic and are difficult to replicate online,
 - A direct to customer legacy with a house file and content that can be repurposed for an eCommerce channel, and
 - World-class loyalty program with strong repeat visits.

Questions?

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