

# Citi's Global E-Commerce Retail Outlook

## Global Omnichannel Trends and Top Retail Picks for 2013

- **Omnichannel is a Global Game Changer** — With the advent of the digital age, consumer needs and wants are rapidly evolving, and successful retailers are likewise evolving their omnichannel capabilities to meet or even anticipate and lead trends. While some of our analysts' sectors and regions have yet to embrace e-commerce (e.g. European luxury goods, South African retail), participation in online and other integrated tech initiatives has become a key differentiator of leaders elsewhere. We expect the omnichannel trend to continue to gain traction globally.
- **China Expected to Drive Global Online Sales Growth** — In 2013, online sales are forecasted to increase +18.3% and reach \$1.3 trillion worldwide. We believe that the rapid sales growth in Asia-Pacific, ahead of the global average, will be driven by three markets — China, India, and Indonesia — which are seeing faster B2C e-commerce growth than all other markets globally in 2013. The number of Chinese who buy goods online is expected to nearly double between 2012 and 2016. We believe continued growth in China, and other emerging markets including Brazil, will be driven by increasing Internet penetration. Key drivers include mobile, an expanding middle class, government-driven campaigns to promote consumer spending, continual improvement in infrastructure, product selection, and services offered by e-commerce retailers.
- **10 Key Global Themes** — Each region has its unique set of influencing factors; however, we observe increased investment as brick-and-mortar retailers look to catch up to online pure-play retailers, innovation in fulfillment including same-day delivery pilots in the U.S., greater use of social media vs. traditional advertising, evolving strategies to address mobile penetration and showrooming, and more coordination within organizations as the lines between marketing, IT, and operations blur.
- **E-Commerce All-Stars** — After evaluating the retailers and brand owners covered by Citi's analysts globally, we have identified 10 Top e-commerce picks from Around The World for 2013. We present the leaders in the table below:

Figure 1. Citi Global Consumer Discretionary Coverage: Top E-Commerce Picks for 2013

Ticker	Name	Rating	Share Price	Target Price	ETR	EV/Sales	EV/EBIT	P/E
AMZN	Amazon.com Inc	Buy	\$263.08	\$300	14.0%	1.5	78.7	135.6
FL	Foot Locker Inc	Buy	\$33.76	\$41	23.9%	0.6	5.8	11.8
ITX.MC	Inditex SA	Buy	\$104.30	€ 120	17.5%	3.4	17.0	24.4
M	Macys Inc	Buy	\$42.03	\$57	37.5%	0.8	7.8	10.6
PAP.L	Paddy Power Plc	Buy	\$70.65	€ 75	8.3%	4.3	21.1	7.4
QIHU	Qihoo 360 Technology Co Ltd	Buy (1H)	\$29.47	\$39	32.3%	10.2	81.3	43.1
SFH.AX	Specialty Fashion Group Ltd	Buy (1H)	AUD 1.23	AUD 1.25	4.9%	0.4	10.3	15.4
URBN	Urban Outfitters Inc	Hold	\$39.87	\$47	17.9%	1.7	11.6	19.9
WMT	Wal-Mart Stores Inc	Buy	\$76.02	\$82	10.3%	0.6	9.9	14.1
WSM	Williams-Sonoma Inc	Buy	\$51.19	\$56	11.8%	1.0	10.0	18.3

Source: Citi Research. Market data as of 2 April 2013. Multiples represent the forward estimated year

### ■ Industry Overview



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### See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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# Global E-Commerce Retail Report Roadmap

## 2013 Update from Citi's Consumer Discretionary Team

This report serves as an update to our 2012 report (see the following link: [CIRA's Global E-Commerce Report - Our Proprietary Ranking of Retailers' Omnichannel Capabilities](#)). A total of 24 Citi analysts from around the world have contributed their analysis of key trends and top e-commerce retail picks to this report.

## 10 Top E-Commerce Picks from Around the World

Our 10 Top stock picks are up +40.0% YOY on average, vs. +16.1% for the MSCI The World Index / Consumer Discretionary. We expect our 10 Top picks to continue to outperform the index.

Figure 2. Citi Global Consumer Discretionary Coverage: Top E-Commerce Picks for 2013

Lead Analyst	Region	Sector	Top E-Commerce Pick	Ticker
Neil Doshi	U.S.	Online	Amazon	AMZN
Kate McShane	U.S.	Apparel/Footwear Manufacturers	Foot Locker	FL
Richard Edwards	Europe	General	Inditex	ITX.MC
Deborah Weinswig	U.S.	Broadlines	Macy's	M
James Ainley	Europe	Hotels, Leisure, & Gaming	Paddy Power	PAP.L
Bin Liu	China/Hong Kong	Internet	Qihoo	QIHU
Craig Woolford	Australia	Broadlines	Specialty Fashion	SFH.AX
Oliver Chen	U.S.	Softlines, Specialty, & Luxury	Urban Outfitters	URBN
Deborah Weinswig	U.S.	Broadlines	Walmart	WMT
Kate McShane	U.S.	Hardlines	Williams-Sonoma	WSM

Source: Citi Research

## 10 Key Global Omnichannel Themes for 2013: Summary

1. Asia-Pac is expected to surpass N. America in total e-commerce sales in 2013, reflecting strength in China, population growth, and a growing middle class
2. Electronics, appliance, and media shoppers are most influenced by the Internet when decision making, while online grocery is a largely untapped opportunity
3. Earned media (friend/family recommendations) is an increasingly powerful force, magnified by the growth and proliferation of social media platforms
4. Smartphone and tablet penetration is fueling m-commerce, which we believe is the next frontier in e-commerce, and is also enabling "showrooming" behavior, which retailers can either fight or harness to their advantage
5. The emerging mobile payment ecosystem is fragmented, with several solutions (e.g. Google Wallet, ISIS, PayPal, Square) vying to be the gold standard
6. Brick-and-mortar retailers are finally increasing IT investment to try and catch up to online pure-play retailers
7. Same-day delivery is being piloted by many (including AMZN, EBAY, GOOG, JWN, WMT) but has been mastered by none...yet
8. Omnichannel retail has implications across organizations, from marketing to IT to strategy, and the most successful retailers are rethinking their leadership structure to better incorporate digital functions
9. Newer e-commerce companies are competing by curating personalized experiences for shoppers, finding niche markets for highly specialized goods
10. Retailers are leveraging Big Data more intelligently to gain consumer insights so they can better target offers, manage inventory, and drive overall efficiencies

## Citi's Top Global E-Commerce Retail Picks

**24 analysts contributed their analysis of key trends and top e-commerce retail picks to this report.**

With the advent of the digital age, consumer needs and wants are rapidly evolving, and successful retailers are likewise evolving their omnichannel capabilities to meet or even anticipate and lead trends. In this report, we will review our 2013 global e-commerce retail outlook across the various regions and consumer discretionary sectors in Citi's coverage. This report serves as an update to our 2012 report (please see the following link: [CIRA's Global E-Commerce Report - Our Proprietary Ranking of Retailers' Omnichannel Capabilities](#)). A total of 24 analysts contributed their analysis of key trends and top e-commerce retail picks to this report. We have listed everyone by page number in Figure 3.

**Figure 3. Citi Global Consumer Discretionary Coverage: Lead Analyst, Region, Sector(s), and Reference Page for E-Commerce Outlook**

Analyst	Region	Sector(s)	Page
Craig Woolford	Australia	Food Retailing, Retailing Broadlines, Retailing Softlines, and Food and Beverages	23
Catherine Lim	China/Hong Kong	Apparel/Footwear/Textiles, Retailing Softlines, and Luxury Goods	24
Eddie Lau	China/Hong Kong	Apparel/Footwear/Textiles, Commodity Agriculture, Food Manuf., Natural Products, Broadlines, and Softlines	24
Alastair Johnston	Europe	Food Retailing	25
Richard Edwards	Europe	General Retail	26
James Ainley	Europe	Leisure Time, Lodging, Restaurants, Support Services, and Gaming	27
Thomas Chauvet	Europe	Luxury Goods	28
Petrina Chong	Malaysia	Construction, Department Stores, Food Manuf., Media, Oilfield Equip. & Services, and Tobacco	29
Brady Martin	Russia	Beverages, Food Manufacturers, Food Retailing, and Retailing Hardlines	30
Kgosietse Rahube	South Africa	Containers & Packaging, Gaming, Lodging, and Support Services	31
Zaheer Joosub	South Africa	Apparel/Footwear/Textiles, Drug, Home Furnishings, Hardlines, Softlines, and Specialty Finance	31
Suchart Techapossai	Thailand	Retailing, Lodging, and Property	32
Susan Anderson	U.S.	SMID Apparel Manufacturers	34
Kate McShane	U.S.	Apparel & Footwear Manufacturers	34
Deborah Weinswig	U.S.	Broadlines	36
Deborah Weinswig	U.S.	Food & Drug	38
Kate McShane	U.S.	Hardlines	40
Will Randow	U.S.	Homebuilders, Building Products, and Brokers	42
Neil Doshi	U.S.	Internet	44
Alvin Concepcion	U.S.	Restaurants	45
Gregory Badishkanian	U.S.	Leisure Time, Natural Products, and Restaurants	45
Oliver Chen	U.S.	Specialty Stores & Luxury	46

Source: Citi Research

**Our 10 Top picks are up +40.0% YOY on average, vs. +16.1% for the MSCI The World Index / Consumer Discretionary.**

After evaluating the retailers covered by Citi's analysts globally, we have identified 10 Top e-commerce picks from Around The Globe for 2013. We present the leaders in the table below. We note that our 10 Top stock picks are up +40.0% YOY on average, vs. +16.1% for the MSCI The World Index / Consumer Discretionary as of 1 April 2013. We expect our 10 Top picks to continue to outperform the index.

**Figure 4. Citi Global Consumer Discretionary Coverage: Top E-Commerce Picks for 2013**

Lead Analyst	Region	Sector	Top E-Commerce Pick	Ticker
Neil Doshi	U.S.	Online	Amazon	AMZN
Kate McShane	U.S.	Apparel/Footwear Manufacturers	Foot Locker	FL
Richard Edwards	Europe	General	Inditex	ITX.MC
Deborah Weinswig	U.S.	Broadlines	Macy's	M
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Source: Citi Research

# Global E-Commerce Retail Key Trends

## E-Commerce Sales Top \$1 Trillion for the First Time

**E-commerce grew over 20% in 2012 and topped \$1 trillion for the first time. Growth is expected to slow in 2013.**

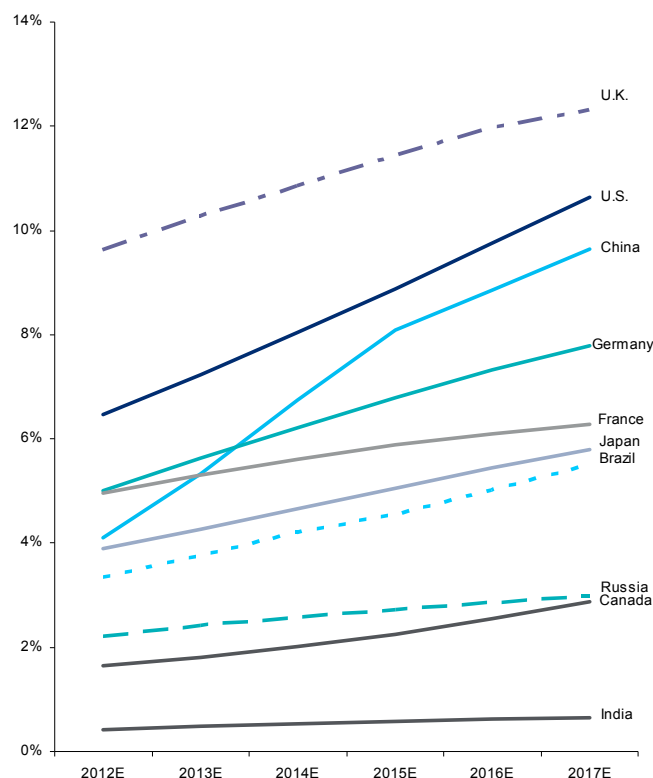
Based on a recent report by eMarketer, business-to-consumer (B2C) e-commerce grew +21.1% in 2012 and topped \$1 trillion for the first time. For 2013, online sales are forecasted up +18.3% to \$1.3 trillion worldwide. We anticipate that consumers will continue to shift spending from brick-and-mortar retailers towards omnichannel options, driven by lower prices, greater convenience, broader selection, availability of product, and more robust and accessible product information. We think that transparency of pricing that the Internet brings has truly transformed shopping forever. The one category that remains almost untapped is grocery, but we believe that will also change over the next few years.

Figure 5. Online Retail as a % of Total (Top 30 Markets by Total Retail)

	2012E	2013E	2014E	2015E	2016E	2017E
U.S.	6.5%	7.2%	8.0%	8.9%	9.7%	10.6%
China	4.1%	5.3%	6.7%	8.1%	8.8%	9.6%
Japan	3.9%	4.3%	4.7%	5.1%	5.4%	5.8%
Russia	2.2%	2.4%	2.6%	2.7%	2.8%	3.0%
Germany	5.0%	5.6%	6.2%	6.8%	7.3%	7.8%
U.K.	9.6%	10.3%	10.8%	11.4%	12.0%	12.3%
India	0.4%	0.5%	0.5%	0.6%	0.6%	0.7%
France	5.0%	5.3%	5.6%	5.9%	6.1%	6.3%
Brazil	3.3%	3.8%	4.2%	4.6%	5.0%	5.5%
Canada	1.6%	1.8%	2.0%	2.3%	2.5%	2.9%
Italy	1.3%	1.6%	1.9%	2.3%	2.7%	3.1%
Iran	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Australia	2.0%	2.2%	2.6%	2.9%	3.3%	3.6%
Spain	0.9%	1.1%	1.2%	1.4%	1.5%	1.6%
Mexico	1.4%	1.6%	1.8%	2.1%	2.3%	2.6%
South Korea	12.7%	13.4%	13.8%	14.1%	14.2%	14.1%
Indonesia	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
Turkey	2.1%	2.4%	3.0%	3.4%	3.7%	4.1%
Argentina	2.3%	2.7%	2.9%	3.3%	3.5%	3.7%
Saudi Arabia	0.4%	0.5%	0.6%	0.6%	0.7%	0.7%
Netherlands	4.2%	4.6%	5.0%	5.4%	5.7%	6.0%
Venezuela	0.7%	0.8%	0.8%	0.9%	0.9%	0.9%
Switzerland	3.8%	4.1%	4.4%	4.7%	4.9%	5.2%
Belgium	3.0%	3.3%	3.6%	3.8%	4.1%	4.4%
South Africa	0.5%	0.5%	0.6%	0.6%	0.6%	0.6%
Taiwan	3.5%	3.6%	3.6%	3.6%	3.7%	3.7%
Colombia	0.6%	0.8%	1.0%	1.2%	1.5%	1.8%
Poland	4.4%	5.0%	5.6%	6.3%	6.7%	7.1%
Thailand	0.8%	0.8%	0.9%	0.9%	0.9%	0.9%
Vietnam	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

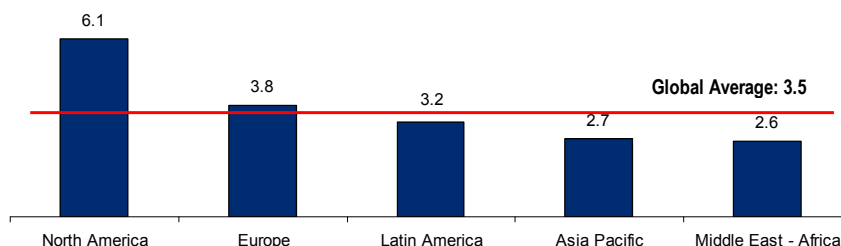
Source: Citi Research, Euromonitor

Figure 6. Online Retail as a % of Total (Top 10 Markets by Total Retail)



Source: Citi Research, Euromonitor

Figure 7. Average Hours per Day Per Visitor Spent Online by Region



Source: Citi Research, comScore Media Metrix December 2012 (Worldwide Ages 15+)

**For the first time, Asia-Pacific is expected to surpass North America as top e-commerce region in 2013.**

**North America No Longer Top Dog.** In 2013, Asia-Pacific is expected to surpass North America as the top region for e-commerce sales for the first time.

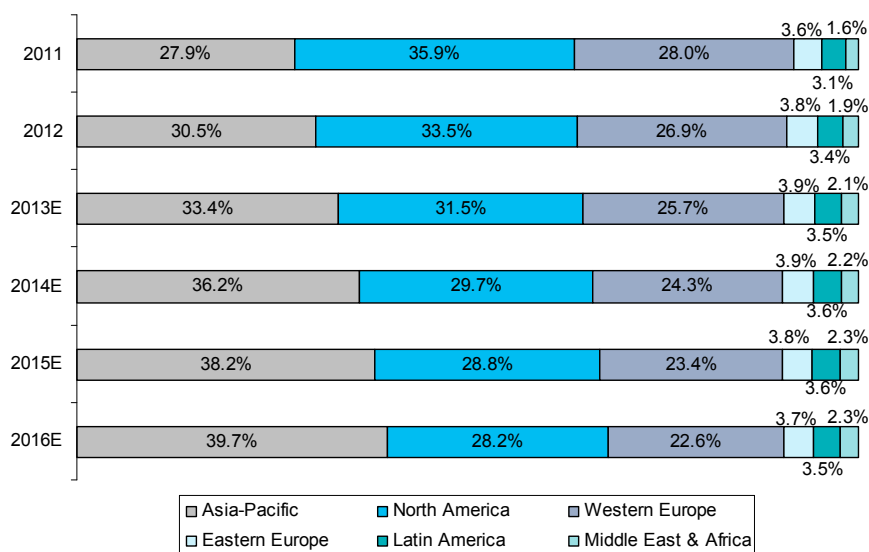
**North America Breakdown:** E-commerce sales grew +13.9% in 2012 to \$365 billion. Sales are expected to increase + 12.2% in 2013 to \$409 billion, according to eMarketer.

E-commerce is nascent but an opportunity for future growth in Canada. The Canadian e-commerce landscape is a paradox, as Canadians are relatively heavy Internet users, for example ranking #1 worldwide for online banking use, but are infrequent online purchasers. E-commerce represents only 1.6% of Canadian retail sales, vs. 6.5% in the U.S., and Canada ranks near the bottom of the top 10 global retail markets in terms of online penetration (Figure 6).

Unlike their neighbors to the south, Canadian consumers often want to touch and feel product, and lack a "catalog culture." In addition, Canadian online retailers are subject to the same sales taxes as bricks-and-mortar retailers. However, Canadian e-commerce is expected to begin to realize its potential over the next few years. Euromonitor estimates that Canadian consumers spent \$5.3B in 2012 online; that amount should nearly double to \$10.3B by 2017.

**Asia-Pacific Breakdown:** E-commerce sales grew more than +33% in 2012 to \$332 billion. Sales are anticipated up more than +30% in 2013 reaching \$433 billion, according to eMarketer.

**Figure 8. B2C E-Commerce Sales Breakdown by Region, 2011–16E**



Source: Citi Research, eMarketer (Jan 2013)

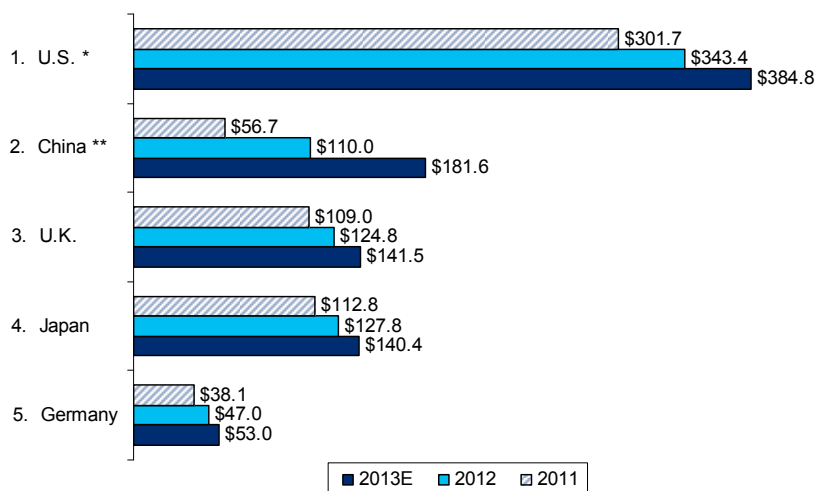
Note: Includes travel, digital downloads and event tickets purchased via any digital channel (including online, mobile, and tablet); excludes gambling; numbers may not add up to 100% due to rounding

**China Expected to Drive Global Online Sales Growth.** We believe that the rapid sales growth in Asia-Pacific, ahead of the global average, will be driven by three markets — China, India, and Indonesia — which are seeing faster B2C e-commerce growth than all other markets globally in 2013.

**The number of Chinese who buy goods online is expected to nearly double between 2012 and 2016.**

Due to its size, China serves as the primary driver of growth in the Asia-Pacific region, expected to surpass Japan as the world's second-largest B2C market in 2013 (Figure 9). According to Euromonitor, Internet retail sales increased +84% YOY in China last year, and accounted for 4.1% of total retail sales in China (Figure 5). Average spending per e-commerce consumer is currently relatively low in China with the most frequently shopped categories being apparel and groceries according to Bain. While this falls below all major North American and European markets, the sheer growth in the number of China's online buyers should continue to propel aggregate e-commerce growth (Figures 9 and 10), and improved payment security and product quality online should boost higher ticket categories such as electronics. The number of Chinese who buy goods online is expected to nearly double between 2012 and 2016, driven by population growth and a growing middle class, resulting in significant potential upside for B2C e-commerce sales in China over the next few years. According to a Bain survey, the majority of non-e-commerce shoppers expected to make their first online purchase in 2012, with about 40% of these shoppers headed to online platforms Taobao or Tmall. The most popular categories for first-time e-commerce buyers are electronics, apparel, and groceries.

**Figure 9. Top 5 Countries for B2C E-Commerce Sales, 2011–13 (\$B)**



Source: Citi Research, eMarketer (Jan 2013)

Note: Includes travel, digital downloads, and event tickets purchased via any digital channel (including online, mobile, and tablet); excludes gambling; ranked by 2013 figures; \*excludes event tickets; \*\* includes sales from businesses that occur over C2C platforms; excludes Hong Kong



Figure 10. Digital Buyers Worldwide, by Country, 2011–16E (millions)

	2011	2012	2013E	2014E	2015E	2016E
<b>Asia-Pacific</b>	<b>334.8</b>	<b>391.1</b>	<b>457.6</b>	<b>523.1</b>	<b>591.7</b>	<b>653.5</b>
China	178.4	219.8	270.9	322.1	374.9	423.4
Japan	70.2	73.3	75.6	77.0	78.2	79.2
India	14.5	19.2	24.6	30.0	36.2	41.8
South Korea	22.2	23.3	24.4	25.4	26.3	26.9
Australia	9.8	10.2	10.6	10.9	11.2	11.5
Indonesia	2.0	3.1	4.6	5.9	7.4	8.7
Other	37.6	42.2	47.0	51.8	57.3	62.1
<b>Western Europe</b>	<b>156.8</b>	<b>168.6</b>	<b>178.8</b>	<b>186.1</b>	<b>192.1</b>	<b>197.3</b>
Germany	38.2	41.2	43.3	44.4	45.2	45.9
U.K.	33.0	34.8	36.5	37.5	38.2	38.9
France	24.5	26.5	28.1	29.2	29.8	30.4
Spain	13.4	14.5	15.9	17.2	18.6	19.5
Italy	10.5	11.7	13.0	14.2	15.4	16.6
Netherlands	7.3	7.8	8.1	8.3	8.5	8.6
Sweden	4.1	4.3	4.5	4.6	4.7	4.8
Denmark	2.5	2.7	2.9	3.0	3.0	3.1
Finland	2.3	2.4	2.5	2.6	2.7	2.8
Norway	2.2	2.3	2.4	2.5	2.6	2.7
Other	18.8	20.3	21.6	22.6	23.4	24.1
<b>North America</b>	<b>156.7</b>	<b>164.2</b>	<b>171.3</b>	<b>178.8</b>	<b>185.8</b>	<b>192.6</b>
U.S.	143.4	149.8	156.1	162.6	168.7	175.0
Canada	13.3	14.4	15.2	16.2	17.1	17.6
<b>Eastern Europe</b>	<b>63.9</b>	<b>75.2</b>	<b>85.2</b>	<b>95.2</b>	<b>102.5</b>	<b>107.4</b>
Russia	19.6	23.1	26.2	29.3	31.4	32.7
Other	44.3	52.1	59.0	65.9	71.1	74.7
<b>Latin America</b>	<b>50.3</b>	<b>63.6</b>	<b>73.0</b>	<b>82.5</b>	<b>90.6</b>	<b>97.5</b>
Brazil	19.1	23.7	26.7	29.7	31.9	33.9
Argentina	6.4	8.1	9.2	10.4	11.3	11.8
Mexico	5.8	7.2	8.4	9.6	10.9	12.1
Other	19.1	24.7	28.8	32.8	36.5	39.7
<b>Middle East &amp; Africa</b>	<b>30.0</b>	<b>40.9</b>	<b>49.8</b>	<b>58.6</b>	<b>65.8</b>	<b>73.1</b>
<b>Worldwide</b>	<b>792.6</b>	<b>903.6</b>	<b>1,015.8</b>	<b>1,124.3</b>	<b>1,228.5</b>	<b>1,321.4</b>

Source: Citi Research, eMarketer (Jan 2013)

Note: Ages 14+; Internet users who have made at least one purchase via any digital channel within the past year; includes online, mobile and tablet purchases; numbers may not add up due to rounding

Figure 11. Average B2C E-Commerce Sales per Digital Buyer Worldwide, by Country, 2011–16E (\$)

	2011	2012	2013E	2014E	2015E	2016E
<b>North America</b>	<b>2,044</b>	<b>2,221</b>	<b>2,388</b>	<b>2,542</b>	<b>2,695</b>	<b>2,847</b>
U.S.*	2,104	2,293	2,466	2,626	2,785	2,937
Canada	1,395	1,470	1,590	1,697	1,813	1,955
<b>Western Europe</b>	<b>1,597</b>	<b>1,738</b>	<b>1,865</b>	<b>1,998</b>	<b>2,120</b>	<b>2,222</b>
U.K.	3,304	3,585	3,878	4,194	4,501	4,722
Norway	2,259	2,530	2,796	3,040	3,231	3,341
Denmark	2,064	2,185	2,286	2,485	2,660	2,787
Finland	1,430	1,592	1,752	1,873	1,967	2,032
Sweden	1,298	1,465	1,627	1,802	1,945	2,075
Italy	1,230	1,380	1,522	1,678	1,804	1,885
Spain	1,165	1,280	1,358	1,424	1,475	1,548
France	1,211	1,258	1,316	1,382	1,462	1,542
Germany	997	1,141	1,224	1,306	1,372	1,438
Netherlands	960	1,024	1,109	1,192	1,268	1,337
Other	1,032	1,147	1,233	1,324	1,408	1,487
<b>Asia-Pacific</b>	<b>743</b>	<b>850</b>	<b>947</b>	<b>1,057</b>	<b>1,123</b>	<b>1,179</b>
Australia	3,283	3,547	3,802	4,033	4,278	4,483
Japan	1,607	1,743	1,857	1,953	2,050	2,140
South Korea	783	880	973	1,050	1,115	1,190
China**	318	501	670	852	956	1,039
India***	597	632	665	691	708	724
Indonesia	282	337	391	437	480	516
Other	545	589	628	657	677	699
<b>Latin America</b>	<b>549</b>	<b>578</b>	<b>620</b>	<b>669</b>	<b>686</b>	<b>704</b>
Mexico	721	854	952	1,030	1,049	1,065
Brazil	730	717	741	792	800	806
Argentina	365	380	428	471	508	545
Other	378	428	474	514	532	553
<b>Eastern Europe</b>	<b>497</b>	<b>549</b>	<b>587</b>	<b>628</b>	<b>650</b>	<b>665</b>
Russia	569	628	670	715	738	758
Other	465	515	550	590	610	625
<b>Middle East &amp; Africa</b>	<b>480</b>	<b>504</b>	<b>542</b>	<b>575</b>	<b>601</b>	<b>622</b>
<b>Worldwide</b>	<b>1,162</b>	<b>1,243</b>	<b>1,318</b>	<b>1,399</b>	<b>1,459</b>	<b>1,513</b>

Source: Citi Research, eMarketer (Jan 2013)

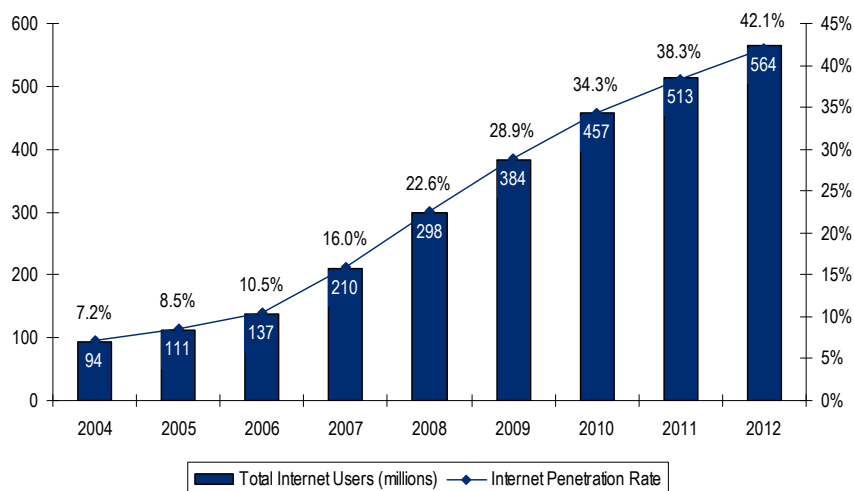
Note: Includes travel, digital downloads, and event tickets purchased via any digital channel (including online, mobile, and tablet); excludes gambling; \* excludes event tickets; \*\* includes sales from businesses that occur over C2C platforms; excludes Hong Kong; \*\*\* digital travel sales represent roughly 80% of B2C e-commerce sales

According to the China Internet Network Information Center (CNNIC), China had 564 million total Internet users in 2012, up +10% YOY (Figure 12), and 242 million e-commerce shoppers. Internet penetration rate is 42.1% and has been steadily climbing. The broadband penetration rate is 98.3% but the average Internet connection speed in China is only 100.9KB/s, well below the world average of 230.4KB/s. 66% of China's Internet users access the web through mobile phones. On average, Chinese Internet users spend 20.5 hours per week on Internet access, or nearly 3 hours per day, which is relatively low on a global basis (Figure 7).

We believe continued growth in China and other emerging markets will be driven by increasing Internet penetration including mobile, an expanding middle class, government-driven campaigns to promote consumer spending, and improving infrastructure, product selection, and services offered by e-commerce retailers.



Figure 12. China Internet Users vs. Internet Penetration Rate

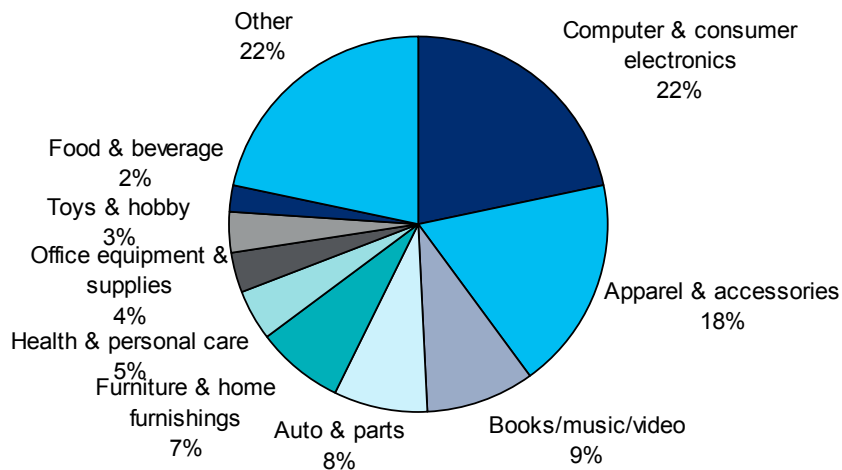


Source: Citi Research, CNNIC

## Bypassing the Store: Consumers Rethink How They Shop

**Online Sales by Product Category.** Computer and consumer electronics is the most shopped product category online (22% of online retail sales), closely followed by apparel and accessories (18%). Beyond those two categories, however, the space becomes quite fragmented, as shown below:

Figure 13. U.S. Online Retail Sales by Product Category (2012E)



Source: Citi Research, eMarketer (Sept. 2012)

Figure 14. U.S. Retail E-Commerce Sales, by Product Category: 2010–16E (\$ billions)

	2010	2011	2012E	2013E	2014E	2015E	2016E
Computer & consumer electronics	\$35.7	\$41.9	\$48.6	\$55.9	\$63.8	\$71.9	\$80.2
% total	21.3%	21.6%	21.7%	21.8%	22.0%	22.1%	22.2%
Apparel & accessories	\$28.0	\$34.2	\$41.0	\$48.6	\$56.6	\$64.8	\$73.0
% total	16.7%	17.6%	18.3%	19.0%	19.5%	19.9%	20.2%
Books/music/video	\$14.4	\$17.2	\$20.4	\$23.8	\$27.3	\$30.9	\$34.7
% total	8.6%	8.9%	9.1%	9.3%	9.4%	9.5%	9.6%
Auto & parts	\$16.2	\$17.0	\$18.3	\$19.7	\$21.1	\$22.5	\$24.0
% total	9.7%	8.7%	8.2%	7.7%	7.3%	6.9%	6.6%
Furniture & home furnishings	\$11.9	\$14.2	\$16.5	\$18.8	\$21.3	\$23.9	\$26.6
% total	7.1%	7.3%	7.4%	7.3%	7.3%	7.3%	7.4%
Health & personal care	\$7.5	\$8.7	\$10.1	\$11.5	\$13.0	\$14.5	\$16.0
% total	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.4%
Office equipment & supplies	\$6.3	\$7.1	\$7.9	\$8.6	\$9.3	\$9.9	\$10.5
% total	3.8%	3.7%	3.5%	3.4%	3.2%	3.0%	2.9%
Toys & hobby	\$5.7	\$6.7	\$7.8	\$9.1	\$10.4	\$11.8	\$13.3
% total	3.4%	3.4%	3.5%	3.6%	3.6%	3.6%	3.7%
Food & beverage	\$3.8	\$4.4	\$5.1	\$5.9	\$6.8	\$7.7	\$8.8
% total	2.3%	2.3%	2.3%	2.3%	2.3%	2.4%	2.4%
Other	\$37.9	\$42.9	\$48.5	\$54.2	\$60.4	\$67.1	\$74.7
% total	22.7%	22.1%	21.6%	21.2%	20.8%	20.6%	20.6%
<b>Total</b>	<b>\$167.3</b>	<b>\$194.3</b>	<b>\$224.2</b>	<b>\$256.0</b>	<b>\$289.8</b>	<b>\$325.2</b>	<b>\$361.9</b>

Source: Citi Research, eMarketer (Sept. 2012)

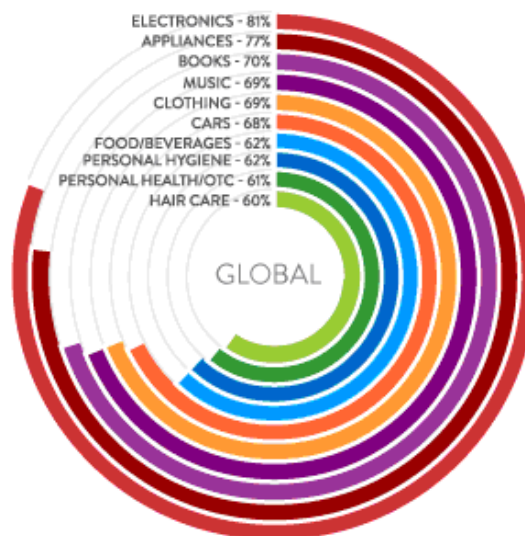
Note: eMarketer benchmarks its retail e-commerce sales figures against U.S. Department of Commerce data, for which the last full year measured was 2011; excludes travel and event tickets

Categories gaining penetration are computer & consumer electronics, apparel & accessories, books/music/video, furniture & home furnishings, and toys & hobby. Categories losing penetration are: auto & parts, and other. However, we note that these categories continue to grow in absolute dollar terms. The two tracked consumables categories, health & personal care and food & beverage, have remained and are expected to stay relatively stable. While the online grocery channel is expected to grow at an annual rate of +9.5% to reach \$9.4B in 2017, according to IBISWorld, we note that retailers have been slow to enter online consumables, driven by low margins and high shipping costs.

**81% of consumers cited the importance of the Internet when purchasing electronics, 77% for appliances, 70% for books, and 69% for music.**

**Internet Influence by Category.** We believe that the Internet is increasingly impacting how consumers make new product purchase decisions. Based on a recent global survey conducted by Nielsen, the Internet plays an important role when consumers are interested in purchasing new products in categories like electronics (81% of consumers surveyed cited the importance of the Internet), appliances (77%), books (70%), and music (69%) (Figure 15). Interestingly, online appears to be gaining momentum as an influence in consumption categories as well. The survey results also indicate that consumers in Asia-Pacific, Latin America, and Middle East/Africa are the most engaged in online decision-making.

**Figure 15. Top 10 New Product Categories Ranked by Percent of Claimed Internet Importance in Decision-Making Process**



Source: Citi Research, Nielsen Global Survey of New Product Purchase Sentiment, 3Q12

Note: Based on respondents with online access only. New products are defined as any product not purchased in the past

## Increasing Influence of Social Media

**Consumers Trust Their Family and Friends.** We believe that social media is an integral decision-making tool for consumers hunting for new products. With the growing popularity of e-commerce and mobile applications, we think consumers are increasingly responding to these channels as opposed to traditional advertising. We expect this trend to persist, driven by the Millennial customer. Social media complements traditional e-commerce in that it can be an effective soundboard for consumers to make recommendations on products, share retail experiences, and research future purchases from a “third-party” reviewer.

**Some 92% of consumers trust earned media (e.g. recommendations from friends and family) above all other forms of advertising.**

According to Nielsen's latest Global Trust in Advertising report (April 2012), which surveyed more than 28,000 Internet respondents in 56 countries, 92% of consumers globally said they trust earned media (e.g. recommendations from friends and family) above all other forms of advertising, up +18% since 2007. Online consumer reviews are the second-most trusted source of brand information and messaging, with 70% of global consumers surveyed online indicating they trust messages on this platform, up +15% in four years.

**Only 58% of global online consumers trust messages on company websites.**

The report also showed that only 58% of global online consumers trust messages found on company websites, well below the trust level for earned media, and 50% trust email messages that they signed up to receive. A total of 40% rely on ads served alongside search engine results, 36% trust online video advertisements, and 33% believe the messages in online banner ads, up +27% since 2007. Sponsored ads on social networks, a new format included in the 2011 Nielsen survey, are credible among 36% of global respondents.

**Know Your Customer.** We believe the most successful retailers will be a part of a robust social media dialogue, forging deeper and more meaningful relationships with consumers. Through social analytics, retailers have the opportunity to build a strong profile of their customer base and consequently capitalize on merchandising and pricing initiatives. In addition, mobile searches and purchase history can provide a slew of data on user preferences, and can feed retailers' hot trends and other invaluable data sets. Mobile analytics allow retailers to reach individual consumers via their personal devices and better understand what their customer is looking for.

**A Picture Is Worth a Thousand Words.** According to Michelle Crammes, Founder and CEO of SkuLoop (now part of Revionics), social media-driven models are trending toward a more visual, less word-driven format.

**Among the Interbrand Top 100 brands, nearly 6 in 10 (59%) now use Instagram, reaching 90 million active users.**

Among the Interbrand Top 100 brands, nearly 6 in 10 (59%) now use Instagram, reaching 90 million active users, according to a February 2013 report by Simply Measured. This is up +9% from 54% of the Top 100 brands using Instagram in November 2012. Engagement is growing, with the average brand photo receiving over 4,800 engagements (likes, comments, Tweets, and Facebook shares), up +35% vs. November 2012. Interestingly, 98% of Instagram photos posted by top brands are now shared to Facebook, resulting in 274 engagements per photo, a +30% increase quarter over quarter and demonstrating the interconnectivity of social media platforms. A total of 41% of brands now post at least one photo per week, up from 34% in November 2012. Among major social networks, only Pinterest adoption is growing faster, with +10% growth over the same period vs. Instagram's +9%. Pinterest is the fastest standalone site yet to cross the 10 million unique visitor mark, which generates more referral traffic than YouTube, Google+, and LinkedIn combined. That total same-store referral traffic from Pinterest to five surveyed specialty apparel retailers rose 389% in the second half of 2011. JWN is an example of a traditional retail trendsetter, having established its own Pinterest page in March 2011.

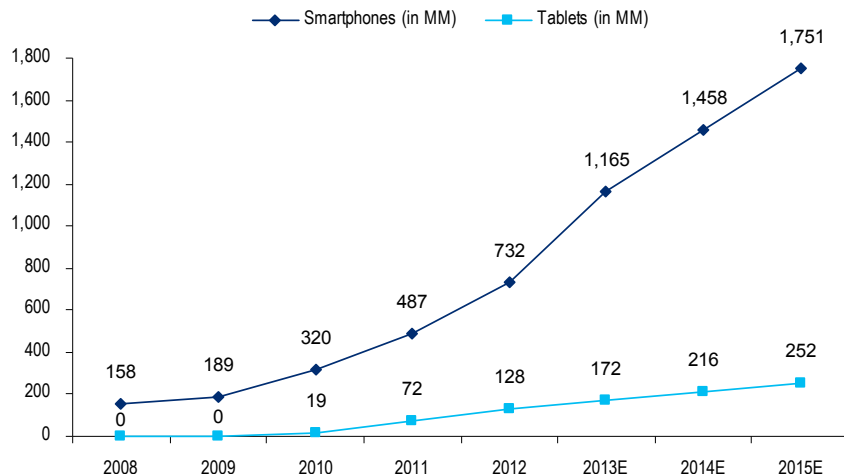
Another notable platform, The Fancy, is being heralded as the next Pinterest. It is a site where consumers can "discover amazing stuff, collect the things you love, buy it all in one place." The Fancy combines the transaction capabilities of a daily deal site (e.g. Groupon) with the visuals and organizational scheme of Pinterest. As with Pinterest, users can curate and organize images into list or boards. Unlike in the case with Pinterest, users can shop and buy at the Fancy or by clicking through to a third-party site. The Fancy pushes a daily email of specials to members.

## Rapid Growth of Mobile and M-Commerce

**We expect global smartphone shipments up +59% in 2013, and to continue to grow in the 20%– 25% range through 2015.**

**Growth of Mobile.** Per Citi's U.S. Hardware team, led by Jim Suva, global smartphone unit sales grew +50% YOY in 2012, and are expected to accelerate to +59% YOY in 2013. Further, our Mobile Handset Team expects global smartphones to continue to grow in the 20%–25% range through 2015. We expect smartphones to account for more than 50% of total handsets shipped globally by 2013, effectively doubling the penetration of smartphones from 2011 levels. Our Hardware team also forecasts global tablet sales up +33% YOY in 2013 and expects them to sustain high growth levels (at least +30%) through 2015.

Figure 16. Global Smartphone and Tablet Forecast



Source: Citi Research

**76% of smartphone owners use their mobile device while shopping.**

**The Showrooming Threat is Real.** A total of 54% of U.S. adults responsible for at least half of their household's grocery shopping have a smartphone, and 76% of smartphone owners use their mobile device while shopping, according to a recent survey by Perception Research Services International. 53% of smartphone owners polled use their devices to compare prices.

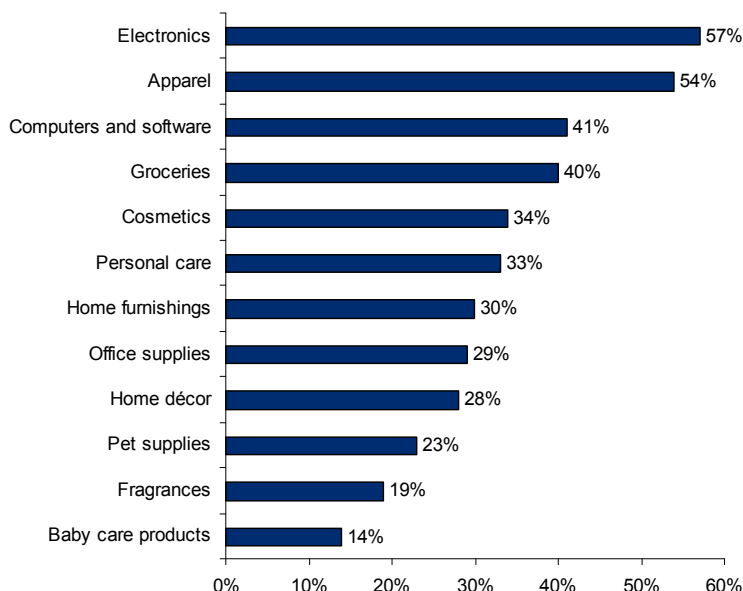
Figure 17. "I Use My Smartphone to..."



Source: Citi Research, Perception Research Services International

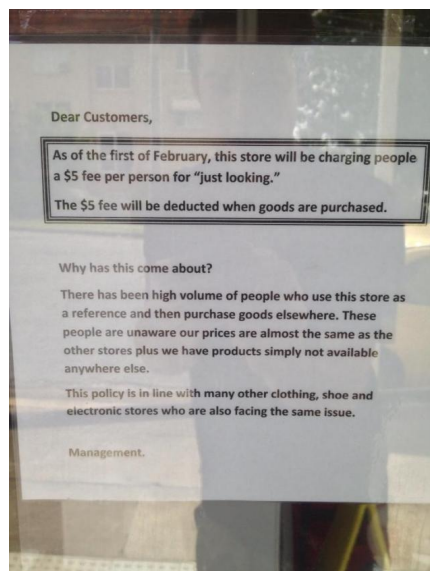
Smartphone owners use their phones while shopping for a wide variety of products, the survey also says. Topping the list, 57% of smartphone owners use their devices while shopping for electronics, closely followed by 54% for apparel.

Figure 18. "I Use My Smartphone While Shopping For..."



Source: Citi Research, Perception Research Services International

Figure 19. Celiac Supplies Store Sign: \$5 Fee for "Just Looking"



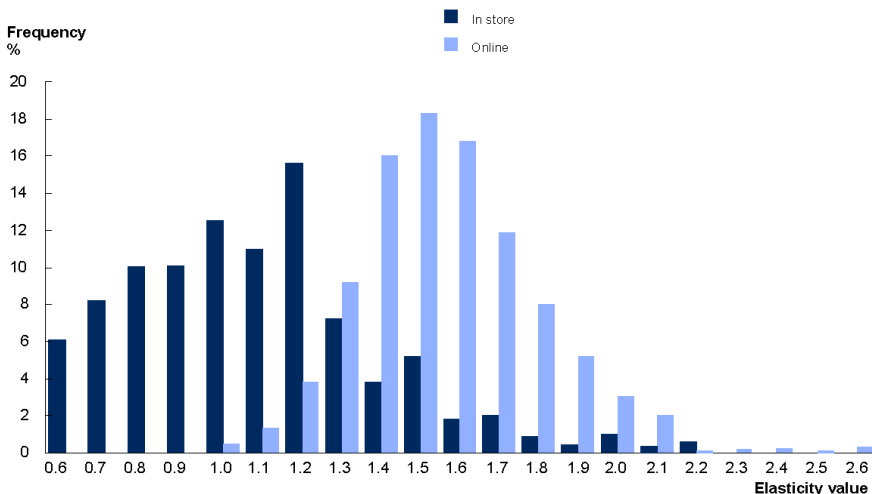
Source: Citi Research, BarrettFox

Some retailers are pursuing strategies to combat showrooming. In February 2013, Celiac Supplies, an Australian gluten-free grocery store, began charging a \$5 fee for "just looking." TGT sent a letter to vendors in January 2012 to open discussions on new partnerships that would enable TGT to compete fairly with online retailers. In May 2012, the company notified its stores that it would discontinue selling AMZN's Kindle, and WMT followed suit in September 2012. In addition to pulling showroomed products, retailers are using geo-fencing (GPS technology that rewards consumers for in-store presence) and unique barcodes that cannot be scanned by price-checking apps.

More recently, in January 2013, TGT announced its most aggressive tactic yet to fight showrooming: year-round online price matching. The online list includes Amazon.com (excluding Marketplace) as well as the websites of WMT and BBY, among others. TGT had tested the practice during Holiday 2012. Mark Schindele, TGT SVP of Merchandising Operations, noted that the company monitors prices of 30,000 items, and thousands more online, to make sure that it is competitive. BBY followed suit in February 2013, making its online price-match policy effective year-round, but with a shorter return window. BBY has not stated how many price matches it honored during Holiday 2012, but most experts estimate that fewer than 5% of customers ask for a price match. We believe the online price matching program is especially focused on giving shoppers increased confidence and peace of mind that they are getting the best deal available. Interestingly, while brick-and-mortar pricing elasticity tends to be normally distributed around 1.0, online elasticity distribution tends to be normally distributed around a much higher value, with less overall valuation (Figure 20). The most successful retailers are developing a fundamental understanding of the difference, in order to avoid a race to the bottom as some have feared with online price matching.

**Price elasticity is higher online than in-store**

**Figure 20. Elasticity Variation by Channel**



Source: Citi Research, Revionics

Retailers are also exploring strategies to harness showrooming behaviors for their own benefit. One crucial tactic is to provide a value-added in-store shopping experience. For example, TGT is sending special coupons directly to shoppers' mobile devices to encourage in-store purchases. WMT offers free in-store pick-up for online orders, allowing customers to avoid shipping fees and wait times. We believe WMT is welcoming showroomers with the conviction that these consumers will ultimately decide to purchase the item in-store or on the company's website, plus other items discovered in-store during the trip. JWN draws customers to physical stores through its superior service, ranking #1 in the 2012 Luxury Consumer Experience Index, with 96% of shoppers polled who earn over \$150K saying they plan to shop at JWN stores again.

**Figure 21. Example of a QR Code**



Source: Citi Research, comScore

**QR Codes.** QR codes (Figure 21) are an increasingly popular mobile commerce technology with many smartphone owners. QR codes are two-dimensional barcodes that can encode a URL, text, or information that is read by QR scanner smartphone apps allowing instant connectivity to online features. The most common sources of QR codes are printed magazines and newspapers or product packaging. During Holiday 2012, for example, TGT equipped its top toys with a QR code in order to increase shopping convenience and to drive sales. TGT recognized that consumers are busy during the Holiday season and that parents typically shop with children. As a result, the items on the "Top 20 Toy List" had a QR code that could be scanned in order to purchase the toy directly using a mobile device and ship it for free to anyone, anywhere in the United States. Consumers did not have to sneak the toy into their cart or carry a gift home only to ship it to a loved one later.

A Perception Research survey finds that 44% of smartphone owners have used a QR code, 32% know what QR codes are but have never used one, 18% have seen them but don't know what they are, and only 6% are completely unfamiliar with QR codes (Figure 22).

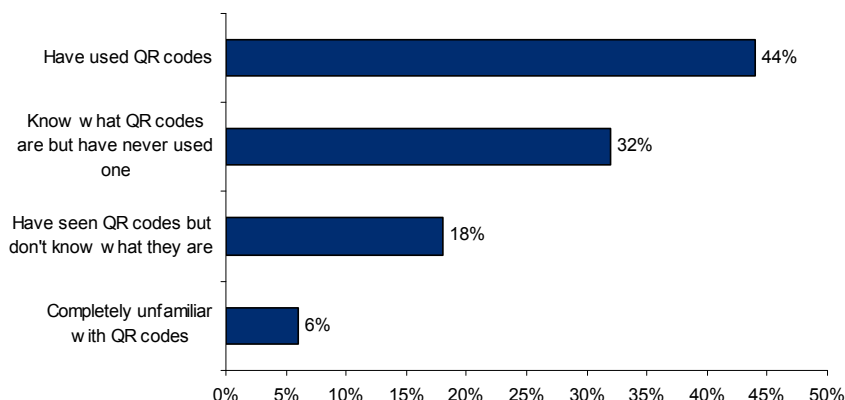
Among smartphone owners that have used QR codes, 69% have scanned a QR code to get product information, 65% to get information on promotions, 42% to read customer reviews, 40% to participate in a loyalty program and get rewards, and 29% to get information on a store location, the survey says.



We expect QR codes to continue to gain popularity as more consumers become aware of their purpose and retailers improve the content.

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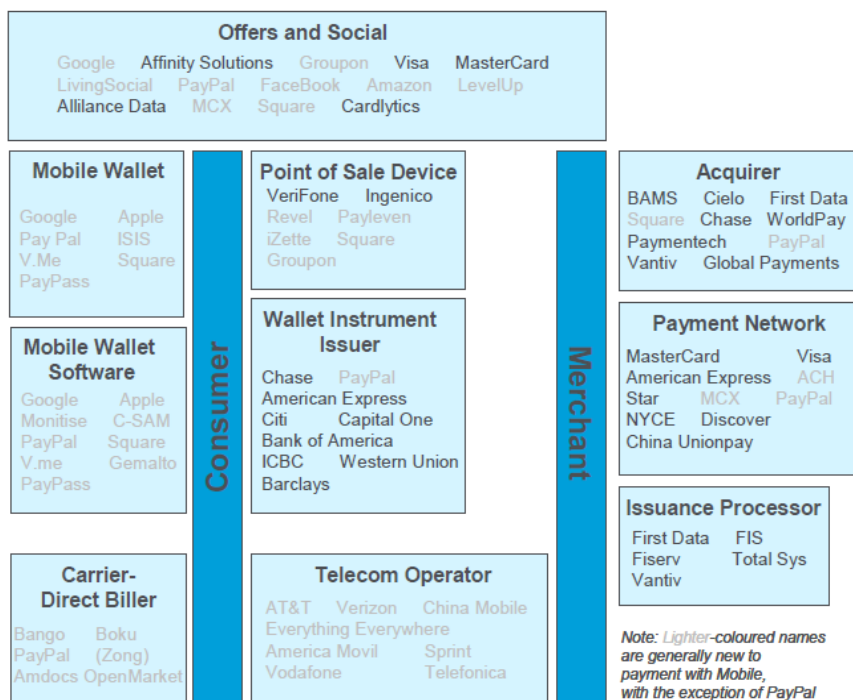
Figure 22. Smartphone Owner Familiarity with QR Codes



Source: Citi Research, Perception Research Services International

**Mobile Payments.** Figure 23 below provides an overarching picture of the different roles in mobile payments (new and traditional) and includes several representative role-players (again, new and traditional). Figure 23 does not demonstrate the process flow, which depends on the type of purchase transaction, depicted in Figure 24.

Figure 23. Emerging Mobile Payment Ecosystem



Source: Citi Research

Figure 24. Mobile Payments Overview by User Experience

	Mobile Wallet	Mobile Payment Instrument	Closed-loop Mobile Pymt Instrument	Existing Cards, Mobile POS	Carrier Direct Billing
<b>Description</b>	<ul style="list-style-type: none"> <li>Secure repository for existing payment instruments (credit or debit)</li> <li>Not a new payment instrument</li> </ul>	<ul style="list-style-type: none"> <li>Separate payment instrument (consumer stored value account) backed by multiple funding sources</li> <li>Popular E-Commerce products going mobile</li> </ul>	<ul style="list-style-type: none"> <li>Store-specific mobile payment solution</li> <li>Usually tied to loyalty program and focused on efficiency/speed and ease of use</li> </ul>	<ul style="list-style-type: none"> <li>Mobile POS terminals which accept existing credit and debit cards</li> <li>Evolving to location aware mobile wallet functionality on consumer app</li> </ul>	<ul style="list-style-type: none"> <li>Consumer charge purchases to wireless bill</li> <li>Traditionally used for digital goods, small-ticket payments</li> </ul>
<b>Merchant Acceptance</b>	<ul style="list-style-type: none"> <li>Utilizes contactless technology such as NFC</li> <li>Merchant POS terminals need to be upgraded for compatibility</li> </ul>	<ul style="list-style-type: none"> <li>Could utilize contactless tech.</li> <li>Merchant POS needs to be modified/upgraded e.g. keypad or QR (exception: plastic card over existing payment rails).</li> </ul>	<ul style="list-style-type: none"> <li>Accepted at merchant's stores</li> <li>Mobile apps, based on some contactless technology (QR, 2-D barcodes)</li> </ul>	<ul style="list-style-type: none"> <li>Card reader plugged into merchant mobile device</li> <li>Minimal infrastructure changes – mobile device and app</li> </ul>	<ul style="list-style-type: none"> <li>Not accepted for purchase amount above specific limit</li> </ul>
<b>Key Features</b>	<ul style="list-style-type: none"> <li>Needs a secure element on mobile device</li> </ul>	<ul style="list-style-type: none"> <li>No secure element needed – "cloud based" i.e. payment information stored in the cloud</li> </ul>	<ul style="list-style-type: none"> <li>Loyalty programs can accelerate adoption</li> </ul>	<ul style="list-style-type: none"> <li>Limited investment required by merchant for basic card acceptance</li> </ul>	<ul style="list-style-type: none"> <li>Limited use cases</li> <li>High margins for carriers</li> </ul>
<b>Examples</b>	<ul style="list-style-type: none"> <li>Google Wallet</li> <li>ISIS</li> <li>V.me by Visa</li> </ul>	<ul style="list-style-type: none"> <li>PayPal</li> <li>Amex Serve</li> <li>LevelUp</li> </ul>	<ul style="list-style-type: none"> <li>Starbucks</li> </ul>	<ul style="list-style-type: none"> <li>Square</li> <li>Intuit GoPayment</li> <li>PayPal Here</li> </ul>	<ul style="list-style-type: none"> <li>Boku</li> <li>Zong (PayPal)</li> <li>BilltoMobile</li> </ul>

Source: Citi Research, AlixPartners

**Mobile payment sales are expected to reach \$617B in 2016, representing a +42% 5-year CAGR.**

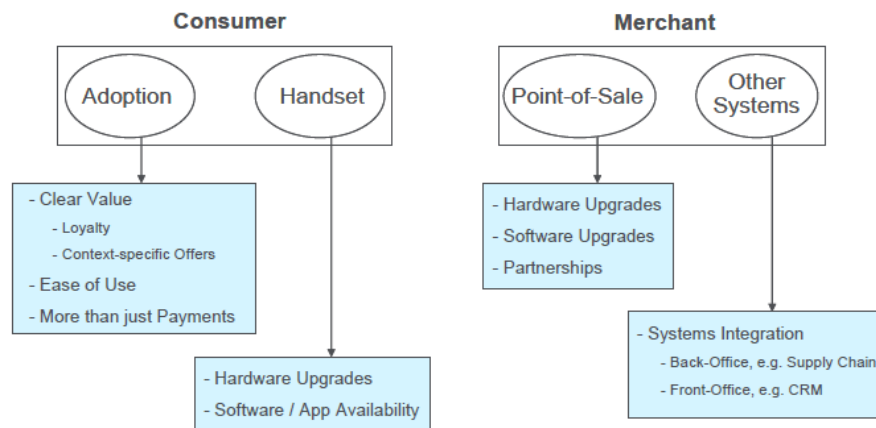
While NFC remains unavailable on the iPhone, mobile payments are nevertheless growing quickly. According to Gartner, mobile payment sales grew over +60% in 2012 to about \$171.5B, vs. \$105.9B in 2011. Furthermore, the number of mobile payment users is estimated at 212.2 million people vs. up +32% from about 160.5 million people in 2011. Longer term, Gartner estimates that mobile payment sales will reach \$617B in 2016, representing a +42% 5-year CAGR, with 448 million users.

According to Citi's Mobile Payment Research Team (please see page 21 for link to full report), the mobile payments opportunity in emerging markets is likely to evolve quite differently from that in developed markets.

In emerging markets, we can leapfrog from a cash-based society to mobile payments — not very different from the communications industry wherein we went from post offices to mobile phones without stopping for the wire-line infrastructure to be laid out. Here, the ubiquity of mobile phones can help governments, businesses, and individuals overcome a set of pressing and persistent issues, i.e., the general lack of access to financial services, computers, and Internet connectivity. This is a "blue sky" opportunity, and typically there isn't any established competition to worry about.

In developed markets, while the opportunity is large, there are incumbent payments industry players as well as a range of contenders, and co-operation is not a given, unlike in many emerging markets, where the presence of a dominant financial services player or telecom has resulted in quicker progress.

Figure 25. What Needs to Happen for Mobile Payments Adoption in Developed Markets



Source: Citi Research. Note: The simplified picture above ignores, for now, the complex "background" issues such as decisions on common standards, data privacy, and data security.

**Impact of Fragmentation.** Fragmentation in offerings may be keeping any one solution or group of providers from properly scaling up as the gold standard for mobile payments. The implication is that merchants and consumers have less of an opportunity to build trust with solutions. We do not believe that this negative impact of fragmentation will abate over the next few years, especially as MCX lies on the horizon, adding yet one more option. However, fragmentation may also have the benefit of pushing providers to fight harder to offer a superior solution and to tailor offerings to local markets.

**NFC is technology that lets people wave their phones in front of a payment terminal to pay for goods and services.**

**NFC.** Near Field Communication (NFC) is a wireless communication technology that allows data to be exchanged between devices located a few centimeters apart. NFC is a technology that enables consumers to do two main shopping activities, including 1) making payments with a wave or touch of a device anywhere on a contactless POS reader, and 2) reading information and picking up special offers and coupons from posters or billboards on which an RF tag has been embedded.

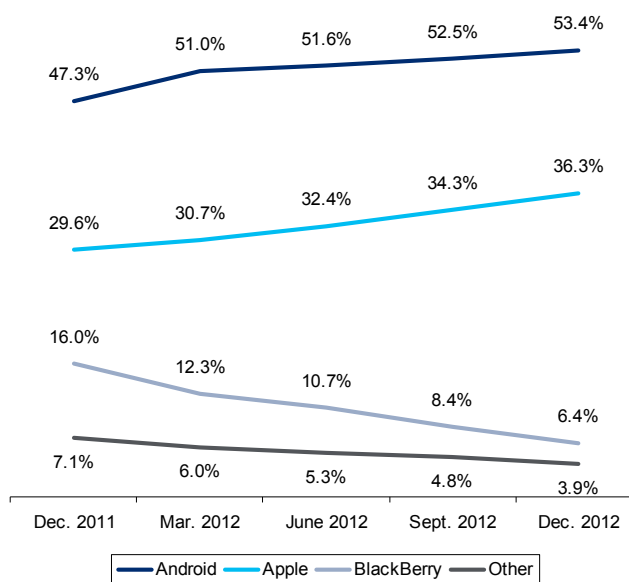
With respect to its application as a method of payment, NFC has many opportunities and challenges in 2013. Critics of the technology claim that tapping a phone versus swiping a credit card is not a big change, and there is a perception that NFC is unreliable, the readers don't work, and consumers don't view the technology as a time saver. Proponents of NFC such as Google and FirstData (sponsors of the Google Wallet project), however, view mobile payments as a potentially revolutionary innovation for retail. In spite of the present technological challenges, mobile payments are becoming increasingly popular and are positioned to grow 4x from \$170 billion in 2010 to \$630 billion in 2014, according to Google.

The market opportunity is large, as a study conducted by IHL about one year ago found that only 8.7% of retailers said they currently use NFC, while another 13% would use it within the next 12 months. NFC is also a global opportunity. According to an IMS Research survey published in December 2012, which polled 700 consumers from China, Japan, Poland, South Korea, Turkey, the U.K., and the U.S., 60% of respondents were either "very interested" or "interested" in a mobile phone that could replace their bank card.

**The limiting factor for NFC adoption is the number of mobile phones in circulation with the chips embedded.**

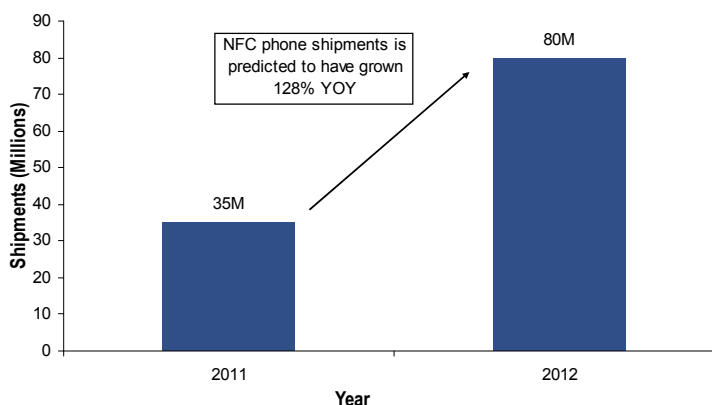
One of the primary barriers to entry is that NFC requires compatible phones and readers. Many consumers do not own the appropriate phones yet, as only select Android OS phones contain the chips. Apple is the main player that has yet to release an NFC-enabled handset, and the 2012 launch of the iPhone 5 again did not include the chip. Google Android ranks as the top smartphone platform with 53.4% market share and steadily gaining (Figure 26), while Apple's share is significantly less at 36.3% but also growing. Android has achieved 500 million devices activated in total and 1.3 million activations per day. By 2014, 50% of smartphones will have NFC (about 150 million phones), according to Google and Telenius estimates. However we note that Apple is reportedly working on a less-expensive iPhone as an alternative to the existing model, which could launch as soon as later in 2013, which could boost Apple market share.

**Figure 26. U.S. Smartphone Market Share**



Source: Citi Research; comScore

**Figure 27. NFC Phone Shipments**



Source: Citi Research, IMS Research

**Google Wallet is one example of an NFC payment system that retailers are testing today.**

**Google Wallet.** Google Wallet is an NFC mobile payment product that was launched on May 26, 2011. Google Wallet has partnerships with 14 retailers including Bloomingdale's, Macy's, and Duane Reade (WAG) for the SingleTap technology. The SingleTap technology opens several secure channels to the retailer's point-of-sale system and offers customers the ability to pay, redeem offers, and earn loyalty credit with a single tap of a mobile phone. Among companies in our coverage universe, Macy's is the first to widely test NFC in its stores. In October 2011, Macy's announced a partnership with Google to test the Google Wallet in select locations. Macy's also has advertisements which customers can tap to directly receive a real-time, in-store coupon. Google-enabled smartphones with the Google Wallet app can work at over 140,000 U.S. merchants within the MasterCard PayPass network, vs. 120,000 a year ago. In addition, VeriFone has outfitted over 40,000 lanes with POS systems to take Google Wallet. Overseas, Barclaycard and Orange UK have created a "Quick Pay" contactless payment solution. PayPal also released a NFC peer-to-peer payment (P2P) system in 2011.

**MCX.** More than a dozen retailers, including TGT and WMT, representing over \$1 trillion in sales, have formed a merchant/customer exchange, or MCX, in 2012. The secure mobile payment network would challenge Google Wallet and could boost mobile sales. Unfortunately, so far there are few available details on this merchant-led initiative, but we do know that the intent is to lower interchange-related costs. MCX envisions a number of consumer-use cases including payments, discounts, promotions and marketing while minimizing the need for merchants to invest in new technology and point of sale equipment. The MCX platform will also take a "hands-off" approach to retailer's transaction and customer data.

**Gartner's prediction is that NFC will be used, but ultimately for ticketing, not payments.**

Given the absence of an NFC chip in the iPhone, industry experts believe use of the technology will remain relatively low through 2015. Interestingly, Gartner doesn't peg slow adoption of NFC on handset makers, but rather suggests that NFC payment involves a change in user behavior and requires collaboration among stakeholders that includes banks, mobile carriers, card networks, and merchants. Gartner's prediction is that NFC *will* be used, but ultimately for ticketing, not payments. PayPal President David Marcus echoed the sentiment in a December 2012 blog post: "The NFC payments debate will slowly die in 2013. Is tapping a phone on a terminal any easier than swiping a credit card? I don't think so — it's not solving a real consumer problem and it's not providing additional value to encourage me (or anyone else for that matter) to change my behavior."

**Location-based mobile coupons are on the rise.**

**Mobile Couponing.** Mobile coupons also represent an opportunity for retailers. comScore has found that nearly two-fifths, 37%, of smartphone users have downloaded a mobile coupon on their phone with location-based couponing offers from retailers. The survey also revealed that 77% of consumers say they would be swayed to one store over the other if they received a location-based coupon for a similar product from one of the stores. In addition, 75% of smartphone consumers say they prefer mobile to paper coupons.

**Retailers are beginning to test mobile devices as POS systems.**

**Mobile Devices as a POS.** Mobile devices are also beginning to be used to substitute traditional point-of-sale (POS) cash registers. Only about 6% of retailers used mobile POS devices last year, according to an NRF survey, but half expected to add them over the next 18 months. A fully outfitted iPod touch with a scanner and card reader costs about \$500, while the current POS registers run between \$5,000 and \$7,000. Some retailers are starting to experiment with these less expensive alternatives to process customer transactions in more convenient locations within the stores.

## Links to Relevant Reports

Citi analysts around the world have addressed the growing emergence of the Internet in a variety of ways in recent months including (click links to read the full report):

Deborah Weinswig & Neil Doshi

13 January 2013

**2013 Retail Technology Deep Dive – Outlook for the Broadlines, Food & Drug Retailers & U.S. Internet** — We believe 2013 represents a transition year with retailers realizing that now is the time to take a step back and revisit their technology playbook. Our companies are hiring data scientists, establishing offices in Silicon Valley, and stepping outside of their comfort zones in order to defend their turf, even switching to offense when it comes to combating the showrooming threat. We believe our most successful retailers are focused on establishing sustainable omnichannel business models for the long term in a dynamic retail environment.  
[2013 Retail Technology Deep Dive - Outlook for the Broadlines, Food & Drug Retailers & U.S. Internet](#) (link)

Neil Doshi & Deborah Weinswig

4 January 2013

**U.S. Internet Stocks Playbook for 2013** — Based on strong 2011 trends and the increasingly material impact of Mobile, Local & Video platforms, we now forecast 2012 U.S. Net Advertising Revenue of \$42B (up 14% Y/Y). And we have modestly tweaked our 2013 U.S. Internet Retail forecast down to \$254B (up 15% Y/Y) vs. \$256B previously due to a modestly softer Q4:12 holiday season and continued concerns around Macro issues as we enter 2013.  
[U.S. Internet Stocks Playbook for 2013 - 2013 Outlook & Key Themes for the U.S. Internet & Retail Stocks](#) (link)

Craig Woolford

14 December 2012

**The Secrets to Online Retail Success** — Australian retailers have spent 2012 raising the standard of their online offer. In Issue 55 of What's In Store?, we address whether they have come far enough. Our scorecard highlights JB Hi-Fi, Masters, Dotti, and Rebel Sport as the most advanced websites. However, the real prize will come from higher marketing spending and lower prices (& free shipping). The biggest sales opportunity exists for Orotan, Premier Investments, Specialty Fashion and Myer where there is 5%+ sales upside.  
[What's In Store? Issue 55 - The Secrets To Online Retail Success](#) (link)

Ashwin Shirvaikar, CFA, Philip Stiller, CFA, Tomasz Smilowicz, Robert Schlaff, & Donald Fandetti, CFA

28 November 2012

**Upwardly Mobile II: A Long and Winding Road for Mobile Payments – Eight Crucial Questions Answered** — In this report, we focus on eight questions that address the issues of business model evolution, technology and adoption. We find most importantly, that mobile payments could simplify and alter some elements of the traditional four-party payments system as information and interaction increase in importance, versus the actual payment transaction itself. The type and timing of technology is still not clear but what is clear is that in the last 6 months, new and credible non-NFC solutions have emerged. Infrastructure must be upgraded to enable Mobile Payments for any technology that becomes the global standard, and the timeframe will be technology dependent. Merchants may very well wait until there is more clarity on technology before making investments towards adoption. Finally, we believe consumer adoption will depend on the presence of a “killer app” – an app that is simple for both consumers to adopt and use and is widely available.  
[Citi GPS: UPWARDLY MOBILE II - A Long and Winding Road for Mobile Payments – Eight Crucial Questions, Answered](#) (link)

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## Company and Sector Profiles

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## Australian Broadlines Retail

**Analyst:**

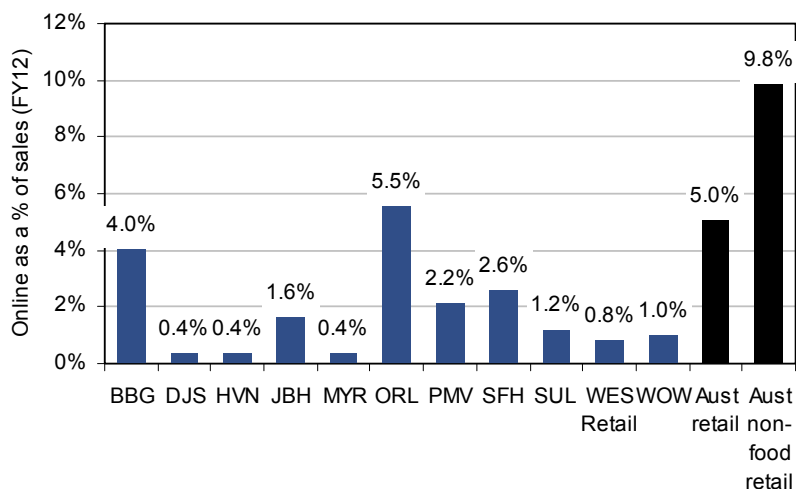
**Craig Woolford**

**Key Theme #1: Australian Retailers in Catch-Up Mode** — Listed retailers in Australia have low online sales penetration. Both traffic and conversion lag their U.S. and U.K. peers. While most retailers still need to sharpen their price points, we view the inadequate traffic levels visiting their websites in the first instance as the most pressing issue for 2013. Underinvestment in marketing to drive the traffic levels is one of the key causes. We see a need for higher investment into marketing methods like search engine optimization, Google adwords, social media, and traditional marketing channels.

**Key Theme #2: Alternative Fulfillment Channels to Separate Winners from Losers** — Australian retailers need to improve their range of delivery options given to consumers. We see three core fulfillment areas which, if introduced, could lead to higher online sales. These are offering free shipping, rolling out lockers (refrigerated for supermarkets), and giving the option of click 'n collect. Additional delivery features will drive costs higher. We estimate that free shipping detracts ~10% from profit margins. In addition, developing the systems for real-time store level inventory creates a capex risk, given the technology needs to be rolled out to every store.

**Our Top E-Commerce Pick for 2013** — Specialty Fashion is our top stock to benefit from e-commerce in 2013. The company has grown online sales as a share of total sales from 2.1% in 1H12 to 3.6% by 1H13, but it is targeting a level of 15% in two years time. The company is focused on this channel and has invested in dedicated online team members, new platforms, and an expanded logistics pick and pack facility to support e-commerce capabilities. The company will introduce real-time inventory in the near future. The company's customer database currently has over 55% of the Australian female population as members and recorded 16 million visits across its six websites during 1H13. We see significant online upside as the company leverages these investments. We have a Buy recommendation on Specialty Fashion.

**Figure 28. Australian Listed Retailers: Online Sales as % of Total Sales (FY12)**



Source: Company reports, Citi Research

## China & Hong Kong Retail

### Analysts:

Eddie Lau (Lead)

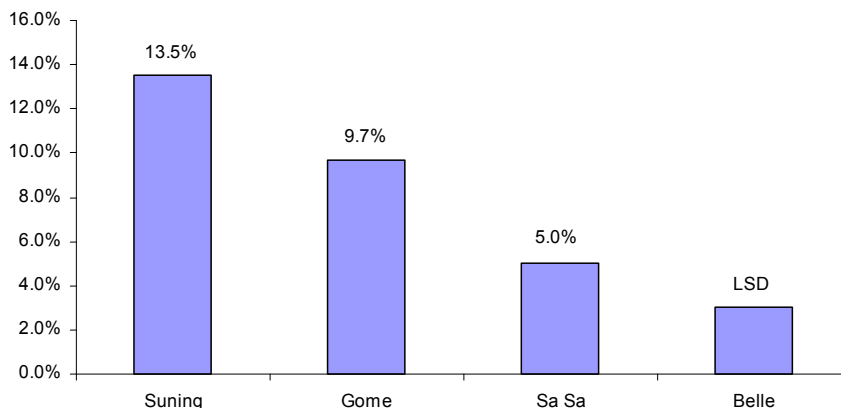
Catherine Lim

**Key Theme #1: Strong growth in Online Retail Sales, but Omnichannel not Top Priority to All Retailers** – According to Euromonitor, Internet retail sales increased +84% YOY in 2012 and accounted for around 4.1% of total retail sales in China. There has been more aggressive investment in e-commerce by appliance distributors, mainly due to a new entrant and the commodity nature of the merchandise. We estimate online represents 9.7% of Gome's and 13.5% of Suning's 2012 revenue, which is loss making. Online sales contribute about 5% of cosmetic distributor Sa Sa's FY13E revenue and are profitable. While the online channel begins to affect sales revenue of retailers, it seems most China retailers are still at the investment phase on their e-commerce if at all. Online sales represent an insignificant sales percentage for department stores, jewelry retailers, grocery retailers and brands such as Belle. Department stores are still primarily operated under a consignment arrangement and there are few private labels or exclusive merchandise. Hypermarket operator Sun Art offers pre-packing service for customers who order merchandise online, as well as an online store on T-Mall for non-FMCG products. Meanwhile, some successful online retailers such as Liebo Apparel, a top selling apparel brand on Taobao's T-Mall, are expanding its off-line retail stores.

**Key Theme #2: Online Profitability Depends on Competition** — Sharp losses at Gome's e-commerce platform are partly due to investment, insufficient sales volume, and price competition from the pure online new entrant. We believe Belle's e-commerce operation is also loss making due to the initial investment. When online prices are consistent with the store prices, the e-commerce profitability depends on processing and delivery expenses. The net profit margin of Sa Sa's e-commerce business at 10.4% is still lower than the 12% net margin of the Hong Kong retail business.

**Key E-Commerce Pick: Qihoo (QIHU)** — E-commerce accounts for about 50% of Qihoo's ad revenue, which comes from its navigation page. Qihoo's start-up page plus browser search box accounts for around 15%–20% of total China market search queries. The company launched the beta version of its full search engine last August and we think the monetization potential is high.

Figure 29. China Retailers: FY12E / FY13E E-Commerce Sales Penetration



Source: Company reports and Citi Research

## European Food Retail

### Analysts:

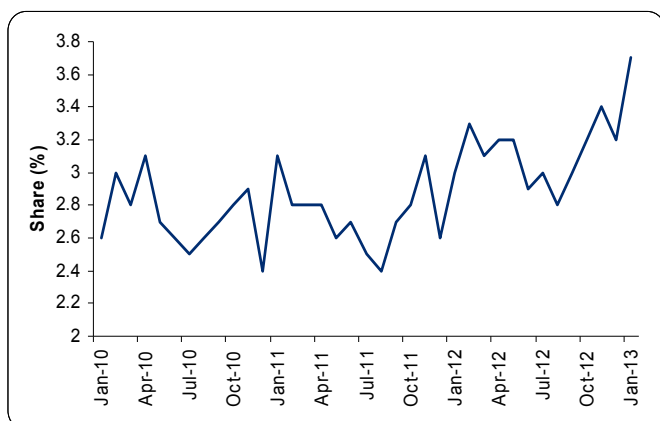
Al Johnston (Lead)

Pradeep Pratti

**Key Theme: Rise of 'Click-and-Collect' / 'Drive'** — When it comes to online shopping, both customers and retailers seem to be embracing the 'click-and-collect' model (or 'Drive' as it is known in France). For customers, it is all about convenience and lower prices. Customers shop online and pick up their shopping at a physical store at a time that is convenient to them as opposed to waiting at home around pre-allotted delivery slots. They also avoid paying additional home-delivery fees. For retailers, the model offers a more profitable way of expanding their online offerings without having to incur significant distribution costs (fleets of vans, drivers etc.). Most of the pickup points are attached to existing stores and require limited capex. A click-and-collect model that offers an Internet shopping option while leveraging existing store network will be a significant component of future online growth, we think, as it offers better economics compared to online home-delivery. The channel also offers retailers a fighting chance to compete against specialist/Internet-only players, especially in the non-food /general merchandise categories that have seen significant declines in sales in recent years.

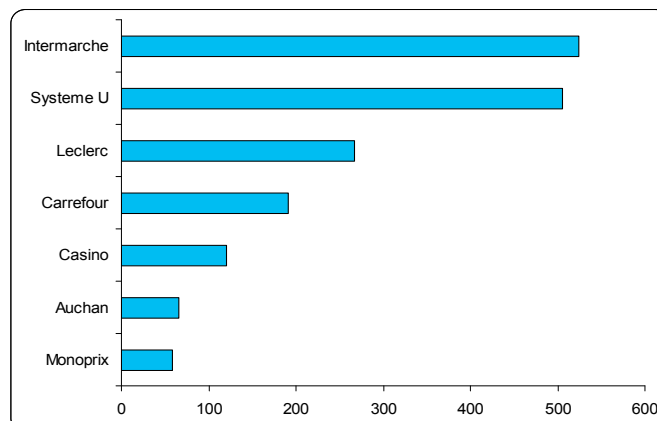
**E-Commerce Winners and Losers** — In the U.K., three of the four leading supermarkets have strong online businesses. Tesco has over 140 Grocery click and collect locations and over 1,500 for general merchandise and has recently reported 15% sales growth in online groceries. Sainsbury has click-and-collect facilities at most of its stores (general merchandise only), and its online grocery sales are growing c20%. Asda is also expanding its click and collect offering for both grocery and general merchandise. Morrisons has yet to build an online food business and does not have pickup points, a factor that explains at least some of its recent poor trading. In France, the number of 'Drive' locations exploded in the last few years from around 120 pick-up points in 2010 to over 1950 now. The unlisted operators Intermarche, Leclerc and Systeme U were the leaders in embracing this model together accounting for over two-thirds of the drive locations in the country. Carrefour and Casino are playing catch-up with the former, opening around 170 Drive locations in 2012 and the latter leading its rollout with CDiscount pick-up points. We think the lack of click-and-collect channel definitely explains some of Carrefour's and Casino's recent weak trading performances compared to the independents. Finally, Ahold is also beginning to roll out its click-and-collect network, with Albert Heijn recently opening three pickup points in Netherlands and Peapod opening eight in the U.S.

Figure 30. U.K.: Internet Sales as % of Food Sales



Source: ONS, Citi Research

Figure 31. France: Independents lead in 'Drives'



Source: Lineaires (Drive Insights - Olivierdauvers.fr), Citi Research

## European General Retail

### Analysts:

Richard Edwards (Lead)

Dan Homan

Assad Malic

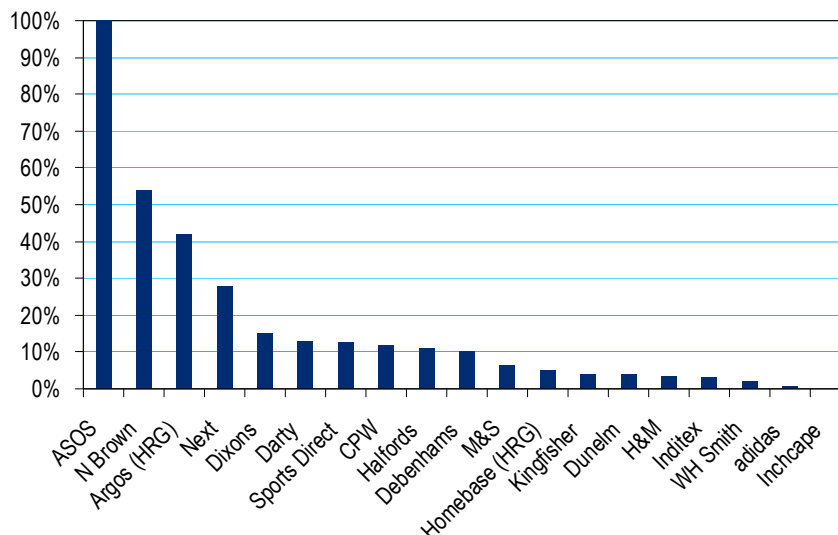
**Key Theme #1: Consumer Flexibility a Top Priority** — Due to the rapid development of purchase options and different fulfillment strategies by leading retailers, customers now expect a huge variety of choice when purchasing. During browsing and at the point of sales, customers expect online, mobile-based, and app-based systems to complement the store portfolio. On order fulfillment, customers now expect a choice of home delivery (with specified delivery dates and times), collect in store, and options such as collect-plus. Those retailers that react quickest and provide these options first are likely to see market share gains.

**Key Theme #2: Profitability** — In order to thrive in an online/multichannel world, retailers must have a distribution and logistics set up that enables them to cope with many small value orders. The IT and logistics systems must be efficient enough to maintain profitability on products sold regardless of the sales channel. Currently, many retailers are finding that online sales are driving EBIT margins lower. This effect is magnified as stores become less profitable as sales move online.

**Our Top E-Commerce Pick for 2013: Inditex** — We argue that Inditex is one of the few European retailers operating an online retail proposition that minimally cannibalizes the group's store-base and that is group EBIT-margin enhancing. The former stems from the group's general low-single-digit market-share positions across its 82 markets (excepting Iberia). To date, Inditex trades online in 17 geographic markets across all 8 store concepts, representing c.50% of group sales. Over time, the group's online capability will be rolled out across all markets for all concepts.

Taken together with the group's rapid store-opening program in the higher-growth Asian and Emerging markets, we expect the group to continue to deliver 'GDP-plus' LFL sales growth, driving c.+10%–15% compound EPS growth from here. This is a view underpinned by the group's recent doubling of the design, sourcing, and store-feedback management capacity. In combination with a c.2%–3% dividend yield, this should drive a c.+15% ETR over time. Long-held Buy rating retained.

Figure 32. European General Retailers: 2012 E-Commerce Sales Penetration



Source: Company Reports; Citi Research

## European Hotels, Leisure, & Gaming

### Analyst:

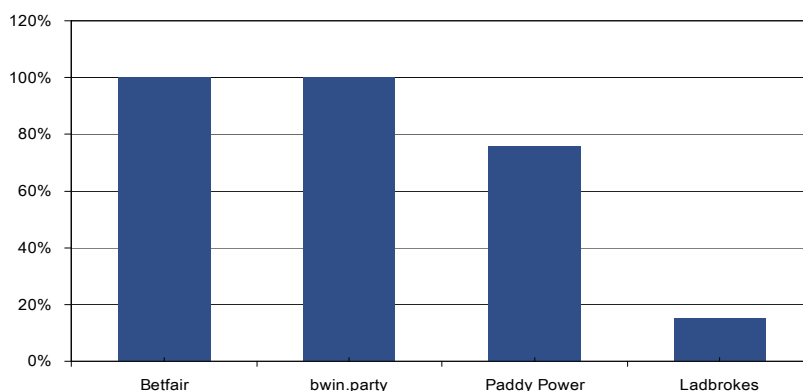
James Ainley

**Key Theme #1: European Online Gaming is in Strong Growth** — Across the diverse European Hotels, Leisure & Gaming sector, we see the strongest online story in Gaming. A favorable regulatory environment in the U.K. has allowed the industry to blossom, and many of the online industry's market leaders are now listed there. Regulation across the rest of Europe is evolving, with countries such as Italy and Spain broadly embracing online gaming while Germany and France continue to have a more prohibitive stance. Online gaming in Europe is worth over €10bn pa (GGY - Gross Gambling Yield) and accounts for c13% of the total European gambling market. Industry growth remains strong at c10% pa, despite the lackluster European macro environment.

**Key Theme #2: The U.S. Is Finally Moving to Regulate** — In 2011, the DoJ ruled that the 1961 Wire Act, banning online gambling in the U.S., referred only to sports betting. Since then, Nevada, Delaware and New Jersey have all permitted some form of online gaming (Poker and/or Casino). California, Illinois, Massachusetts, Hawaii, Pennsylvania, Mississippi, and Iowa have all recently drafted regulation still to be voted on. We don't expect many of these bills to pass at this point, but over the next few years we expect most states to begin to regulate and tax online gambling, specifically casino and poker. We think the U.S. online gambling market could be worth over \$10B p.a. (GGY) by 2018 and think European operators could be well placed to capitalize given their proven expertise.

**Our Top E-Commerce Pick for 2013: Paddy Power** — Paddy Power is one of the market leaders in Europe. About 76% of its EBIT comes from online operations, and growth remains strong, with net revenues and EPS +25% and +17%, respectively, in FY12. We expect strong growth to continue and forecast double-digit revenue growth. Key markets for the group are U.K. and Australia, and the group recently entered the Italian market (the largest land-based gambling market in Europe), where we see significant potential. Paddy Power's business is 100% in regulated markets unlike some peers, which gives a good degree of regulatory and tax certainty. On a cash-adjusted basis, the shares trade at 21.7x FY13E, falling to 17.4x FY14E P/E. Gaming peers trade at 16.8x and 15.6x, respectively. PAP's historical average P/E premium has been 25%, implying an FY14E P/E of c20x, or €68 per share. To this, we add our forecast for net cash per share of €7, making a total of €75. This coincides with our increased DCF target of €75 (from €64), which reflects our forecasts for higher growth rates.

Figure 33. European Gambling Peers: Online EBIT as % of Group Total



Source: Citi Research, Company Reports

## European Luxury Goods

**Analyst:**

Thomas Chauvet

**Key Theme #1: E-Commerce Offers Marginal Growth Opportunities for the Luxury Sector in 2013 and Beyond** — Overall e-commerce penetration in the luxury sector remains low (low-single-digit percentage of industry sales in our estimates). We argue that it will remain so in the medium term. This largely reflects the desire of luxury makers to control and protect brand equity and quality of service/store experience through a largely directly operated distribution channel. It will be difficult to replicate the magic of the tangible luxury shopping experience online. While specialist luxury e-commerce sites have emerged and experienced high growth rates in recent years (Yoox, Net-A-Porter, Gilt), their profitability remains low and their business model is too dependent on the brand's willingness to grant them distribution agreements. Moreover, the Internet enables instant price comparisons across various regions, and given the unusual price structure of the luxury industry (goods in Asia priced ~30%–40% higher than in Europe), brands are unlikely to make products available on European sites to consumers based in regions with higher retail price (and often higher margins), such as China and Japan). We also note that proliferation of counterfeit goods remains a major issue; this is another reason why e-commerce is unlikely to become a meaningful distribution channel for the luxury sector, in our view, as consumers will remain reluctant to purchase big-ticket items such as high-end watches or jewelry online without good assurance that these products are genuine.

**Key Theme #2: Social and Digital Media as a Communication Tool Rather than a Revenue Driver** — We think e-commerce can be used as an effective way to attract new customers to the brand. Net-A-Porter (fully owned by Richemont) argues that its global reach helps generate revenues with new potential customers in remote locations where it will not be able to open a store. The Internet — social and digital media in particular — is also widely used by luxury brands as a communication tool to provide detailed product information, increase brand awareness, and create a “buzz” about the brand to eventually drive traffic into the store.

**We Cannot Isolate an E-Commerce Top Pick for 2013; However, We Highlight the PPR/Yoox JV as a Potential Source of Value Creation** — Although exposure to e-commerce is likely to remain immaterial in the luxury sector for the time being, we are excited about PPR and Yoox's joint venture formed in 2012. The JV will develop PPR's luxury brands' online presence through mono-brand stores, in particular Bottega Veneta and Saint-Laurent (Gucci is not yet part of the agreement). We think this agreement reflects growing interest from luxury groups to retain a high degree of control over the brand image when moving online, while outsourcing the operational side of the shopping experience to reputable multi-brand e-commerce operators that effectively act as logistics partners.

**Figure 34. Luxury Sector: E-Commerce Penetration, 2010–12E**

	2010E	2011E	2012E
Burberry	4%	5%	6%
Hugo Boss	1%	2%	2%
Luxottica	<1%	<1%	<1%
PPR (Luxury division)	1%	1%	2%
LVMH	<1%	<1%	<1%
Richemont	4%	5%	6%
Swatch Group	<1%	<1%	<1%
Tod's Group	<1%	<1%	<1%

Source: Citi Research, Company Data

# Malaysian Retail

**Analyst:**

Petrina Chong

**Key Theme #1: Malaysia E-Commerce to See 15% CAGR** — Online retail sales in Malaysia are forecasted to grow 15% CAGR from \$275M in 2011, according to *Euromonitor*. The Asia Digital Marketing Association (ADMA) noted that online retail sites have a 53% reach in Malaysia in 2011 (up from 44% in 2010) and that Malaysians spent an average of \$2,000 each per year on online purchases. The most sought-after products were airline tickets (33%), clothes (27%), and mobile phones (26%).

**Key Theme #2: Domestic E-Commerce Likely in Its Infancy** — Top retail sites in Malaysia have been predominantly international, based on ADMA data. ADMA also quotes McKinsey, saying it expects the local e-commerce market to grow at 10% CAGR in 2011–15. We understand from Parkson's management that online retailing in Malaysia is still in its infancy, but it is looking to set up a multi-channel platform to complement its existing department store business.

**Limited Exposure for Malaysian stocks** — In our coverage, Parkson's Malaysian business does not disclose any breakdown for online shopping, i.e. there is currently no significant contribution from online shopping. Parkson is one of the largest department store chains in Malaysia, with 39 stores nationwide and one shopping center. Its closest competitor, Aeon Co (Malaysia), has 30 stores and 19 shopping centers.

**Figure 35. Malaysia's Top Retail Sites (Total Unique Visitors '000)**

Retail	6,270
Amazon sites	1,564
Apple.com worldwide sites	1,134
Alibaba.com	926
Avg	564
Groupon.my	486
Apac sale group	412
Samsung Group	365
Mgid	273
Dell	263
Hewlett Packard	226

Source: ADMA 2012 Yearbook, Citi Research

**Figure 36. Key Online Purchases by Malaysian Internet Users**

Purchased online in past six months	% of Internet users
Travel (e.g. plane tickets/hotel)	19.8
Clothes	18.8
Holiday (in own country)	12.9
Healthcare and pharmaceutical products	12.8
Books	12.2
A gift for someone	12.0
Shoes	10.6
Personal items eg watches/handbags etc	9.6
Films	9.4
Holiday (abroad)	9.0
Music	7.1
Mobile phone	6.9
Broadband/hi-speed Internet	4.5
Financial product eg insurance	3.5
Flat screen TV	3.2
Beer	3.1

Source: ADMA 2012 Yearbook, Citi Research



## Russian Retail

**Analyst:**

**Brady Martin**

**Key Theme #1: The Russian Internet Is Important...** — Russia, with over 68 million Internet users, is the largest Internet population in Europe and the sixth-largest in the world. The Internet advertising market has exploded from <1% of total ad spending in 2011 to over 16% by 2012.

**Key Theme #2: ...But from an Equity Perspective, E-Commerce Is Not** — E-commerce penetration is growing in Russia. The country's largest consumer electronics retailer, M.video, has been aggressively growing its e-commerce business in recent years, likely in an effort to avoid (or at least mitigate) the effect e-commerce will have on the consumer electronics business when Russia's consumer habits catch up with those in developed markets. However, despite the fact that the company's Internet sales jumped 56% y-o-y in FY12 (vs. +20% for the overall business), e-commerce still accounted for <3% of FY12 sales. Russian food retail is still driven by the key themes of increasing penetration of modern retail and sector consolidation, and therefore at present e-commerce is at best an afterthought. The country's largest food retailer, X5 Retail Group, for instance, has the largest e-commerce presence among food retailers, and growth rates are high; however, the company's online efforts accounted for <0.1% of FY12 sales.

**Our Top E-Commerce Pick for 2013: No Clear Winners** — Excluding media/IT stocks, we do not see an obvious way to invest in e-commerce in Russia among the consumer companies we cover in Russia. While we note M.video's focus on e-commerce and the company's professed "omni-channel strategy," high growth in its e-commerce business in recent periods, and the fact that it has the largest share of Internet sales in its overall turnover, we see the growth of e-commerce as more of a threat to M.video's core business than as an opportunity to expand. For food retailers, while e-commerce may eventually play a role, we believe the largest players will primarily focus their attention on exhausting the potential for expanding their physical real estate before looking for significant contributions from any virtual presence.

## South African Retail

### Analysts:

Zaheer Joosub

Kgosietsile Rahube

Most SA retailers still have limited e-commerce capabilities.

Clicks has the highest ratio of online sales to total sales: 2%.

Online stores offered by SA retailers are focused toward more upper-income consumers.

### E-Commerce in SA Retail — A Long Way to Go

South African retailers, on average, have limited to no e-commerce penetration currently. Most of the e-commerce offerings are limited to displaying some merchandise ranges on sites (most notably on separate sites per brand), with only Pick n Pay, Woolworths, JD Group, Clicks, Truworths and Massmart having any online purchasing functionality. Mr Price was the latest addition to online shopping since we last published. Most SA retailers still need to refine their supply chains for such an offering. Only Clicks, Woolworths, Mr Price, and Pick n Pay, for example, have a “collect in store” and direct delivery model. The shopping culture in SA is such that people prefer the experience of shopping rather than buying products online. Below, we show the exposure to e-commerce of the SA retailers.

Figure 37. SA Retail: 1) Merchandise on Sites, 2) Online Store, and 3) % Online to Total Sales

	On-line Site Merchandise	On-Line Store	% of Total Sales
<b>Food/Drug</b>			
Pick n Pay	Yes	Yes	1%
Shoprite	No	No	0%
Spar	No	No	0%
New Clicks	Yes	Some Brands	2%
<b>Apparel</b>			
Mr Price	Yes	Yes	1%
Foschini	Yes	No	0%
Truworths	Yes	Yes	>1%
<b>Furniture</b>			
JD Group	Yes	Some Brands	>1%
Lewis	No	No	0%
<b>Other</b>			
Woolworths	Yes	Yes	>1%
Massmart	Yes	Some Brands	>1%

Source: Company Reports and Citi Research Estimates

### Most of Online Platforms Are Targeted to the Middle to Upper End

Why is it taking longer for online sales to grow compared to other markets?

#### Key Reasons:

- **Supply chain:** Most are still building their supply chains to cater to this need and do not currently have a system that supports Omni-Channel integration. Some merely use Internet sites for product display.
- **Security:** Customers and retailers have a fear of online shopping, citing security as a reason. It is security with product (theft of product during delivery) and not payment security (a concern in some parts of the world).
- **Investment:** With the Africa story playing out and most retailers looking for stronger growth outside SA, most are concentrating their efforts and investments on expansion in Africa, rather than online retail.

SA is a technologically advanced country, and thus data or Internet limitations are not holding it back from growing online retail, especially through smartphones. However, most agree that over time this will become a viable channel of sales (next 5–10 years). While most have begun slowly trialing this offering, only a handful have actually gone ahead and launched online sites, e.g. Pick n Pay, Woolworths, Mr Price, and Clicks. We still see this being a more upper-end offering in the near term in SA (especially given low Internet penetration levels in other income groups).

## Thai Retail

**Analyst:**

**Suchart Techaposai**

**Internet Retailing in Thailand Is Still in an Infant Stage** — According to Euromonitor, it is estimated to be worth ~Bt 20.6bn in 2012, with 10% annualized growth during 2007–12, a rate doubling that of total retail spending for the same period. However, it represents 19% of non-store retailing and merely 0.8% of total retail spending in Thailand. Low penetration to Internet may be the reason. In addition, concerns over the security of online payment systems, product quality, and delivery times deter consumers buying products from Internet retailers, according to Euromonitor. (Figures 38-39.)

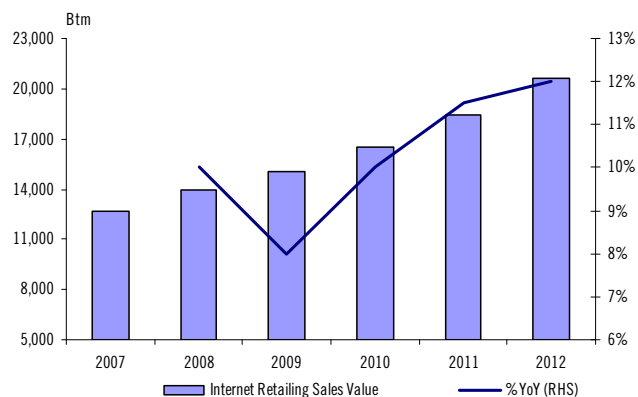
**Internet Penetration Is Rising** — # of Internet users in Thailand grew at 4%–7% YoY during 2005–11, to 14.8mn, with the penetration rate rising from 12% in 2005 to 23.7% by end-2011 based on a National Statistical Office database. This is low vs. 32% penetration to computer and 66.4% to mobile. (Figures 40-41.)

**Consumer Electronics, Video Game Hardware, and Appliances are Bought Most via Internet** — Of all online shopping in Thailand, one-third is Electronics and Video Game Hardware and 18% is Consumer Appliances. In terms of growth momentum, apparel, and consumer healthcare, Internet shopping grew faster. This suggests the channel is for the younger generation, who spend the most time on computer and mobile. (Figures 42-43.)

**Highly Fragmented, with No Clear Leader** — Internet retailing in Thailand is highly fragmented, with no clear leader. [www.weloveshopping.com](http://www.weloveshopping.com) is the largest online shopping website in Thailand. It was launched by True Corporation PCL, one of the three leading telecom service provider in Thailand in 2006. More than 100,000 retailers joined the website, offering 1 million products and services. **BIGC** is the only hypermart seriously focusing on online shopping in 2010 as an alternative to accessing a wider client target, via [www.shoppingonline.bigc.co.th](http://www.shoppingonline.bigc.co.th), offering packaged F&B, personal care products, household items, and IT & electronics. The shoppers can either pick up the purchased items or let BIGC deliver them if certain conditions are fulfilled. Its market share is merely 0.2% of total Internet shopping according to Euromonitor.

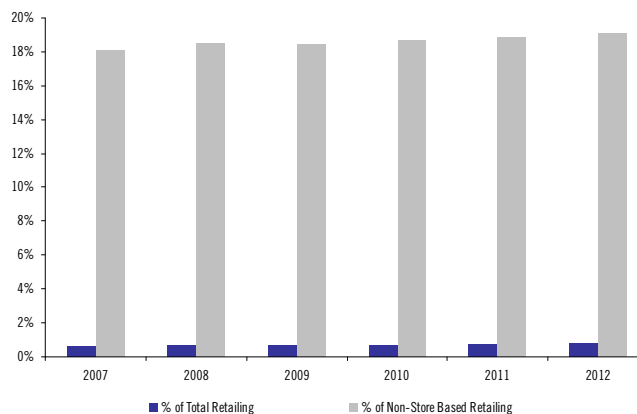
**Bright Prospect, with Bias toward Apparel** — According to Euromonitor, Internet retailing will continue to grow at a pace much higher than broad-based retail spending, due to increasingly busy lifestyles, improving security of online transactions, and more widely-recognized store-based retailers offering products to the channel. Apparel online shopping will be the highest-growth segment.

Figure 38. Internet Retail Sales Value and %YoY Growth



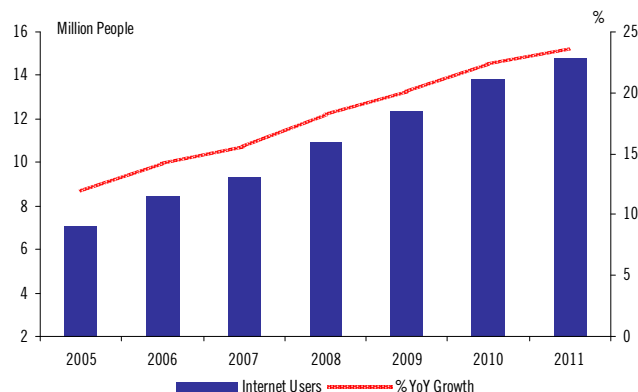
Source: Euromonitor and Citi Research

Figure 39. % of Internet Retailing to Total Retail and % to Non-Store Retailing



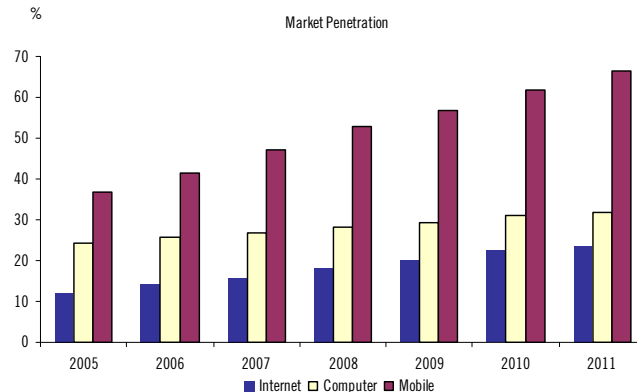
Source: Euromonitor and Citi Research

Figure 40. No. of Internet Users and %YoY Growth



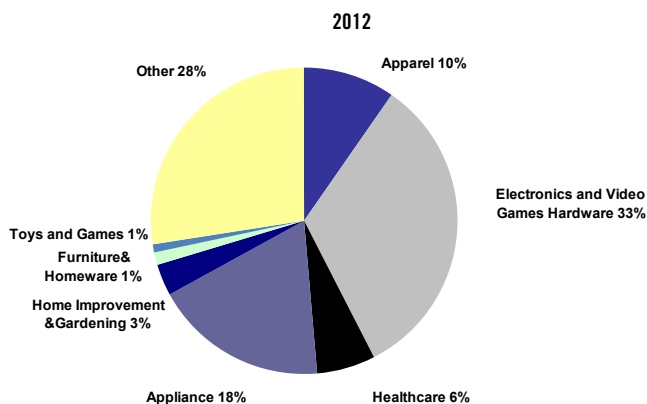
Source: NSO and Citi Research

Figure 41. Penetration Rate (% to Total Population)



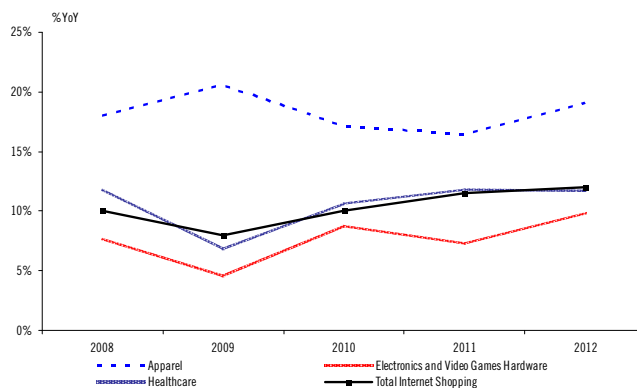
Source: NSO and Citi Research

Figure 42. Proportion of Internet Shopping by Products



Source: Euromonitor and Citi Research

Figure 43. %YoY Growth for Apparel, Healthcare, Electronics & Video Games Hardware and Total Internet Shopping Sales Value



Source: Euromonitor and Citi Research

## U.S. Apparel/Footwear Manufacturers

### Analysts:

Kate McShane (Lead)

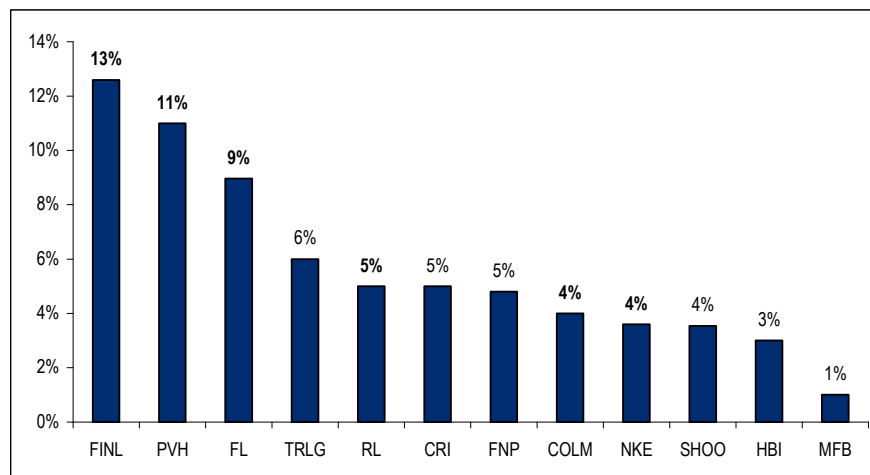
Susan Anderson (SMID)

**Key Theme #1: Higher Omnichannel Capex Continues** — Retailers are increasingly shifting focus from the B&M model and embracing new e-commerce practices to cater to evolving shopping habits and stave off online competition. The majority of companies in our universe plan to continue to increase capex budgets in 2013 (~+25% YOY on average), with spending focused on e-commerce, digital capabilities, and systems enhancements to improve customer experience, as well as further spending on B&M stores. Companies adding new e-commerce sites in 2013 include RL, CRI, and SHOO. FINL also continues e-commerce platform work after its unsuccessful relaunch in November 2013, with management planning to announce the new strategy within the next month, relaunching in early 2014.

**Key Theme #2: Free Shipping & Alternative Shipping Likely to Continue** — In an era of greater price transparency, shipping costs play a more important role in customers' purchase decisions and are likely viewed as another "markdown" by companies when taking gross margin into account. In response, retailers are resorting to lower purchase thresholds for free shipping, free returns, and order fulfillment from B&M stores and distribution warehouses to increase online competitiveness. While shipping thresholds vary by retailer, more are testing (and, in some cases, executing) a flat-rate (à la Amazon Prime) model. FL and FINL offer free shipping on a wide assortment on their main sites ('>10,000 items' eligible at footlocker.com and 'thousands of items' at finishline.com). We do not expect major changes to policies at either longer term. Both provide in-store pickups (FINL ships to local stores on certain items within in 2 hrs; FL free Send-to-Store option with standard shipping) and are developing mobile capabilities. While returns are not free, both retailers allow in-store returns, which we think is important to stay competitive with benchmark Zappos (famous for free shipping both ways). E-commerce was 8.1% of sales for FL and 10.9% for FINL in FY12.

**Our Top E-Commerce Pick for 2013: FL** — With many established e-commerce banners (led by Footlocker.com and Eastbay.com, plus Champs, Lady FL, CCS.com, and Run.com), FL continues to develop omnichannel capabilities, from remodeling and testing new B&M concepts, to smartphone, tablet, and PC apps. In addition to e-commerce investment made in 2012 (especially in the U.S. and Europe) and prior, FL's board also recently approved a 35% YOY increase in the capex budget (to \$220M), focused on omnichannel, including retail stores, systems, and digital. FL's management has noted that digital has the potential to deliver the highest top-line growth at the company over the next several years. It plans to continue to invest in digital to maximize longer-term potential. In the most recent quarter (F3Q13), FL reported nearly 50% growth YOY in consolidated e-commerce sales across banners.

Figure 44. Apparel/Footwear Manufacturers: 2012 E-Commerce Sales Penetration



Source: Citi Research, Company Reports. Note: Estimates bolded

## U.S. Broadlines Retail

### Analysts:

Deborah Weinswig (Lead)

Nathan Rich

**Key Theme #1: Leveraging Retailers' Top Asset: Real Estate** — Can brick-and-mortar retailers beat Amazon at its own game? We believe Amazon has differentiated its retail business in three key ways: service, selection, and pricing. The Broadlines retailers are developing capabilities to match Amazon in each of these areas. *On service*, retailers are rethinking how they utilize their stores to deliver product to the consumer. M, JWN, and WMT are using inventory in their stores to fulfill online demand and increase speed-of-delivery (historically a key advantage for Amazon). This is also reducing the amount of inventory that retailers must carry and improving turns and margins. In addition, it is often easier for customers to make returns to a store than to ship merchandise back, which is a further differentiator for brick-and-mortar stores. *On product selection*, retailers are expanding their online assortments to include additional styles, sizes, and colors of products sold in stores and increase the breadth of selection in key categories. However, we see an opportunity for retailers like TGT to develop an online marketplace similar to Amazon, and we believe that WMT's online marketplace could be expanded. *On pricing*, the threat of showrooming has proven to be a key concern for retailers. We see an opportunity for retailers to increase price transparency and consistency across channels, and we have been particularly impressed with TGT's "Online Price Match" program, which we expect to become more prevalent. We believe WMT could follow suit.

**Key Theme #2: Big Data and Predictive Analytics** — Retailers are increasingly merging their marketing, e-commerce, and IT departments and are hiring "Chief Customer Officers" to provide insights on today's omnichannel consumer. Big Data is a key opportunity, and retailers remain in the early innings with respect to their ability to turn Big Data insights into actionable merchandising and marketing decisions. Interestingly, the U.S. Food & Drug retailers (discussed in the next section) have done a better job of turning insight into action despite being less sophisticated with retail technology overall. The opportunity is significant, as customers who shop multiple channels will spend 2x–4x more with a retailer and are more profitable than customers who just shop one channel. Work with Big Data and predictive analytics is helping M to edit and optimize its assortments based on customer preferences, and WMT has leveraged its Social Genome project to analyze social media feeds and power social-commerce applications.

**Key Theme #3: E-Commerce Is Long-Term Margin Accretive** — E-commerce sales could grow to 20% of total sales for the U.S. Broadlines retailers over time. While some of this growth is likely cannibalization of store sales, retailers with an integrated omnichannel strategy should gain share of wallet and grow their base of loyal customers. Growth in e-commerce sales should also be EBIT-margin accretive in the long term, as lower fixed costs offset lower gross margins. However, in the near term, the EBIT margin on online sales is in line with to below overall company margins, as retailers are making substantial investments in systems, talent, and distribution to drive growth. We believe that retailers may soon reach the peak period of investment.

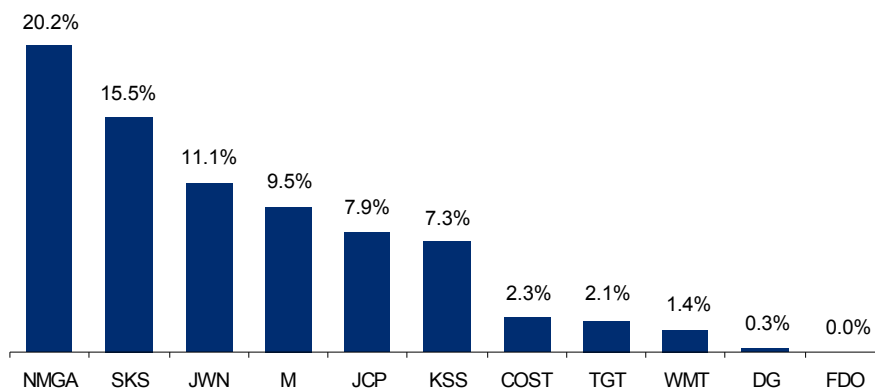
**Our Top E-Commerce Pick for 2013: Macy's** — In 2012, e-commerce sales increased +41.0% YOY on top of +39.6% growth in 2011. M has truly embraced the idea of omnichannel. The company can fulfill online orders out of 292 of its 841 stores currently and will expand this to 500 stores by the end of the year. This is driving sales through greater inventory availability across all channels. We see no signs that online growth at M is slowing down. We expect another year of 40% online sales growth in 2013, driven by an expanded online assortment (including more fashion apparel and the addition of categories not sold in stores like lighting),



further improvements in inventory availability, and strength in the home category online. *We estimate that if M experiences 40% e-commerce growth in 2013, it could add 300–400 bps to total comps.*

**Our Top E-Commerce Pick for 2013: WMT** — Since the acquisition of Kosmix and creation of @WalmartLabs in 2011, WMT has been hungry for top Silicon Valley talent to increase its omnichannel sophistication and move faster with key initiatives. In 2012, WMT piloted "Scan & Go" and receipt comparison mobile tools, as well as same-day delivery. The company also launched its "Pay with Cash" option for online orders and the new "Polaris" search engine, which increased online conversion by +10%–15%. Most recently, WMT announced it will test lockers in 12 stores beginning in Summer 2013. These lockers will hold goods ordered online until shoppers pick them up in the store. In addition, WMT is developing e-commerce opportunities in the U.K., Brazil, and China. We believe WMT has a significant omnichannel opportunity globally. Management expects worldwide e-commerce sales for the company to reach \$9B in 2013, which would represent about 2% of our total sales forecast.

**Figure 45. U.S. Broadlines Retailers: 2012 E-Commerce Sales Penetration**



Note: DG, SKS, TGT, and WMT are estimated.

NMGA = Neiman Marcus

Source: Company Reports, Citi Research

## U.S. Food & Drug Retail

### Analysts:

Deborah Weinswig (Lead)

Nathan Rich

**Key Theme #1: The Best at Building Customer Loyalty** — The U.S. Food & Drug retailers have developed best-in-class loyalty programs using Big Data and predictive analytics. We believe these programs serve as a key differentiator and competitive advantage:

- **CVS:** The CVS ExtraCare loyalty card program has about 70 million active cardholders and continues to drive customer retention and sales. ExtraCare members buy 85% more items per trip (4.4 items vs. 2.4 for non-cardholders).
- **KR:** We believe KR has gained market share as a result of its best-in-class loyalty program. KR is also the only U.S. Food & Drug retailer with a credit card program. The loyalty program operates in partnership with dunhumby and is exclusive to KR in the U.S. supermarket channel. dunhumby analyzes customer purchase history to glean insights on shopping behavior and uses those insights to make pricing and merchandising decisions. For example, targeted, insight-driven price investments recommended by dunhumby have resulted in a +15% increase in price perception for KR. Customers who are digitally engaged with KR are more loyal, and in December, the company reached a milestone of more than 500 million digital coupons downloaded.
- **SWY:** SWY's "Just for U" (J4U) program was rolled out nationally in mid-2012 and could represent the next generation in personalization if successful. The individualized deals are a distinct competitive advantage (with savings up to 20% more than SWY's Club Card prices), and the program also addresses "pre-shopping" by allowing consumers to sign up for deals and coupons on their home computer or mobile phone. We believe J4U could provide a +200 bps ID sales lift in 2013 as it gains traction. SWY is seeing greater participation and funding of promotions from vendors, as J4U is driving incremental sales for those vendors. Indeed, four out of five CPG companies experienced above-industry average volume growth at SWY with J4U.
- **WAG:** In September 2012, WAG introduced Balance Rewards, and the company already has nearly 60 million registrants. While WAG came late to the game with its loyalty program, we believe that this program will drive front-end comp sales as it builds critical mass. Furthermore, Balance Rewards provides WAG with an integrated view of the customer across channels and enables more customization in marketing to consumers.

**Key Theme #2: Going Mobile** — CVS and WAG have mobile apps that allow users to manage their prescriptions from their smartphones. WAG has stated that 40% of online prescription refills now come via mobile, and its mobile app has been downloaded over 10 million times, as of February 2013. CVS recently appointed a Chief Digital Officer charged with prioritizing omnichannel initiatives among business unit leadership. Research firm Gartner predicts that by 2015, 25% of companies will have a Chief Digital Officer. SWY noted that incremental spending and frequency of purchase are higher for mobile users by about +40%.

**Key Theme #3: The Race to Figure Out Online Grocery** — The online grocery channel represents just 0.6% of the \$850B+ food retail market and is expected to grow at an annual rate of +9.5% per year to reach \$9.4B in sales by 2017, according to IBISWorld. The supermarkets have been slow to enter online grocery, due to low margins and high shipping costs. However, several food retailers, including WMT, are testing online grocery, but in limited geographies. We note that

AMZN also offers national delivery of non-perishables. We see a first-mover advantage for the retailer that can figure out online grocery.

**Our Top E-Commerce Pick for 2013: No Clear Winners** — E-commerce has yet to play a significant role in U.S. Food & Drug retail. The U.S. supermarkets have been slow to adopt the online model used by their European peers, and we expect it will be some time before we see online grocery distribution gain prominence in the United States. While the drugstores in our coverage universe are omnichannel leaders, integrating mobile, social, and digital initiatives with the in-store experience, we estimate that online sales penetration for CVS and WAG remains limited at just 0.5% of retail sales.

## U.S. Hardlines Retail

**Analyst:**

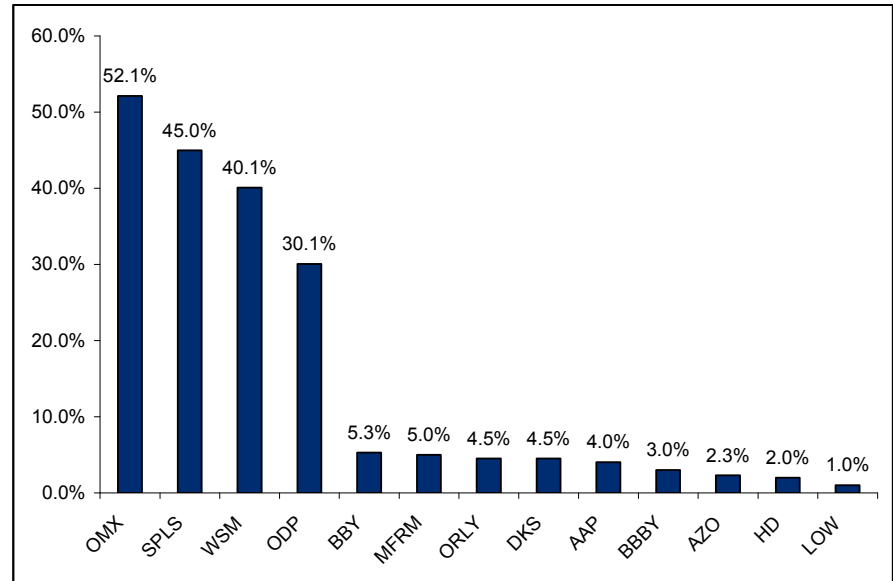
**Kate McShane**

**Key Theme #1: Increasing Omnichannel Investments** — Hardline retailers are increasingly turning to e-commerce: 1) to drive top-line growth; 2) as a response to changing customer shopping preferences; and 3) due to online retail competition ("Showrooming Effect") to remain competitive and provide a seamless complement to the B&M shopping experience. Most recently, HD began the rollout of Buy Online Ship to Store, which it expects to complete by 1Q13-end. The new capability rounds out HD's omnichannel capabilities, which include Buy Online Pick Up in Store and Buy Online Return in Store already in place. We have also seen online investments in international regions including LOW's launch of the lowes.ca website for its Canadian market in 4Q12.

**Key Theme #2: Shipping Strategies Evolve to Drive Purchases** — Our retailers continue to adjust shipping programs to maximize the impact from their online growth strategies. While shipping options vary by retailer, a common theme has been lower purchase thresholds for free shipping or free shipping altogether. SPLS announced that it will be offering free shipping on all staples.com orders beginning March 15, joining BBY as only the second retailer within our hardlines coverage to offer free shipping without minimum purchase. Excluding these two retailers, free shipping requires an average purchase of about \$62 for most hardlines retailers. We believe minimum purchase thresholds are likely to continue to decline as retailers achieve supply-chain efficiencies to offset higher shipping expenses.

**Our Top E-Commerce Pick for 2013: WSM** — Within our hardlines coverage universe, WSM operates the largest stable of online banners (Williams-Sonoma.com, PotteryBarn.com, PotteryBarnKids.com, pbteen.com, WestElm.com, Rejuvenation.com, Cultivate.com, MarkAndGraham.com). WSM continues to invest in supply chain and tech to drive its 3 growth initiatives: growing existing brands, global expansion, and launching new businesses. In 3Q12, WSM launched Mark and Graham as a personalized gift-giving brand. In e-commerce, WSM improved website navigation to accommodate growing product assortment. Furthermore, it is investing in data and algorithmic-driven product recommendations. We believe investments are bearing fruit given e-commerce revenue growth of +17% in the most recent reported quarter (~3Q12).

Figure 46. Retailing/Hardlines: 2012 E-Commerce Sales Penetration



Source: Company Reports, Citi Research. Note: AAP, ORLY, SPLS, BBY, DKS, BBBY, HD, LOW & MFRM est.

## U.S. Housing Retail

**Analyst:**

**Will Randow**

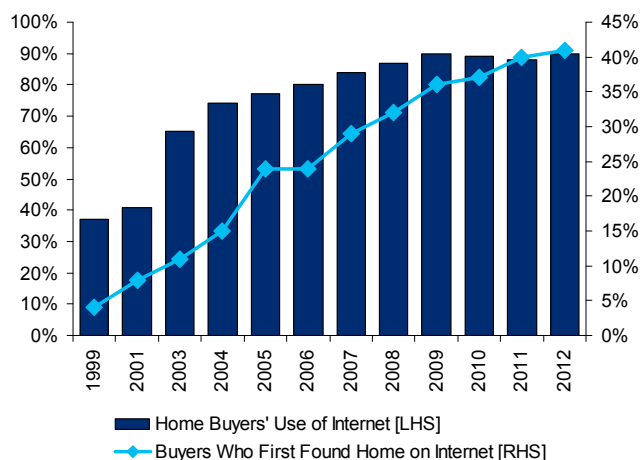
**Key Theme #1: The Internet Is an Industry Enabler** — Homebuilders and real estate brokers need to continue to leverage online search engines, desktop and mobile sites, and related resources when planning their marketing strategies. Surveys of home buyers and sellers from the National Association of Realtors (NAR) and Google speak to our conclusion in three ways. First, since 1999 the percentage of U.S. home buyers who utilize the Internet in their home buying process steadily rose from 37% in 1999 to about 90% in 2012. Second, over 40% of home buyers today find the home they buy on the Internet, compared to only 4% in 1999, as shown in Figure 47. Third, 89% of recently surveyed new home shoppers used mobile devices during their home search, given the advent of fast smartphones and related convenience on-the-go or on-the-couch. Trends in newspaper print subscriptions and advertising also lend credence to the importance of online marketing. According to the Newspaper Association of America, U.S. paid newspaper circulation has declined at a CAGR of 2.5% since 2003 to 93 million papers in 2011, and during the same period, newspaper print advertising slowed at a 9.2% annual pace, to \$20.7B. At the same time, in 2003 through 2011, U.S. Internet ad spending rose at annual rate of 20.1% per year, to \$31.7B in 2011, according to the IAB's Internet Advertising Revenue Report, on Internet and smart phone/tablet usage growing a breakneck pace.

**Key Theme #2: The Internet Hasn't Changed Traditional Broker \$ Share** — At first blush, it would appear that new upstarts that market homes online (e.g. Zillow and Trulia) and even help close home sales in-person at lower fees (i.e. Redfin) would eliminate the need for traditional real estate brokers that charge ~2.5% commission rates for each of the 2 sides of a home sales transaction (i.e. ~2.5% x 2 = ~5% of the home sale price). However, over 80% of homes sold continue to be through a broker in the U.S. Further, brokerage commissions have remained steady over the past decade, as shown in Figure 48. We have three key takeaways from these findings and our industry discussions. First, home buyers still desire in-person guidance when making one of the largest transactions of their lives despite arguably healthy commission levels. Second, the traditional brokerage model likely will persist as the traditional model casts a wider marketing net through Multiple Listing Services and incentive-based compensation to drive home sales velocity. Third, those builders and brokers that do not effectively leverage online tools most likely will be at a disadvantage to their more effective peers (in the same markets).

**Our Coverage Positioned Well for this Cyberholistic World** — We find that homebuilders and real estate brokers exhibit strong desktop and mobile web presences to support sales velocity, reach more customers amid declining newspaper print circulation, and trim the higher advertising expense of traditional ads. For our coverage, Internet marketing channels often used include user desktop and mobile websites, third-party sites (e.g. Zillow), Facebook, and YouTube.

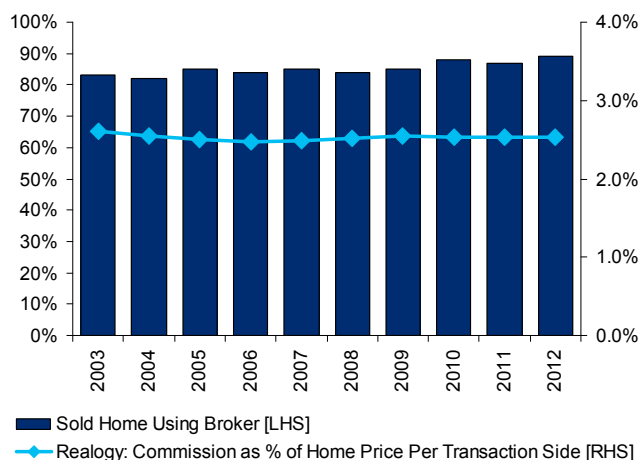
**E-Commerce Derivatives in Housing** — While we cover no pure-play e-commerce related companies, covered homebuilders and Neutral-rated Realogy (RLGY) effectively utilize their scale to benefit from the previously discussed trends. For reference, RLGY is the largest real estate broker in the U.S., involved in 1 out of every 4 brokered residential real estate transactions. The company and its agents and franchisees partner with Google, Yahoo, Trulia, Zillow, and other third-party websites. Also, RLGY maintains a dedicated YouTube channel showcasing thousands of property listings through its Real Estate Franchise Services (RFG) segment.

Figure 47. National Association of Realtors: % of U.S. Home Buyers



Source: NAR Profile of Home Buyers/Sellers & Citi Research

Figure 48. National Association of Realtors: % of U.S. Home Sellers



Source: NAR Profile of Home Buyers/Sellers & Citi Research

Please note that the NAR survey results depicted above were based on a statistically significant U.S. national sample set of slightly under 100,000 home buyers and sellers compared to over 5 million new and existing home sales. In addition, we use Realogy's two U.S. homes sales segments RFG and NRT (~25% market share of U.S. brokered home sales market) as a proxy for brokerage commission levels in the United States. Realogy's results imply commission levels remained fairly steady at ~5% of a given U.S. homes sales transaction value (i.e.  $\sim 2.5\% \times 2 = \sim 5\%$ ).

## U.S. Online Retail

**Analyst:**

Neil Doshi

**Key Theme #1: Offline to Online Continues** — As we note in Figure 49, online retail sales accounted for ~11% of total U.S. retail (adjusted) in 2012, and we expect ~100 bps of expansion in 2013 and in 2014. We expect established online retailers to be well positioned for the shift. Furthermore, we note many e-commerce companies are now acting as enablers for smaller businesses to sell their goods through those e-commerce companies. EBAY, AMZN's FBA and 3P programs, and GOOG are providing venues for retailers to sell goods online.

**Key Theme #2: Mobile Driving Additional Growth** — According to Internet Retailer, m-commerce in the U.S. was approximately \$21B in 2012, up nearly 98% vs. 2011 (eBay did ~\$10B in 2012 but was excluded because EBAY is not a retailer but a platform for retailers). We believe that mobile commerce has been driving additional growth, as consumers are buying more often with their tablets and mobile devices. Plus, mobile price comparison apps have enabled consumers to price-check items in-store and compare with online retailers. Companies like AMZN and EBAY have used this to drive incremental mobile sales given that goods on their sites are sometimes cheaper than in-store.

**Our Top Pick Is Amazon** — **1)** There is still significant secular growth for online retail, with our expectation that online will continue to rise by approximately 1% annually from the current 10% U.S. level; **2)** AMZN has significant share (approximately 20%) of U.S. online retail sales and its current momentum suggests continued significant share gains for the foreseeable future; this, combined with 1), has constituted our Double-Double Thesis; **3)** AMZN has been developing significant new revenue growth runways: Consumer Staples, Footwear & Apparel, International Expansion, Amazon Web Services, Digital Media Offerings, and now Office/Industrial Supplies...; **4)** AMZN has the ability to materially expand margins from its current 3% level back to its 2003–10 average 6% level and to long-term levels in the high-single-digit % range. Gross Margin expansion will likely be driven by scale, improved vendor terms, and the ongoing mix shift toward third-party (3P) marketplace sales and Amazon Web Services, which we estimate to be ~\$2B in 2013. And each of the core opex lines — Marketing, Technology & Content, Fulfillment, and G&A — carries the ability for long-term leverage driven by scale; and **5)** AMZN has arguably one of the best management teams in the Internet sector, based on its consistency, operational and strategic track record, focus on innovation and customer service, and long-term shareholder orientation.

**Figure 49. Citi Online Retail Sales Forecast (\$B)**

Sales in \$B	2009	2010	2011	2012E	2013E	2014E
U.S. Retail	\$3,672	\$3,926	\$4,157	\$4,364	\$4,560	\$4,743
Y/Y Change	-7%	7%	6%	5%	5%	4%
U.S. Retail (Adj)	\$1,777	\$1,877	\$1,915	\$2,014	\$2,105	\$2,189
Y/Y Change	-4%	6%	2%	5%	5%	4%
U.S. Online Retail Sales	\$143	\$165	\$190	\$221	\$254	\$292
Y/Y Change	1%	15%	16%	16%	15%	15%
Online As % of Retail	3.9%	4.2%	4.6%	5.1%	5.6%	6.2%
Y/Y Increase in Penetration	0.3%	0.3%	0.4%	0.5%	0.5%	0.6%
Online As % of Retail (Adj)	8.1%	8.8%	9.9%	11.0%	12.1%	13.3%
Y/Y Increase in Penetration	0.4%	0.7%	1.2%	1.0%	1.1%	1.2%

Source: Citi Research; Department Of Commerce. Adjusted = Excl. Motor Vehicles & Parts, Gas Stations, Food & Bev Stores, Health & Personal Care Stores, Food Services & Drink Places



## Restaurants, Leisure, & Healthy Lifestyles

### Analysts:

Greg Badishkanian

Alvin Concepcion

Within our coverage, e-commerce is most relevant for some of our restaurant (DPZ), toy companies (HAS/MAT), and healthy lifestyles (NTRI/WTW) companies.

**DPZ** — At DPZ, about a third of their business is digital today and there are several reasons for their focus on e-commerce in the U.S. It provides: 1) A opportunity to take share from regional chains as Domino's, Papa John's and Pizza Hut have 85% of the growing online pizza sales space today; 2) Based on their surveys, customers like ordering online as they can see all the different products that the company offers; 3) the company is seeing that average ticket is little bit higher. In addition, the company believes with their database, there is an opportunity to individualize the selling effort to the customer which they are currently not fully capitalizing on.

**Weight Loss** — At weight loss companies such as NTRI and WTW, there has been an increased focus on e-commerce. The key reasons for the focus on e-commerce for weight loss companies would be: 1) providing anonymity and ease of use, which is appealing to the generally underpenetrated male segment; 2) higher margins through lower customer acquisition costs or through leveraging costs; and 3) provides additional weight loss support through online tools or community. The business model at NTRI has historically been more focused on e-commerce given the nature of the diet plan (food is sent monthly to their customers' home) and transactions are conducted either online or over the phone. At WTW, they have significantly focused more on increasing their men's business, which is primarily online given male dieters typically prefer the ease and anonymity of online.

**Toys** — At the toy companies, major retail chains such as WMT, TGT, and a major specialty toy retailer remain the primary sales distribution channel for industry sales but we estimate online penetration has grown to 17% in 2012 (from 15% in 2011) and we estimate it to increase in 2013. In addition toy companies recognize that digital can be a competitor for children's time and are focused on integrating digital into their product offerings. At MAT, they view digital as a way to enhance customer's engagement with their existing brands and are focused on taking advantage of the increased penetration of digital devices and declining digital costs by increasing the presence of their brands through social media sites, videos, digital games and apps. They have also continued combining digital technology with traditional toy patterns through their Apptivity line with their Barbie Photo Fashion doll and Fisher-Price Apptivity Monkey although over results for that line have been mixed. At HAS, their recent launch of B-Daman, like BeyBladeBattles.com includes a fully integrated online and mobile portion that will allow customers to scan and unlock their B-Damans online. They are also focused on building their mobile gaming platform and have created a new Hasbro Mobile Gaming Network that makes it easier for consumers to move between all of Hasbro's gaming apps and is also a platform to cross-sell Hasbro's physical games.

Figure 50. Estimated Online Penetration

Online Penetration (% of Sales)	2010	2011	2012	2013E
DPZ (U.S.)	25%	30%	36%	39%
HAS	15%	15%	17%	19%
MAT	15%	15%	17%	19%
NTRI	96%	95%	96%	96%
WTW	17%	22%	28%	31%

Source: Citi Research, Company Reports, and Klostors Trading

## U.S. Softlines, Specialty, & Luxury Retail

**Analyst:**

Oliver Chen

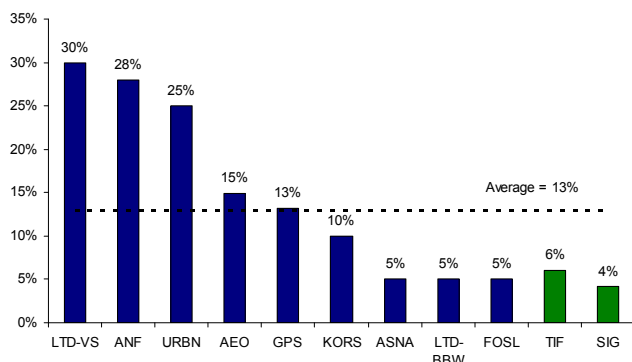
**Expect Continued Sector Growth of 20%–30%, with ~13% Penetration Going Higher; URBN Is the E-Comm Standout**

**Our Top E-Commerce Pick for 2013: URBN** — While we acknowledge that we rate URBN Neutral on valuation and stock run, and evolving execution at Anthropologie, we applaud impressive, encouraging long-term prioritization of e-commerce. We believe URBN's e-commerce initiatives cater to customers and will support the growth and development of the URBN business: (1) URBN expects e-commerce to reach 50% penetration within 5 years, and we believe this is likely given extremely strong reception to e-commerce during holiday of +38% on top of an already strong e-commerce business. (2) URBN is improving lead times on shipping to 1–2 days by shipping to customers from nearby stores & opening a new DC. (3) URBN recently implemented mobile POS: A customer can make a transaction anywhere on the sales floor of the store using an iPad.

**Specialty Retail E-Commerce Grew 34% on Average, with ~13% Penetration** — E-commerce notably increased during 2012, particularly during Holiday for specialty retailers. URBN's e-commerce was up 38% during Holiday, partly attributable to new mobile POS systems in stores. ASNA reported +30% for Holiday growth of e-commerce, and AEO reported +24%. ANF recently announced +52% DTC growth vs. 4Q a year ago. GPS estimates 2012 e-commerce was up 20% and recently opened e-commerce sites in Japan for Gap & Banana. SIG (Kay & Jared) noted a +39% increase in online Holiday sales. We attribute some of the increase to strategic online promotions during holiday, including free shipping opportunities at many retailers. Exceptional e-commerce strength benefited moderate in-store performance during holiday caused by unfavorable December mall traffic (-3.8%) and weather-related headwinds. Results also support the idea of “showrooming,” which retailers describe as customers finding desirable items in stores but waiting to make purchases online.

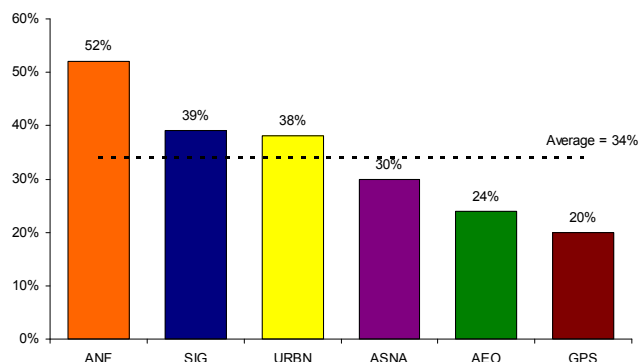
**E-Comm Is a Strategic Focus at Most** — Specialty retailers are supporting development of new systems to improve e-commerce exposure. KORS is bringing e-commerce in-house, as it was previously operated and run by JWN, and ASNA is making e-commerce operations internal for its five brands. GPS & URBN aim to improve ship times to 1–2 days by implementing shipping capabilities from stores. While customers prefer shopping at TIF & COH stores, both companies highlighted an increased investment to improve online shopping experience. COH launched its e-commerce business in China in November 2012.

Figure 51. Apparel Retailers Have Greatest E-Commerce Penetration



Source: Citi Research

Figure 52. E-Comm Noted Growth Rate During Holiday Release



Source: Citi Research

### Companies Mentioned

Abercrombie & Fitch Co. (ANF.N; US\$45.46; 2); adidas Group (ADSGn.DE; €81.61; 1); Advance Auto Parts Inc (AAP.N; US\$82.83; 2); Aeon Co (M) Bhd (AEOM.KL; RM13.20; Not Rated); Ahold (AHLN.AS; €12.12; 1); Amazon.com (AMZN.O; US\$263.32; 1); American Eagle Outfitters Inc. (AEO.N; US\$18.84; 1); American Express Co. (AXP.N; US\$67.64; 1); Apple, Inc. (AAPL.O; US\$429.79; 2); Ascena Retail Group Inc. (ASNA.O; US\$18.14; 2); ASOS Plc (ASOS.L; £33.78; 1); AT&T Inc (T.N; US\$37.57; 1); AutoZone Inc. (AZO.N; US\$400.99; 1); Bank of America Corp (BAC.N; US\$12.15; 2); Barclays PLC (BARC.L; £2.98; 1); Bed Bath & Beyond Inc (BBBY.O; US\$64.77; 1); Belle (1880.HK; HK\$12.76; 1); Best Buy Co Inc (BBY.N; US\$21.64; 2); Betfair (BETF.L; £7.16; 3); BigC Supercenter (BIGC.BK; Bt216.00; 1); Billabong International Ltd (BBG.AX; A\$0.73; 2H); BlackBerry (BBRY.O; US\$15.14; 3H); Burberry Group PLC (BRBY.L; £13.25; 2); bwin.party digital entertainment plc (BPTY.L; £1.44; 2); Capital One Financial Corp. (COF.N; US\$54.63; 1); Carphone Warehouse (CPW.L; £2.00; 1); Carrefour (CARR.PA; €22.07; 2); Carter's Inc. (CRI.N; US\$57.37; 1); Casino Guichard Perachon (CASP.PA; €83.76; 2); China Mobile (0941.HK; HK\$82.75; 1); Citigroup Inc (C.N; US\$44.11; Not Rated); Clicks Group Limited (CLSJ.J; R59.00; 3); Coach Inc. (COH.N; US\$50.39; 1); Columbia Sportswear Co (COLM.O; US\$58.01; 3); Costco Wholesale Corp (COST.O; US\$107.68; 2); CVS Caremark Corp (CVS.N; US\$55.24; 1); Darty Plc (DRTY.L; £0.43; 3); David Jones Ltd (DJS.AX; A\$3.02; 3); Debenhams Plc (DEB.L; £0.84; 2); Dell Inc (DELL.O; US\$14.26; Not Rated); Dick's Sporting Goods Inc (DKS.N; US\$47.24; 1); Discover Financial Services (DFS.N; US\$44.68; 2); Dixons Retail PLC (DXNS.L; £0.33; 2); Dollar General Corp. (DG.N; US\$50.54; 1); Domino's Pizza Inc. (DPZ.N; US\$50.09; 2); Dunelm (DNLM.L; £8.40; 1); eBay Inc (EBAY.O; US\$56.16; 2); Facebook Inc (FB.O; US\$25.42; 2); Family Dollar Stores Inc (FDO.N; US\$58.40; 2); Fifth & Pacific Companies Inc (FNP.N; US\$18.61; 2); Finish Line Inc (FINL.O; US\$19.32; 2); Foot Locker Inc (FL.N; US\$33.75; 1); Fossil Inc (FOSL.O; US\$93.49; 1); Gap Inc. (GPS.N; US\$35.74; 2); Gome (0493.HK; HK\$0.81; 1H); Google Inc (GOOG.O; US\$813.04; 1); Groupon, Inc. (GRPN.O; US\$5.62; 2H); Halfords Group Plc (HFD.L; £3.25; 2); Hanesbrands, Inc. (HBI.N; US\$45.92; 1); Harvey Norman Holdings Ltd (HVN.AX; A\$2.74; 3); Hasbro Inc (HAS.O; US\$43.39; 3); Hennes & Mauritz AB (Hmb.ST; SKr234.70; 2); Hewlett-Packard Co (HPQ.N; US\$22.10; 3); Home Depot Inc (HD.N; US\$71.02; 1); Home Retail Group (HOME.L; £1.57; 3); Hugo Boss Group (BOSSn.DE; €89.06; 1); Inchcape PLC (INCH.L; £5.07; 2); Inditex (ITX.MC; €104.30; 1); JB Hi-Fi Ltd (JBH.AX; A\$14.73; 3); JC Penney Co Inc (JCP.N; US\$14.55; 2); JD Group Ltd (JDGJ.J; R34.39; 2); JP Morgan Chase & Co (JPM.N; US\$48.28; 1); Kering (PRTP.PA; €175.40; 1); Kingfisher PLC (KGF.L;

£2.91; 1); Kohl's Corp (KSS.N; US\$45.71; 2); Kroger Co (KR.N; US\$32.79; 1); L Brands Inc (LTD.N; US\$46.00; 1); Ladbroke's (LAD.L; £2.28; 2); Lewis Group Limited (LEWJ.J; R64.45; 2); Lowe's Cos Inc (LOW.N; US\$38.02; 2); Luxottica Group SpA (LUX.MI; €39.92; 1); LVMH (LVMH.PA; €136.70; 1); Macys Inc (M.N; US\$42.03; 1); Maidenform Brands, Inc (MFB.N; US\$17.19; 2); Marks and Spencer Group PLC (MKS.L; £3.94; 2); Massmart Holdings Ltd (MSMJ.J; R189.04; 1); MasterCard Inc. (MA.N; US\$540.59; 1); Mattel Inc (MAT.O; US\$44.02; 1); Mattress Firm Holding Corp (MFRM.O; US\$33.63; 1); Michael Kors Holdings Ltd. (KORS.N; US\$54.16; 1); Morrison (Wm) (MRW.L; £2.83; 1); Mr Price Group Ltd (MPCJ.J; R118.30; 1); Myer Holdings Ltd (MYR.AX; A\$2.95; 3); M.video (MVID.MM; US\$8.04; 1); N Brown (BWNG.L; £4.11; 2); Next Group PLC (NXT.L; £44.08; 1); Nike Inc (NKE.N; US\$58.90; 1); Nordstrom Inc (JWN.N; US\$54.99; 2); NutriSystem Inc (NTRI.O; US\$8.27; 1H); Office Depot Inc (ODP.N; US\$3.84; 2); OfficeMax Inc. (OMX.N; US\$11.38; 2H); Orono Group Ltd (ORL.AX; A\$7.09; 3); O'Reilly Automotive Inc (ORLY.O; US\$104.38; 2); Paddy Power (PAP.L; €70.50; 1); Papa John's International Inc (PZZA.OQ; US\$61.57; Not Rated); Parkson Holdings Bhd (PRKN.KL; RM4.63; 2); Pick'n Pay Stores (PIKJ.J; R42.85; 2); Premier Investments Ltd (PMV.AX; A\$8.52; 3); PVH Corp. (PVH.N; US\$105.94; 1); Qihoo 360 Technology (QIHU.N; US\$29.47; 1H); Ralph Lauren Corporation (RL.N; US\$167.93; 1); Realogy Holdings Corp. (RLGY.N; US\$46.33; 2); RedFin Network Inc (RFNN.PK; US\$0.00; Not Rated); Richemont (CFR.VX; SFr76.70; 1); Safeway Inc (SWY.N; US\$25.59; 1); Sainsbury (SBRY.L; £3.86; 1); Saks Inc (SKS.N; US\$11.37; 2); Samsung Electronics (005930.KS; W1,525,000; 1); Shoprite Holdings (SHPJ.J; R181.62; 1); Signet Jewelers Ltd. (SIG.N; US\$68.21; 2); Spar Group Limited (SPPJ.J; R115.30; 2); Specialty Fashion Group Ltd (SFH.AX; A\$1.23; 1H); Sports Direct International Plc (SPD.L; £4.21; 1); Sprint Nextel (S.N; US\$6.23; Not Rated); Staples Inc (SPLS.O; US\$13.07; 2); Starbucks Corp (SBUX.O; US\$58.26; 1); Steven Madden, Ltd. (SHOO.O; US\$42.52; 1); Super Retail Group Ltd (SUL.AX; A\$12.23; 3); Swatch Group AG (UHR.VX; SFr558.00; 2); Target Corp (TGT.N; US\$68.83; 1); Telefonica SA (TEF.MC; €10.61; 2); Tesco (TSCO.L; £3.86; 3); Tiffany & Co. (TIF.N; US\$72.00; 1); Tod's SPA (TOD.MI; €109.80; 1); True Religion Apparel Inc (TRLG.O; US\$25.72; 2); Trulia Inc (TRLA.N; US\$31.21; Not Rated); Truworths Ltd (TRUW.ZI; US\$0.04; Not Rated); Urban Outfitters Inc. (URBN.O; US\$39.87; 2); Verizon Communications Inc (VZ.N; US\$49.50; 1); Visa Inc. (V.N; US\$167.95; 2); Walgreen Co (WAG.N; US\$47.32; 1); Wal-Mart Stores Inc (WMT.N; US\$76.02; 1); Weight Watchers International Inc (WTW.N; US\$41.32; 2); Wesfarmers Ltd (WES.AX; A\$40.72; 3); Western Union Co. (WU.N; US\$14.84; 1); WH Smith PLC (SMWH.L; £7.58; 1); Williams-Sonoma, Inc. (WSM.N; US\$51.18; 1); Woolworths Holdings Limited (WHLJ.J; R71.79; 1); Woolworths Ltd (WOW.AX; A\$34.36; 3); X5 Retail Group (PJPq.L; US\$17.00; 2); Yahoo! Inc (YHOO.O; US\$23.78; 2); Yoox (YOOX.MI; €14.80; 3H); YUM! Brands Inc. (YUM.N; US\$70.15; 2); Zillow, Inc. (Z.O; US\$52.99; 1H)

## Appendix A-1

### Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

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