27 June 2013 | 13 pages

Real Estate/Property (Citi)
North America

O Canada – Why the Canadian Marketplace Appeals to Retailers and Landlords

Key Takeaways from Citi's Retail/REIT Field Trip in Toronto

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- **Citi's Take** — Citi's REIT and Retail research teams, led by Michael Bilerman and Deborah Weinswig, respectively, spent two days north of the border in Toronto doing a deep dive on the Canadian retail real estate market, which has experienced strong growth and significant interest from U.S. and international retailers. While there is some concern over the potential for a slowing housing market, the retail industry appears ripe for continued expansion and interest from abroad. On the trip, we met with senior management from the key Canadian landlords including the listed REITs (Riocan, First Capital, Calloway), pension funds (Cadillac Fairview/Ontario Teachers, Oxford/OMERS) and private companies (SmartCenters, Wittington). We also spent time with key retailers in the Canadian market including Walmart, Loblaw's, The Bay and Holt Renfrew, as well as newcomer Target. We toured key properties in the Toronto market including Yorkdale Mall, Square One Mall, Eaton Centre, the former Maple Leaf Gardens, Liberty Village, and a number of other shopping centers. Lastly, we met with Google and Nomi to discuss retail technology strategies for Canadian and U.S. Retailers, and we hosted a lunch with industry experts from Ryerson University and Citi. Please see Fig. 1 for details. The top 10 takeaways from our tour are below:

- **#1: The Growth of Big Box** — Canada has lower retail space per capita compared to the U.S., partly driven by planning/zoning restrictions and traditionally smaller format retailers. However, Canada has experienced significant 'big box' retail development, led by the expansion of retailers such as Walmart. Over this time, retail space per capita has increased to 16 sq. ft. which is still lower than the U.S. at 24 sq. ft. Supply additions from the rollout of Walmart and Target will continue to add to supply. There hasn't been an enclosed mall constructed in Canada since 1988 with only a modest increase in space from expansion projects. Despite the growth of big box, Canada malls seem to be healthy, with average sales productivity of ~$600/sq. ft. (vs. U.S. malls at ~$460/sq. ft.) and occupancy cost ratios around 16-18%. U.S. retailers continue to expand into Canadian mall space, though are initially challenged by high rents and taxes relative to the U.S., and higher costs in Canada regarding labor, distribution, and language. This is offset by the significantly higher productivity of stores in Canada, which can average 2-4 times higher than a retailer's domestic store base. 80% of Canada's population lives within 100 miles of the U.S., so brand knowledge is high. Canada is often viewed as a "laboratory" for international expansion, and Toronto and Vancouver are usually chosen as the first markets to enter.

< *continued on pg. 2* >

Key Takeaways (cont'd)

- **#2: Housing Market Concerns** — The strength in Canada's resource-driven economy was apparent on our tour around the greater Toronto area (GTA). While there has been significant retail development, there has also been significant housing development. There are currently numerous condos under construction in the downtown Toronto area with several more planned projects. The risk of a slowdown in housing construction and weaker housing values on a highly leveraged Canadian consumer was a key focus across our meetings with real estate owners and retailers. Views were mixed on the potential impact on consumption and real estate, though we walked away concerned that weaker commodity prices could cause a further slow down in economic activity. Net immigration to Canada has been high and remains a key component to growth.

- **#3: Price Even More Important to Canadian Consumers** — The Canadian consumer is an even more price conscious shopper than the U.S. consumer. On average, Canadians pay 24% of their income in taxes, compared to just 12% for the average U.S. consumer, which leaves less money in their pockets for discretionary purchases. As a result, Canadians spend more time researching prices online before buying. WMT has capitalized on this trend with a greater number of rollbacks and its "multi-save" program, which offers discounts for buying in bulk (e.g. 1 for $6, 2 for $10).

- **#4: Retail Divide Growing between A and B/C Malls** — There has been a divergence in the performance of Canada's A and B/C malls over the past several years. The very limited supply of premium retail square footage has made it difficult for top retailers to grow, and it can take U.S. retailers 2-3 years to find A-type space for a store. Our meetings highlighted the significant upside potential to invest and remodel B/C sites into better-performing A properties.

- **#5: Canadian Retail REITs Divergent Strategies** — We met with large cap retail real estate owners RioCan (REI), shopping centre owner First Capital (FCR), and big box shopping centre owner Calloway (CWT). The three companies have divergent strategic objectives. RioCan has been very focused on expanding its footprint in both Canada and the U.S., recently buying lower productivity Canadian malls and establishing platforms in Texas and the Northeast of the U.S. First Capital is focused on expanding its exposure to urban retail with strong demographics including redevelopment, while Calloway remains largely an entity that grows through buying newly built shopping centers from partner SmartCenters, who primarily develops Walmart-anchored centers. We also met with senior management of the large private retail real estate owners including Cadillac Fairview (Ontario Teachers), Oxford (OMERS) and SmartCenters (Mitch Goldhar). The mall base in Canada seems to be healthy, with our tours of Yorkdale and Square One demonstrating how powerful assets can be. Unfortunately for public market investors, the Canadian mall industry is largely owned and managed by the Canadian pension funds, so it is difficult to get exposure. SmartCenters presented a compelling case for Vaughn Metropolitan Center, a potential $3-5B mixed use development north of the GTA where the subway expansion and Bus Terminal will start. There is opportunity here for office, residential, retail, potential casino and significant open space and park.

- **#6: What it means for U.S. REITs** — Kimco has a 50/50 JV with Riocan which owns 45 high quality assets across Canada and generates ~10% of Kimco's pro rata NOI. A slowing Canadian economy might impact growth, though the industry structure (limited supply and expanding U.S. retailers) should reduce risk. Further depreciation in the Canadian Dollar could have a modest impact going forward. Despite selling down LatAm assets, Kimco remain committed to the Canadian JV. Both Simon and Tanger have been competing to develop Outlet Centers in the U.S. Simon's JV with Calloway in Toronto (Halton Hills) is 90% committed and likely to open higher, SmartCenters/Calloway/Simon have a 1/3rds JV in Montreal to develop another centre. Tanger is also progressing with expansions at Cookstown (North Toronto) and Saint-Sauveur (outside Montreal) and ground up development at Kanata (Ottawa). We also met with Macerich's JV partner Cadillac Fairview. The JV currently owns 8 assets though Cadillac Fairview would be happy to reduce the JV to 5-6 higher quality assets in key markets (LA, NY). Similar to U.S. mall landlords, Canadian pension funds have been selling weaker quality malls from their portfolios and also buying department store boxes for redevelopment.

- **#7: Retailers Slow to Catch Up to a Digital Customer** — Internet usage and smartphone penetration in Canada exceed the U.S., yet Canadian retailers have been slow to invest in retail technology, and omnichannel sophistication is lacking. Broadband penetration is 80% in Canada (vs. 69% in the U.S.), 55% of consumers have smartphones (vs. 48% in the U.S.), and the Canadian consumer searches 175 times per month (vs. 83 in the U.S.). However, TGT lacks a transactional website in Canada, and WMT is still working to add site-to-store capabilities and online SKUs.

- **#8: Newcomer Struggles with Execution** — We were underwhelmed by our shopping experience at the Target store in the Square One Mall. We noticed significant out-of-stock issues in consumables, especially in paper towels, toilet paper, diapers, and beauty. This week marked the first week that TGT promoted consumables in its circular, and we believe the store was not stocked appropriately for the sales volume. The store was also heavily staffed relative to the traffic we observed. Square One is one of TGT's largest stores at over 160k sq. ft. and is expected to be one of the highest volume in the company. We expect TGT to work quickly to address these issues.

- **#9: WMT Firing on All Cylinders** — We were impressed with WMT's store at Square One, which is the company's largest in Canada at 223,000 square feet. Traffic levels were strong on the Tuesday afternoon when we visited. The store features more rollbacks and has "multi-save" offers throughout the store to cater to the price-conscious shopper. Since TGT opened in the same mall earlier this year, WMT has added more color in kids' apparel to better compete with TGT's offering. The company also executes its "Store of the Community" strategy. There is a high population of Asian consumers in the local market, and WMT's food assortment features items that cater to the tastes of these customers.

- **#10: Nordstrom Should Find Its Niche** — JWN will open its first Canadian store next Fall in Calgary, AB and has announced five stores in total through 2016. We think JWN could find its niche positioned between The Bay (which serves a customer similar to Macy's) and Holt Renfrew (which serves a customer similar to Saks). We saw little competition for the young affluent and aspirational customers that are core to JWN, and we don't believe department store competitors will be able to compete with JWN on service. We toured the site of JWN's future store at the Yorkdale Mall, which is the top performing mall in the country and will be a flagship-type store for the company.

Canadian Market Tour Agenda

Figure 1. Agenda for the Canadian Market Tour (June 24-25, 2013)

Monday, June 24		
12:00 PM	Canadian Economic Outlook and Retail Landscape	Dana Peterson, Canadian Economist, Citi Dr. Tony Hernandez, Director, Ryerson University
2:00 PM	First Capital Realty (FCR.CN) Management Meeting Liberty Village Tour	Dori Segal, President & CEO, First Capital Realty Karen Weaver, EVP & CFO, First Capital Realty
4:30 PM	Eaton Center Mall Tour with Cadillac Fairview Canadian Tire (CTC.CN) Store Tour	John Sullivan, President & CEO, Cadillac Fairview Russell Goin, EVP-Investments, Cadillac Fairview Clive Baxter, SVP-Ontario Portfolio, Cadillac Fairview Meredith Vlitas, Senior Marketing Director, Cadillac Fairview
5:30 PM	The Bay Store Tour, Hudson's Bay Company (HBC.CN)	Richard Montgomery, Store Manager, The Bay
6:45 PM	Dinner with Google Canada (GOOG.US) and Nomi (Private) *Nomi is a retail tech company helping retailers optimize mobile marketing	Rafe Petkovic, Retail Industry Head, Google Canada Wesley Barrow, Co-Founder and Chief Revenue Officer, Nomi
Tuesday, June 25		
7:30 AM	George Weston Limited (Loblaw's, Choice Properties) Management Meeting Tour of the former Maple Leaf Gardens (now a Loblaw's store)	Tony Grossi, President, Wittington Properties Geoffrey Wilson, SVP-Financial Control and IR, George Weston Ltd.
9:45 AM	Riocan (REI.CN) Management Meeting Tours of the Yonge Eglinton Centre, Leaside Centre, Sunnybrook, Bayview, The Shoppes on Avenue, and Lawrence Square	Edward Sonshine, CEO, Riocan Frederic Waks, President & COO, Riocan Raghunath Davloor, EVP, CFO, and Corporate Secretary, Riocan John Ballantyne, SVP-Asset Management, Riocan
11:30 AM	Lunch with Oxford (OMERS) Management Yorkdale Mall Tour (#1 Mall in Canada)	Michel Brouillard, VP-Retail Leasing, Oxford Properties Group Jean-Marc Rouleau, Director-Retail, Oxford Properties Group
1:00 PM	Holt Renfrew Store Tour	Barbara Wolfson, DVP-Sales & Service, Holt Renfrew Nadine Omidi, Director of Sales, Holt Renfrew
2:00 PM	Target (TGT.US) Store Tour at Square One Mall	No Management
2:30 PM	Walmart (WMT.US) Store Tour at Square One Mall	Jim Thompson, COO, Walmart Canada Bill Tofflemire, CFO, Walmart Canada Randy Hutchings, SVP of Operations, Walmart Canada Susan Schutta, Senior Director of Corporate Affairs, Walmart Canada Ted Wynhofen, District Manager, Walmart Canada Rodd Olmstead, Regional Vice President, Walmart Canada Domenic Vitalei, Store Manager, Walmart Canada
4:15 PM	Calloway (CWT.CN) and SmartCenters (Private) Management Meeting	Mitch Goldhar, Owner, SmartCenters Huw Thomas, Interim President & CEO Mario Calabrese, CFO Rudy Gobin, EVP of Asset Management

Source: Citi Research

Company Valuation and Risks

Kimco Realty Corp

(KIM.N; US$21.05; 2)

Valuation

We value KIM using a combination of NAV, AFFO and primarily FFO multiple valuation. For KIM our valuation methodologies take into consideration the company's balance sheet, joint ventures, development pipeline and shopping centre tenant exposure. Our ~$23 NAV assessment uses a 6% cap rate on the portfolio. We set our target price at $22.50 which is roughly inline with our NAV and implies a ~19x AFFO multiple on '14 AFFO which is roughly inline with peers.

Risks

If private market cap rates expand more than we anticipate, the stock could underperform our target price. If private market cap rates compress more than we anticipate, the stock could outperform our target price. Other risks to our target price include Kimco's ability to maintain its progress selling non core assets and acquiring good quality centers. If these factors have a greater negative impact than we expect, our target price could prove optimistic. Conversely, if the impact on the company from any of these factors proves to be less than we anticipate, the stock could materially outperform our target price.

Macerich Co

(MAC.N; US$60.52; 1)

Valuation

We value MAC using a NAV valuation and an AFFO and FFO multiple valuation. Our ~$70 NAV assessment uses a 5.2% cap rate on the portfolio. We set our $71 price target at a ~1% premium to NAV (on a 5.2% cap rate). This implies a ~25x 2014E AFFO multiple, which is roughly inline with high productivity peers.

Risks

If private market cap rates expand more than we anticipate, the stock could underperform our target price. If private market cap rates compress more than we anticipate, the stock could outperform our target price.

With the majority of the portfolio located on the West Coast, MAC is exposed to regional economic fluctuations in this region. In addition, occupancy levels could erode should store closings continue. Deterioration in demand for retail space or increases in store closures, driven by factors including a continued downturn in consumer spending, would potentially put pressure on occupancy and rental rates. If the impact on MAC from these factors proves to be greater than we anticipate, the stock could fail to reach our target price. These risks are somewhat offset, however, by management’s proven operating discipline, the stock’s low historical price volatility, and MAC’s historical earnings stability and low occupancy cost compared to peers. If these factors prove more resilient than we expect, the stock may materially exceed our target price.

Tanger Factory Outlet Centers Inc

(SKT.N; US$32.85; 1)

Valuation

We value SKT using a combination of NAV, AFFO and FFO multiple valuation. For SKT, our valuation methodologies take into consideration the company's balance sheet, resilient outlet center portfolio and great operating track record. This methodology results in a target price of $40 which is at a ~13% premium to our NAV estimate. We use a ~23x AFFO multiple and a ~20x FFO multiple on 2014 AFFO and FFO estimates given the strength of outlet centers, organic growth capabilities, low leverage, and limited balance sheet risk

Risks

If private market cap rates expand more than we anticipate, the stock could underperform our target price. If private market cap rates compress more than we anticipate, the stock could outperform our target price.

Factors that could cause the stock to trade below our target price include SKT's annual lease expirations of about 20%, though this is somewhat mitigated by the company's historical success in renewing leases. In addition the company is focused on the outlet business, so any material change in retailer demand for the outlet center format could have a large positive or negative impact on Tanger. SKT is a small-capitalization company with limited liquidity for larger investors. The limited liquidity adds to potential price volatility. Should these factors have a greater or less-than-expected negative impact, our target price could prove overly optimistic or could be materially outperformed.

Nordstrom Inc

(JWN.N; US$59.02; 2)

Valuation

Our $60 target price for Nordstrom, Inc. is based on a forward P/E valuation method. In our valuation, we use a target multiple of approximately 14x on our 2014 EPS estimate. Our target multiple for Nordstrom reflects the company's compelling growth profile, expanding e-commerce business, increased investments to drive top-line growth ahead, and the improving profitability of its credit card business, offset by potential operating margin pressure. Our target multiple of 14x is slightly below the company's 10-year historical median forward P/E of 15.1x, and between the high of 21x and low of 6x.

Risks

Risks to JWN achieving our target price include both industry- and company-specific risks, including the following factors: 1) near-term volatility in same-store sales trends given the macroeconomic environment; 2) JWN's "aspirational" positioning in the competitive landscape could prove to be difficult; 3) the magnitude of technology investments could be less than expected; and 4) more or less operating margin pressure than anticipated. If the impact on the company from any of these factors proves to be greater/less than we anticipate, it may prevent the stock from achieving our target price.

Target Corp

(TGT.N; US$69.10; 1)

Valuation

Our 12-month target price is $79. In our P/E valuation analysis, our target multiple of ~14x on our 2014 EPS estimate is essentially in-line with TGT's 10-year median of 14.5x. We believe that a target P/E multiple in-line with the 10-year median multiple is prudent in light of our concerns about the pace of the consumer recovery. However, we do expect earnings growth at TGT to benefit from company-specific drivers ahead. Longer term, we expect TGT to benefit from: 1) SSS growth and market share gains driven by its P-Fresh remodel program and merchandise reinventions, as well as its 5% rewards program, 2) long-term square footage growth, 3) margin expansion driven by better sourcing and technology improvements, 4) profitability in its credit segment as risks are better managed, 5) increased share repurchases and/or dividend growth, 6) the use of proceeds from the credit card portfolio sale, and 7) entry into Canada.

Risks

We believe the risks that Target faces are based on stock liquidity, earnings stability, price volatility, and financial strength.

Risks we see to the achievement of our target price include: 1) a faster-than-anticipated recovery in consumer spending and retail sales; 2) merchandising challenges in apparel and home could negatively impact SSS; 3) increased competition from department stores may result in lost market share; 4) slower square footage growth weighs on topline growth if the economy recovers faster than expected; and 5) volatile conditions in the consumer credit market could cause earnings from TGT's credit segment to be below our estimate.

If the impact on the company from any of these factors proves to be greater or less than we anticipate, it may prevent the stock from achieving our target price.

Wal-Mart Stores Inc

(WMT.N; US$74.76; 1)

Valuation

We value Wal-Mart using an approx. 15x target forward P/E multiple on our 2014 EPS estimate, which yields a 12-month target price of $89.

Our target multiple of 15x is approx. in-line with WMT's 10-year median of 14.4x. Our target multiple reflects multiple expansion from current levels, driven by: 1) market share gains, driven by price investments, 2) strong growth in WMT's International division, 3) cost savings from improved global sourcing, 4) continued momentum at Sam's Club, and 5) strong positioning in the current consumer environment.

Risks

We believe WMT faces risks based on political risks, stock liquidity, earnings stability, price volatility, and financial strength. Our risk rating also reflects industry and company specific risks.

Risks to the achievement of our target price include: 1) a retrenchment in consumer spending and retail sales; 2) WMT's size may hinder both sales and earnings growth in the future; 3) WMT's core customer is highly sensitive to macroeconomic pressures; 4) the earnings impact of foreign currency exchange rates could be greater or less than expected; and 5) the implementation of new technologies to drive its online business carry execution risk.

If the impact on the company from any of these factors proves to be greater/less than we anticipate, it may prevent the stock from achieving our target price or could cause our target price to be materially outperformed.

Appendix A-1

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Data current as of 31 Mar 2013	**Buy**	**Hold**	**Sell**	**Buy**	**Hold**	**Sell**
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