DEPARTMENT STORES

CURRENT TRENDS

- Year-over-year sales for the department store segment increased 21.3% in 2021 over 2020; however, a return to contracting sales is expected from 2022 through 2026.
- Strip malls and power centers continue to report higher foot traffic and fewer vacancies than traditional indoor malls. In turn, some department stores are shifting their store formats to remain competitive with open-air concepts.
- Mall operators are focusing on more experiential anchors like bowling alleys and arcades instead of traditional department stores.

PROJECTED VALUES
(12-MONTH OUTLOOK)

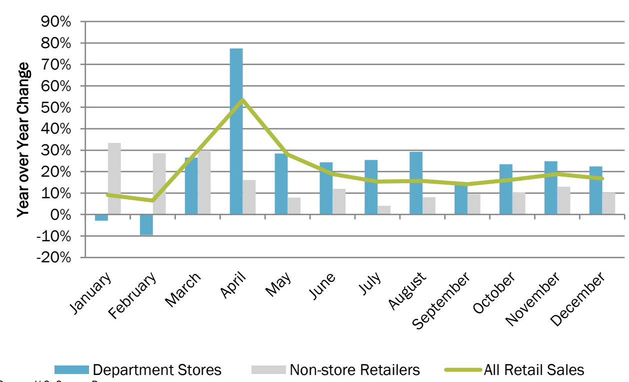
APPROXIMATE NET RECOVERY ON COST

85%-100%
high end

80%-95%
mid tier

75%-90%
mass market

CHANGE IN RETAIL SALES BY CATEGORY- 2021



Source: U.S. Census Bureau

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SIGNS OF RECOVERY: Department stores showed signs of recovery in 2021 following a long downturn accelerated by the COVID-19 pandemic. Year-over-year sales for the department store segment increased 21.3% in 2021 over 2020 per U.S. Census Bureau data. The category saw accelerated recovery from the pandemic as stimulus funds along with pent-up demand helped drive the rebound in sales. Higher sales coupled with leaner inventory levels offset the need for deeper markdowns, which benefited gross margins. Driving segment momentum, revenue for Macy's, Kohl's and Nordstrom increased 42.4% over 2020, a 3.4% drop from the first three quarters of fiscal year 2019, according to a December 2021 news release by Retail Dive. These three retailers account for over 70% of sector revenue. It's important to note that on March 21, 2022, Kohl's Corp. confirmed it had received preliminary acquisition interest from multiple prospects. It remains to be seen how an acquisition may influence the company's sales performance or operating strategy going forward.

For its fiscal year ended January 29, 2022, Macy's comparable store sales increased 43.0% on an owned basis and 42.9% on an owned-plus-licensed basis over 2020. In the fourth quarter of 2021, Macy's reported comparable sales growth of 28.3% on an owned basis and 27.8% on an owned-plus-licensed basis versus 2020; and increases of 6.6% and 6.1%, respectively, versus 2019. In addition, digital sales increased 12% compared to fourth quarter 2020 and 36% compared to 2019. The company increased its new customer count by 26% over 2019 to 19.4 million. Kohl's fourth quarter net sales increased 5.8% over the same period in 2020, with expansion of its shop-in-shop Sephora concept expected to be a key driver of growth in 2022. Nordstrom's recovery has been slower than its competitors; however, fourth quarter net sales increased 23% compared with the same period in 2020 and were flat against the same period in 2019.

Additionally, U.S. sales for Dillard's and Hudson's Bay Company increased 16% and 30%between the 2019 and 2021 holiday seasons, respectively. Total holiday season sales increased despite the ongoing pandemic and supply chain disruptions. Mastercard reported an 8.5% increase in overall holiday spending compared with 2020. The average transaction total per shopper grew 18% over 2019. Apparel and jewelry sales saw the most growth, increasing 47.3% and 32%, respectively, in 2021 and 29% and 26.2%, respectively, over the 2019 holiday season.

Consumer preference for online shopping grew significantly during the pandemic. E-commerce sales rose 11% from 2020 to 2021, and online sales represented about 21% of total retail spending, up from 14.6% in 2019, according to Mastercard. Online sales during the 2021 holiday season increased 61.4% over 2019, compared with 2.4% in-store sales growth for the same period. Macy's plans to shutter 10 locations in early 2022 in response to continued e-commerce growth. The company expects to close 125 stores in lower-tier malls by 2023.

SHIFTS IN TRADITIONAL MALLS: Major department stores performed well in 2021, but e-commerce growth and pandemic-related uncertainty limited their momentum. Foot traffic did not reach pre-pandemic levels during the 2021 Black Friday weekend, according to analytics firm Placer.ai. In response to changing consumer behavior, some mall operators are moving away from traditional department store anchors and instead focusing on becoming cultural or entertainment hubs with experiential anchors like bowling alleys and arcades to attract younger shoppers. Additionally, department stores like Macy's and Bloomingdale's are experimenting with store formats better suited for open-air shopping center locations, which continue to out-perform indoor malls.

Strip-center rentals grew 3.1% in 2021, the highest among retail property types, followed by neighborhood centers at 3%, according to global real estate services firm JLL. Indoor mall vacancy rates increased to 7.2% nationwide in the second quarter of 2021, up from 4.9% in 2019. Vacancy rates for strip centers and power centers hit 5.5% and 5.6%, respectively, and A-, B- and C-grade malls reported vacancy rates of 4.8%, 7.1% and 12.4%, respectively. Vacancies at major malls increased 28% since the first quarter of 2020.

Macy's continues opening "Market by Macy's" concept locations as part of its ongoing growth strategy. The company wants to use these smaller-format store locations in off-mall lifestyle centers to focus on strengthening customer relationships, accelerating digital growth, optimizing store portfolios and reducing costs. The concept will offer more curated brands, local goods, events and eateries. Additionally, Macy's announced an initiative to bring Toys"R"Us to more than 400 U.S. locations and an e-commerce website beginning in 2022.

Retailers continue to offer convenient, contactless pickup and delivery services amid the ongoing pandemic, and customers will ultimately need compelling reasons to shop department stores for items that cannot be found in specialty or discount retail outlets, otherwise department stores will stagnate.

INDUSTRY OUTLOOK: Analysts expect the department store segment to contract over the next five years. In a 2022 Market Outlook report, Coresight Research estimates department store sector revenue will decline between 0.5% and 1.5% in 2022 over 2021. This could take 2022 revenues to as much as 15.9% below pre-pandemic levels following the strong rebound generated in 2021.

Research firm IBISWorld expects sector revenue to decrease at an annualized rate of 4.3% through 2026 because of growing competition from online retailers coupled with a continued shift by retailers out of the sector and into warehouse club and super-center concepts.

Additionally, Coresight Research expects the department store sector will continue to consolidate market share among its three major players, Kohl's, Macy's and Nordstrom, increasing their combined share to 75% of the market in 2022 compared to 70% in 2021.

VALUATION OUTLOOK: After several years of declining sales, department stores worked hard to offset 2020's pandemic-related losses with innovative strategies and experiential retail in brick-and-mortar stores, which drove interest and grew brand loyalty in what had been seen as an outdated concept. Stores offered curated merchandise assortments with new categories, products and brands to drive engagement from a new customer base.

How liquidation values hold up for the department store sector will in large part be dependent on what level of multiplier can be realized in a going-out-of-business setting as retailers comp against higher volume historical sales. Additionally, although social distancing rules are relaxing around the globe, concerns related to the pandemic continue for some consumer demographics, especially as it relates to shopping in indoor mall locations. In the short term, the retail industry may be under pressure as economic uncertainty weighs on domestic and international markets. In particular, rising fuel and food prices resulting from inflation will affect consumers of every demographic and may curb spending on non-essential items for those with lower levels of discretionary income.

The Expert: Becky Goldfarb

Bringing over 20 years of experience in the disposition and valuation of retail and consumer products, Becky Goldfarb oversees all aspects of retail asset valuations. Prior to joining Valuations, Becky was responsible for the financial analysis of retail dispositions across all industry sectors. Read her full bio here.

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