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# GLOBAL RETAIL RESEARCH



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## FROM THE DESK OF DEBORAH WEINSWIG

The United Nations General Assembly's annual high-level debates officially kicked off in New York City this past week, with an agenda that included a sharp focus on the threat of climate change. I had the distinct fortune to attend the organization's first-ever fashion show, "Women Empowering Women" at which Anjali Sharma, owner of French Curve, and Varsha Mahendra, creator of Jus' Blouses, showcased their clothing collections, along with female designers from Ethiopia, Mongolia, Palestine, Papua New Guinea and Peru. It was a high-profile gathering of women saluting women's economic empowerment. I guarantee you, if the industry embraced the intersection of technology and retail with as much determination and energy as I witnessed at this event, we'd be headed for surging sales this holiday season.

This September, US consumer confidence rose to the highest level in more than a year, buoyed by continued progress in the labor market, stock-market gains and falling gasoline prices. Rising household confidence has typically heralded stronger consumer spending.

Meanwhile, Alibaba and Alipay continue to dominate retail conversations, and retail-industry watchers around the world began to speculate on the impact the newly launched iPhone 6 will have on holiday 2014 sales. Concerns about geopolitical risks continue to loom, with the US launching a new assault in the war on terror, though overall US retail business trends remain largely unaffected.

Back-to-school sales were sluggish, and spending is likely to remain weak into the holiday period. It's not a disaster, but no victory either. We all hope for a new, fashion cycle outside of tech and wearables that will revitalize retail excitement! On a more upbeat note, retailers are increasingly embracing the idea of the store as theater/showroom, a trend they expect will drive traffic above holiday 2013 levels.

## US RETAIL—KEY ECONOMIC NEWS

While median annual household income in the US showed a year-over-year increase in 2013 for the first time in six years, the rise was only 0.3% when adjusted for inflation—a level not high enough to be considered statistically significant. However, other factors suggest that consumer spending (and thus US retail sales) is starting to build momentum this year—a trend that could pick up speed going forward.

These include a firming job market and drop in new unemployment benefits filings, a retreat in fuel costs, and strengthening consumer sentiment.

Jobless claims plunged last week to a two-month low, a sign that the labor market continues to strengthen. Initial claims for unemployment benefits decreased by 36,000 to 280,000 (seasonally adjusted) in the week ended Sept. 13. The median

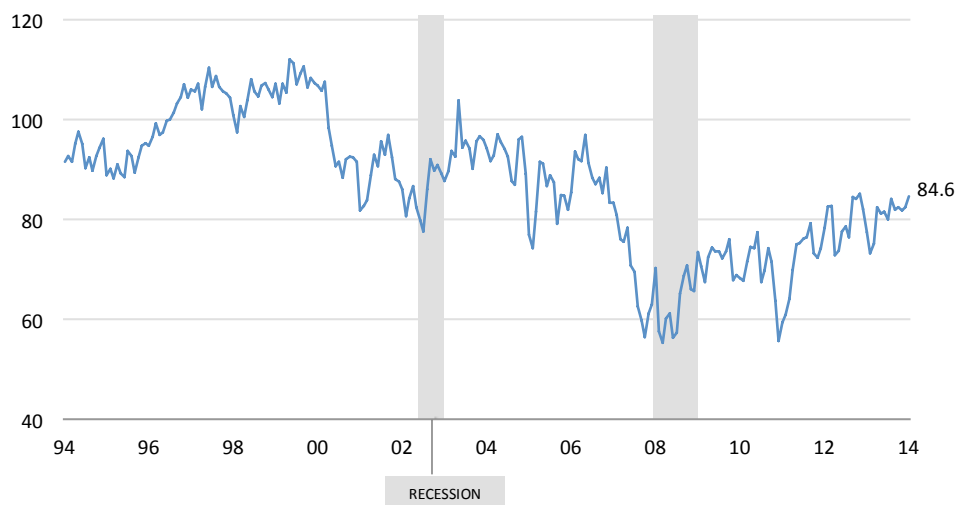


forecast of 52 economists surveyed by Bloomberg called for a decline to 305,000. Meanwhile, the number of people already collecting unemployment benefits fell to a more than seven-year low.

Cheaper prices at the gas pump could continue to have a positive impact on consumer spending going forward. As of September 21, the average price of a gallon of regular gasoline was \$3.37, a drop of \$0.09 in two weeks (adding up to a decline of \$0.34 over the last 13 weeks). This is the lowest level it's been in over six months, according to AAA, the nation's largest federation of auto clubs.

The Thomson Reuters/University of Michigan preliminary September reading on the index of consumer sentiment rose to 84.6, up from the final August reading of 82.5. This was the best result in 14 months, handily beating the median Bloomberg consensus estimate of 83.3. Along with the robust August retail sales report, this reading suggests that consumers are beginning to feel better about their situations in terms of employment, income and overall economic outlook—and that they may be ready to open up their wallets and spend. However, the FBIC cautions that the average US consumer remains highly value-focused.

University of Michigan Consumer Sentiment Index



Through September 30, 2014

Source: Thomson Reuters and University of Michigan



## US RETAIL SALES ENVIRONMENT

Retail sales climbed in August at the fastest pace in four months (and previous readings were adjusted upward), which we consider an encouraging sign for US third-quarter growth prospects.

According to the US Department of Commerce, advance monthly retail sales (excluding autos) registered a 0.3% month-over-month gain in August as consumers took advantage of an approximate 6.2% decline in gasoline prices since the summer began. On a year-over-year basis, retail sales (excluding autos) rose 4.1% in August, and are up 2.8% year-to-date.

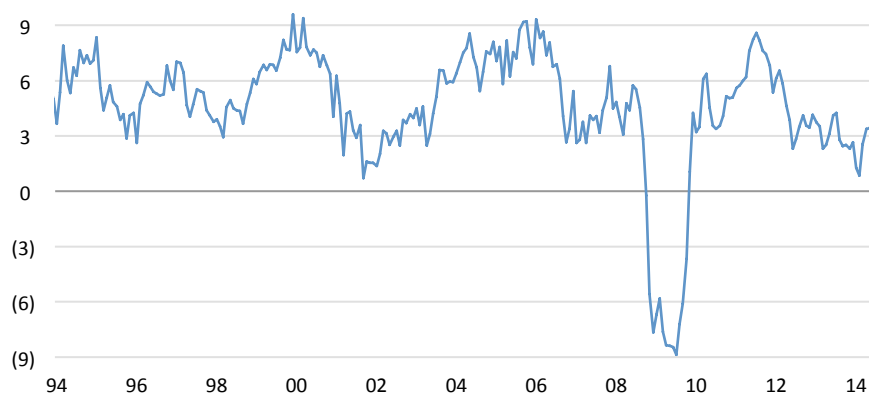
The strongest retail channel in August was auto sales, which posted month-over-month growth of 1.5%. (They are up roughly 8% year-to-date, and have increased 9.5% from August 2013.) Other strong retail channels in August (on a month-over-month basis) were building material & garden equipment (up 1.4% for the month and 6.7% year-over-year), sporting goods, hobby, books & music stores (up 0.9% for the month and 4.8% year-over-year), and health & personal care stores (up 0.6% for the month and 8.1% year-over-year).

Throughout much of this incipient recovery, consumers have shopped with intent, benefitting one category to the neglect of another. For example, the recent strength in autos and housing meant that apparel sales suffered. We've also seen industry consolidation improving sales results at individual retailers, even while aggregate government figures continue to reflect a somewhat anemic overall economy. In August, sales at clothing stores rose 0.3% over July's levels, and were up 3.2% year-over-year. Meanwhile, department store sales (excluding leased departments) fell 0.4% in August and fell by 1.2% year-over-year.

The rate of decline in US store traffic slowed during the iPhone 6 launch (falling 1.4% in the week ended September 13 from a year earlier, according to ShopperTrak), and improved as the week went on. Traffic surged 9.6% at electronics stores, representing their best weekly gain since September 2012. Apparel stores also had their best week in six weeks, with store traffic falling by low-single digits. September traffic is down 2.8% month-to-date, the best showing since April.



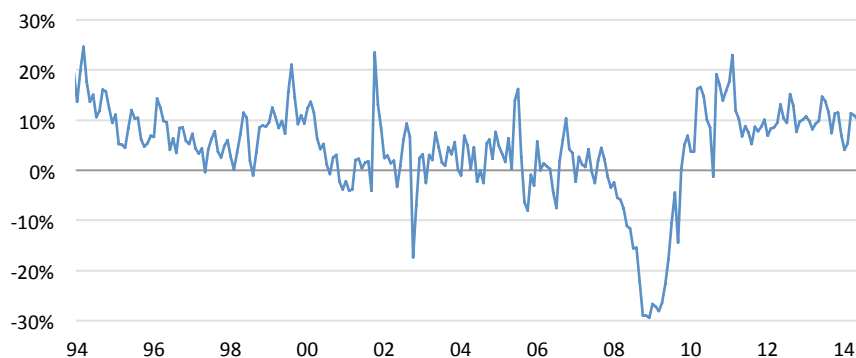
**U.S. Retail Sales—Excluding Autos & Parts (YoY%)**



Through August 31, 2014

Source: US Department of Commerce

**Automobile and Other Motor Vehicle Dealers (YoY%)**

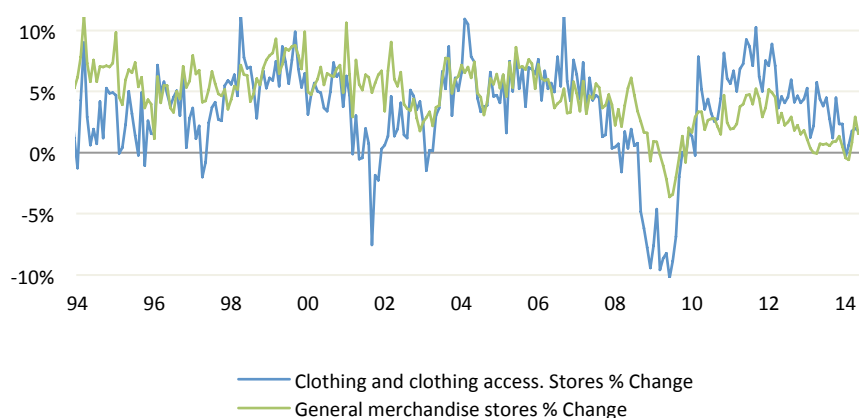


Through August 31, 2014

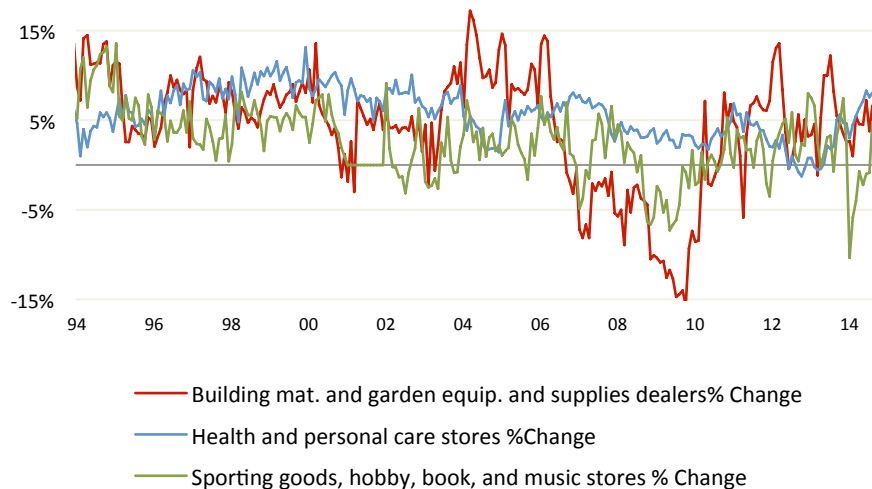
Source: US Department of Commerce



## Clothing and Clothing Accessories Stores and General Merchandise (YoY%)



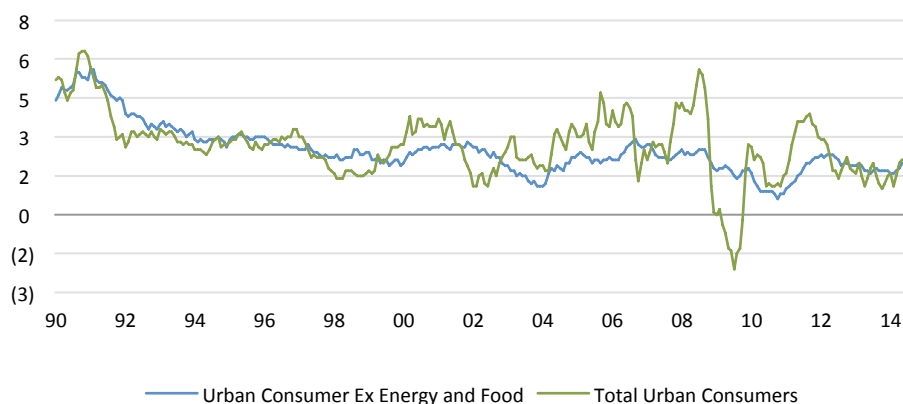
## Other Retail Categories (YoY%)







US Consumer Price Index (YoY %)

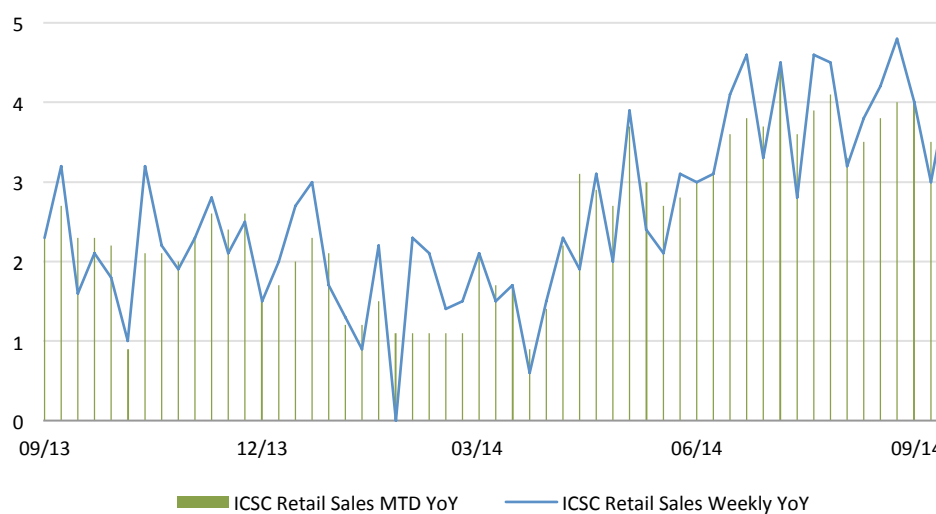


Through August 31, 2014

Source: US Department of Commerce

In its weekly release, the International Council of Shopping Centers (ICSC) reported that US retail sales rose 3% year-over-year in the week ended September 16. On a sequential basis, sales were at their weakest in nine weeks, falling 260 basis points from the prior week, as the back-to-school shopping season came to a close. ICSC said business was strong at wholesale, dollar and discount stores.

ICSC Weekly Retail Sales



Through September 20, 2014

Source: International Council of Shopping Centers



## GLOBAL RETAIL EARNINGS RELEASES

**Nike Inc.** reported F15 Q1 sales rose 14.5% to \$8 billion, in tandem with a 15% gain for Nike brand to \$7.4 billion, with all product types and geographies contributing except Action Sports and Golf. Gross margin expanded 170 bps reflecting a higher margin product mix, higher average prices and continued growth in Nike's DTC business. SG&A rose 21% as demand creation expense increased 21% to \$2.5 billion supporting marketing for the World Cup and net income of \$962 million increased 23.4% from year ago levels. Following 18% growth in FQ1, Nike lifted its guidance for Greater China sales to a low-to-mid teens rate from a high single digit rate. Nike enters its FQ2 with worldwide futures orders for Nike Brand (deliveries through January 2015) up 14% on a currency neutral basis. *Nike Inc. press release, September 25.*

**Inditex** sales climbed 11% in local currencies for the first six months of 2014. Despite reporting a 4.5% first-half comp and 11% constant-currency sales increase, gross margin contracted 100 basis points, to 57.6%, while net profit fell 2.4%, to €928 million. During that same period, the group opened stores in 40 different markets, bringing its worldwide network to 6,460 stores in 88 markets. Zara recently launched its online shopping platform in Mexico, with remaining Inditex brands to follow soon. Zara will also launch online in South Korea the week of September 22, with online store on China's Tmall to follow. *Inditex website, September 16.*

**Hennes & Mauritz** reported that Q3 sales rose 21%, with gross profits and net income both keeping pace at a 20% increment. The company sees continued strong sales development for the other brands in the H&M Group: COS, & Other Stories, Monki, Weekday, Cheap Monday and H&M Home. For the most recent period (September 1–23), sales increased 7% in local currency and have been adversely impacted by unusually warm weather in most markets. H&M's online store in China (launched this month) and in Italy and Spain (launched in August) are off to very good starts. Hennes & Mauritz plans 375 net new stores this year, which along with expansion into new geographies and categories and new e-commerce markets (France in March 2014 as well as the aforementioned), should support continued strong sales momentum for the next few years. *H & M Hennes & Mauritz AB press release, September 25.*

**Richemont** reported five-month sales ahead of its annual meeting. Total sales rose 4% in constant currency and were up 1%, reflecting weakness in the US dollar and Japanese yen relative to the Euro. In constant currency, Asia/Pacific sales were flat, reflecting an 8% drop in Japan, while sales jumped 12% in the Americas and 6% in Europe and the Middle East. European and Middle-Eastern sales continued to benefit from tourism. In the Asia-Pacific region, sales were lower in Hong Kong, Macau and mainland China, offsetting positive developments in other markets. In mainland China, retail sales grew while the rate of decline in wholesale sales softened. Cartier jewelry continued to outperform watch sales, which have suffered from weak demand and destocking, particularly in Asia-Pacific. *Richemont press release, September 17.*





**Neiman Marcus** reported flat FQ4 (ended August 2) sales of \$1.11 billion, while comps rose 4.9%. FY14 sales were \$4.84 billion, with comps up 5.5%. Online sales rose 13.7% and 12.9% in FQ4 and FY14, to \$276 million and \$1.1 billion, respectively. Gross margin was flat for both periods, while the SG&A ratio rose in FY14, reflecting higher marketing and selling costs in support of the company's online growth and omnichannel initiatives. After several lackluster seasons, women's apparel was the bright spot in FY14, with vendors at the very top (Brunello Cucinelli, Chanel and Tom Ford) remaining very strong. FY14 sales per square foot were \$579 versus \$552. Neiman Marcus reported losses for FQ4 and FY14 reflecting the October 2013 acquisition of the company by an investor group. Adjusted FQ4 EBITDA of \$96.7 million compares with \$96.4 million, and for FY14, adjusted EBITDA was \$677.6 million versus \$671.5 million. Separately, on September 15, the company announced the purchase of MyTheresa.com, a Munich-based online luxury website and the Theresa specialty store located in Munich. The acquired company has revenues of ~\$130 million and ships to more than 120 countries. *Neiman Marcus press release and conference call, September 17.*

**Prada** reported weak topline growth for the first-half and Q2, reflecting adverse FX and weakening demand in China. Q2 sales rose 2.9%, to €962 million; retail sales were flat, owing to a 7% drop in leather goods sales, to €496 million. This was offset by double-digit gains in footwear, FTW and others; wholesale revenues rose 14%. Prada's two largest regions, Europe and Greater China (PRC, HK and Macau) experienced Q2 sales declines of 3% and 1%, respectively, with remaining regions posting gains. H1

revenues rose 1.3%, to €1,751 million, gross margin contracted 160 bps to 71.8% and net income declined 20.6%, to €245 million. According to Prada, recent trends haven't shown signs of improvement, as the persistent difficult economic and political conditions continue to hamper consumer spending. The company expects its H2 performance to remain broadly in line with H1 results, with margins under continued pressure, modestly offset by cost-cutting. *Prada press release and H2 presentation, September 19.*

Company	Reporting Period	Currency	Revenues (Millions)		% Change	Gross Margin		Basis Points Change	Net Income (Millions)		YoY% Change	Store Fleet Period End	
			2014	2013		2014	2013		2014	2013		2014	2013
H&M	Q3	SEK	38805	32040	21.1%	58.3	58.8	(50)	6060	4452	36.1%	3341	2964
Inditex	H1	Euro	8085	7655	5.6%	57.6	58.6	(100)	931	952	(2.2)%	6460	6104
Neiman Marcus*	Q4	USD	1113	1119	(0.5)%	31.6	31.6	NC	-13	11	NM	79	79
Nike Inc.	Q1	USD	7982	6971	14.5%	46.6	44.9	170	962	779	23.4%	858 <sup>1</sup>	758 <sup>1</sup>
Prada	H1	Euro	1751	1728	1.3%	71.8	71.5	30	245	286	(14.5)%	566	491
Richemont	H1	Euro	5323	5044	5.5%	62.9	63.6	(70)	882	924	(4.5)%	N/A	N/A

\* adjusted net income reflects impact of 2013 acquisition

<sup>1</sup> at fiscal year ended May



## OTHER NEWS MAKING HEADLINES

- According to a report published by the Economic Information Daily and Visa, 98.19 million Chinese traveled overseas last year, making Chinese tourists the largest group from any one country in the world, and potentially the largest foreign shopper affecting the US retail market.
- The number-one shopping destination for Chinese tourists is the United States. Chinese tourists spent 128.6 billion yuan (\$20.9 billion) in overseas markets in 2013, a 24% jump year over year. In fact, Chinese consumers spent \$1,368 average per capita in overseas markets last year, three times more than foreign tourists spend in China. In e-commerce, the Chinese spent 3.1 billion yuan in 2013, with US retailer websites their number-one choice for online shopping.
- IMF is warning that a slowdown in emerging markets could spill over and hurt advanced economies. According to the IMF's estimates, every one-percentage-point reduction in emerging-market economic growth depresses growth in advanced economies by a quarter of a percentage point. This suggests that the weakness in developing countries could be a major factor behind the recent disappointing progress of the economic recovery in the developed world.
- The euro enjoyed its biggest annual gain in six years in 2013, as the currency bloc emerged from its longest-ever recession and investors flooded back in. However, the Eurozone economy is forecasted to expand just 1.2 % this year, less than half the 2.8% pace in the US. Loan growth remains weak in the region, while unemployment hasn't budged from its high of 11.5%. About a quarter of young workers can't find a job—a problem for retailers that depend on this market.

## RETAIL TECH HIGHLIGHTS

- Apple's big splash this month (beyond the unveiling of the iPhone 6 and iWatch) was its mobile payment solution, Apple Pay, which is widely expected to drive further development of the so-called payments revolution—where phones or other mobile devices can be used to pay for goods, replacing cash or cards. According to a 2014 Catalina survey, lack of convenience and worries about personal-data security are the main reasons why people have been so slow to adopt digital payment apps. If it works as promised, Apple Pay addresses the security problem with its tokenization and fingerprint verification systems, which protect personal data and could make mobile transactions safer than credit cards.
- An R2D2-shaped robot partly backed by Google is now delivering small items to guests at Starwood's Aloft hotel in Cupertino, California. The machine was developed by Santa Clara startup Savioke, which benefited from a Google Ventures investment earlier this year. The company's robot—named "Botlr"—uses the same kind of



navigation technology as Google's self-driving cars, and can be programmed by hotel employees to perform a variety of small tasks. Savioke hopes to extend its pilot program to other hotels by next year, and foresees other uses for the devices (such as hospital work, where robots are already becoming more prevalent).

- Mobile sales on smartphones and tablets made up 27% of online viewing in June, up from 21% in February. Cisco has predicted that mobile and video traffic could make up 69% of the world's Internet traffic by 2018.

## FBIC RETAIL NEWSWIRE

***Claire's to set up shop in more Toys "R" Us stores, offering jewelry and accessories for tweens and broadening offering to toys and videogames.*** The companies plan to expand their partnership to about 100 stores in Europe and 12 locations in the US by the end of 2014, after a successful European pilot program. Mr. Urcelay, who became the Toys "R" Us CEO last year, has pursued a turnaround plan that included steep discounts to clear inventory before stuffing its shelves with new product for the holidays—a make-or-break season for toy sellers. Under Mr. Urcelay, Toys "R" Us has also sought to make up ground on e-commerce as it also seeks to recover from a sales slump in its physical stores. *Wall Street Journal, September 17.*

***Michael Kors (the company) announced a secondary of 11.6 million shares*** on behalf of Sportswear Holdings Limited, which eliminates founders Silas Chou's and Lawrence Stroll's investment in KORS shares. Both men have stepped down from the board. While the brand continues to enjoy brisk demand, these investors are on to fresher opportunities. Michael Kors entered the current quarter with a 65% inventory increase. During the Michael Kors' August 4 earnings call CEO John Idol spoke to the company's high inventory commitment (in light of their guidance of a high teen comp for its FQ ending September), explaining that the transition to in-house fulfilment from a third-party for NA e-commerce and in-transit inventory drove the buildup. Still, that's a lot of inventory in an increasingly competitive category with weakening margins and guidance for modest margin contraction this fiscal year. *Company press release, September 4.*

***Target Handpicks Brand Partners for Sustainable 'Made to Matter' Push.*** It's green-friendly and highly competitive. The 'Made to Matter' partnership portfolio includes 16 brands and provides Target with an exclusive pipeline of 100+ products in return for end cap displays, Target's scale and the marketing prowess behind the program. 'Made to Matter' brands include Burt's Bees, Horizon Organic, Kashi, Method, and Seventh Generation. *Ad Age, September 18.*

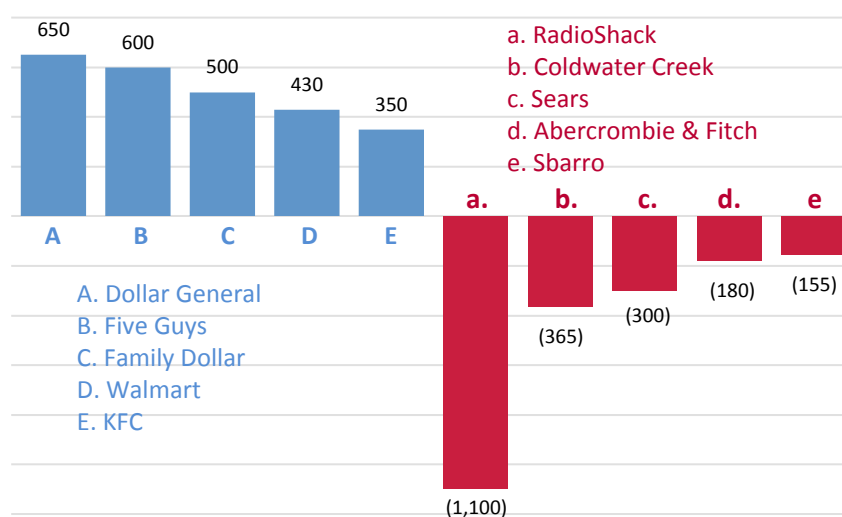
***Nordstrom employs New York Instagrammers to personalize fall accessories.*** Department store chain Nordstrom gathered a group of Instagram aficionados to photograph its fall accessories to add a personal touch to its e-commerce pages. The "Instalog" features shots of handbags, jewelry, boots and hosiery composed by 11 New York-based magazine editors, social media marketers, stylists and bloggers. Including these varied voices on the product pages can help consumers see how items fit into their lifestyles. *Luxury Daily, September 17.*



**Urban Outfitters files 10-Q**, reporting that “thus far, during the third quarter of fiscal 2015, comparable Retail segment net sales are low single-digit negative.” Urban’s CFO, Frank Conforti recently addressed investors at Goldman Sachs’ 21st Annual Retail Conference (September 3-4) regarding e-commerce, and referred to his CEO (and founder of Urban Outfitters) Dick Hayne, comments that he sees e-commerce accounting for as much as 50% of the company’s revenues. *Company press release, September 9.*

**The Common Area** published the Marcus & Millichap infograph on retailers with the most planned openings and closings. Not surprisingly, retailers topping the list of opening the most store locations have a value focus (notably Dollar Store, Family Dollar and Walmart), while those with the highest number of closings are struggling brands and retailers. Radio Shack reported a Q2 20% comp-store decline on September 11, along with a \$1.35 loss per share (versus a \$0.51 per share loss in Q213). Both Coldwater Creek and Sbarro recently filed for bankruptcy. *ICSC’s Shopping Centers Today September 2014 issue.*

Number of Stores Expanding/Downsizing



Source: Marcus & Millichap

**The Home Depot confirmed that its payment data systems have been breached**, which could potentially impact customers using payment cards at its US and Canadian stores. There is no evidence that the breach has affected stores in Mexico or customers who shopped online at HomeDepot.com. The investigation began September 2, immediately after the company received reports from its banking partners and law enforcement that criminals may have hacked its payment data systems. Responding to the increasing threat of cyber-attacks on the retail industry, The Home Depot previously confirmed it will roll out EMV chip-and-PIN" payment systems to all US stores by the end of 2014, well in advance of the October 2015 deadline established by the payments industry. *The Home Depot press release, September 8.*



***The Home Depot updated its response on September 18,*** confirming that the malware used in its recent breach has been eliminated from its US and Canadian networks. Its investigation confirmed that the criminals used unique, custom-built malware to evade detection. The malware had not been seen previously in other attacks, according to Home Depot's security partners. The cyber-attack is estimated to have put payment card information at risk for approximately 56 million unique payment cards. The malware is believed to have been present between April and September 2014. *The Home Depot press release, September 18.*

***VF Corp. Appoints Leader of its Global Jeanswear Innovation Center.*** In a newly created role, Sudhakar Puvvada will oversee VF's recently established Jeanswear Innovation Center focusing on denim advancements to benefit its jeanswear brands, including Wrangler®, Lee® and 7 For All Mankind®, and other brands throughout its portfolio. Puvvada joins VF from Ashland, Inc., where he was VP, Technology Platforms. Also, he has worked in a number of research and product development roles in the home and personal care categories, including 14 years at Unilever. VF introduced its Innovation Center strategy in 2013 and began to elevate innovation initiatives with existing teams to support key projects. Now, under Puvvada's leadership, the company will assemble teams of chemists, scientists, engineers and designers for the Innovation Center who will combine their expertise in technology and new materials with VF's proprietary insights and deep understanding of consumer needs. *VF Corp press release, September 18.*

***Timberland targets \$3.1 billion in revenues; details plans to add \$1.4 billion to topline over next five years.*** Timberland expects substantial growth in each major geographic region: Americas, EMEA and Asia Pacific. Growth will be driven by industry leading innovation and product diversification; consistent channel discipline; meaningful expansion of its direct-to-consumer (DTC) business; and a significant amplification of how Timberland communicates and connects the brand with consumers. Growth in the Americas will account for ~50% of the anticipated \$1.4 billion in total revenue growth (a 14% annual increase) balanced across wholesale and DTC channels. In EMEA (Europe/Middle East/Africa), Timberland expects to add \$380 million and reach \$1 billion by 2019. The Asia Pacific (APAC) region is expected to double, growing revenues by 15% annually to reach \$620 million by 2019 with most of the \$310 million increment to come from China and South Korea, largely untapped markets for the brand. Timberland's DTC revenues are expected to reach \$1.1 billion,

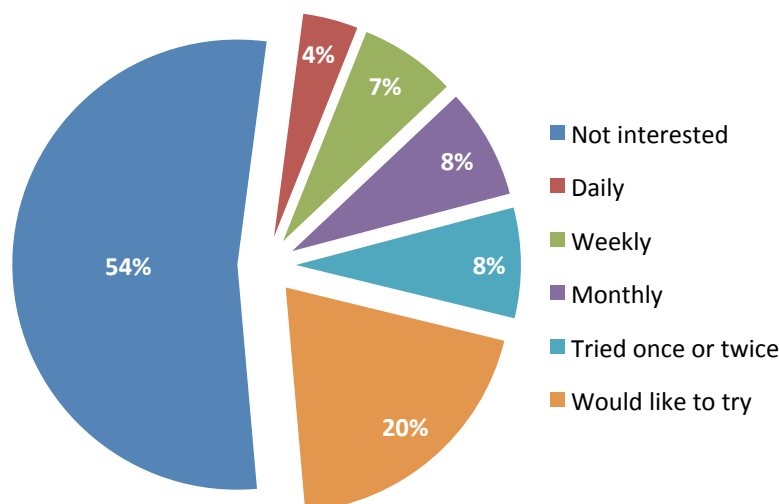
an additional \$570 million and an annual growth rate of 15%. E-commerce is expected to be Timberland's highest percentage growth channel, increasing by 31% annually and adding \$180 million in revenues over the next five years. Timberland plans to expand its global retail store presence by adding 130 stores to its current base of approximately 230 stores. *VF Corp analyst meeting September 17.*

***Mom-and-Pop shops growing again.*** REIT executives at Kimco Realty and Equity One report an uptick in small-shop occupancy. At Equity One, overall occupancy increased 120 basis points, to 84.8%, in the most recent quarter, while Kimco sees small-shop occupancy hitting 90% within the next 12 months. The boost comes from greater access to credit lines from small banks. *ICSC's Shopping Centers Today September 2014 issue.*





US mobile phone users who have made a purchase via a retailer\* mobile app,  
by frequency, June 2014 (% of respondents)



Note: n=2,295; \*retail store or brand

Source: 451 Research, "2014 US Consumer Survey" as cited in company blog, July 25, 2014

**Retail purchases via apps? Mobile users take a pass.** More than one-third of US smartphone users employ a retail app at least weekly, according to the March 2014 poll by Forrester Consulting commissioned by Tapjoy. Interestingly, however, they aren't using their phones for transactions. According to a poll conducted by 451 Research just over one-quarter of US mobile phone users had made a purchase via a retail mobile app. And, while one-fifth of respondents showed interest in buying something via a retail store or brand app, the percentage of mobile phone users who had no interest was more than 2.5 higher, at 54%. *eMarketer, September 18.*

**An update on Sperry Top Sider.** Wolverine Worldwide (WWW), owner of Sperry Top Sider, expects strong Q4 revenue growth, driven by one extra week in the period and the full launch of Sperry Top Sider apparel into the 55 Sperry retail stores. Going forward, a full Sperry apparel launch is an important growth initiative for WWW, which has partnered with Li & Fung to be licensee for Sperry apparel. There will be a full launch into third-party retail in early 2015. The brand had been on a spectacular run until late 2013 and into 2014. It was the most popular casual footwear brand in the US, and its international potential has barely been tapped (though a plan to do so is currently under way). Sperry grew from ~\$150 million a year as a domestic, mature male, brown boat shoe brand, into a nearly \$500 million a year dual-gender, boat and non-boat shoe and is now on the verge of becoming a head-to-toe lifestyle brand. It commands more than 70% of the US boat shoe category.





# GLOBAL RETAIL UPDATE



The brand has enjoyed robust growth, with topline advancing 30%, 30% and 19% in the first three quarters of 2013. In Q414, however, it sales growth slowed to a high-single-digit pace, and weakened to a mid-single-digit rate in FY Q1. Weather was a major culprit, as the company didn't have enough cold-weather boots. In addition, Sperry exited one family-channel account that had been overly promotional (representing \$20 million wholesale). WWW believes that Sperry is turning the corner.

It ranks as the #2 brand in WWW's portfolio in both revenue and profit contribution. There have also been a number of leadership changes at Sperry; three months ago, it hired a new Head of Marketing and a new Head of Sales and, more recently, it added a new Head of the Sperry brand, Rick Blackshaw (from Keds, where he was the architect behind that company's resurgence). Blackshaw is the most brand-oriented, consumer-centric mind in the business. The best use of Rick's talent is to put him in charge of leading the brand that needed him most—and that was Sperry Top Sider. We think Q3 is going to be a tough quarter, given this year's weaker back-to-school sell-in versus 2013 results. Year-over-year comparison will also be tough for Sperry, but we expect improvement in Q4 and further progress in 2015. *Based on comments from WWW's CFO, Donald Grimes at the Goldman Sachs 21<sup>st</sup> Annual Global Retail Conference, September 3-4.*