CIBC Asset Management

March 2021

THE CONSUMER AND COVID-19

Part 3 (of 3): Changes in how we PLAY

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Almost a year after the first COVID lockdowns, a strong political will continues to support the economic recovery. Barring any unforeseen new virus variant or mutation that renders the current slate of vaccines ineffective, our focus can now shift to understanding the "new normal".

Key themes within PLAY:

- **Uneven recovery**
- **Favouring at-home and outdoor activities**
- **E-commerce acceleration**

We see 3 key themes in PLAY. First, the recovery in consumer spending has been uneven. An increase in monthly average spending of 5-7% in the U.S. and Canada since June 2020 (figures 1 and 2) has a number of important elements. Spending on goods (especially hardlines, such as appliances) is benefiting from reduced spending on services (e.g. travel, dental services, fitness). We also see a shift that favours larger retailers designated as 'essential', while smaller retailers have been forced to close or operate under restrictions.

Second, the home and the outdoors have emerged as key areas of focus for consumer spending. Where we previously questioned how home prices would fare and what that would mean for confidence, we believe this question has been answered. Home prices are up strongly! Home improvement spending levels also signal confidence in the value and importance of this asset, in our view. Consumers are also spending to experience the trails, mountains, roadways and waterways that are available to them and still allow them to keep distancing protocols.

Lastly, a consistent pandemic theme has been an acceleration in e-commerce penetration. The definition of convenience is changing and all e-commerce models are resonating to some degree with the consumer. This includes desktop and mobile e-commerce, as well as delivery and pick-up.

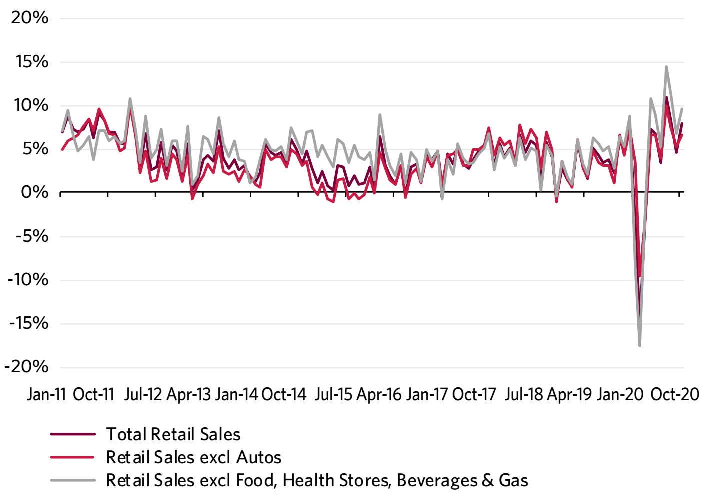
The uneven recovery

Some consumer categories, especially services, have been completely unavailable to most consumers during the pandemic (due to capacity restrictions, border closures, quarantine guidelines, product delays etc.).

Our analysis shows that about $500~800 billion U.S. is not flowing to traditional avenues as a result of the pandemic, driving about 3.5-6% growth across the remaining categories that are available. Certain retail segments such as home improvement and sporting goods are meaningfully outgrowing the average, with percentage sales increases of high-teens to low 20s year-over-year. Others, such as apparel and accessories, are lagging, with declines that touched high teens (percentage) year-over-year. We see a very similar trend in Canada and the United States.

Figure 1: Monthly retail sales, U.S.

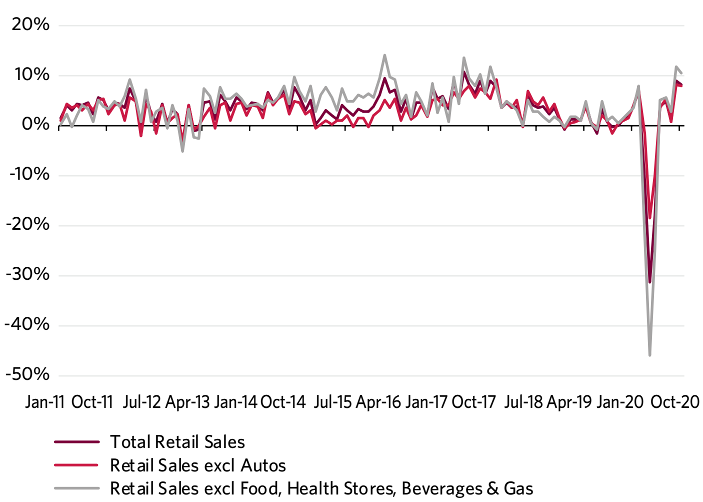
Year-over-year % change



Source: US Census Bureau Advance Monthly Retail and Food Services

Figure 2: Monthly retail sales, Canada

Year-over-year % change



Source: Statistics Canada

COVID-19 restrictions appear to have benefited larger (and generally public) retailers. In Canada in particular, we estimate that approximately 2-4% of market share was gained by ten of the largest retailers in Canada. In part, this is due to the increase in eating at home, which shifted spending out of restaurants (i.e. services) and into grocery retail. Even excluding the food share shifts, we believe that larger discretionary retailers[1] saw benefits that translated into market share gains. This was a result of capacity/opening restrictions imposed on local (and generally smaller) private retailers.

Favouring at-home and outdoor activities

At home

COVID-19 has transformed the role of the home. Caution around public spaces and large gatherings has consumers eating more meals, doing more work and engaging in recreational activities from home. The home has risen in importance and this is reflected in resale home prices. Despite job losses and a plunge in GDP, home prices **increased** by approximately 17% in both the U.S. and Canada through December 2020.

Consumer spending on home improvement has also been robust. Solid sales trends at The Home Depot and Lowe's continued with strength throughout 2020; the lumber and outdoor/garden segments strained to meet the increased demand.

More home renovation

Historically, Home Depot has had stronger relationships with contractors while Lowe's has stronger relationships with do-it-yourself consumers. One key factor driving the outperformance of Lowe's relative to Home Depot is that consumers are reluctant to bring contractors into their homes (landscaping and outdoor improvements are an exception, of course). They're also reluctant to take on large projects such as kitchen renovations, that might force them to move out of their homes for a period of time.

[1] Examples include Canadian Tire, Walmart, Dollarama, The Home Depot Canada and Lowe's Canada/RONA

More home offices

This bias could change as the economy re-opens and more people get vaccinated.

Spending on the home hasn't just been about treated lumber, nails and drywall. Decor items, small appliances and items that add more discrete home office or workout/exercise space have all been popular. We see this in the strong numbers from a range of retailers, including Canadian Tire (retail sales up >20% in 2Q), Wayfair, Restoration Hardware, and Best Buy.

Consumer spending around the home has also translated into more demand for 'boredom busters'. These include pool toys, board games and similar items. When Canada's Spin Master (maker of Paw Patrol and Hatchimals) reported its second

Boredom busters remain popular

quarter results, its Activities, Games, Puzzles and Plush segment grew by 19.2% and its Outdoor segment (e.g. pool toys) grew by 9.1%, even though overall revenue declined. Canadian Tire noted similarly strong pent-up demand for boredom busters.

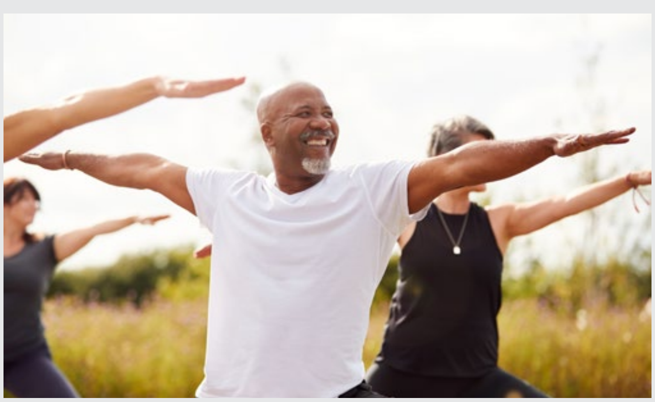
Outdoors

There's also been increased consumer spending in the outdoors. Both local outdoor fitness/active lifestyles (e.g. running, jogging, cycling) and destination-style outdoor experiences such as camping, boating and off-roading have benefited.

Nike, Dick's Sporting Goods benefit from the outdoor trend

Nike's fiscal Q1 direct sales increased 12%, driven by an 82% increase in Nike brand digital sales. Footwear sales were particularly strong. Dick's Sporting Goods, one of Nike's retail partners, also reported strong numbers, including a 20.1% net sales increase. Dick's same-store sales increased 20.7%, led by a 194% increase in e-commerce sales. The one notable area of weakness in the sporting goods category is team sports, which has been negatively impacted by social distancing. However, retailers like Dick's are optimistic that team sports will recover once the economy reopens.

Exercise moves outdoors



Be a tourist in your own country

Have car, will travel

Who needs a hotel?

People still need their cars

U.S. passenger travel (vehicle miles traveled) had recovered to >80% of pre-lockdown levels[2] by August 2020 (and recovered further leading into U.S. Thanksgiving), demonstrating consumers' willingness to venture out of their homes. While vehicle miles have almost recovered to March 2020 levels, the summer of 2020 still didn't see a recovery to typical summer driving peak levels.

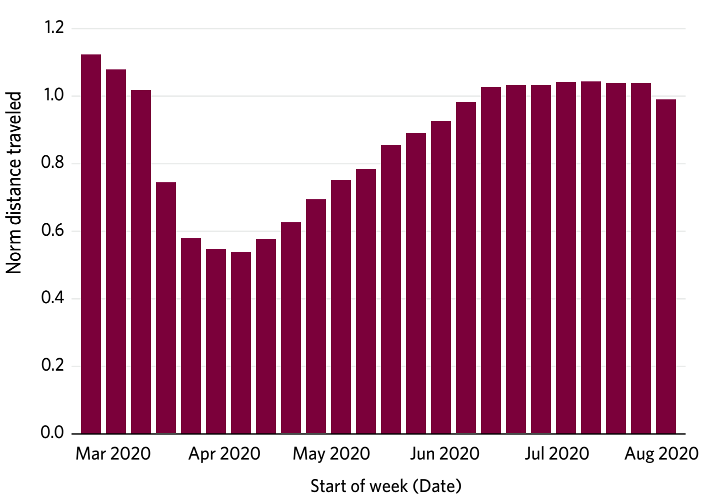
In the interest of safety, many consumers will likely continue to prioritize travel in a personal vehicle, if possible, over public transportation. The need to travel may have arisen because some workplaces reopened, but it probably also reflects broader pent-up demand to engage with the physical world and not just the digital one. Auto parts and service is one category that has benefited. Results from Advance Auto Parts, Autozone and O'Reilly Auto Parts confirm this. Meanwhile the supply of new vehicles within North America continues to rebuild from low levels.

With the recovery in driving, it comes as no surprise that related activities (powersports, boats, RVs) have also benefited.

COVID-19 created an opportunity for branded companies in these industries to convert new buyers into lifetime customers. Based on a global survey conducted by Bombardier Recreational Products (BRP) in August, the company found that 77% of its powersports customers purchased a BRP product for the first time. This is an increase of 51% compared to the comparable period the year before. Among new customers, roughly 41% were completely new to the powersports industry, representing an almost threefold increase.

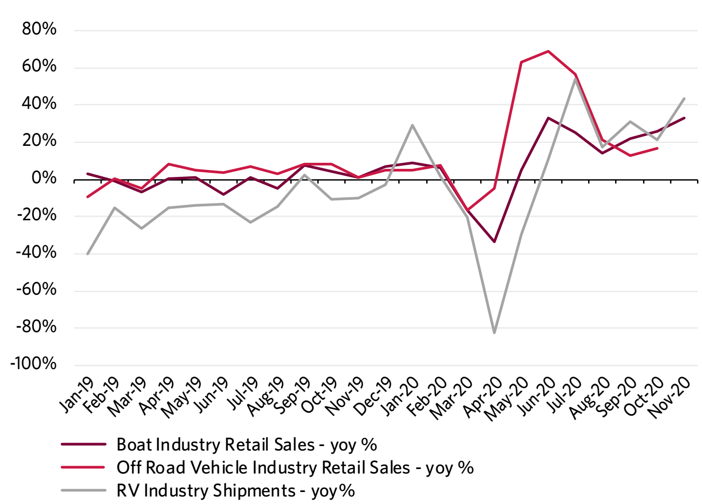
There's good reason to believe that the outdoor theme will continue. This continuation of this trend is manifesting in many ways, including the purchase of snow-related toys (e.g. from snowshoes to snowmobiles), and products that make extended time outdoors more tolerable (e.g. propane heaters and warm winter coats).

Figure 3: U.S. weekly vehicle miles traveled



Source: INRIX AI Traffic

Figure 4: Sales of boats, off-road vehicles and RVs



Source: SSI, Polk, RVIA

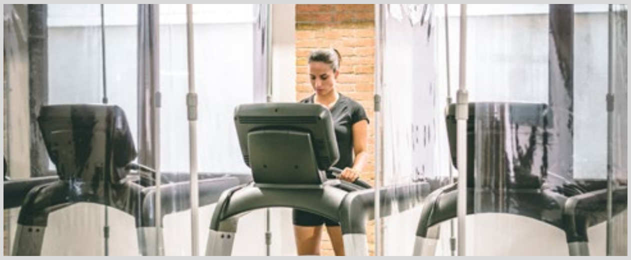
[2] Source: INRIX data analyses

E-commerce acceleration

Online facilitates many of the transactions that we're observing for PLAY, while acting as a domain for PLAY itself—online is growing as a provider of community.

Some avenues of spending are unavailable or appear unsafe at this time. Other categories are in secular decline (e.g. movie theatres) and have experienced an accelerated trend that could result in long-term structural change, regardless of a favourable vaccine outcome in the future.

Fitness



Planet Fitness (fitness clubs) reported a 78% revenue decline in 2Q.

Peloton (exercise equipment) fiscal 4Q (ended June 30) revenue grew 172% on a 113% increase in subscriptions.

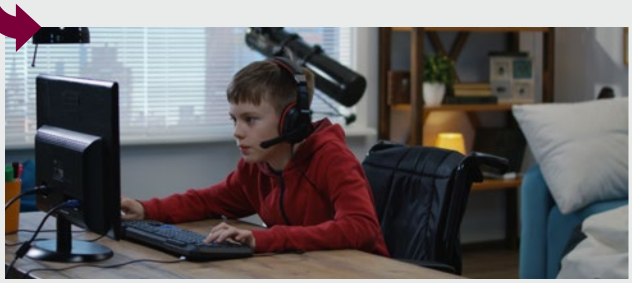
Movies

Cineplex/AMC attendance declined 100% in 2Q.

Disney+ subscriber growth of >70% in fiscal 3Q, then advanced further to 73.7m subscribers in fiscal 4Q from 57.5m in fiscal 3Q.

Games

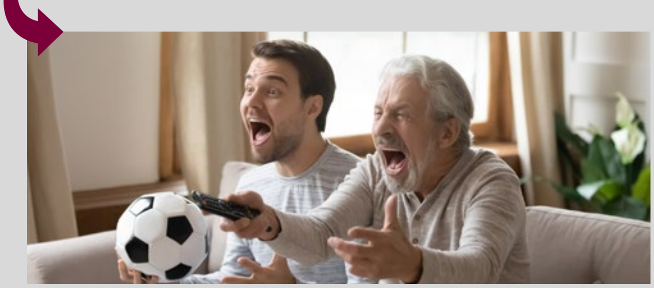
Parents continually encouraging their children to put down the remote and go play outside.



Twitch (video streaming service) minutes watched are up 69% to 1,116b minutes in 2020 (with 6.9m monthly streamers, up 90%).

Sports betting

Wynn Las Vegas Operations operating revenue decline of 86% in 2Q.

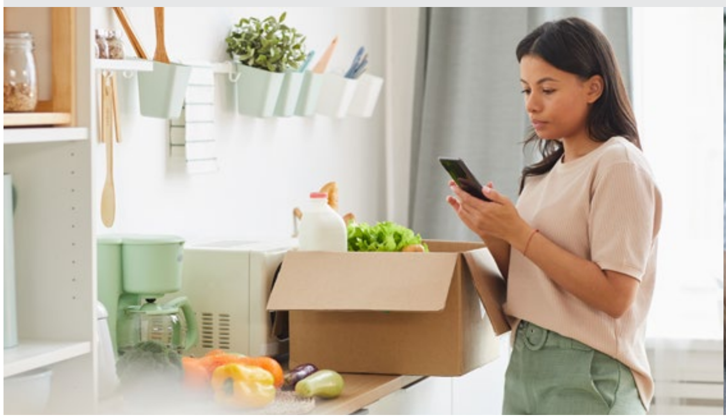


Draft Kings (sports betting company) 20% increase in pro-forma revenue in June 2020 (revenue decline of 9.6% for full 2Q) as live sports returned.

After COVID-19—The future of the consumer

Here are our thoughts on some consumer themes we expect will persist for the rest of the pandemic and beyond:

1. Consumer confidence will likely be fragile during the recovery phase. This depends largely on employment and whether key assets (e.g. house prices, stock market valuations) continue to hold their value. But signs are good so far, given increasing stock market valuations and home prices in 2020 and early 2021.
2. Personal savings remain elevated versus historical levels (at 20.5% in the U.S. in January 2021 vs. about 5-7% pre-COVID). This could translate into pent-up demand that is unleashed as the recovery unfolds.
3. Advances in e-commerce have accelerated consumer adoption, particularly in grocery/food retailing.
4. 'Contactless' and safety will become important elements for consumers as long as the virus remains a threat.
5. Success achieved by big brands and large companies today, to the detriment of smaller companies, could threaten consumer choice and innovation down the road.
6. Responsible Investing and ESG[3] issues will remain front and centre, particularly social factors related to safety and inclusion.
7. Supply chains must adapt, given the stresses on traditional 'Just-in-Time' models. Global trade tensions and the need for better disaster planning processes will become key considerations in strategic planning.
8. The successful experience of working from home is likely to bring about longer-term changes in how real estate is used/optimized. Trends associated with casual fashion and apparel are also likely to become more relevant in consumer wardrobes.
9. Will the sharing economy be impacted, and for how long? Trends in shared mobility (e.g. Uber, Lyft) and sharing more generally (Airbnb, clothing rental) could be interrupted by safety concerns.



[3] Environmental, social and governance