

Research @ Citi Podcast, Episode 25: Well Spent — A Consumer Health Check

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Transcript:

Paul Lejuez (00:00)

We want to see companies growing both stores and online. But again, the winners are the ones that we think can do both, and those are the ones that are going to succeed in this new retail landscape.

Anne Malone (00:12)

Hi, I'm Anne Malone, Citi's Head of Equity Research for the Americas. I'm pleased to be joined by Paul Lejuez, who leads our Consumer team and covers a big swath of retail — department stores, specialty softlines and food retailing — and Steve Zaccone who covers broadlines and hardlines. Thanks for joining me. Countdown to Citi's Global Consumer and Retail Conference outside Miami, March 9<sup>th</sup> through the 11<sup>th</sup>. We're going to have a number of corporates, and no doubt some themes will emerge. It's not as if we lack for headlines these days on so many fronts. So, Paul, what themes do you expect to come from the conference at a meeting of that many corporates?

Paul Lejuez (00:46)

Yeah, thanks Anne, and thanks everybody for joining. You know, we're in the midst of earnings season, and so everybody wants to know how holiday went. I think that's going to be a focus for the investors that attend the conference. It certainly is going to be a topic of conversation for all the companies that are attending, and there is a very broad range of companies — 55, approximately, in total. We think holiday, like I said, is going to be a big focus. And, of course, there are a lot of issues out there that are on people's minds, anywhere from tariffs to immigration policy to weather, which can obviously have an impact on the retail landscape as a whole. We think all of them will be topical. Hopefully, we're going to start to see some better weather than we've seen in the beginning of February when it's been very cold and I think it's been a drag on a lot of these retail businesses. But I think there's no shortage of issues on the minds of investors and on the minds of consumers. Inflation is likely to be a hot topic. Everyone's talking about the price of eggs, and I'm sure that has the potential to put some pressure on a certain group of consumers that I think investors will certainly want to dig into.

Anne Malone (01:52)

So bottom line, holiday. A success or no?

Paul Lejuez (01:57)

It was a big success. Holiday was very strong pretty much across the board. And I think when we look at the November–December period from the companies that we've already heard from, they had good things to say. From our credit card data that Citi has, we have certainly seen an improvement in trends in the November–December period. A little bit of a slowdown, however, in January and into February — February, especially, has been weak, goes back to

the weather comment that I made a second ago. It has been remarkably cold at a time of year when a lot of these retailers would like to see weather start to get warm. But when we look back at holiday, it was a very strong season.

Anne Malone (02:42)

So in addition to that week or January, February, you gave us a little bit of the laundry list. The other concerns after we get past that, we can't control the weather, obviously. So take your pick, tariffs, immigration, deregulation, M&A. What else is on their mind? And where do we come out on thinking about this group of stocks?

Paul Lejuez (03:01)

Yeah, sure, and I'll start and then maybe Steve can chime in on some of his universe. But, you know, tariffs are certainly front and center for a lot of our companies. I think it's fair to say that because we've seen this before, many companies over the last several years have made some adjustments to where they source to account for, let's say, tariffs on China. Now, there's a lot of uncertainty about where we will see tariffs go next. That sometimes changes by the week, sometimes by the day, sometime by the hour, right? So we'll see where tariffs ultimately go, but I'd say, generally speaking, as it pertains just to China tariffs, our companies are in a much better position than they were four or eight years ago because of some of the adjustments that they've made. And I think all eyes are on inflation and whether or not tariffs that get put into effect cause inflation. Do they cause some pressure on the consumer generally? Is it more specific to the lower income consumer? That's certainly on people's minds. And look, interest rates are important to folks as well. Tariffs are not the only thing that matters. We're not living in a vacuum. There are a lot of different dynamics within the retail landscape that are topical and front and center, but tariffs certainly seems to be in the news in a very big way these days. I don't know if Steve has anything to add to that.

Steve Zaccone (04:26)

Yeah, yeah, thanks Anne, for having me. I would say the thing I chime in on would definitely be rates, right? Persistently high interest rates have been a problem for the consumer, right? Whether that's low income, middle income, higher income, when you look at certain areas of retail, they are very heavily impacted by higher rates impacting purchases, most notably big ticket discretionary items that continues to be weak. On the tariff front, I think to echo Paul's point, it's a lot of uncertainty. You know, we've definitely seen some consumers do some stock-up trips. And if potential tariffs that were going to come into place, we're still waiting to see if there's going to be more. So it feels like we're just in a bit of an uncertain environment. And since we're focused on the near term, I think it's important to call out, too: there's been a little bit of a delay in tax refund payments. That's created a bit of noise in the month of February. A lot of the retailers we cover, the management teams, I think they're acknowledging, there's a lot of confusion with weather, with tax refund delays, with this tariff uncertainty. So it's hard to really get a good read on the consumer, you know, versus the consumer being pretty strong during the holiday season.

Anne Malone (05:37)

We talked about a lot of different topics here. Is there any point of having discussion about regionally? Is it cold all over with weather? Is inflation— is there anything regionally we should talk about in the U.S.?

Paul Lejuez (05:48)

Yeah, I mean, I think, when we look at a very high level, and I'm sure there are going to be differences, but, you know, for those of us and for those of you listening that are in the northeast down to the southeast, there have been some remarkably cold temperatures out there, very unseasonably cold. So not sure if every single region, I would say, is seeing the same level of unseasonably cold weather, but certainly on the East Coast from the northeast to the southeast, it has been remarkably cold. Hard to say though if every single region is impacted the same way, but certainly the East Coast is feeling the brunt of it.

Anne Malone (06:32)

You brought up the common theme that we keep hearing about, the price of eggs. So anything more specific on food retail that we should think about? Any trends that are different there, any themes that are any different there?

Paul Lejuez (06:45)

Yeah, again, I could start, cover some of the food retailers. Steve covers some of the warehouse clubs that obviously play in food. And, you know, we certainly have lived through a couple of years of food inflation starting back in 2022. And one of the things that I would say was a result of that very fast and persistent food inflation is that we saw the consumer gravitate towards value. They were looking to find ways to make their dollars go further. And we saw a lot of consumers gravitate to those value players that tend to bring everyday low price to the consumer, and I think it caused some market share shifts towards those retailers that are doing the best job at providing value. We also in the time of inflation in food type products, things that the consumer just can't live without, sometimes we see that get taken out of more discretionary purchases. And so we see some pressure in other categories in retail that would be considered more non-discretionary. That's something that we'll certainly be keeping our eyes on because it is something that we saw pressure a lot of retailers playing in discretionary categories when inflation first started back in 2022. Steve, I don't know if there's anything to add on your side.

Anne Malone (08:14)

Let's talk some examples, too, when you're outlining that, Steve. What are some examples of what might get hit hardest?

Steve Zaccone (08:21)

Well, I mean, I think to echo Paul's point, it feels like inflation is definitely picking up on the fresh food side of the business, right? So if inflation stays elevated in food retail, there are concerns that some of the discretionary categories, you know, could get hit. So we talked about briefly my big ticket discretionary items, right? Like some of the— you know, the durable goods kind of out there. You need to think about some of the discretionary purchases you make within you know, a store that, you know, your basket size stays the same, but if the consumables percentage continues to go up or costs a little bit more for eggs, maybe you don't grab, you know, the new T-shirt or something else that's in the store as well. So I think it's just more so that wallet share shift was a big theme post the pandemic, and it probably still matters. People are still kind of spending a bit more on consumables because they cost more, and you've got less dollars in your pocket to spend on discretionary.

Anne Malone (09:11)

So we take all of this together, and it is quite a long list, what do you think is priced into the stocks? And you could fairly answer me and say, Well, that varies from day to day and week to week because of the volatility that we've seen in some of the markets. But what do you think is

priced in? And pick your topic. Will the weather improve? Tariffs will be better or worse than we think. What'll happen with immigration. But are there any overriding themes that you can come up with on the valuations?

Paul Lejuez (09:39)

Yeah, this is Paul. I think uncertainty at a very high level, is what the market is...

Anne Malone (09:45)

Fair enough. *[laughs]*

Paul Lejuez (09:46)

...yeah, is pricing in to a lot of these retailers. And your point is a good one. There is a lot of volatility in these names, it does depend on the week and the day and the—the headlines of the day that have to do with some of those, the topics that we talked about, whether it's tariffs, inflation or consumer confidence or employment, all of these things matter. But I think it's fair to say that, you know, we have come to a period where there's a little bit more uncertainty, and I think the investment community is trying to sort it all out with all of these moving pieces. Steve, anything to add there?

Steve Zaccone (10:25)

Yeah, I would just say, with the uncertainty, right, there's definitely a favoritism towards some of the retailers that have been winning, right? Like they are trading at elevated valuations relative to history. And some people would argue that's justified. You're gaining more market share. You've got, you know, you matter more to the consumer, right? Like, you've got a higher margin rate than you did pre-pandemic. Whereas some of the retailers that have underperformed and lagged in this environment, they're definitely struggling from a valuation perspective. And in this environment of uncertainty, you know, it's hard to kind of take a swing at some of these retailers for a turnaround if, you know, maybe it doesn't play out, right? I think it seems like the environment is still going to be very much uncertain. You probably want to stick with the winners and then be very selective in some of these turnaround stories or these opportunities to regain market share. The last point I'd make is there have been certain categories that have struggled for the last couple of years, right? You know, call it home improvement, call it home furnishings, call it consumer electronics, right? And then you do wonder if they start to see a bit of a recovery just on years of easy compares and kind of replacement cycles.

Anne Malone (11:37)

And is that—the home improvement, I hadn't thought about that. Is that a post COVID phenomenon? Everyone fixed up their house for those two years and there's nothing left to do?

Steve Zaccone (11:47)

It's a little bit of that. So that's definitely the—you know, the pandemic giveback: it's been the last three years of challenging performance. Mortgage rates matter a lot, right, because you basically have homeowners who are kind of locked in at mortgage rates. They're not moving. So you've got this, you know, limited turnover effect, which impacts large project activities. It's a combination of multitude of factors. And this is an area where typically a very resilient area of the economy people continue to spend on, you cater to a more middle to upper income consumer, but it's been challenged. You've definitely seen discretionary dollars go elsewhere amongst consumer spending.

Anne Malone (12:27)

So we talk about uncertainty and volatility, and I guess we could argue this is our new normal for the next several years and not very likely to change. Just broader and maybe on the brighter side, what are the key metrics you look at in — let's call it these sectors or subsectors — to judge winners, losers, the health of a turnaround? What are the key metrics?

Paul Lejuez (12:51)

Maybe I'll start. I mean, something that Steve actually just mentioned a second ago. I mean, you know, who's gaining market share is obviously very important no matter what sector we're looking at. Is it a rising tide where every company can do well in a certain sector, or are we playing in an environment where there are going to be winners and losers? And I think what we've seen over the last several years is it has not been a rising tide necessarily. If interest rates were lower, I think it probably would have created a little bit more of a rising tide scenario, but, you know, that's obviously not the world that we've been living in the last couple of years. We're hopeful that we get to that point where interest rates start to come down a little bit and can start to benefit a lot of these retail groups across the board. But we do pay a lot of attention to who's gaining market share in each independent category at a very high level. I mean, obviously, we're paying a lot of attention to the employment picture. We pay a lot of attention to household wealth, which has been actually growing very nicely over the last several years. The consumer balance sheet is a very good shape. The primary drivers of that have been equity market gains and appreciation in home prices. And so we pay a lot of attention quite simply to how's the market performing and how's the housing market holding up? All important for "the consumer" across the board, but also specifically for a lot of the subsectors within our retail universe. I don't know, Steve, anything to add?

Steve Zaccone (14:30)

Yeah, I think Paul hit on the macro stuff, so I can touch on the micro. I mean, the fun thing about retail is, like, it's very simple, right? It's like, can you grow your same-store sales, which is your organic growth rate, right? So every earnings season, we kind of go in, and Paul and I have this big breadth of coverage, and it's just like, who's gaining share? Who's losing share? You can quickly see it based on same-store sales growth, right? And then, you know, usually, it's like, what's driving the same-store sales growth? You're being promotional or you're not being promotional. So the beauty of retail is like every earnings season, you're so focused on the same-store sales growth, and I think it tells you who's really outperforming versus who's losing share. So that's really where we start and end with a lot of focus in our coverage.

Anne Malone (15:13)

It's perhaps surprising, perhaps not. We have not used the online vs. bricks comparison that was so prevalent the last couple of years to talk about who's winning and who's losing there. Is that debate over and did online win? Is there a swing back? Is there anything to say on that topic?

Paul Lejuez (15:32)

It was certainly, again — this is Paul — certainly a big shift, obviously, as everyone is, I think, well aware, during the pandemic, when a lot of stores were shut down. If you were not deemed essential, it was very difficult to shop in stores for a while. So we saw a big rise in online penetration that held up for a year and change after the pandemic began. And then as stores started opening back up, people felt more comfortable going back into shopping physical locations. We started to see that swing back the other way, and online probably lost a little

share. I think at a very high level, you know, we're at a point now where, you know, for most companies, you know, eComm is probably growing a little bit faster than bricks-and-mortar, but not all, you know, there are some differences, and I don't think it's an either or, like, did online win or did bricks-and-mortar win. I think it's actually more of you know, who are the retailers that do both very well and integrate both their online and bricks-and-mortar presence. You know, we use the term omnichannel to describe the sort of interdependence of those two channels. And I think, you know, the winners are those that have done that very well. So at a high level, we continue to pay attention to both. We want to see companies growing both stores and online. But again, the winners are the ones that we think can do both, and those are the ones that are going to succeed in this new retail landscape. Steve, anything to add on your end?

Steve Zacccone (17:09)

Yeah, I mean, I would totally agree with that. I think, we've done some good work as a team that when you look at the industry overall, 2025 is going to be a year of very significant retail store closures. Obviously, those would be the market share donors, some of those smaller retailers that have kind of struggled, you have horrible balance sheets. The ones we cover, and you know, we've mentioned as before, definitely would gain share. I think when you think about retailers that are winning, you're still allocating a lot of dollars towards that eComm side of the business, whether it's improving speed of delivery, right, like getting product closer to the customer, you know, buy online, pick up in store, all those omnichannel capabilities. They all still matter. It just feels like the transitional shift in retail that happened probably happened ten years ago and then accelerated during the pandemic. And now you're at a point where you probably are a little bit more of a steady state growth with eComm outpacing a bit, and the big probably continue to get bigger and gain that market share.

Anne Malone (18:09)

It's probably a good place to wrap it up. I look forward to seeing both of you in Florida, and thanks for being on. This podcast was recorded on February 26, 2025. Join us for the next episode of Research @ Citi podcast. Lucy Baldwin will be speaking to Alex Saunders on the future of crypto. Thanks so much.

[Disclaimer] (18:28)

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