

2011 BDO USA, LLP

RETAIL COMPASS SURVEY OF CFOs

EXECUTIVE SUMMARY



SOLID YEAR-END RETAIL SALES FORGE PATH FOR 2012 GROWTH

AFTER A CRUEL SUMMER OF MARKET DIVES, JOBLESSNESS AND PLUMMETING CONFIDENCE LEVELS, THE RETAIL SECTOR OFFERS A GLIMPSE OF OPTIMISM FOR THE REMAINDER OF THE YEAR. BETTER-THAN-EXPECTED SEPTEMBER SAME STORE SALES AND MODERATE HOLIDAY SALES FORECASTS FROM THE NRF ARE WELCOME NEWS, AS RENEWED WORRIES SURFACE THAT WE'RE HOVERING AROUND A DOUBLE-DIP RECESSION.

Add to that the expectations for a 3 percent increase in total 2011 sales, reported by 100 retail chief financial officers, and there's some cause for confidence in the consumer. While this figure would be down from the 4.7 percent sales increase reported by the Commerce Department in 2010, it marks the study's most optimistic forecast since 2007. In fact, the results of our fifth annual *Retail Compass Survey of CFOs* suggest that while economic concerns linger among executives, they are making confident decisions around inventory levels and growth plans for 2012.

THE BDO RETAIL COMPASS SURVEY OF CFOs is a national telephone survey conducted by Market Measurement, Inc., an independent market research consulting firm, whose executive interviewers spoke directly with chief financial officers. The survey was conducted within a scientifically-developed, pure random sample of the nation's leading retailers. The retailers in the study were among the largest in the country, including 10 interviews with CFOs from the top 100 U.S. retailers, based upon annual sales revenue. The fifth annual survey was conducted in August and September of 2011.

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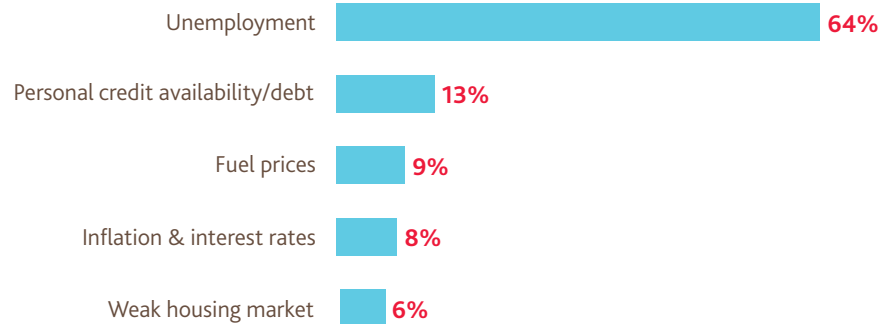
► FEW CFOs EXPECT A QUICK ECONOMIC TURNAROUND

Despite positive sales projections, the outlook for the economic climate as a whole is less rosy. The vast majority (77%) of CFOs say they expect to see a continuation of stagnant economic conditions in the next year. Just 11 percent expect to see an economic turnaround in the next year, up only slightly from 2010 (9%), and 12 percent anticipate a double dip. When asked about the pace of economic recovery, 38 percent of CFOs say improved consumer confidence will be the most important factor, and another 36 percent cite lower unemployment as the linchpin to a turnaround. And the catch 22: until unemployment levels stabilize, consumer confidence is expected to remain low; with most CFOs (64%) saying it will be the biggest obstacle to confidence for the remainder of 2011. Relief does not appear to be in sight. The Congressional Budget Office predicts that unemployment will remain above 8 percent until 2014.

“Retailers may not anticipate a full recovery in the near future, but we’re not seeing gloom and doom in sales expectations,” said Doug Hart, partner in the Retail and Consumer Product Practice at BDO USA, LLP.

“Despite the low confidence levels, macroeconomic conditions are not weighing on the consumer’s wallet as much as expected.”

Top Barriers to Consumer Confidence



► BRIGHTER BACK-END SALES FORECASTS

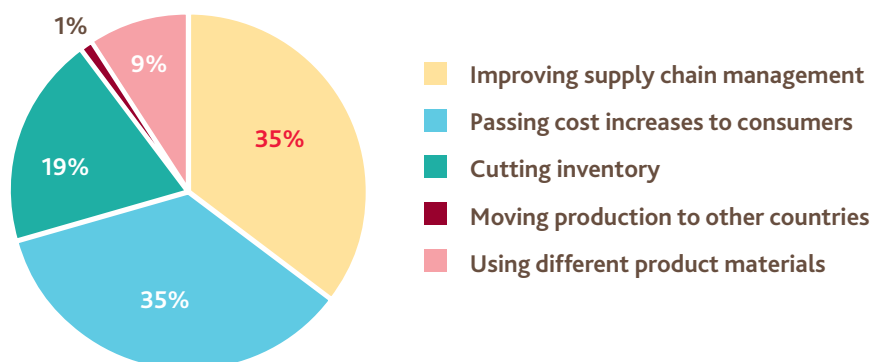
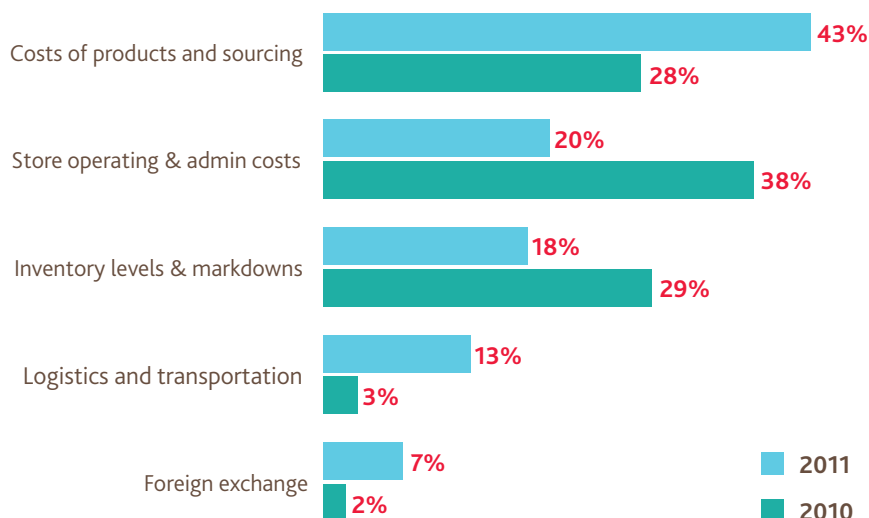
Retailers are moderately optimistic for sales in the second half of 2011, including the all-important holiday season. A majority (51%) expect sales to increase during this period, up from 44 percent in 2010. Overall, retailers project a 3.5 percent increase in comparable store sales for the second half of 2011, nearly doubling CFOs' pessimistic 2010 projections (1.9%). This projection mirrors those of other industry leaders. Both the ICSC and ShopperTrak forecast a 3 percent increase in holiday sales, while the NRF expects an increase of 2.8 percent.

Retailers place great weight on sales growth. In fact, 38 percent of CFOs say revenue is their primary financial metric focus. Still, another 36 percent say EBITDA (earnings before interest, tax, depreciation and amortization) is their primary financial focus. Sales growth is normally considered the best snapshot of the strength of the retailer's brand and competitive positioning. However, when it comes to credit and financing decisions, EBITDA is paramount, as it is considered the best indicator of recurring cash flows.

► DESPITE COST INCREASES, INVENTORY LEVELS STABILIZE

Retailers made confident inventory decisions for the 2011 holiday season. A vast majority (82%) of retail CFOs report they either increased (31%) or maintained (51%) inventory levels, compared to 2010. Still, they remain split over whether too little (53%) or too much inventory (47%) poses a greater risk this holiday season.

Target's enormously successful campaign with Missoni showed the danger of insufficient inventory. Retailers seem to be erring on the side of more, even in the face of significant cost increases, which are a major concern for them. In fact, while many CFOs (43%) name products and sourcing costs as the greatest threat to their operating margins for the remainder of 2011 (a notable 54% jump from 2010), just 19 percent of retailers report cutting inventory as their primary response to inflation. Instead, most retailers are passing cost increases onto consumers (35%) or improving supply chain management (35%). Given that retailers ordered holiday inventory during the height of raw materials cost inflation, margins necessitated that retailers pass along those cost increases to the consumer.

Top Priorities in Response to Cost Inflation**CFOs Name the Greatest Threats to Margins**

“Retailers will rely on attractive product offerings to offset the price increases and make the registers ring this holiday season,” said Al Ferrara, partner and national director of the Retail and Consumer Product Practice at BDO USA, LLP.

► U.S. M&A ACTIVITY TO INCREASE, STRATEGIC BUYOUTS ON THE TABLE

The appetite for M&A deals is on the rise. Nearly all (96%) retail CFOs expect M&A activity to increase or remain steady in the next year. This follows the already busy year of dealmaking we've seen, including BJ's Wholesale, Gymboree, JCrew and Timberland acquisitions. Most CFOs (66%) expect M&A activity to take place primarily in the United States, followed by the Asia-Pacific region (18%) and Europe (16%). However, the CFOs in the top 100 largest retailers who

were included in the sample have greater expectations for the international market. Seventy-five percent of CFOs in the top 100 expect Europe to see the majority of M&A activity.

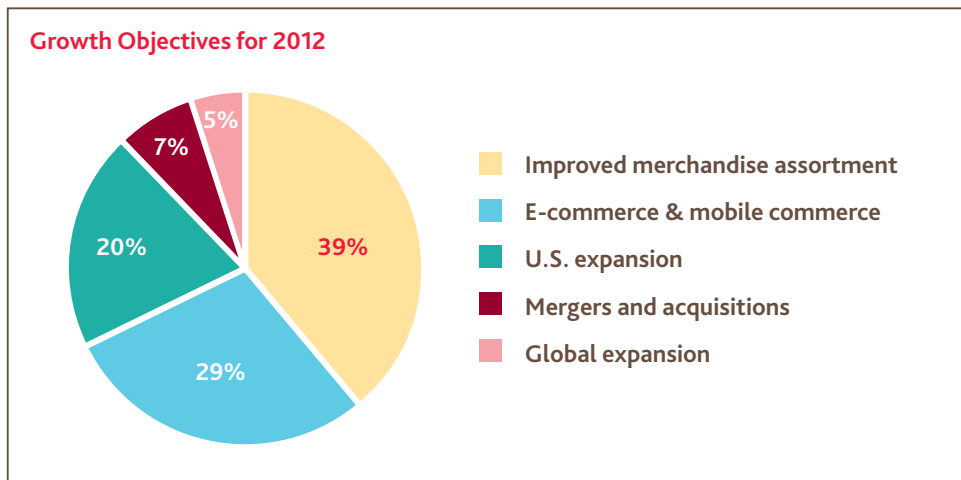
Although private equity deals have dominated acquisition activity, CFOs expect to see a fair share of strategic buyouts in the next year. In fact, CFOs are split on whether upcoming M&A activity will be primarily driven by strategic buyers (52%) or financial buyers (48%). On average, CFOs say they would expect to see an EBITDA multiple of 6.6 for an acquisition in the retail and consumer product space. According to averages from PitchBook, this multiple is down from the 2010 average of 6.8 and the 2009 average of 8.2.

► RETAILERS RAMP UP MOBILE INVESTMENT, E-COMMERCE CHANNELS

While M&A looks to be a force in 2012, retailers are eyeing growth opportunities in e-commerce and mobile channels. More than a quarter of CFOs (29%) say e-commerce and mobile commerce will be their primary objectives for growth in the next year, eclipsed only by improving merchandise assortments (39%). Despite comparison shopping apps giving consumers potentially competitive information, retailers overwhelmingly view mobile commerce as an opportunity (86%), as opposed to a threat (11%). CFOs at the top are even more optimistic. Among the CFOs at top 100 largest retailers in the sample, 100 percent expect to increase their mobile investment in the upcoming year. Overall, 54 percent of CFOs plan an increase in mobile commerce investment next year.

Retailers are also more bullish on growth from their online sales channels. Nearly half of CFOs (49%) expect more than 10 percent growth this year, up 44 percent from 2010 projections (34%). On average, retailers expect revenue from online channels to grow by 11.9 percent in 2011. With comScore reporting 12 and 14 percent increases in Q1 and Q2 e-commerce sales, respectively, 2011 has been a banner year for e-commerce growth.

“Most companies see [mobile] as a trend that is going to continue to increase and are jumping on the bandwagon to make sure their sites are well positioned to take advantage of the emerging market,” Ferrara told *Mobile Commerce Daily*.



► POTENTIAL FEDERAL TAX REFORM CAUSES CONCERN

Consumer spending is not the only challenge to retail revenue in the next year. Given Washington’s increasingly heated budget rhetoric, it’s not a surprise that the majority (58%) of CFOs say they are most concerned about a federal income tax aspect of a tax reform bill. CFOs also note concern over potential employee related tax (19%) and state income tax (11%) reforms. More than 20 states are currently affected by Internet sales tax laws, but just 12 percent of CFOs cite Internet sales tax issues as their greatest tax reform worry. Most (63%) do not expect Internet sales tax legislation to have a meaningful impact on their business.

► ASIA MARKETS IMPROVING THE MOST FOR SOURCING OPPORTUNITIES

Similar to 2010, CFOs point to Asia as the region improving most in terms of sourcing (58%), even in the face of natural disasters and economic concerns. South America’s economy, led by Brazil, received increased attention this year. Sixteen percent of CFOs name it as the region with the most improved sourcing opportunities, a significant jump from 2010 (5%). Improvements in North America (13%), Europe (8%), Central America (3%) and Africa (1%) sourcing were also cited.

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ABOUT THE RETAIL AND CONSUMER PRODUCT PRACTICE AT BDO USA, LLP

BDO has been a valued business advisor to retail and consumer product companies for over 100 years. The firm works with a wide variety of retail clients, ranging from multinational Fortune 500 corporations to more entrepreneurial businesses, on myriad accounting, tax and other financial issues.

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