2012 BDO USA, LLP
RETAIL COMPASS SURVEY OF CFOs

HEATED POLITICAL & ECONOMIC CLIMATE MODERATES RETAILERS' YEAR-END OUTLOOK

AMID GREAT UNCERTAINTY, RETAILERS ARE APPROACHING YEAR-END RESULTS WITH TEMPERED OPTIMISM.

Stores had a strong start after a better-than-expected 2011 holiday season but then struggled through several months of low consumer confidence and spending levels. After moderate sales dips in the spring and summer, retailers saw strong back-to-school season results before September sales cooled again. With the fourth quarter heralding a highly anticipated presidential election and the crucial holiday shopping season, questions abound about how retailers will fare.

Despite an inconsistent year in the retail industry thus far, the results of our sixth annual ***Retail Compass Survey of CFOs*** found that CFOs expect a 4.5 percent increase in total 2012 sales. This forecast shows improving confidence when compared with sales projections for 2011 (+3 percent) and 2010 (+2 percent), but in recent years retailers have been relatively guarded in year-end expectations. Last year, total retail sales exceeded expectations and increased 7.3 percent, according to the Commerce Department.

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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 11 percent of the top 100 based on annual sales revenue. The sixth annual survey was conducted in August and September of 2012.

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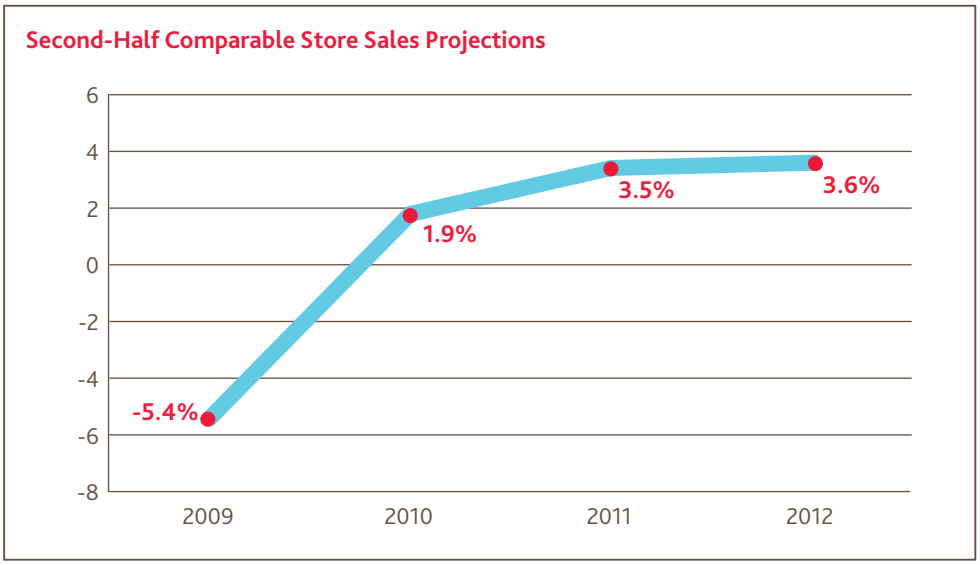
"Retailers aren't counting their dollars just yet. Forecasts are cautious as retailers closely watch unemployment, election results and inventory levels—any of which could throw a wrench in holiday results," Doug Hart, partner in the Retail and Consumer Products Practice at BDO USA LLP, told the *Wall Street Journal*.



▶RETAILERS EXPECT STABLE SECOND-HALF SALES

Looking at the back half of the year, retailers anticipate solid sales results for their stores open a year or more. With signs pointing toward a strong finish to the third quarter, nearly half of CFOs (48 percent) forecast an average increase of 3.6 percent in comparable store sales for the second half of 2012, which includes holiday results. This is consistent with 2011 projections (3.5 percent), and also aligns with expectations from major industry associations. The National Retail Federation (NRF) predicts a 4.1 percent increase in 2012 holiday sales, while ShopperTrak's estimates are slightly less optimistic at 3.3 percent.

▶ONLINE SALES CONTINUE TO CLIMB

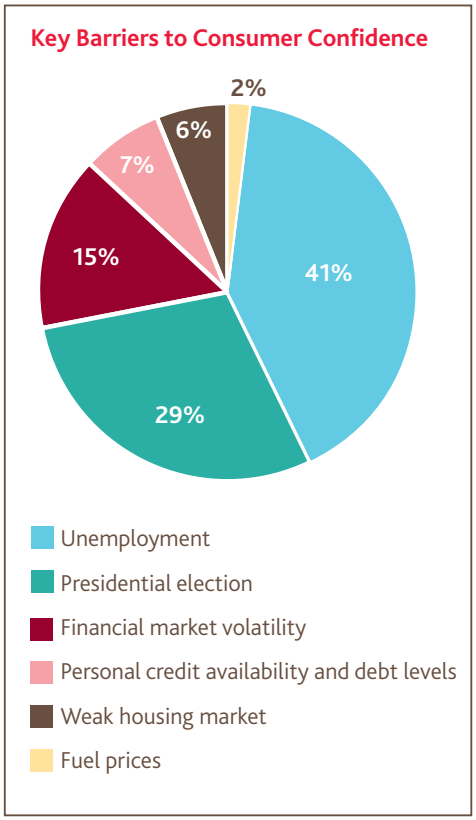
As retailers continue to adjust to omni-channel platforms, there is still plenty of room for growth online. Following exceptional online sales results in 2011, including 10 days that saw over $1 billion in e-commerce sales (according to comScore), the majority (51 percent) of CFOs say their companies' online sales will grow by 5 to 10 percent in 2012. On average, the retailers surveyed expect a 5.9 percent increase in total 2012 online sales. While the prediction is conservative compared with last year's expectation of an 11.9 percent increase, it comes on top of the $194.3 billion in e-commerce sales reported by the Commerce Department in 2011.

Looking at the holiday season specifically, CFOs expect holiday shoppers will again take advantage of online exclusives, promotions and free shipping options. Retailers expect an increase of 4.6 percent in holiday-specific online sales.

▶CFOs' ECONOMIC OUTLOOK IMPROVES, BUT UNEMPLOYMENT REMAINS A CONCERN

Positive year-end forecasts are echoed by growing confidence in the overall economic picture. While a majority (57 percent) expect to see a continuation of stagnant economic conditions in the near future, the number of CFOs forecasting an ongoing economic turnaround nearly tripled this year (32 percent, up from 11 percent in 2011).

Views on the economic picture may be improving, but unemployment levels continue to trouble the industry. When asked which economic challenge has had the greatest impact on consumer confidence so far this year, 60 percent of CFOs cite unemployment. Amid fluctuating jobless claims and an unemployment rate that just fell below 8 percent for the first time since 2009, it is no surprise that 41 percent of retailers say unemployment will have the most impact on consumer confidence during the remainder of 2012. However, with unemployment levels finally dipping below the 8 percent threshold for the first time since the beginning of the recession, there may be room for cautious optimism. Retailers also say financial market volatility (15 percent), personal credit availability and debt levels (7 percent), a weak housing market (6 percent) and fuel prices (2 percent) will be top influencers of consumer confidence in the remainder of 2012.



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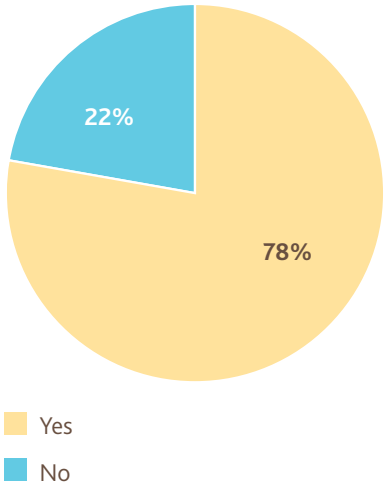
▶POTENTIAL TAX REFORMS LOOM LARGE AHEAD OF PRESIDENTIAL ELECTION

With the most important shopping period of the year coming on the heels of November's election, retailers will be monitoring the race closely. As Election Day draws near, 29 percent of CFOs point to the presidential race as the top influencer of consumer confidence. The vast majority (78 percent) of CFOs also say that they are concerned about potential tax reforms as a result of the election. When asked what aspects of a potential tax reform bill concern them the most, the majority (58 percent) of CFOs cite federal income tax. This is followed by employee-related tax (22 percent), internet sales tax (9 percent) and state income tax (9 percent). CFOs' responses align with retailer tax concerns in 2011, when 58 percent of CFOs also identified federal income tax as a top tax reform challenge.

However, retailers in the top 100 by revenue have a different set of tax worries. Fewer CFOs in the top 100 (36 percent) cite federal income tax as their top concern. Instead, the largest retailers are divided over state income tax (27 percent) and internet sales tax (27 percent) as the greatest potential tax threat. When it comes to internet-specific legislation, this marks a considerable increase over 2011 when just 10 percent of retailers in the top 100 cited internet sales tax as a major concern.

"Retailers have been watching the online sales tax fight in California closely," says Randy Frischer, tax partner in the Retail and Consumer Products Practice at BDO USA, LLP. "As businesses continue to expand their online strategies, potential changes to internet sales tax collection are a growing risk."

Are CFOs Concerned About Tax Reforms as a Result of the 2012 Presidential Election?



▶MOBILE REMAINS KEY TO HOLIDAY SALES AS INVESTMENTS HOLD STEADY

Following a banner year for mobile traffic and sales in 2011, mobile sales as a percentage of total online sales hit 16 percent this summer, according to IBM. As a result, consumers can expect another year of heavy mobile engagement through apps, mobile coupons and texts this holiday season. The majority of CFOs (77 percent) report that they have maintained their investment in mobile commerce for the 2012 holiday season. Another 19 percent of retailers will increase their mobile investment this year to capitalize on or catch up to the growth in mobile commerce.

▶RETAILERS SEEM UNDAUNTED BY SHOWROOMING

Despite the uptick in mobile usage and sales, most retailers are not concerned about the practice of showrooming, where consumers browse in brick-and-mortar stores and then buy online at discounted prices. Showrooming has made headlines in the hardlines space, but most retailers are not letting the practice throw them off course. When asked if they view showrooming as a threat to their business, the overwhelming majority (88 percent) of CFOs say no.

Widespread confidence aside, retailers are employing a variety of strategies to keep shoppers in their stores. When asked about their primary strategy for countering showrooming, 25 percent of CFOs say they are improving their customer service model, and another 25 percent report expanded options for in-store pickups and returns for online purchases. As the CEO of Toys"R"Us noted on CNBC, in-store pickups and returns are a key tactic this year to improve the shopping experience for customers during the holidays and one of the reasons they are hiring more seasonal workers. Other methods to counter showrooming include product exclusivity (17 percent) and price-matching with online retailers (17 percent).

"Showrooming is not a fad or something that is just cool to do for the moment and will pass," Stephen Wyss, partner in the Retail and Consumer Products Practice at BDO USA, LLP, told *Reuters*. "It's a real indicator of consumer behavior, and how consumers are going to continue to behave, using technology, to maximize their savings and the efficiency of their shopping."

▶INVENTORY LEVELS STEADY FOR HOLIDAYS

Although sales expectations are positive, a majority (55 percent) of CFOs say they have maintained their inventory levels for the 2012 holiday season. One-in-four say they have increased their inventory, but on average, CFOs project a flat increase of 1.1 percent over 2011 levels. Retailers remain divided about whether too much or insufficient inventory is the bigger risk to their holiday sales. Amid pressures to avoid heavy discounting and preserve margins, 58 percent of retailers say too much inventory is the greatest risk, a change from 2011 when a majority (53 percent) cited insufficient inventory as the bigger risk.

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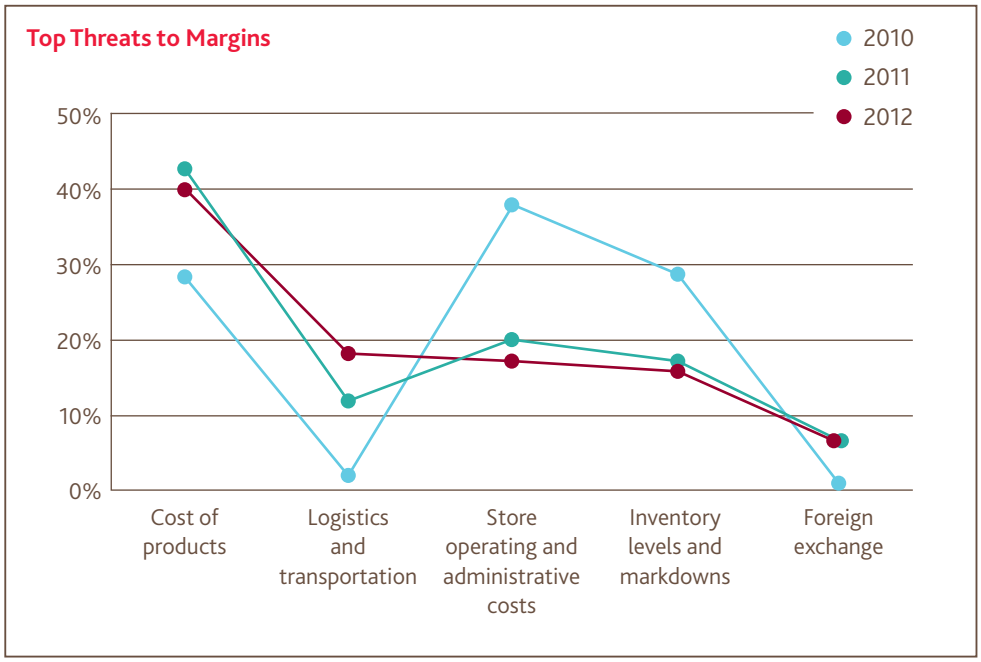
"Retailers still remember the lessons from 2008 when a glut of inventory led to deep discounts," Hart told *MarketWatch*. "They are still cautious on inventory."



▶COST OF PRODUCTS REMAINS TOP THREAT TO MARGINS

Inventory levels, however, are not the greatest threat to margins for most retailers in the remainder of 2012. Instead, the cost of products tops the list, with 40 percent of retail CFOs noting it as the primary threat. CFOs also cite logistics and transportation and store operating costs in addition to inventory levels and markdowns. Among CFOs at the 100 largest retailers, however, 36 percent say inventory levels and markdowns are the top threat to margins, up from 25 percent in 2011.

"Commodity costs may have stabilized, but price-conscious consumers are keeping retailers on their toes," Al Ferrara, partner and national director of the Retail and Consumer Product Practice at BDO USA, LLP told *MarketWatch*. "This winter, meticulous inventory selection and promotion decisions will take center stage in the competition for holiday shoppers."

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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