2013 BDO USA, LLP
RETAIL COMPASS SURVEY OF CFOs

RETAILERS REMAIN CAUTIOUS, BUT GREEN LIGHT OMNICHANNEL INVESTMENTS

THERE IS ONE WORD TO DESCRIBE RECENT ECONOMIC NEWS: MIXED.

Sales results and consumer confidence are uneven following the expiration of the payroll tax holiday, higher gas prices and delays in tax refunds, and while the housing market continues to improve, the jobs picture has been slow to rebound. In this environment, retail executives are naturally approaching the year with caution, but they are also busy making investments in their company and others to meet growing demand for an omnichannel experience.

In January, we polled 100 retail chief financial officers for our annual ***Retail Compass Survey of CFOs***, and we found that CFOs see a promising year for deal flow and capital investment across channels. Amid lingering questions about the state of the consumer, CFOs project a 3.2 percent increase in total store sales, down from last year's expected 4.5 percent increase, but in line with projections released by the National Retail Federation. Similarly, they anticipate a 2.3 percent increase in comparable store sales this year, down from last year's projected 4.1 percent growth.

While concerns over consumer confidence are likely driving these more conservative projections, the increase comes on top of 2012's strong 4.2 percent growth. Moreover, only seven percent of CFOs say they expect their total sales to decrease this year, a sign that retailers see the industry stabilizing.

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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. The seventh annual survey was conducted in January of 2013.

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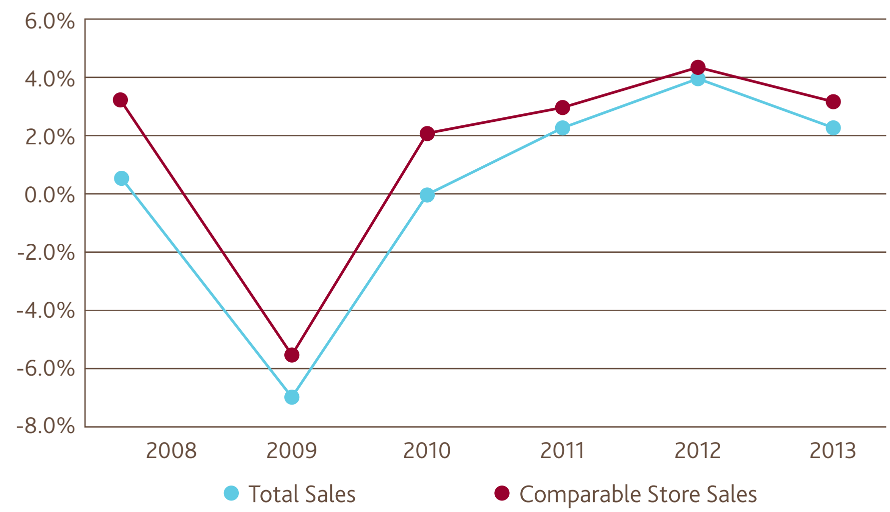
"Retailers had to decode a slew of mixed sales and economic results at the beginning of the year," said Doug Hart, partner in the Retail and Consumer Products practice at BDO. "But with February's sales numbers coming in brighter than expected, retailers no longer fear the worst-case scenario. As housing markets and other influencers of consumer confidence improve, there's positive momentum in the industry."

Comparable Store and Total Sales Forecasts



▶MORE MOMENTUM AROUND ONLINE SALES

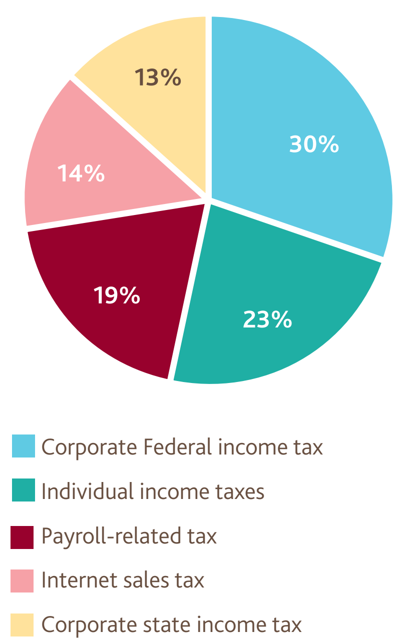
Online sales had a banner year in 2012, and CFOs expect that momentum to continue. Nearly three in four CFOs (74 percent) expect their e-commerce sales to increase this year, and on average, retailers expect online sales to increase 6.9 percent in 2013. Just as stores integrate their brand experience across channels, they are also beginning to integrate online sales into their broader sales accounting practices to develop a more accurate picture of their performance. Two-thirds (66 percent) of CFOs say they include online sales in their comparable store sales reports.

▶CONSUMER CONFIDENCE REMAINS UNSTABLE AS ECONOMIC & TAX CONCERNS PERSIST

Consumer confidence fluctuated substantially over the course of 2012, and started 2013 at a one-year low. With consumers watching the ongoing deficit and debt conversation unfold in Washington and seeing little substantial job growth, they are feeling the fragility of economic recovery. While affluent consumers are better-equipped to offset those headwinds, it's putting significant pressure on lower income consumers. Retail executives are all too aware of the tenuous economic situation and are carefully watching the leading influencers of consumer confidence: 40 percent see unemployment levels as the top factor influencing consumer confidence, while 24 percent and 18 percent cite tax increases and personal credit availability, respectively. And although the fiscal cliff debate was ostensibly resolved at the beginning of the year, retailers express concern that changes to individual taxes will further stretch consumers' budgets. When asked which tax changes concern them most in the coming year, 23 percent of CFOs cite individual income taxes, second only to corporate taxes (30 percent).

"Retailers have already observed increased consumer anxiety due to the expiration of the payroll tax holiday at the beginning of the year," said Randy Frischer, tax partner in the Retail and Consumer Products Practice at BDO. "The national tax debate is not over, and retailers know that customers may have less money to spend this year than last."

CFOs' Primary Tax Concerns



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▸RETAIL IS A BRIGHT SPOT FOR DEAL-MAKING

The retail industry is poised for another year of heavy deal flow as steadier markets, renewed interest in international growth and the desire for omnichannel capabilities fuel an investment rebound. In fact, nearly all retail CFOs (94 percent) expect merger and acquisition (M&A) activity to increase or remain steady in 2013. And CFOs' bullish forecasts follow $324.6 billion in global retail and consumer M&A activity in 2012, which was up 33 percent over 2011 and the busiest year since 2007, according to Dealogic. A majority of CFOs (68 percent) expect U.S. markets to see the most deal volume, followed by the Asia-Pacific market (20 percent) and Latin America market (7 percent).

"We're seeing more appetite for e-commerce deals," said Al Ferrara, partner and national director of the Retail and Consumer Products practice at BDO. "Many retailers feel that they don't have the time or resources to develop new technologies internally, so they're looking outside for companies who can enhance their brand experience across channels."

While deal flow in 2012 was driven by both financial and strategic buyers, CFOs are more bullish on strategic deals in 2013. As retailers prepare to grow omnichannel capabilities and reach new markets overseas through acquisitions, 59 percent of CFOs say strategic buyers will be the primary driver of M&A activity. Still, private equity has been playing an important role, fueling many restaurant deals in particular, and 41 percent of CFOs say financial buyers will be the biggest driver of deals this year. CFOs expect to see an EBITDA (earnings before interest, taxes, depreciation and amortization) multiple of 5.2 on average for an acquisition in the retail and consumer products space.

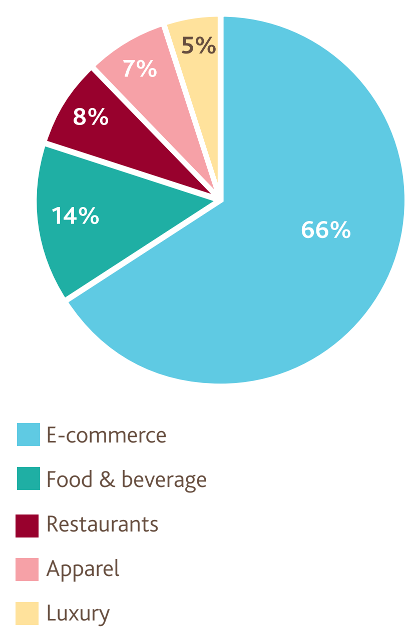
"Private equity investments in the retail and consumer products sector have waned in recent years as retailers worked to navigate the ebb and flow of consumer spending," said Lee Duran, partner and Private Equity practice leader at BDO. "Still, many private equity funds continue to find compelling investment opportunities in the sector, providing capital to companies with strong value propositions to fuel their expansion into new merchandising channels and markets overseas."

▸RETAIL IPOs CLIMBING, E-COMMERCE LEADING THE WAY

Retail CFOs also forecast robust IPO activity in 2013. Following 13 U.S. retail public offerings in 2012 (according to Intrepid Investment Bankers), a vast majority of CFOs (83 percent) expect to see more or about the same number of retail IPOs this year. When asked what the biggest driver of a company's ability to go public in 2013 is, CFOs point to the strength of the U.S. economy and stock market (42 percent), as well as strength of brand (24 percent) as top factors.

Despite a handful of lackluster IPOs in 2012, there is significant interest in the e-commerce sector. Two-thirds of retail CFOs think e-commerce will see the most IPO activity in 2013, and a few companies have already taken strides to go public this year by hiring experienced executives and focusing on profitability and predictability of financials. Outside of e-commerce, successful IPOs from Bloomin' Brands, Chuy's and Del Frisco's last year are likely influencing the 22 percent of retail CFOs who expect the food & beverage and restaurant categories to see the most IPOs in 2013.

Which Sectors Will See the Most IPO Activity?



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▶U.S. EXPANSION REMAINS A KEY STRATEGY, CREATES JOBS

Canada has been a hot spot for expansion for retailers like Target, Wal-Mart and Lowe's. But despite the headlines around entry into international markets, U.S. expansion remains a key growth strategy in the retail industry. When asked about their primary growth strategy for 2013, U.S. expansion was the top choice, cited by 30 percent of CFOs. Expanding retailers like Apple and H&M will continue to look for Class-A store locations in high-traffic spots to afford better access and convenience for customers. Several online brands are also introducing storefronts for the first time as they look to appeal to shoppers who want to see and try on merchandise in person. In addition to store expansion, CFOs also say improving merchandise assortment (24 percent) and e-commerce and mobile commerce (22 percent) will be top growth tactics this year.

"The retail storefront isn't going anywhere just yet," said Ted Vaughan, partner in the Retail and Consumer Products practice at BDO USA, LLP. "The opportunities abroad and online are clear, but retail executives still believe that U.S. stores are a core part of the business."

Amid plans to open new stores, fine-tune merchandise and expand online channels, many retailers will be looking to add staff in stores and their corporate offices. According to the NRF, the retail industry already supports one in four U.S. jobs, and over one-third of CFOs (34 percent) say the number of employees at their company will increase this year. Another 57 percent say the number of employees will stay about the same.

▶RETAILERS' INVESTMENTS ARE PROOF OF OMNICHANNEL PUSH

As more and more shopping is done online, retailers want to ensure they have a modern, attractive and integrated e-commerce and store presence. As a result, when asked where they plan to invest the most capital this year, CFOs are split. While 32 percent say overall advertising and promotions will be their biggest investment, it's clear they will be looking to entice consumers both online and in-stores. Twenty-nine percent of CFOs say they will invest the most capital in their e-commerce channel, and 26 percent say redesigning/remodeling stores will be their top investment.

Mobile is increasingly becoming table stakes in retail operations. Consumers can expect to see ongoing engagement via the channel, with 60 percent of retailers planning to maintain their investment in mobile for 2013 and 38 percent planning to increase it. Retailers continue to tinker with ways to integrate mobile and create an omnichannel shopping experience, ranging from installing mobile technologies in their stores (such as in-store GPS and similar apps) to developing mobile shopping apps for the proliferating number of smartphones and tablets on the market.

▶COMPENSATION ON THE RISE, BUT PERFORMANCE METRICS IMPORTANT

Attracting and retaining strong leaders is paramount to success as retailers reshape strategy and launch new initiatives. As a result, 30 percent of CFOs expect their management's compensation to increase this year, and only 5 percent forecast a decrease, despite continued scrutiny around pay packages. Still, a majority of retailers (66 percent) say their companies' leaders have an incentive plan to tie pay to performance, and 71 percent say that a profitability-based metric is the primary measure.

▶SALES AND EBITDA ARE PRIORITY FINANCIAL METRICS

Sales results are the most common way that shareholders, investors and the industry measure a retailer's performance, so it is no surprise that 53 percent of retail CFOs say sales are their primary financial metric. Over one-third (35 percent) say they are most focused on gross sales and 18 percent say they are most focused on comparable store sales. Another 33 percent say they are most focused on EBITDA, a leading indicator of recurring cash flows. Although sales metrics are often looked to first, margins are a key metric in assessing a retailer's performance, especially in a challenging economic climate. Margin deterioration can be indicative of poor performance even as sales remain healthy.

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"As companies try to recruit and retain top leaders, compensation will likely grow through more leveraged opportunities," said Randy Ramirez, senior director with the Compensation and Benefits practice at BDO USA, LLP. "A number of retail companies are either going very narrow in their market approach, or are opting for a broad market approach, and they're doing it with an incredible sense of urgency to capture evolving consumer preferences. Pay-for-performance plans easily reinforce company goals and let leaders feel confident in their business strategy."

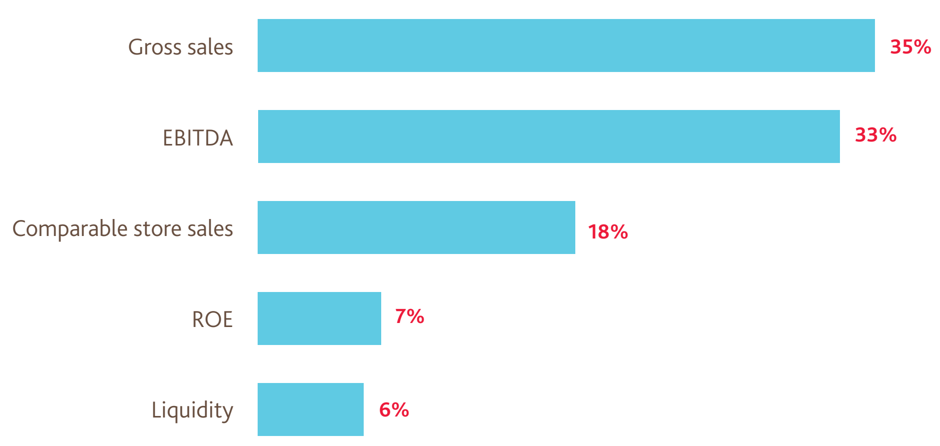
▶CFOs ARE FAIRLY OPTIMISTIC ON CREDIT MARKETS

Retailers looking to refinance debt in order to lower interest expense may have better luck finding financing at attractive rates this year. A majority of CFOs (55 percent) feel that there is sufficient capacity and appetite in the credit markets and say they expect it will be not challenging (19 percent) or only slightly challenging (36 percent) for retail and consumer product companies to refinance debt in 2013. Still, 19 percent expect it will be very challenging, a sign that some retailers may have greater access than others depending in part on their 2012 results.

▶REGULATION AND INDUSTRY COMPETITION AMONG TOP RISKS

Amid potential tax increases, spending cuts and ongoing fiscal policy debates, it's no surprise that a plurality of CFOs (34 percent) cite federal, state and local regulations as the top risk to their business in the next year. In addition, 32 percent of CFOs say competition and consolidation is their most concerning risk as they look to differentiate offerings and attract consumers in a crowded marketplace.

Priority Financial Metrics



Retailers also point to U.S. and foreign supplier and vendor issues (16 percent), data breaches (12 percent) and geopolitical events and natural disasters (6 percent) as top risks in the year ahead.

▶HOLIDAY POST-MORTEM REVEALS CONCERN OVER LOW-MARGIN SALES

As the New Year began, retail executives analyzed holiday strategies to determine what worked best. In a testament to the growing importance of omnichannel retailing, some of the most successful campaigns in 2012, including Gap's "Pin to Win" promotion, engaged customers via online channels. One-third of CFOs cite email and social media promotions as a top strategy in 2012, and 16 percent cite free shipping.

Consumers remain very focused on deals, and promotional discounting—available across all of a retailer's channels—is still a stalwart of holiday strategy: 29 percent of CFOs indicate that it was their most successful strategy last year. When asked about the least successful tactics, on the other hand, 41 percent cite extended store hours and 22 percent note Thanksgiving weekend promotions. Despite record Thanksgiving weekend sales, retailers may be weary of competing for market share over what are often low-margin sales.

The retail industry continues to make great strides to adapt to the new normal of consumer behavior. While retail executives will still contend with economic uncertainty in 2013, they are not holding back growth plans. Expanding the breadth and depth of their sales channels and investing in new capabilities and improved merchandise will be key to acquiring consumers this year, and the retail industry seems up for the challenge.

ABOUT THE RETAIL AND CONSUMER PRODUCTS 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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