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2010 BDO USA, LLP
RETAIL COMPASS SURVEY OF CFOs
EXECUTIVE SUMMARY

WHILE THE COUNTRY THUS FAR IS FALLING SHORT OF MOST EXPECTATIONS, A REVERSAL OF THE RECESSIONARY TRENDS APPEARS TO BE UNDERWAY.

By all accounts September same store sales results were a positive surprise, quieting fears of a double dip recession and bolstering retailers' confidence as they enter the 2010 holiday season. Discounters largely reported flat sales compared to 2009 results, while specialty and department stores are showing some rebound.

Still, this doesn't mean U.S. consumers are back to their spendthrift ways. However, retailers have certainly improved their outlook and are feeling less pessimistic than last year. In fact, the Retail & Consumer Product Practice of BDO USA polled chief financial officers (CFOs) at leading U.S. retailers and found that sentiment is gradually improving, evident from better sales projections and less conservative inventory controls. Still, unemployment is the underlying factor that is inhibiting a truly bullish stance. Until the jobs situation drastically improves, retailers have modest expectations.

MAJORITY OF RETAIL CFOS DOUBT DOUBLE DIP SPECULATION

According to the *BDO USA Retail Compass Survey of CFOs*, 82 percent of chief financial officers at leading U.S. retailers anticipate a continuation of stagnant economic conditions as opposed to a double dip (9%) or an ongoing turnaround (9%). The majority (78%) of retail CFOs cite an ongoing economic turnaround as most dependent upon lower unemployment or consistent improvement in consumer confidence and spending. In contrast, CFOs believe the economic turnaround is less dependent upon a rebound in the housing market (10%) or continued rebound in the U.S. and global and financial markets (9%). Only two respondents believe the success of the

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THE BDO USA, LLP RETAIL COMPASS SURVEY 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. This edition of the survey examined the opinions of 100 CFOs at the largest retailers in the country, with revenues of more than $100 million based on annual sales revenue. The survey was conducted in August and September of 2010. This is the fourth annual survey.

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

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Retailers are looking forward to some improvement in sales this year, with CFOs expecting a 1.95 percent increase in overall sales for 2010.

Financial Reform Bill will influence an ongoing turnaround.

▶AMID A SLUGGISH CONSUMER CONFIDENCE FORECAST, UNEMPLOYMENT TO BLAME

Unemployment is still the underlying factor weighing on the economy. Seventy-six percent of CFOs cite it as the economic issue having the greatest impact on consumer confidence for the balance of 2010 (a jump from 64% in 2009). The impact of personal credit availability and debt levels (14%), the weak housing market (4%) and market volatility (4%) are also playing a role.

▶RETAILERS BANK ON CONSUMERS TO START SHOPPING, SALES OUTLOOK BRIGHTENS

CFOs expect their comparable store sales for the second half of 2010 to increase by 1.9 percent, up from the 4 percent decrease predicted in 2009. Forty-four percent of CFOs say their comparable store sales for the second half of 2010 will increase compared to the second half of 2009. Only 18 percent of CFOs say comparable store sales will decrease when comparing the second halves of 2010 and 2009. This is down from 50 percent of CFOs who cited a decrease last year when comparing the second half of 2009 to 2008.

Retailers are looking forward to some improvement in sales this year, with CFOs expecting a 1.95 percent increase in overall sales for 2010. Last year, the Census Bureau reported that total sales were down 6.2%.

Fortunately, 47 percent of CFOs anticipate their total sales revenue for 2010 will increase over 2009. Only 21 percent of CFOs project a decrease in total sales for 2010, which is a less conservative outlook than 2009 (60%).

Forty-four percent of CFOs expect their total sales revenue to increase in the second half of 2010 compared to the second half of 2009. Only 22 percent of CFOs say revenue will decrease when comparing the second halves of 2010 and 2009, which is down significantly from 2009 (49%) and 2008 (29%). Overall, 47 percent of CFOs expect their total sales revenues for all of 2010 to increase over 2009, up from just 19 percent who cited an increase last year.

▶INVENTORY TO MEASURABLY INCREASE IN 2011, DESPITE THREATENING MARGINS

While keeping a close eye on inventory, nearly half of retail CFOs (42%) plan to measurably increase inventory purchases in the first half of 2011. Others are holding off – sixteen percent are delaying planned increased inventory purchases until the second half of 2011, and 24 percent are waiting to increase inventory until 2012 or later. Only 17 percent of CFOs plan to increase their inventory levels during the 4th quarter of 2010.

CFOs are split over whether too much inventory (53%) or insufficient inventory (47%) presents a greater threat to their holiday sales. A delicate balance seems to be the key to success this holiday season as retailers prefer to repeat their lean inventory levels of 2009 rather than the excess holiday inventories and markdowns of 2008. This is likely why the majority (58%) of CFOs are focusing on strict inventory management and selective merchandising this year to keep costs down.

For the remainder of 2010, retail CFOs cite store operating and administrative costs (38%) as the greatest threat to their margins, followed by inventory levels and markdowns (29%), and costs of products and sourcing (28%). Despite operating cost concerns, few see delayed expansion (22%), layoffs (11%), lease renegotiations (7%) or store closings (1%) as a top priority to reduce expenses.

▶ADDITIONAL FINDINGS OF THE BDO USA RETAIL COMPASS SURVEY OF CFOS INCLUDE:

E-Commerce Expected to Grow. For the 53 percent of retailers with an online store, the popularity of comparison shopping seems to be creating a boon for online sales. A whopping 83 percent of CFOs anticipate their online sales channel will grow in 2010 compared to 2009. Many CFOs (38%) point toward an expected growth of 5 to 10 percent, and 34 percent point to an optimistic growth projection of more than 10 percent.

Mixed Assessment of Stimulus Package Provisions. The two-year anniversary of the Economic Stimulus Act is approaching, yet retail CFOs are still torn about which provisions have been helpful for their business. So far, the consumer tax incentives/Make Work Pay are having the biggest impact (40%) followed by corporate tax incentives (25%),

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bonus depreciation (22%) and increased deduction limits for asset write-offs (15%).

Retail M&A Activity to Rise. Despite a tepid outlook, almost all CFOs (94%) anticipate that merger and acquisition activity in the retail sector will increase or stay about the same during the next year or so as low interest rates and a favorable corporate debt climate remain. Recent transactions like investment firm Bain Capital's acquisition of Gymboree and recent claims by the World Retail Congress that retailers must consolidate to spur growth show this forecast is proving to be true. Seventy-six percent of CFOs expect retail M&A to take place in the United States market as opposed to Asia-Pacific (17%) or Europe markets (7%).

Asia Market Improving Despite China Sourcing Issues. When asked which one region CFOs will look to do business with in the future, Asia (39%) and Southeast Asia (24%) still lead the pack; as Vietnam, Indonesia, Cambodia and Bangladesh continue to gain popularity as apparel sourcing countries. North America (11%), Europe (7%), Central America (6%), South America (5%) and Africa (2%) follow. Interestingly CFOs, who do business in China, (24%) say their company has taken actions to reduce exposure to Chinese sourcing in the past year. Inflation remains a threat for Chinese suppliers and retailers question their ability to absorb costs and maintain profit margins. Therefore CFOs with exposure to China have taken action to reduce Chinese sourcing this past year (24%).

Retailers Commit to Going Green. According to The National Academy of Sciences' recent global survey of 1,400 climate researchers, ninety-seven percent of respondents believe we are causing global warming. Perhaps retailers agree - 70 percent of CFOs say they are involved in green practices. In fact, retailers are taking a number of steps to reduce their carbon footprints including recycling (70%), using less paper (64%), and reducing electricity in: stores (43%), offices/other facilities (38%) and distribution centers (26%).

Taking Advantage of Green Tax Incentives. Retailers are also taking advantage of green tax incentives, as "going green" becomes more beneficial to the bottom line. CFOs said they are taking advantage of the following green tax incentives: energy efficient lighting (88%), energy efficient heating/cooling systems (35%), energy efficient building insulation (19%), state and local green incentives (19%) and energy efficient commercial building deductions on new buildings (12%).