

Consumer Business Compass

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The Newsletter of the BDO Seidman
Retail and Consumer Product Practice

The Big Picture

Retail CFOs Cite Shifting Concerns Amid Volatile Economic Forces



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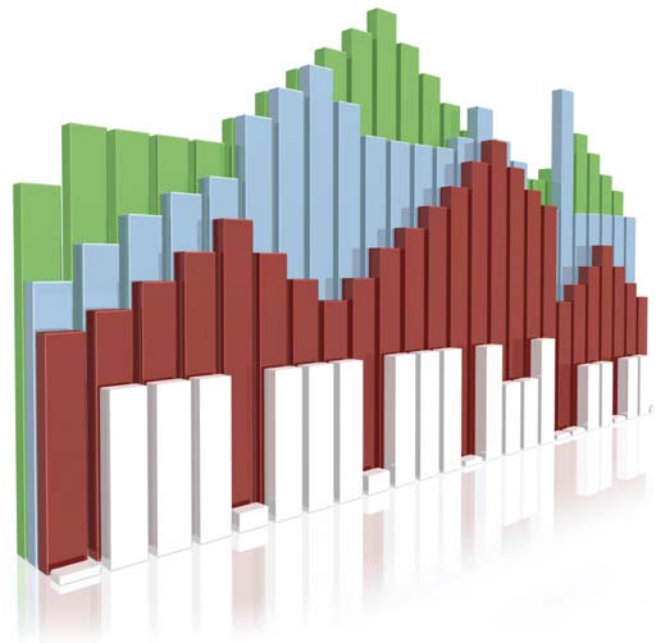
The continued decline of the housing market, increasing concern with credit markets and weak job reports have begun to bring the dreaded R-word to the tongues of our nation's economists. While any talk of recession would be premature at this time, the aforementioned realities combined with recent earnings warnings from major retailers, such as Target and Lowes, would seem to be a major cause of concern for the retail industry.

A recent study by BDO Seidman, LLP, of chief financial officers (CFOs) at leading U.S. retailers showed a shift in how these concerns are perceived in the industry.

Shifting Consumer Confidence Concerns

Close to half (47%) of the CFOs cited high fuel costs as the issue having the greatest impact on consumer confidence in the first half of 2007. However, looking forward to the balance of the year, there was less agreement among the CFOs on the main issue that will impact consumer confidence. High fuel costs (29%) and the weak housing market (25%) were cited by at least one-quarter of these executives, while interest rates (19%) and the sub-prime lending crisis (15%) were also mentioned by a number of CFOs.

When you consider that high fuel prices have been with us for some time now, the shift in concern towards issues such as interest rates and the sub-prime lending crisis seems to indicate a



growing anxiety about a potential credit crunch for consumers. Given the existing concern with the weak housing market – remember many consumers borrow based on the value of their homes – and the recent volatility in the stock market, discretionary income may dry up and that could have a negative impact on the retail sector as we move into the critical holiday shopping season. Overall, the retail CFOs predicted 5.6 percent growth in 2007.

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Managing Risk

Recent news coverage of food and toy safety issues related to Chinese suppliers, as well as widely publicized data breaches that have occurred at some retailers, have also heightened risk management concerns for the retail industry. According to the BDO Seidman study, 61 percent of the retail CFOs state that they have increased their level of investment in cyber security to combat potential data problems and almost three-quarters (74%) of the top 100 retailers have increased their investment in this area. By comparison, close to one-third (32%) of the CFOs say their company has increased the level of personnel and financial resources they devote to risk management for supplier and vendor activities. Since only a percentage of retailers use Chinese suppliers, but virtually every retailer must deal with electronic data security, it makes sense that more CFOs are reporting increased investments to curb cyber breaches compared to supply chain security.

These findings are from the most recent edition of the **BDO Seidman Retail Compass Survey**, which examined the opinions of 140 chief financial officers at leading retailers located throughout the country. The retailers in the study were among the largest in the country, with revenues of more than \$100 million, including 23 percent of the top 100 based on annual sales revenue.

Some of the major findings of BDO Seidman Retail Compass Survey of CFOs:

- **Same Store Sales Lag Overall Growth.** A slight majority of the retail CFOs (56%) reported an increase in sales revenue over 2006 during the first six months of this year. However, when considering only comparable store sales the percentage of retailers reporting an increase dropped to less than half (45%). Less

than a fifth (18%) of the CFOs reported a decrease in revenues in the first half of the year, with 22 percent reporting a drop in comparable store sales.

- **Rose Colored Glasses?** Looking forward, a majority (71%) of the retailers anticipate total 2007 sales revenue to increase from 2006, with only 11 percent predicting a decrease. Overall, the CFOs estimated average revenue growth of 5.6 percent for 2007.
- **Top 100 Retailers.** The largest retailers have had the most positive results this year, with more than two-thirds (83%) of the CFOs at the top 100 retailers surveyed reporting increased sales in the

percentage of mentions (21%) among the balance of the retailers surveyed.

- **Most Retailers Stay Close to Home.** Less than a fifth (18%) of these leading retailers have stores or sales outside of the United States. However, close to half (45%) of the top 100 retailers report international sales.
- **Internet Fastest Growing Sales Channel.** Internet sales account for only 8 percent of annual revenue among leading retailers and only 3 percent among top 100 retailers according to the CFOs. However, in terms of growth, almost half (49%) of the retailers cited the Internet as their fastest growing sales channel. One-third

The BDO Seidman Retail Compass Survey, examined the opinions of 140 chief financial officers at leading retailers located throughout the country.

initial six months of 2007. These executives were equally confident (83%) regarding growth for the full year; however the estimated growth rate for the top 100 retailers (4.6%) was a full point below all retailers.

- **Weak Housing Concern of Largest Retailers.** Among the financial officers at the top 100 retailers, almost half (45%) pointed to the weak housing market as the primary issue to impact consumer confidence during the remainder of the year, which is more than double the

(33%) of the top 100 CFOs view the Internet as their fastest growing channel.

- **FIN 48 Headache!** More than three-quarters (78%) of the retail CFOs feel FIN 48, a new accounting rule that requires companies to take a more stringent approach to reporting uncertain income tax positions, has increased the difficulty of their financial reporting function. The impact was even greater among the CFOs at the top 100 retailers. Eighty-six percent of these largest retailers cited increased difficulty in reporting finan-

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CFOs Cite Shifting Concerns

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cially due to FIN 48, with 29 percent describing the level of difficulty as “high.”

- **Size Matters.** When asked what specific reporting areas present the most challenge under the new FIN 48 requirements, almost half (49%) of the retail CFOs cite accounting methods for inventory capitalization and revenue. More than one-third (38%) cite state-local and Internet tax issues and 13 percent mention international tax issues. However, for CFOs at the top 100 retailers, a majority (53%) identify state-local and Internet issues as the most challenging aspect of the FIN 48 reporting.
- **Pay Disclosure Has Little Impact on Retail.** Less than a fifth (19%) of the CFOs report that the new focus on executive pay and stock-based compensation disclosure in financial statements has impacted their company’s compensation practices.
- **Minimum Wage Has Minimum Impact.** While a majority (62%) of the CFOs indicated the increase in the minimum wage over the next two years will impact their labor costs, only 9 percent described the impact as substantial. More interesting, is the finding that better than a third (38%) of the retailers felt the increase in the minimum wage will have no impact at all on their labor costs.

The **BDO Seidman Retail Compass Survey** is a national telephone survey conducted by Market Measurement, Inc., an independent market research consulting firm, whose executive interviewers spoke directly to chief financial officers, using a telephone survey conducted within a scientifically developed, pure random sample of the nation’s largest retailers (with revenues ranging from over \$100 million to billions of dollars).

U.S. Retailers “Going Green”

According to the BDO Seidman Retail Compass Survey, two-thirds of chief financial officers (CFOs) at leading U.S. retailers say their company is actively involved with “green” or environmentally friendly practices, and 44 percent of those indicate they have increased their investments in these practices during the past two years. Among the top 100 largest retailers, 83 percent are involved in green practices and a majority of those (62%) have increased their green investments during the past two years.

Among those retailers involved with green practices, more than a third (34%) are pursuing internal activities (environmentally modifying operations and structures) exclusively; while 9 percent are focused solely on external practices (selling green products). A majority (57%) of these retailers are pursuing a combination of both external and internal green practices. When asked to identify the greatest motivator for their company to pursue environmentally friendly practices, two-thirds of the CFOs cited the company’s corporate image (54% cited “image among consumers” and 13% cited “image among shareholders”). Tax breaks or tax incentives was the greatest “green” motivator among 15 percent of the CFOs, followed by 10 percent citing city/state or zoning regulations.

“Retailers are focused on the importance of implementing environmentally friendly and energy efficient business strategies, commonly referred to as going green,” said Catherine Fox-Simpson, a Partner in the Retail and Consumer Product Practice at BDO Seidman, LLP. “These businesses reap a two-fold benefit from pursuing green practices—consumer appeal and substantial tax breaks.”

Any retail or consumer product businesses seeking assistance on tax matters related to “green” practices can contact Catherine M. Fox-Simpson at cfox@bdo.com.

Mark Your Calendars...

The following is a list of upcoming conferences, seminars and data announcements from the leading retail associations and business bureaus:

October 2007

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| October 14-17 | FMI Risk, Insurance and Safety Management Conference
Westin City Center
Dallas, TX |
| October 15-17 | ICSC Fall Conference
Hilton New Orleans Riverside
New Orleans, LA |
| October 18-19 | NRF Financial Executives Council Meeting
Omni Hotel
San Diego, CA |
| October 21-23 | FMI Retail Store Development Conference
Renaissance Harborplace Hotel
Baltimore, MD |
| October 22-24 | ICSC Southeast Conference
Georgia World Congress Center
Atlanta, GA |
| October 24 | Retail Advertising and Marketing Association Toronto Regional Event
Ryerson University
Toronto, ON |
| October 25 | Argyle Executive Forum's 2007 Leadership in Retail Forum
New York, NY |

November 2007

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| November 7-9 | National Association of Convenience Stores Show
Georgia World Congress Center
Atlanta, GA |
| November 11-13 | Private Label Trade Show
Rosemont Convention Center
Chicago, IL |
| November 13-14 | ICSC Mixed-Use Conference
Paris Las Vegas
Las Vegas, NV |
| November 13-15 | BAI Retail Delivery Conference and Expo
Mandalay Bay Resort and Casino
Las Vegas, NV |
| November 15-16 | Consumer Data Security
Green Valley Ranch Resort & Spa
Las Vegas, NV |

December 2007

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| December 5-7 | ICSC Centerbuild Conference
Arizona Biltmore
Phoenix, AZ |
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BDO Seidman Retail & Consumer Product Practice

BDO Seidman, LLP has been a valued business advisor to retail and consumer product companies for almost 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.

For more information on BDO Seidman's service offerings to this industry vertical, please contact one of the regional service leaders below:

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