

2014 BDO USA, LLP RETAIL COMPASS SURVEY OF CMOs



RETAILERS EAGERLY USHER IN EARLIEST HOLIDAY SEASON ON RECORD

Consumers could hardly catch their breath this year, as black and orange abruptly changed to red and green the day after Halloween. After three lackluster quarters of growth this year, retailers nonetheless emerged optimistic, rushing into the holiday season earlier than ever in order to capitalize on their cheerier-than-expected performance outlook.

Ahead of this early push, our ninth annual *Retail Compass Survey of CMOs* polled 100 chief marketing officers at leading retailers to gauge their sentiments on holiday sales, promotions and strategies to entice consumers and beat out competition. As the broader economy slowly improves, unemployment continues to edge downward and consumer confidence has risen to pre-recession levels, we found that retailers remain resilient as they tinker with promotional

strategies across channels to lure shoppers wherever they may be.

► MERRIER SALES PROJECTIONS

Despite slow sales gains throughout much of this year, CMOs still forecast a healthy 4.1 percent increase in total holiday store sales, which falls directly in line with the National Retail Federation's 4.1 percent expected increase, and is a full percentage point higher than actual retail sales gains in the 2013 season. Overall, a majority (65 percent) of retailers believe sales will increase this year, with only 12 percent expecting a sales decrease.

With residual hype around the latest iPhone release, new smart watches and a number of other new mobile tech devices, retail CMOs once again expect consumer

THE BDO RETAIL COMPASS SURVEY OF CMOs is a national telephone survey conducted by Market Measurement, Inc., an independent market research consulting firm, whose executive interviewers spoke directly with chief marketing 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 ninth annual survey was conducted in September and October of 2014.

For more information on BDO USA's service offerings to this industry, please contact one of the following regional practice leaders:

CONTACT:

DAVID BERLINER, New York
212-885-8347 / dberliner@bdo.com

PAUL BROCATO, Chicago
312-616-4639 / pbrocato@bdo.com

AL FERRARA, New York
212-885-8000 / aferrara@bdo.com

RANDY FRISCHER, New York
212-885-8445 / rfrischer@bdo.com

DOUGLAS HART, San Francisco
415-490-3314 / dhart@bdo.com

NATALIE KOTLYAR, New York
212-885-8035 / nkotlyar@bdo.com

ISSY KOTTON, Los Angeles
310-557-0300 / ikotton@bdo.com

RICK SCHREIBER, Memphis
901-680-7607 / rschreiber@bdo.com

ALAN SELLITTI, New York
212-885-8599 / asellitti@bdo.com

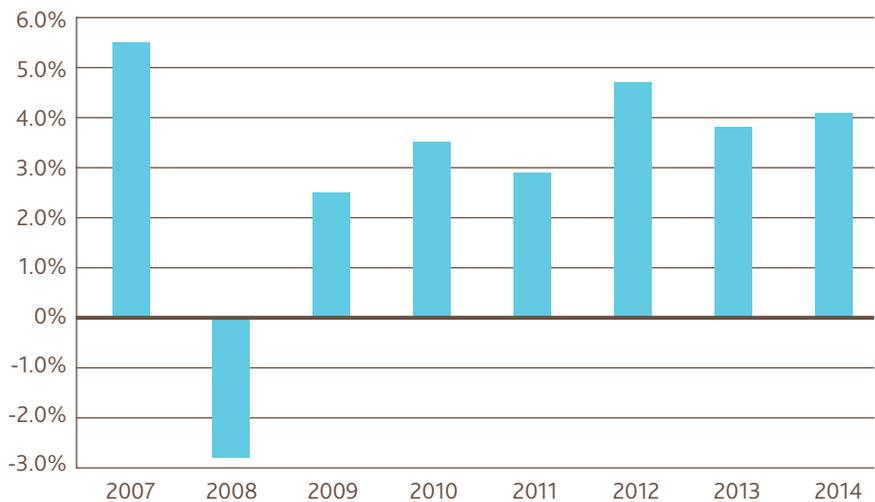
TED VAUGHAN, Dallas
214-665-0752 / tvaughan@bdo.com

electronics will be both the top performing (73 percent) and most discounted (58 percent) product category. The Consumer Electronics Association (CEA) predicts that Americans will spend a record \$34 billion on electronics alone this holiday season, with tablets, laptops, televisions, smartphones and videogame consoles topping adults' wish lists this year. Millennials will continue to aggressively purchase mobile, "cord-cutting" devices such as smartphones and tablets, for which annual sales have risen 300 percent and 700 percent respectively since 2010, according to the CEA, but television sales have also shown surprising resilience as a top consumer electronics pick this year after having declined in 2013.

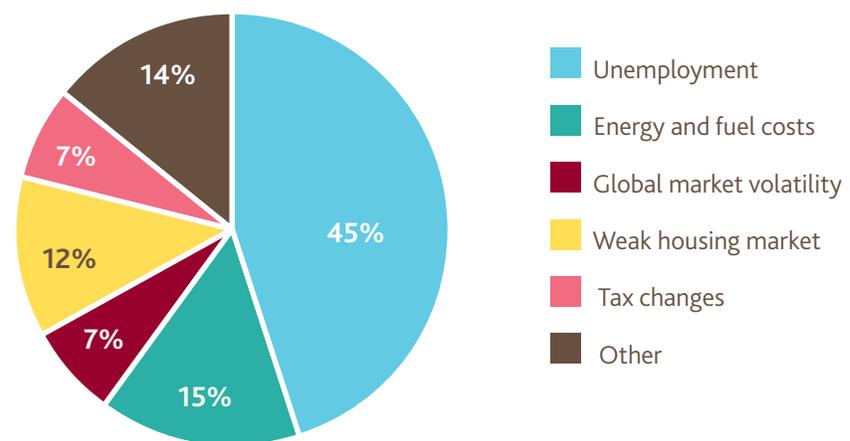
Retailers are also leveling their expectations around gift card sales. The past several holiday seasons saw more shoppers choosing this easy and flexible purchase and, last year, CMOs forecast a 6.9 percent increase in sales. Slower growth is expected this year: Among the surveyed retailers who sell gift cards, 38 percent expect gift card sales to increase this year. Overall, CMOs project a 2.7 percent boost in sales in the runup to the holidays, which should still help buoy margins in January and February as shoppers begin redeeming.

"Sales gains have been uninspiring this year, but retailers have pushed through, and there's confidence in the air for the make-or-break holiday season," said Doug Hart, partner in the Retail and Consumer Products Practice at BDO. "To execute on this confidence, retailers need the right mix of attractive new products and enticing deals to loosen the purse strings of skittish consumers. Expect to see an even longer season this year, with heavy promotions from November through January."

Holiday Sales Projections over Time



Which Will Have the Greatest Impact on Holiday Sales?



► UNEMPLOYMENT REMAINS TOP THREAT TO SALES

This year has brought promising gains in employment levels, with U.S. unemployment dropping below 6 percent for the first time since the recession. Still, as long-term unemployment and underemployment continue to hamper consumers' disposable income, retailers remain cognizant of tight purse strings, and a plurality (45 percent) identified unemployment as their No. 1 perceived threat to sales. Meanwhile, the number of retailers citing energy and fuel costs

(15 percent) remains constant with last year's figures, as does the amount that cites global market volatility (7 percent) and tax changes (7 percent). As gas prices have steadily dropped across the U.S. throughout the fall, many retailers are hoping that consumers' savings at the pump will turn into more gifts under the tree. Also of note, with slow but steady recovery across many U.S. housing markets this year, fewer retailers (12 percent vs. 16 percent in 2013) cited housing market changes as their greatest risk.

► INVENTORY LEVELS STAY CONSTANT DESPITE OPTIMISM

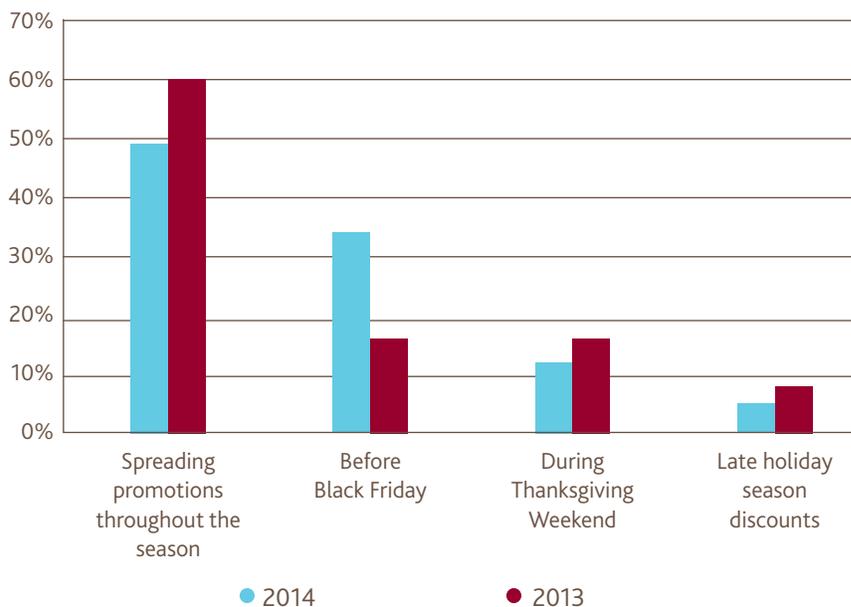
In the midst of labor negotiations at critical West Coast ports, many retailers began purchasing holiday inventory early this year in order to have contingency plans in place. Even with this early buying and more upbeat sales projections, retailers have largely maintained the same numbers as 2013 when it comes to stocking shelves with merchandise. A majority of retailers (55 percent) say they have kept their inventory levels consistent with last year, pointing to an expected 1.1 percent increase in overall inventory for the 2014 season. Cheerier sales projections and increased consumer confidence aside, retailers are realistic when it comes to their inventory, understanding that paltry gains in disposable income over the past 12 months means that skittish consumers could underperform, prompting the need for retailers to slash prices and dump excess inventory later in the season.

► 'BLACK NOVEMBER' DOWNPLAYS THANKSGIVING WEEKEND

The holiday creep made an unprecedented leap this year. As more consumers are beginning their holiday shopping earlier in the season, retailers have moved up their promotional activity accordingly. In fact, over one-third (34 percent) of retailers surveyed planned to run most of their holiday season promotions by the time consumers sat down to Thanksgiving dinner. With these early deals capturing more of shoppers' limited holiday budgets, most retailers' Black Friday and Cyber Monday projections came in low this year.

Overall, they forecast a 2.4 percent increase in Black Friday sales and a 3.9 percent increase in Cyber Monday sales, which could still be considered healthy gains considering Wal-Mart, Amazon, Office Depot, Lowes and a cadre of other major players began promotions the day after Halloween this year. So far, initial reports point to an overall slowdown in Thanksgiving weekend sales, which were likely diluted due to the impact of sales activity earlier in the season. Online sales, however, have been a bright spot: Cyber Monday sales growth reached 8.5 percent according to *Bloomberg*, while e-commerce sales were up 17 percent year-over-year

How Would You Best Describe the Timing for Most of Your Holiday Promotions?



for Thanksgiving Day and Black Friday, according to IBM. As retailers' look to beat out competition and entice consumers with deals earlier in the season when shopping budgets are still discretionary, the pressure to offer more unique deals is prompting retailers to boost their overall promotional activity, and nearly two-thirds (64 percent) of retailers plan to offer more discounts and deals this year.

"[Black Friday] won't have the impact that it's had in the past simply because [shopping] has been spread out," Ted Vaughan told *Washington Post*. "The single day isn't as significant."

► HOLIDAY MARKETING BUDGETS SEE SMALL GROWTH

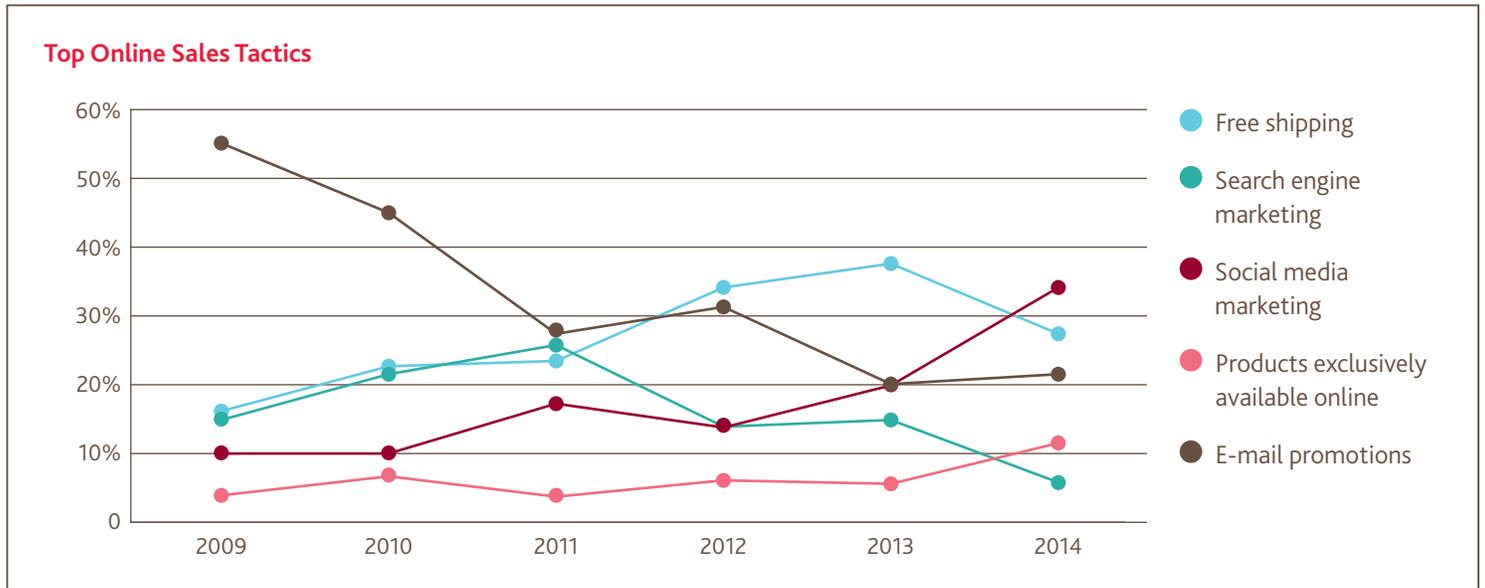
Despite the push for more deals throughout the holiday season, CMOs' modest sales projections have kept their marketing budgets steady. A full 72 percent of retailers plan to spend about the same on marketing and advertising as they did last year, as all retailers surveyed anticipate a 1.1 percent rise in spending, compared to a decline of .98 percent in 2013. With the same amount of

resources at their disposal, retailers have been busy strategizing over the right mix of digital channels and in-store promotional tactics to stay in front of consumers throughout the season.

► RETAILERS REVAMP FOCUS ON SEAMLESS CUSTOMER EXPERIENCE

Success for retailers increasingly boils down to how convenient they make their customers' shopping experience, especially during the holiday season, when stores are packed and lines are long. As part of their overall holiday strategy, retailers have been working hard to finesse every touchpoint of their customers' journey, and 36 percent of retailers say their promotional strategy is equally focused between in-store and online. A full 71 percent of retail CMOs are familiar with the concept of an enhanced omnichannel shopping experience, and of those, one-in-four say that they have changed their holiday marketing strategy this year in response to consumers' demand for a more seamless experience across channels.

Of those retailers, 100 percent are using consistent pricing across channels, 95 percent are using consistent promotional strategies across channels and 86 percent are expanding



product delivery options for customers. Giants including Toys “R” Us, Target and Macy’s have made considerable efforts ahead of the holiday season to provide consumers with greater flexibility, including the expansion of their digital shelves and online promotions, more robust buy-online-pick-up-in-store options and new mobile apps for in-store product searches.

► DOORBUSTERS AND IN-STORE DEALS REMAIN HOT

As holiday creep prompted an early start to the season and helped to spread out shopping in November, retailers are pulling out all the stops to capture as much in-store foot traffic as possible this year. To beat out their competition, 67 percent of retailers say that exclusive in-store deals and discounts will be their top tactic to draw consumers to their stores and entice them to buy early and often. Doorbusters and limited-time products and promotions will also be key strategies this year, as retailers are aware that cart size can grow nicely if they can simply get shoppers into stores. Meanwhile, in-store events are the top tactic for 17 percent of CMOs, who hope that appealing, in-person offerings can persuade shoppers to brave the crowds and browse the shelves, instead of just their tablets and computer screens.

► EXPECTED GROWTH IN E-COMMERCE DRIVES ONLINE SALES TACTICS

Forecasts from Adobe, comScore and Forrester all point to double-digit growth in e-commerce sales this holiday season, prompting many retailers to home in strategically on their online marketing tactics. This year, 19 percent of CMOs say they will focus most of their promotions online, up from 13 percent in 2013. Over the last five years, the top online sales tactics have shifted considerably, and retailers are now deploying a more diverse range of offerings.

Social media sites continue their rise as a preferred online marketing channel, as 84 percent of retailers plan to use it this year, and one-in-three (34 percent) claim that it will be their most profitable online promotional tactic – more than any other category. Of those that plan to use social media, the vast majority of retailers (76 percent) will focus on Facebook campaigns, while Twitter and LinkedIn remain the second and third most popular social networks, with 27 percent and 21 percent, respectively, using these platforms. In the face of greater competition and increased promotional activity, look for more retailers experimenting with “buy buttons” on platforms such as Facebook and Twitter, as they look to accelerate the path to purchase and help boost conversion rates and ROI of their social activity.

Meanwhile, another 28 percent of CMOs say that promoting free shipping will help them

yield the most online sales this season. Many major players, including Target and Best Buy, made sure to reduce or eliminate their order minimums and extended the frequency of their free shipping offerings. Although it may cut into margins, customers have grown accustomed to quick and cheap access to products, and free shipping is becoming a key differentiator for brick-and-mortar retailers trying to win over customers from online behemoths like Amazon and Overstock.

► MOBILE GAINS FURTHER GROUND AS HOLIDAY MAINSTAY

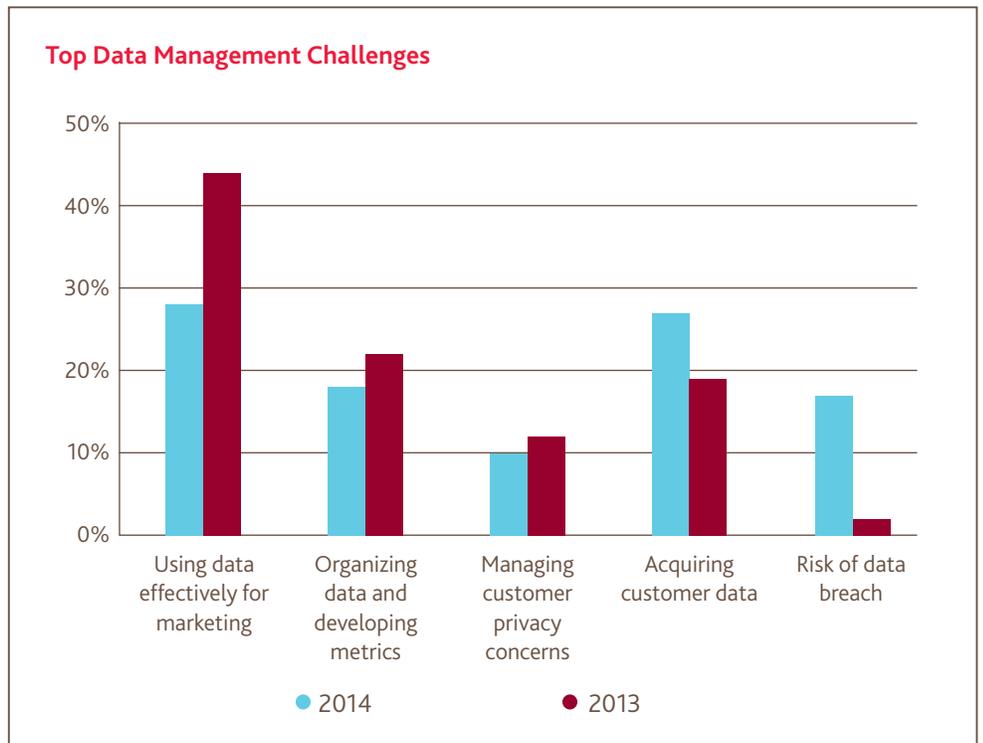
Gone is any doubt surrounding mobile’s long-term role as a critical platform in retailers’ holiday marketing playbooks. In the 2013 season, mobile orders jumped 50 percent year over year, accounting for 29 percent of total holiday e-commerce orders, according to Custora. This year, comScore predicts mobile sales will skyrocket 25 percent, and approximately half of all the retailers surveyed (49 percent) plan to include mobile technology in their holiday marketing strategy this year, up from 38 percent in 2013. Overall, retailers will spend 14 percent of their marketing budgets on mobile, a jump from 6 percent in 2012. In terms of the most popular mobile strategies this year, 34 percent will focus most heavily on flash sales and daily deals, 27 percent will focus on mobile coupons and the remainder will focus primarily on QR codes (18 percent), apps (13 percent) and text messaging campaigns (7 percent).

“More retailers are waking up and investing in mobile, and this year signals a turning point in how they are vying for consumers’ attention during the peak holiday season,” said Natalie Kotlyar, partner in the Retail and Consumer Products practice at BDO. “Mobile engagement is quickly becoming table stakes when it comes to winning over new customers and converting sales in November and December. The most successful retailers will be those that are out in front, experimenting with new technologies and developing the convenient shopping experience demanded by today’s customers.”

►CYBERSECURITY MOVES UP ON LIST OF DATA MANAGEMENT CONCERNS

Building out digital channels also requires retailers to bolster their cybersecurity. The past 12 months have brought a number of large-scale, costly and high profile data breaches and cyber threats targeting the web-based platforms of some of the biggest names in the industry, including Home Depot, Neiman Marcus and eBay. Especially after Target’s detrimental breach last December, all retailers remain keenly aware of their perceived cyber risks this holiday season. In fact, concerns over data breaches spiked this year, with 17 percent of surveyed retailers calling it their No. 1 challenge pertaining to customer data, up from only 2 percent last year. Meanwhile, roughly one-in-three (34 percent) retailers perceive risks related to potential data breaches and cybersecurity to be higher this year than in 2013. This mirrors the findings from our 2014 *Retail RiskFactor Report*, in which 91 percent of retailers noted privacy concerns related to security breaches – the eighth most cited risk overall.

Outside of cybersecurity, as retailers look to effectively manage and capitalize on their troves of customer data accessed through in-store purchases, e-commerce and social media, a full 72 percent find data management challenging, and 45 percent



find it very challenging. Actually acquiring customer data remains tricky given ongoing debate surrounding consumer privacy and the prohibitive cost of new data mining technologies, and 27 percent note it as their top data challenge this year, up from 19 percent last year. Still, retailers are more comfortable when it comes to using customer data for marketing efforts (cited as a top challenge by 28 percent vs. 44 percent in 2013), organizing data and developing metrics (18 percent vs. 22 percent in 2013), and managing customer privacy concerns (10 percent vs. 12 percent in 2013).

This year marks a real shift in holiday spending, as our own Ted Vaughan noted in

Women's Wear Daily, and "...by 2020, the official start to the holiday season may be in October...[as] consumers now expect holiday promotions to come early and end late." With modestly optimistic projections, a record early start and the de-emphasis on major shopping days, 2014 may go down as the first year in which the holiday season truly became a marathon, as opposed to a sprint. We will see come January whether retailers are able to accept the new normal, differentiate themselves in this intense promotional environment and post new gains as they enter the new year.

“The sheer volume of transactions that occur during the peak holiday shopping season helps put the gravity of retailers’ cyber threats into perspective,” said Karen Schuler, Managing Director at BDO Consulting, leading the firm’s Forensic Technology Services practice in Washington, D.C. “Protecting customers’ personally identifiable information and credit card data requires that retailers constantly assess the vulnerabilities of their web-based platforms and point of sale systems throughout the year, and then bolster their IT controls to address these weaknesses. Using this proactive approach, combined with carefully designed data breach response protocols, retailers can mitigate the risk of breaches in the first place, and more effectively respond to cyber attacks when they do occur.”



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

BDO has been a valued business advisor to retail and consumer products 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.

ABOUT BDO USA

BDO is the brand name for BDO USA, LLP, a U.S. professional services firm providing assurance, tax, financial advisory and consulting services to a wide range of publicly traded and privately held companies. For more than 100 years, BDO has provided quality service through the active involvement of experienced and committed professionals. The firm serves clients through 52 offices and over 400 independent alliance firm locations nationwide. As an independent Member Firm of BDO International Limited, BDO serves multinational clients through a global network of 1,328 offices in 150 countries.

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. BDO is the brand name for the BDO network and for each of the BDO Member Firms. For more information, please visit www.bdo.com.

Material discussed is meant to provide general information and should not be acted on without professional advice tailored to your firm's individual needs.

© 2014 BDO USA, LLP. All rights reserved.

