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Bain & Company expects a third consecutive year of solid holiday sales

by Darrell Rigby, Kris Miller, Josh Chernoff and Suzanne Tager

Bain is forecasting that holiday sales this year will grow 3.5%, in line with results in 2010 and 2011 and substantially above the 2.1% 10-year average. High gas prices and unemployment may dampen consumer spending, but elevated consumer confidence should ring cash registers. We expect digital retail sales to drive growth this holiday season, up 16% over holiday sales in 2011. This year, too, performance will vary widely by retailer, with winners employing innovative omnichannel strategies to increase sales.

Optimism will drive spending this holiday season, but uncertainty looms in 2013

Bain expects GAFO sales to grow 3.5% in 2012, down slightly from 3.7% growth in 2011 and 3.8% growth in 2010 (*Chart 1*).¹ This is well above the 10-year average of 2.1% but still below the strong 5%-plus growth in 2004 and 2005. With 3.5% growth, total annual GAFO sales will reach an estimated \$1.206 trillion in 2012, 5% higher than the prerecession peak of \$1.149 trillion in 2007.

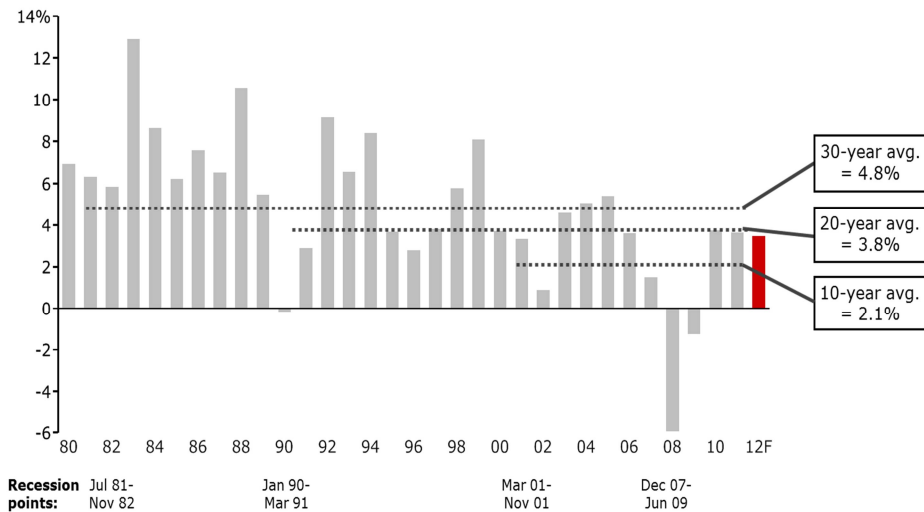
Our holiday growth expectations are tempered by several negative economic factors:

- *Gas prices have continued to rise.* At \$3.74 a gallon, the average price of gas is 10% higher this October month-to-date than it was a year ago. We estimate that the average household has spent 3% more on gas to date in 2012 than it did in the same period in 2011. This means that the average household has roughly \$100 less in its wallet going into the holidays. That gap could become smaller if we see a seasonal decline in gas prices similar to last winter's. However, if gas prices remain high, consumers may well cut spending in other categories.

¹ See Chart A in the Appendix for definitions of GAFO and other sales measures.

Chart 1:

Holiday sales growth, 1980-2012



Note: *Holiday* is defined as November and December; growth rates are based on the most comparable data available by time; 1980-1992 growth rates are for GAF; 1993-2011 growth rates are for GAFO; 2012 is Bain's growth rate forecast

Source: US Census Bureau; Bain analysis

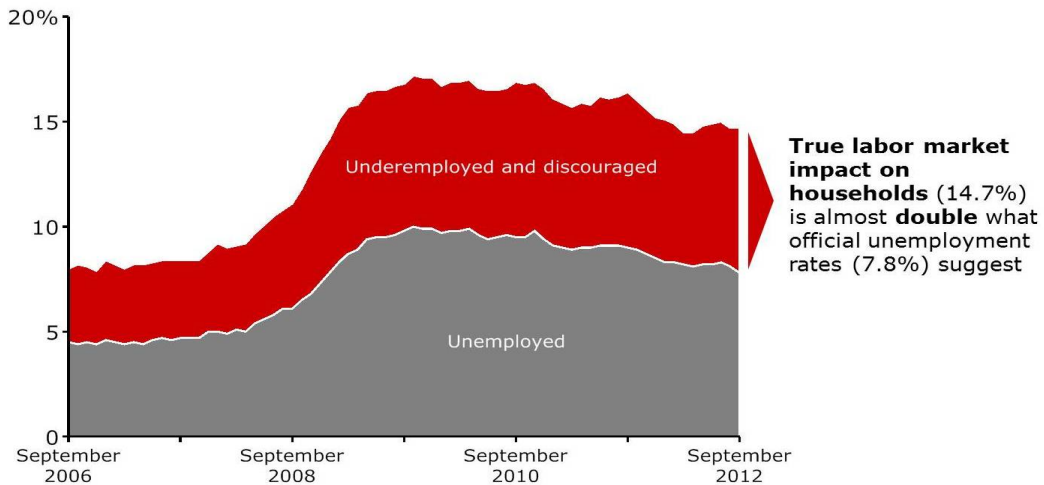
- *Unemployment has improved but remains high.* Current unemployment is at 7.8%, down from 9% in 2011 but above prerecession levels. Weekly jobless claims averaged 370,000 in the last three months, down from highs of 450,000 in early 2011. Accounting for underemployed and discouraged workers, 14.7% of Americans are heading into the holiday season negatively impacted by the job market—an improvement over last year's 16.4% but still significant (*Chart 2*).
- *Wages are stagnating.* Nominal wages increased 0.9% in the third quarter of 2012, below the 1.7% increase in the same period in 2011. In addition, average hourly earnings have stayed the same on a real basis over the last five years. This may curb consumers' ability to spend this holiday season, despite their high confidence levels.

There is some good news too:

- *Recent sales momentum is healthy.* GAFO sales are up 3.3% to date this year, close to 3.6% growth in the comparable period in 2011. Back-to-school sales in August and September saw growth of 2.2%, in line with 2010 back-to-school performance of 2.3% but less than the dramatic 5.2% gains in 2011. Our analysis shows a strong correlation between back-to-school and holiday sales growth ($R^2 = .66$), which should bode well for holiday sales this year. Furthermore, with positive year-over-year growth in 11 of the last 12 months, there is good reason to believe consumers will continue to spend into the holidays (*Chart 3*).

Chart 2:

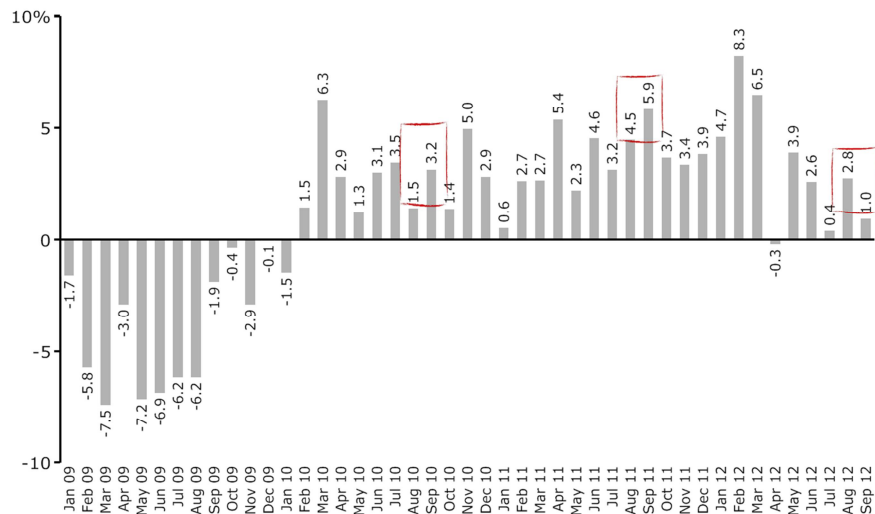
Unemployment rate, September 2006-September 2012



Source: Bureau of Labor Statistics

Chart 3:

GAFO year-over-year growth, January 2009-September 2012



Note: Advanced monthly retail sales have been used for September 2012; September 2012 shows GAFO growth rate (office supplies have not yet been reported)

Source: US Census Bureau; Bain analysis

Chart 4:

Consumer confidence and sentiment, September 2006-September 2012



Note: The Michigan Index of Consumer Sentiment includes a preliminary reading for October 2012; the Michigan Index of Consumer Sentiment is indexed to 1964; the Consumer Confidence Index is indexed to 1985

Source: The Conference Board; Thomson Reuters/University of Michigan

- *Home and equity markets are up over last year.* New and existing home sales have increased in each of the last 12 months, with the Case-Shiller Composite 20 Index reporting average selling prices up 7% this year. The S&P 500 Index is up 15% in 2012 to date, a much stronger performance than the 5% drop over the same period last year. Strength in home and equity markets may increase consumers' readiness to spend.
- *Consumer confidence is at a five-year high.* Both major indexes, the Consumer Confidence Index and the Michigan Consumer Sentiment Index, are up 30% this year (Chart 4). This is a significant improvement over last fall, when consumer confidence was almost as low as it had been during the recession. The preliminary October reading for the Michigan Consumer Sentiment Index is at its highest level since September 2007. Notwithstanding mixed economic fundamentals, consumers are upbeat.
- *Retailers, too, seem optimistic going into the holiday season.* Global Port Tracker is forecasting that October retail cargo volumes will be up 9.9% over last year. Total retail inventories were up 4% as of July, another indication that retailers are anticipating healthy holiday sales. The National Retail Federation expects retailers to add 585,000 to 625,000 seasonal workers, in the range of the 607,500 seasonal workers hired in 2011. Amazon alone is planning to hire an additional 50,000 US workers for the holidays.

Not all consumers are equally optimistic going into the holidays. Affluent consumers (households earning \$100,000-plus per year) make up 21% of US households and account for 38% of all US consumer spending.² These consumers have most of their wealth tied to financial assets, and they have benefited from the stock market's strong performance in 2012. They are most likely to have jobs. The unemployment rate for this segment is only 4%, and its members are likely to feel the most optimistic heading into the holidays. Luxury retailers in particular will benefit from these trends. Bain's annual *Luxury Goods Worldwide Market Study*, published this month, predicts the luxury market will grow 10% globally and 13% in the Americas in 2012.³

Aspirational consumers (households earning approximately \$50,000 to \$100,000 per year) make up 29% of US households and account for 33% of US consumer spending. Because most of their assets are tied to housing, the housing crisis has disproportionately impacted them. With housing prices up this year and new construction surging 15% in September alone, this segment should feel relatively optimistic going into the holiday season. Midtier retailers could benefit if aspirational consumers are able to turn optimism into spending. However, limited credit availability in comparison to pre-recession years may still curb their expenditures.

Lower-half consumers (households earning less than \$50,000 per year) make up 50% of US households but are responsible for just 29% of US consumer spending. This segment continues to suffer from high unemployment, which means these consumers aren't likely to spend a lot more this holiday season than they did last year. However, we don't anticipate a significant drop in this group's spending: Last year's sales already reflect the high unemployment.

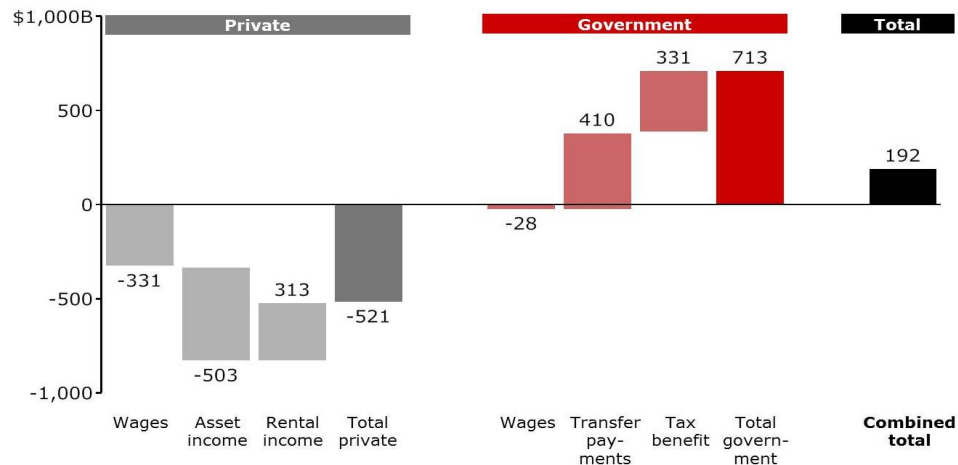
Although Bain expects the net effect of macro trends to produce solid growth in holiday sales, we remain cautious about the economic outlook for 2013. Bain's Macro Trends Group analysis shows that a high level of government support has been underwriting growth in the private sector (*Chart 5*). Current plans call for a steep retreat in government support in 2013—a combination of expiring tax breaks and cuts in federal spending—that could produce a “fiscal cliff” (*Chart 6*). If a fix is not in place before year's end, disposable personal income could fall significantly and destroy the positive momentum we've seen in 2012 to date. The impact of the fiscal cliff would be most significant on affluent consumers, who could experience an average decrease in their after-tax income of 5.1% to 10.5% in 2013 (*Chart 7*). The magnitude of the fiscal cliff's impact would be less for the aspirational and lower-half segments, which would see their 2013 after-tax income drop by 3.7% to 5.1%.

² See Chart B in the Appendix for definitions of consumer segments.

³ For a copy of the study, please contact Cheryl Krauss at cheryl.krauss@bain.com or Frank Pinto at frank.pinto@bain.com.

Chart 5:

Change in sources of US personal disposable income between Q1 2007 and Q2 2012, versus 2007 baseline, at Q2 2012 price levels

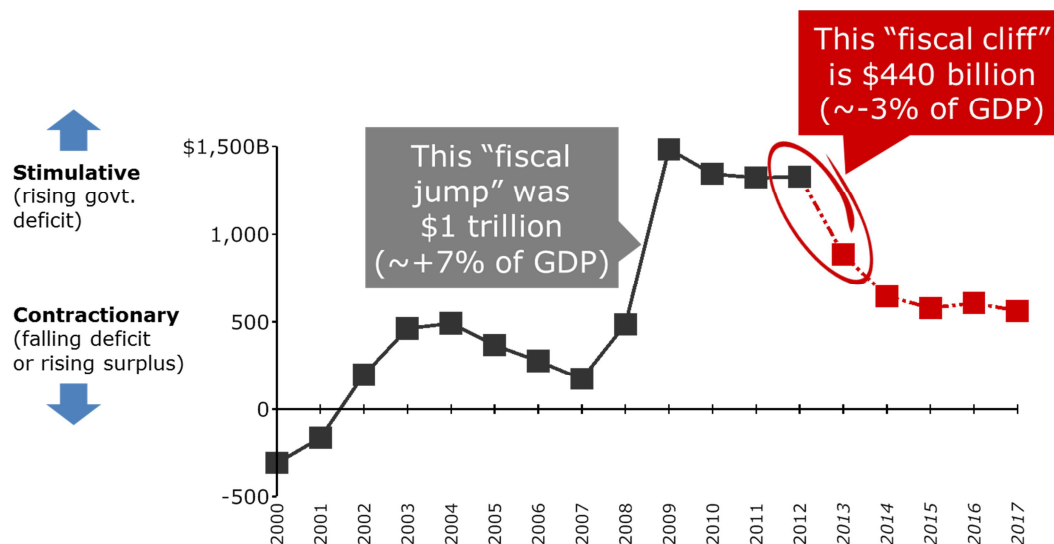


Note: Numbers are nominal and seasonally adjusted to Q2 2012 levels; the comparison is between the relative share of each component in Q1 2007 versus its actual share in Q2 2012

Source: Bureau of Economic Analysis; Bain Macro Trend Group analysis

Chart 6:

US historical and projected fiscal deficit (or surplus), 2000-2017

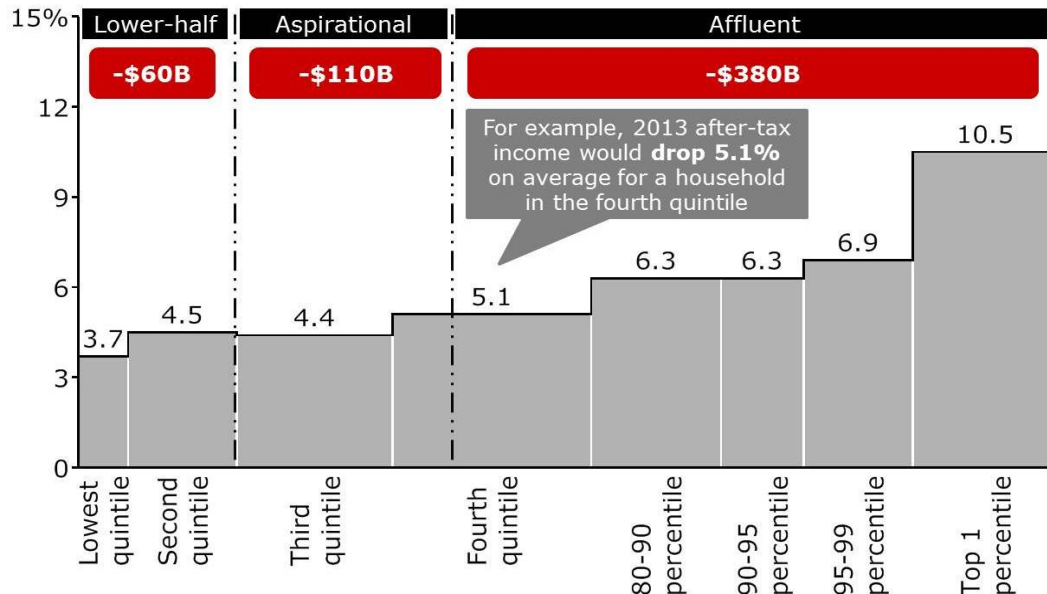


Note: All values have been adjusted for inflation to 2012 estimated price levels

Source: Congressional Budget Office; Bureau of Economic Analysis; Bain Macro Trend Group analysis

Chart 7:

Estimated impact of potential fiscal cliff
on after-tax income in 2013 vs. 2012,
by share of total US taxable income

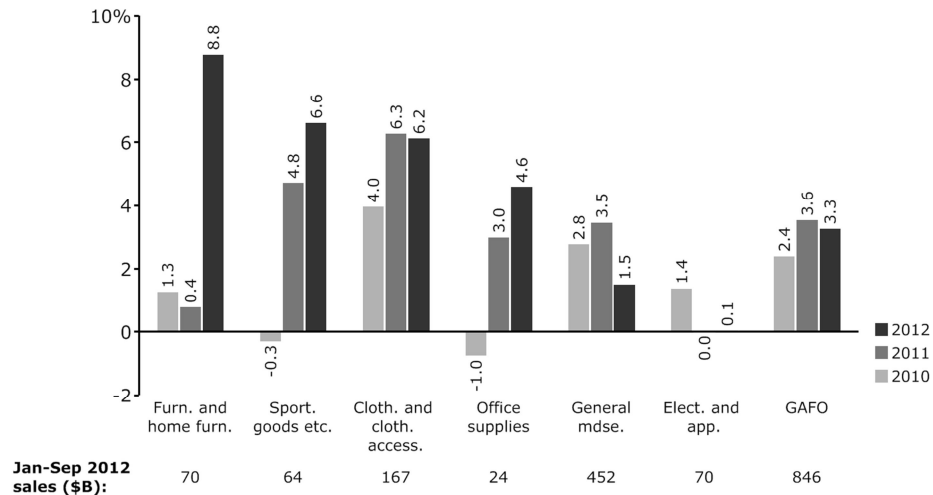


Sales momentum through September 2012 varied across GAFO categories (*Chart 8*). Furniture and home furnishings have come a long way since the steep declines during the collapse of the housing market. Customers returned to furniture stores with the upturn in all home sales, but particularly new home sales, which saw a 28% year-over-year increase in August of this year. Low refinancing costs and higher home values also made it possible for owners of existing homes to take on refurnishing projects. At the same time, traditional electronics and appliances stores continue to struggle: Growth in this category has been flat in 2012. Retailers in this sector are facing a serious challenge with consumers visiting stores to look at merchandise but then making their purchases at general merchandise outlets or online. In fact, some consumers are skipping store visits altogether: ShopperTrak predicts that foot traffic in the electronics category will be down 8% in 2012.

The two largest GAFO categories, clothing and general merchandise, saw profits fall in the second half of 2011, in part due to the heavy use of promotions and discounts (*Chart 9*). The trend reversed in 2012, with profits growing year over year at an average rate of 14% in the first two quarters. If retailers hold the line on pricing, and consumer demand is as strong as forecasted, we could see this momentum continue into the holidays on an aggregate level. However, given differences in pricing and markdown strategies and outcomes, we expect profits to vary greatly across retailers.

Chart 8:

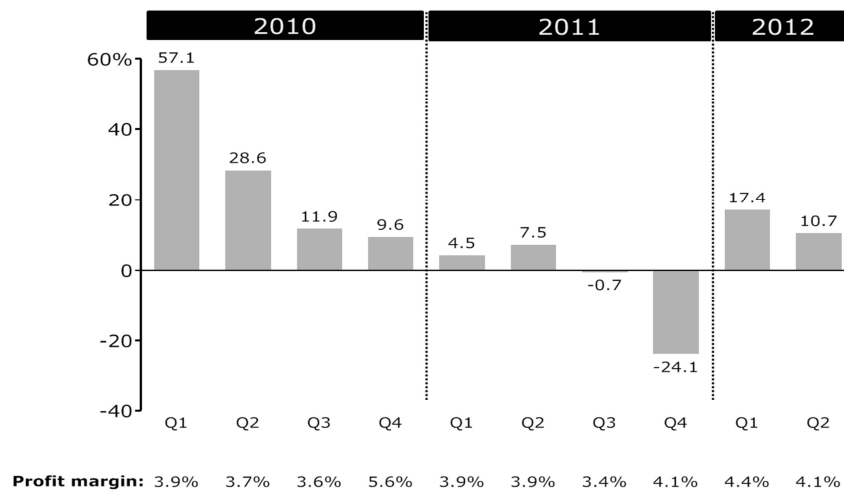
GAFO categories year-over-year growth,
January through September 2010-2012



Note: The rate for office supplies in 2012 is for January through August; the 2012 GAFO rate of growth excludes office supplies in September
Source: US Census Bureau

Chart 9:

Clothing and general merchandise profits,
quarter-over-quarter change, 2010-2012



Note: Includes companies with more than \$50 million in assets; profits are measured as after-tax income; clothing and general merchandise represent about 73% of GAFO sales
Source: US Census Bureau

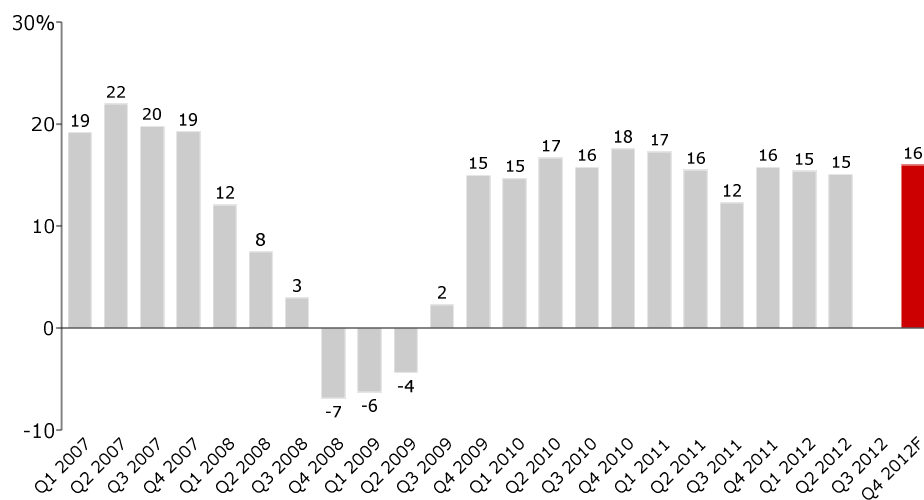
Digital retail: This holiday season's growth engine

E-commerce sales grew at a rate of 15% in the first half of 2012, reaching a whopping \$100 billion according to the US Census Bureau.⁴ Shopping via computers and mobile devices will play a greater role this holiday season than in any year past, as retailers roll out innovations to make online shopping more fun, convenient and competitive.

We are forecasting e-commerce sales growth of 16% this holiday season (*Chart 10*). Measuring e-commerce is getting harder though. The lines between e-commerce and in-store purchases are increasingly blurred. Consumers research their purchases online before going to the store, compare products and prices in-store using their mobile devices, order online but pick up in stores, or shop in stores but then order via kiosk for home delivery of out-of-stock items. Forrester Research predicts that 45% of 2012 retail sales will be influenced by digital channels in some way. For the purposes of our forecast, we focus on GAFO sales and e-commerce sales as defined by the Census Bureau because we can track reported outcomes, but we acknowledge that these metrics are not perfect. The challenge: Reporting standards differ across retailers and channels, and growth in digital retail will exacerbate the inconsistencies. This is a pervasive problem. Virtually all omnichannel retailers are struggling to come up with metrics that reflect the blurring of channel definitions.

Chart 10:

E-commerce sales year-over-year growth,
Q1 2007-Q2 2012



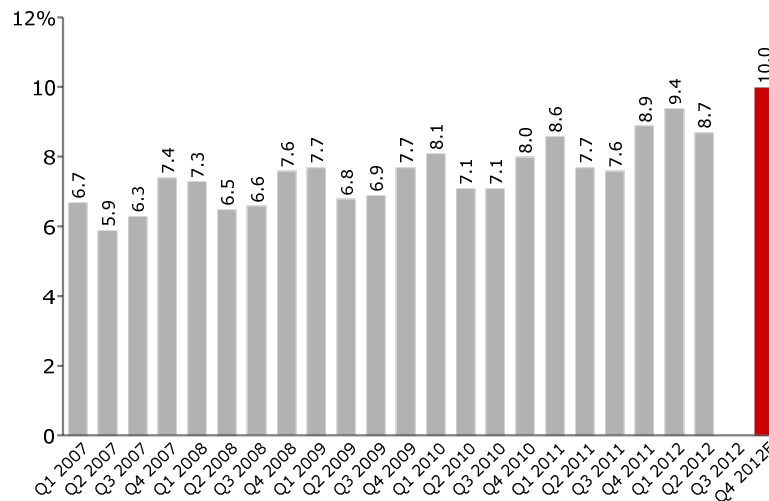
Note: Q4 2012 is a Bain forecast; Q3 2012 will not be released by the Census Bureau until November 16

Source: US Census Bureau

⁴ See Chart C in the Appendix for the Census Bureau's definition of e-commerce.

Chart 11:

E-commerce sales as a percentage of total retail sales, 2007-2012



Note: Q4 2012 is a comScore forecast; Q3 2012 has not yet been released
Source: comScore

However we define it, e-commerce is becoming a larger and larger part of US consumers' lives. According to Forrester Research, 167 million US consumers made online purchases in 2012—that's 78% of all Internet users. ComScore expects online sales to account for around 10% of total retail sales during the fourth quarter of 2012, up from 8.9% a year ago (*Chart 11*). Online penetration varies widely across large retail categories, with consumer electronics estimated at 20%, apparel and accessories at 12%, and home improvement and grocery both at 2%. Growth also will vary by category, with consumer electronics, apparel and accessories, and grocery outpacing the e-commerce average, while home improvement grows more slowly.

We expect mobile commerce to be in the spotlight this holiday season. More consumers have smartphones and tablets, and retailers have escalated investments in mobile offerings. Internet Retailer is predicting that mobile devices will generate \$11 billion in sales in 2012, more than double the 2011 figure of \$5 billion. According to comScore, smartphones comprised 50% of all phones in use in the United States at the end of August 2012. This means that 116.5 million people over age 12 own a smartphone they can use for shopping, up 38% from the 84.5 million reported in August 2011. In addition, nearly 40 million mobile phone users own a tablet device, giving them yet another way to shop. For their part, retailers have continued investing in user-friendly mobile applications, and today 83 of the top 100 retailers are estimated to have at least one mobile offering.

E-commerce is getting more and more competitive, and the big players are getting bigger and growing faster than the market. E-commerce market leader Amazon grew at 36% and generated nearly \$15 billion in North American sales in the first two quarters of 2012. Nordstrom's and Macy's digital businesses grew 42% and 36% respectively in the

first half of 2012, also outpacing the e-commerce market. And innovative online-only retailers like Birchbox, Warby Parker and Everlane are turning up the heat on traditional retailers. The lesson is clear: If traditional retailers want to succeed this holiday season, they will have to execute their omnichannel strategies effectively.

Digital retail is disrupting the business model of traditional brick-and-mortar retailers, and they are responding aggressively with new features and promotions. For example, Walmart is offering same-day shipping in select cities this holiday season; Nordstrom has free in-store pickup of online orders; and Best Buy has introduced free delivery for items that are out of stock in its physical stores. These are just a few examples of a wide range of strategies and operational issues that retailers need to resolve in the changing omnichannel world. We are excited about exploring these changes in detail in our next issue. Among the topics we will discuss are the following:

- How are digital innovations changing the way people shop?
- What are the implications for retailers' operations and economics, and especially for the evolving role of the store?
- How are retailers overcoming the challenges of delivering a seamless omnichannel shopping experience?
- What innovative marketing and sales strategies are retailers implementing this holiday season?

Ring in a successful holiday season

We believe there is considerable potential for 2012 to be another successful holiday season, and that belief is reflected in our growth forecasts of 3.5% for GAFO sales and 16% for e-commerce sales. But with full economic recovery far from certain, there will be winners and losers across categories. Retailers will have to employ innovative strategies to address changing consumer habits in the digital world. We look forward to sharing insights on what the winners are doing and what is enabling their success.

Here is a preview of our upcoming holiday issues:

- **Issue #2:** Omnichannel: Digital disruption and retailer opportunities
- **Issue #3:** Holiday half-time report: What is working?
- **Issue #4:** Pricing and promotions: How deep are the discounts?
- **Issue #5:** A 2012 holiday recap and a 2013 outlook

Newsletter schedule

Our next newsletter will be released in the first half of November, with a new issue every two to three weeks through the holiday season (*Chart 12*). This schedule allows us to incorporate newly released holiday forecasts and performance data in a timely manner. Please let us know if you have any questions or suggestions for additional analysis, or if you would like to arrange a follow-up discussion on the US and global economy with Bain's Macro Trends Group.

Chart 12:

Indicator update and newsletter schedule

Data source	Oct			Nov				Dec					Jan		
	8-14	15-21	22-28	29-4	5-11	12-18	19-25	26-2	3-9	10-16	17-23	24-30	31-6	7-13	14-20
US Census Bureau Advance Retail Sales (GAFS/GAFO)	▲ (10/15)					▲ (11/14)				▲ (12/13)				▲ (1/15)	
ICSC Monthly Same Store Sales			▲ (11/1)					▲ (11/29)					▲ (1/3)		
Michigan Consumer Sentiment		▲ (10/26)				▲ (11/21)				▲ (12/21)					
Consumer Confidence Index			▲ (10/30)				▲ (11/27)					▲ (12/27)			
BEA Gross Domestic Product		▲ (10/26)						▲ (11/29)			▲ (12/20)				
BEA Personal Income and Outlays		▲ (10/29)						▲ (11/30)			▲ (12/21)				
Holidays						▲ <i>Thanksgiving (11/22)</i>					▲ <i>Christmas (12/25)</i>				
Bain Retail Holiday Newsletter (tentative)		★			★			★			★			★	

Appendix

Chart A:

Definitions

	GAFO	GAFS	GAF	Nonauto retail sales
General merchandise stores	✓	✓	✓	✓
Clothing and clothing accessories stores	✓	✓	✓	✓
Furniture and home furnishings stores	✓	✓	✓	✓
Electronics and appliances stores	✓	✓		✓
Sporting goods, hobby, book and music stores	✓	✓		✓
Office supplies, stationery and gift stores	✓			✓
All other retail trade sales not included in GAFO (excluding auto and auto parts)				✓
Auto and auto parts sales				

Chart B:

US consumer segments

	Affluent	Aspirational	Lower-Half
Income	• \$100,000+ per year	• \$50,000-\$100,000 per year	• <\$50,000 per year • Tied to unemployment and government benefits
Population	• 21% of households	• 29% of households	• 50% of households
Consumption	• 38% share of overall consumption	• 33% share of overall consumption	• 29% share of overall consumption
Jobs	• Unemployment: <4% • Unemployed, underemployed and discouraged: ~7%	• Unemployment: ~6% • Unemployed, underemployed and discouraged: ~12%	• Unemployment: ~15% • Unemployed, underemployed and discouraged: ~30%
Assets	• Housing represents one-third of assets • Financial investments represent two-thirds of assets	• Housing dominates assets	• None

Source: Bain Macro Trends Group analysis

Chart C:

US Census Bureau e-commerce definition

Definition	US Census Bureau <i>e-commerce sales</i> are sales of goods and services where an order is placed online by the buyer, or price and terms of sale are negotiated online; payment may or may not be made online.
Methodology	Based on a sampling of 12,500 retail companies that are representative of the industry.
Categories	All retail trade sales. Includes online auctions directed at individual consumers. Excludes online travel services, financial brokers and dealers, and ticket sales agencies.

Source: US Census Bureau

Selected References

Bain & Company has included in this document information and analyses based on the sources referenced below as well as our own research and experience. Bain has not independently verified this information and makes no representation or warranty, express or implied, that such information is accurate or complete. Projected market and financial information, analyses and conclusions contained herein are based (unless sourced otherwise) on the information described above, and Bain's judgments should not be construed as definitive forecasts or guarantees of future performance or results. Neither Bain & Company nor any of its subsidiaries or their respective officers, directors, shareholders, employees or agents accept any responsibility or liability with respect to this document.

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