October 23, 2011

**Bain predicts solid growth for the holidays**

By Darrell Rigby, Kris Miller and Josh Chernoff

Despite continued economic unease in the United States, Bain is forecasting GAFO growth of 3% this holiday season—above the 10-year historical average of 2.1% but below last year’s 4.1% growth.¹ E-commerce sales are becoming an increasingly important component of retailers’ success, with mobile playing a bigger role this holiday season than ever before. Bain is forecasting e-commerce holiday sales will grow 15% in 2011, 4 points higher than 2010. Underlying our forecasts are results that will vary widely by retailer. In this newsletter, we also take an in-depth look at the “hourglass effect”: Luxury and value retailers fare well, while retailers in the middle feel continued pressure.

**Back to the future:**
**Holiday sales will finally beat prerecession levels**

Bain is forecasting holiday sales this year will grow 3% over 2010—below last year’s surprising 4.1% growth but still above the 10-year average of 2.1% (Chart 1). With 3% holiday sales growth, total annual GAFO sales will reach an estimated $1.171 trillion, finally surpassing the prerecession peak of $1.149 trillion in 2007. Although some retail categories will receive a boost from inflation this holiday season, GAFO categories generally will not. The Federal Reserve Bank of Philadelphia’s consensus forecast for fourth-quarter 2011 core CPI inflation is 2%; however, GAFO-specific inflation has been flat to negative over the last year and does not show signs of a reversal in the near term. Clothing is the only GAFO category that has experienced some inflation – up 1.3% in June 2011 from the prior year and likely to continue to increase given rising input costs.

¹ See Charts A and B in the Appendix for GAFO definitions and forecasts
Chart 1:

**Holiday sales growth, 1981–2011**

![Graph showing holiday sales growth from 1981 to 2011]

- 30-year avg.: -4.9%
- 20-year avg.: -3.8%
- 10-year avg.: -3.1%

Note: Holiday is defined as November and December; growth rates are based on the most comparable data available by time. 1991-1992 growth rates are for GAF; 1993-2010 growth rates are for GAFI; 2011 is the Bain growth rate forecast.

Source: US Census Bureau; Bain analysis

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Chart 2:

**Clothing and general merchandise profits, Q4 2001–2011**

![Graph showing clothing and general merchandise profits from Q4 2001 to 2011]

<table>
<thead>
<tr>
<th>Revenue ($B)</th>
<th>After-tax profit ($B)</th>
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</thead>
<tbody>
<tr>
<td>2001</td>
<td>$1698</td>
</tr>
<tr>
<td>2002</td>
<td>$1746</td>
</tr>
<tr>
<td>2003</td>
<td>$1804</td>
</tr>
<tr>
<td>2004</td>
<td>$1848</td>
</tr>
<tr>
<td>2005</td>
<td>$1950</td>
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<tr>
<td>2006</td>
<td>$2098</td>
</tr>
<tr>
<td>2007</td>
<td>$2218</td>
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<td>2008</td>
<td>$2083</td>
</tr>
<tr>
<td>2009</td>
<td>$2148</td>
</tr>
<tr>
<td>2010</td>
<td>$2218</td>
</tr>
<tr>
<td>2011E</td>
<td>$2278</td>
</tr>
</tbody>
</table>


Note: Includes companies with greater than $50 million in assets; profits are measured as after-tax income; clothing and general merchandise represent ~75% of GAFI.

Source: US Census Bureau
Growth is good, but profitable growth is better. We have seen eight straight quarters of year-over-year profit growth in clothing and general merchandise—the two largest GAFO categories. Estimates for the third quarter of 2011 indicate this upward trend may flatten. What does this mean for the holidays? Bain analysis suggests profits will be close to flat in the fourth quarter at the aggregate level (Chart 2), but we expect them to vary greatly across retailers and value segments.

We base our outlook of 3% sales growth on a variety of positive and negative indicators:

- **Sales momentum going into the holidays is strong.** Sales have been trending up since February 2010 (Chart 3), and August–September 2011 GAFO sales grew an impressive 4.9% year-over-year. According to Bain analysis, over the past 18 years, changes in back-to-school sales have explained 66% of changes in holiday sales. Momentum matters, and all six GAFO categories showed stronger back-to-school growth than overall year-to-date trends (Chart 4).

- **Home and stock values are on an upswing.** Case-Shiller reports that average housing prices nationally are up 3.6% from the first quarter of 2011. And the S&P 500 Index is up 5% since last year, and up 11% since the beginning of October. With these recent increases fresh in their minds, consumers—at least affluent consumers—may well be encouraged to shop this holiday season.

- **Interest rates continue to fall.** The Federal Reserve Bank of New York reports consumer credit card interest rates have dropped more than 125 basis points from last August. Mortgage rates also continue to fall, dropping below 4% for 30-year fixed-rate loans from 4.25% last year, according to Mortgate-X. Additionally, although the number of homeowners eligible to refinance continues to decrease, the $783 billion in refinancing expected this year by the Mortgage Bankers Association should give some consumers extra spending power for the holidays.

- **Gasoline prices are trending down.** After peaking at $3.96 per gallon in May, prices fell 13%, to $3.42, by mid-October, and are expected to continue falling through the holidays. Lower gas prices could put an extra $100 in the wallet of the average American household over the holidays, although prices are still above 2010 levels ($2.80-$3.00 per gallon).

- **Overall, inventories are expected to continue to increase, which suggests retailers are optimistic heading into the holiday season.** As of August, total retail inventories were up 4.1% over 2010.² Forecasts for port container import volume, a leading indicator of retail inventory changes, are positive. Global Port Tracker estimates positive year-over-year growth from September to December, following a 7% drop in August versus 2010. In addition, a BDO USA survey of 100 retail CFOs found that 82% report maintaining or increasing holiday inventory this year.

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² The Census Bureau reports inventory data with a two-month lag.
Chart 3:
GAFO year-over-year growth rates, 3-month rolling average, September 2008–September 2011

Note: September 2011 data are based on GAFO.
Source: US Census Bureau

Chart 4:
Year-to-date and back-to-school GAFO performance, year-over-year growth, by category, 2011

| Back-to-school vs. holiday (%) | 63% | 41% | 59% | 23% | 73% | 65% | 66%
|-----------------------------|-----|-----|-----|-----|-----|-----|-----
| Year-to-date 2011 vs. 2010  | 4.3%| 5.9%| 5.8%| 7.9%| 4.8%| 4.7%| 4.9%|
| Back-to-school 2011 vs. 2010 | 0.0%| 1.3%| 0.0%| 3.0%| 2.0%| 2.9%| 3.9%|

Note: Year-to-date performance was calculated for January through September, comparing 2011 and 2010. Office supplies for September 2011 are based on Bain projections. R-squared represents the amount of one variable explained by another variable. Source: US Census Bureau.
Chart 5:  
Total US unemployment rate, September 2005–September 2011

Source: Bureau of Labor Statistics, Bain Macro Trends Group analysis

Chart 6:  
Consumer confidence and sentiment, September 2001–September 2011

Note: MCI indexed to 1964; CCI indexed to 1985
Source: The Conference Board, Thomson Reuters/University of Michigan
• **Retailers are hiring more workers.** According to the National Retail Federation, retailers outside the automotive, fuel and restaurant sectors are planning to hire an additional 480,000 to 500,000 workers for the holiday season. This forecast is roughly in line with last year’s 495,000 increase in seasonal workers but does not include the 100,000 retail jobs created since last August. In total, retailers will have 100,000 more staff members this year than they had heading in to the very strong 2010 holiday season.

• **Unemployment rates, though high, have stabilized.** The official unemployment rate hovered at 9.1% from July through September. The true impact of the labor market on households is almost double what the official rate suggests, however. When we include underemployed and discouraged workers in the September rate, nearly 17% of the working-age population was feeling the effects of the weak labor market (Chart 5). Although many without jobs will struggle through the holidays, those with jobs are less likely to be skittish as they were when layoffs made daily headlines and the unemployment rate was spiraling upward.

• **Consumer confidence is waning.** The Consumer Confidence Index fell to 44.5 in August 2011 — the lowest rate since April 2009 (Chart 6); and preliminary results from the Michigan Consumer Sentiment Index in October suggest that consumers’ expectations for the next six months have hit the lowest level since May 1980. While this is discouraging news, historical results indicate only a weak connection between consumer confidence and actual consumer spending.

**Digital retail continues to thrive as we enter the holidays**

Digital retailing is the most disruptive force to hit the retail industry in decades. It allows consumers to shop the way they want to shop with 24/7 access, trusted recommendations from friends and the best deals available. So it is not surprising that e-commerce continues to grow faster than physical retail sales. According to Forrester Research, online penetration of total retail sales will reach nearly 9% this year. E-commerce experienced double-digit sales growth during the first half of 2011 (Chart 7); and Bain expects the pace to continue through the holiday season, with growth of 15% over 2010. Online behemoth Amazon.com has become the “Walmart of the web.” The company is expected to sell $10.9 billion in North America in the fourth quarter. This is up 51% over last year and Amazon likely will grow at least 30% in 2012 . . . all while raising consumers’ expectations for convenience, value, trust and selection. Furthermore, m-commerce is on the rise. Internet Retailer reports that consumers will purchase more than $5 billion worth of goods in 2011 via their mobile devices.
The effects of digital retailing extend far beyond e-commerce and m-commerce sales. Digital retail is changing the way people shop and altering relationships between retailers and consumers. According to Forrester Research, nearly 50% of total retail sales are influenced in some way by the web: Consumers start their shopping trips online, where they research product content, review customer ratings and search for the best prices.

Consumers are also accessing the web in stores via smartphones. Bain analysis suggests there will be an additional 30 million smartphone users in the United States this holiday season compared to last year. The stakes are high. Digital retail presents an opportunity to gain share by offering the consumer a seamless shopping experience across all channels – online, mobile and physical. But it also presents a tremendous threat to the economics of brick-and-mortar retail.

**Beneath the averages:**
**A tale of three households and the “hourglass effect”**

Not all consumers are on the same footing this holiday season, and not all retailers face the same outlook. Bain’s Macro Trends Group describes a “tale of three households” in vastly different economic circumstances: affluent, aspirational and lower-income (Chart 8). The result is what we call the “hourglass effect”: Luxury retailers at the top and value retailers at the bottom are experiencing strong growth, while many retailers that cater to those in the middle are struggling (Chart 9).
Chart 8:

Total US population and consumption by household tier, 2010

Source: Bain Macro Trend Group analysis

Chart 9:


Source: Capital IQ, company annual reports
Bain recently teamed with ShopperTrak to understand traffic trends by value tier during the back-to-school season. According to ShopperTrak, midtier retailers saw a much bigger drop-off in traffic than luxury and value retailers did. While luxury, value and outlet saw decreases of 3.3%, 2% and 0.5% respectively, midtier specialty apparel and footwear stores saw traffic fall 4.6% and midtier nonapparel specialty stores suffered an 8.2% drop.

**The affluent household**

Affluent households earn more than $100,000 per year. Although they represent the smallest portion of households, they consume the most. This group remains largely insulated from the economic troubles that continue to plague many Americans. Despite recent volatility in the equity markets and softness in upper-end housing prices, affluent household assets have largely rebounded from the recession. Furthermore, unemployment in this segment remains low. Among the affluent, most of whom have college degrees, the unemployment rate is under 4% (Chart 10).

This is all good news for luxury players, many of whom are showing strong momentum heading into the holidays:

- Tiffany & Co. saw second-quarter 2011 sales in the Americas jump 25% from 2010, with most of that growth coming from purchases by foreign tourists.
- The LVMH Group saw US sales increase by 17% in the first half of 2011.
- September total luxury same-store sales rose 5.5%, with Nordstrom and Saks Fifth Avenue posting growth of 10.7% and 9.3%, respectively.
- Burberry saw revenue growth of 29% in the second quarter of 2011, and Finance Director Stacey Cartwright reported seeing “no evidence of any slowdown” ahead of the holiday season.

This strength in affluent consumer spending suggests that this holiday season will be a great finish to one of luxury retailers’ best years in recent memory. In our annual *Luxury Goods Worldwide Market Study*, released this month, Bain predicts robust growth in 2011 of 13% globally and 12% in the Americas.4

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3 ShopperTrak provides a 24/7 managed service that counts the number of shoppers entering and exiting retail stores in 40,000 locations in 72 countries. ShopperTrak’s daily retail foot traffic analytics help set strategies for shopper conversion, store labor scheduling and marketing. [www.shoppertrak.com](http://www.shoppertrak.com)

4 For a copy of the study, please contact Cheryl Krauss at cheryl.krauss@bain.com or Frank Pinto at frank.pinto@bain.com.
Chart 10:

Three distinct US household tiers

<table>
<thead>
<tr>
<th></th>
<th>Affluent</th>
<th>Aspirational</th>
<th>Lower-Income</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income</strong></td>
<td>$100,000+ per year</td>
<td>$50,000-$100,000 per year</td>
<td>&lt;$50,000 per year</td>
</tr>
<tr>
<td><strong>Population</strong></td>
<td>21% of households</td>
<td>36% of households</td>
<td>43% of households</td>
</tr>
<tr>
<td><strong>Consumption</strong></td>
<td>38% share of overall consumption (up 5 percentage points 2006-2010)</td>
<td>33% share of overall consumption (down 2 percentage points 2006-2010)</td>
<td>29% share of overall consumption (down 3 percentage points 2006-2010)</td>
</tr>
<tr>
<td><strong>Jobs</strong></td>
<td>Unemployment: &lt;4%</td>
<td>Unemployment: &lt;6%</td>
<td>Unemployment: ~15%</td>
</tr>
<tr>
<td><strong>Assets</strong></td>
<td>Housing represents one-third of assets</td>
<td>Financial investments represent two-thirds of assets</td>
<td>Housing dominates assets</td>
</tr>
<tr>
<td></td>
<td>None</td>
<td></td>
<td>None</td>
</tr>
</tbody>
</table>

Source: Bain Macro Trends Group analysis

The aspirational household

Aspirational households, households that earn $50,000 to $100,000 a year, have seen the biggest turn of fortune during the recession and through 2011. These aspirants to the American Dream have been pummeled by the housing downturn because the majority of their wealth is tied to home equity. The value of their housing assets has bottomed out in many markets, and roughly one in four mortgages remains underwater—that is, the mortgage exceeds the value of the home. Aspirational consumers continue to trade down, hunt for deals and defer purchases. We have seen spending shift away from midtier retailers to off-price players and discounters. Looking at February-July 2011, dollar stores and off-price retailers saw same-store sales jump 5.2%, while midtier department stores posted just 1.9% growth.

Despite the hourglass effect, some midtier retailers are prospering. Throughout 2011 a number of them significantly outperformed the average and gained share from competitors (Chart 11). And we expect to see continued midtier competition benefit one or two players within each sector at the expense of the rest of the field.
**Chart 11:**

Growth in sales of selected retailers by retailer type, January–June 2010 to January–June 2011

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The lower-income household

Households earning less than $50,000 a year represent the largest segment in the United States yet account for the smallest share of consumption. These lower-income households are still struggling under the burden of an unemployment rate at 14% and a “fully-loaded” rate above 25%.

The winning retailers here are dollar stores and off-price retailers that are delivering lower prices on a wider range of brands and products, and expanding into increasingly attractive and convenient real estate. Customers are heading to the nearest dollar store, scooping up everything from basics to low-cost splurge items, then heading to traditional mass merchant retailers and grocery stores only to complete their shopping lists. The three largest dollar store chains—Dollar General, Family Dollar and Dollar Tree—have grown at an average rate of more than 8% every year since before the recession. They now boast 19,500 stores in the United States and plan to open an additional 1,000-plus stores before the end of the year. We expect dollar stores to continue to outperform other formats during the holiday season, with consensus forecasts projecting double-digit revenue growth in the fourth quarter.
Here’s to another happy holiday season!

We believe that this holiday season will bring solid growth of 3% for GAFO categories and 15% online. But growth and profits are not a given. As always, strategy, the timing of promotions and service across all channels will dictate outcomes. In future issues of this newsletter, we’ll dig deeper into consumer mindsets, e-commerce and omnichannel strategies, and describe what we see as winning approaches to ringing holiday registers.

A preview of our upcoming holiday issues:

- **Issue #2**: Where have all the mall shoppers gone?
- **Issue #3**: Omnichannel retail special edition: The future of retail

**Newsletter schedule**

Our next newsletter will be released in early 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.

**Chart 12:**

<table>
<thead>
<tr>
<th>Data Source</th>
<th>Oct</th>
<th>Nov</th>
<th>Dec</th>
<th>Jan</th>
</tr>
</thead>
<tbody>
<tr>
<td>US Census Bureau Advance Retail Sales (GAFS/GAFO)</td>
<td>14-Oct</td>
<td>15-Nov</td>
<td>13-Dec</td>
<td>12-Jan</td>
</tr>
<tr>
<td>ICSC Monthly Same Store Sales</td>
<td>6-Oct</td>
<td>3-Nov</td>
<td>1-Dec</td>
<td>5-Jan</td>
</tr>
<tr>
<td>Consumer Confidence Index</td>
<td>25-Oct</td>
<td>29-Nov</td>
<td>27-Dec</td>
<td></td>
</tr>
<tr>
<td>BEA Gross Domestic Product</td>
<td>27-Oct</td>
<td>22-Nov</td>
<td>22-Dec</td>
<td></td>
</tr>
<tr>
<td>BEA Personal Income and Outlays</td>
<td>28-Oct</td>
<td>22-Nov</td>
<td>23-Dec</td>
<td></td>
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</tbody>
</table>
| Bain Retail Holiday Newsletter (tentative) | ⭐️ ⭐️ ⭐️ ⭐️ ⭐️
## Appendix

### Chart A:

**Definitions**

<table>
<thead>
<tr>
<th>Category</th>
<th>GAFO</th>
<th>GAFS</th>
<th>GAF</th>
<th>Nonauto retail sales</th>
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<td>General merchandise stores</td>
<td>✔</td>
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</tr>
<tr>
<td>Clothing and clothing accessories stores</td>
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<td>✔</td>
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<tr>
<td>Furniture and home furnishings stores</td>
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<td>✔</td>
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<tr>
<td>Electronics and appliances stores</td>
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<td>✔</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sporting goods, hobby, book and music stores</td>
<td>✔</td>
<td>✔</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Office supplies, stationery and gift stores</td>
<td>✔</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All other retail trade sales not included in GAFO (excluding auto and auto parts)</td>
<td>✔</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Auto and auto parts sales</td>
<td></td>
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### Chart B:

**Forecasted holiday sales growth, 2011**

<table>
<thead>
<tr>
<th>Measure</th>
<th>Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>GAFO</td>
<td>November-December</td>
</tr>
<tr>
<td>All retail (excluding online) except auto and gas services</td>
<td>November-January</td>
</tr>
<tr>
<td>All retail (including online) except auto, gas and restaurants</td>
<td>November-December</td>
</tr>
<tr>
<td>All retail (including online) except auto and gas</td>
<td>Q4</td>
</tr>
<tr>
<td>GAFO</td>
<td>November-December</td>
</tr>
<tr>
<td>GAFO</td>
<td>November-December</td>
</tr>
<tr>
<td>GAFO (June-August)</td>
<td>November-December</td>
</tr>
<tr>
<td>Same-store or comparable-store retail sales, excluding Walmart</td>
<td>November-December</td>
</tr>
</tbody>
</table>

Source: Deloitte; National Retail Federation; Internet Retailer; ShopperTrak; International Council of Shopping Centers; 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.


Bureau of Economic Analysis. “Chain-Type Price Indexes for BEA Retail and Food Service Sales.” Table, September 30, 2011. Available at [http://www.bea.gov/iTable/iTable.cfm?ReqID=12&step=1&acrdn=2](http://www.bea.gov/iTable/iTable.cfm?ReqID=12&step=1&acrdn=2) (accessed October 20, 2011).


Steigrad, Alexandra. “Strong Comps Fail to Ease Holiday Concerns.” WWD, October 7, 2011.


