

BAIN RETAIL HOLIDAY NEWSLETTER

Issue #1



October 22, 2013

Bain expects fourth consecutive year of omnichannel growth

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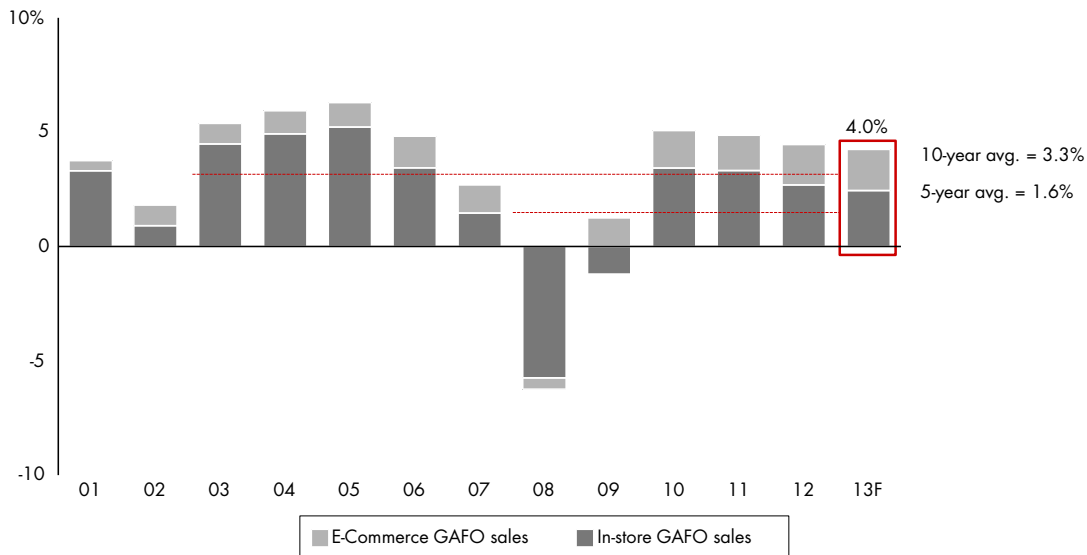
Bain is forecasting omnichannel sales growth of 4% this holiday season, in line with last year. Our forecast encompasses both in-store and e-commerce sales for GAFO categories.¹ We predict in-store GAFO sales growth of 2.5% to 3%, lower than last year's 3% rate but in line with the 10-year average. We expect e-commerce sales to be a strong driver again, with growth of 15% to 17%. Continued improvement in financial markets, housing, and employment has increased consumer wealth and purchasing power, which bodes well for spending this holiday season. However, some watch-outs exist: Recent retail sales momentum, falling consumer confidence, and strong spending on durables could dampen GAFO sales in November and December.

Moderate growth across blurring channel boundaries

Bain expects omnichannel GAFO sales growth of 4% this holiday season (*Figure 1*). Our forecast includes both in-store and online GAFO sales because the two are increasingly difficult to separate. Omnichannel shopping is blurring boundaries, as customers move from personal computers to mobile devices to physical stores throughout the purchase process. For example, a customer may go to a store and see a product she wants, compare prices on her mobile phone, and later buy the product on her computer for pickup in another store. Alternatively, while she is commuting home from work, she may buy a product on her tablet that is shipped from a nearby store to reduce delivery times. These omnichannel shopping behaviors enrich customers' experiences but make sales attribution by channel, and even by device, far more challenging. Any discussion of in-store GAFO sales alone does not tell the whole story. So this year, for the first time, we are forecasting overall GAFO sales growth, across all channels.

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

Figure 1: Growth in holiday omnichannel GAFO sales, 2001 – 2013F



Note: Holiday is defined as November and December; growth rates are based on the most comparable data available by time; e-commerce growth only applies to GAFO sales categories; the growth rates for 2013 are Bain's forecasts
 Source: Bain analysis; Forrester Research, Inc.; US Census Bureau

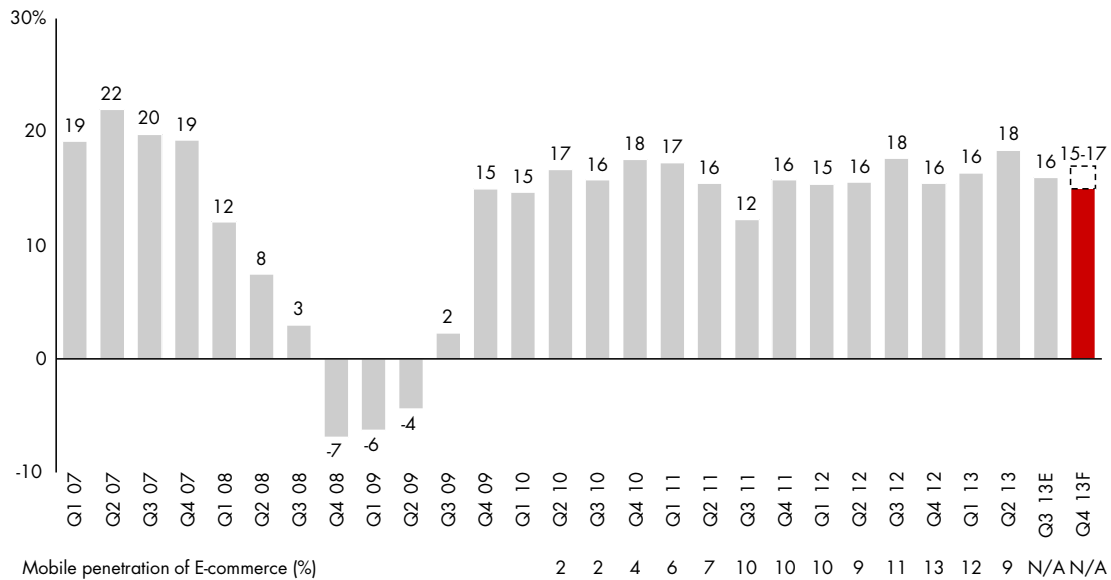
In-store GAFO sales are still critical to the holiday season, comprising roughly 90% of omnichannel GAFO sales. We forecast in-store GAFO sales growth of 2.5% to 3% in the 2013 holiday season, possibly below last year's growth of 3% but above the 10-year average growth of 2.2% (Figure 2). E-commerce has continued to show strong momentum, with 18% growth in the second quarter and 16% estimated growth in the third quarter of 2013 (Figure 3). Increases in e-commerce sales are being driven by consumers' growing adoption of tablets and other mobile devices, and by retailers' investments in better mobile sites and applications. Bain believes that e-commerce will continue its strong momentum and grow 15% to 17% this year. As a point of comparison, analysts expect Amazon's US sales to grow 24% during the last quarter of 2013.

Figure 2: Growth in holiday in-store GAFO sales, 1980 – 2013F



Note: Holiday is defined as November and December; growth rates are based on the most comparable data available by time; 1981-1992 growth rates are for GAF (defined in appendix exhibit 1); 2013 is Bain's growth rate forecast
 Source: US Census Bureau; Bain analysis

Figure 3: E-commerce year-over-year quarterly sales growth, 2007 – 2013F



Source: U.S. Census Bureau; eMarketer; comScore; Bain analysis

Macroeconomic foundations offer a mixed message

Macroeconomic foundations create a varied environment for this holiday season (*Figure 4*). Wealth metrics such as the S&P 500 Index, housing prices and unemployment numbers are most predictive of holiday sales, and this year they point to higher growth. At the same time, recent sales momentum, another predictor of holiday sales, has been sluggish; year-to-date GAFO sales have grown more slowly compared to both last year and the 10-year average. The contradiction between these indicators suggests that although consumers are on better financial footing, that may not translate directly into higher holiday sales growth. We discuss reasons for this later in the issue, including a shift in spending towards durables, and a recent downturn in consumer confidence.

Figure 4: Indicators of holiday GAFO sales growth

	LEADING INDICATOR	MEASURE	2012 VALUE	2013 VALUE	IMPLICATION FOR 2013 GAFO
WEALTH AND INCOME METRICS	S&P 500	Month-to-date growth (momentum)	-0.8%	2.9%	●
	S&P 500	Year-to-date growth	12.2%	19.3%	●
	Case-Shiller index	January–July growth	6.9%	11.1%	●
	Unemployment rate (reported)	Year-over-year change, September	-1.2 percentage points	-0.5 percentage points	●
	New-home sales	Year-over year growth, January–August cumulative	20.5%	67.8%	●
	Disposable personal income	Growth from August 2012	0.3%	0.9%	◐
RETAIL PERFORMANCE	July and August spending	Year-over-year growth, July and August GAFO sales	4.3%	2.5%	○
	YTD GAFO sales growth	Year-over-year growth, January–August cumulative	5.4%	1.6%	○
	Walmart Q4 sales, consensus estimates	Year-over-year sales growth, Q4	2.8% US only (4.4% total)	2.2% US only (3.5% total)	○
	Retail holiday hiring	Year-over –year change	~13%	≤0%	◐
OTHER	Michigan Consumer Sentiment Index	Index value, October	78.3	75.2	◐
	10-year treasury note rate	Year-over-year change, October	-0.39 percentage points	0.82 percentage points	○

● Implies higher growth than last year
◐ Implies growth in-line with last year
○ Implies lower growth than last year

Note: Measures that showed a non-significant relationships to holiday GAFO sales growth include gas prices, the Consumer Price Index, household debt, existing-home sales and the US trade-weighted dollar index; the unemployment rate inclusive of underemployed and discouraged workers had similar results to reported unemployment; all daily metrics were taken at market close on October 18, 2013; GAFOs used to approximate GAFO for August 2013
Source: Bain analysis; US Census Bureau; Bureau of Labor Statistics; Capital IQ (public filings); Case-Shiller 20-City Composite Index; Michigan Consumer Sentiment Index; National Retail Federation; National Association of Home Builders

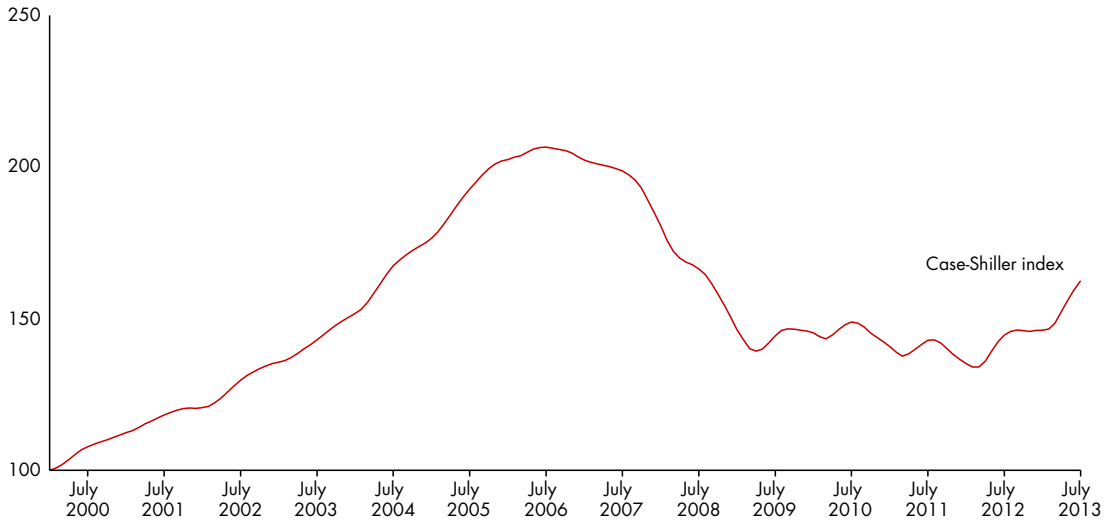
Consumers' ability to spend is at its strongest level since the recession

This year, measures of consumer wealth and financial stability, including the S&P 500 Index, the housing market and employment data are up across the board. Consumers have more wealth and income to draw on this holiday season.

- Financial markets have had a blockbuster year, as demonstrated by the S&P 500 Index's 19% year-to-date gain. The index is at historic highs, which is especially good news for more-affluent consumers, who have two-thirds of their wealth in financial assets. Since October 1, the S&P 500 has climbed 3%, evidence of strong momentum heading into the holiday season, especially compared to last year, when growth was flat over the same period.
- The housing market has improved this year, which, combined with low interest rates, will renew homeowners' access to home equity lines of credit for holiday spending. The 20-city Case-Shiller

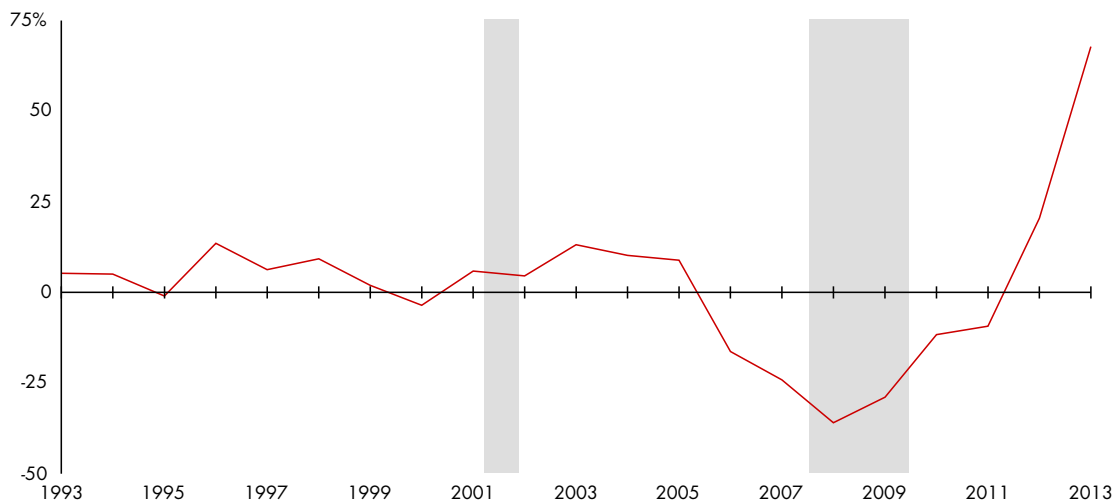
home-pricing index is up 11% since January, versus 7% over the same period last year (*Figure 5*). The index is still well below its 2006 levels, meaning some owners are still underwater. That said, continued upward momentum in home prices is clearly a positive trend for consumers' wallets and psyches. Similarly, new-home sales are up an impressive 70% this year versus an increase of just 21% during this period last year (*Figure 6*).

Figure 5: Case-Shiller index, July 2000 – July 2013



Note: Indexed to 100 in January 2000 and seasonally adjusted
 Source: US Census Bureau; Case-Shiller 20-City Composite Index

Figure 6: Year-over-year new-home sales growth, January – August 1993 – 2013



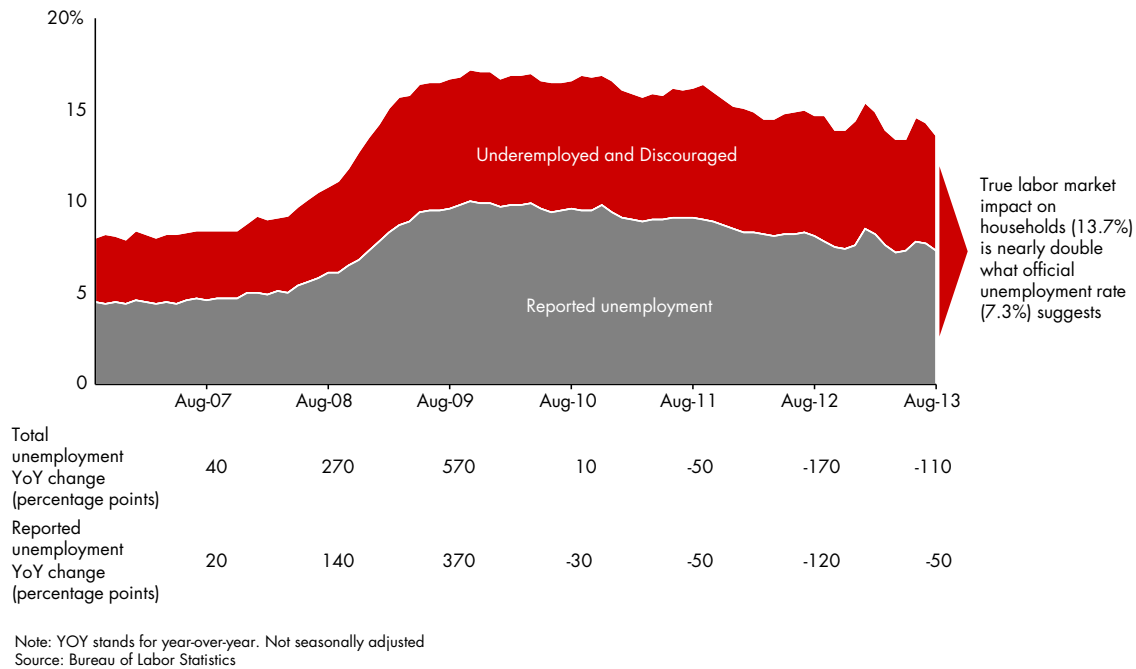
Recession periods:

Mar. 01 – Nov. 01

Aug. 07 – Jun. 09

Source: National Association of Home Builders

Figure 7: Measures of unemployment, August 2006 – August 2013



Total unemployment YoY change (percentage points)	40	270	570	10	-50	-170	-110
Reported unemployment YoY change (percentage points)	20	140	370	-30	-50	-120	-50

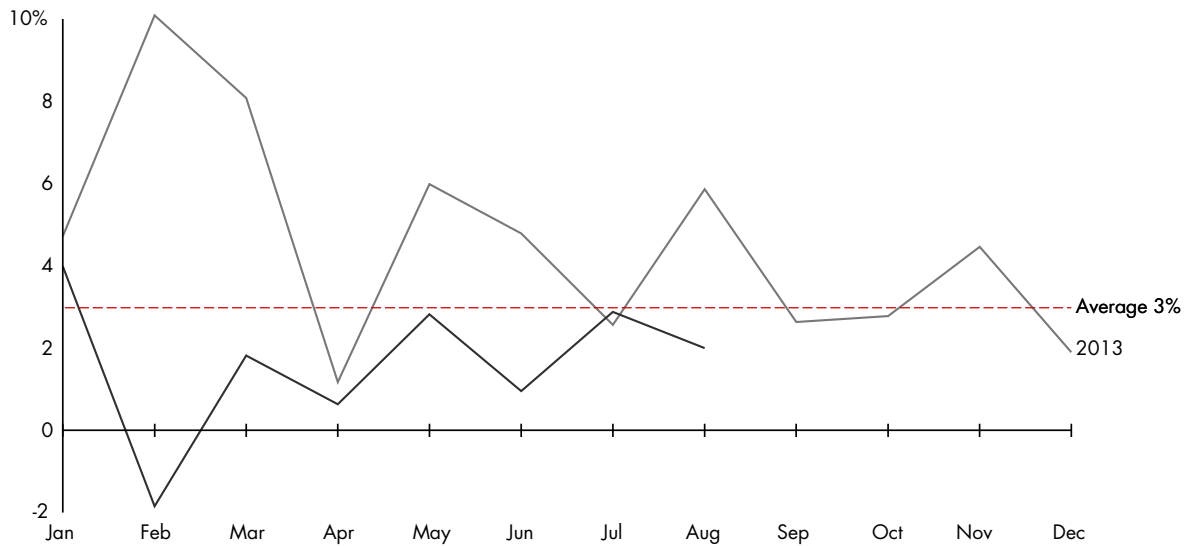
- Reported unemployment is down again this year, 0.5 percentage point since this time in 2012 and 2.5 percentage points over the past four years (Figure 7). The sum of unemployment, underemployment, and discouraged workers was also down, by 1.1% over the past year, more than the 0.5 percentage point decrease in unemployment alone. More jobs bode well for consumers’ confidence and their ability to spend this holiday season.

Where has all the spending gone?

In-store GAFO sales growth has slowed this year, increasing just 1.6% year-over-year during January through August 2013 versus 5.4% for the same period last year (Figure 8). Some of this slowdown is due to cannibalization from online sales, but other factors are also at work:

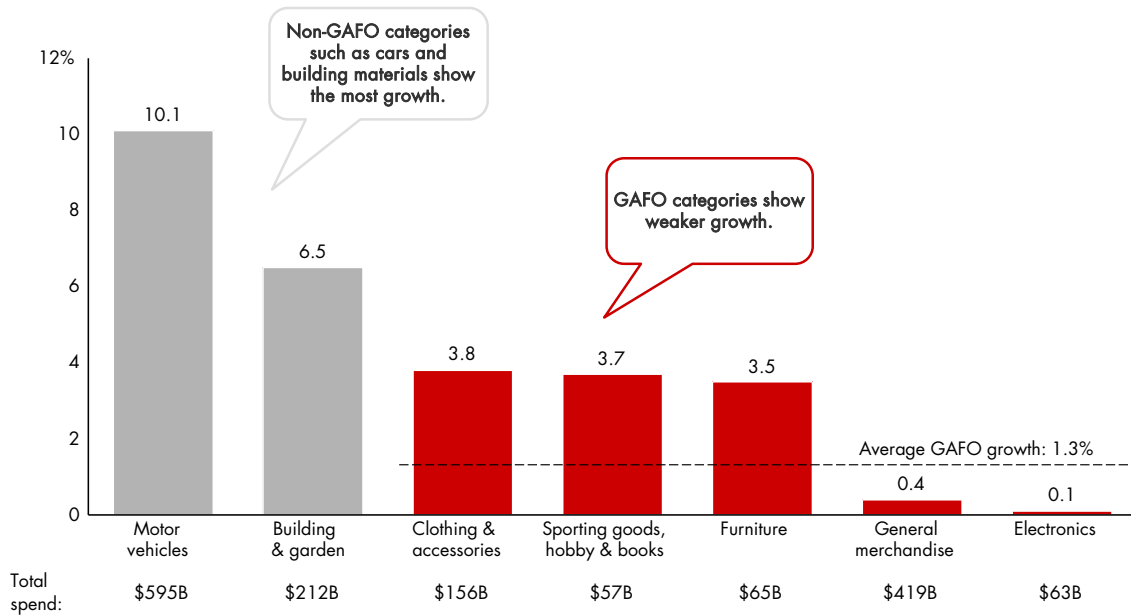
- GAFO sales in the first half of this year grew on top of a very strong 2012. This challenged the 2013 measures, as they had to grow off of a larger sales number. However, last year’s holiday growth was at slower pace, which means that this year’s holiday growth rates do not face as high hurdles as earlier in the year.

Figure 8: Year-over-year in-store GAFO sales growth, by month



Note: Excludes e-commerce; not seasonally adjusted; includes furniture and home furnishing, electronics and appliances, clothing, sporting goods, books, music, hobby, general merchandise, office supplies, stationery and gifts; August 2013 is an advance estimate of GAFO
 Source: US Census Bureau

Figure 9: Year-over-year in-store consumer spending by category, January – August 2013



Note: Excludes office supplies, stationery and gifts because no advance data are available for these categories; excludes e-commerce
 Source: US Census Bureau

- This year, consumers have been spending more on durable goods (*Figure 9*). Consumer spending on motor vehicles and building materials between January and August increased by 10.1% and 6.5% respectively in 2013, much higher than their 10-year average increase over the same period (1.1% and 1.9% respectively). Because spending in these two durables categories is roughly as large as GAFO spend, GAFO growth has likely been impacted. The increase in durables spending probably is due to a combination of pent-up demand from the recession, anticipation of higher interest rates and aggressive marketing—trends that are likely to continue throughout the holiday season.
- Consumer confidence fell quickly over the past few months, from a high of 85 in July to 75 in October. Some of this drop was due to the government shutdown and the debt crisis. In last week's deal, Congress reopened the government through January 15 and raised the debt ceiling until February 7, which should calm the financial markets and consumers through the holiday season. However, uncertainty about long-term solutions could continue to affect consumer confidence and spend.
- Although unemployment has dropped, even those fortunate enough to be employed see many of their neighbors out of work or underemployed. This creates a psychological headwind to discretionary spending, even among consumers who have recently acquired new wealth or income. Walmart has stated that its customers are feeling on shaky ground this year. In response, the retailer is planning to cut costs and offer “basic products” at lower prices.
- Most market analysts are predicting a slower holiday season this year. Fourth-quarter consensus estimates across the top 30 retailers suggest just 1% weighted average growth, and several research firms have predicted flat to falling hiring.

Retailers are sending mixed signals this holiday season

No one has greater insight into holiday sales than retailers themselves, which will drive sales based on their inventory, pricing, promotion, marketing, online, and store service strategies. Retailer-specific strategy and execution are leading to mixed outlooks:

- This year, Walmart is hiring 55,000 seasonal workers compared to 50,000 in 2012. But the company recently lowered its global fiscal year 2014 sales growth estimate from 5% to 6%, to 2% to 3%.
- Informed by data analysis of shopping patterns, Target has significantly decreased its seasonal hiring, from 88,000 in 2012 to 70,000 this year.
- Toys “R” Us and Kohl’s will maintain holiday hiring at 2012 levels, adding 45,000 and 50,000 seasonal workers respectively.
- Amazon.com expects to increase its seasonal positions this year from 50,000 to 70,000 in response to increased customer demand.

Successful retailers are innovating to deliver a superior omnichannel experience for their customers

This season more retailers will deliver seamless omnichannel experiences and roll-out innovations in fulfillment, marketing, pricing and information technology. Target plans to have its “Buy Online, Pick Up in Store” service operating at all 1,800 of its US stores by Black Friday. Macy’s will be using at least 500 of its 800 stores as online fulfillment centers by the end of the year. Walmart has launched an improved mobile app that “scans as you shop,” expediting access to product reviews and checkout. EBay is investing heavily in new mobile-payment technologies. Staples, Target, Toys “R” Us and Best Buy are all promising to match Amazon.com’s pricing. Other retailers are using technology to empower store associates to make real-time pricing decisions.

In our future releases, we focus on a number of omnichannel themes to keep you up to date on the latest trends and innovations this holiday season:

- **Issue #2 (mid-November):** I want it, I want it now and I'm not afraid to use this mobile device!
- **Issue #3 (early December):** Post-turkey roundup, and the art and science of pricing and marketing.
- **Issue #4 (mid-December):** The prime-time battle: Amazon.com versus an outstanding omnichannel store experience.
- **Issue #5 (late January):** Post-holiday outlook and retailer imperatives for 2014.

Please let us know if you have specific topics you would like to learn more about. We look forward to sharing news of innovations and interesting strategies with you this holiday season.

Appendix

Exhibit 1: Definitions of retail sales measures

	Omnichannel	Traditional in-store		
	GAFO	GAFO	GAFS	GAF
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	✓	✓		
Online sales in the categories above	✓			
All other retail trade sales not included in GAFO				

Note: Omnichannel GAFO sales include in-store and online sales for both traditional retailers and online-only retailers. In-store GAFO sales do not include sales of online-only retailers or the online sales omnichannel retailers that break out online sales in their reporting. However, in-store GAFO sales may include the online sales of omnichannel retailers that do not report a break-out between their online and offline sales in their census filings.

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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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