

BDO CAPITAL RETAIL & CONSUMER PRODUCT

Q2 2010 Industry Update



CONSUMER CONFIDENCE DROPS, WHILE LUXURY CONSUMPTION BOUNCES BACK

► SUMMARY

After several months of improvement, consumer confidence suffered its second consecutive decline, dropping to 50.4 percent in July and leaving retailers queasy in advance of back to school and the holidays. Persistently high levels of unemployment, tight credit, and stock market gyrations continue to cast clouds over retail and consumer goods. Amid the uncertain signs of economic improvement, June retail trends surprisingly show better than expected sales for luxury and department stores, while discounters are disappointed. Upper-income spending surged, while lower-income spending dropped. Typically, upper-income Americans' spending habits mirror the Consumer Confidence Index (CCI) while for lower-income Americans, the revenues of Wal-Mart perhaps are a better barometer of financial health. June retail data bucks these historical trends and shows an uncertain future for retailers.

CONTACT:



JEFFREY R. MANNING
Managing Director
212-885-7396
jrmanning@bdocap.com

www.bdocap.com

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► CCI AND SPENDING TRENDS AMONG UPPER-INCOME HOUSEHOLDS

As the economy and consumer confidence become volatile, the upper-income group is able to reduce spending during uncertain economic times, and increase spending when times are better. In 2003-2006, when consumer confidence rose, upper-income expenditures did as well; and when CCI dropped in 2008 due to the implosion of Wall Street, spending among those earning over \$100k annually also fell. If this trend continued, the mid-year CCI drop would be matched by more conservative spending. However, same-store sales at department stores rose 5.9 percent, and same-store sales at luxury chains soared 8.8 percent.

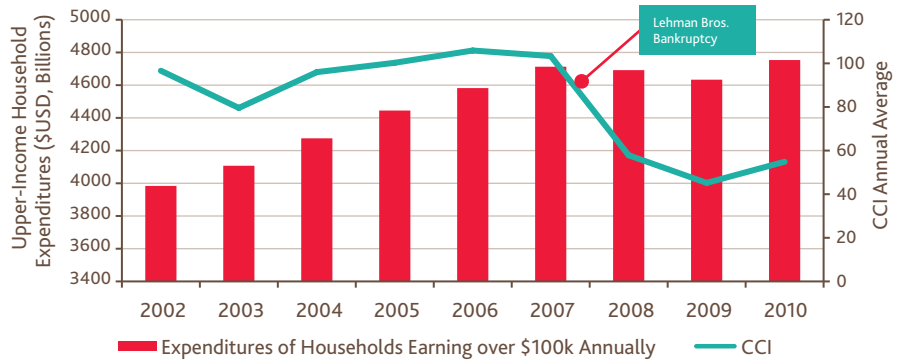
► SPENDING TRENDS OF THE WAL-MART CUSTOMER

Wal-Mart revenues effectively mirror the expenditures of households making under \$25k a year. This group's rate of spending has slowed due to high rates of unemployment, high consumer debt levels, continuing home foreclosures, and dismal prospects for improvement. This shift in spending could help explain Wal-Mart's sluggish growth in the first quarter of fiscal year 2011.

Wal-Mart CFO Thomas Schoewe asserted that rising gas prices prevented customers from shopping as often and spending as much. Despite better-than-expected first quarter 2011 results, Wal-Mart growth slowed as same store sales declined 1.4 percent due to "soft consumer traffic, partially offset by an increase in average ticket, compared to the first quarter of fiscal year 2010," according to a Wal-Mart press release. Strong international growth also helped bolster the retailer's revenues.

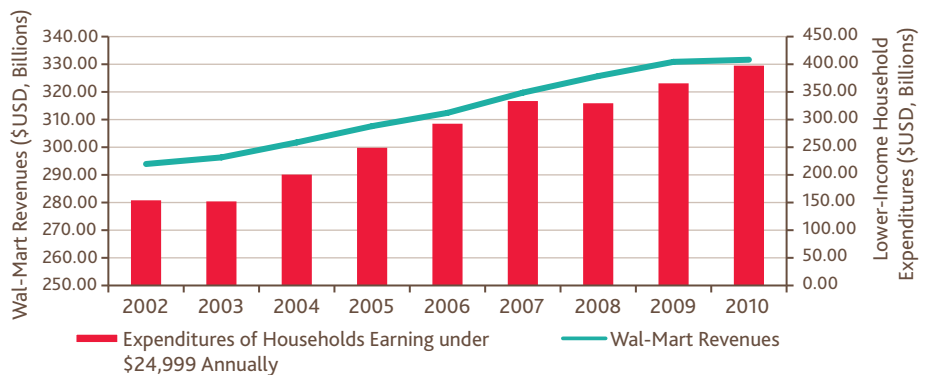
Discount retailers like Wal-Mart typically improve amid economic downturns, but not so in the current Great Recession. In June, discounters saw sales rise a mere 2 percent. As The Great Recession began, wealthier shoppers flocked to Wal-Mart, possibly explaining the increase in revenues despite stagnant expenditures from 2007 to 2008 by their core customers. Executives at the retail heavyweight cite "frugality fatigue" as one cause of their May decline in revenues. As these "recession shoppers" become tired

Consumer Confidence Index and Expenditures Among Upper-Income Households



Source: IBIS World, The University of Wisconsin

Wal-Mart Revenues and Expenditures Among Lower-Income Households



Source: IBIS World, CapitalIQ

of bargain shopping, they take their wallets to higher-end department stores such as Nordstrom (sales jumped 14.1%) or Macy's (sales rose 6.5%). Hence, Wal-Mart revenues were flat and luxury retailers surprised with an increase in revenues.

► SAME STORE SALES – OUTLOOK FOR THE FORESEEABLE FUTURE

Are these spending trends sustainable? Spending among less affluent Americans slowed in the past two years. Expenditures among wealthier Americans is higher than 2007 and 2008 spending levels, indicating that this spending trend also might not be sustainable. A return to pre-2008 levels of spending might be the best indication of economic health and recovery. Until then,

retail will likely continue to be a mixed bag, with discrepancy between upper-income and lower-income spending.

► BDO CAPITAL ADVISORS AND THE UNCERTAIN CONSUMER & RETAIL ENVIRONMENT

While the economists and pundits are perplexed about the Great Recession, the state of the recovery, and the economic outlook over the next 12-18 months, we have practical recommendations as business people try to run business during these uncertain times:

1. **Focus on Cash Flow to Avoid any Liquidity Crunch:** Everyone in our business talks about "cash is king," but

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refining your cash flow modeling and monitoring may prevent little issues from becoming a major crisis;

2. Communicate Bad News to the Right

Constituents: Uncertainty can grow into a major distraction. You are not alone during these challenging times, and by communicating effectively and forthrightly to your lenders, vendors, customers, and employees you should build credibility and linkage that will pay off substantially as the economy finally returns to a normal path;

3. Increase Transparency with Senior

Lenders: Many providers of working capital, especially those catering to the middle market, remain skittish and under regulatory scrutiny. Officers and directors

need to keep in close contact with these lenders to avoid developing any "credibility gaps" that may undermine access to working capital for future growth.

4. Document the Business Judgment Rule:

As you manage your business, document your thinking along the way to mitigate risk in the event of a "double-dip" or another economic setback. Business judgment protects officers and directors from after-the-fact attacks and litigation, but you need to keep your files up to date; and

5. Hire a Seasoned Team of Professionals:

Although self serving, the point is special situations work has become highly specialized, and while each situation is unique, the shared experience from

other companies that have successfully reorganized gives these professionals credibility with stakeholders that may be hugely beneficial. Finally, think about the following: if a person comes down with a serious illness, their first thought is usually not how to find the cheapest doctor to provide care. Get a seasoned team of professionals, and be prepared to pay for quality and value. A lot of business people who go cheap early end up buying higher quality resources in the end.

BDO Capital Advisors works in concert with BDO Consulting and BDO Corporate Advisors, LLC to provide a range of service solutions in a one-stop-shop to deal with your restructuring and special situations needs.

ABOUT JEFFREY R. MANNING

Mr. Manning is a managing director and group head of BDO's special situations practice. With 29 years of professional experience, he has been active across the special situations market since 1983, with activity in investment banking, loan workout, operating restructuring, value investing, bankruptcy advising, and loan trading.

Prior to joining BDO Capital Advisors, LLC (formerly Trenwith Securities, LLC), Mr. Manning was the Chief Executive Officer of FTI Capital Advisors. He has also led the special situations practice at other Wall Street firms, including Legg Mason Wood Walker and Rodman & Renshaw, and he started the Global Bank Debt trading at Schroder Wertheim. Mr. Manning began his career with Manufacturers Hanover Trust, spent five years working at Dun & Bradstreet and then he moved to Wall Street at S.N. Phelps & Co.

Mr. Manning holds a B.A. from Yale University and an M.B.A. from Columbia University. Mr. Manning is qualified as a General Securities Representative and as a General Securities Principal. He also holds the Certified Turnaround Professional designation.

A frequent speaker at industry and university events, Mr. Manning authored a chapter for the Thomson Reuters / Aspatore book *Inside the Minds: The Industries Most at Risk in Bankruptcy* Legal and Financial Experts on What to Expect, Avoiding Financial Trouble, and Thoughts on the Future. Jeff's chapter is entitled "Saving Technology and Service Companies from Chapter 11".

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