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SUMMER 2013
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THE NEWSLETTER OF THE BDO RETAIL AND CONSUMER PRODUCTS PRACTICE

CONSUMER BUSINESS COMPASS

RETAILERS GET BRIEF REPRIEVE ON ACA RULES, BUT PREPARATION IS STILL CRITICAL

By Patrick Pilch and Tony DaSilva

New features of The Patient Protection and Affordable Care Act (PPACA), also known as the Affordable Care Act (ACA), were scheduled to go into effect Jan. 1, 2014. In July of 2013, a critical aspect of the ACA, the Employer Mandate, was delayed until Jan. 1, 2015, in order to provide employers and insurers with additional time to implement the data management and administrative systems necessary to comply with the reporting requirements under the ACA. Not surprisingly, the delay was widely welcomed by industry groups, such as the National Retail Federation, and a variety of interest and advocacy organizations have renewed their calls for permanent changes, or at least further delay. A recent poll conducted by The Kaiser Family Foundation found that 43 percent of respondents had an unfavorable view of the ACA, while 35 percent had a favorable view and 23 percent were undecided.

While the outcome of efforts to change or further postpone aspects of the law is unclear, the delay creates an opportunity for retail leaders to consider employer challenges and determine appropriate benefit plan design and structure for their employees and enterprises.

The complexity of the mandate and costs of compliance create additional pressure on

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DID YOU KNOW...

At the end of Q2, retail space vacancies hit their lowest mark in four years, according to ***The Wall Street Journal***.

According to a ***Nielsen*** survey, geography plays a big role in determining shopping habits and brand affinity, as 60 percent of respondents in Asia-Pacific were willing to pay extra for designer products, which exceeds the global average by 17 points.

Our ***2013 BDO Retail RiskFactor Report*** found that 97 percent of retail businesses cite federal, state and local regulations as a risk to their business.

Consumer comfort levels reached a five-year peak in June, according to the ***Bloomberg Consumer Comfort Index***.

Half of all retail and hotel projects will be green buildings by 2015, says a recent ***SmartMarket*** report.

New data from ***UPS*** reveals that 46 percent of U.S. online consumers felt less likely to comparison shop if they're absorbed in a specific retailer's mobile app.

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ACA RULES

management in planning for implementation. The overall impact of healthcare reform on retailers' business models cannot be understated. Therefore, now is an opportune time for employers to assess the ACA's effects. Retailers should review current health benefit plans, check their prospective compliance with the rules and assess penalty risks. They should also compare various plans and benefit alternative structures that could satisfy compliance requirements and employee retention, recruitment, productivity and satisfaction objectives, as well as address the financial challenges that retailers face every day.

KEY CONCERNS FACING RETAILERS

The retail industry faces many unique challenges related to the ACA. Net profit margins are among the lowest when compared with the bottom lines of companies in other industries. Retailers also employ more part-time—and often lower-paid—employees than other industries, which heightens the sensitivity to the ACA. A 2012 Mercer survey showed that approximately 50 percent of retailers currently do not offer coverage to employees who work 30 hours per week or less. The same survey found that over 40 percent of retailers believe their current plans will not meet the 9.5 percent of household income affordability test. Lastly, the 2013 Kaiser survey cited above found that the cost of insurance was the greatest impediment for the uninsured to overcome. Even if employers offer coverage to the previously ineligible or uninsured, will the uptake in coverage materialize if employees feel that the available subsidies are not adequate or that the coverage is unaffordable?

WHAT OPTIONS SHOULD RETAILERS EXPLORE?

Extending coverage to currently ineligible employees will likely result in increased costs to many retailers. It's important to look at the states in which you currently operate, since some may expand Medicaid coverage (to individuals at 133 percent of the federal poverty level), which could cover employees and potentially take the employer out of the picture. As the Kaiser poll found, part-time employees typically opt out of coverage due to a lack of affordability. Will the individual mandate, which imposes a penalty on individuals who fail to maintain coverage, cause part-timers to enroll in an employer's plan? Social science studies suggest that even a small penalty can modify behavior and could lead the uninsured to enroll in a plan, even if the cost of the insurance exceeds the amount of the penalty.

Faced with so many variables and technicalities to weigh and analyze, retailers shouldn't lose sight of the fact that any contemplated change to their workforce strategy needs to align with customer strategy. That is a priority.

Determining the optimal mix of full-time and part-time employees and identifying customer composition, demographics, location needs and enhanced experience is the place to start. Considering the costs of administrative and compliance responsibilities is also critical. For example, it will be difficult to manage and control hours if you operate under a decentralized or independent decision-making model.

QUESTIONS RETAILERS SHOULD CONSIDER

- What composition of full-time and part-time employees will achieve the right balance between health care costs and workforce productivity?
- What will be the real and practical impact of reducing all or a segment of the workforce to less than 30 hours in order to fall outside of the ACA penalties for failure to meet the employer mandate?
- What will happen if affordable coverage is extended to substantially all employees with 30 hours or more, as well as their dependents?
- Should you stay the course and pay the penalty?
- Do the existing health plans meet the PPACA's definition of "affordability?"
- What will it take to make a plan affordable?
- What is the status and likely outcome of the insurance exchanges in the states in which you operate?
- What is the status of the healthcare providers in the markets you operate? Are they creating their own insurance plans?
- How can you move to lower cost of care providers (including hospitals and physician groups) in the markets?
- What are the true costs or benefits of the various options of providing healthcare insurance to employees?

While the calculus associated with the right mix of full-time and part-time employees shifts the perspective to cost cutting, retailers need to consider options to leverage the data and available technologies to understand customer preferences and purchasing patterns, and identify opportunities to grow revenue per full-time employee. Through leveraging technology, partnerships with distributors, and social media, retailers can also address the potential cost increases associated with the ACA.

Thinking through healthcare reform will require retailers to examine their operating models. The world is no longer static, and change management efforts must be undertaken as retailers manage scheduling and hours, productivity, training and overall workforce strategies. Cogent and frequent communication is imperative to all parties. Retailers experienced anxiety before the government announced the one-year delay, feeling that they had not had adequate time to prepare for the law's rollout. It is important to take action now, so that retailers are on stronger footing and are better organized as 2015 approaches.

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BDO SPOTLIGHT:
Q&A with Randy Frischer

What led you to focus your accounting work in the retail industry?

I am primarily a generalist, but a retail focus became a natural area of interest for me as a result of being assigned as the tax partner to some of the firm's retail clients. Over the past 20 years, I've worked with some of the firm's largest retailers, as well as middle market and entrepreneurial companies. Also, I've had quite a few inbound retail clients in the U.S. that are based in Europe. What I find most interesting from a tax perspective about the industry is that retailers normally have high effective tax rates and cash flow. Tax savings and tax deferral are important to alleviate these concerns through recommendations of such things as favorable accounting methods, credits, and sales and use tax advice. Overall, the retail industry affords me the opportunity to assist clients in achieving their management goals.

What do you see as some of the biggest challenges that are facing the industry right now?

In my view, the biggest challenge facing the industry is growth in an e-commerce world. Brick-and-mortar retailers are undergoing big changes in the online retail side of their business. Rents and payroll are becoming a large burden. This presents numerous planning opportunities, since many of the traditional expenses are reduced with an Internet retail operation. The big players, such as Amazon.com, are firmly entrenched in the online space, and it creates a daunting challenge for many retailers that lack the resources of these larger competitors.

What are some of the biggest opportunities for growth that you see?

Many business models in the retail sector are becoming Internet-based. The biggest growth opportunity right now involves reinventing retail business to appeal to a broader public. To do so, retailers should consider critical approaches to offering consumers something unique (a niche business, e.g., Starbucks), or maintaining a substantial online business to stay competitive. Retailers, particularly small businesses, are teaming with Amazon.com for its customer appeal, customer base and large distribution facilities.

I also think new growth opportunities are going to involve controlling costs. My retail clients are reducing expenses by managing payroll, rent and inventory costs. For instance, some retailers are looking more toward distribution centers to drop ship inventories. Reexamining cost inefficiencies will help spur growth and profits, but real growth will primarily depend on how they reinvent themselves to achieve market share.

What are some potential impacts of tax changes—both corporate and individual—that you see on the horizon?

There has been a lot of attention focused on how to make state sales tax collections apply to each online sale, and it will likely remain a hot topic over the next year or two. Many smaller online retailers are now competing without having to charge a sales tax, and proposed legislation would change all of this in order to put everybody on equal ground. This could particularly affect small retailers, as they would no longer have the ability to not charge sales tax. The record keeping burden and possible quicker shipping of the large online retailers could create setbacks for smaller retailers. In addition, increases in individual tax rates will likely lead to some cuts in discretionary spending. If people think that they have less wealth, they are going to be more careful and spend less. Once the holiday season gets going, we'll see the real effects of this dynamic.

What do you see as the overall impact of the work you do?

On the tax side, a lot of the work we do is transactional. The retail industry faces some of the highest effective tax rates of any sector in the economy, which provides us with a unique challenge when we sit down with our clients and analyze their tax situations. We focus on diverse issues such as more favorable accounting methods, more efficient and cost-effective inventory strategies, state and local tax structuring, rent planning and overall supply chain dynamics that we can improve in order to leverage tax opportunities. Ultimately, we're focused on working to provide exceptional service that helps our clients meet their challenges and achieve their business objectives.

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RETAIL IPO ACTIVITY TO SLOW, BUT 2013 TO REMAIN A STRONG YEAR OVERALL

By Ted Vaughan

2012 heralded the best year for retail initial public offerings since 2002—S&P Capital IQ reported seven offerings for the year—and when we released our ***2013 IPO Outlook Study*** earlier this year, 30 percent of capital markets executives expected IPOs in the retail and consumer products space to continue to grow in 2013. Now that we're well into the second half of the year, how have those expectations fared?

Through the first half of this year, 2013 is poised to do even better than 2012. We've seen eight planned or executed IPOs from a broad range of retail and consumer products brands, much of it driven by private equity firms. Some of the most notable IPOs have included a planned $100 million offering from luxury retailer Neiman Marcus, as well as offerings for Claire's, COTY, RetailMeNot, Fairway and Noodles & Company. China-based online retailer LightInTheBox.com also presented the first public offering of a Chinese company in the United States this year, successfully raising $78.9 million in the process. Robinsons Retail Group, an operator of hardware stores, supermarkets and department stores in the Philippines, indicated plans to file an IPO in their home country, but have placed it on hold until market conditions improve.

Some key factors underlie this relatively robust IPO activity. In particular, the first half of the year is a ripe time for retail IPOs. Companies are often coming off a high from holiday sales (which can now extend well into January), so they not only have the resources to support an IPO filing, but also the strength of their Q4 results bolstering the company's attractiveness to potential shareholders.

At the same time, the U.S. economy is in the midst of a modest recovery. Job numbers are slowly starting to stabilize, with unemployment remaining steady at just below 8 percent. Housing prices are inching upward, interest rates remain low and consumer confidence has been improving as promotions have encouraged increased spending. Though the retail sector continues to see only soft growth, June and July have both seen stronger same-store sales than those observed earlier in the year, indicating that consumers may be loosening their budgets a little more.

Another factor likely influencing these IPOs—as well as those that may be headed down the pike—is growing international interest in going public in the U.S. While international markets have attractive qualities, such as high growth short-term opportunities, they also carry more risk. With the U.S. economy on the mend, the U.S. markets offer longer-term growth and stability. The growing competitiveness of online retail and rise of omnichannel retailing are also driving companies to investigate new strategies for raising the funds necessary to make investments in online and mobile technology.

The second half of the year is not likely to be quite as busy on the IPO front. In July, we released our ***IPO Halftime Report*** exploring capital market executives' assessment of the first half of the year, and their projections for the second half. This time, 28 percent of executives surveyed expect an increase in retail IPOs for the rest of the year and, in many ways, this is unsurprising. The third and fourth quarters of the year are times of heavy promotional activity and end-of-year planning for retailers as they ramp up their back-to-school and holiday shopping activities, pushing IPO planning to the back burner. At the same time, the restaurant and food & beverage sectors, which are less influenced by the holiday calendar, may proceed as planned with IPOs. A few additional offerings over the next six months puts 2013 on track to meet or exceed 2012's numbers, rounding out a solid year for retailers looking to go public.

If your company is considering entering the public markets in the next year, providing a promising value proposition to potential investors should be a top priority. You should be able to demonstrate steady annual growth, as well as the ability to both predict quarterly earnings in the next year and to hit those targets. Many of this year's IPOs came on the heels of strong earnings results and future projections. You should also carefully track investor appetites. Neiman's planned IPO comes on the heels of a relatively strong stretch of growth for the luxury retail sector, as high-income consumers have weathered the economic storm over the past year.

Finally, you should clearly outline the ultimate goal of the IPO. How you use your proceeds, in many ways, will determine whether shareholders will see value in investing. Will you be using proceeds to pay down debt, make investments in new technology or perhaps even acquire another firm? Any IPO must be rooted in solid financials and a clear path forward, both for your own company and for potential shareholders.

This article was originally published in Chain Store Age.

Ted Vaughan is a partner in the Retail & Consumer Products practice at BDO. He can be reached at tvaughan@bdo.com.

THREE LESSONS FOR FRANCHISE LEADERS

By Jay Duke

We recently had the pleasure of attending and sponsoring the FaegreBD Franchising Summit, hosted by Brian Schnell, an esteemed thought leader in the franchise industry. Amid recent growth, there is an air of excitement around franchising, and we returned with fresh insights and perspective on this dynamic time in the industry.

Here are a few of our most memorable takeaways from the program:

Effective franchise leadership requires setting (and sticking to) priorities.

As Steve Romaniello, Managing Director of Roark Capital Group, told us, franchise leaders should be laser-focused on the objectives that are achievable. To effect real change, set priorities that will enhance the company and have few barriers or prohibitive costs and execute there first.

You can only be as successful as the leaders you have in place.

It's crucial to be extremely careful in choosing leaders. Leaders in this industry must be decisive and, to achieve success, underperformers should be eliminated quickly. Steve recommends looking at metrics on a daily and weekly basis to evaluate leaders and teams.

Pay close attention to unit level metrics.

Many franchisors don't pay enough attention to the unit level metrics of day-to-day operations for each location. According to the "panel of pros," this means they are missing out on key opportunities to optimize profitability, make better informed business decisions and effect swift change. It's important to find a way to aggregate your day – and your POS system may help – to get actionable data on an hourly and daily basis to run stores effectively from a corporate level.

We were proud to sponsor and participate in such a powerful program and first-class event. Following the successful meeting, I was happy to reaffirm my commitment to the industry by personally giving $5,000 to FranPAC to support the endeavors of the International Franchise Association (IFA).

And while the speakers and insights were exceptional, the icing on the cake was having the chance to network with new friends and connect with clients and colleagues. We hope to see you at next year's event!

Jay Duke is the Southwest Assurance regional managing partner at BDO and leader of the Franchise practice. He can be reached at jduke@bdo.com.

PErspective in Retail & Consumer Products

The franchise space has been a bright spot within the retail sector in 2013, demonstrating signs of significant growth, as evidenced by the addition of 19,160 jobs in May and another 27,910 jobs in June, according to the ADP National Franchise Report. This growth has attracted the attention of private equity investors that are emerging as a significant source of growth capital within the industry. But "getting the deal done" is not an easy task.

In order to ensure franchisors successfully navigate and capitalize on these opportunities, it's important to keep in mind several common mistakes that companies make and how to avoid them:

1. **Not investing in qualified professional counsel.** Having skilled legal and financial counsel is a bottom-line requirement in these types of transactions. Investing in good advisors upfront will help to avoid snags during and after the financing.
2. **Inadequate or non-existent due diligence.** Both the buyer and the seller need to complete thorough due diligence before entering into a transaction. On the buy side, a private equity firm should be looking in particular at the management team, the strategy and the value proposition of the franchise. On the sell side, the franchisor must be sure to get its house in order with updated, clean balance sheets and a clear understanding of the unit economics of its company.
3. **Failing to plan for the long term.** With these types of deals, a franchisor is often selling his or her most significant asset, and needs to be thinking in terms of not only his or her success, but also the success of the franchise itself. Any franchisor going into a deal thinking only of his or her own bottom line will likely put off a prospective investor.
4. **Maximizing profit at the expense of the franchisees.** When investing in a franchise, a private equity firm isn't only entering into an agreement with the franchisor—it is also entering into an agreement with a large network of franchisees. The fortunes of the franchise rise and fall on the success of these business owners, and the deal must take into account their long-term growth and health.

To read further about common private equity mistakes and how to manage investments in the franchise industry from the bottom up, visit the *Consumer Business Compass* blog and read our post: "Private Equity and Franchising: 7 Pitfalls to Avoid."

PErspective in Retail & Consumer Products is a feature examining the role of private equity in the retail and consumer products industry.

2013 CALENDAR

The following is a list of upcoming conferences and seminars of interest for retail and consumer product executives:

SEPTEMBER 2013

September 16-17
2013 IFA Public Affairs Conference*
JW Marriott
Washington, D.C.

September 18
Luxury Retail Summit 2013
National Museum of the American Indian
New York, N.Y.

September 25-26
Springboard Franchise Summit*
Hotel Monaco
Philadelphia, PA

September 25-27
Cross-Channel Retail Executive Summit
Four Seasons
Dallas, Texas

September 30-October 1
2013 Multi-Unit Foodservice Operator (MUFSO) Super Show
Hyatt Regency at Reunion Tower
Dallas, Texas

September 30-October 2
Shop.org Annual Summit 2013
Lakeside Center at McCormick Place
Chicago, Ill.

OCTOBER 2013

October 2-3
Chain Restaurant CEO Policy Summit
TBA
Washington, D.C.

October 9-10
Franchise Leadership and Development Conference
Intercontinental
Atlanta, Ga.

October 20-22
American Bar Association Franchise Conference
Rosen Shingle Creek Resort
New Orleans, La.

October 24-26
West Coast Franchise Expo
Anaheim Convention Center
Anaheim, Calif.

October 10-11
TAMU Retailing Summit*
Westin Galleria Hotel
Dallas, Texas

October 12-15
NACS Show
Georgia World Congress Center (GWCC
Atlanta, Ga.

October 13-16
Association for Retail Technology Standards Users' Conference
The Drake Hotel
Chicago, Ill.

October 16-18
RILA's Retail Law Conference
The Ritz-Carlton Phoenix
Phoenix, Ariz.

NOVEMBER 2013

November 4-6
Restaurant Finance and Development Conference*
Wynn Las Vegas
Las Vegas, Nev.

November 14-15
Women's Wear Daily Apparel & Retail CEO Summit
Plaza Hotel
New York, N.Y.

November 17-19
Private Label Trade Show
Rosemont Convention Center
Chicago, Ill.

**Indicates that a BDO representative will be present at the event*

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BDO RETAIL AND CONSUMER PRODUCTS PRACTICE

BDO has been a valued business advisor to retail and consumer product companies for 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.

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