

2012 BDO RETAIL RISKFACTOR REPORT



RETAILERS FOCUS ON EXTERNAL BUSINESS THREATS AS STRATEGY CONCERNS EASE

The *2012 BDO RiskFactor Report for Retail Businesses* examines the risk factors in the most recent 10-K filings of the largest 100 publicly traded U.S. retailers; the factors are analyzed and ranked by order of frequency cited.

Retailers appear more confident in their business strategies and consumer spending outlook, due to generally positive sales results in early 2012. As retailers grow more adept at responding to evolving shopping practices and multiple selling platforms, they are turning their attention towards new challenges and opportunities.

This year, retailers are increasingly concerned about risks that lie outside of their control and could threaten positive momentum. The unpredictable challenges of running a retail business loom large, including technology implementation and security, supply chain disruptions and geopolitical events. This changing focus is one of the primary findings of the sixth annual *BDO RiskFactor Report for Retail Businesses*.

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"Despite a dip in April, consumer spending has been improving, so retail executives feel that their strategy adjustments are on point," said **Doug Hart, partner in the Retail and Consumer Products practice.** "This year, there is an increasing concern over unknown external factors that could derail the execution of their strategies. While retailers are also concerned about gas prices this summer, they are otherwise encouraged by consumer spending."

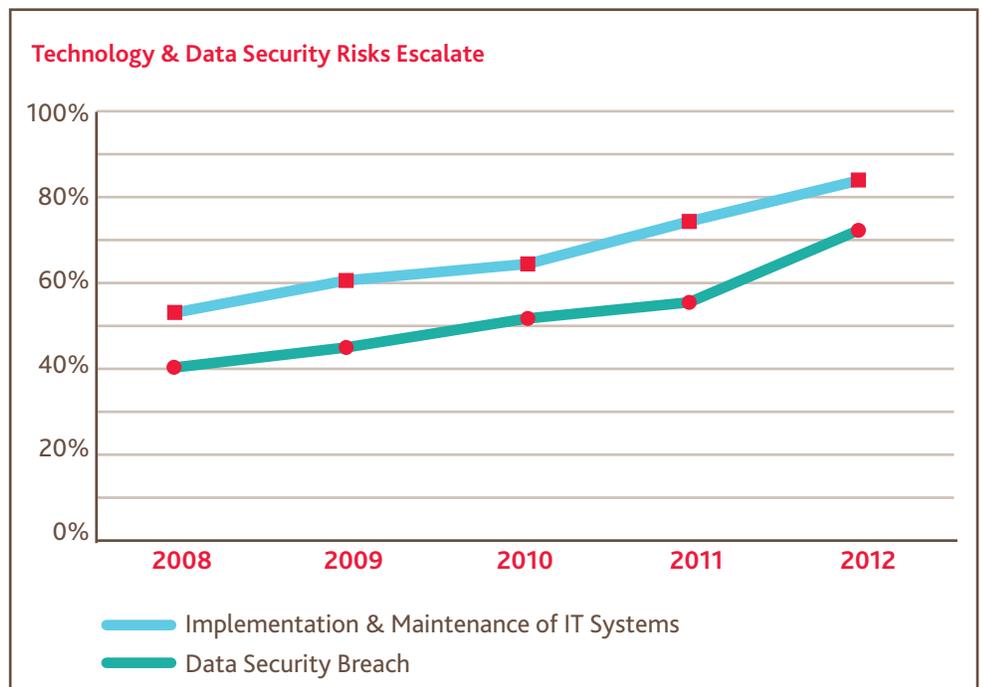
► FUEL PRICES OVERTAKE UNEMPLOYMENT AS TOP ECONOMIC RISK

As summer approaches, retailers are feeling the heat from volatile fuel prices. For the fourth consecutive year, general economic concerns remain the top retail risk factor, cited by 99 percent of companies. However, of the retailers who note the economy as a risk, 71 percent indicate fuel prices as a primary reason, up from just 58 percent last year. The increase marks the first year that energy costs have overtaken unemployment as the top economy-related risk factor since 2009. With tepid progress in job reports, 68 percent of retailers note lingering concerns over unemployment, but the risk is down from its peak in 2010 (70 percent). Rising costs at the pump have not yet had a significant impact on consumer spending, but expectations of record-high gas prices this summer are keeping retailers on high alert.

► TECHNOLOGY CONCERNS CENTRAL AS OMNI-CHANNEL BECOMES THE NEW RETAIL REALITY

The growth of e-commerce and the dominance of smartphones have created a retail market that is more competitive than ever. Retailers understand that they must overhaul their technology strategy or risk becoming obsolete. Yet as the industry places more focus on adding new technologies and adjusting existing IT infrastructure, retailers are increasingly aware of the accompanying operational and reputational risks. This year, 83 percent of retailers noted concern over the maintenance of IT systems and operations, a notable rise from the 12th most-cited risk factor to the sixth.

Security risks are also on the rise, made salient in the aftermath of several high-profile consumer data breaches. In March 2012, a breach at payments processor Global Payments Inc. was said to have affected as many as 1.5 million credit card accounts. As retailers recognize the importance of data protection, security risks jumped 31 percent from the 19th most-cited risk factor to the 12th. Moreover, retailers are carefully monitoring pending anti-terrorism bills that will likely reach the Senate floor this year. Online privacy measures included in the legislation could translate to costly and cumbersome changes in retail technology efforts.





► U.S. EXPANSION RISKS DECLINE AS RETAILERS RIGHTSIZE AND GO GLOBAL

As retailers focus on e-commerce strategy and trim down on excess square footage, the risks associated with U.S. growth and expansion are at the lowest levels since the start of the study in 2006. This year, just 46 percent of retailers cite concerns over U.S. expansion, a decline from 67 percent in 2011. Instead, retail expansion strategies are increasingly focused on global opportunities. The majority (68 percent) of retailers note risks associated with international operations as a concern.

► GLOBAL SUPPLY CHAIN RISKS FURTHER COMPLICATED BY CURRENCY FEARS

While international growth presents substantial opportunities, it also invites a host of unpredictable and potentially harmful operational risks. As retailers expand their global footprint, they are more aware of these external vulnerabilities. For the third year in a row, U.S. and foreign supplier and vendor concerns were the second most commonly cited risk factor, listed by 97 percent of companies. Although commodity costs have stabilized, the rise in China sourcing costs is contributing to supply chain fears and pricing

pressures. Among the retailers who note supply chain risks, 81 percent specify pricing pressures as a key factor of their concern. Currency risk is also a mounting issue as Europe's financial crisis continues and the Obama administration puts more pressure on the yuan. The majority (56 percent) of retailers cited volatile currency exchange rates as a major economic risk, compared to just 27 percent in 2011.

Further complicating retail supply chain management is the risk of uncontrollable political events and natural disasters. The Japanese tsunami and volatility in the Middle East were just a few of the geopolitical events that presented operational concerns to retailers over the past year. In the wake of these threats, business interruption risks are more worrisome to retailers, with geopolitical events and natural disasters increasing from the ninth most-cited risk factor to the fifth.

► FEARS EASE OVER HEIGHTENED REGULATIONS

As the conversation in Congress shifts away from corporate taxes and focuses instead on the Buffett Rule and individual taxpayer concerns, retailers are feeling less threatened. While the majority of retailers (85 percent) note federal, state or local regulations as a risk, that concern is beginning to stabilize

"Although the number of loss-related events has remained steady over the past 10 years, the impact of these events on retail businesses has grown quite dramatically as companies have streamlined their global supply chain operations," said **Clark Schweers, managing director at BDO Consulting and head of the firm's Insurance Claim Services practice.** "Many retailers are unaware of the impact that third and fourth tier supplier disruptions could have on their business. Leading companies are looking for ways to manage the risk associated with sole-sourced supplier relationships."

following an all-time high of 92 percent last year. Risks associated with U.S. accounting standards and regulations also declined, falling from the 14th most-cited risk factor to the 17th. This decline is likely due to general relief over IFRS standards, particularly as adoption of the framework appears to be on a less accelerated track than initially thought.

► BRAND PROTECTION A GROWING PRIORITY

Although concern over litigation and legal proceedings declined this year (73 percent versus 84 percent in 2011), brand protection remains a high priority for retail businesses. This year witnessed a number of counterfeit rulings and trademark violations involving major brands like Apple Inc. and Louis Vuitton. As retailers expand into international markets, brands become more vulnerable. Reflecting this concern, 40 percent of retailers cited risks associated with intellectual property rights and trademarks—the highest level since the report's debut. Brands have also become increasingly important for differentiation in the marketplace, and 39 percent of retailers note concern over the loss of exclusive relationships and products.

► AS CONSUMERS RECOVER, HOLIDAY PERFORMANCE MORE IN FOCUS

With brand differentiation a key objective, many retailers are rebranding or adjusting their marketing to appeal to today's consumer. In fact, the ability to respond to changing consumer trends remains a top risk factor, cited as a concern by 83 percent of retailers. Although this concern has eased over the last 12 months, moving from the fifth most-cited risk factor to the sixth, keeping up with consumer tastes is playing an important role in holiday sales results. Retailers are placing a great deal of weight on fourth quarter results and the ability to attract shoppers during the highly competitive holiday season. Concern over holiday results and the seasonality of the industry increased to the 19th most-cited risk, up from the 22nd in 2011. The high-stakes holiday season has a considerable impact on momentum and strategic plans for the year ahead, making it crucial for success.

The RiskFactor Report for Retail Businesses tells us that retailers are adjusting to the new retail reality—a reality that places more emphasis on online channels and international operations. Companies are navigating these changes with confidence in their strategies and a solid understanding of the consumer. In 2012, retailers are more aware than ever of their increased exposure to the risks that threaten operations. Most concerning are the unforeseeable and unpredictable aspects of this changing business landscape that could upend the industry's newfound confidence.

Top 20 Risks for Retailers	2012		2011		2010	
General Economic Conditions	#1	99%	#1	97%	#1	96%
U.S. and Foreign Supplier/Vendor Concerns	#2	97%	#2	95%	#2	86%
Competition & Consolidation in Retail Sector	#3	94%	#2t	95%	#3	85%
Federal, State and/or Local Regulations	#4	85%	#4	92%	#6	72%
Terrorism, Natural Disasters & Geo-political events	#5	84%	#9	83%	#7t	70%
Implementation & Maintenance of IT Systems	#6	83%	#12	73%	#10	64%
Dependency on Consumer Trends	#6t	83%	#5	87%	#11	63%
Credit Markets/Availability of Financing & Company Indebtedness	#8	82%	#6	86%	#4	84%
Consumer Confidence and Spending	#9	81%	#11	77%	#5	83%
Labor (health coverage, union concerns, staffing)	#10	78%	#7	84%	#7	70%
Legal Proceedings	#11	73%	#7t	84%	#12	62%
Privacy Concerns Related to Security Breach	#12	72%	#19	55%	#16	51%
Failure to Properly Execute Business Strategy	#13	68%	#10	80%	#20	43%
International Operations	#13t	68%	#15	70%	#15	55%
Loss of Key Management/New Management	#15	63%	#12t	73%	#17	49%
Consumer Credit and/or Debt Levels	#16	59%	#17	65%	#9	69%
Changes to Accounting Standards and Regulations	#17	58%	#14	72%	#13	58%
Mergers & Acquisitions, Joint Ventures	#18	54%	#18	62%	#18	47%
Seasonality and Cyclicity of Results; Holiday Sales	#19	49%	#22	48%	#19	44%
Insurance Costs & Uninsured Liabilities	#20	46%	#21	53%	#21t	40%
Impediments to Further U.S. Expansion	#20t	46%	#16	67%	#14	57%

*t indicates a tie in the risk factor ranking

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