2011 BDO RETAIL RISKFACTOR REPORT

RETAILERS WATCH CONSUMER BEHAVIOR CLOSELY AS ECONOMY RECOVERS

The ***2011 BDO RiskFactor Report for Retail Businesses*** examined the risk factors in the most recent 10-K filings of the largest 100 publicly traded U.S. retailers; the factors were analyzed and ranked by order of frequency cited.

The report has been cited in the following media outlets*: CFO, CNBC, Forbes, Convenience Store News, Media Post, Supermarket News*, as well as the *International Council of Shopping Centers* and *National Retail Federation* publications.

Concerns of a double-dip recession surface as gas prices escalate and the economy is strained by weaker than expected May numbers on factory activity, the job market, housing prices and consumer sentiment. Retailers, who are already wary about their second-half performance in light of price increases, now have more headwinds to navigate to get consumers into the stores. This is likely why nearly all (87%) retailers are concerned about consumer demand and interest this year (jumping from 63% in 2010), a primary finding of the fifth annual edition of the ***BDO RiskFactor Report for Retail Businesses.***

Risks associated with consumer confidence and spending are becoming less of a concern, moving down to number eleven on the retail industry's watch list (compared to #5 in both 2010 and 2009). Still, increased uncertainty about consumer behavior challenges retailers to find new and creative ways to encourage spending through the slow upward economic trajectory. Risks associated with general economic conditions (97%) support these sensitivities.

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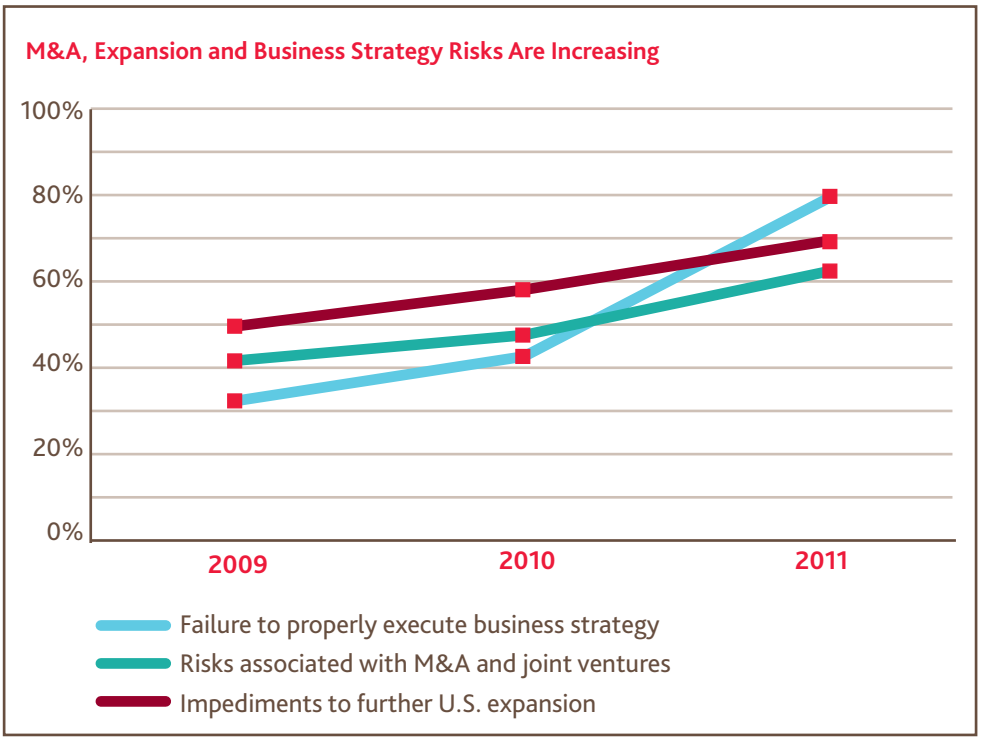
"This year, retailers are looking internally for solutions," **Doug Hart, Partner and West Coast Region Head for the Retail and Consumer Product Practice,** said in a *CNBC Squawk on the Street* exclusive interview. "Consumers are spending a bit more freely and can be prompted into spending. It's up to retailers to control their own destiny by retaining proven executives to successfully execute their business strategy and compete for their customers' attention."

▶REGULATION RISKS ARE ON THE RISE

Government budgets are tighter than ever before. Pressing issues like looming deficit gaps, healthcare costs, possible new lease accounting standards and the Dodd-Frank reform could be why 92% of retailers cite concerns over federal, state and local regulations, reflecting a 28% increase, and a 20 percentage point increase, over 2010 (72%). This includes outstanding uncertainty about pending tax increases, which may have a considerable effect on multistate retailers. Risks associated with accounting standards and regulation saw a 24% jump, and a 14 percentage point increase, this year (72%, up from 58% in 2010).

▶INCREASED INTERNAL PRESSURES POINT RETAILERS TO CONTROLLABLE RISKS

Controllable risks are the critical opportunities to test pricing, experiment with social media and e-commerce to reach customers, and sharpen inventory selection and merchandising strategies. This is especially important in fending off competition, which has become an increasing concern for retailers this year (95% versus 85% in 2010). Surpassing the competition requires both strong leadership and strong personnel. Seventy-three percent of retailers cite risks associated with the loss of key personnel, a notable 49% jump, and a 24 percentage point increase, from 2010 (49%). Labor concerns are apparent for 84% of retailers, likely due to increased employee healthcare costs.



"Retailers are shifting away from the defensive recessionary mode. They are paying more attention to controllable risks, as opposed to external factors like economic conditions," said **Doug Hart**.

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▶RETURN OF MERGERS, ACQUISITIONS AND GROWTH PLANS

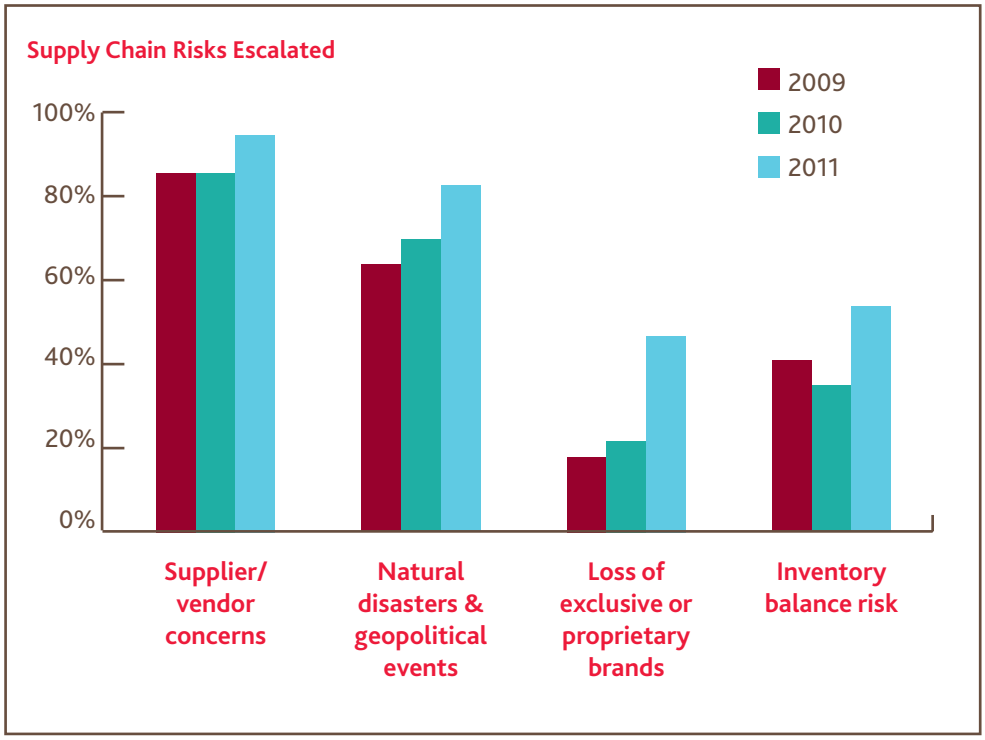
Eighty percent of retailers are concerned about their ability to successfully execute business strategy this year, an 86% jump, and 37 percentage point increase, over 2010 (43%). This comes at a time when the industry has experienced a spate of retail buyouts by private equity firms, which is likely why risks associated with mergers and acquisitions and joint ventures are back on the rise (62%), up from 47% in 2010. The industry also recognizes risks associated with renewed interest in expansion plans (67%). Target, Kohl's and Best Buy are just a few of the many companies that recently announced updated store formats and concepts.

▶RISING COMMODITY COSTS ESCALATE SUPPLY CHAIN RISKS

Dependency on the stressed consumer continues to cloud the industry's outlook, especially as pricing pressures make it impossible for retailers to absorb costs. Nearly all retailers (95%) express markedly more concern over supplier and vendor issues, and among these companies, the top risk is higher commodity costs (84%). Input cost pressures strain negotiations with manufacturers, likely explaining why risks associated with the loss of exclusive and proprietary brands were cited more than twice as frequently as last year. We are, however, seeing a change in the balance of power in these negotiations as smaller "hot" brands with products that sell fast gain leverage over bigger brands with products that are slower to move off the shelves.

▶PRIVACY OF CUSTOMER DATA REMAINS A CONCERN

Recent security breaches involving Sony Playstation and Michael's remind the industry that risks associated with data theft continue to increase. This year, more than half (55%) of retailers cite it as a concern, a jump from 2010 (51%), 2009 (46%), 2008 (40%) and 2007 (26%). Companies see more risks associated with the implementation and maintenance of technology and systems (73%) as they seek new ways to manage the influx of data across their operations. This is a continued increase from 2010 (64%), 2009 (61%), 2008 (54%) and 2007 (50%).



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The RiskFactor Report for Retail Businesses tells us that retailers will continue to be tested by the shaky and prolonged economic recovery. Keeping and winning customers will be critical to the industry's emergence from the recession. Therefore, retailers recognize that their success heavily relies on a sound business strategy and the support of trusted leadership and advisors.

Top 20 Risks for Retailers

Rank		2011	2010	2009
1.	General Economic Conditions	97%	96%	96%
2.	U.S. and Foreign Supplier/Vendor Concerns	95%	86%	86%
2t.	Competition & Consolidation in Retail Sector	95%	85%	87%
4.	Federal, State and/or Local Regulations	92%	72%	66%
5.	Dependency on Consumer Trends	87%	63%	63%
6.	Credit Markets/Availability of Financing & Company Indebtedness	86%	84%	93%
7.	Labor (health coverage, union concerns, staffing)	84%	70%	74%
7t.	Legal Proceedings	84%	62%	47%
9.	Terrorism, Natural Disasters & Geopolitical events	83%	70%	64%
10.	Failure to Properly Execute Business Strategy	80%	43%	32%
11.	Consumer Confidence and Spending	77%	83%	74%
12.	Implementation of IT Systems	73%	64%	61%
12t.	Loss of Key Management/New Management	73%	49%	48%
14.	Changes to Accounting Standards and Regulations	72%	58%	44%
15.	International Operations	70%	55%	47%
16.	Impediments to Further U.S. Expansion	67%	57%	50%
17.	Consumer Credit and/or Debt Levels	65%	69%	49%
18.	Mergers & Acquisitions, Joint Ventures	62%	47%	41%
19.	Privacy Concerns Related to Security Breach	55%	51%	46%
20.	Inventory Balance	54%	35%	41%

*t indicates a tie in the risk factor ranking

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