

# 2010 BDO RISKFACTOR REPORT

FOR RETAIL BUSINESSES



## ECONOMIC CONDITIONS LINGER AS CHIEF CONCERN FOR RETAILERS IN 2010

**S**trengthening. In short, the U.S. retail sector is strengthening its performance from severe 2008 lows. Earnings reports are steadily improving, M&A deals are picking up, and inventory is gradually replenishing – but still, cautious optimism permeates. Recent data paints a mixed picture for 2010. The consumer confidence index rose to 63.3 in May (the third-consecutive increase since March 2008), and consumer spending (including discretionary purchasing) is on the rise. However, May retail sales were down 1.2%, the largest drop in eight months. Other red flags that cloud the industry's outlook include: high unemployment, tight credit, flat wages, threats of inflation and consistent stock market dips.

The *2010 BDO RiskFactor Report for Retail Businesses* outlined concerns for retailers in 2010 through an analysis of leading risk factors cited by the 100 largest public U.S. retailers. For the second year in a row retailers identified general economic conditions (96%) as their chief concern. Despite this, of the retailers who cite general economic conditions as their leading concern, only 49 percent cite financial market turmoil, a drastic reduction from the 97 percent of retailers who cited it as a concern in 2008. Retailers are more concerned over unemployment (70%), interest rates (56%) and inflation (41%). Concerns over U.S. and foreign suppliers and vendors jumped to the second spot this year (86%) while credit availability and company indebtedness (84%) dropped in importance (#4), but remains a critical concern for retailers in 2010.

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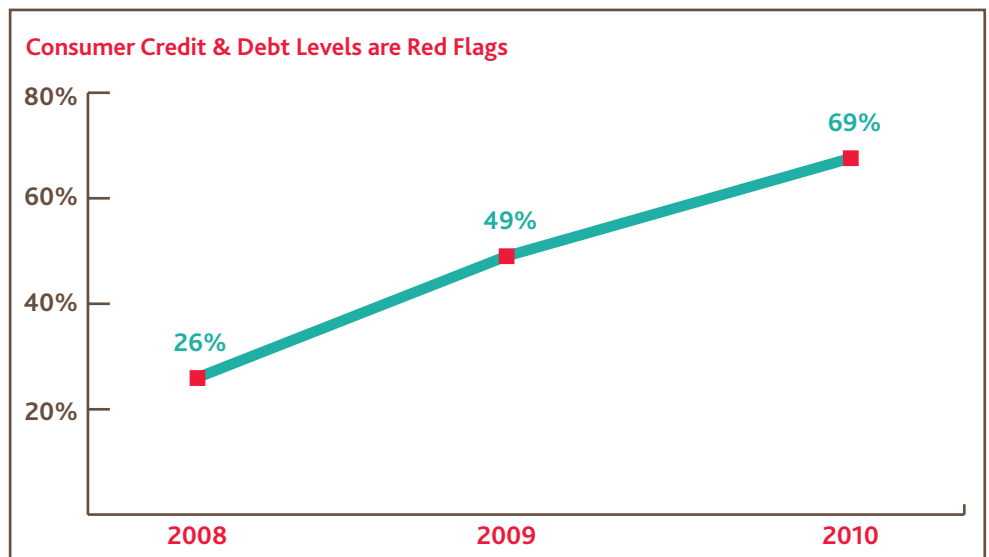
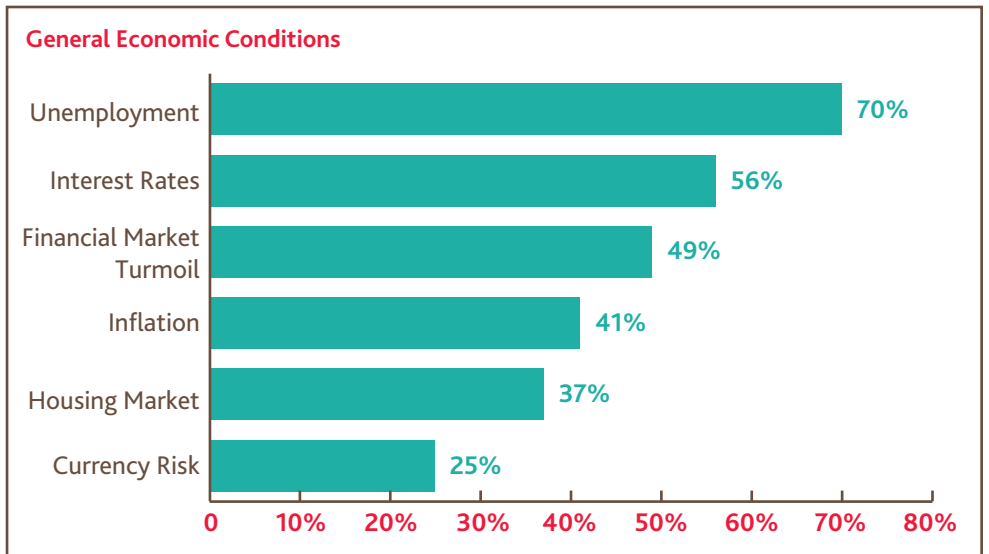
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“Although the economy has improved over 2009, retailers are still concerned about general economic conditions, unemployment and consumer credit. The May 2010 sales results confirmed that the consumer rebound is still a work in progress. Until consumer spending is fueled from actual income growth and not savings accounts, retailers have modest expectations for a consumer comeback,” said **Doug Hart, a Partner in the Retail and Consumer Practice at BDO.** “In the interim, retailers need to continue focusing on the fundamentals of cost control and careful inventory management, while selectively looking for strategic growth opportunities.”

Additional findings from ***The 2010 BDO RiskFactor Report for Retail Businesses*** include:

**► GENERAL ECONOMIC CONDITIONS**

Of the 96 percent of retailers that cited general economic conditions as a concern, unemployment (70%) and energy/oil (70%) are most frequently cited followed by interest rates (56%), financial market turmoil (49%), inflation/deflation (41%), the housing market (37%) and currency risk (25%). In 2009, of the 96 percent of retailers that cited general economic conditions as a concern, financial market turmoil was most frequently cited (97%) followed by energy and oil (69%), unemployment (62%), interest rates (50%),

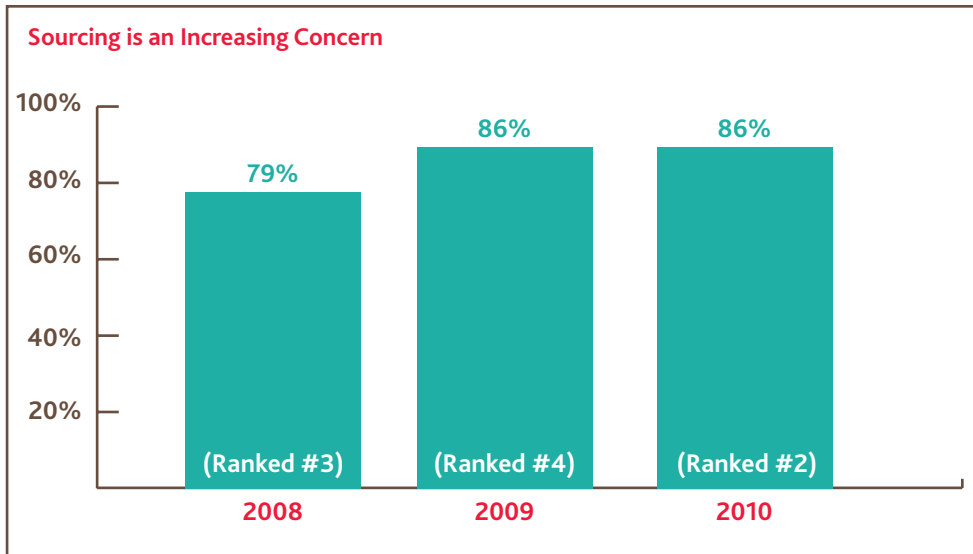


inflation/deflation (33%), the housing market (31%) and currency risk (16%).

**► CONSUMER CREDIT AND DEBT LEVELS ARE RED FLAGS**

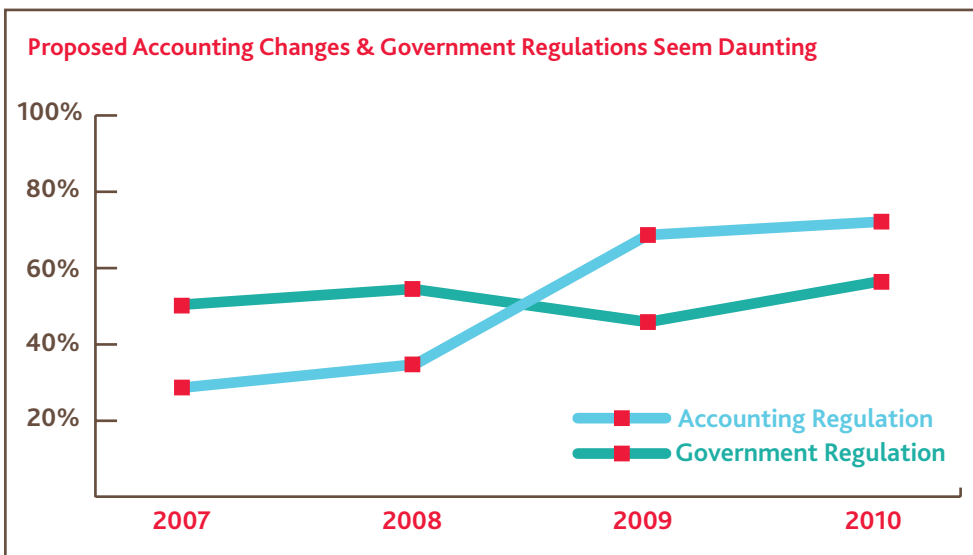
Evidence indicates that the source of the recent surge in consumer spending was savings, not consumer credit or income growth, driving the personal savings rate to 2.7 percent - the lowest level since September 2008. While consumer borrowing rose unexpectedly in March, it was only the second gain in the last 14 months. Uncertainty over consumer spending sustainability is likely

driving the vast majority (69%) of retailers to be acutely concerned over consumer credit and debt levels. In 2009, almost half (49%) of retailers cited it as a concern; still a big increase from the 26 percent of retailers who cited it as a concern in 2008. Consistent with 2009, sixty-three percent of retailers focus on consumer trends and demand this year, a continued increase from 45 percent of retailers who cited it as a concern in 2008.



**► DOWNPLAY ON U.S. EXPANSION EFFORTS**

Fifty-seven percent of retailers cited impediments to U.S. expansion as a concern, a significant drop in importance (#14) compared to 2009 (#11), 2008 (#4) and 2007 (#3). Most retailers are in “hunker down” mode and looking to expand when operations show real, live turnaround. While a few retailers are escalating their store openings, their efforts are focused on opening 5-10 stores as opposed to the 500 stores retailers may have considered in brighter economic periods. Some retailers do see an opportunity for new locations, taking advantage of a cheap retail lease market.



**► CREDIT MARKET AVAILABILITY IS RETURNING**

In 2009, credit market availability rose to #2 from being the #11 risk in 2008. While company financing is still a sensitive area (#4), it appears to be improving as evidenced by the declining number of recent retailer bankruptcies.

**► STRATEGY EXECUTION IS KEY FOCUS**

Almost half (43%) of retailers express concern about business strategy execution this year, signifying a dramatic increase from 2009 (32%) and 2008 (4%). Because of the recession, retailers are renewing their focus on fundamentals including inventory, operating expenses, capital expenditures, accounts payable and credit facilities.

**► PROPOSED ACCOUNTING CHANGES SEEM DAUNTING**

More than half (58%) of retailers showed an increased concern over U.S. accounting standards and regulations this year, up from 2009 (44%), 2008 (36%) and 2007 (32%). Retailers are especially concerned about the proposed lease accounting rules that will cause their debt levels to increase at a time when credit is already tight. This regulation will also require retailers to bring these leases onto their balance sheets that are currently based on very rough estimates of long-term future sales, which often drive the amount of store rent.

**► SOURCING IS AN INCREASING CONCERN**

Foreign and U.S. sourcing moved up to the #2 concern from #4 in 2009. Given U.S. retailers’ reliance on China and other foreign vendors, they are acutely aware of Chinese labor cost inflation and U.S./China business relations, which have recently been strained. Retailers also realize that many of their vendors and transportation partners have reduced capacity during the downturn. If consumer demand returns, some retailers are concerned about whether their current supply chain will be able to match that demand and whether they will experience cost increases.

### *The 2010 BDO RiskFactor Report for Retail Businesses*

examined the risk factors listed in the most recent SEC filings of the largest 100 publicly traded U.S. retailers; the factors were analyzed and ranked by order of frequency cited.

### Top 20 Risk Factors of the 100 Largest U.S. Retailers

2010 Rank			2009 Rank	2008 Rank
1.	General Economic Conditions	96%	1	2
2.	U.S. and Foreign Supplier/Vendor Concerns	86%	4	3
3.	Competition & Consolidation in Retail Sector	85%	3	1
4.	Credit Markets/Availability of Financing & Company Indebtedness	84%	2	11
5.	Consumer Confidence and Spending	83%	5	6
6.	Changes to Federal, State and/or Local Regulations	72%	7	8
7.	Labor (health coverage, union concerns, staffing)	70%	5	5
7T.	Terrorism, Natural Disasters & Geopolitical events	70%	8	9
9.	Consumer Credit and/or Debt Levels	69%	12	20
10.	Implementation of IT Systems	64%	10	7
11.	Dependency on Consumer Trends	63%	9	12
12.	Legal Proceedings	62%	14	10
13.	Changes to Accounting Standards and Regulations	58%	17	18
14.	Impediments to further U.S. Expansion	57%	11	4
15.	International Operations	55%	14	19
16.	Privacy Concerns Related to Security Breach	51%	16	16
17.	Loss of Key Management/New Management	49%	13	14
18.	Mergers & Acquisitions	47%	20	15
19.	Seasonal Flux in Sales	44%	17	13
20.	Failure to Properly Execute Business Strategy	43%	23	31

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