

RETAIL SECTOR WEEKLY

Key Retail News and Commentary

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Did You Know...?

The Federal Reserve cut the federal funds rate for the first time in four years, seeking with an aggressive half-point mover to prevent a steep housing slump and turbulent financial markets from triggering a recession. The rate was reduced from 5.25% to 4.75%, double what many economists had been expecting.

Home Builders Offering Deals

Residential builders are launching promotional price reductions and other incentives in a bid to attract anxious homebuyers and move standing inventory off their books.

A three-day national campaign last weekend by Hovnanian Enterprises Inc. featuring price cuts as deep as \$100,000 has drawn special attention and was seen as a sign of just how bad things are in the U.S. residential housing market.

Dubbed the "Deal of the Century" sales promotion, Hovnanian said it topped expectations and resulted in more than 2,100 home sales.

"Market conditions have changed," said Chief Executive Ara Hovnanian during a presentation last week from a home-builder conference hosted by Credit Suisse. "The market has been fraught with concessions and incentives."

The CEO said the recent promotion led to sales rates that were 10 times the recent pace.

"There are interested buyers in the marketplace," Hovnanian said, but they are hesitant because they want to catch the bottom. Also, potential buyers hear negative commentary on the housing mar-

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Toys R Us Inc: Retailer of the Week

Toys R Us continued to make very modest improvements in its core toy retailing business (excluding gains from the sale of assets). However, two other important considerations remain. First, is the mountain of debt which is causing overall losses due to the interest expense resulting therefrom. Second, is that the success of this sector of retail is very fourth dependent, particularly the month of December. Accordingly, the true test of the Company's ability to turnaround operations will not come until late this year as that is when the lion's share of sales and earnings will come. Since the Company remains highly leveraged, Global Credit will retain its "D", moderate amount of credit risk, credit rating for Toys R Us. However, we believe that Toys R Us will see stable operations for the back half of this year. Long term with this heap of debt, the situation might be more problematic.

BACKGROUND

Toys R Us operates retail stores worldwide that offer toys, baby products, and children's apparel. The Company maintains retail locations in 49 US states, Puerto Rico, and 33 foreign countries. There were 1,533 stores in operation as of August 4, 2007. In 2005, Toys R Us was acquired by private equity through a leveraged buy out. However, this acquisition has straddled the Company with over \$6 billion in debt. Over the past two years, management has concentrated on improving the domestic Toys R Us business and a store rationalization process has commenced therein. Toys R Us is also in the process of divesting of non core real estate.

As a side note, Toys R Us expects no material impact on financial performance from the latest toy recalls.^

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Home Builders Offering Deals

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ket in the media and the problems shaking the mortgage market, he said.

The fears are hitting the entire home-building industry. The National Association of Home Builders said its confidence index fell again in September, tying the all-time low reached in early 1991.

Home builders are struggling against a glut of unsold homes, and cancellation rates have surged, resulting in the parade of special offers. But some market watchers think these sales promotions are not necessarily a signal that buyers should jump in to the market now.

Although Hovnanian's recent event will likely generate cash flow and reduce the company's leverage, "competitors are likely to respond with even bigger discounts, so deals for homebuyers are likely to get even better over time," wrote Banc of America Securities analyst Daniel Oppenheim in a research note last week.

Also, the promotion may trigger more cancellations in Hovnanian's backlog as buyers "either cancel or renegotiate the contract price to reflect the recent sale price," the analyst said.

"In addition, we expect mortgage issues to prevent many buyers currently in the backlog from closing without further price concessions, since appraisers will likely use the recent sales as comparisons," Oppenheim wrote.

Dan Klinger, President of Hovnanian's mortgage business, said some of the deals during the recent event were pre-qualified for home loans, and that he expects by the end of this week to get a handle on how many buyers qualify for mortgages. He acknowledged that lenders are demanding better credit ratings, more money down and better income documentation.

Buyers are seeing how desperate builders are, so they figure there might be more deals. More home builders will do this if Hovnanian is able to close on a lot of these homes its sold.

First Page

Did You Know...?

For the third consecutive year, about nine out of 10 consumers conducting transactions online (87%) have experienced problems. Intolerance has grown, as 42% who have experienced problems have switched to a competitor or abandoned the transaction entirely, and another 52% stopped doing business with the company.

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FYI for the DIY

... **Home Depot Inc.** raised its year-end earnings forecast slightly after agreeing to buy back 289.3 million shares of its common stock (14.6% of outstanding shares), for \$10.7 billion. The company now expects earnings per share from continuing operations to decline by 7% to 9% versus a previous forecast of a decrease of 12% to 15%.

... As part of its renewed focus on its regular warehouse stores, **Home Depot** is shutting down its Landscape Supply stores - a small standalone chain that targets hard-core gardeners. The closings include five stores in metro Atlanta and six in the Dallas-Fort Worth area.

... Lowe's Companies Canada, ULC, a subsidiary of **Lowe's Cos.**, plans to open its first three stores in Canada the week of December 10, 2007. The first of six stores expected to open this year will be in Brantford, Hamilton and Brampton. A Toronto store is slated to open in late January. Lowe's has 18 additional sites in the pipeline.

... **United Rentals, Inc.** will hold a special meeting of stockholders on October 19th to vote on a proposal to adopt its merger agreement with affiliates of **Cerberus Capital Management, L.P.** Per the agreement each share of United Rentals common stock will be converted into the right to receive \$34.50 in cash.

... **The Sherwin-Williams Company** entered into an amendment to its Five Year Credit Agreement dated August 28, 2007, increasing the amount available for borrowing and obtaining the issuance, renewal, extension and increase of a letter of credit by \$100 million up to an aggregate availability of \$150 million.

... **RONA** continued to increase its presence in British Columbia by acquiring 100% of the operating assets and real estate of lumber, building materials and hardware specialist **Dick's Lumber**. This transaction follows the 2006 **Curtis Lumber** and **Mountain Building Supplies** acquisitions and the addition of 14 stores in BC in the past two years through store openings and the recruitment of independent dealers.

... With the softness in its garden and pet businesses not abating, **Central Garden & Pet Company** is postponing its planned common stock public offering and concurrent private placement to its Chairman. In addition, the company has withdrawn its guidance for the first quarter ended September 29, 2007.

... **Do It Best Corp.** will be returning a record-setting \$126.2 million rebate to its members, in spite of a challenging housing market, softness in some regional economies and continued high fuel prices.

Bankruptcy Blotter

... After three years of mounting losses, **The Bombay Company** filed for bankruptcy protection in the Northern District of Texas, Fort Worth Division. A proposed \$115 million DIP loan provided by **GE Capital Corp.** will allow the company to pay employees and fund its operations while seeking a buyer.

... In addition to the above, **Bombay Company** has selected a joint venture of **Tiger Capital Group, Crystal Capital Group LLC** and **SB Capital Group LLC** to serve as the lead bidder, or stalking horse, for its inventory. However, the company is running a process on a parallel track between the time the court signs off on its proposed auction rules and the actual auction to pursue a going-concern sale and seek competing liquidation bids, or a hybrid of a going-concern and agency-disposition deal.

... **Hancock Fabrics Inc.** reported sales of \$18.5 million for the month of August ended September 1st and a net loss of \$17.6 million. Included in the net loss were \$13.0 million in reorganization items.

... The court confirmed a plan of reorganization for **Bally Total Fitness** that would allow the company's creditors to be repaid in full and give shareholders 40 cents a share. The centerpiece of the plan is a financing agreement with a group of investors led by hedge fund **Harbinger Capital Partners** that will infuse \$233.6 million into the company.

... Absent new labor contracts by September 30th, **Interstate Bakeries Corp.** will consider shutting down the company and move forward with a plan

that may include the sale of the company and/or its assets in its entirety or in a series of transactions.

... **Pacific Lumber Co.** will file its bankruptcy-exit plan by the end of September to comply with the ruling of a judge who declined to give the company the deadline extension it sought. No information regarding the plan distribution was available.

... In other news, **Pacific Lumber Co.** won approval from the court to make a \$552,910 payment to its pension plan, a move the company said will boost employee morale.

... The **United Auto Workers** union asked the Court to deny **Delphi Corp.'s** plan to pay up to \$37.6 million in bonuses to top executives, claiming the plan violates the terms of a labor settlement it reached with the company in June. A court hearing on the bonuses is scheduled for September 27th.

... **Delphi Corp.** is seeking approval of a \$38.5 million agreement with **General Motors Corp.** for technical and manufacturing information about certain Delphi products. The license agreement would allow GM to manufacture the parts themselves or buy them from another supplier.

... In other news, **Delphi Corp.** wants to sell some brake operations to **TRW Automotive Holdings Corp.** as part of its effort to shed non-core operations before it exits Chapter 11 later this year. The sale is subject to court approval and a potential competitive auction. Terms of the deal were not disclosed.

Feedback?

Questions?

Suggestions?

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Health & Beauty Aids

... After a two-month undercover investigation, Chicago's Department of Consumer Services cited 71 pharmacies with overcharging on 145 total products. The department's retail fraud unit investigated 190 **Walgreens, CVS** and **Osco** stores in August and September and concluded more than one-third of the stores had overcharged shoppers.

... **Cardinal Health** has signed an agreement to supply hot and cold packs at discounted prices to members of Premier Purchasing Partners. Premier Purchasing Partners is a unit of San Diego-based **Premier Inc.**, the largest health-care purchasing alliance in the United States.

... **Beauty.com**, one of the fastest growing prestige beauty e-commerce sites is rolling out a new, con-

temporary design this fall with industry-leading shopping features to help customers discover the best beauty products to highlight their individual lifestyle. Beauty.com is owned by **Drugstore.com**.

... **Longs Drugs** has been an island institution for five decades, with a fiercely loyal following established and maintained by catering to Hawaii's multicultural population. But Longs' dominance in Hawaii could be threatened by the entry of **Walgreens Co.**, the largest U.S. drugstore chain, which is planning an aggressive expansion, starting with its first isle store to open in November. Walgreens wants to open 25 to 30 stores over the next few years, nearly matching the number of Longs stores in Hawaii and giving the Deerfield, Ill.-based company a presence in every state except Alaska.

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Management on the Move

... **The Kroger Co.** named **Rick Going** President of the company's new Michigan division. Mr. Going, who joined Kroger in 1981, will oversee Kroger's store operations in Michigan, which includes 138 stores.

... **Larry Wahlstrom** is the new President of **Shaw's Supermarkets Inc.**, succeeding **Carl Jablonski**, who has decided to retire after 38 years with the company. Mr. Wahlstrom has been President of **Jewel-Osco**. Both Shaw's and Jewel-Osco are units of **Supervalu**.

... **AmerisourceBergen's Kurt Hilzinger** resigned his position as the company's President and COO to join a private equity group. Current CEO **Dave Yost** will assume the role of President while the role of COO will remain vacated.

... **AnnTaylor Stores Corporation** appointed **Michael J. Nicholson** as EVP, CFO of the company. Mr. Nicholson joins Ann Taylor after seven years with **Limited Brands, Inc.**, most recently as EVP, Chief Operating and Financial Officer for **Victoria's Secret Beauty Company**.

... **Gap Inc.** reported that **Todd Oldham** will team with **Old Navy** to serve as the brand's Design Creative Director. Mr. Oldham plans to also develop and launch a line of merchandise under the Todd Oldham name to be sold exclusively at Old Navy stores in the future.

... **Cabela's Inc.** announced the resignation of **Lynn P. Ferguson** from his position as SVP of Retail Strategy and Real Estate Development for family and personal reasons. **Dennis Highby**, the company's President and CEO, will assume responsibility for retail strategy and real estate development until a replacement is named.

... **Gander Mountain** reported that **Dennis Lindahl**, EVP, Strategy and Business Development, resigned from the company by mutual consent.

... **Payless ShoeSource** hired **Scott Ramsland** as SVP, General Merchandising Manager, International, reporting to **Matt Rubel**, CEO and President of the company. Mr. Ramsland most recently served as SVP, General Merchandising Manager at **Rack Room Shoes**.

... **Kirkland's, Inc.** announced the resignation of **Sharyn M. Hejci** as the company's VP and General Merchandising Manager to pursue other interests. **Christine Treganowan**, the company's Divisional Merchandising Manager and formerly with **Sears Holdings**, will serve as interim General Merchandising Manager.

... **CSK Auto Corporation** named **Michael D. Bryk** to the position of SVP of Finance and Controller. Mr. Bryk previously served for fourteen years in a variety of financial executive and management positions with **CompUSA**.

... **Keith A. Cousins**, EVP and Chief Development Officer of **Movie Gallery, Inc.**, resigned at the company's request in connection with the elimination of his position as part of the company's broader restructuring program.

... **Staples, Inc.** appointed **Justin M. King**, Chief Executive of **J Sainsbury plc**, and **Robert E. Sulentic**, a group President at **CB Richard Ellis**, to its Board of Directors.

... **OfficeMax** reported that **Sam Martin** assumed the role of EVP and COO effective last week. Mr. Martin most recently served as SVP of Operations of **Wild Oats Markets Inc.**

Hi Tech Entertainment

... **Circuit City Stores Inc.** is slowing down its turnaround efforts and reevaluating its plans to add stores after posting disappointing sales for the second quarter ended August 31, 2007 of \$2.64 billion, down 6.2% versus sales of \$2.82 billion for the comparable period last year. The company reported a net loss of \$62.8 million for the quarter versus net income of \$10.0 million last year.

... **Best Buy Co., Inc.** reported revenue for the second quarter ended September 1, 2007 of \$8.75 billion, up 15.1% versus revenue of \$7.60 billion for the comparable period last year. Net income for the quarter was \$250 million versus \$230 million last year.

... **P.C. Richard & Son**, will open its 50th retail showroom in the New York metro area next month. The company is the industry's largest family-owned and operated CE and Majap dealer.

... Is **RadioShack** trying to become GameShack? The company has started selling video game hardware and software on its Web site and is preparing an in-store test.

... **PC Mall, Inc.** completed the acquisition of privately-held **SARCOM**, one of the nation's largest independent IT solutions providers. PC completed the acquisition for \$55 million, consisting of \$47.5 million in cash and \$7.5 million in shares of PC Mall stock.

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Heard in the Grocery Aisle

... The **Great Atlantic & Pacific Tea Company** and **Pathmark** have agreed to give the US Federal Trade Commission (FTC) at least two weeks notice before attempting to close A&P's \$679 million acquisition of Pathmark. We anticipate this deal being finalized sometime this fall.

... It is being reported that **Hampton Retail Investors LLC** purchased 17 former Albertsons grocery stores in Colorado, and plans to renovate and rent out the properties to non-food retailers. This group of stores were vacated following the purchase of **Albertsons'** assets in the region by **Supervalu**.

... **D'Agostino Supermarkets** is celebrating its 75th anniversary this fall. The 18-store chain competes directly with the likes of **Food Emporium, Fresh Direct** and **Whole Foods**.

... **Hannaford Supermarkets** announced this week that it plans to build a new supermarket in Augusta, Maine that is designed to qualify for "platinum certification" from the US Green Building Council (USGBC) and its Leadership in Energy and Environmental Design (LEED) rating system.

... **The Kroger Co.** reported that its second quarter net earnings totaled \$267.3 million, compared to \$209.0 million during the same period a year ago. Fiscal second quarter revenue increased 6.6% to \$16.1 billion, and same-store sales increased 5.8 percent with fuel and 5.1 percent without fuel.

... Meanwhile, **Kroger** has been quietly but steadily expanding its financial services business since beginning with a Kroger credit card three years ago. Stores now market mortgages, home equity lines of credit and a just-expanded set of a half-dozen insurance coverages from identity theft to home and life policies.

... The presence of **Gristedes**, long a fixture on the New York food retailing landscape, continues to slowly erode. According to a recent New Times article, the number of Gristedes stores has been

cut in half over the past decade to 39 today (with 35 of them being in Manhattan). Competition, particularly from **Whole Foods** and **Trader Joe's**, along with escalating rent and utility costs and an inability to successfully boost prices have left the chain at a competitive disadvantage.

... Seattle-based **Associated Grocers'** shareholders voted overwhelmingly last week to approve the sale of the company to **Unified Grocers**, and the transaction is now scheduled to close in a matter of days. The combination will form a \$4 billion company.

... In Indiana, it has been reported that virtually every store owned by **Marsh Supermarkets** will be converted to one of two banners - Marsh Home-town Markets or Marsh The Marketplace. The only exception: the O'Malia's Food Markets owned by the company. The move is seen by local analysts as reflecting a commitment by Sun Capital Partners, which bought the company from the Marsh family in 2006, to continue investing in the stores.

... Five of the nine former **Stop & Shop** stores acquired by operators that are part of **Wakefern Food Corp.** opened as Shop Rites last week in South Jersey. The openings bring the total number of Shop Rites in the state to 127. Two additional stores are set to open at the end of this month.

... Leading Internet grocer **Peapod, LLC**, and **Stop & Shop** opened a third facility on Long Island to better serve the needs of consumers looking for the convenience of online grocery shopping and delivery to their home or business.

... The SEC charged two former **Penn Traffic** executives, **Leslie Knox**, the former Chief Marketing Officer, and **Linda Jones**, a former Vice President, with fraud. The company fired both in February 2006 for deliberately choosing to prematurely recognize promotional allowances as a way of meeting budget numbers.

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The Global World of Sports and Footwear

... Subsequent to the **Genesco** shareholder approval of the acquisition of **The Finish Line**, the fur started to fly. **UBS**, the lender financing the acquisition, has asked for additional financial data from Genesco, claiming a "material event" may have occurred, potentially nullifying its Commitment Letter to finance the acquisition. Genesco filed suit demanding "specific performance" of the merger claiming all conditions were met, which prompted a response from The Finish Line claiming breach of the Merger Agreement by Genesco for withholding certain financial information.

... **Dick's Sporting Goods** continues to expand its "private brands" strategy, having inked a deal with **Reebok** to design, source, market, and sell Reebok athletic apparel under the RBK brand. In addition, the company entered a strategic partnership with **Nike USA** to license the ACG brand for the U.S. market.

... In other news **Dick's Sporting Goods** will open a 52,000 square foot store at the Mallat Barnes Crossing in Tupelo, Mississippi in the Spring of 2008 in a former **Parisian** department store. **Hibbett Sports** will renovate its store at the same mall.

... **Gander Mountain Company** recovered computer equipment previously lost containing certain customer transaction information relating to a single store in Greensburg, Pennsylvania. An independent security assessment firm verified that no customer data was accessed or compromised.

... **Bass Pro Shops** will open its newest local store, the company's sixth in Florida, at Dolphin Mall, five miles west of Miami International Airport on October 4th.

... **The Walking Co.** launched a new website with more than 40 premium comfort brands and an improved search feature.

... With comp store sales expected to decline in the range of 2% to 3% for the second quarter, **Sport Chalet Inc.** now expects earnings for the quarter to be in the range of breakeven and 2 cents per share versus an average estimate of 14 cents per share. Earnings for the second quarter last year were 12 cents per share.

... **Modell's Sporting Goods** will celebrate the grand opening of a 20,000 square foot store located in Stamford, Connecticut later this week.

... **Bakers Footwear Group, Inc.** reported sales for the second quarter ended August 4, 2007 of \$42.0 million, down 11.0% versus sales of \$47.2 million for the comparable period last year. The net loss for the quarter was \$8.7 million, roughly 8.7 times higher than the loss of \$1.0 million last year.

... **Big 5 Sporting Goods** intends to open its fourth store in the Tucson, Arizona market in a former **Oscor** drug store.

... **Eastern Mountain Sports** is relocating its store in Henrietta, New York to a 15,000 square foot location in nearby Pittsford, New York.

Did You Know...?

Consumer confidence tumbled across the board, reaching the lowest level since May 2006, as Americans view the current economy negatively and display growing pessimism about the future. As a result, the overall RBC CASH Index stands at 71.1 for September, more than 18 points below August's 89.3 level.

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Off the Rack

... **The TJX Companies, Inc.** entered into a Settlement with respect to the customer class actions in the U.S. Canada and Puerto Rico relating to customer claims arising from the criminal intrusion(s) into TJX's computer system. The cost of the settlement, \$130 million after tax, was already reflected in the company's earnings for the second quarter. The settlement is subject to court approval.

... **Casual Male Retail Group** continued the expansion of its lifestyle brand portfolio with the launch of ShoesXL, its new website and catalog business offering an extended range of shoes for the big and tall man from top brand names.

... **Dress Barn, Inc.** reported sales for its fiscal year ended July 28, 2007 of \$1.43 billion, an increase of 9.7% over sales for the prior year of \$1.30 billion. Net income for the year was \$101.2 million, up 28.2% from net income last year of \$79.0 million.

... **Tandy Leather Factory, Inc.** is opening a new retail store in Anchorage, Alaska. This is the ninth of ten planned store openings for 2007 and brings the number of store to 71.

... **Filene's Basement** opened its latest retail location, a 46,000 square foot store in Columbia, Maryland.

... With its failure to file its Form 10-Q for the fiscal second quarter with the SEC, **The Children's Place Retail Stores Inc.** received a Nasdaq Staff Determination letter from the Nasdaq Stock Market. The company anticipated receiving this letter and is working with Nasdaq to alleviate the situation.

... The Board of Directors of **Gottschalks Inc.** approved the repurchase of up to 2 million shares of its common stock over the next 12 months. The company will finance the purchase of the shares through cash and borrowings upon the completion of its newly amended credit agreement with GE Financing.

... **Claire's Stores**, which was acquired by **Apollo Management** last May, reported sales for the first six months of fiscal 2008 grew 6.89% to \$706.1 million from \$661.1 million as comp store sales decreased 0.3%. Adjusted EBITDA for the six months was \$125.0 million, a 2.4% decrease compared to \$128.0 million for the comparable period last year.

Did You Know...?

The number of foreclosure filings reported in the U.S. last month more than doubled versus August 2006 and jumped 36% from July. A total of 243,947 foreclosure filings were reported, up 115% from 113,300 in the same month a year ago.

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Mass Merchant Musings

... **Seiyu**, the Japanese retailer that is 53.6% owned by **Wal-Mart**, reported that it expects a 76% greater loss this year than previously projected, and attributed the increase to a 7% cut in its labor force (450 jobs), mostly headquarters staff that was instituted because of low sales. Wal-Mart has invested more than \$1 billion in Seiyu, but has been unable to get much traction in the marketplace.

... Building on the success of its first eight Supercenters in Ontario, **Wal-Mart Canada** officially opened nine additional Supercenters, for a total of 17 in Canada. Supercenters were introduced in Canada in late 2006.

... Bowing to growing pressure, **Wal-Mart** announced further improvements to the health care benefits it offers its 1.3 million full- and part-time U.S. associates, offering more personalized choices, reduced deductibles, pre-deductible health care credits and a \$4 co-pay for over 2,400 covered generic prescriptions.

... **Meijer** has opened in-store medical clinics in two Illinois units, but with a difference – these Medical Marts are staffed by actual doctors, and not just nurse practitioners.

... **Factory Card & Party Outlet Corp.** reported sales for the second quarter ended August 4, 2007 of \$62.8 million, a decrease of 5.3% versus sales of \$66.3 million for the comparable period last year. However, net income for the quarter was \$2.3 million, up 20.9% versus net income of \$1.9 million last year.

... **Amscan Holdings** announced its intention to acquire **Factory Card & Party Outlet** in an all cash deal valued at \$72 million, including the assumption of debt. The deal is subject to customary conditions, including shareholder approval.

... **Costco** will become the fifth anchor store at Lakewood Center making it the single largest enclosed shopping center in the Los Angeles metro area. The move is a first for Costco in Southern California, where it has never before opened its doors as a part of a super regional shopping center.

... **Martha Stewart** is touting her tie-in with **Macy's Inc.** to sell a new line of home accessories this fall, but is also making an effort in her long-troubled relationship with **Kmart**. Kmart is re-launching its Martha Stewart Everyday home furnishings line for the first time in nearly a decade.

Specialty Items

... For its second quarter ended September 1, 2007, **Pier 1 Imports, Inc.** reported sales of \$344.6 million, down 7.1% versus sales of \$370.7 million for the comparable period last year. For the quarter, the company reported a net loss of \$43.4 million, down significantly from the \$73.1 million loss last year, as management drove costs out of the business.

... Four months after ground was broken, construction of **Ikea's** first Ohio store in West Chester, outside of Cincinnati is on schedule for opening next spring.

... **Pet Valu, Inc.** and **Pet Valu Canada Inc.** advised that a motion is being pursued in the Ontario Superior Court of Justice to include the companies, together with certain other retailers, as defendants in a potential class action lawsuit concerning the manufacture and sale of pet food products alleged to contain tainted ingredients.

... **Borders Group** plans to sell most of its British

and Irish subsidiaries to private equity firm **Risk Capital Partners** for 10 million pounds sterling, in an effort to focus on its U.S. business. The transaction includes 41 Borders superstores and 28 Books etc. stores in the UK and the Borders superstore in Ireland.

... Meanwhile, **Barnes & Noble, Inc.** will open a new store in Maumee, Ohio in early October and signed a lease agreement to open a store in Macon, Georgia in March 2008.

... For its fiscal year ended August 25, 2007, **AutoZone Inc.** reported sales of \$6.17 billion and net income of \$595.7 million, representing increases of 3.7% and 4.6% respectively.

... The shareholders of **Guitar Center, Inc.** approved the proposed merger agreement with an affiliate of **Bain Capital Partners, LLC.** Under terms of the agreement, Guitar Center stockholders will receive \$63.00 in cash per share.

Rating Changes and Outlooks

S&P Rating Changes				
Company	Credit Rating		Credit Outlook	
	Current	Prior	Current	Prior
SUSSER HOLDINGS CORP	B+	B+	NM	STA
RISKMETRICS GROUP INC	B	B	NM	STA
KOHL'S CORP	BBB+	A-	STA	STA
SAKS INC/FKA PROFFITTS INC	B+	B+	NM	POS
FRIENDLY ICE CREAM CORP	NR	B-	NR	NM
GREAT ATLANTIC & PACIFIC TEA CO ,THE	B-	B-	NM	NM
PATHMARK STORES INC	B-	B-	NM	NM
VICORP RESTAURANTS INC	B-	B	NEG	NEG
AMERICAN FAMILY LIFE INSURANCE	NR	A+	NR	STA
VERIFONE	BB-	BB-	POS	STA
DOLLAR GENERAL CORP	B	BB+	NEG	NM
WHOLE FOODS MARKET INC	BB+	BBB-	NEG	NM
SEMINOLE TRIBE OF FLORIDA INC	BBB	BBB-	STA	STA
VERIFONE	BB-	BB-	POS	STA
FRIENDLY ICE CREAM CORP	NR	B-	NR	NM
EXPRESS LLC	B-	B	STA	STA
TARGET CORP	A+	A+	NM	STA
DARDEN RESTAURANTS INC	BBB+	BBB+	NEG	STA

Did You Know...?

The Retail Sector Newsletter has increased readership each week since publishing began?

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Toys R Us Inc: Retailer of the Week

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FINANCIAL PERFORMANCE

Segment Reporting

Toys R US, Income Statement Second Quarter

	2007	2008
Net Sales	\$980 mm	\$994 mm
Comp Store Sales	-0.20%	1.10%
Gross Profit	\$320 mm (32.7%)	\$335 mm (33.7%)
Operating Income/Loss	\$3 million	(\$4) mm

Toys R Us, Income Statement First Six Months

	2007	2008
Net Sales	\$2 b	\$2.02 b
Comp Store Sales	-3.60%	3.10%
Gross Profit	\$662 mm (33.2%)	\$674 mm (33.4%)
Operating Income/Loss	(\$9) mm	\$4 mm
Store Count	587	585

Toys R Us, International, Income Statement Second Quarter

	2007	2008
Net Sales	\$890 mm	\$998 mm
Comp Store Sales	-0.40%	5.90%
Gross Profit	\$318 mm (35.7%)	\$365 mm (36.6%)
Operating Income	\$11 mm	\$17 mm

Toys R US, International, Income Statement First Six Months

	2007	2008
Net Sales	\$1.68 b	\$1.91 b
Comp Store Sales	1.60%	4.90%
Gross Margin	\$595 mm (35.4%)	\$679 mm (35.6%)
Operating Loss	(\$12) mm	(\$6) mm
Store Count	649	693

Babies R Us, Income Statement Second Quarter

	2007	2008
Net Sales	\$562 mm	\$613 mm
Comp Store Sales	5.80%	2.20%
Gross Profit	\$210 mm (37.4%)	\$236 mm (38.5%)
Operating Income	\$65 mm	\$78 mm

Babies R Us, First Six Months

	2007	2008
Net Sales	\$1.16 b	\$1.26 b
Comp Store Sales	5.20%	2.50%
Gross Margin	\$440 mm (38%)	\$492 mm (39%)
Operating Income	\$156 mm	\$182 mm
Store Count	234	255

Did You Know...?

The National Retail Federation is forecasting 4% growth in U.S. retail sales during the Nov.-Dec. 2007 period to \$474.5 billion, the slowest U.S. holiday sales expansion since 2002, when sales increased 1.3%, and beneath a 10-year average increase of 4.8%.

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Toys R Us Inc: Retailer of the Week

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Corporate Income Statement, Second Quarter

	2007	2008
Net Sales	\$2.43 b	\$2.6 b
Gross Profit	\$848 mm (34.9%)	\$936 mm (35.9%)
SG&A Expenses	\$837 mm (34.4%)	\$921 mm (35.4%)
Operating Income	11 mm (.5%)	\$15 mm (.6%)
Interest Expense	\$129 mm	\$120 mm
Gains on Sale of Assets	\$0	\$13 mm
Net Loss (income tax benefit of \$2 mm for FY 07 and \$45 mm for FY 08)	(\$111) mm	(\$42) mm

Corporate Income Statement, First Six Months

	2007	2008
Net Sales	\$4.84 b	\$5.19 b
Gross Profit	\$1.7 b (35.1%)	\$1.84 b (35.6%)
SG&A Expenses	\$1.69 b (35%)	\$1.8 b (34.9%)
Operating Income	\$6 mm	\$36 mm
Interest Expense	\$259 mm	\$242 mm
Gains on sales of assets	\$0	\$15 mm
Net Loss (income tax benefit of \$89 mm for both years)	(\$156) mm	(\$83) mm
Retail Store Count	1,470	1,533

Toys R Us domestic stores saw a very modest increase in comp store sales for the second quarter due to higher demand for entertainment merchandise, partially offset by lower sales of juvenile and apparel categories. Year to date comp store sales were positively impacted by sales of entertainment and seasonal merchandise, again partially offset by lower demand for juvenile and apparel products. Net sales also grew as a result of higher Internet revenues, partially offset by the store base shrinking.

Toys R Us International saw comp store sales performance take an upswing due to strong demand for entertainment, core toys, infant care, and learning categories. Year to date comp sales experienced a smaller gain due to softer demand in seasonal goods.

Babies R Us also experienced comp gains, although not to the point of last year. Strong performing categories were commodities, infant care, and apparel. However in this year's second quarter and first six months, there were lower sales of furniture.

For Toys R Us domestic, the gross margin rate grew 100 basis points in the (second) quarter to quarter period due to lower product costs. The year to date gain was only 20 basis points due to mark-down activity undertaken in the first quarter.

For Toys R Us International, the gross margin rate increased 90 basis points in the quarter to quarter period and 20 basis points in the year to date period. Quarterly results were favored by better product pricing in certain markets. However, the year to date period then saw more markdown activity undertaken in other markets.

For Babies R Us, margins grew by 110 basis points in the quarter to quarter period and 110 basis points in the year to date period. This favorable performance was tied to better initial product pricing.

SG&A expenses benefited from a lower rate of depreciation. Overall actual expenses rose in part due to increases in payroll and advertising expenditures. Reduced rates of borrowings helped with the decrease in interest expense. Current year to date, there was \$16 million received from sale of vacant properties to Vornado Surplus Realty LLC, partially offset by a minor restructuring charge of \$1 million.

For this year's second quarter and first six months, Toys R Us recorded \$4 million and \$12, respectively, of interest income.

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Toys R Us Inc:Retailer of the Week

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BALANCE SHEET

Excess cash has been directed at paying down debt levels. Over the next twelve months, Toys R Us

	2007	2008
Cash	\$664 mm	\$230 mm
Receivables	\$186 mm	\$173 mm
Inventory	\$2.07 b	\$2.09 b
Current Assets	\$3.26 b	\$2.78 b
Total Tangible Assets	\$8.3 b	\$7.9 b
Accounts Payable	\$1.02 b	\$1.2 b
Revolver Borrowings	\$434 mm	\$65 mm
Short Term Japanese Bank Loans Due this year	\$316 mm	\$235 mm
Unsecured Credit Facilities	\$1.3 b	\$1.48 b
Real Estate and Other Secured Credit Facilities	\$3 b	\$2.8 b
Notes and Japanese Loans	\$2 b	\$1.53 b
Total Debt	\$7.04 b	\$6.11 b
Total Liabilities	\$9.59 b	\$8.93 b
Current Ratio	1.3:1	1.2:1
Leverage Percentage (tangible assets only)	116%	113%
Working Capital Coverage	2.7 months	1.6 months

will have \$329 million due compared to \$626 million for the same period last year, including the Japanese short term borrowings. We believe that the Company should be in a position to repay or refinance maturing debt.

Borrowings under the Company's \$2 billion secured revolver have been decreased from \$434 million to \$65 million in the year over year first half period. Better control of inventory is aiding in this area. In addition, there was a modest increase in account payable turns, averaging 46 days for last year's second quarter end compared to 49 days for this year's second quarter end. Therefore, Toys R Us is getting a bit more out of its cash flow as vendors may be waiting a few more days for payments on invoices due.

The drop in cash lowered the current ratio a bit. Currently, Toys R Us has just an adequate current ratio. However, liquidity and the weak working capital coverage can be supported by excess credit availability. Toys R Us had excess capacity of \$977 million as of August 4, 2007. And of course, and as stated above, Toys R Us remains highly leveraged despite the approximate \$93 million reduction in debt levels.

OUTLOOK

It would appear that gains in operating performance slowed in the second quarter of this year, particularly with the largest domestic unit going from an operating profit of \$3 million for last year's second quarter to an operating loss of (\$4) million for this year's second quarter. But again, the real test of management's efforts to tweak the store base and develop effective merchandising will come in the fourth quarter. Still, any major slowdown in operations resulting from macro economic factors could become problematic with more than \$6 billion of debt remaining on the balance sheet.

For clients we see no major squeeze on liquidity in the near future, particularly given excess availability under the \$2 billion revolver. Clients should, however, stay in close tune when Global Credit provides third quarter and full year results for fiscal 2008.

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Did You Know...?

REMEMBER - "Setting an example is not the main means of influencing another, it is the only means."
- Albert Einstein

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