

RETAIL SECTOR WEEKLY

Key Retail News and Commentary

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Store Sales Still Slow

Turns out having a Leap Day wasn't much help, as leading retailers turned in mostly slow sales for February. And while some were a little less lackluster than predicted, stores execs are singing what's becoming a very familiar tune – consumers are worried about the economy, pinched by gas prices, and running out of credit.

“There's no denying that shoppers are determined to keep a tight lid on spending, and we expect retail sales to generally remain weaker and deteriorate through the rest of the year,” says Frank Badillo, senior economist for TNS Retail Forward. “And right now, the big question mark is jobs and income. For now, shoppers' self-inflicted cutbacks are more of a result of credit problems. But if unemployment starts to rise and people's income goes down, that will change.”

In its most recent ongoing ShopperScope survey, TNS says that the trend toward cutting back is strongest among lower income households. Some 31% of the down-market shoppers in its survey say they plan to spend less than last year, compared with 28% of middle market households, and 25% of affluent households.

And yep, consumers say it's all because of high gasoline and food prices. High gasoline prices are driving plans by 46% of shoppers to spend less overall- including more than half of all down marke-

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States Bros Holdings Inc : Retailer of the Week

Stater Brothers Holdings remains a moderately high risk, 'D' credit with a stable outlook. Despite some elevated food costs and increasing competition in its local markets, the firm successfully boosted its bottom line by 9.1% in Q1 2008. The construction of the new distribution facilities remains on schedule; the company opened its dry distribution center subsequent to the close of Q1 2008. Despite a heavy capital budget, Stater maintains a substantial amount of cash on its balance sheet; this asset-side liquidity should ease vendor worries.^

OPERATING PERFORMANCE: 3 MONTHS ENDED DECEMBER 30, 2007

13 weeks, \$ in millions	12/30/2007	YOY Var.	12/24/2006
Revenue	\$943.00	4.30%	\$904.40
Comparable Store Sales Growth	3.30%	N/A	0.90%
Operating Profit	\$27.20	-3.60%	\$28.20
Operating Margin	2.90%	(23 bps)	3.10%
Net Profit	\$10.80	9.10%	\$9.90
Tangible Net Worth	\$17.10	N/A	(\$4.10)
Total Debt	\$810	15.70%	\$700
EBITDAR / (Rent + Interest Expense)	2.36x	3.50%	2.28x

During the opening quarter, sales expanded by 4.3% to \$943 million. When adjusting for the Christmas holiday shift, comparable store sales increased 3.3%. When accounting for inflation, it seems as

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Did You Know...?

Considering the impact of higher prices, a bigger debt burden and sagging home prices, Americans were poorer at the end of 2007 than they were the year before. For all of 2007, household net worth rose 3.4% to \$57.7 trillion, the slowest growth in five years. After the effects of 4.1% inflation are included, real net worth fell for the year.

Store Sales Still Slow

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households. And because of rising food prices, about half of all shoppers say they are avoiding food items that seem "just too expensive."

Consumers also say they are eating out less, using more coupons and consolidating their spending at stores where they can save money.

In February, Wal-Mart benefited from that trend. The chain reported February comp store sales results that outperformed the market. In the U.S., comp store sales results gained 2.5% over the prior year. The company said that sales in apparel, long a weak spot at Wal-Mart, improved and that sales in food, flat-panel TVs, digital audio, video games and pharmacy were also strong.

Softness in the home area persisted. In an effort to put shoppers back in the mood for home décor, the company also unveiled a new home-furnishing line last week, called Canopy. Aimed at the budget shopper, Wal-Mart says prices on the new line are 40% below competitors'.

Many, however, expect sales of home furnishings, which were also an especially soft spot at JCPenney, to continue to struggle. While sales got really bad for home improvement retailers first and then furniture stores, it's finally trickling down. And it's not likely to get better unless something happens to ignite the housing market.

The new focus on thriftiness also helped discount warehouses. At Wal-Mart's Sam's Clubs, comp store sales gained 2.8%, without fuel; with gas, comp store sales gained 5.2%. Gasoline also helped other warehouse retailers, with Costco posting a 7% jump, and BJ's Wholesale Club recording a gain of 5.9%.

But it's still tough sledding for department stores. At JCPenney, sales fell 6.7% and at Kohl's, 3.8%. Even high-end retailers also saw declines, with sales dropping 7.3% at Neiman Marcus, and 5.8% at Nordstrom. Among department stores, Saks Fifth Avenue was the only one to buck the trend, with sales gaining 3.4%.

Apparel also took it on the chin, with sales at the Gap dropping 6%, including an unexpected downturn at its Banana Republic division. And at Limited Brands, which owns Victoria's Secret and Bath & Body Works, sales fell 9%. While there were plenty of declines in the teen market, there were some out-and-out homers too. Comp store sales at Buckle jumped 24.3%, Aeropostale gained 7%, and at Pacific Sun, sales increased by 6%.

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Did You Know...?

In a recent survey, 49% of senior executives from consumer products companies remain confident about their respective company's prospects in international markets versus 71% in the four quarter of 2006. However, optimism for prospects in the U.S. market sunk to 22%, marking the first time in recent years when more executives were pessimistic about the domestic economy than optimistic.

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Off the Rack

...Wilson's the Leather Expert reported an 8.7% drop in revenues for the fourth quarter to \$121.4 million. Comps were down 2.4% on top of a 21.6% drop last year. Net loss for the quarter was \$8.4 million, as the company incurred a non-cash impairment charge of \$19.7 million related to liquidated stores and assets. Revenues for the year were down 12.7% to \$280.4 million on a comp store decline of 10.4% on top of a 17.2% drop last year.

...Women's retailer Chico's reported a net loss of \$20.5 million for the fourth quarter, a swing from \$18.2 million in profits for the same period last year. Revenues were down 7.9% to \$409.3 million for the three months. Comps fell 15.7%.

...Macy's will not be reporting monthly revenue figures going forward. The company is joining the likes of Sears Holdings and Home Depot. Many feel monthly revenue figures to be very unreliable due to the timing of certain events and weather

related issues. ...JC Penney announced the grand opening of 10 new stores this week. The company is continuing to roll out its rapid expansion plan despite the downturn in consumer spending. JC Penney has been struggling with its top line on a comp store basis, but it feels like the expansion plan is still warranted.

...Revenues at Gottschalk's were \$37.7 million for the month of February, an 11.5% decline from the same month last year. Comp store sales for the month were down 9.5%. The company is operating with 4.6% less comparable inventory today than it was a year ago.

...Bon Ton Stores reported revenues of \$217 million for the month of February, down 8.7% from the same month last year. Comp store sales for the chain were down 7.2%, as retail traffic has generally slowed in a tough environment.

Bankruptcy Blotter

... The **American Bankruptcy Institute**, citing data from the **National Bankruptcy Research Center**, said 76,120 people filed for bankruptcy in February, a 15% increase from January. Business bankruptcies also surged, climbing to a four-month high of 4,326.

... The court is expected to approve **NRDC Equity Partners'** \$80 million bid for **M. Fortunoff**. In addition, Fortunoff received final approval to its \$85.0 million DIP facility.

... **Princeton Ski Shop Inc.** retained Keen Consultants and its wholly owned subsidiary KPMG CF Realty LLC, to market and assist with the disposition of the company's retail leasehold interests located in New York and New Jersey, vacant land located in Upstate New York, as well as their intellectual property.

... **Princeton Ski Shop** was awarded another 90 days to keep control of its Chapter 11 case as the retailer completes GOB sales. The company now retains its exclusive right to file a plan of reorganization through June 2nd.

... **Tweeter Home Entertainment Group Inc.** won four more months to control its bankruptcy case as it sorts out the claims against it. The company now has through June 5th to file its plan of liquidation without the threat of competing plans.

... **Move Gallery Inc.** won permission to pay 400 managers and executives up to \$4.7 million if the video rental chain meets certain earnings by the end of this summer.

... The **International Brotherhood of Teamsters** says **Interstate Bakeries Corp.'s** proposed bank-

ruptcy reorganization plan is not likely to achieve a rehabilitation of the company and is urging the court to reject its. The company's plan, funded by **Silver Point Finance**, requires it to reach new labor contracts with the union.

... **Wickes Furniture Co.**, which is liquidating its business, signed a deal with a joint venture made up of **Retail Consulting Services Inc.**, **Hudson Capital Partners LLC**, **Crystal Capital Fund LP** and **Julius M. Feinblum Real Estate Inc.**, for the rights to the company's store leases for \$3.5 million.

... After a brief suspension, **Sharper Image Corporation** plans to immediately resume redemption of all its customers' Gift Cards, Reward Cards, Gift Certificates and Merchandise Certificates for their full value as follows after Bankruptcy Court approval.

... In other news, **Sharper Image** asked the court to approve the hiring of a liquidator to help the company close about half of its locations, 96 stores. The company was recently allowed to tap into a \$35 million DIP facility, which with final approval will total \$60 million.

... A **Pacific Lumber Co.** subsidiary, **Scotia Pacific Co.**, is asking the court for permission to tap \$51.2 million in bankruptcy loans, saying it urgently needs financing to stay afloat and reorganize its business.

... Investors, led by hedge fund **Appaloosa Management LP**, are resisting **General Motor's** offer to help finance Delphi's exit from bankruptcy, saying the deal would "materially" increase the auto maker's influence over Delphi. The dispute threatens to derail Delphi's reorganization.

Feedback?

Questions?

Suggestions?

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Specialty Items

... For its fiscal year ended February 3, 2008, **PetSmart, Inc.** reported net income of \$258.7 million, or \$1.95 per share, which compares with the prior fiscal year's net income of \$185.1 million, or \$1.33 per share. This year's earnings excluding the 53rd week, the benefit for the first quarter MMI transaction and costs associated with the exit of the SLT business were \$1.47 per share.

... **AutoZone, Inc.** plans to open a new distribution center in Hazleton, Pennsylvania. When completed in the summer of 2008, the new DC will employ approximately 400 and distribute parts and products to AutoZone store in surrounding states. The company operates 7 other distribution centers throughout the country.

... **Barnes & Noble, Inc.** reported store sales for the fiscal year ended February 2, 2008 of \$4.648 billion, up 4.3% excluding the impact of the extra week during 2006. **Barnes & Noble.com** sales were \$477 million for the full year, up 13.4% excluding the extra week in 2006.

... **Barnes & Noble** will release its fourth quarter and full year earnings on Thursday, March 20th. Be sure to look for **Global's** updated analysis and assessment shortly thereafter.

... **Cost Plus, Inc.** will release its fourth quarter and fiscal year end results on Wednesday, March 19th. Be sure to look for **Global's** updated analysis and assessment shortly thereafter.

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Management on the Move

The Board of Directors of **Builders Firstsource, Inc.** elected **Floyd Sherman** as President of the company, in addition to his current position as CEO, to fill the position vacated by **Kevin O'Meara** upon Mr. O'Meara's departure.

... **Dorsey R. Gardner** and **Philippe J. Gastone** resigned from the Board of Directors of **Huttig Building Products, Inc.** effective the date of the company's 2008 Annual Meeting. Messrs. Gardner and Gastone will not be replaced on the Board and the Board has reduced the size of the Board to nine members from eleven members.

...**Safeway** announced the appointment of Frank Herringer and Kenneth Oder to its board of directors.

...**Roundy's Supermarkets** announced that it was appointing Don Fitzgerald as the vice president of merchandising and procurement.

...**United Natural Foods** announced that Robert A. Sigel was retiring as president of **Millbrook Distribution Services** on March 14th. Casey Van Rysdam will replace Mr. Sigel.

...Steven Lightman, a member of the Board of Directors at **Sharper Image**, stepped down this

week. It was stated that Mr. Lightman's resignation is not the result of a disagreement with the company.

...Peter Weedfald, Chief Marketing Officer at **Circuit City**, stepped down this week. Mr. Weedfald joined Circuit City in 2006 from Samsung Electronics, where he was senior vice president of sales and marketing.

...Steven Pappas, president of Circuit City's small stores, stepped down this week. Mr. Pappas joined Circuit City in 2006. Pappas had spent 21 years at Radioshack prior to signing on at Circuit City.

...David B. Zant, Vice Chairman, Private Brands, Merchandise Planning and Internet Marketing at **Bon Ton Stores** has submitted his resignation. Mr. Zant had been with Bon Ton Stores since 2005.

...Jill Dean stepped down as the president of **Tween Brands Limited Too**. Ms. Dean was president of the chain for the past year. She had spent nearly 20 years with **Limited Brands**, including the position of top merchandiser and CEO of the company's **Lane Bryant** division from 1994-2001.

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Hi Tech Entertainment

...**Barnes & Noble** said that it expects to see some turbulence and is predicting an especially challenging year. The company is not expecting to live up to estimates for the year. The company's fourth quarter revenues were down 3% to \$1.85 billion, on a comp store decline of 0.5%. Last year, the company had the benefit of the latest Harry Potter book.

...**Office Depot** is taking a page out of the manuals of **Best Buy** and **Circuit City**. The company is rolling out its Tech Depot Services that is designed to help customers in their homes and offices. 85 locations are already participating in the program and the company is going to continue to expand the service.

...**Tech Data** acquired the assets of **Scribona AB**, an IT distributor in Sweden, Finland and Norway. Scribona posted revenues of \$1.3 billion last year and Tech Data views the acquisition as a strategic purchase to gain market share in Scandinavia. Last year the company worked to streamline its European operations by closing a facility in Germany.

...**Sharper Image**, which is operating under bankruptcy protection, has asked the courts to hire a liquidator to help close down around half of its

184 locations. Sharper Image says a liquidator will ensure "the most feasible, economical and efficient means of achieving the disposition of the merchandise." The company currently is operating under "severe liquidity restraints."

...**Sharper Image** has been given the go ahead to accept gift cards that were bought before the company filed for bankruptcy. Customers must redeem the card in one purchase, and the purchase must total twice as much as the card is worth.

...**Trans World** lost \$66 million in the fourth quarter on a 23% decline in revenues to \$451.5 million and a comp store decline of 12%. During the quarter, the company recorded a non-cash charge of \$43.4 million relating to a deferred tax asset and a non-cash asset impairment charge of \$30.7 million. Net loss for the fiscal year was \$99.4 million.

...**Blockbuster** reported profits of \$38.1 million for the fourth quarter, beating estimates. The company posted revenues of \$1.57 billion for the quarter, helped by a 7.4% increase in worldwide same store sales and by-mail revenues. Excluding severance costs and certain other items, profits for the quarter were \$54.9 million.

Heard in the Grocery Aisle

...**Tesco** announced plans to open 10 Fresh & Easy stores in the Phoenix, Arizona metro area during the coming year.

...**Tops Markets** has announced the completion of the final conversion of a Martin's Super Food store to the Tops Markets banner.

...**Ahold** CEO John Rishton is rumored to be interested in making a deal with either **Delhaize** or **Casino**.

...**Stop & Shop** has announced that it will be voluntarily recalling four types of chicken products.

...**Stop & Shop** and **Giant Food** announced plans to reduce prices on salad dressing, cooking oils and condiments.

...**Safeway** may sell Blackhawk Network, its gift-card unit. The company would do the transaction because CEO Steve Burd believes that the equity markets are not properly valuing the company.

...**Safeway** CEO Steve Burd announced that the firm's 20,000 square foot store format should be operational in May 2008.

...Indiana-based **Village Pantry Markets** announced that it was purchasing nine **AmeriStop Market** locations in central Ohio.

...The chairman of the **Great Atlantic & Pacific Tea Company** mentioned at an investor conference that the integration of Pathmark Stores is going well. He also stated that the company would begin selling freshly cut vegetables and fruit in Pathmark's produce department. Chairman Haub also noted that he was seeing no change in customers' behavior.

...**Peet's Coffee & Tea Inc** has announced that it will begin launching coffee kiosks in 100 grocery stores run by **Raley's**.

...**Delhaize Group** said that it plans to take a \$18.6 million charge related to the value of 25

Sweetbay stores that were not performing up to previously made financial projections.

...**Food Lion** has announced a new vendor program that will focus on data sharing and collaboration. The grocer is launching this program in an effort to boost sales.

...During the fiscal third quarter, which began on January 27, **Village Super Markets** announced that it expects its 25 ShopRite stores to record comparable store sales of between -1% and 1%. On a year to date basis, revenue has increased 6.6% to \$556.4 million, while net income has grown 16% to \$10.7 million. During the first six months, same store sales have risen 2.9%.

...**Supervalu** CEO Jeff Noddle stated that he believes that food retailers will be capable to passing along most of the food inflation on to its customers during the coming year.

...**Supervalu** announced that it expects same-store sales to improve by 1% to 2% during fiscal 2009.

...Approximately 7,500 unionized workers across five southern states announced that they had ratified the contract offer extended by **Kroger**.

...The **National Cooperative Grocers Association** generated more than \$945 million of combined sales during 2007.

...**Performance Food Group** announced that it produced \$15.1 million in profit during the final quarter of its fiscal year on sales of \$1.6 billion. Consolidated fiscal 2007 sales grew 8.2% to \$6.3 billion, generating a 19.2% increase in net earnings from continuing operations of \$51.1 million.

...Contamination fears are prompting **Meijer** to announce a voluntary recalling of more than a ton of Red Curry Chicken and Jasmine Rice frozen entrees.

Did You Know...?

In the clearest suggestion yet of a recession, U.S. non-farm payrolls fell by 63,000 in February, the second straight decline. It was the largest drop in payrolls since March 2003 and was largely unexpected as economists were looking for a tepid gain of about 20,000.

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Health & Beauty Aids

...**Snyder's Western Drug Store** announced the sale of 4 Montana locations to **CVS**. Terms of the deal were not disclosed.

...**CVS** owned **MinuteClinic** announced that it has opened its 500th in-store clinic. **CVS** expects to open another 150 to 250 clinics by the end of fiscal 2008.

...**Walgreen** announced it was entering the Wash-

ington D.C. market with a store on 22nd and M streets.

...**Cardinal Health** announced that it was purchasing the assets of **Enturia Inc.** for \$490 million.

...**Longs Drug Stores** announced that it had grown profits by 24.5% to \$98.9 million, during fiscal 2008. The company's annual revenue expanded 5.8% to \$5.26 billion.

Mass Merchant Musings

... **Wal-Mart** plans to open 81 new stores in 30 states this month, and will open a total of 170 supercenters in the current fiscal year.

... Comp store sales increases of 2.5% at **Wal-Mart** stores and 5.2% at **Sam's Club** during the month of February exceeded Wal-Mart's expectations because of continued strength in the grocery, health and wellness and entertainment U.S. business segments, with sales trends in apparel improving compared to the last several months.

... Building on its ongoing commitment to help customers save money and live better, **Wal-Mart** began to introduce the new **Canopy™** home furnishings brand. The line delivers on the company's price leadership promise with prices up to 40% below competitors.

... **Asda**, the **Wal-Mart** owned supermarket in the UK, is closing its chain of George high street stores following a four and a half year trial run of the stand-alone clothing concept.

... **Costco Wholesale Corp.** reported net sales for its second quarter ended February 17, 2008 increased 12% to \$16.617 billion, from \$14.508 billion for the comparable period last year. Net income for the quarter was \$327.9 million, compared to \$249.5 million last year.

... **Costco** announced that it is on track to open 29 new stores this year. At the same time the company announced that it plans to open its first store in Australia in 2009.

... One thing **Costco** will not be selling in any of its stores are Crocs. **Crocs, Inc.** reiterated that it is not selling, never has sold and does not plan to sell its Crocs branded merchandise to Costco.

... **BJ's Wholesale Club, Inc.** reported sales for its

fiscal year ended February 2, 2008 of \$8.815 billion, up 6.2% versus sales of \$8.303 billion in the prior year. Net income for the year was \$122.9 million, up 70.6% versus last year's net income of \$72.0 million, which included a \$20.9 million charge for discontinued operations.

... **Family Dollar Stores, Inc.** reported sales for its second quarter ended March 1, 2008 of \$1.833 billion, down 5.9% versus sales of \$1.947 billion for the comparable period last year.

... **Dollar Tree Stores, Inc** reorganized by creating a new holding company structure, to create a more efficient corporate structure. The operations of the company and its subsidiaries will not change as a result of the reorganization. As part of the holding company reorganization, a new parent company named **Dollar Tree, Inc.** was formed.

... **Target** opened 26 new stores over the past weekend in 16 states, including its first store in Washington, D.C.

... **Shopko** will be building its first store in Council Bluffs, Iowa, the fifth overall store in the state. The store will be designed based on the company's prototype design encompassing 80,000 square feet. Also in 2008, the company will open five new stores in Wisconsin and another in Minnesota including three full-line stores and three Shopko Express stores.

... **Big Lots, Inc.** reported sales for its fiscal year ended February 2, 2008 of \$4.656 billion, down 1.8% versus prior year sales of \$4.743 billion. Net income for the year was \$158.5 million, including \$6.1 million of gains from the KB bankruptcy and insurance proceeds, versus net income of \$124.0 million in the prior year.

Did You Know...?

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

Rating Changes and Outlooks

Rating Changes					
Company	S&P Credit Rating		S&P Credit Outlook		GCS Credit Rating
	Current	Prior	Current	Prior	Current
LINENS HOLDING CO	CCC+	B-	NEGATIVE	NEGATIVE	F+
BUILDING MATERIALS HOLDINGS INC/BMC WEST	B	BB-	NM	NM	D
GENESCO INC	B+	B+	STABLE	NM	C
SUBURBAN PROPANE PARTNERS LP	BB-	B+	STABLE	STABLE	D+
DRIVETIME AUTOMOTIVE GROUP INC	B+	B+	NM	STABLE	NR
REGIONS BANK	A+	A+	STABLE	NM	NR
HHGREGG INC (FKA GREGG APPLIANCE)	B+	B	STABLE	STABLE	D+
LIMITED BRANDS INC	BBB-	BBB-	NM	NEGATIVE	C+
DILLARDS INC-HQ	BB	BB	NEGATIVE	STABLE	D

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The Global World of Sports and Footwear

... **The Finish Line, Inc.** entered into a Settlement Agreement settling all litigation relating to the proposed acquisition of **Genesco Inc.** and the provision of financing for the acquisition by **UBS**. The pending merger with Genesco was terminated with the Finish Line. UBS agreed to pay Genesco a cash payment totaling \$175 million and the issuance to Genesco 6.5 million shares of Finish Line company stock. Of the \$175 million cash payment, UBS will pay \$136 and Finish Line responsible for \$39 million.

... **West Marine, Inc.** is delaying the distribution of its fourth quarter and fiscal year earnings release from its previously scheduled date of March 11th. The delay principally is due to management's continuing analysis of certain current and historical expense accruals. No new date for the release of these results has been scheduled.

... **Golfsmith International Holdings, Inc.** reported a net loss for its fiscal year ended December 29, 2007 of \$40.8 million, compared with a net loss of \$8.1 million in the prior year. Excluding a non-cash impairment charge, the company's net income would have been \$2.2 million. Sales for the year were up 8.5% to \$388.2 million.

... **Dick's Sporting Goods, Inc.** will release its fourth quarter and fully fiscal year results on Tuesday, March 11th. Be sure to look for **Global's** updated analysis and assessment shortly thereafter.

... **Scheels All Sports** will enter the Kansas City, Kansas market as an anchor tenant on an under-development, \$750 million water park/retail complex. The store is the furthest south the chain of 23 stores has ever opened a store.

... **Quiksilver** reported net revenues for its first quarter ended January 31, 2008 of \$605.3 million, up 14.5% versus net revenues of \$528.7 million for the comparable period last year. For the quarter, the company reported a net loss of \$21.9 million, including a loss of \$7.3 million for discontinued operations, versus net income of \$2.5 million last year.

... **GE Commercial Finance Corporate Lending** is providing a \$197 million asset based credit facility to **Steve & Barry's**.

... **Tommy Hilfiger Group** and the Stride Rite unit of **Collective Brands, Inc.** reached a mutual agreement under which Tommy Hilfiger will bring its men's and women's footwear business in-house effective January 1, 2009. Stride Rite will continue to remain a licensee for the Tommy Hilfiger Kids footwear line through December 31, 2009.

... **Brown Shoe Company** reported sales for its fiscal year ended February 2, 2008 of \$2.360 billion, down 4.5% versus sales of \$2.471 billion for the prior year. Net income for the year was \$60.4 million, down 8.0% versus last year.

Did You Know...?

In a sign that home sales may be stabilizing, an index of sales contracts on previously owned U.S. homes was flat in January, though the level was down almost 20% from the prior year. By region, January's pending home sales index fell 4.1% in the Northeast and 6.1% in the South. The index rose 13.0% in the West and 0.6% in the Midwest.

Options and Resources

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States Bros Holdings Inc: Retailer of the Week

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though Stater is maintaining its existing customers, but not adding many new ones (see Comparable Store Sales). The firm saw strength in categories such as produce, service meat department, floral, and gift cards. The grocer's environment just got more difficult due to the introduction of Tesco. CEO Jack Brown insists that new competition is not hurting results; at this point he may be correct since Tesco only had a handful of Fresh & Easy stores at December's end. Management also indicated that it was in the market for some of the stores that Albertsons LLC is trying to unload.

The firm's gross margin declined 84 basis points to 25.9%. The decline was the result of higher product costs that could not entirely be passed on to customers along with some price investments. CEO Brown, similar to other industry executives, does not see rising inflation subsiding anytime soon. He further remarked that other competitors have been trying to pass through greater amounts of inflation to their customers; this plays into Stater's hands as a low price leader. The company's SG&A burden declined 63 basis points to 21.7%; the reduction was the result of lower advertising expenses. Despite successful overhead cost controls, higher than normal food inflation pushed the company's operating profit downward by 3.2% to \$27.2 million. Reduced interest expense and a gain recorded from the sale of a store helped net income rise 9.1%.

CEO Brown reported that the company has begun moving product into its new dry distribution warehouse and that the transition is moving smoothly. In addition, construction of the firm's refrigerated facility is on schedule to be completed in June and operational in early-August. Management projects that the new facilities will generate between \$20 million and \$30 million in annualized cost savings. While the company has taken on some extra leverage in the past 12 months, the company's EBITDAR coverage actually improved 3.5% to 2.4 times.

LIQUIDITY & FINANCIAL STRUCTURE

After the first quarter of fiscal 2008, Stater had cash and equivalents totaling \$209.4 million on its balance sheet. CFO Phil Smith stated that he views \$100 million of balance sheet cash as a minimum threshold that the grocer does not want to go below. The cash stash could be useful if either opportunities arise or competitors engage in price wars. The grocer's bank agreements total \$100 million. At the close of the quarter, the company had no direct borrowings and \$45.4 million worth of letter of credit pledged against a revolver (see Bank Reference). During Q1 2008, Stater Brothers had borrowed \$0.8 million on Santee's line of credit but fully repaid this balance by December's end.

Cash outflow from operations of \$14.6 million failed to cover capital expenditures of \$52.6 million, though cash flow from operations is seasonally weak during that period. The elevated capital spending figure is the result of the construction of the new facilities. CFO Smith stated that the company would look to deleverage its balance sheet with the free cash flow generated from the new facilities. At the close of the quarter, the Stater's tangible net worth totaled \$17.1 million. This figure is historically very high for the firm, because of habitual equity withdrawals. This number may continue to improve since CEO/Owner Brown stated that he currently has no intention to pay himself a dividend in the foreseeable future.

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FYI for the DIY

... Due to a difficult year in the housing market, **84 Lumber** closed a dozen of its stores at the end of December.

... **Menards**, on the other hand, has opened its newest 240,000 square foot store in Oregon, Ohio as part of the company's plan to add an estimated 15 stores in 2008. Included in those plans is a new store schedule to open in Toledo, Ohio in late spring.

... **Building Materials Holding Corporation** reported sales for fiscal year ended December 31,

2007 of \$1.001 billion, down 21.6% versus sales of \$1.277 billion in the prior year. For the year, the company reported a net loss of \$312.7 million, versus net income of \$102.1 million in the prior year.

... In other news, **Building Materials Holding** amended its senior secured credit facility, providing for a \$200 million revolving line of credit maturing in November 2011 and adjusting the term loan maturity to coincide with the revolver. As of February 29th, there were no borrowings under the revolver and \$346 million outstanding under