

RETAIL SECTOR WEEKLY

Key Retail News and Commentary

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Planning For The Other Guy's Bankruptcy

Unless your business is fortunate enough to have such a diverse customer base that the loss of even the largest of them will have no significant impact on your operations or profits, businesses should be aware of the possibility of a key customer's bankruptcy. That planning should start from the beginning of any significant business relationship.

Businesses must carefully structure the payment terms and other financial arrangements with their customers. Businesses should focus on obtaining protections to ensure payment, including the use of letters of credit, credit insurance, factoring of receivables, credit limits and other financial arrangements, which manage the risk of non-payment. Businesses should also have an effective system for credit management; monitoring payments to ensure no customer is falling seriously behind on its payments. A customer chronically late with payments should signal that a change in credit terms may be warranted.

A company must do meaningful due diligence about the prospective customer prior to beginning any new material business relationship. While just a few years ago a simple credit report would be sufficient to establish creditworthiness, today the far-flung locations of business partners, their diverse corporate structures and ever expanding number of business arrangements require more inquiry. While such an investigation is by no means foolproof or fraud-proof, it is clearly worth the effort to at

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Building Materials Holdings Inc: Retailer of the Week

The homebuilding market conditions significantly declined in the fourth quarter and continued to negatively impact operating results. New home construction slowed dramatically on a national basis as the macroeconomic environment remained challenging with elevated inventories of unsold homes, low buyer demand, and the continued mortgage crisis. Despite these difficult market conditions, the distribution side of the company's business continued to gain market share, thereby partially offsetting the overall decline of business.

For the year, the company recorded a net loss of \$312.7 million compared to net income of \$102.1 million in 2006. Excluding impairments and discontinued operations, the company would have reported a net loss of \$13.8 million, a loss nonetheless. With the severe decline in operations the company was forced to amend its bank credit facility, reducing the amount available to borrow and shortening the repayment period for its term loan. As a result of the above, we have decided to downgrade the company's Credit Rating to "E" with a "Negative" Outlook. To give you an idea of the negative impact of market conditions, we ended last year with a "C-" Credit Rating.^

Operations

(\$ in Millions)	For the Fiscal Year Ended			
	31-Dec-05	31-Dec-06	31-Dec-07	Change
Sales	\$2,912.20	\$3,203.30	\$2,285.00	-28.70%
Gross Margin	\$658.30	\$687.10	\$442.40	-35.60%
% of Sales	22.60%	21.40%	19.40%	-209 BP
Overhead	\$420.9	\$496.5	\$438.1	11.7%
Operating Income	\$237.5	\$190.6	\$4.3	-97.7%
% of Sales	8.2%	6.0%	0.2%	-576 BP
Net Income	\$114.0	\$102.1	(\$312.7)	N/A
% of Sales	3.9%	3.2%	N/A	N/A

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Remember...

How we spend our days is, of course, how we spend our lives.

Planning For The Other Guy's Bankruptcy

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least consider whether doing business with the other party is worth the risk of non-payment.

If and when one of your significant customers files for bankruptcy, you should act immediately. A debtor's assurances that it will be "business as usual" after bankruptcy should be taken with several tons of salt. Bankruptcy law has many extremely short deadlines within which parties must act to protect their rights, particularly at the start of a case.

Therefore, the first step any business should take when confronted with a bankruptcy notice is to contact or obtain bankruptcy counsel. Bankruptcy counsel is critical to an evaluation of your legal and financial position and will allow you to fully exercise your rights in the bankruptcy case.

A business should next provide its counsel with a complete record of its contracts and invoices with the debtors, as well as a detailed listing of all current ongoing work in progress under those agreements. Such information is critical to determine what your business has at risk in any bankruptcy. For example, your business may have valuable lien rights or claims, which could be lost without prompt action in a bankruptcy court. Having a complete understanding of your legal and factual positions is critical to evaluating whether your company should (or must) continue to do business with a debtor.

No amount of planning can eliminate the risk of a customer or supplier filing for bankruptcy, but it can reduce the impact of such an event. Just as you have to practice defensive driving to be safe on the highway, you should also practice "defensive business" in your dealings with other companies to protect your bottom line.

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Bankruptcy Blotter

... Companies in Chapter 11 reorganization, anxious to secure bankruptcy-exit financing amid an intensifying credit crunch, are signing up for pricier loans and other burdensome conditions that experts say could undermine their restructuring efforts.

... **Princeton Ski Shop Inc.** is seeking permission to sell its leases, intellectual property and vacant land as it liquidates its assets. The company is proposing that interested bidders submit their offers by April 14th for an April 16th auction. A hearing is scheduled for April 4th.

... **Friedmans Inc.** reported sales for the period January 27, 2008 through February 23, 2008 of \$29.5 million and net income of \$1.5 million, which included a \$2.8 million tax benefit.

... **Lillian Vernon Corp.** received court approval to sell its assets at an April 1st auction with **Creative Catalog Holding Corp.'s** \$9.25 million offer setting the floor price for the business. Competing bids are due March 31st.

... The **Reno Golf Etc.** franchise co-owned by **Richard and Jocelyn Long** filed for Chapter 7 liquidation. The Sparks, Nevada business, which was only operational from July 2006 through March 15th, lost nearly \$63,000 last year. The petition lists \$188,000 owed to unsecured creditors.

... **Dotcast Inc.** will withdraw its patent infringement lawsuit against **Movie Gallery Inc.** under a new settlement that Movie Gallery says will save it money. The settlement agreement will provide

economic benefit to the debtors' estates by expunging claims related to the license agreement and avoiding the cost and expense related to further potential litigation.

... **Southern Building Products Inc.**, Florida's largest maker of roof and floor trusses sought shelter under Chapter 11 last week. The company's sales revenues fell from a high of \$33 million in 2005 to \$11.6 million in 2007.

... **Delphi Corp.** won court approval to sell its wheel bearings business to **Kyklos Inc.**, a unit of **Hephaestus Holdings Inc.**, for \$46.2 million however, the purchase price can be adjusted down by \$26 million if a new collective bargaining agreement with the UAW union can't be reached before the sale closes on April 30th.

... In other news, **Delphi Corp.** launched a formal investigation into allegations of improper trading by investors in the consortium that has proposed to pump \$2.55 billion into the struggling auto parts company. Preliminary inquiries have shown that at least six investors have either acknowledged some short-selling activity or have refused to cooperate with the investigation.

... Also, **Delphi Corp.** won court approval to auction the assets of its damper business, with **Ten-neco Inc.** serving as the lead bidder with an \$18.8 million offer. Delphi plans to conduct the auction by April 14th with bids due on April 10th. The hearing on the results of the auction are scheduled for April 30th.

Feedback?

Questions?

Suggestions?

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Management on the Move

... **Wal-Mart** has reportedly tapped **Rob Cissell** to oversee the company's growth in China. Mr. Cissell was most recently serving as CEO of **Robert Dyas**, a hardware chain. Mr. Cissell will serve as COO and head merchandising, marketing and retail operations for **Wal-Mart China**, reporting to **Ed Chan**, President of Wal-Mart China.

... **Cabela's Incorporated** announced the retirement of **Michael Callahan**, SVP of Business Development and International Operations. Mr. Callahan joined the company in 1990 and held numerous leadership positions in merchandising and marketing as well as serving as SVP of Retail Operations.

... **Hibbett Sports, Inc.** appointed **Albert C. Johnson** and **Terrance G. Finley** to its Board of Directors, and announced that **Clyde B. Anderson** would not stand for re-election. Mr. Johnson has served as a financial consultant since 1998, having begun his career at **Arthur Andersen**. Mr. Finley is currently President of the merchandising group at **Books-A-Million, Inc.**

... **DSW** appointed **Elaine Eisenman, Joanna Lau** and **Roger Markfield** to its Board of Directors. Ms. Eisenman currently serves as Dean of Babson Executive Education, a division of **Babson College**. Ms. Lau currently serves as CEO of **Lau Technologies**, an executive consulting and investment company, and Mr. Markfield is a non-executive officer employee of **American Eagle Outfitters** and has served as a Director of AEO since March 1999.

... **Brown Shoe Company** elected **Mario L. Baeza** and **Harold "Bud" Wright** to its Board of Directors. Mr. Baeza is the founder of **The Baeza Group**, a merchant banking firm focusing on investments in the U.S. Hispanic market, as well as in Latin America. Mr. Wright has 38 years of retail experience, the first 28 as an operating principal of **Macy's**, and the last 10 in executive search, specializing in retailing.

... **United Rentals, Inc.** appointed **Kenneth B. Mettel** as VP - Strategy and Planning. Mr. Mettel has served in senior management roles since joining the company in 2001, and helped guide the company's rental rate and fleet management initiatives.

... **Jeffrey N. Boyer**, President and CFO of **Michaels Stores, Inc.** is resigning from the company effective April 4th. While a search for a replacement is

underway, the company named **Lisa K. Klinger**, SVP - Finance and Treasurer, to be acting CFO and has named **Richard S. Jablonski**, VP Finance and Corporate Controller, as principle accounting officer.

... **Cost Plus World Market** extended the employment contract of President and CEO **Barry Feld** through October 2012, a three year extension.

... **RedEnvelope, Inc.** appointed **Philip E. Neri** as its new CFO, replacing **William T. Gochnauer** who has been serving as the company's Interim CFO since December 2006. Mr. Neri previously served as the Director of Finance of **Restoration Hardware, Inc.** and as acting CFO at **Gump's Corp.**

... **Talbots** has appointed **Lori Wagner** to the CMO post, where she will oversee the advertising, catalog development and direct marketing. Ms. Wagner was previously CMO of Cole Haan's Nike division.

... **Stage Stores** has said that **Michael McCreery** will be retiring. Mr. McCreery has served as the company's Executive Vice President since 2001 and Vice Chairman since 2007. Previously, he was the company's CFO.

... **Limited Brands** has moved **Margaret Wright** to the position of Executive Vice President of Victoria's Secret intimates production. Ms. Wright was Senior Vice President of sourcing, and has been with the company since 2002.

... **Mervyns** tapped **John Goodman** as the new CEO. Mr. Goodman joins the company from Levi Strauss Dockers brand, where he held the position of president and CEO.

... **Michael McCoy** will be leaving the Board of Directors at **Wilson's the Leather Expert**. He cited other commitments that require his time.

... **William G. Morton** has elected to retire from the Board of Directors at **Radioshack**.

... **California Grocers Association** announced that **Ronald Fong** would become its new President and Chief Executive Officer.

... **Longs Drug Stores** announced that **Todd Vasos** has become the firm's new Executive Vice President and Chief Operating Officer.

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Heard in the Grocery Aisle

... **Bi-Lo Holdings** announced that it was opening its first **Super Bi-Lo** in the Charlotte, North Carolina market. The company already has some standard **Bi-Lo** locations in the state.

... **Central Grocers** announced that it is hoping to move to a larger site by the end of fiscal 2009. Currently the co-op is looking at a 900,000 square foot facility in Joliet, Illinois and another site in Portage, Indiana.

... **Hannaford** reported that a security breach exposed 4.2 million credit card numbers. This incident affects the stores in the northeast as well as the **Sweetbay** locations in Florida. In addition, a number of smaller supermarkets that use **Hannaford's** products were also impacted. **Delhaize** is **Hannaford's** parent company. The company is now the target of several class action lawsuits.

... **H.E. Butt Grocery** announced that it would begin selling HDTV converters on April 1st.

... **Hy-Vee** is experimenting with a new smaller format of store with a new location in Lincoln, Nebraska.

... **Kroger** placed \$775 million of debt capital in two pieces. The issuance was increased from a previously planned \$750 million. The \$400 million worth of notes mature in 2013 while the other \$375 million worth of notes expire in 2038.

... **North West Company's** purchase of **Cost-U-Less** allowed sales to grow by 12.7% to \$1.05 billion during the fiscal year quarter. Earnings expanded 27.4% to \$62.1 million during the fiscal year ended January 31, 2008.

... **Publix** has announced that it will postpone construction on its Punta Gorda, Florida distribution center. Management did mention that it hopes to build a facility in the Orlando area.

... **Rosebud Fine Food Market and Deli** plans on opening a location in downtown Pittsburgh.

... **Safeway** and **Giant Food** are in the middle of negotiating a contract extension with workers in the Washington DC/Baltimore market. The current labor agreement expires on March 30th. As a precaution, the grocers have begun accepting applications for temporary workers. As a reminder, the last round of labor negotiations a few years ago were particularly bruising.

... **Safeway** announced that it would begin offering shingles vaccinations at 700 of its pharmacies across 15 states.

... NSF International has given **Spartan Stores** the NSF Shop Fresh certification. Spartan was given the recognition because its food quality standards are well above what is required.

... **Supervalu** plans on closing its Livonia, Michigan distribution center. Operations will be moved mainly to Ohio.

... **Supervalu** is closing its stores in Great Falls, Montana and Harve, Montana on April 17th. In late April, Supervalu will sell the Harve location to **Gary & Leo's IGA**. Gary & Leo IGA announced plans to reopen in early summer.

... **Supervalu** announced that **Cub Foods** would no longer allow customers to pay using their fingerprint. The vendor that was providing this service declared bankruptcy and has ceased operating.

... **Tesco's Fresh & Easy** locations will now be accepting American Express.

... **Village Super Market** announced that it was issuing \$16 million worth of special dividends to its shareholders.

Did You Know...?

A new study says that more than 75% of Americans think the country is in a recession, reflecting a crisis of confidence that economists say could make the economy worse. The same study reported that 79% of Americans are worried about a depression lasting several years.

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Health & Beauty Aids

... **AmerisourceBergen** CEO Yost announced that the company was looking to sell its PMSI business.

a private-label care provider directory on its website.

... A division of **AmerisourceBergen** announced that it had launched a recall of some heparin injection vials.

... **Rite Aid** announced that it would remove a portion of a tax asset from its balance sheet. In addition, the company predicts its fourth quarter losses will be larger than previously expected.

... Fitch announced that it was maintaining **Cardinal Health's** BBB+ rating despite recently weak performance.

... **Walgreens** is attempting to enter the worksite health center business by acquiring **I-trax Inc.** and **Whole Health Management**. Terms of the Whole Health Management agreement were not disclosed. Walgreens offered \$278 million in cash for I-trax Inc., in addition to assuming \$18.3 million of debt. Both purchases require some regulatory approval but are expected to close within 60 days. Each of the acquired companies operate clinics inside of or near large corporate campuses.

... **CVS** announced that it had reached a settlement with the Justice Department and a number of state Attorney Generals with regard to a dispute over the distribution of a generic drug. CVS has agreed to make payments totaling \$36.7 million while admitting no wrongdoing.

... **Drugstore.com** announced that it had launched

The Global World of Sports and Footwear

... According to a report by **Global Industry Analysts**, the world bicycles market is projected to reach in excess of \$61 billion by 2010, growing at a CAGR of 5.28% over the 2001-2010 period. Asia-Pacific, with a share estimated at 47.37% in 2007, is the largest bicycle market worldwide.

foot store in Scarborough, Maine, about 25 miles south of L.L. Bean's flagship store.

... **Gander Mountain Company** will release its fourth quarter and year-end financial results on Tuesday, April 15th. Be sure to look for **Global's** updated analysis and assessment shortly thereafter.

... **Sport Supply Group, Inc.** announced its intention to transfer the listing of its common stock from the **American Stock Exchange (AMEX)** to the **NASDAQ Stock Market (NASDAQ)**. The company anticipates that its shares will begin trading on NASDAQ on March 28th. The company's ticker symbol will remain "RBI".

... **Reebok International**, a subsidiary of **Adidas**, and **Dick's Sporting Goods** officially introduced its new apparel partnership, which includes the launch of a men's and women's sports apparel collection merchandised via new shop-in-shops throughout all 340 Dick's stores in the U.S.

... **lululemon athletica inc.** will release its fourth quarter and full year results on Wednesday, April 2nd. Be sure to look for **Global's** updated analysis and assessment shortly thereafter.

... **Recreational Equipment, Inc.** plans to open a second store in Pittsburgh, Pennsylvania in the spring of 2009. The 26,000 square foot, two-story location will be located at Settlers Ridge Town Center.

... **lucy activewear** will open two new stores in April in Darien, Connecticut and Bethesda, Maryland as part of its new store expansion - making a total of 66 stores nationwide.

... **Cabela's** is invading **L.L. Bean** territory with the opening on May 15th of a new 125,000 square

... Reflecting the difficult period for footwear retailers in general, **Shoe Carnival, Inc.** reported sales for its fiscal year ended February 2, 2008 of \$658.7 million, down 3.4% versus sales in the prior year of \$681.7 million. Net income for the year was \$12.8 million, down 46.1% versus net income last year of \$23.8 million.

Mass Merchant Musings

... **Wal-Mart** plans to open its biggest U.S. store on the outskirts of Albany, New York. The store will be a 260,000 square foot two-story supercenter selling department store merchandise as well as groceries, liquor and automotive and other services. The opening is scheduled for May.

owned subsidiary. **Seiyu** has struggled financially, with a recent reported net loss of \$216 million for 2007.

... **Wal-Mart** announced plans to purchase the remaining 4% of Tokyo-based **The Seiyu Ltd**, which operates 400 stores, making it a wholly

... After much speculation, **Costco Wholesale** has confirmed that it will open stores in Australia, with Sydney and Melbourne planned entry points - though no sites have been finalized. The company hopes to open its first Australian unit in 2009.

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Off the Rack

... **Kohl's** has donated \$1 million to the Milwaukee Art Museum for Youth Art Education. The company chose Milwaukee due to the fact that 6,500 Kohl's associates are located in the region. The company is headquartered in Menomonee Falls, WI.

... **Charming Shoppes** posted a loss of \$128.7 million for the fourth quarter, as revenues for the period were down 10% to \$784.9 million. The company also surprised some by forecasting a loss for the first quarter as well. Charming Shoppes is in a restructuring process, with recent cuts of about 13% of its corporate and field management jobs.

... **Ross Stores** managed higher profits for the fourth quarter. Profits were \$94.5 million on revenues of \$1.65 billion for the quarter, up from \$93.1 million in profits and \$1.61 billion in revenues a year ago. For the year, the company made \$261.1 million.

... **Nordstrom** has entered a deal with musician Pete Wentz of pop band Fall Out Boy. The fashion line contains t-shirts, hooded sweatshirts and

denim products and will go on sale next month.

... **Cato Corp** reported a 37% drop in profits for the year to \$32.3 million. For the fourth quarter, results were even worse. The company posted a loss of \$1.8 million for the three months, a swing from \$12.7 million in profits last year.

... **Dillard's** reported profits of \$47.3 million for the fourth quarter, down from \$155 million for the same quarter last year. For the quarter, the company had pretax asset impairment and store closing charges of \$16.1 million, but had a \$10.3 million tax benefit.

... **Macy's** spring campaign features plenty of high priced talent. The company added Carlos Santana, Gabriel Aubry, Mariah Carey, Martha Stewart and Donald Trump to its payroll, drastically increasing the chains star power.

... **Stein Mart** reported a loss of \$12.1 million during the fourth quarter, as revenues fell 9.5% to \$417.4 million. The fourth quarter loss was enough to pull the annual results into the red as well. The company lost \$4.5 million for the year.

Hi Tech Entertainment

... **Handleman** was informed that its securities would be delisted by the NYSE as a result of its non-compliance. The company's market capitalization has been below \$25 million for thirty consecutive trading days, leading to the delisting.

... **Staples** confirmed its \$3.67 billion bid for Corporate Express, a Dutch office supply store chain. The bid was quickly rejected by Corporate Express, claiming the offer was too low. Staples says it is disappointed that Corporate Express have not entered into negotiations.

... **Best Buy** has said it will give \$50 gift cards to customers who purchased HD-DVD players and accessories. The company expects the payout to total \$10 million. The generous move comes a few weeks after Best Buy announced they would no longer be supporting the technology, opting to support Blu-Ray instead.

... **Borders** has said that it is considering putting

itself up for sale, as the company is struggling to find answers for the many problems. The company secured \$42.5 million that it will use to stay in business. The money was fronted by Pershing Square Capital Management, which is a major shareholder in Borders. Borders lost \$157.4 million on \$3.82 billion in revenues for the year.

... **Borders** also announced that it will begin to let workers at its Grove City distribution center go. The layoffs will start in May, as the company begins plans to close down the distribution center.

... **Gibson Guitar** is suing retailers that have been selling the video game Guitar Hero. Gibson claims the game violates a patent it holds. The company has already tried to stop Activision from selling the game. The federal lawsuit claims that **Walmart, Target, Kmart, Amazon, Gamestop, and Toys R Us** should stop selling the game.

Did You Know...?

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

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Options and Resources

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Specialty Items

... Troubled **Linens Holding Co.** reported sales for its fiscal year ended December 29, 2007 decreased 0.9% to \$2.79 billion, as compared with net sales of \$2.82 billion for the prior year. Comp store sales for the year decreased 3.4%. Adjusted EBITDA for the year was negative \$26.2 million compared with positive \$61.6 million for the prior year.

... For its fiscal year ended February 2, 2008, **Cost Plus, Inc.** reported sales of \$1.02 billion, down 1.6% versus sales for the prior year of \$1.04 billion, which contained an extra week. The net loss for the year was \$55.5 million versus a net loss of \$22.5 million last year.

... In other news, **Cost Plus** reported that for the first six months of its new fiscal year it expects sales to be in the range of \$423 to \$438 million compared to \$412 million for the same period in the prior year. Management is projecting a loss from continuing operations for the six months in the range of \$35 to \$40 million versus a loss \$41 million in the prior year.

... **Williams-Sonoma, Inc.** will release its fourth quarter and fiscal year end results on Thursday, March 27, 2008. Be sure to look for **Global's** updated analysis and assessment shortly thereafter.

... **Michaels Stores Inc.** reported sales for its fiscal year ended February 2, 2008 of \$3.86 billion, up a slight 0.5% versus sales of \$3.84 billion for the prior year. The company reported a loss for the year of \$32 million (including \$378 million of interest expense) versus net income of \$41 million (including \$105 million of interest expense) last year.

... **A.C. Moore Arts & Crafts, Inc.** reported sales for its fiscal year ended December 31, 2007 of \$559.7 million, down 5.1% versus prior year's sales of \$589.5 million. Net income for the year was \$3.8 million versus a loss of \$0.4 million last year, which included \$3.4 million before tax of costs related to a change in management.

... **Tiffany & Co.** reported sales for its fiscal year ended January 31, 2008 of \$2.939 billion, up 14.8% versus sales of \$2.561 billion in the prior year. Net income for the year was \$303.8 million, up 19.6% from net income of \$253.9 million in the prior year.

... In spite of gains due to property insurance and litigation settlements that totaled \$6.3 million after tax, **Barnes & Noble** reported net income of \$135.8 million for its fiscal year ended February 2, 2008, versus net income of \$150.5 million in the prior year. Sales for the year were \$5.41 billion, up 2.8% versus sales of \$5.26 billion in the prior year, which included an extra week.

... **Borders** announced that it might put itself for sale and that it has lined up \$42.5 million in financing with Pershing Square Capital Management to help the chain continue operations. The company has lost market share both to online retailers and to discounters like **Wal-Mart** and its possible sale was given mixed prospects by industry analyst. **Barnes & Noble** is said to be taking a good look.

... **The Furniture Idea** is changing its name to **Norwalk Furniture & Design** and offering its franchisees an optional interior revamp. All of the company's 59 franchise locations in the U.S. and Canada will be renamed as will three of the five corporate-owned stores.

Did You Know...?

Recent studies show that the cost of high-calorie foods are less likely to be affected by inflation and, on average, cost less than low-calorie foods. With obesity plaguing the U.S., this trend may hinder low-income families from adopting a low-calorie diet.

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Rating Changes and Outlooks

Rating Changes					
Company	S&P Credit Rating		S&P Credit Outlook		GCS Credit Rating
	Current	Prior	Current	Prior	Current
RESTAURANT CO (INC)	B-	CCC+	STA	NEG	E
CHARMING SHOPPES INC	B+	BB-	NEG	NEG	C-
VICORP RESTAURANTS INC	CCC	CCC	NEG	DEV	NR
O CHARLEYS INC	BB-	BB-	NEG	STA	D
DARDEN RESTAURANTS INC	BBB	BBB+	STA	NM	C-
O CHARLEYS INC	BB-	BB-	NEG	STA	D
DARDEN RESTAURANTS INC	BBB	BBB+	STA	NM	C-
O CHARLEYS INC	BB-	BB-	NEG	STA	D
BUILDING MATERIALS HOLDINGS INC/BMC WEST	B-	B	NEG	NM	E
OFFICEMAX INC	BB-	BB	NEG	NM	D

Building Materials Holdings Inc: Retailer of the Week

(Continued from page 1)

Sales decreased 28.7% or \$918 million to \$2.3 billion. A sharp contraction in new home construction consistent with the national downturn in homebuilding was responsible for the decline. Single-family building permits in the company's markets were down 35% whereas the U.S. overall was down 29% compared to 2006. Weak buyer demand and an excess inventory of unsold homes curtailed new home starts by homebuilders. Sales of construction services were particularly lower since these sales are from production homebuilders who significantly reduced new home construction. Reflecting the lower volume and competitive pricing in the Construction Services segment, gross margins were down 209 basis points to 19.4% from 21.4% in the prior year. However, margins for building products improved due to a shift in sales mix to manufactured building components.

During the later portion of the fourth quarter of 2007, the leading sources of economic and housing data forecasted sharper reduction in housing starts. The rapid deterioration in housing forecasts and the company's operating performance resulted in significant revisions of its operating expectations underpinning the assumptions of recoverability of the carrying amount of customer relationships and goodwill in the Select Build and BMC West operating segments. As a result, management determined that the carrying amounts of these intangibles exceed their respective estimated fair values and recognized a \$337.1 million charge to income in the fourth quarter, the main cause of the magnitude of the loss for the year.

Entering 2008, homebuilding industry forecasts remain weak, prompting management to remain focused on managing costs, generating cash, strengthening the balance sheet and structuring for profitability. Two major programs are now underway to realign the business. First, management is consolidating and streamlining operations in both BMC West and SelectBuild. All of the company operations are under review and specific market realignment plans are being prepared for execution. Management is proceeding quickly to close unnecessary facilities and eliminate unneeded assets. Second, the company is combining SelectBuild back-office functions with existing BMC West support operations.

Liquidity and Cash Flow

The company's balance sheet continues to be more leveraged than we would like to see with total liabilities running at 3.6x tangible net worth. The company's liquidity remains fairly healthy with a current ratio of 2.2:1 at year end, including \$62 million of cash and marketable securities. The company also maintains approximately \$232.8 million of adjusted working capital, covering roughly 6.4 of monthly expenses. Unfortunately, the company had to amend its credit facility, facing the distinct possibility of tripping financial covenants. The revolver was reduced to \$200 million from \$500 million and the financial covenants eased. In addition the company's \$350 million term loan maturity was pulled up to 2011 from 2013. These changes now limit the company's ability to raise funding in the short term.

Outlook

Looking over the next several quarters, we do not see a turnaround in the housing market, which will leave companies like BMHC needing to cut back severely on their operations. Unfortunately, the decline in operations and resultant impact on the company's balance sheet has forced us to lower the company's credit rating to "E", though we see no immediate danger. We will continue to monitor operations closely.

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Did You Know...?

The U.S. economy may be grinding to a halt, the Conference Board said, reporting that the index of leading economic indicators fell 0.3% in February for a fifth-straight decline.

FYI for the DIY

... **Ace Hardware Corp.** restated its previously issued financial statements for the fiscal years ended 2006, 2005, and 2004, the result of an inventory accounting error. Net income for the fiscal years 2006, 2005 and 2004 was reduced by \$18.9 million, \$19.3 million and \$33.5 million, respectively. The company anticipates having its equity restored to previously reported levels within the next two years.

... Unrelated to the above, **Ace Hardware** will re-

lease its financial results for the fiscal year ended 2007 in the second quarter of 2008.

... **Lowe's** revealed plans to delay nearly 20 slated new store openings in areas hit hardest by the flimsy housing market and stubborn credit crunch. While the company did not break down the stalled store plans by state, it did mention California and Florida as areas where declining home values have strained the home improvement market.

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