

# RETAIL SECTOR WEEKLY

## Key Retail News and Commentary

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**REMEMBER -**  
*However beautiful the strategy, you should occasionally look at the results.*

### Banks Continue to Squeeze Credit

Consumers and businesses found it harder to borrow money over the past three months, the Federal Reserve reported, a sign that the historic credit crunch now hitting the economy is still worsening despite Herculean efforts by the Fed.

More than half of the banks surveyed by the Fed said they had tightened the screws on commercial and industrial loans, commercial real estate loans, residential mortgages, and home-equity lines of credit. Large numbers of banks tightened standards for other types of loans, including consumer credit cards.

Almost no banks eased credit terms for any type of loan, the Fed said in its quarterly senior loan officer survey.

The credit squeeze has moved far beyond the subprime segment to affect nearly every borrower. Tighter credit could slow economic growth, especially consumer spending, economists say. Lack of credit could sink the commercial real estate market as well.

“The significant tightening of standards for consumer loans is probably the ugliest news of this report,” wrote Harm Bankholz, an economist for UniCredit Markets. “Investment will continue to shrink, while private consumption growth will come to a halt or even turn negative” in the second quarter.

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### Toys R Us: Retailer of the Week

Toys R Us was able to post higher operating income for fiscal 2008 over both fiscal 2007 and fiscal 2008; however, as has been the situation since the leveraged buy out in 2005, the company continues to be pressured from an extreme debt load. And during fiscal 2008, debt levels saw no reduction. With more than \$2 billion in debt coming due during the current fiscal year, as discussed below, we are unsure how the credit markets may react to this debt and future maturities given the current economic environment. For now, Global Credit will maintain its 'D' credit rating, reflecting a moderate amount of credit risk, in light of the ongoing leveraged situation.

#### BACKGROUND

Toys R Us began business more than sixty years ago with the opening of a baby furniture store, Children's Bargain Town. The Toys R us name made its debut in 1957 and from there became a long stretch of considerable store expansion. The Babies R Us chain premiered in 1996, aimed more at the needs of infants.

By the middle of the current decade, Toys R Us was feeling the competitive pressures from large discount chains, particularly Wal Mart. In July 2005, the company was taken private by a group of private equity investors, including Bain Capital Partners and KKR, through a \$6.6 billion leveraged buy-out. However, this deal left Toys R Us with a massive debt load of approximately \$6 billion. The debt was resold in the open market and as such, the company must file financial statements with the Securities and Exchange Commission.

Since the buy-out, management has closed a number of under performing domestic Toys R Us stores and returned that chain to positive comp store sales performance. The company has also sold a

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## Bankruptcy Blotter

... Corporate default rates in the U.S. climbed for the fifth month in a row in April. **Moody's** reported the U.S. speculative-grade default rate reached 2.1% at the end of April, up from 1.8% in March.

... As a result of the downturn in the economy and lingering credit market woes, more than 18,000 businesses filed for bankruptcy during the first four months of 2008, nearly 43% of those filed in 2007.

... **Linens 'n Things Inc.** won interim court approval to use its \$700 million DIP financing. The approval is subject to final approval later this month.

... In other news, **Linens 'n Things** is seeking court approval to hire **Michael Gries** as Chief Restructuring Officer and to engage **Asset Disposition Advisors LLC** to assist with liquidating assets, primarily the 120 stores the company wants to close.

... **Linens 'n Things** is also seeking approval to extend the period in which it must assume or reject leases from August 30<sup>th</sup> until November 28<sup>th</sup>. The additional time is needed to contem-

plate the store base (possibly more store closings) and attempt to market the leases for store locations that are shuttered.

... **Friedman's Inc.** is seeking court approval for a \$1.7 million retention bonus plan for 44 of its employees and two of its senior managers. The company deems the employees essential to its liquidation and wind-down.

... Meanwhile, the court has extended **Friedman's** exclusivity period to file a plan of reorganization to September 24<sup>th</sup> and to November 24<sup>th</sup> to solicit creditor approval.

... **Kimball Lee Humphreys**, who operated a **Play It Again Sports** franchise in Columbia, Missouri, filed for Chapter 7 bankruptcy protection listing \$344,834 owed to unsecured creditors.

... Unable to secure the \$425 million in bank loans it needed to implement its earlier reorganization plan, **Dura Automotive Systems Inc.** has lined up \$230 million in loans just in time to meet the deadline set by the company's existing lenders. The new loan commitment will fund a plan which now provides unsecured creditors about 8 cents on the dollar versus the previous plan which provided 22 cents on the dollar.

Feedback?

Questions?

Suggestions?

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## Banks Continue to Squeeze Credit

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while private consumption growth will come to a halt or even turn negative" in the second quarter.

The crunch showed few signs of abating. The net fractions of banks reporting tighter lending standards "were close to, or above, historical highs for nearly all loan categories", said the Fed.

Banks said they were restricting credit because of worries about the economy, worries about risk or illiquid markets, and worries about their own fragile capital position.

Banks were increasing interest rate spreads, requiring more documentation, demanding more collateral, or requiring co-signers and or covenants before granting credit.

Consumers are being hit hardest by the stricter lending practices, the survey showed. Standards for all types of mortgages tightened even further, while a record 25% of banks said they were less willing to make consumer installment loans. Standards for home equity loans and credit cards were also much tougher, and fewer banks expected to make student loans in the coming year.

The commercial real estate market has also been hit hard. Nearly 80% of banks tightened standards for commercial real estate loans, just down from the record 80.3% that tightened in the previous quarter.

For commercial and industrial loans to businesses, 555 banks tightened their standards, even though demand for bank loans increased slightly because funds were not available in other markets, notably the commercial paper market.

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## Management on the Move

... **Dyan M. Jozwick** has stepped down from her position as CMO at **The Wet Seal**. Ms. Jozwick will remain with the company through May 30, 2008.

... **Daniel H. Edelman** has been appointed as the new corporate-level president for international retail development at **Macy's**. Mr. Edelman was previously president and COO of San Francisco-based Macy's West. The company has also named **Robert B. Harrison** as Mr. Edelman's replacement. Mr. Harrison was president and COO of Macy's Northwest in Seattle.

... **United Rentals, Inc.** appointed **Kenneth DeWitt** as its VP and CIO. Mr. DeWitt, with 15 years of executive experience leading information technology operations, most recently served as SVP and CIO for **Retail Venture Services, Inc.**, formerly **Value City Department Stores, Inc.**

... **Susan B. Barley**, Principal Accounting Officer of **Pier 1, Imports, Inc.**, announced her retirement effective June 30, 2008. Ms. Barley will continue her employment through August 15, 2008 to assist in the transition of her duties.

... **Raymond L. Arthur** was named CFO of **Pep Boys - Manny, Moe & Jack**, succeeding **Harry F. Yanowitz**, who resigned. Mr. Arthur served as CFO of **Toys "R" Us Inc.** from 2004 to 2006 and was President and CFO of **toyrus.com** from 2000 to 2003.

... **Tuesday Morning Corporation** appointed **Starlette Johnson** to its Board of Directors, increasing the Board from seven to eight members. Ms. Johnson is currently President, COO, and Director of **Dave and Busters, Inc.**

... **Pet Valu, Inc.** elected a new Board of Directors consisting of **Tony Iordanis, Robert T. Kittel, Thomas McNeely, Norman A. McPhedran, Thomas P. Muir, C. Ian Ross,** and **Michael D. Woolcombe.**

... **Walgreens** has named **William "Tom" Grayson** as the vice president of pharmacy acquisitions. The firm has also promoted **Kenneth Amos** to divisional vice president of loss prevention.

... **Ed Shivers, Publix's** vice president of risk management plans to retire on June 16<sup>th</sup>.

## Heard in the Grocery Aisle

... **Harris Teeter** plans to open a new environmentally friendly store in south Charlotte, North Carolina.

... **Harris Teeter** has removed two types of salad due to fears over food contamination.

... **Rancho Liborio**, a Hispanic grocery store, plans to open a store in Colorado Springs, Colorado. The new location is expected to be over 100,000 square feet.

... **Albertsons LLC** announced plans to sell 72 gas stations and convince stores to **Valero Energy**. Terms of the deal were not disclosed; however, the transaction is expected to close during the second half of 2008.

... During the current fiscal year, **Ingles Markets** announced that it would spend \$200 million upgrade and expand its store base.

... **Kroger's** unionized workers in the Ohio Valley have rejected a contract proposal from the firm. The workers at the 12 stores have not set a strike date, as they remain hopeful to return to negotiations.

... **Bashas** announced that it was reducing its workforce by 100 people. The firm cited a weakening regional economy and rising food costs as

the reasons for the overhead reduction.

... **Wegmans** is contemplating building a store in Westwood, Massachusetts. The proposed store would be the Rochester, New York grocer's first store in the suburban Boston Market.

... A slowing economy in southern California and increased competition hurt **Arden Group's** supermarkets. The firm's sales fell 1.3% to \$118.8 million. Profits expanded slightly to \$6.5 million.

... **Meijer** has partnered with Fusion Mobil to start offering wireless phone cards at all 181 of its locations.

... Beginning on May 14<sup>th</sup>, **Winn-Dixie** launched a program that will offer discounts on selected products.

... **Minyard Food Stores** announced plans to offer free prescription generic pre-natal drugs.

... **Safeway** and **Supervalu** have both announced plans to expand private-label organic offerings during the coming year.

... **Delhaize Group** expects that its U.S. operations will improve earnings by 6% to 8% as a result of a better private-label program.

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## Mass Merchant Musings

... The Dublin, California city council voted to ban the opening of retailing businesses larger than 170,000 square feet that devote more than 10% of their sales floor space to nontaxable grocery products.

... **Wal-Mart Stores** is quietly backing away from its plans to expand inside Chicago city limits. Political pressure and fears of a resumption of battles with labor unions prompted the retailer to back away. The company had envisioned the potential of 20 stores in Chicago.

... Keeping to its word of looking outside the U.S. borders for growth, **Wal-Mart** plans to open 27 stores in Canada by the end of the year, most of them supercenters. The openings will give Wal-Mart more than 320 stores north of the border.

... The United Kingdom, Canada, Brazil and China sent **Wal-Mart International** sales up 18% during April to \$7.6 billion, easily outpacing growth at its domestic stores and Sam's Club divisions. For the first quarter, International sales increased nearly 19% to \$24.3 billion.

... **Target Corporation** agreed to sell a 47% interest in its credit card receivables to **JPMorgan Chase** for \$3.6 billion. At Target's option, JPMorgan Chase has also agreed to fund approximately 47% of Target's expected receivables growth in the near term. The transaction is expected to close before the end of May.

... Separately, **Target** reported that sales for the first quarter were up 5% to \$14.3 million, reflecting a 0.7% decline in comp store sales versus prior year. For the first quarter last year, Target reported comp store increases of 4.3%.

... **Canadian Tire** reported gross operating revenue for its first quarter ended March 29, 2008 of \$1.825 billion, up 5.0% versus last year's gross operating revenue of \$1.738 billion. Net income for the quarter was \$66.7 million, up 19.7% versus prior year net income of \$55.7 million.

...In other news, **Canadian Tire** will launch two new store concepts this year, a new small-town store format and an updated version of its large outlets, which will see the store interiors broken into various boutique-type sections to highlight categories such as sporting goods, housewares and auto parts. The small stores will have 14,000 to 18,000 square feet of selling space, about one-third the size of a typical Canadian Tire outlet.

... **Big Lots, Inc.** reported first quarter retail sales increased 2.1% to \$1.139 billion, positively impacted by two large closeout deals: one from a major furniture manufacturer and one from a national drugstore chain. The company expects to report earnings results for the first quarter on Thursday, May 29<sup>th</sup>.

... Sales for the first quarter at **Retail Ventures, Inc.** were virtually flat at \$466.3 million versus sales of \$465.8 million for the first quarter last year. Comp store sales for the quarter declined 4.3% with DSW down 5.4% and Filene's Basement down 0.2%.

... Reflecting the relevance of dollar stores in the current economy, **Dollar Tree, Inc.** reported sales for the first quarter of \$1.051 billion, a 7.8% increase compared to \$975.0 million in the first quarter last year. Comp store sales for the quarter were up a solid 2.1%. The company expects to release its first quarter earnings on Wednesday, May 28<sup>th</sup>.

... Enjoying better growth than even the dollar stores, **BJ's Wholesale Club, Inc.** reported sales for the first quarter of \$2.258 billion, up 12.3% versus the prior year. Comp store sales for the quarter were up 9.6%.

... Reacting to an 8.4% decline in comp store sales for the first quarter, **Duckwall-ALCO Stores, Inc.** is cutting 27 staffers at its headquarters, roughly 10%, in a streamlining move.

### Did You Know...?

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

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## Specialty Items

... **Jo-Ann Stores, Inc.** reported that net sales for its first quarter ended May 3, 2008, increased 5.2% to \$446.1 million from \$424.2 million in the prior year. Comp store sales for the quarter increased 4.5%. The company will report first quarter earnings on May 28<sup>th</sup>.

... **A.C. Moore Arts & Crafts, Inc.** reported sales for the first quarter of \$126.5 million, a decrease of 6.5% versus sales of \$135.4 million during the comparable period last year. For the quarter, the company reported a net loss of \$1.8 million versus net income in the prior year of \$0.3 million.

... **Toys R Us** reported sales for its fiscal year ended February 2, 2008 of \$13.79 billion, up 5.7% versus sales for the prior year of \$13.05 billion. Net income for the year was \$153 million, up 40.4% versus net income of \$109 million in the prior year.

... **Cost Plus, Inc.** will release its first quarter results on Wednesday, May 21, 2008, after the market closes. Be sure to look for **Global's** updated analysis and assessment shortly thereafter.

... **Zale Corporation** reported sales for its third quarter ended April 30, 2008 of \$477 million, up 6.3% versus sales for the third quarter last year of \$449 million. Comp store sales for the quarter were up 5.8%.

... For its first quarter ended May 3, 2008, **Finlay Enterprises, Inc.** reported sales of \$205.3 million, including sales from the recently acquired **Bailey Banks & Biddle**, up 26.0% versus sales of \$162.9

million in the first quarter last year. The company expects to report full financial results for the quarter on May 28<sup>th</sup>.

... Continuing its expansion, **Barnes & Noble, Inc.** will open two new stores in Winter Garden, Florida, and Chino Hills, California next week. In addition, the company signed a lease agreement to open a new store in Covington, Louisiana.

... In other news, **Barnes & Noble** will release its first quarter earnings results on Thursday, May 22<sup>nd</sup>. Be sure to look for **Global's** updated analysis and assessment shortly thereafter.

... About a week after rival **Barnes & Noble** releases its first quarter results, **Borders Group, Inc.** will release theirs. The results will be released on Wednesday, May 28<sup>th</sup>.

... On schedule to open 14 concept stores, **Borders** will debut a new 24,000 square foot concept store in Allen, Texas, in August. The new concept store blends digital and internet options with in-store services.

... **Overstock.com** is expanding its sales to consumers outside of the U.S., entering into a contract with **E4X Inc.** to use its FiftyOne Global eCommerce solution.

... **Advance Auto Parts, Inc.** will release first quarter financial results after the market closes on Thursday, May 15<sup>th</sup>. Be sure to look for **Global's** updated analysis and assessment shortly thereafter.

### Did You Know...?

*The Federal Reserve auctioned \$28.77 billion in safe Treasury securities to big investment firms, part of an ongoing effort to ease credit problems.*

## FYI for the DIY

... **United Rentals, Inc.** entered into a commitment letter with a consortium of banks for the funding of a new, \$1 billion, asset-based revolver loan facility. The new facility will replace the company's existing cash flow revolver, letter of credit facility, and term loan. The new facility is expected to be executed in June.

... **The Home Depot®** will release its first quarter operating results on Tuesday, May 20, 2008. Be sure to look for **Global's** updated analysis and assessment shortly thereafter.

... Operating "out of the box", **Menard's** is purchasing land around a few new stores to develop residential subdivisions. The chain has developed residential areas in Warsaw, Indiana, and Urbana, Illinois, with plans for another development near a store in Oak Creek, Wisconsin. In Yorkville, Illinois the company sold 129 single-family lots to a local homebuilder.

... **Interline Brands, Inc.** reported sales for its first quarter ended March 28, 2008 of \$289.1 million, down 2.1% versus sales for the comparable period last year of \$295.4 million. For the quarter, the company reported net income of \$5.7 million, down 8.1% versus net income of \$9.4 million in the prior year.

... **Central Garden & Pet Company** reported net sales for its second quarter ended March 29, 2008 of \$484.7 million, down ever so slightly from sales of \$485.7 million in the comparable period last year. Net income for the quarter was also down slightly to \$20.5 million versus \$21.5 million last year.

... **Calloway's Nursery, Inc.** reported sales for its first quarter ended March 31, 2008 of \$9.8 million, down 5.1% versus sales of \$10.3 million for the first quarter last year. The company reported a net loss for the quarter of \$124,000 versus a loss last year of \$11,000.

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## The Global World of Sports and Footwear

... **Footstar Corporation** amended its Credit Agreement to extend the maturity date to the earlier of December 31, 2008 or the termination of the Kmart Agreement and to reduce the revolving commitments to \$50 million (inclusive of a \$25 million sublimit for letters of credit). The former maturity date was the earlier of November 30, 2008 or thirty days prior to the termination of the Kmart Agreement.

... Related to the above, **Footstar** declared a special cash distribution to shareholders of \$1.00 per common share and announced that the Board of Directors had approved a plan of liquidation with the orderly dissolution of the company in 2009.

... A new co-branded store by **Nike Inc.** and **Finish Line – Finish Line Ltd** – opens this week in the Phoenix, Arizona area, aimed at gaining a foothold in the niche market of runners and athletes in training. The venture comes on the heels of Nike's basketball-based **House of Hoops** store run by **Foot Locker**, which opened in the Harlem section of New York City in November.

... **Golfsmith International, Inc.** reported sales for the first quarter of \$79.2 million, up 2.0% versus sales of \$77.7 million for the comparable period last year. The company reported a net loss for the quarter of \$5.4 million versus a net loss of \$4.9 million as results were below expectations due to the continuing decline in the rounds of golf played and the lack of new product launches.

... Pursuant to pre-existing contractual commitments, **Gander Mountain** filed an amended Registration Statement on Form S-3 registering 9.7 million shares of its common stock sold in two private placement transactions to **David Pratt**, Chairman of the Board of Gander Mountain, and **Gerald Erickson**, a director of Gander Mountain.

... **Recreational Equipment, Inc. (REI)** reported sales for its fiscal year ended December 31, 2007 of \$1.342 billion, up 13.6% versus sales of \$1.182 billion in the prior year. Net income for the year was \$41.4 million, up 2.9% versus net income of \$40.3 million last year.

... In other news, **REI** plans to open a new 28,000 square foot, one story store in Summerlin, Nevada. Summerlin joins another store in Henderson, Nevada, in serving more than 14,000 active members within the Las Vegas area.

... **L.L. Bean** announced the expansion of its retail presence with its second store in the metro Chicago area in Skokie, Illinois. The company also plans to open a store in South Barrington, also in the Chicago area, and a new store in Pittsburgh,

Pennsylvania in November 2008.

... **Quiksilver Inc.** is being sued by sports network **ESPN Inc.** on claims it violated a trademark on the cable channel's X-Games competition franchise. Quiksilver uses a stylized "X" emblem on clothing, labels and accessories that is "confusingly similar" to ESPN's logo for the series of surfing and biking contests, according to the lawsuit.

... **Collective Brands, Inc.** plans to release its first quarter earnings results on Wednesday, June 4, 2008, after the market closes. Be sure to look for **Global's** updated analysis and assessment shortly thereafter.

... In other news, a federal jury in Portland, Oregon awarded **Adidas** a whopping \$305 million judgment from **Collective Brands**, parent of **Payless Shoes**. The verdict stems from a 2001 lawsuit in which Adidas sued Payless over its trademark three-stripe trademark. Collective Brands is assessing the impact of the verdict and plans to ask the court to set aside the verdict.

... **DSW Inc.** reported net sales for the first quarter ended May 3, 2008 of \$366.3 million, up 3% versus sales of \$357.0 million for the first quarter last year. Sales growth, however, was retarded by a 5.4% decrease in comp store sales.

... **Brown Shoe Company, Inc.** will release its first quarter financial results on Wednesday, May 21<sup>st</sup>. Be sure to look for **Global's** updated analysis and assessment shortly thereafter.

... **Bakers Footwear Group, Inc.** reported that sales for its first quarter ended May 3, 2008 decreased 11.6% to \$43.5 million from \$49.3 million a year ago. Comp store sales for the quarter fell 11.1%, compared to a decline of 9.3% last year.

... With its Walking Co. unit now more than twice as large in sales and number of its stores than its Big Dog business, the Board of Directors of **Big Dog Holdings, Inc.** approved the change of the company's name to **The Walking Company Holdings, Inc.** The company's NASDAQ symbol will also be changed from **BDOG** to **WALK**.

... Meanwhile, **Big Dog Holdings Inc.** reported sales for the first quarter ended March 31, 2008 of \$46.4 million, a 5% increase compared with \$44.2 million a year ago, reflecting the addition of 41 net new Walking Company stores. The company reported an operating loss for the quarter of \$6.6 million versus an operating loss last year of \$5.9 million.

### Did You Know...?

*U.S. chain store sales for the week ended May 3rd rose 2.3% from the year ago period, according to a survey released by the International Council of Shopping Centers. On a week over week basis, sales slipped 0.2%.*

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## Hi Tech Entertainment

... **Overstock** has said that the company is hoping to realize a net income of \$10 million for 2008. CEO Patrick Byrne did not go so far as to predict the profits, but did say he felt it was possible. Overstock has lost \$240 million since its inception in 1999.

... **Circuit City** has agreed to open up its books to let **Blockbuster** do due diligence to get ready for a possible \$1 billion bid for the firm. Many have questioned whether Blockbuster has the funding available for the acquisition. However, Carl Icahn has been rumored to be interested even if Blockbuster does not go through with the acquisition.

... **Amazon** has filed a lawsuit against the State of New York to block a new law that requires out-of-state internet retailers to collect sales taxes if they have a physical presence in the state. The law has been accepted by independent bookstores that say this would level the playing field with Amazon.

... **Trans World** CEO Robert Higgins has withdrawn his offer to buy the struggling music and movie retailer. Higgins teamed with Riley Management for the \$5 per share offer. Together, Higgins and Riley Management own 57% of the outstanding shares of stock.

... **Best Buy** has teamed up with London-based **Carphone Warehouse Group**. Best Buy feels that the \$2.1 billion investment is a way for the company to roll out its big box stores in Europe.

... **Systemax** reported revenues of \$725 million and net income of \$18 million in the first quarter. Both are records for the firm.

... **Barnes & Noble** has said that it will begin selling magazine subscriptions on its website. The company will offer subscriptions to more than 1,000 titles, many at a discount.

## Off the Rack

... **Charming Shoppes** has settled its dispute with two activist shareholder groups, Crescendo Partners and Myca Partners, who combine to own 17.2% of the firm's stock. The battle over the Board of Directors got very ugly during the past few weeks, but the two agreed to expand the board to 11 members and appointed the two members the shareholders were seeking. Charming Shoppes had previously taken the unusual step of suing its own shareholders.

... **Gottschalks** reported a 3.9% drop in April comps, as revenues for the month fell 4.9% to \$38.3 million. For the first quarter, the com-

pany's comps fell 10.3%, as revenues were down 11.8% to \$125.1 million.

... **Bon Ton Stores** reported a 0.9% drop in April comps, as revenues for the month fell 1% to \$209.2 million. For the first quarter, the company's comps fell 4.6%, as revenues were down 5.1% to \$700.2 million.

... **Talbots** reported a 9.8% drop in comps for the first quarter. For the period, the Talbots banner comps fell 7.4% and the J. Jill comps fell 20.2%. Total sales for the company in the first quarter fell 6% to \$542 million.

## Health & Beauty Aids

... **CVS** has announced that it had cut its in-store health clinic expansion plans in half. The druggist plans to open 100 new clinics during the coming fiscal year.

... **Walgreen** has opened its first three in-store clinics in the Denver, Colorado market. Later this year, the firm plans to add some more of these

location in this Denver metropolitan area.

... **CVS** announced that it plans to remove harmful chemicals from its branded household products.

... **CVS** rolled out a series of promotional offerings in conjunction with Mother's Day.

## Options and Resources

**Feedback and Questions:** Should you have any feedback to provide us or questions to ask, please email us at [inbox@globalcreditservices.com](mailto:inbox@globalcreditservices.com)

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### Did You Know...?

*U.S. companies' planned layoffs jumped 68% in April from the prior month to the highest since September 2006, pointing to further deterioration in the labor market.*

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## Toys R Us: Retailer of the Week

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number of owned store properties. The number of stores closed initially was 75, with another 12 sites converted to the Babies R Us chain format.

As of February 2, 2008, Toys R Us operated 585 domestic toy stores in 49 states, which includes 553 traditional stores, 28 side-by-side stores with Babies R Us, and four superstores. Internationally, there were 715 Toys R Us stores in operation that are either owned, licensed, or franchised. At the beginning of fiscal 2009, the company terminated its relationship with franchisors in Turkey, now eliminating 35 locations in that locale.

Also in the US, as of February 2, 2008, there were 260 Babies R Us stores in operation. Internet retailing is performed through two web sites, toysrus.com and babiesrus.com.

### FINANCIAL PERFORMANCE

#### Toys R Us, Domestic

	2006	2007	2008
Net Sales	\$6.43 b	\$5.9 b	\$5.96 b
Comp Store Sales	-1.40%	0.60%	2.20%
Gross Profit	\$1.83 b (28.5%)	\$1.83 b (31%)	\$1.91 b (32.1%)
Store Count	671	586	585

Strong demand for video games and electronics drove better comp performance during fiscal 2008. Sales were also positively impacted by growing internet revenues. During fiscal 2008, this segment opened three new stores and closed one location. Management continues to limit store expansion in light of the weak economy and hefty competition from discount chains, and very wisely so.

Better product pricing helped to achieve higher margin dollars and percentages.

#### Toys R Us, International

	2006	2007	2008
Net Sales	\$2.81 b	\$4.78 b	\$5.34 b
Comp Store Sales	3.10%	2.60%	2.70%
Gross Profit	\$1.05 b (37.2%)	\$1.64 b (34.4%)	\$1.91 (35.6%)
Store Count	641	678	715

As in the domestic stores, demand for electronics and video games, along with action figures, drove comp store sales increases. After markdowns depressed the margin percentage for fiscal 2007, fewer markdowns and better product pricing helped the margin percentage to rebound during fiscal 2008.

During fiscal 2008, forty six new stores were opened while nine were closed.

#### Babies R Us

	2006	2007	2008
Net Sales	\$2.09 b	\$2.38 b	\$2.5 b
Comp Store Sales	5.70%	4.80%	2%
Gross Profit	\$800 mm (38.3%)	\$938 mm (39.4%)	\$990 mm (39.7%)
Store Count	230	251	260

Strong demand for basic infant products drove comp store sales; however, comp increases have become smaller as competitors have reacted. Still, on the margin side better product pricing and the ability to control markdown activity helped to raise margins in both percentage and dollar terms.

During fiscal 2008, this unit opened nine new stores while closing none.

(Continued on page 9)

#### Did You Know...?

The tax rebates starting to show up in Americans' mailboxes and bank accounts will likely be used for food and other basic necessities, making them less of an economic stimulus than the Bush administration hoped for.

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## Retailer of the Week

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### Corporate Income Statement

	2006	2007	2008
Net Sales	\$11.3 b	\$13.1 b	\$13.8 b
Gross Profit	\$3.68 b (32.5%)	\$4.41 b (33.8%)	\$4.81 b (34.8%)
SG&A Expenses	\$3.35 b (29.6%)	\$3.86 b (29.6%)	\$4.14 b (30%)
<b>Operating Income</b>	<b>\$326 mm (2.9%)</b>	<b>\$553 mm (4.2%)</b>	<b>\$665 mm (4.8%)</b>
Interest Expense	\$394 mm	\$537 mm	\$503 mm
Transaction Costs from Buy Out	\$432 mm	\$0	\$0
Gains or Losses from Sale of Real Estate	(\$3) mm	\$110 mm	\$33 mm
Restructuring Charges	\$33 mm	14 mm	\$2 mm
Interest Income	\$31 mm	\$31 mm	\$27 mm
Minority Interest Income or Loss	\$0	\$1 mm	(\$2) mm
<b>Net Income/Loss (tax benefit for fy 06)</b>	<b>(\$384) mm</b>	<b>\$109 mm</b>	<b>\$153 mm</b>

The higher cost structure for fiscal 2008 was the result of unfavorable foreign currency exchange, store remodeling activity, and increased advertising expenditures needed in this competitive environment. Lower interest rates on variable rate debt and lower average revolver borrowings afforded less interest expense for fiscal 2008.

Restructuring charges relate mostly to store locations that have been closed.

#### Did You Know...?

One-Third (33%) of online U.S. adults say they are more likely to shop online because of high gasoline prices, according to a recent Harris Interactive survey.

### Balance Sheet

	2006	2007	2008
Cash/Short Term Investments	\$981 mm	\$765 mm	\$919 mm
Inventory	1.49 b	\$1.69 b	\$2 b
Receivables	\$218 mm	\$230 mm	\$256 mm
Current Assets	\$2.9 b	\$2.86 b	\$3.4 b
Total Tangible Assets	\$8 b	\$7.93 b	\$8.59 b
Payables	\$1.19 b	\$1.3 b	\$1.53 b
Long Term Debt, including current portion	\$5.95 b	\$5.75 b	\$5.84 b
<b>Total Liabilities</b>	<b>\$9.09 b</b>	<b>\$8.97 b</b>	<b>\$9.34 b</b>
<b>Current Ratio (reclassifying maturing debt as short term for fy 08)</b>	<b>1.1:1</b>	<b>1.1:1</b>	<b>0.8:1</b>
<b>Leverage Percentage (tangible assets only)</b>	<b>114%</b>	<b>113%</b>	<b>109%</b>

We have added back to short term liabilities \$2.1 billion in maturing debt during 2008. There is an \$800 million real estate secured loan that will be due in August 2008, which contains a provision for two one year extensions. On whole, we have no concern with that debt being extended. However, there is \$1.3 billion of unsecured debt coming due in December 2008, again with two one-year extension possibilities. Toys R Us indicates that it will extend each for another twelve months. With respect to the unsecured \$1.3 billion, we hope that the commitment is firm and that there is no ability for the lender to deny an extension.

The complete debt structures are more fully outlined in Global Credit's debt analysis section.

While the company had a very weak current ratio, it had \$890 million in excess availability under a \$2 billion revolver to support any shortfall. Borrowings under this line were repaid by February 2, 2008 with the difference relating to outstanding letters of credit of \$110 million.

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## Retailer of the Week

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Of course, Toys R Us saw no real reduction in debt levels and in fact debt increased during the most recent fiscal year. We expect this Company to remain highly leveraged for years to come, probably well beyond the time all of us retire.

### OUTLOOK

We are pleased at the improvement in operating income and the operating margin for fiscal 2008. Still, this nearly \$6 billion in debt is troubling, particularly given the current state of credit granting. And as the unsecured debt comes due over the next few years, will there be lenders willing to refinance it unsecured or take inferior liens on collateral? For now, things should remain calm until the fall when Toys R Us again gears up for another holiday season. We are hopeful that by the fall of this year, something more definitive and specific comes about with respect to the \$1.3 billion in maturing debt (such as a commitment letter from the lender).

For now, we advise clients to closely follow Global Credit ongoing reports and alerts.

## Rating Changes and Outlooks

Company	S&P Credit Rating		S&P Credit Outlook		GCS Credit Rating
	Current	Prior	Current	Prior	Current
COLLECTIVE BRANDS FKA PAYLESS SHOESOURCE	B+	B+	NEG	STA	C
BEST BUY CO INC-BBY	BBB	BBB	NM	STA	B-
CHARMING SHOPPES INC	B+	BB-	NEG	NEG	D-
CLAIRES STORES INC	B-	B	NEG	NEG	B
LINENS HOLDING CO CASE NUMBER 08-10832	NR	D	NR	NM	F+
DUANE READE HOLDINGS, INC.	CCC+	CCC	DEV	NEG	F+
CONSOLIDATED CONTAINER COMPANY LLC	B-	B-	STA	POSITIVE	NR
ACE HARDWARE CORP	BB-		STA		C-
DAVE & BUSTERS INC	B-	B-	POS	STA	E+
GAMESTOP CORP	BB	BB	POS	STA	B-
155 EAST TROPICANA LLC	CCC+	B-	NM	NM	E
SAKS INC/FKA PROFFITTS INC	BB-	B+	POS	NM	C

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