GLOBAL CREDIT SERVICES

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RETAIL SECTOR WEEKLY

Key Retail News and Commentary

Inside this issue:

Remember...

A brand for a company is like a reputation for a person. You earn reputation by trying to do hard things well.

Retailers Facing Credit Crunch

Nearly half of U.S. retailers have seen their lenders tighten credit this year, and a majority don't expect a turnaround in the economy to occur before the second quarter of next year, according to a new study.

The BDO Seidman study, which surveyed 100 chief financial officers at leading U.S. retailers during August and September, also found that 24% of retailers had made, or planned to make, significant layoffs in 2008.

"This is a demonstration of how the credit crunch is affecting Main Street," said Doug Hart, a partner in BDO Seidman's retail and consumer products practice. "It's a direct correlation – if banks get tight, companies will get conservative and they'll lay people off."

Some 63% of CFOs surveyed by the consulting firm do not believe a "meaningful turnaround" in the economy would come before the second half of next year or later – 11% said it will occur in 2010 or later – and 41% said they had experienced constricted credit by their lenders.

"If you surveyed those same CFOs now, over 50% would be experiencing some tightening," Mr. Hart told Rueters.

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Retailer of the Week: Zale Corporation

A very challenging jewelry retail environment, aggravated by the general declining economic environment, forced Zale Corporation to see earnings plummet for fiscal 2008. Revolver debt also increased as the company used those borrowings to fund what we consider an ill advised stock buy back program during this most difficult time. Accordingly, Global Credit will maintain its "D+" credit rating for Zale Corporation, reflecting a somewhat moderate amount of credit risk. Given gloomy expectations for the upcoming holiday season, we are not optimistic about any improvement in profitability going into fiscal 2009.

BACKGROUND

Zale Corporation is a leading retailer of jewelry with retail stores located throughout the United States, Puerto Rico, and Canada. The Company divides itself into two primary segments, Fine Jewelry and kiosks. The Fine Jewelry segment includes chains Zales Jewelers, Gordon's Jewelers, Zales Outlet, and in Canada, the Peoples and Mappins Jewellers chains. As of July 31, 2008, there were 1,396 retail stores operating under this segment. Kiosks are operated in malls under the Piercing Pagoda chain (the lead chain for this segment) along with other trade names of Plumb Gold and Silver and Gold Connection. As of July 31, 2008, there were 739 kiosks in operation. Over the past two years, the number of kiosks have been reduced, including closing all kiosks in Canada that were operating under the Peoples II name.

Zale Corporation provides credit insurance on its private label credit card accounts, which includes credit life and credit disability. The credit cards themselves are underwritten by Citicorp; Zale Corporation assumes no credit risk.

In September 2007, Zale Corporation sold its upscale Bailey Banks & Biddle chain to Finlay Enterprises for $190 million and recorded a pre tax gain on the transaction of $14 million.

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Retailers Facing Credit Crunch

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U.S. banks and other lenders, reeling from a global credit crunch with roots in the housing meltdown, have curtailed lending and retailers this year have faced a double whammy – tighter credit and dismal consumer spending levels.

One example is women's apparel retailer Talbots Inc., majority-owned by Japan's Aeon Co. Ltd. Talbots sales were already in a slump before two major banks earlier this year said they were cutting off their letters of credit. The company has been cutting staff and streamlining operations.

To manage their businesses in the tough environment, retailers have cut back on their inventories and shuttered stores. Some 37% of surveyed CFOs said they would reduce planned inventory purchases in 2008, and 36% said they had, or would, close stores.

But should there be flexibility in credit lines, retailers need to take advantage of that in advance of the crucial holiday season, where the bulk of profits are made.

Less inventory that is manufactured abroad and imported into the United States does not bode well for foreign economic growth. The "ripple effect" of that means slowed spending by consumers abroad.

They are a growth market for U.S. goods and that's been a real silver lining in our economy.

Bankruptcy Blotter

The number of businesses that sought to liquidate under Chapter 7 bankruptcy protection rose 7% last month to 3,836 businesses, up from 3,576 in August, indicating that the U.S. financial crisis is putting more struggling companies out of business.

Linens 'n Things filed a motion to place the company up for sale, abandoning its efforts to reorganize as per its original preliminary plan of reorganization. The sale will result in either a total liquidation of the chain, 371 stores, or as a going concern. To date, their is no firm offer to acquire the company as a going concern.

Versa Capital Management won court approval to open the bidding on **Boscov's** at $288 million. The company is racing to get a deal done as soon as possible as it needs to get its stores stocked for the holiday season and a failure to sell the firm could potentially push it into liquidation. The date for the acution has been set for October 20, 2008.

Shoe Pavilion notified the court that it had not been able to find a buyer for its remaining 64 stores as a going concern and will now solicit bids to liquidate the chain. The company hopes to have the auction process completed by October 17th.

For the three month period June 9th through August 31st, **Goodys Family Clothing** reported a net loss of $33.7 million on total revenues of $211.4 million.

Unsecured creditors of **Steve & Barry's** want to interview the founders of the chain to determine if they can bring lawsuits against them for their alleged involvement in questionable loans and accounting practices.

Unsecured creditors of **Interstate Bakeries**, who stand to recover nothing under the company's plan of reorganization, are balking at the company's bid to enter into a deal with private equity firm **Ripplewood Holdings**. A hearing is scheduled for later this week.

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.

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Management on the Move

Mothers Work, Inc. promoted COO **Edward Krell** to CEO, replacing Dan Matthias who will retire on September 30. Krell will also serve as a director of the company.

Lord & Taylor named **Brendan L. Hoffman** CEO, replacing Jane Elfers, a 19 year company veteran. Hoffman was chief executive of Neiman Marcus Direct prior.

Golfsmith appointed **Sue E. Gove** as EVP and COO. Gove has been an independent consultant since 2006, when she left Zale after eight years in several senior roles.

RadioShack Corp. named **Lee Applbaum** EVP and Chief Marketing Officer. Applbaum was CMO for Schottenstein Stores previously.

Golf & Tennis Pro Shop, Inc. appointed Home Depot founder **Arthur M. Blank** as Chairman of the company's board of directors. Former Chairman **Bill Hamlin** has retired.

Big Y Foods named **William D. White** CFO, replacing Herbert D. Dotterer, who retired in July.

Dick's Sporting Goods announced that **Joseph M. Schmidt**, currently EVP of Operations and COO, will become the chain's President on Feb. 1, 2009.

The Finish Line named **Glenn Lyon** CEO. Alan Cohen will retire from the position on Dec. 1, but will remain The Finish Line COB. Lyon joined Finish Line in 2001 as EVP and chief merchandising officer.

Foot Locker's U.S. head **Rick Mina** is leaving the company amid a management reorganization that includes:

- **Keith Daly** will remain as CEO of the U.S. Foot Locker, Kids Foot Locker and Footaction and report directly to CEO Matt Serra.
- **Marla Anderson**, CEO of Lady Foot, will also now report directly to Serra.
- **Ron Halls**, who had responsibility for all international reporting to Serra, will add responsibility for Champs Sports, global sourcing and Team Edition.
- **Rubin Hanan**, CEO of Champs, and Jim Bulzis, VP of global sourcing and Team Edition, will report to Halls.
- **Stacy Cunningham**, who had been Divisional VP marketing for Foot Locker USA for the past eight years, is now corporate VP of marketing reporting to Serra.
- **Chad Smoak**, VP of retail brand marketing, will report to Cunningham.

Best Buy Co. appointed **Gerard R. Vittecoq** to its board of directors. Vittecoq is a group president of Caterpillar, Inc.

Did You Know...?

U.S. consumer spending was flat in August, the Commerce Department reported. The result was lower than the +0.2% consensus estimate.

Health & Beauty Aids

Walgreens' Take Care Health Systems opened new locations in Knoxville and Memphis, bringing to 18 the total clinics open in Tennessee.

Walgreens settled allegations of falsely billing Medicaid with a $10 million payment. Two pharmacists who worked for Walgreens stores in Minneapolis initiated the lawsuit, claiming the company charged states as if some Medicaid recipients were uninsured when those members were actually covered by Medicaid and by private insurance.

Cardinal Health will spin off its medical product businesses. Current Vice Chairman David L. Schlotterbeck will head the new firm. Cardinal expects that the spin-off will be completed by the middle of calendar 2009. When adjusting for the spin-off, management expects Cardinal to generate $90 billion of revenues during 2009. The newly created clinical and medical product company will generate about $4 billion of annual sales.

Also, **Cardinal Health** has paid $34 million to settle alleged violations of the Controlled Substances Act, specifically the diversion of shipments of hydrocodone. As part of the settlement the DEA will reinstate several of the company's licenses to distribute controlled substances, which had been suspended.

The Senate passed the **Ryan Haight Online Pharmacy Consumer Protection Act of 2008**.

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The Global World of Sports and Footwear

Foot Locker acquired the CCS skate from dELiA*s for $102 million plus adjustments for the assets. To date, dELiA*s has connected the CCS brand, which sells skateboard shoes, apparel and accessories, to its consumer base through e-commerce and catalog. But given the size of FL's brick-and-mortar network, some 3,700 doors worldwide, the retailer could decide to convert some of its underperforming storefronts to the CCS banner. In connection with the transaction, dELIA*s entered a separate agreement with Alloy, Inc. to acquire certain intellectual assets used specifically in the CSS business. These assets will be transferred to FL at the deal's closing.

Forzani Group retail sales for the seven weeks ended Sept. 21 rose 0.8% year-over-year for FGL. Overall same store sales were flat during the period with corporate comps off 2.0% and same store sales in franchise doors, primarily located in Quebec, up 3.5% y-o-y. Regionally, western Canada same store sales were flat while doors in eastern provinces, predominantly Ontario, were off 3.2%.

NexCen Brands is selling its Waverly furniture business to Iconix Brand Group for $26.0 million. Meanwhile, NEXC says it's making progress on a revised strategic plan for its franchising businesses, including The Athlete's Foot.

The Walking Co. intends to almost entirely exit the once 231-door Big Dog chain by the end of Jan. 2009. At that time, there will only be 6-8 Big Dog outlets left in operation. But WALK's exodus from the retail concept and brand that was its foundation and lone business before its March 2004 acquisition of The Walking Co., will cause the company to turn another annual loss in 2008. Last year, the company posted a $3,456,000 loss on sales of $233.3 million. Slightly more than 77% of the annual loss, or $2.67 million, was generated by Big Dog Sportswear, which also suffered a nearly 17% drop in annual sales to $71,133,000.

Cabela's has completed the sale of $200 million in asset-backed, three-year notes. The securitization finances the growth of the retailer's credit card portfolio and is expected to provide sufficient liquidity through Q1/09.

Gander Mountain signs Alliance Data Systems to a multiyear pact for a new private label credit card and database marketing services. Alliance also inks an extension to continue providing co-brand credit services to the outdoor retailer.

The **SEC** sued 16 people for insider trading involving **Dicks Sporting Goods** acquisition of **Galyan's** in June 2004. Defendants include Joseph J. Queri, Jr., DKS' SVP of Real Estate, and several of his friends and relatives. The group collectively profited by more than $620,000 from Queri, Jr.'s tip that Dick's would be announcing its acquisition of Galyan's Trading Co. on June 21, 2004. The day after the public announcement of the deal, Galyan's shares rose 50% to $16.68. Five of the defendants have agreed to settle the SEC charges without admitting or denying the allegations

Mass Merchant Musings

99c Only Stores' Chairman, Dave Gold, has proposed to acquire the chain's underperforming Texas stores. In response, the NDN board formed a committee of independent board members to consider the proposal and other alternatives for the exit plan.

Wal-Mart added new programs to its health care benefits for associates, including a "Life with Baby" initiative designed to help them have healthier pregnancies and infants. The company said 92.7% of associates have health care coverage; 50.2% have coverage through Wal-Mart's plan.

PriceSmart Inc. has acquired properties in both Panama City, Panama and Alajuela, Costa Rica in order to construct new PriceSmart warehouse clubs and develop adjoining commercial centers. The company currently operates four warehouse clubs in Panama and four in Costa Rica.

Family Dollar Stores, Inc. sales rose 8.2% to $1.766 billion for the fourth quarter ended August 30. Comp store sales increased 5.6%. Net income expanded 40.6% to 53.2 million. For the full year, sales grew 2.2% to $6.983 billion, comps up 1.2% but net income off 4.0% to 233.1 million. FY2008 had one less week of sales than FY2007. FDO management issued FY2009 guidance of sales increasing 3% to 5%, comp store sales increasing 1% to 3% and earnings between $1.58 and $1.78 per share. The company expects to open approximately 200 new stores.

Did You Know...?

The U.S. economy lost 159,000 jobs in September, the Labor Department reported, bringing the total losses for the year to 760,000 jobs.

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Hi Tech Entertainment

Circuit City Stores, Inc. sales dropped 9.6% to $2.391 billion for the second quarter ended August 31. The net loss expanded 281% to $239.2 million including $73.0 million of non-cash asset impairment charges. Comparable store sales decreased 13.3%. All store opening plans have been suspended, and store closures are a possibility. CC has abandoned trying to find a buyer, and will instead focus on improving the company's performance to keep operating. To that end, management is focusing on improvements and promotions for the critical Holiday season that can be implemented easily, including merchandising, signage in stores, and brand marketing to drive traffic. CC withdrew all guidance for the remainder of the year.

Office Depot, Inc. reached a sale/leaseback deal for eight of its retail stores with One Liberty Properties, Inc. The total sale price was approximately $47.6 million.

Lehman Brothers' part of **Staples, Inc.**'s $3 billion credit agreement has been assumed by Barclays Bank PLC. Staples used the facility for its acquisition of Corporate Express.

Best Buy Co. changed its by-laws to increase the number of seats on its board of directors from twelve to thirteen.

GameStop has reached an agreement to acquire 332-door French video game retailer Micromania for $700 million in cash. If the transaction is cleared by the European Commission, it is expected to close in November. GME will fund the purchase from cash on hand, its existing revolving credit facility, and a $150 million term loan from Bank of America.

Borders Group Inc. issued 5.15 million warrants at $7 a share to Pershing Square Capital Management, which holds $42.5 million of Borders' debt and is the largest shareholder. Pershing Square has been pushing Borders to find a buyer, but without success due to the tight credit markets.

Off the Rack

Burberry will open a children's clothing store this fall in The Westchester Mall in White Plains, NY. It will be the brand's first freestanding children's store in the country.

Kohl's Department Stores passed the 1,000 store mark when it grand-opened 46 new doors on October 1. Also, according to the *Wall Street Journal*, Kohl's management recently predicted that Holiday comps would be down 2% to 4% compared to last year. However, the chain does stand to benefit from the financial difficulties of some competitors, notably Boscovs, Mervyn's and Bon-Ton.

Saks Direct, Inc. has chosen to implement the FiftyOne global ecommerce solution, which will enable Canadian consumers to shop and buy online at saks.com.

Did You Know...?

U.S. consumer confidence continues to rise. For September, the index hit 59.8 up from 58.5 in August, according to the Conference Board.

Upcoming Reporting Dates

Company	Event	Date
Fred's, Inc.	Investor Conference	Oct 7, 2008
Ingram Micro	Quarterly Results	Oct 23, 2008
Kroger	Investor Conference	Oct 15, 2008
Limited Brands	Quarterly Results	Oct 8, 2008
Safeway Inc.	Quarterly Results	Oct 7, 2008

Rating Changes & Outlooks

Company	S&P Credit Rating		S&P Credit Outlook		GCS Credit Rating
	Current	Prior	Current	Prior	Current
CSK AUTO CORP NOW PART OF O'REILLY AUTOMOTIVE	NR	B-	NR	NM	E+
WENDYS INT'L INC	B+	BB-	STABLE	NM	D+

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Heard in the Grocery Aisle

Fresh & Easy sales were $135.1 million for the six-month period ended August 23, according to financial statements from parent Tesco. Operating loss was $106.7 million reflecting low leverage on the considerable distribution infrastructure that's in place to support growth. The 90 stores are generating an average of $11 per square foot per week, with some stores hitting a remarkable $25 per square foot per week.

Giant Eagle Inc. and **Heinen's Fine Foods** reached a tentative deal with UFCW Local 880, covering 8,700 Cleveland and Akron, OH employees. The contract is awaiting member approval.

Penn Traffic has settled with the SEC over the company's accounting practices in 2001 to 2003. The settlement requires Penn Traffic to hire an independent examiner who will oversee the company's promotional-allowance internal controls and financial reporting.

Seiyu, the Wal-Mart-owned Japanese supermarket chain, will close 20 of its 393 stores by mid 2009. Seiyu has lost money in each of the last six years.

Wegman's is replacing the block-letter logo it's used since the '70s with a retro script-style logo. The new mark will show up on employee uniforms and consumables first, signage later.

Also, **Wegman's** is testing a self-checkout system. If the test is successful, Wegman's will roll out the concept to other stores.

Kroger reached a new agreement with UFCW Local 700, covering 1100 workers in Indiana.

Whole Foods Market, Inc. was sued for $67.9 million by Seattle developer TRF Pacific after it stopped work on the store at Interbay Urban Center. Whole Foods had reportedly tried to delay or cancel its lease there, and shrink the store from 60,000 to 40,000 sq ft.

Village Super Market, Inc., an operator of 25 Shop Rite supermarkets in New Jersey and Pennsylvania, reported sales were up 10.7% to $298.0 million in the fourth quarter ended July 26. Comp store sales increased 3.6%, and net income was up 9.0% to $6.9 million. For fiscal year 2008, sales rose 7.8% to $1.128 billion. Net income was $22.5 million, an increase of 10%. Comps increased 2.5% for the full year.

Did You Know...?

The ISM index of manufacturers' production fell sharply to 43.5% in September from 49.9% in August, according to the Institute for Supply Management.

General Retail News

The 20th Annual **Retail Theft Survey** conducted by Jack L. Hayes International finds that shoplifters and employees stole over $6.7 billion in 2007 from the 24 major retailers surveyed. Panel member companies apprehended 708,962 perpetrators last year and recovered more than $150 million in stolen merchandise.

The **National Retail Federation** (NRF) welcomed today's House passage of the bill to address the nation's financial crisis, saying the legislation will help protect Main Street jobs while also stabilizing Wall Street and credit markets. In addition to establishing a system to restore stability to the U.S. financial markets, the House-approved legislation includes two significant and longstanding retail priorities that were added to the bill earlier this week by the Senate:

- One measure renews a depreciation rule that expired at the end of 2007 that allowed retailers who lease their stores to write-off remodeling expenses over 15 years rather than the previous 39 years. The rule will be extended through the end of 2009 and expanded to include owned stores for the first time. The NRF successfully argued that it was unfair to put retailers who own their own stores—many small or rural merchants—at a disadvantage.
- The other item, strongly backed by the NRF, will require health plans to provide the same level of coverage for mental illnesses as physical illnesses. The bipartisan compromise says coverage for mental health can be no more restrictive than for other coverage, including co-pays, deductions and out-of-pocket expenses.

Also, the **National Retail Federation** reported that more consumers plan to celebrate the Halloween holiday and, on average, plan to spend more for it than last year. Overall, Halloween sales are expected to rise 14% to $5.77 billion, while holiday sales are predicted to grow by just 1.5%.

Specialty Items

BMTC Group's stock buyback offer ended with the company repurchasing 3,134,147 shares out of the 4,000,000 authorized.

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FYI for the DIY

Building Materials Holding Corp. was sued in U.S. District court in Los Angeles by 14 former construction employees, who accused the company of failing to pay for overtime work. The plaintiffs are seeking class certification for the suit.

Also, **Building Materials Holding Corp.** amended its credit facility with its lenders. The amended facility provides the same $540 million between a revolver and term loan, but with higher interest rates for both.

84 Lumber has begun bidding on light commercial projects involving steel framing and other types of commercial building products in an effort to expand its focus beyond residential building. In the Grand Palisades at Lake Austin outside Orlando, the company is supplying the building materials for 890 condo units.

United Rentals, Inc. acquired Corpus Christi, Texas-based, Portland U-Rent-It, Inc., an $11 million rental company that focuses on the industrial market. URI management is pursuing growth in industrial rentals, which is not as soft as the construction rental market.

Richelieu Hardware sales fell 0.1% to $111.8 million for the third quarter ended August 31. Earnings were up 5.8% to $9.6 million. In July, Richelieu acquired the assets of Acroma Sales Ltd., a wood finishing products distributor.

Home Depot will build two new distribution centers of approximately 658,000 square feet each in Redlands, California and Monroe, Ohio. The company is in the process of revamping its distribution centers to go towards a newer fast-flow, “rapid deployment center” format, moving away from centralized distribution.

ProBuild will close its Jarrell, Texas, manufacturing plant in November. The company plans to continue servicing its Austin-area customers through other area locations.

Retailer of the Week: Zale Corporation

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FINANCIAL PERFORMANCE

INCOME STATEMENT	FY 2006	FY 2007	FY 2008
Net Sales	$2.15 b	$2.15 b	$2.14 b
Weighted Average Comp Store Sales between all chains	1.6%	-0.2%	-0.7%
Store Count, fine jewelry and kiosk	1,383/893	1,401/793	1,396/739
Gross Profit	$1.11 b (51.5%)	$1.12 b (52.2%)	$1.05 b (49.0%)
SG&A Expenses, including cost of credit insurance operations	$1.03 b (47.8%)	$1.03 b (47.9%)	$1.04 b (48.5%)
Operating Earnings	**$79.4 mm (3.7%)**	**$92 mm (4.3%)**	**$11.7 mm (.5%)**
Interest Expense	$11.2 mm	$19.0 mm	$12.4 mm
Gain from Pension Termination Settlement	$13.4 mm	$0	$0
Loss from Derivatives	$1.68 mm	$7.18 mm	$0
Other Income	$0	$0	$3.5 mm
Earnings or Loss from Discontinued Operations	($6.06) mm	$11.1 mm	$7.08 mm
Net Income, tax benefit for FY 08	**$53.6 mm**	**$59.3 mm**	**$10.8 mm**

Comp store sales did turn positive in the second half of fiscal 2008, averaging nearly 6% for that six-month period. However, most of this increase was tied to clearance activity or lowering prices to meet other competitors’ price points. In this sector, over the past twelve months several rivals have been forced out of business and a few others are teetering towards bankruptcy. This might eventually help Zale Corporation, however, the company continues to do battle with huge Signet Group, parent of Kay Jewelers.

The goal of divesting of the Bailey Banks & Biddle chain was so that Zale Corporation could focus more on the mid-tier market. Also, Zale Corporation continued to close locations in the Zales and Gordon’s chains and within the Piercing Pagoda chain (kiosks). During fiscal 2008, there were 26 and 54 net locations shuttered, respectively. *(continued on page 8)*

Did You Know...?

U.S. factory orders fell 4% in August, the Commerce Department reported. Orders for durable goods fell 4.8% in August, and orders for nondurable goods fell 3.3%.

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Retailer of the Week: Zale Corporation

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While Zale Corporation was able to bump up the margin rate a bit for fiscal 2007, those clearance sales along with declines in revenues associated with lifetime warranties forced margins to be lower in both dollar and percentage of sales terms for fiscal 2008. Although the company implemented cost cutting initiatives, expenses still rose for fiscal 2008, despite slower sales, due to higher occupancy expenses and severance payments made to employees let go as a result of those cost cutting efforts.

For fiscal 2007, interest expense jumped due to higher revolver borrowings and rising interest rates. However for fiscal 2008, a lower average interest rate charged on debt, 5.1% for fiscal 2008 versus 6.6% for fiscal 2007, along with less revolver borrowings led to the decline in interest expense. The revolver borrowings were lower throughout the fiscal year even as Zale Corporation ended fiscal 2008 with higher debt levels.

During fiscal 2008, Zale Corporation sold its interest in a diamond knows as the "Incomparable Diamond" and recorded a gain of $3.5 million. Also, discontinued operations for fiscal 2008 represented the Bailey Banks & Biddle chain and the gain recorded from the sale of that unit to Finlay Enterprises.

BALANCE SHEET	FYE 2006	FYE 2007	FYE 2008
Cash	$42.6 mm	$37.6 mm	$65.6 mm
Inventory	$903.3 mm	$1.02 b	$779.6 mm
Current Assets	$1.05 b	$1.17 b	$970.6 mm
Tangible Assets	$1.37 b	$1.51 b	$1.32 b
Revolver Debt	$202.8 mm	$227.3 mm	$326.3 mm
Total Liabilities	$658.2 mm	$711.4 mm	$823.8 mm
Current Ratio	**2.6:1**	**3.1:1**	**3.0:1**
Tangible Leverage Percentage	**48%**	**47%**	**62%**

During fiscal 2008, Zale Corporation repurchased a net of $324.7 million of stock, after giving effect to stock options exercised. Some of this came from excess cash on hand, however, a good deal of the buy backs were financed by additional revolver debt. Given industry conditions we question whether this is a good use of debt. If the holiday period and going into 2009 prove very difficult for this retail sector, would not management want that excess revolver capacity to cover operations if cash flow could not(?)

The sizable drop in inventory reflects the divesting of the more than 65 Bailey Banks & Biddle stores in September 2007 along with efforts to reduce merchandise levels. We are concerned that inventory could now be too lean thus causing the opportunity for missed sales.

The decline in cash and the increase in revolver debt has shifted Zale Corporation to being a little leveraged on a tangible basis. At this point in time, we see no cause for concern, however, that could change if cash balances are eroded and debt rises again. Excess credit availability as of July 31, 2008 of a little more than $129 million was not overly strong in our opinion.

Since Zale Corporation lumps payables and accrued expenses together on the balance sheet, we are unable to determine if suppliers are being stretched out more as a means to enhance cash flow.

OUTLOOK

Again, we look towards a very challenging holiday period for Zale Corporation. The company will probably post a loss for the first quarter of fiscal 2009, ending October 31. The second quarter should be profitable but after that earnings, become very questionable.

Ideally, we would like management to halt stock repurchases, and the debt incurred therein, until financial performance improves. While we are maintaining a "D+" credit rating for Zale Corporation, for the short term we see no immediate concerns about liquidity, evidenced by a solid current ratio. Still, clients should continue to closely follow ongoing Global Credit updates and alerts.

Did You Know...?

First-time claims for unemployment benefits rose 1,000, to 497,000 last week, the highest level since late September 2001. Without hurricane Ike, the initial claims would have been about 439,000.

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