

# RETAIL SECTOR WEEKLY

## Key Retail News and Commentary

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#### **Remember...**

*The highest reward for a persons' toil is not what they get for it, but what they become by it.*

### Free-Cash Rise May Signal Start Of Economic Turn

The first year-long improvement in free-cash margin (free cash flow to net sales) since December 2007 suggests that non-financial public companies are in the process of turning the corner in terms of financial performance, according to an upcoming research report on over 3,500 companies by the Georgia Tech Financial Analysis Lab.

For the twelve months ended in March, free cash margin improved to 4.60%, up from the 4.12% reached in December 2008, the current low point in the recession. This is a particularly striking development in that it is the first twelve-month period since December 2007 that there has been improvement in free cash margin, according to the report.

Charles Mulford, the Georgia Tech accounting professor who directs the Financial Analysis Lab, says he was stunned by the free cash margin recorded in the survey. In contrast, the figure stood at 2.63% in March 2001. That was, by all accounts a mild recession. Ironically in what we are calling the great recession, companies are generating more cash for the shareholder.

Based on the Lab's "Free Cash Margin Index"—which looks at companies based on their free cash flow measured as a percentage of revenue for the trailing twelve-month period—the research provides support for the improvement in stock prices we have seen since early March 2009 as well as the notion that the country may be heading out of the recession.

Driving the upturn in free cash margin was a small cut in capital spending and a heftier dive in the cash cycle, a working capital metric which the researchers define as receivables days plus inventory days less payables days in a firm's cash cycle. Firms are truly becoming lean and mean and just about keeping pace with a decline in profitability.

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### Retailer of the Week: Pier 1 Imports

Although down from last year's first quarter, Pier 1 Imports still posted a sizable operating loss for the first quarter of fiscal 2010. One-time gains allowed for positive net income, however, we do not see this repeating in subsequent quarters. Although the Company is attempting to bring down lease costs, we still believe that this may not be sufficient enough to return the chain to sustainable profitability and that more store closings above what has been announced could be necessary. While we see no immediate problem with liquidity in the near term, longer term (post holiday 2009) is another issue. Accordingly, Global Credit will continue to rate Pier 1 Imports an "E", high credit risk to vendors providing the Company goods or services on open credit terms. Unfortunately, we have yet to see anything that would indicate that profits are close at hand, factoring out any special one-time gains.

#### **BACKGROUND**

Pier 1 Imports offers unique merchandise from around the world for the home operating 1,073 stores as of May 30, 2009 throughout the US and Canada. In recent years responding to significant losses, the Company has begun to shrink its store base by closing under performing sites and limiting new store expansion. For the current fiscal year, 50 stores are slated for closure with 27 locations fiscal year to date that landlords have agreed to lease termination or where lease modifications could not be reached. The Company anticipates that the closing of these 27 locations

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## Free-Cash Rise May Signal Start Of Economic Turn

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The findings come on the heels of several industry studies by CFO magazine of companies in the CFO Midcap 1500 index. Those studies, based on an analysis of data provided by Capital IQ, show that some mid-market companies have managed to hold their own in terms of cash earnings per share, often despite declining sales. As they have in the Georgia Tech data, tougher accounts receivable efforts as well as cuts in SG&A seem to have played a part in the results.

Explaining how corporations have managed a boost in free cash flow in the face of the recession, it comes down to the fact that corporations are just better at managing their operating working capital. The innovations of just-in-time manufacturing have reduced inventory needs and companies have grown expert in curbing receivables days.

Tying up much less cash in working capital has helped weather this storm on a cash flow basis, still the belt-tightening is only half the picture. It is important to note that while we are encouraged by the improvement in free cash margin and we are significantly outperforming where we were, to get any sustainability in free cash flow we have to get improvement in profitability.

Feedback?

Questions?

Suggestions?

[Click Here](#)

## Management on the Move

**Staples, Inc.** appointed **Amee Chande** SVP of Strategy. Chande was VP of New Business Development for Wal-Mart Stores prior.

**Supervalu Inc.** CEO **Craig Herkert** will assume the additional role of president, replacing **Mike Jackson**, President and COO, who is retiring. SVU's three retail regions will be combined under **Pete Van Helden**, who will become EVP, Retail Operations. Helden currently runs the West region. **Kevin Tripp**, currently EVP and President of the Midwest region, is also retiring.

**Walgreen Co.** promoted **Wade D. Miquelon** to EVP and Chief Financial Officer, and promoted **John W. Spina** to Corporate VP of Retail Integration and New Format Development.

**Neiman Marcus Group, Inc.** appointed **Wanda Gierhart** SVP and Chief Marketing Officer. Gierhart was President and CEO of TravelSmith, a travel apparel and accessory retailer, previously.

**Rex Stores Corp.** Chairman & CEO **Stuart A. Rose** assumed the President title and responsibilities on June 30, as the previous President & COO **David L. Bearden** was terminated on that date.

**H.E. Butt Grocery Co.**'s CFO **Martin Otto** will add the title and duties of Chief Merchant when **Steve Harper** retires on January 1, 2010.

**Golfsmith International** hired **Dan Sawall** as SVP and General Merchandise Manager. Sawall most recently was General Manager for Nike Factory Stores, Inc.

**Finlay Enterprises, Inc.** director **Rohit M. Desai** resigned from its board. Desai's resignation was not the result of a disagreement with the company.

**Office Depot, Inc.** director **Michael J. Myers** died on July 1. The Company's Board has not yet nominated anyone to fill Myers' position.

## 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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## Bankruptcy Blotter

Defaults among junk-rated U.S. companies soared in June as the recession continued to weaken credit quality and constrain lending. The 18 companies that defaulted in June put the year-to-date total at 119, which helped push the trailing 12-month speculative grade default rate to approximately 9.2% in June from 8.1% in May.

**Eddie Bauer Holdings Inc.** received permission to tap its \$100 million DIP loan after some wrangling by both the company's term loan lenders and its unsecured creditors. The court has previously allowed the company to tap \$90 million of the loan on an interim basis.

While creditors vote on its Plan of Reorganization, **Sportsman's Warehouse** is seeking court approval of its \$50 million bankruptcy exit facility with **General Electric Capital Corp.** A hefty portion of the exit loan will go toward repaying the company's \$85 million DIP facility, also provided by General Electric Capital Corp.

**Building Materials Holding Corp.** received final approval to access its \$80 million DIP financing. The company describes the \$80 million as "ample liquidity" to pay its bills as it implements a pre-negotiated restructuring of its balance sheet.

**Fleetwood Enterprises, Inc.** signed an Asset Purchase Agreement to sell its Garrett, Indiana manufactured housing plant for \$1.75 million, subject to bankruptcy court approval and a purchase price deduction for the assumption of certain warranty obligations to **Adventure Homes, LLC.**

**Bison Building Materials** filed a reorganization plan, having closed or consolidated 16 units in Arizona, Nevada, Colorado, New Mexico, Ohio and Texas, and pared its work force down from 1,350 at its peak to the current 556 employees. Going forward, Bison will operate nine locations in and around Houston and Beaumont, Texas.

Unable to raise the cash it needs to operate through the summer, **Ritz Camera** is seeking court permission to sell its remaining 400 stores to either a liquidator or a going-concern buyer. Under the proposed auction rules, bidders would be required to submit their offers by July 16<sup>th</sup> ahead of a July 20<sup>th</sup> auction.

The court gave **Crabtree & Evelyn Ltd.** permission to borrow up to \$10 million of its \$40 million DIP Loan provided by owner **Kuala Lumpur Kepong Berhad.** A final hearing on the facility is scheduled for July 29<sup>th</sup>.

### Did You Know...?

*First-time state unemployment claims in the week ending July 4 fell 52,000 to 565,000, the Labor Department reported. It was the lowest level of initial claims since January. Continuing claims rose 159,000 to 6.88 million.*

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## Off the Rack

**American Apparel, Inc.** received an extension from the NYSE, giving it until August 19 to file its form 10-Q for the quarter ended March 31.

**J.C. Penney Co., Inc.** raised its guidance for the second quarter, and now expects a loss of \$0.08 to \$0.12 per share, including the impact of the contribution of common stock to its pension plan, better than previous guidance for a loss of \$0.15 to \$0.25 per share. Second quarter comp store sales are now expected to decrease 9.5% to 10.5% from a decrease of 9% to 12% guided previously.

Also, **J.C. Penney** is launching its new Herald Square, New York City flagship with a \$1 million marketing campaign.

**Gap Inc.** has partnered with local retail operator Armin Systems Limited to open Gap stores in Thailand. The first locations are planned to open in spring 2010.

**Stage Stores, Inc.** expects to use the Goody's name—acquired in the July 3 bankruptcy auction—in about 50 former Goody's markets where there is strong customer awareness of that brand. Any Goody's bannered stores will use Stage Stores' merchandising concepts and format.

**TJX Companies, Inc.** raised second quarter guidance after reporting stronger than expected June sales. Earnings are now expected to be \$.56 to \$.59 per share compared to \$.48 a share in Q2 last year.

**Destination Maternity Corp.** sales decreased 6.4% to \$142.5 million in the third quarter of fiscal 2009. Comp store sales fell 5.5%. DEST now expects third quarter earnings to exceed the top end of its prior earnings guidance range of \$0.74 to \$0.91 per share, citing strong margins and reduced costs.

**Bebe Stores, Inc.** sales fell 25.1% to \$125.3 million in the fiscal fourth quarter ended July 4. Same store sales decreased 29.2%. For the full year just ended sales were off 14.0% to \$580.9 million with same store sales falling 20.9%. BEBE warned that earnings would be at or below the low end of the range previously guided as a result of lower comparable store sales.

**Gymboree Corp.** raised second quarter earnings guidance \$0.10 per share to \$0.19 to \$0.24 per share. Comp store sales are now expected to be negative mid-single digits, better than the mid- to high single digits guided previously.

**Aeropostale, Inc.** raised second quarter earnings guidance to \$0.45 to \$0.47 per share, up from \$0.43 to \$0.45 per share. This guidance includes pre-tax charges of approximately \$3.0 million—\$0.03 per share—from closing the Jimmy'Z concept.

**Ross Stores, Inc.** now expects second quarter earnings to be well ahead of original guidance. Earnings are now projected to be \$.73 to \$.75 per share, up from \$.60 to \$.63 per share guided previously.

## Hi Tech Entertainment

**Office Depot** is under investigation for its pricing practices in the U.S. Communities contract program. Attorneys General in Florida, Missouri, Colorado and Texas are looking into reports that the offices supplies retailer mispriced items in violation of the contract.

**Best Buy** is planning to sell electric vehicles, including bicycles, Segways and motorcycles, according to multiple reports. Some California stores are reportedly already selling electric bicycles and scooters.

**HHGregg, Inc.** is ramping up its expansion plans, and now expects to open 20 to 22 new stores this year, and 40 to 45 stores in fiscal 2011, mostly in large and mid-sized metropolitan markets in the Mid-Atlantic region,

including Philadelphia, Pennsylvania; Baltimore, Maryland; and Washington, D.C. HGG is planning a fourth central distribution center to serve the Mid-Atlantic region to open in early fiscal 2011. Capex budget has been increased to \$45 to \$50 million for this year, up from previous expectations of \$30 to \$35 million.

Research firm **iSuppli** lowered its outlook for 2009 electronic equipment sales, and now expects the segment to drop 9.8% to \$1.38 trillion this year. iSuppli had projected a 7.6% drop previously.

**Amazon.com, Inc.** launched a beta of its cell phone e-commerce site, amazonwireless.com, which sells phones from AT&T and Verizon Wireless.

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## Mass Merchant Musings

**Family Dollar Stores, Inc.** sales rose 8.3% to \$1.843 billion in the third quarter of fiscal 2009 ended May 30. Comp store sales increased 6.2%. Net income for the period was up 35.5% to \$87.7 million. Gross margin expanded 180 basis points to 36.2% in the third quarter. Looking ahead to the fourth quarter ending August 29, FDO expects sales will increase between 4% and 6% and comp store sales will be up 2% to 4%, with earnings of \$0.39 to \$0.43 per share. For the full fiscal year earnings are expected to be between \$2.03 and \$2.07 per share, up from \$1.66 in fiscal 2008.

**99c Only Stores** sales rose 8.9% to \$332.1 million for the first quarter of fiscal 2010 ended June 27. Same-store sales increased 7.2%. During Q1, NDN opened two stores in California, re-opened one Texas store which had been closed due to a hurricane and closed 11 Texas stores. Expansion plans for fiscal 2010 are for opening 10 to 12 stores with the majority

in the second half and all but two in California. The company reports earnings August 5.

**PriceSmart, Inc.** sales increased 8.0% to \$306.5 million for the third quarter of fiscal year 2009 which ended on May 31. Net income was off 17.9% to \$8.7 million, but the Q308 result included a \$2.0 million benefit from an expense reversal. PSMT had 26 warehouse clubs in operation as of May 2009, compared to 25 warehouse clubs in 2008.

*Crain's Chicago Business* reports that **Walmart** is cautiously optimistic about the possibility of opening a second store within the Chicago city limits. Union interests have thus far prevented Walmart from expanding beyond its one location in the city.

**Target Corp.** now expects second quarter earnings to meet or exceed the current median FirstCall estimate of \$0.64 per share.

## Specialty Items

**Perfumania Holdings** filed its 10K for the fiscal year ending January 31, after a two month delay. Sales were up 42.2% to \$429.3 million (compared to the equivalent calendar period last year), while net loss was \$87 million from income of \$7.4 million previously. The net loss includes an asset impairment charge of \$68.1 million and interest expense of \$12 million.

**AutoZone, Inc.** entered into a new \$800 million revolving credit agreement which expires in 2012, and terminated an existing \$700 million five-year facility and a \$300 million four-year facility, both established in 2006.

**Smith & Hawken** is liquidating inventory and shutting its doors. The 56 store retailer is owned by ScottsMiracle-Gro Co., who has been shopping the chain for over a year.

**Toys "R" Us, Inc.** has extended its \$2 billion senior secured revolving credit facility from July 2010 until May 2012. There were no substantial changes to the terms.

**iParty Corp.** extended its \$12.5 million revolving line of credit with Wells Fargo for three years to July 2, 2012. iParty currently operates 50 party goods retail stores.

### Did You Know...?

*The U.S. trade deficit fell 9.8% to \$25.96 billion in May, the Commerce Department reported, defying expectations that it would expand.*

## Health & Beauty Aids

**Duane Reade Inc.** is making cash tender offers for its \$210 million of senior secured floating notes due December 2010 and its \$195 million of 9.75% senior subordinated notes due August 2011. The offers will be funded by—and is contingent on the success of—an offering of new senior secured notes and new senior subordinated notes.

Also, **Duane Reade** will install HP Photo Centers in over 200 of its stores in the greater New York City area.

**Cardinal Health's** board of directors officially approved the spinoff of CareFusion Corp. 80%

of the shares of the new company go to Cardinal Health shareholders, with Cardinal Health retaining the remaining shares.

**Walgreens** reached a temporary deal with the State of Delaware, and will continue to fill Medicaid prescriptions while negotiations continue for a permanent solution.

Also, **Walgreens** opened its first store in Alaska, in the city of Wasilla, on July 12. Now WAG has stores in all 50 states.

**The Little Clinic** is opening five new locations inside Kroger stores in Memphis, Tennessee.

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## Heard in the Grocery Aisle

**Supermarkets are shrinking**, according to a report from the Food Marketing Institute referenced in *Contract Magazine*. The average supermarket size expanded from 2002 through 2006, peaking at 48,750 sq. ft. that year. In 2008, the average store was only 46,755 sq. ft.

Five store, El Paso, Texas-based **Quality Food Marts** has been purchased by brothers Oscar, Mike and Armando Pina, who operate three Hispanic supermarkets under the Vista banner in the area, the *El Paso Times* reported.

**Sprouts Farmers Market** opened two new stores in Brea and Riverside California. A third new location in Orange is will open July 31st.

Hawaii grocer **Times Super Market** is buying **Star Markets'** seven supermarkets, the

*Honolulu Star Bulletin* reported. The acquired stores will be rebranded and will expand Oahu-based Times' reach onto Maui and Kauai.

**Tops Friendly Markets**, which was purchased by Morgan Stanley from Ahold in December 2007, has discontinued its services agreement with Ahold. The chain now has more than 100 employees at its Buffalo, New York, headquarters and manages all operational functions from there.

**Fresh & Easy** stores in California—which are all self-checkout with no cashiers—may be forced to add personnel for checkouts involving alcohol sales, the *LA Times* reported. The state Senate is considering a bill that would require live cashiers at all supermarkets that sell alcohol to prevent sales to minors or the intoxicated.

## General Retail News

**Localized discounting**—even down to the individual store level—is becoming more prevalent across sectors, with retailers as diverse as Gap, Home Depot and Wal-Mart all exploring the tactic, the *Wall Street Journal* reported. Markdown optimization software systems allows retailers to realize better margins where available by gearing discounts based on local demand.

**Cotenancy clauses** in retail leases are giving chains the leverage to negotiate lower rents or even break leases, according to a story in the *Wall Street Journal*. When anchors or other key tenants leave, or occupancy levels fall below a threshold, it can be a violation of the lease triggering rent reductions. The article reports that Chico's FAS Inc. has saved \$8.1 million already, and Charming Shoppes Inc. estimated that it will save roughly \$10 million.

**Cargo rates from Asia** are set to rise on August 10. The Transpacific Stabilization Agreement (TSA), citing average current shipping rates that are "not sustainable" for the next 12 months, is adopting an across-the-board increase of \$500 per 40-foot container (FEU). There will also be proportionate price increases for other equipment sizes with the rates applying commodities and U.S. destinations. Additionally, the TSA intends to pursue full implementation of a quarterly bunker fuel charge that was raised July 1 to reflect higher fuel costs. Q1 cargo demand from Asia to the U.S. was 20% below the prior year period, and Q2 shipments have only shown slight improvement. There was a \$1,000-\$1,200 decline in average revenue per container during the Oct. 2008-May 2009 timeframe, the TSA said.

## FYI for the DIY

The American Hardware Manufacturers Association's Home Improvement Industry Confidence Indexes declined in June, with the Current Situation Index falling 12.4 points to 41.7 and the Future Expectations Index falling 24.1 points to 1262.1 from an all-time high of 186.2 in May.

**Tractor Supply Co.** expects net income for the second quarter will be approximately \$54.0 million to \$54.8 million for the second quarter ended June 27. The company reports on July 22. TSCA lowered its sales guidance for the

year, now expecting revenues of \$3.15 to \$3.25 billion compared to \$3.2 to \$3.3 billion guided previously with same store sales flat to -2% compared to the original expectation +1.5% to -1.5%. But earnings guidance for the year was raised to \$2.78 to \$2.92 per diluted share compared to original guidance of \$2.58 to \$2.74.

**Richelieu Hardware** sales fell 4.1% to \$110.1 million in the second quarter ended May 31. Net income fell 19.8% to \$7.3 million. Canada accounted for \$92.0 million, or 83.6% of total sales.

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## The Global World of Sports and Footwear

### Did You Know...?

*The index of consumer sentiment from Reuters and the University of Michigan fell to 64.6 in July, down from 70.8 in June.*

The global sporting goods market was flat in 2008 at \$284 billion in retail value following a solid 4% increase in the previous year, according to a study by market research company NPD. The U.S. market fell 2%, pulling down the growth in the Americas region by 1%, and Europe also recorded a 1% decline. The Asian market, fueled by the Olympic build-up in China, managed a 4% growth rate while the relatively small Africa/Middle East region had a 7% growth rate. In athletic footwear, NPD says sales in the Americas fell 3%, while they were flat in Europe, up 8% in Middle East/Africa and up 4% in Asia. Sports apparel sales were flat in the Americas, down 4% in Europe, but up 6% in Middle East/Africa and up 1% in Asia. For sports equipment, Americas sales fell 3% while Europe was up 1%, Middle East/Africa was up 6% and Asia was up 4%.

**Man Alive** under **Finish Line** ownership, as detailed in a public filing, reflects a chain with an eroding top line and gross margins that was a significant drain on its parent company. In the

most recent FY ended February 28, Man Alive had a \$26.4 million loss from continuing operations on sales of \$67.6 million. On a pro forma basis without that drain, FINL would have had a \$30.4 million profit on sales of \$1,194.7 million instead of the \$4.0 million profit it reported on sales of \$1,262.3 million.

**L.L. Bean** was voluntarily dismissed with prejudice on Jul. 3 as a defendant in the ongoing patent infringement suit filed by TEC-Technology Enabled Clothing in late March.

**West 49**, the operator of action sports retail stores in Canada, renewed its credit facilities until June 30, 2010.

**Bob's Stores** hires JustEnough, a Durham, NC software company, to oversee inventory management and implement a replenishment solution for the 34-door chain. The modular solution is forecast to be fully operational in 60 days.

## Upcoming Reporting Dates

| Company               | Event               | Date         |
|-----------------------|---------------------|--------------|
| Amazon.com            | Financial Results   | Jul 23, 2009 |
| Bebe Stores           | Financial Results   | Aug 27, 2009 |
| BJ's Wholesale Club   | Investor Conference | Jul 15, 2009 |
| Cache                 | Financial Results   | Jul 20, 2009 |
| Central Garden & Pet  | Investor Conference | Jul 14, 2009 |
| Destination Maternity | Investor Conference | Jul 14, 2009 |
| Express Scripts       | Financial Results   | Jul 30, 2009 |
| IAC Interactive       | Financial Results   | Jul 29, 2009 |
| Ingram Micro          | Financial Results   | Jul 30, 2009 |
| Loblaw Companies      | Financial Results   | Jul 24, 2009 |
| McKesson              | Financial Results   | Jul 28, 2009 |
| Nordstrom             | Financial Results   | Aug 13, 2009 |
| Office Depot          | Financial Results   | Jul 28, 2009 |
| Rent-A-Center         | Financial Results   | Jul 28, 2009 |
| Ross Stores           | Financial Results   | Aug 20, 2009 |
| Sherwin-Williams      | Financial Results   | Jul 21, 2009 |
| Shoppers Drug Mart    | Financial Results   | Jul 22, 2009 |
| Stage Stores          | Investor Conference | Jul 14, 2009 |
| Supervalu             | Financial Results   | Jul 28, 2009 |
| Tractor Supply        | Financial Results   | Jul 22, 2009 |
| Whole Foods Market    | Financial Results   | Aug 4, 2009  |

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## Retailer of the Week: Pier 1 Imports

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will result in charges of \$8 million, \$5 million expended during the first quarter, for lease exit costs, severance payments, and leasehold improvements write downs. The cash portion is expected to be partially offset by inventory liquidation sales.

Beyond the 50 sites, Pier 1 Imports will work to reduce rents. Since launching this initiative in late fiscal 2009, the Company has generated \$9 million in lease cost savings. However as noted in the first paragraph, we still have doubts on whether lease concessions alone can return this chain to good financial health, particularly given what could be a more prolonged and sustained reduction in consumer spending. Therefore, we believe that this retail concept may not be able to support a 1,000 plus store base.

Pier 1 Imports has also revamped its merchandise content, in fact, well more than once.

During the first quarter of fiscal 2010, the Company effectively had one of its foreign subsidiaries purchase \$78.9 million of Pier 1 Import's \$165 million 6.375% notes due 2036. The current market value of this debt was just \$27.4 million. With a difference in the purchase price and market value, Pier 1 Imports recorded a gain of \$47.8 million on the transaction. The debt is now effectively moved off Pier 1 Import's balance sheet. However in the grand scheme of things, we did not see the balance sheet as the most pressing issue for Pier 1 Imports. Proceeds from the debt offering completed back in early 2006 and the sale of the Company's headquarters building last year, providing more than \$100 million in cash, enabled Pier 1 Imports to beef up cash reserves and avoid borrowing, despite ongoing losses. Accordingly, we do not anticipate this as a means to halt the heavy red ink.

Also because of the put features of the notes, this transaction will now require Pier 1 Imports to repay or refinance the remainder of the notes on or before February 15, 2011.

Finally during the first quarter of fiscal 2010, Pier 1 Imports accepted a settlement for a legal issue undertaken by one of its foreign subsidiaries against an unnamed party. The agreement netted Pier 1 Imports \$10 million in a settlement, which was recorded as a one-time gain to earnings.

### OPERATING PERFORMANCE

| Income Statement  | 1ST QTR<br>FY 2009 | 1ST QTR<br>FY 2010 |
|---|--------------------|--------------------|
| Net Sales   | \$310 mm           | \$281.1 mm         |
| Comp Store Sales  | (\$0.1)            | (\$0.1)            |
| Store Count   | \$1,116.0          | \$1,073.0          |
| Gross Profit  | \$87.6 mm (28.2%)  | \$84.8 mm (30.2%)  |
| SG&A Expenses   | \$118 mm (38%)     | \$111.5 mm (39.6%) |
| <b>Operating Loss</b>   | <b>(\$30.4) mm</b> | <b>(\$26.7) mm</b> |
| One Time Gains  | \$0                | \$57.8 mm          |
| Interest Expense  | \$3.6 mm           | \$2.94 mm          |
| Interest and Other Income   | \$1.5 mm           | \$936,000.0        |
| <b>Net Income/Loss</b><br><b>(small income tax benefit for FY 2010)</b> | <b>(\$32.8) mm</b> | <b>\$29.3 mm</b>   |

Pier 1 Imports still suffered from ailing comp store sales performance. While margin dollars declined with lower sales, as a percentage of sales, margins rose 200 basis points as better inventory control allowed for less markdown activity. Also, lower distribution costs and better sourcing of merchandise helped to raise the margin rate. While expenses also dropped with lower sales, as a percentage of sales, expenses increased 160 basis points. Certain fixed costs could not be leveraged against a declining sales base and there was also the expenses tied to shutting down store locations.

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## Retailer of the Week: Pier 1 Imports

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| Balance Sheet/Liquidity                                   | May 31, 2008        | May 30, 2009        |
|---|---------------------|---------------------|
| Cash  | \$80.8 mm           | \$135.8 mm          |
| Receivables   | \$19.3 mm           | \$16.2 mm           |
| Inventory/Inventory Days Turnover                         | \$384.8 mm/135 days | \$294.2 mm/114 days |
| Adjusted Current Assets<br>(cash, receivables, inventory) | \$485 mm            | \$446.2 mm          |
| Total Assets  | \$760.9 mm          | \$593.2 mm          |
| Payables/Payable Days Turnover                            | \$80.2 mm/28 days   | \$61.1 mm/24 days   |
| Balloon Mortgage Debt                                     | \$19 mm             | \$19 mm             |
| 6.375% Notes due 2036                                     | \$165 mm            | \$84.8 mm           |
| Total Liabilities   | \$522.3 mm          | \$413.2 mm          |
| <b>Current Ratio</b>                                      | <b>1.9:1</b>        | <b>2.0:1</b>        |
| <b>Leverage Percentage</b>                                | <b>69%</b>          | <b>70%</b>          |

The good news is that optimal inventory management enabled Pier 1 Imports to reduce inventory levels and increase turns while reducing payables and shortening the average pay back period to vendors.

The increase in cash year over year resulted from the headquarters building sale, however, the Company burnt through \$20 million of cash during the first quarter. Still, existing cash reserves and excess credit capacity under a \$325 million secured revolver should easily see Pier 1 Imports through to the holidays. At most recent first quarter end, the current ratio was more than adequate. Despite the partial debt moving off the balance sheet, the leverage position was about the same, just a little on the high side but nothing overly concerning for now. The reduction in fixed assets coming from stores being closed, leasehold improvements being written down, and the sale of the headquarters building lowered the overall asset base.

### OUTLOOK

The greatest challenge for Pier 1 Imports is to move comp store sales performance more towards a break-even level. This would also allow Pier 1 Imports to better leverage certain costs. However as discussed above, we are not certain that this retail concept can support 1,000 or so stores in the current retail environment. The Company's leading competitor, Cost Plus, which is also suffering from losses, maintains a store base less than a third of Pier 1 Imports. And again if lease modifications cannot do it alone, the Company will need to go back to the drawing board with respect to store closures.

The current level of consumer spending and confidence does not bode well for a near soon recovery for this retailer. While we see no immediate issue with liquidity today, clients should continue to closely follow ongoing Global Credit updates and alerts along with watching their exposures. Second quarter results should be announced in late September or early October.

## Rating Changes & Outlooks

| Company                              | S&P Credit Rating |       | S&P Credit Outlook |            | GCS Credit Rating |
|--------------------------------------|-------------------|-------|--------------------|------------|-------------------|
|                                      | Current           | Prior | Current            | Prior      | Current           |
| DUANE READE HOLDINGS, INC.           | CC                | CCC+  | NEGATIVE           | DEVELOPING | E-                |
| HARRY & DAVID HOLDINGS INC           | NR                | CC    | NR                 | NEGATIVE   | NR                |
| FINLAY FINE JEWELRY CORP             | D                 | NR    | NM                 | NR         | F+                |
| DRIVETIME AUTOMOTIVE GROUP INC       | B-                | B+    | NEGATIVE           | NM         | NR                |
| RISKMETRICS GROUP INC                | BB-               | B+    | STABLE             | POSITIVE   | NR                |
| HHGREGG INC<br>(FKA GREGG APPLIANCE) | B+                | B+    | NM                 | STABLE     | D+                |
| ALBERTSONS LLC                       | NR                | BBB-  | NR                 | NM         | E                 |
| QVC INC                              | NR                | BB+   | NR                 | NM         | NR                |

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