

Fall 2008

Shopping for Liquidity: What's a Retailer to Do?

The Stressed Consumer

Against the backdrop of government leaders warning of possible catastrophic depression-era economic consequences from the spreading subprime mortgage crisis and credit crisis, the confluence of negative factors affecting the American consumer is overwhelming:

- Home values are plunging
- Foreclosures are soaring
- Unemployment is up
- Housing sales are down
- Prices are rising
- Credit is evaporating

Going into the critical Christmas selling season, the International Council of Shopping Centers recently forecast that consumer spending will increase by 1.7 percent, while the National Retail Foundation (NRF) forecast an increase

of 2.2 percent. Both forecasts are significantly below the 4.4 percent increase that the NRF typically reports, making this year one of the slowest growth holiday seasons since 2002.¹

Impact on Retailers

Given the economic conditions, it is no wonder that consumer spending is down and retailers are uneasy. Indications that consumers have cut back on spending are prevalent.

The September 2008 General Merchandise Comp Store Sales Analysis reports shopper traffic trends throughout the country and highlights the decline faced by the retail industry.² September 2008 U.S. shopper traffic declined a total of 14.2 percent from September 2007, with the largest drop of 17.8 percent in

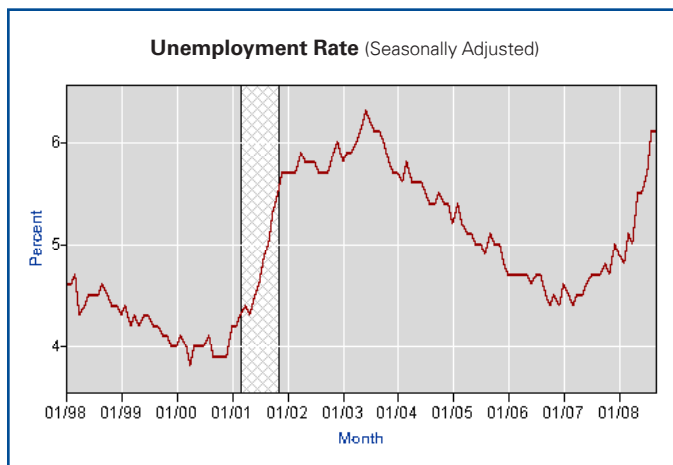
the Northeast (see table on Page 2). These numbers reflect the overall concerns of consumers due to the struggling economy.

The Federal Reserve's October 2008 Beige Report states that economic activity has been slow with decreased consumer spending in retail, auto sales, and tourism. With consumer spending slow, many shoppers have concentrated their purchases on less expensive brands and on necessary items such as food and other staple items.³ Furniture and apparel sales have declined. In September 2008 alone, furniture sales dropped over 2.3 percent, the most since 2003, while apparel and clothing sales have decreased by that same amount, representing the greatest

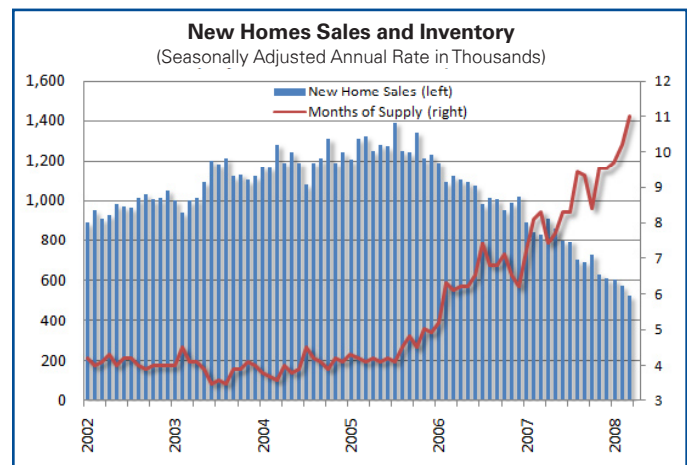
¹ National Retail Foundation and ICSC.

² General Merchandise Comp Store Sales Analysis Report and ShopperTrak, September 2008.

³ Federal Reserve's October 2008 Beige Book.



Source: Seeking Alpha, "Economic Report Summary: Plunging Home Prices and Consumer Confidence," June 29, 2008 (Note: Cross-hatched area represents recession)



Source: U.S. Census Bureau

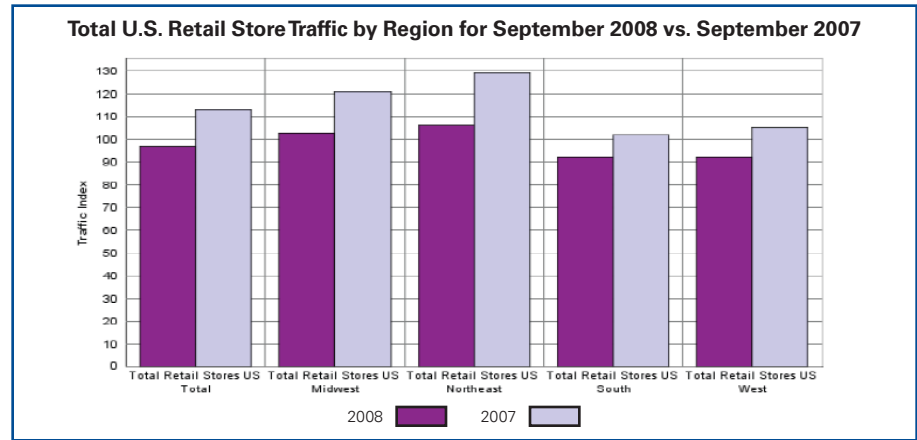
month over month decline this year. Department stores also were negatively affected, as they typically stock more discretionary merchandise. Macy's, J.C. Penney Co., and Nordstrom are just a few of the many retailers that have trimmed their third quarter profit forecasts after sales fell short of expectations.⁴

Although discounters such as Wal-Mart reported positive September sales, they reported that the sale of discretionary items was soft, with electronics and videogames among the weakest categories.⁵ MasterCard also reported that electronics and appliances sales were weak, with reported sales dropping 13.8 percent in September compared to the same period last year.

Increasing Retail Distress

The effect of decreasing customer traffic and sales can be seen in an analysis of the top 35 North American retail companies as determined by sales (see table on Page 3).⁶ Between September 2007 and September 2008:

- The stock price of 27 (77.1 percent) of the 35 retailers declined; 18 by more than 20 percent.⁷
- The debt-to-equity ratio of 23 (65.7 percent) of the 35 retailers increased; 7 by more than 100 percent.⁸
- Comparable store sales decreased in the most recent quarterly filings for 19 (54.3 percent) of the 35 retailers relative to the same 2007 quarter.



Source: September 2008 General Merchandise Comp Store Sales Analysis

The retailers that reported positive comparable store sales growth in 2008 are those categorized as necessity or discount stores (i.e., Walmart, Kroger, Walgreens), emphasizing the consumers' focus on buying necessities rather than discretionary items.

Retailer's Response

It is estimated by the International Council of Shopping Centers that there will be over 5,770 store closings this year, up 25 percent from 2007 (see below). In addition to store closings, expansion plans have also taken a hit. J.C. Penny, Lowe's, Home Depot, and Office Depot are just a few of the retailers that have decided to scale back or delay their expansion plans.⁹ As seen with Linens 'n Things (LNT) and Mervyns, Chapter 11 reorganizations can quickly turn into Chapter 11 liquidations. LNT will be liquidating 371 of its stores¹⁰ and Mervyns will be liquidating 149

stores.¹¹ Moreover, Circuit City has announced that it is actively seeking a buyer, while Talbots has announced that it is cutting expenses and costs by trimming 9 percent of its staff.^{12,13}

Liquidity and Lenders

The liquidity crisis affecting lenders is making it increasingly difficult for retailers to access financing. Any retailer seeking to refinance its credit facility—especially any recent highly leveraged LBOs—will find this environment extremely challenging. First, lenders are protective of their capital and are extremely cautious about new financings. Second, from October 2007 to October 2008, loan rates have increased approximately 175 to 225 basis points. Third, according to Barbara Anderson, Managing Director at National City Retail Finance, updated inventory appraisals in certain discretionary retail segments are increasingly showing depreciating

Store Name	Store Closings/Expansion Plans
Ann Taylor	Closing 117 stores nationwide.
Cache	Planning on closing 20 to 33 stores.
Charming Shoppes	Owner of Lane Bryant and Fashion Bug will close 150 underperforming stores.
Circuit City	Closing 155 stores.
Dell	Closing 140 stores.
Disney Stores	Closing 98 stores.
Eddie Bauer	Closed 27 stores and is planning on closing 2 outlet shops by the end of 2008.
Foot Locker, Inc.	Closing 140 stores.
The Gap Inc.	Opening 100 new stores and closing 115 locations by the end of 2008.
The Home Depot, Inc.	Closing 15 underperforming locations.
Pacific Sunwear	Announced earlier this year it will be closing its 153-store Demo chain.
Talbots	Closing 78 of its children's' and men's stores.
Zales and Piercing Pagoda	Announced earlier this year it is closing 105 underperforming stores and kiosks.

Source: The New York Times, "Retailing Chains Caught in a Wave of Bankruptcies," April 15, 2008, Money.Aol.Com, "36 Retail Stores Closing Doors," and The Wall Street Journal, "Circuit City to Retrench," November 3, 2008.

⁴ MarketWatch.com, "Macy's Slashes Profit, Sales Forecasts; Shares Skid," October 10, 2008.

⁵ The New York Times, "Gadgetry Takes a Hit as Nervous Consumers Plan for Lean Holidays," October 15, 2008.

⁶ KPMG Corporate Finance LLC reviewed the Top 35 North American traditional retailers by sales, excluding Internet-based companies and automotive dealerships, and those not reporting comparable sales statistics. Data sourced through One Source and company filings.

⁷ Publix Super Markets Inc. is not a publicly traded company.

⁸ Bed Bath & Beyond Inc. and AutoZone, Inc. did not report total debt-to-equity ratios.

⁹ Capital IQ and New York Times, "Retailing Chains Caught in a Wave of Bankruptcies," April 15, 2008.

¹⁰ Reuters.com, "Update 1-Linens 'n Things Store Closings to Begin Friday," October 15, 2008.

¹¹ Newsday.com, "Mervyns Says It Will Close all 149 stores; Becomes Latest Retailer to Citing Falling Liquidity," October 17, 2008.

¹² mysanantonio.com, "Mervyns, Retailers Trapped in the Middle," October 5, 2008.

¹³ Directmag.com, "Talbots to Ax 9 Percent of Workforce to Cut Costs," June 8, 2008.

Store Name	Sales	Stock Performance			Debt to Equity Ratio		
	% Change for Comp Store Sales*	Sept - 07 Stock Price	Sept - 08 Stock Price	% Change in Stock Price	Oct - 07 Total Debt to Equity Ratio	Oct - 08 Total Debt to Equity Ratio	Comparison
Circuit City Stores, Inc.	-13.3%	7.91	0.76	-90.39%	0.00	0.26	+
The Gap Inc.	-10.0%	18.44	17.78	-3.58%	0.00	0.04	+
Office Depot, Inc.	-10.0%	20.62	5.82	-71.77%	0.20	0.28	40.0%
OfficeMax Incorporated	-10.0%	34.27	8.89	-74.06%	0.90	1.31	45.6%
The Home Depot, Inc.	-7.9%	32.44	25.89	-20.19%	0.50	0.63	26.0%
Staples, Inc.	-7.0%	21.49	22.50	4.70%	0.10	0.75	650.0%
Limited Brands, Inc.	-7.0%	22.89	17.32	-24.33%	0.60	1.32	120.0%
Nordstrom, Inc.	-6.0%	46.89	28.82	-38.54%	0.30	2.28	660.0%
Macy's, Inc.	-5.8%	32.32	15.19	-53.00%	0.70	1.06	51.4%
Kohl's Corporation	-5.6%	57.33	46.08	-19.62%	0.20	0.33	65.0%
Lowe's Companies, Inc.	-5.3%	28.02	23.69	-15.45%	0.30	0.30	0.0%
Barnes & Noble, Inc.	-4.7%	35.26	28.08	-20.36%	0.00	0.14	+
J.C. Penney Company, Inc.	-4.3%	63.37	33.34	-47.39%	0.80	0.72	-10.0%
Dillard's, Inc.	-4.0%	21.83	11.80	-45.95%	0.50	0.57	14.0%
The Pantry, Inc.	-2.5%	25.63	21.19	-17.32%	2.50	3.59	43.6%
Supervalu Inc.	-1.3%	39.01	21.70	-44.37%	1.80	1.45	-19.4%
Foot Locker, Inc.	-0.5%	15.33	16.16	5.41%	0.10	0.06	-40.0%
Target Corporation	-0.4%	63.57	49.05	-22.84%	0.60	1.46	143.3%
Bed Bath & Beyond Inc.	-0.1%	34.12	31.41	-7.94%	0.00	0.00	0.0%
Safeway Inc.	0.5%	33.11	23.72	-28.36%	1.00	0.85	-15.0%
AutoZone, Inc.	0.6%	116.14	123.34	6.20%	4.00	4.80	20.0%
Winn-Dixie Stores, Inc.	0.9%	18.72	13.90	-25.75%	0.00	0.03	+
Publix Super Markets Inc.	1.3%	NA	NA	NA	0.00	0.00	0.0%
Rite Aid Corporation	1.6%	4.62	0.84	-81.82%	1.90	4.62	143.2%
Walgreen Company	2.6%	47.24	30.96	-34.46%	0.00	0.11	+
The Great Atlantic & Pacific Tea Company	2.8%	30.46	10.82	-64.48%	0.90	2.68	197.8%
CVS Caremark Corporation	3.1%	39.63	33.66	-15.06%	0.77	0.28	-63.6%
Family Dollar Stores, Inc.	3.6%	26.56	23.70	-10.77%	0.20	0.20	0.0%
The TJX Companies, Inc.	4.0%	29.07	30.52	4.99%	0.40	0.40	0.0%
Best Buy Co., Inc.	4.3%	46.02	37.50	-18.51%	0.10	0.57	470.0%
The Kroger Co.	4.7%	28.52	27.48	-3.65%	1.40	1.48	5.7%
Wal-Mart Stores, Inc.	5.0%	43.65	59.89	37.21%	0.60	0.67	11.7%
Costco Wholesale Corporation	9.0%	61.37	64.93	5.80%	0.00	0.25	+
BJ's Wholesale Club, Inc.	15.5%	33.16	38.86	17.19%	0.00	0.01	+
GameStop Corp.	20.0%	56.35	34.21	-39.29%	0.60	0.26	-56.7%

* Most recent quarterly sales compared to the corresponding quarter in the previous year.

† Total debt-to-equity increased by an undeterminable number.

Source: One Source, recent company quarterly reportings.

inventory values. As collateral values shrink, borrowers' availability shrinks as well, presenting challenges to both borrowers and lenders. Moreover, depreciated asset values pose a heightened risk to lenders in a liquidation scenario. In Mrs. Anderson's opinion, if the economy doesn't turn around, the real liquidation value test will come after holiday spending season.

Next Steps

Aside from offering customers discounts and promotions, retailers will need to be creative, proactive, and aggressive in exploring all financial and strategic alternatives. The traditional shelter of Chapter 11 may not offer retailers much refuge if inventory values and the availability of new financing continue to decrease. In fact, one lender has noted

that "retailers can no longer raise a new bank group for a DIP financing." KPMG Corporate Finance's professionals have the requisite retail sector and transaction experience to formulate and execute a strategic plan to assist you in navigating your business through this challenging economic environment. Retailers should evaluate one or several paths towards preserving value and creating liquidity.

KPMG Corporate Finance LLC

KPMG Corporate Finance LLC understands the pros and cons of various financial and operational techniques for preserving value and creating liquidity. We can customize an approach to help best meet your needs. KPMG Corporate Finance has significant retail and real estate knowledge and experience gained through deep consumer markets sector knowledge that we leverage across

our diverse product offering. Our Special Situations Advisory Group (SSAG) understands how to develop and execute the appropriate strategies in this difficult economic environment. First, SSAG regularly accesses alternative sources of debt and equity capital. These alternative capital sources are actively lending and investing into this restrictive credit market. Second, SSAG executes strategies to help a company deleverage its balance sheet

through a negotiated debt restructuring; and third, SSAG can effectuate an accelerated M&A process for all or a portion of your business, including noncore assets. Such transactions can quickly (30–90 days) raise cash for your business. Contact one of our seasoned professionals to help you confidentially assess the strategic path that makes sense for your business.

KPMG Corporate Finance provides a full suite of investment banking and advisory services to its domestic and international clients. Our professionals have the experience and depth of knowledge in global M&A to advise clients on restructurings, mergers and acquisitions, sales and divestitures, capital raises, buy-outs, financings, fairness opinions, and other advisory initiatives. In addition, we remain independent of financing sources, helping to ensure that our efforts are objective and aligned with the goals of KPMG's firms' clients. Operating in 51 countries, KPMG's Corporate Finance practice comprises more than 1,800 professionals who are able to meet the needs of KPMG's firms' clients across the globe. In 2007, as a leading financial adviser, KPMG's Corporate Finance practice completed 450 deals totaling US\$27.5 billion, according to Thomson Financial's global M&A league tables.

Retailers should evaluate one or several paths toward preserving value and creating liquidity. These include:	
Creating liquidity	Debt restructuring: <ul style="list-style-type: none"> • Negotiate with lenders to explore all opportunities to extend deadlines and increase availability. "Deleveraging" should be your mantra. • Negotiate with landlords to explore all opportunities to restructure leases, including lease terminations, rent reductions, term modifications, size reductions, subleases, and assignments. • Negotiate with trade creditors to explore all opportunities to enhance liquidity by extending terms, consolidating vendor relationships, and considering debt-for-equity swaps.
Capital raise	<ul style="list-style-type: none"> • Confidentially seek financial and strategic partners domestically and internationally. • Confidentially seek alternative financing sources with more patient capital during this market cycle. • Monetize real estate via sale-leasebacks.
Acquisitions or disposals	<ul style="list-style-type: none"> • Confidentially explore opportunities either to sell all or a portion of the business, or to acquire strategically complementary businesses. • Market and dispose of excess owned and leased properties.
Cash management	<ul style="list-style-type: none"> • Implement a third-party analysis of your operations to identify cost rationalization and enhanced cash flow management techniques.

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