



For: Retail Clients – U.S. Markets
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Department Stores

JC Penney continues to excel. Back to school inventories are built, young men's and junior departments look like we remember the Gap's glory years. Weekly promotions are driving increased sales and the look is for every family shopper. Last year's ripped and torn jeans are gone replaced by basics and embroideries, fashion for young women is in the hip-hugging styles and cuts. No longer are 90% of the inventories dominated by relaxed fit – it's tighter, snug around the hips and butt and either straight or flared (as in boot) cut. Fashion tops are basics – more blouses than last year but better quality polo-type shirts in a wide breadth of colors. We're looking at "no season" colors from pastels to brights to the basic blacks and navy solids. Penney has also covered everything from khaki (cotton and poplin) to woven slacks but not in fashion cuts – basics rule. It's the strongest back to school presentation of any store – department or specialty we've seen and early sales indicate strong quarterly results.

Kohl's is looking better, some new fixtures in older stores and has done an excellent job clearing out old merchandise and being aggressive about marking down in-season goods that haven't sold. We see two issues that could be troublesome; they continue to make less impact in categories - housewares, home furnishings, small electrics - even a few expensive handbags. What may be more important is the fabric weight of back-to-school clothing. We've seen the more traditional fall weight clothing across the southern tier of stores and it makes no sense – school will start and it's still 90 degrees in mid-August. Colors are dark and it's much more of an October look than August. We wonder if this will result in some trouble ahead with slow moving product.

Macy's (Federated) is very clean on clearance, they've moved out last season goods without dramatic margin loss. Fall merchandise is not overloaded and we anticipate lower than last year inventories in all fashion departments. Back-to-school is heavy with denim but with a significant increase in house brands compared to last year. An example is Docker's, an assortment mainstay, has been reduced in favor of private label alternatives. The customers are getting a better value and Macy's improved margin.

Office Stores & CE Stores

Staples is the best prepared of the office product chains for back-to-school. Most stores have moved school supplies to the front of the store, many in the space immediately following the entrance to the store and before the check out stands. The merchandise is ready; they have a strong notebook computer presence with at least two saleable units for each model on display. Managers are tied into local school supply requirements and, depending on the municipality, have in-store promotions to compliment "no tax days" if applicable.

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Office Max is making an attempt to get ready for BTS but is struggling to merchandise the stores. It also has the local school list of mandatory items available for customers, specials on backpacks, pencils, pens, paper, notebooks, etc. The chain is making a more concentrated effort than they did last year. They are not deep in laptops and monitors as their competition at CompUSA, Staples and Office Depot.

Office Depot is an interesting mix. Stores look great, have plenty of product but unlike the competition, school supplies remain in their normal shelf locations despite the tremendous investment back-to-school marketing. We were particularly impressed with the depth of advertised school supplies (pens, paper, folders, notebooks, etc.) but surprised at the lack of in-store quantities in the computer section. Stores displayed an average of 12 notebooks, 14 desktop choices and 18 monitors all on display, but we found that more than a few notebooks, desktops and monitors were out-of-stock. To the chains credit, advertised models were available for pickup and sale in most stores and, make no mistake, they are selling. Several managers commented that college students, typically with a parent's credit card, had little price resistance. Inventories of desktop computers were not as consistent nor were monitors – although most stores have backstock on advertised items.

Circuit City is doing extremely well with the new Q phone from Motorola for Verizon Wireless. Typical stores have sold one unit per day in the 45 days they have been out, and sales are continuing at that pace. This information jives with the announcement yesterday that Motorola has sold 150k of these so far. This is hot and is driving conversions to Verizon and sales at Circuit City. We've also spent time with sales associates finding out about the acceptance of high definition DVD players. The chain's employees are well versed in the technology, particularly Blue Ray. As a practical matter, this brand of HD DVD runs right at \$1000 for the player and the consumer needs a 1080i (highest of the high-def) TV. They sell only Sony and Samsung right now, but announced Mitsubishi this week that they are re-entering the chain. Currently there are about 30 skus of DVD players available for sale in the stores. There is an astounding difference in sharpness, color and clarity and they are doing a great job of displaying it.

Specialty Stores

Pier 1 is making a merchandise comeback – at least we think their future hinges on it. Their new look, dubbed “Loft 21” is an urban look and a major step in the right direction. They continue to eliminate home furnishing accessories and have concentrated that department on supporting the Loft 21 room ensemble look. Dishes and glassware that meant to go with tables and chairs,

Radio Shack can be summed up in a few words: Julian Day, CEO, sweeping cost reductions at corporate headquarters expected, purge has already started, focused on issues that will impact investor confidence. More to follow but you can expect the unexpected. And don't just take our perspective, a major real estate developer in Dallas bought 5.6% of the common stock one day after the announcement of Day's hiring.

Talbot's we've not heard a lot about lately but remain very heavy in last season goods. Our interpretation is that they missed badly in sales and margin is now taking a substantial hit.

Limited stores new fall merchandise looks good – plenty of fall colors but in lighter weight fabrics. They've also made a heavy investment in three new jean looks as their predominant denim assortment.

We've commented in the past about the **Charlotte Russe** turnaround and it continues with impressive numbers this week. We're surprised considering so much of their inventory, these last four months, has been old season markdowns and stores screaming \$2.99 with signs in front of every location. Our concern is that the momentum continues with in-season goods and customers aren't trained to wait until merchandise is rock-bottom priced.

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Discount Stores & Off Price

Target is still setting up back-to-school in their flex area this week. Apparently all stores received the bulk of the seasonal merchandise over three weeks culminating with fashion shirts, women's tops and novelty sweat tops. Our estimate is that the shop is 80% complete. The area is already being heavily shopped by Moms. There's a major push into improving presentation standards in all stores. We've seen the effects in major markets as significant as Los Angeles where historically it's been a challenge to enforce presentation guidelines and maintain in-stock in basics.

TJ Maxx customers are greeted with a sizeable banner at the door entrances announcing, "Huge Clearance, New Markdowns Taken". Once inside the store, the signage turns to departmental back-to-school promotions. Stock levels are high and neatly arranged for customer including transition and fall apparel. Shoes are in browns and blacks and remaining fall colors. Our observation is that the stores are busy, with plenty of shoppers buying throughout the store.

Ross signage says up to 75% off but the in-store stock does not reflect the ads. Stores are low on seasonal merchandise as well as transition fall wear. They are promoting a "Shoe Sale" but have mostly sandals and low shoe count. The stores are a merchandise nightmare. The same condition exists in most of the chain because of in-store personnel cutbacks. Stores had moderate traffic but not the buying volume we saw at TJ Maxx or Marshall's.

Marshall's signage says "Storewide Clearance up to 70% off" and the stores reflect the clearance going on. Marshall's has more clearance on hand than Ross or TJ Maxx. Fall stock is at levels between Ross on the low end and TJ on the high end of the inventory count. Stores had moderate shoppers but, unlike Ross, were making purchases.

We'll continue to analyze Back-To-School progress in the weeks ahead.