

May Retail Sector Focus

Off to the Races

Markets continue to be “off to the races” on no real news; earnings season, which picked up last week, did not justify the rally. We believe the strong March-May performance has been driven by government stimulus that modestly spurred pent-up demand, by less negative economic data, and by the market perception that refinancing risk is diminished because of the bank loan and bond market strength. *We discuss our view of the economic picture on page 3.*

- **April same store sales proved better than feared, and guidance implies that 1Q earnings should be OK.** The low end (WMT, TGT) continues to outperform the high end (NMG, SKS), and most retailers that sell Easter merchandise benefited from the Easter shift into April. As the end of Q1, guidance comments for most retailers were more important than sales performance; retailers disappointed the Street by not raising guidance more.
- **We are lowering our sector recommendation on HG Retail to Underweight from Neutral, based on relative valuations.** Given the removal of Macy’s, JCPenney and Limited Brands from the sector index, the weight of AA-rated Wal-Mart has risen to 40%, giving the index an even more stable profile and tighter spread. The HG Non-Food Retail Index trades at an SOT of 315bp versus the JULI at 408. Our HG Credit Strategist is constructive on HG spreads, weighted heavily to financials, which should lead to relative underperformance for HG Retail.
- **We maintain our Underweight on HY retail,** as we believe there will be a better entry point after this rally fades. The key risk to this rating is that bank-loan refinancing transactions could buoy the market, which is fraught with refinancing fears. We continue to like somewhat recession-resistant names like Blockbuster, GNC and Rent-A-Center, and the less liquid yet safe names Eye Care Centers and Nebraska Book Company. We believe there are more compelling opportunities in the bank debt market than in HY bonds. We particularly like bank debt at Blockbuster, Dollar General, GNC, Sally Beauty, Toys R Us, and Yankee Candle.
- **The HY Retail Index does not currently include JCPenney and Macy’s; if it did, we believe their presence would distort (tighten) spreads.** We expect that Macy’s, with two \$1.1 billion bond issues, would become the second-largest issuer in the index at about 13% (Dollar General would remain #1) while JCPenney would account for just under 7% and take a #3 position just ahead of Limited.

HG & HY, Consumer Products, Food, Retail

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June may retest the market

The average HY bond we cover has rallied 16 points year to date. In HG, Non-Food Retail rallied 168bps (approximately 50bps attributable to the removal of M, JCP and LTD at the end of April) versus 118bps for the HG Index. We believe the strong March-May performance has been driven by three key items:

- High-grade, high-yield, and bank loan markets have opened up somewhat.
- Economic data became less negative, but not yet positive.
- Lower tax payments (and greater refunds), as well as government stimulus, have helped to spur pent-up demand.

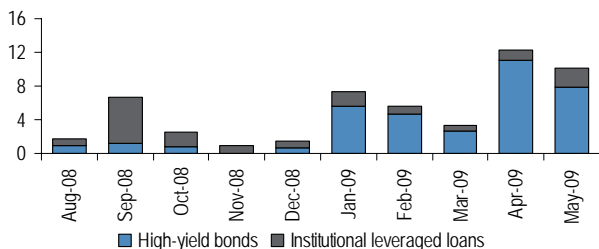
We see a June return of more negative economic data, and less stimulus, which could temper the rally.

Refinancing risks have abated . . . for now

Robust earnings from several financial institutions, coupled with an uptick in new issuance, provided support to the market. To date, new issuance has been from mostly high-quality names. The investment grade market saw the first uptick in new issuance back in December/January, but even the high-yield market issuance picked up in April/May.

Figure 1: High-yield bond and loan issuance

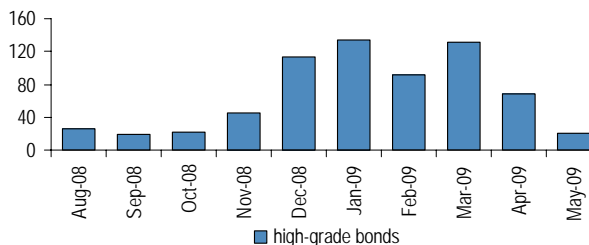
\$ in billions



Source: J.P. Morgan.

Figure 2: High-grade bond issuance

\$ in billions



Source: J.P. Morgan

In high yield, we believe that the clear opening of the new issue market (albeit mostly for high-quality or secured deals), drove up names that had been under pressure because of refinancing fears (Rite Aid and Toys R Us in HY). The bond and loan markets traded up because equity markets were stronger; equity markets traded up because refinancing risk is now muted since bond markets are up. It is a bit circular but somewhat helps to explain the market rally on no new credit information.

We expect to see HY retailers selectively come to market with bank-line refinancing transactions or secured bond deals to take out near-term maturities. Loan market news has already reported that Toys R Us has started the process to refinance its

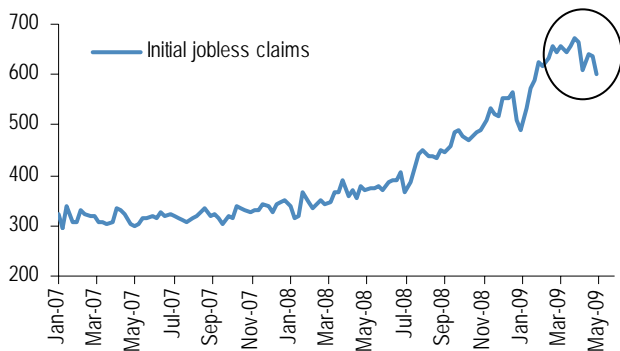
ABL. Press has mentioned Neiman Marcus and Rite Aid as other candidates for bank-line refinancing deals.

Less negative economic data helped, too

Initial jobless claims declined, yet claims remain well above historical levels and unemployment continues to rise. Unemployment should rise through midsummer. Importantly to retailers, unemployment moves in lockstep with credit card charge-offs. We showed in our March Retail Sector Focus that charge-offs have spiked in 2009. They have continued to rise through April, beginning to even outpace the rate of increase in unemployment.

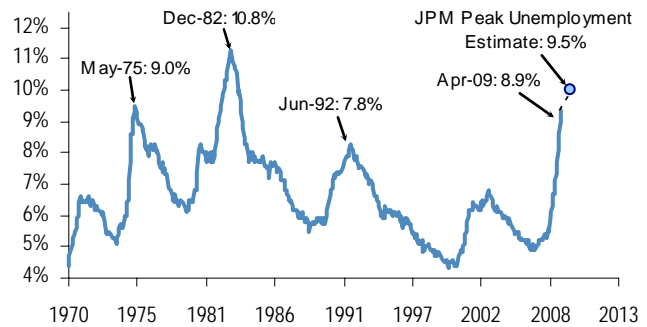
Figure 3: Jobless Claims

Jobless claims (000s)



Source: J.P. Morgan.

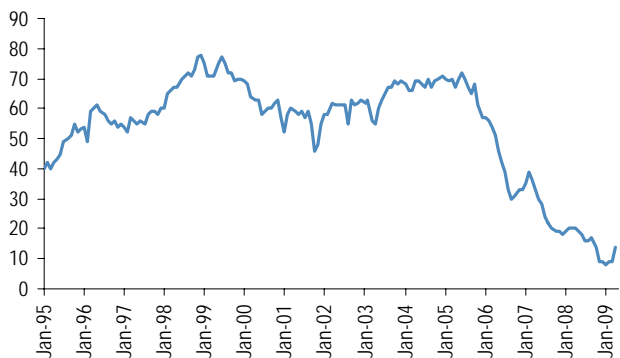
Figure 4: Unemployment Rate



Source: J.P. Morgan.

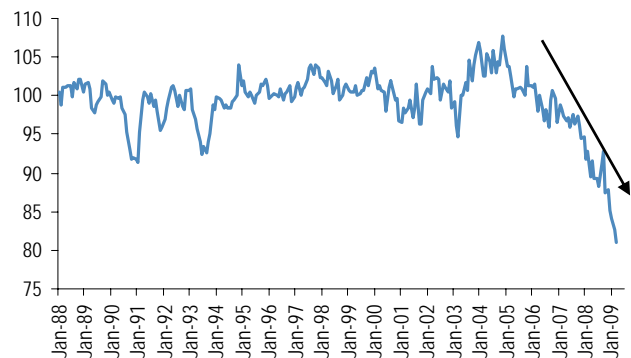
Housing data are similarly mixed. The National Association of Home Builders Index shows that confidence has come off the lows but remains well below historical levels even in past economic times. While homebuilders are becoming less pessimistic, small business pessimism is growing.

Figure 5: NAHB Index



Source: J.P. Morgan.

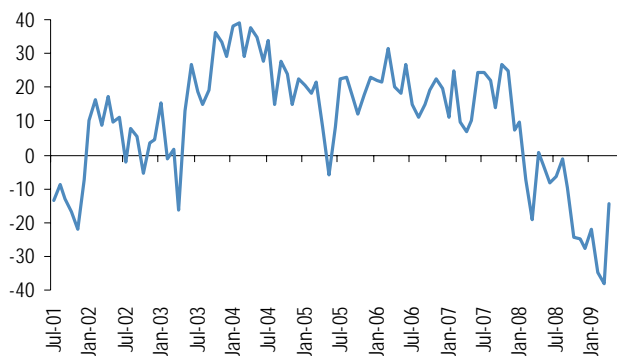
Figure 6: NFIB Small Business Optimism



Source: J.P. Morgan.

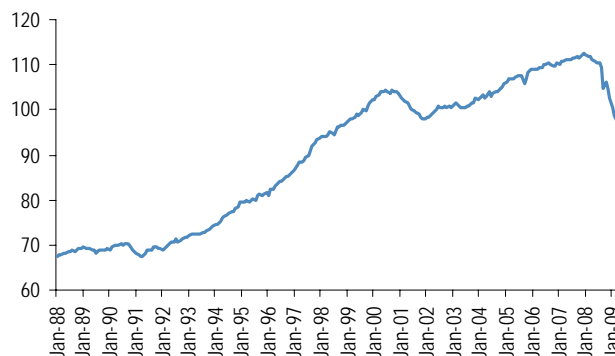
And the Empire State Survey shows a rebound in its poll of NY manufacturers, but when we look at actual industrial production (85% of which is manufacturing with the remainder from utilities and services), it continues to decline.

Figure 7: Empire State



Source: J.P. Morgan.

Figure 8: Industrial Production



Source: J.P. Morgan.

We believe we may be nearing the bottom but do not expect a strong rebound in the consumer. Retailers have lowered inventories to better match the lower level of demand, and clearance inventories are particularly light.

Pent-up demand is driving consumers into the stores. . . .

We believe the fourth-quarter pullback was mostly due to job-loss fears and early announcements of layoffs. As we discussed in our February Retail Sector Focus, we heard of nearly 80,000 retail layoffs alone from November 1, 2008, through January 30, 2009. (The retail sector accounts for about 14.5-15 million jobs overall, or 10-12% of total US jobs.) Given job concerns, we believe the consumer pulled back, and during 4Q bought only the necessity holiday items, trading down where possible and chasing sales (food retailers even spoke of consumers “destocking the pantry”).

Now with the uptick of stimulus in early 2Q 2009, we believe the consumer is slowly and selectively coming back into the store to satisfy pent-up demand for basics (in food, we call this “restocking the pantry” but believe we are seeing it in apparel and other retail as well). Traffic is declining less at the malls, but still declining, and the consumer continues to look for bargains.

June may be the reality check

From January through May, the consumer has benefited from tax refunds, lower tax payments, cost-of-living adjustments (COLA), Making Work Pay stimulus, and Social Security one-time stimulus. We use the chart below, from J.P. Morgan economist Michael Feroli, to demonstrate the monthly stimulus.

Table 1: Support to personal income from public sector (a partial tally)

\$bn, monthly rate, relative to detrended 2008 baseline							
	Jan	Feb	Mar	Apr	May	Jun	Jul-Dec
COLA	3	3	3	3	3	3	3
Making Work Pay	0	0	0	5	5	5	5
Social Security one-time	0	0	0	0	14	0	0
Tax Refunds	3	9	10	9	3	0	0
Total	6	12	13	17	25	8	8
M/M Change	6	6	1	4	8	-17	0

Source: J.P. Morgan.

- Since January, the consumer has benefited from \$3 billion in monthly COLA stimulus and increasing tax refunds. This chart does not show it, but the consumer has also spent \$100 billion less in taxes in Jan-April because of lower 2008 earnings.
- As we entered February and March, tax refunds ticked up, peaking at \$10 billion.
- Also in April, the Making Work Pay tax credit stimulus of \$5 billion per month kicked in.
- And in May, the one-time Social Security stimulus (\$14 billion) will be layered on top of all the above items.

When we reach June, however, this stimulus drops off considerably, as we will be done with refunds and the one-time Social Security stimulus, although the COLA and Making Work Pay will continue. Importantly, consumers tend to react at the onset of stimulus (or the early stress of things like rising costs of food or gas), but once it has been in place for several months, the consumer tends to fall into a normal trend. It is for this reason that we don't try and overlay the year-over-year benefit the consumer has from lower gas prices. Keep in mind that retail gasoline prices peaked in June 2008 at just over \$4, but the largest month-to-month jump last year was in April. The largest month-to-month decline came last October '08, and since December, gasoline prices have risen steadily each month, so we don't expect this to feel like "stimulus" to the consumer, even though prices remain below those a year ago.

HG Retail recommendations and outlook

We are lowering our sector recommendation on HG Retail to Underweight from Neutral, based on valuations. Given the removal of Macy's, JCPenney and Limited Brands from the sector index, the weights of AA-rated Wal-Mart and A-rated Target have risen to 40% and 21%, respectively, giving the index an even more stable profile. The HG Non-Food Retail Index trades at an SOT of 315bp versus the JULI at 408. Our HG Credit Strategist is constructive on HG spreads overall, which should lead to relative underperformance for HG Retail.

We are modifying several of our ratings given the move in spreads over the last three months:

- **We are lowering WMT to Neutral from Overweight solely on valuation, as business and credit metrics have been stable.** WMT bonds have rallied to an SOT of 125bp for the 10-yr notes. This is meaningfully tighter than other credits in the index, leaving little room for outperformance in a spread-tightening environment.
- **We are also lowering our COST recommendation to Neutral from Overweight** based on rich valuation.
- **We are raising our recommendation on KSS to Overweight from Neutral.** KSS has navigated the weak consumer environment quite well and credit metrics have been stable. KSS has outperformed its national department store competition from a same store sales perspective over the last few quarters. Its balance sheet is in solid shape, and it has no near-term maturities. KSS cash bonds trade slightly cheaper than the HG Retail Index overall, providing good spread pickup.

HG Retail recommendations

Ticker	% of IG Non-food Retail Index	Cash spread relative to Index ¹	5yr CDS level	JPM Credit recommendation	Comment
WMT	40%	-	80	↓ Neutral	WMT's performance has been solid, and its credit ratios stable throughout the downturn, benefiting from consumers trading down. Spreads have rallied and are now much tighter than the index, leaving less room for outperformance.
TGT	21%	-	95	Neutral	Same-store sales performance has been sluggish relative to historical trends and WMT. Relative value is attractive, but proxy contest with Pershing Square is negative noise. TGT remains committed to its strong credit ratings, but a change in the board composition is a risk to this. \$1.25bn of bond maturities in 2009 may necessitate new bond issue.
HD	16%	-	120	Underweight	Macro backdrop remains very weak for home improvement. EBITDA declined 26% in 2008. Expect demand to remain depressed through 2009.
LOW	7%	-	115	Underweight	Demand for home improvement items is likely to remain depressed through 2009, which will weigh on LOW's operating performance and credit metrics. LOW is managing its balance sheet and cash flow conservatively in the weak environment.
SPLS	4%	+	135	Not rated	
COST	4%	-	NA	↓ Neutral	COST's business model (bulk, low prices) is outperforming in the weak US macro environment, but not totally immune. Operating results have been solid. Balance sheet is conservatively managed. Rich valuation.
KSS	3%	+	115	↑ Overweight	Sales performance has been solid compared with peers and credit metrics steady through the downturn. KSS is well positioned to emerge from recession in even stronger competitive position.
AZO	2%	+	95	Underweight	Although operating performance has been relatively steady in the tough US macro environment, the company has been implementing a more aggressive capital structure policy, resulting in weaker credit metrics. AZO increased its adjusted debt/EBITDAR leverage metric to "at least 2.5x" from 2.1x. It bought back \$850mn of stock in fiscal 2008, and \$76mn in F2Q09.
JWN	1%	+	270	Neutral	Nordstrom's geographic dispersion is skewed to California (43.2% of operations in the West; 25% in California), one of the hardest hit housing markets in the US. The high end consumer continues to be quite weak. JWN's leverage has increased, but remains relatively modest at 2.3x.
BBY	1%	+	NA	Not rated	
VFC	1%	-	75	Not Rated	
M	-		335	Overweight	Although most of the positive catalysts have played out and Macy's bonds have rallied meaningfully over the past few months, we still like the relative value versus other cross-over retailers. We are comfortable with Macy's liquidity position and don't expect material credit metric deterioration.
JCP	-		275	Neutral	JCP's cash position of \$2.1bn at 1Q09 provides cushion in a weaker operating environment. Recent bond tender reduces debt another \$100mn. \$750mn credit facility renewed on a secured basis.
LTD	-		335	Underweight	Same-store sales trends have been very weak, negative for the past year and a half. LTD got covenant relief to its credit facility, yet had to pledge security for the amendment. Looks rich relative to M given its higher leverage, weaker operating performance and downward pressure on ratings.
JNY	-		365	Underweight	JNY's operating trends continue to be very soft, and it is heavily exposed to US Department stores (55% of revenues). Recent tender for 2009 notes and consents received improve JNY's available liquidity under its secured revolver and slightly improve its credit metrics. But given the weak business trends and valuation, we recommend Underweight.

Source: J.P. Morgan.

HY Retail recommendations and outlook

We maintain our Underweight on HY retail, as we expect the rally to fade through June/July. The biggest risk to our rating is that refinancings of bank lines may drive up retail bond prices as the perceived refi risk dissipates. Press has already commented on potential bank loan refinancing deals in the works at Toys R Us (ABL matures July 2010) and likely at Neiman Marcus (ABL matures October 2010) and Rite Aid (ABL matures September 2010).

- We continue to like somewhat recession-resistant names like Blockbuster, GNC and Rent-A-Center, and the less liquid relatively safe names Eye Care Centers and Nebraska Book Company.
- We believe there are more compelling opportunities in the bank debt market. We particularly like bank debt at Blockbuster, Dollar General, GNC, Sally Beauty, Toys R Us, and Yankee Candle.

The HY Retail Index does not currently include JCPenney and Macy's; if it did, we believe their presence would distort (tighten) spreads. We expect that Macy's, with two \$1.1 billion bond issues, would be the second-largest issuer in the index at about 13% (Dollar General would remain #1) while JCPenney would account for just under 7% and take a #3 position just ahead of Limited.

We are using the following metrics to come up with our relative value view:

- Bank debt appears cheap relative to bonds, particularly for Blockbuster, Claire's Stores sub notes, Dollar General sub notes, GNC, Sally Beauty, Toys R Us, and Yankee Candle. For each turn of leverage, in our view, an investor should get 325-350bps additional spread.
- Capital structures remain too top heavy, particularly for Bon-Ton, Claire's Stores, and Michaels Stores; potentially for Burlington Coat and Neiman Marcus.
- High unemployment in California, Michigan, Nevada, North Carolina, Oregon, Rhode Island, and South Carolina will hurt Michaels Stores, Rite Aid and Saks the most.
- Earnings should be benign because estimates are adequately conservative, but we don't yet expect any companies to raise full-year guidance. We *do not* see a post-recession rebound in sales this year.
- The average retailer we covered saw bond prices rise 2 points in March, 15 points in April, and another 2 points in the first 2 weeks of May.

Table 2: Sector weighting chart – Percentage of issuer in JPM Retail and Food & Drug High-Yield Index

Company/bond	maturity	% of HY Retail	STW	Recommendation	Comment
Dollar General Corp.		15.9%			
10.625%	15-Jul-15		748	Hold	Defensive, particularly given high percentage of consumables - over 60% of sales. Bank debt looks cheap to bonds. Expect margin expansion in '09 from shrink Reduction. Potential IPO candidate (bonds have a 33 1/3% clawback)
11.875%	15-Jul-17		861	Hold	
Limited Brands		8.2%			Covered by Ginger Chambless
6.125%	01-Dec-12	(NI)	815	Sell	
5.250%	01-Nov-14		788	Sell	
6.900%	15-Jul-17		717	Sell	
7.600%	15-Jul-37	(NI)	593	Sell	
Sally Holdings LLC		5.7%			
9.250%	15-Nov-14		732	Hold	Beauty care viewed as defensive, bonds have held in better than most retail. We worry that prolonged downturn does eat into sales and EBITDA margins.
Michael's Stores, Inc		5.1%			We fear that management changes and weak results are not great for morale.
10.000%	1-Nov-14		1,740	Hold	Even with easy comparisons, holiday qtr was weaker than expected. New CEO has a strong resume from Wal-Mart and Ben Franklin Crafts. 10-K reported that sponsors own \$233 million of the zeros.
11.375%	1-Nov-16	(NI)	2,388	Hold	
0.000%/13.000%	1-Nov-16		2,918	Hold	
Toys R Us, Inc.		5.0%			
7.625%	1-Aug-11		2,168	Hold	sss down mid-single digits, and gross margin down 110bs. Refi risk in mid-I to late-2010. We prefer bank debt to bonds.
7.875%	15-Apr-13		2,051	Hold	
Neiman Marcus Group, Inc.		4.8%			
9.750%	15-Oct-15		1,875	Hold	High end consumer reacts more to financial market turmoil, do not "need" much that they buy. Management managing down costs. Liquidity is solid - unused revolver, that won't likely be used this year or next. Own ~60% stores.
10.375%	15-Oct-15		2,472	Hold	
Gamestop Corp.		4.7%			
8.000%	1-Oct-12		640	Hold	Even if industry momentum slows considerably, cash flow is very strong. Modest acquisition risk. Reiterated 1Q guidance in mid-April.
Yankee Candle Co., Inc.		3.0%			
8.500%	15-Feb-15		1,294	Hold	Wholesale/retail balance provides better diversification than other retailers. Offset lost sales to Linens by adding Pier 1 and Target. Lower oil may benefit 2009 cost structure by late in the year.
9.750%	15-Feb-17		1,514	Hold	
Burlington Coat Factory		1.8%			
11.125%	15-Apr-14		1,776	Hold	Off priced stores expected to do better in a downturn. Begin paying cash interest on holdco notes in April 2009. Long vendor payable terms.
Claire's Stores, Inc.		1.8%			
10.375%	1-Jun-15		3,213	Hold	No liquidity risk near term, as the company elected to PIK its toggle notes. Free cash flow should be close to neutral for 2008.
10.500%	1-Jun-17		3,230	Hold	
Bon-Ton Stores, Inc.		1.6%			
10.250%	15-Mar-14		3,722	Hold	Tightest inventory control of the group (down mid teens). No liquidity risk, but modest vendor risk.
Dollarama Group LP		1.5%			
8.875%	15-Aug-12		921	NR	Dominant market position in Canada. Well run business. Seeing margin pressure from high import cost of Chinese goods, but have cushion to sustain this.
NBTY, Inc.		1.5%			
7.125%	1-Oct-15		656	Hold	Industry is somewhat countercyclical. Integration of Leiner likely to disrupt next quarter.
Blockbuster, Inc.		1.4%			
9.000%	1-Sep-12		2,964	Buy	Cash flow strong, focused on debt pay down. Refinancing complete, pushing out next refi risk to September 2010. Bonds downgraded in April to Ca/CC (S/N).
Dillard's, Inc.		1.2%			
7.130%	1-Aug-18		1,696	Hold	Results poor, but asset rich. Used cash and revolver to take out Nov '08 bonds. Activist shareholders instigated sale of plane, travel agency, and 16 store closures in '08. Own 70% of stores.
7.000%	1-Dec-28		1,442	Hold	
Nebraska Book Co.		1.2%			
8.625%	15-Mar-12		2,015	Buy	Defensive segment - college bookstore retail and used textbook wholesale. Well run business. Holdco notes now pay cash interest (began 9/08). Refi risk May 2010 (15 months after original maturity).
0.000%/11.000%	15-Mar-13		5,248	Buy	
Eye Care Centers of America, Inc.		1.1%			
10.750%	15-Feb-15		1,034	Buy	Somewhat defensive. Highmark (owner) trying to tender for bonds at par, but they are callable in 2/2010 at 105 3/8. Ratings upside.
Saks, Inc.		1.1%			
9.875%	1-Oct-11		1,187	Sell	Recently hurt by slowing tourist traffic, NYC weakness, and slowing of high-end consumer. Asset rich - own 70% of real estate. Carlos Slim is largest shareholder.
GNC Corp.		0.7%			
FRN's	15-Mar-14	(NI)	898	Buy	Somewhat defensive vitamin category. Benefiting from roll out of GNC store-within-a-store at Rite Aid. SSS positive each qtr in 2008, proving some recession resistance.
10.750%	15-Mar-15		1,250	Buy	
Food & Drug					
Rite Aid Corp.		13.3%			
10.375%	15-Jul-16	(NI)	1,203	Hold	Renovation, systems and merchandise integration, and promotions at acquired stores started to show up in better margins in '10 (ends 2/1020). Refi risk pushed out to 9/2010 when revolver and AR facility backstop mature. Management intends to refinance revolver, term A, and AR facility by end of '09.
7.500%	1-Mar-17		1,079	Hold	
8.625%	1-Mar-15	(NI)	2,046	Hold	
9.375%	15-Dec-15	(NI)	2,017	Hold	
9.500%	15-Jun-17		1,838	Hold	
7.700%	15-Feb-27	(NI)	1,882	Hold	
Duane Reade, Inc.		2.3%			
FRN's	15-Dec-10	(NI)	1,310	Hold	Refi risk in mid 2010 - DRD must refinance the FRN 120 days prior to maturity or the ABL maturity is pulled forward to that date (8/18/10).
9.750%	1-Aug-11		2,732	Hold	

Source: J.P. Morgan estimates.

More value in bank debt

Given the bond market rally, we see more value in the bank debt of a number of retailers and note that any refinancings that benefit the bond market should benefit the bank market equally (or more).

The table below shows the discount investors demand for taking on an additional unit of leverage. This month, the spread required to compensate for another turn of leverage narrowed considerably, to 330-350bps, down from over 500bps for the past several months. Before the 4Q market meltdown, that spread used to be closer to 150bps.

We calculate the incremental spread (column B) investors are getting per additional turn of leverage (column A) to trade from bank debt into bonds. We then average those spreads and compute the spread/turn of leverage (boxes C for seniors and D for subs). We use these averages to calculate the theoretical fair spread (column E, or average incremental spread x incremental leverage). Where the discrepancy is positive, bank debt is cheap relative to bonds, and where it is negative, bonds are cheap relative to bank debt.

(Negative) = bonds cheap to bank
 Positive = bank cheap to bonds

Table 3: Bonds vs. bank debt relative value as of May 15, 2009

Ticker	Coupon	Maturity	Bank Lev	Total Lev	Bond Bid px	Bond Z-spd	Loan Ask px	Loan LIBOR Spd	(A) Addl Leverage	(B) Addl Spread	(E) Theoretic fair spread	Differential (bp)
BBI	9.000	9/12	2.0 x	3.5 x	48.00	3615	69.00	3310	1.5 x	305	508	203
BCFACT	11.125	4/14	3.4 x	4.5 x	71.00	1854	69.00	1407	1.1 x	447	365	(82)
CLAIRE	9.250	6/15	7.8 x	10.7 x	40.00	3009	54.00	1770	3.0 x	1239	990	(249)
CLAIRE	10.500	6/17	7.8 x	12.3 x	35.00	3263	54.00	1770	4.6 x	1493	1,619	127
DG	10.625	7/15	2.5 x	3.8 x	102.25	781	93.00	436	1.3 x	345	433	88
DG	11.875	7/17	2.5 x	4.6 x	102.00	867	93.00	436	2.1 x	431	734	303
GNC	FLOAT	3/14	3.0 x	4.4 x	85.00	854	87.00	588	1.3 x	266	448	182
GNC	10.75	3/15	3.0 x	4.9 x	88.00	1129	87.00	588	1.8 x	541	652	111
MIKE	10.000	11/14	5.2 x	6.8 x	66.50	1919	76.00	932	1.6 x	987	535	(451)
MIKE	11.375	11/16	5.2 x	8.4 x	47.00	2657	76.00	932	3.2 x	1725	1,125	(600)
NMG	9.000	10/15	3.9 x	5.4 x	44.00	2112	73.00	1074	1.6 x	1038	518	(520)
NMG	10.375	10/15	3.9 x	6.5 x	42.00	2984	73.00	1074	2.7 x	1910	943	(967)
RCII	7.500	5/10	1.9 x	2.6 x	99.00	698	96.00	337	0.7 x	361	222	(139)
SBH	9.250	11/14	3.0 x	4.2 x	99.00	701	94.00	707	1.3 x	-6	419	425
SBH	10.500	11/16	3.0 x	5.0 x	98.00	812	94.00	707	2.1 x	105	735	630
TOY	7.375	10/18	4.2 x	6.1 x	54.00	1457	83.00	1130	1.9 x	327	644	317
YCC	8.500	2/15	3.3 x	5.1 x	75.50	1265	75.00	898	1.8 x	367	594	227
YCC	9.750	2/17	3.3 x	6.1 x	67.00	1498	75.00	898	2.8 x	600	996	396
Average – senior notes and loans									1.5 x	516		
Average – sub notes and loans									2.7 x	972		
Incremental spread/turn of leverage – senior									(C)	333		
Incremental spread/turn of leverage – sub									(D)	354		

Source: J.P. Morgan estimates, company data.

Capital structures are still too top-heavy

We use market values of bank debt and bonds to calculate “market leverage.” We use this for 2 reasons: 1) to test the long-term sustainability of the capital structure (is it too top-heavy?), and 2) to test whether total leverage is greater than the value of the business. Those companies that come up too top-heavy and over-levered in general are in need of additional equity and are the prime candidates for debt-for-equity exchanges, in our view. However, we don’t have many near-term triggers like debt maturities to spur this activity.

Bank leverage needs to come down over time. Largely as a result of the 2006-2007 LBO boom, bank leverage is high in the retail sector. Even when we calculate bank leverage (net debt/EBITDA) using market value for the debt, we have several companies with ~4x bank leverage (Bon-Ton, Claire's and Michaels Stores). And if we calculate bank leverage on estimated trough EBITDA, it over 5x for Bon-Ton, Michaels, and over 4x at Claire's. Given that none of these bank lines matures until 2011 and beyond, this is not yet a major risk. However, in 2011-2013, we believe we need to see bank leverage come down to 2x-3x max.

Table 4: Market value – bank debt

	BBI	BONT	BCFACT	CLAIRE	DG	GNC	MIK	NMG	RCII	RAD	SBH	TOY	TOY Del
Face value of bank debt & sec	258	648	908	1,622	2,300	669	2,445	1,625	1,055	2,906	1,014	4,234	1,642
Face value of bonds & other	878	510	428	960	1,881	415	1,484	1,321	238	3,403	713	1,311	0
Face value of Debt	1,136	1,158	1,337	2,582	4,181	1,084	3,929	2,946	1,293	6,310	1,727	5,545	1,642
Market value of bank debt & Sec	235	616	638	965	2,182	582	1,894	1,186	1,018	1,984	953	3,529	1,278
Market value of bonds & other	703	214	333	322	1,921	357	765	571	236	2,068	703	820	0
MV of Debt	938	830	971	1,287	4,103	940	2,659	1,758	1,253	4,051	1,656	4,349	1,278
Cash	107	20	27	205	378	66	33	223	196	152	105	783	109
LTM EBITDA	295	157	275	209	905	222	467	451	357	968	342	906	631
Trough EBITDA	220	119	175	196	815	177	355	280	303	775	274	725	505
Bank debt ratios													
Book value bank/EBITDA (net)	0.5 x	4.0 x	3.2 x	6.8 x	2.1 x	2.7 x	5.2 x	3.1 x	2.4 x	2.8 x	2.7 x	3.8 x	2.4 x
MV Bank/EBITDA (net)	0.4 x	3.8 x	2.2 x	3.6 x	2.0 x	2.3 x	4.0 x	2.1 x	2.3 x	1.9 x	2.5 x	3.0 x	1.9 x
MV Bank/trough EBITDA (net)	0.6 x	5.0 x	3.5 x	3.9 x	2.2 x	2.9 x	5.2 x	3.4 x	2.7 x	2.4 x	3.1 x	3.8 x	2.3 x

Source: Company reports and J.P. Morgan estimates.

Bond leverage is over what we believe is fair EV for some. We believe that even when we calculate leverage using market value of bonds (face value for bank debt), leverage appears higher than what we believe is a realistic enterprise value, particularly for Claire's Stores and potentially for Michaels Stores. When we use estimated trough EBITDA, leverage is above fair enterprise value for Bon-Ton, Burlington, Claire's, Michaels, and Neiman Marcus.

Table 5: Market value chart – bond leverage

	BBI	BONT	BCFACT	CLAIRE	DG	GNC	MIK	NMG	RCII	RAD	SBH	TOY	TOY Del
Total debt ratios													
Book value total debt/EBITDA (net)	3.5 x	7.3 x	4.8 x	11.4 x	4.2 x	4.6 x	8.3 x	6.0 x	3.1 x	6.4 x	4.7 x	5.3 x	2.4 x
MV total debt/EBITDA (net)	2.9 x	5.4 x	4.4 x	8.3 x	4.2 x	4.3 x	6.8 x	4.4 x	3.1 x	5.0 x	4.7 x	4.7 x	2.4 x
MV total debt/trough EBITDA (net)	3.9 x	7.1 x	6.9 x	8.9 x	4.7 x	5.4 x	8.9 x	7.0 x	3.6 x	6.2 x	5.9 x	5.9 x	3.0 x

Source: Company reports and J.P. Morgan estimates.

Unemployment's impact on HY retail

As we noted earlier, unemployment continues to rise. Here we look at unemployment by state, compared to retailers' exposure to the states. Seven states already have unemployment rates of over 10%: California, Michigan, Nevada, North Carolina, Oregon, Rhode Island, and South Carolina.

The retailers with the greatest percentage of stores in these states are Michaels Stores (31% of stores and 21% in CA alone), Rite Aid (24% overall, 13% CA) and Saks (26% overall, 16% CA).

Table 6: HY retail stores and unemployment by state

State	BBI	BCFACT	BONT	CLE	DDS	DG	ECCA	GME	GNC	MIK	NTY	NMG	RAD	RCII	SKS	TOY	YCC	Unemployment rate
Alabama	61	6	0	22	11	465	1	76	46	10	2	0	97	65	1	9	3	9.0%
Alaska	17	1	0	3	0	0	0	5	11	3	0	0	0	15	0	1	0	8.5%
Arizona	129	5	0	23	17	52	19	84	60	36	9	1	0	64	3	15	5	7.8%
Arkansas	18	2	0	10	8	227	0	26	26	3	2	0	0	40	0	5	1	6.5%
California	562	43	0	134	3	0	0	479	360	224	50	6	605	144	17	106	14	11.2%
Colorado	108	5	1	28	9	21	16	60	75	28	4	1	21	58	3	10	10	7.5%
Connecticut	60	10	1	15	0	0	0	61	44	13	7	0	80	41	3	14	12	7.5%
Delaware	15	3	0	3	0	23	0	19	18	4	1	0	43	20	0	3	2	7.7%
Distr of C	4	0	0	1	0	0	3	2	7	0	0	1	7	4	1	0	0	9.8%
Florida	393	26	0	88	46	424	41	318	317	68	43	7	0	208	17	57	34	9.7%
Georgia	156	13	0	44	14	476	17	139	139	33	8	1	213	100	3	28	15	9.2%
Guam	3	0	0	0	0	0	0	2	0	0	4	0	0	0	0	0	0	N/A
Hawaii	23	0	0	10	0	0	0	23	21	0	9	1	0	23	1	1	0	7.1%
Idaho	11	2	0	10	2	0	2	11	12	7	1	0	19	20	0	3	0	7.0%
Illinois	205	23	0	68	3	307	30	190	141	38	14	3	0	118	5	38	27	9.1%
Indiana	108	10	14	33	3	318	2	80	74	15	4	0	10	105	1	17	14	10.0%
Iowa	24	1	19	24	5	171	2	32	31	7	4	0	0	38	0	7	5	5.2%
Kansas	54	5	0	18	7	145	4	33	29	8	2	0	0	55	0	6	5	6.1%
Kentucky	72	4	3	19	6	309	11	64	46	7	2	0	117	90	0	10	6	9.8%
Louisiana	80	8	0	17	14	332	14	67	47	11	4	0	68	50	1	10	3	5.8%
Maine	6	2	0	5	0	0	0	10	8	2	0	0	81	37	0	3	4	8.1%
Maryland	112	15	3	27	0	57	15	100	74	22	8	0	147	76	2	19	17	6.9%
Mass.	112	12	1	34	0	0	0	93	65	22	13	2	165	70	2	21	31	7.8%
Michigan	145	15	21	51	0	237	0	125	116	36	14	1	296	113	2	32	20	12.6%
Minnesota	58	5	19	38	0	16	27	56	70	22	4	1	0	4	1	11	9	8.2%
Mississippi	38	2	0	17	6	266	3	39	29	3	4	0	27	36	0	5	2	9.4%
Missouri	95	5	0	24	12	311	0	70	63	19	5	1	0	81	1	16	11	8.7%
Montana	5	6	8	3	0	0	7	8	7	4	0	0	0	14	0	1	0	6.1%
Nebraska	28	1	9	14	3	80	5	21	22	4	0	0	0	15	0	4	4	4.6%
Nevada	45	5	0	12	4	0	5	42	28	17	9	1	1	27	2	8	2	10.4%
N. Hampshire	20	3	1	8	0	0	0	25	20	7	4	0	69	21	0	7	7	6.2%
New Jersey	145	26	2	30	0	22	15	161	110	27	11	2	277	44	4	41	17	8.3%
New Mexico	27	2	0	12	6	42	3	25	21	3	3	0	0	45	0	3	0	5.9%
New York	211	28	22	62	0	232	0	237	195	48	32	3	674	181	8	54	31	7.8%
N. Carolina	132	10	0	45	16	487	12	136	121	29	9	1	0	148	3	21	15	10.8%
North Dakota	6	1	4	0	0	0	1	8	6	2	0	0	0	3	0	1	1	4.2%
Ohio	165	17	28	53	16	473	10	184	148	31	17	0	239	239	5	37	22	9.7%
Oklahoma	66	3	0	16	10	276	4	48	39	7	2	0	0	50	1	7	4	5.9%
Oregon	84	4	0	22	0	0	13	31	28	18	6	0	71	31	2	8	2	12.1%
Pennsylvania	167	24	37	62	0	399	1	205	174	42	31	1	583	155	3	45	27	7.8%
Puerto Rico	37	2	0	0	0	0	0	45	23	0	13	0	0	43	0	4	0	N/A
Rhode Island	23	4	0	4	0	0	0	15	13	3	1	0	46	18	0	2	4	10.5%
S. Carolina	74	5	0	26	8	333	3	66	53	9	6	0	105	73	2	10	10	11.4%
South Dakota	9	4	5	0	12	1	4	4	5	2	1	0	0	4	0	2	1	4.9%
Tennessee	97	6	0	32	11	419	18	90	68	2	10	0	88	132	1	17	12	9.6%
Texas	443	41	0	129	59	983	88	373	277	91	32	7	0	440	10	60	19	6.7%
Utah	46	2	0	12	6	9	4	28	28	11	3	0	23	24	0	8	0	5.2%
Vermont	10	1	4	0	4	0	0	7	4	2	2	0	38	9	0	1	3	7.2%
Virginia	128	14	0	37	9	248	14	145	103	32	8	1	201	70	4	27	20	6.8%
Virgin Islands	2	0	0	0	0	0	0	0	0	0	1	0	0	0	0	0	0	N/A
Washington	119	0	31	0	0	0	3	77	61	32	14	0	138	72	0	16	1	9.2%
West Virginia	19	5	9	8	0	153	2	29	22	4	3	0	104	33	0	4	2	6.9%
Wisconsin	68	7	30	24	0	85	16	49	58	18	6	0	0	21	0	11	9	8.5%
Wyoming	10	1	3	1	0	0	0	8	5	1	0	0	0	5	0	0	0	4.5%
Total stores	4855	433	236	1425	318	8414	432	4331	3568	1087	442	42	4653	3592	109	846	463	

Source: Company reports and websites and J.P. Morgan estimates. Note: Unemployment rate is as of March 2009.

1Q earnings should be uneventful

We kicked off HY retail earnings 2 weeks ago with solid reports from Duane Reade, GNC, and HSN. Burlington (with a May year end) reported earlier that 3Q that was well above expectations on favorable winter weather and continued cost cuts. Last week Blockbuster reported mixed results but maintained full-year EBITDA guidance, and Yankee Candle posted somewhat softer results than in the past few quarters. If the earnings to date are any indication, Street estimates are conservative enough (there have been no big misses).

The strong April rebound continues into May

HY market strength, including an uptick in new issuance reduced investor fears about retail refinancing risk over the next 18 months. While we did not believe the lows were justified over the past 5 months, we don't believe the rally was justified, either. We would expect levels to stabilize somewhere lower than today's levels, and remain Underweight. Bonds rallied 15 points in April and another 2 points so far in May.

Table 7: Retail bond prices as of first trading day of each month: July 2008 to Present (lows shaded)

Date	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09	May-09
BBI 9% '12	81.00	79.00	79.25	65.25	56.75	47.50	45.00	50.50	53.00	45.00	52.00
BCFACT 11.125% '14	80.00	73.38	68.50	55.25	39.00	24.00	31.00	30.00	25.00	17.00	31.25
BONT 10.25% '14	65.00	53.00	46.75	36.50	17.00	14.00	12.00	15.25	12.00	31.00	69.75
CLAIRE 9.25% '15	52.50	43.00	41.50	41.50	31.00	18.00	21.00	24.00	19.00	30.50	40.00
CLAIRE 9.625% '15	43.25	30.00	28.38	29.00	18.50	10.00	9.00	7.00	6.00	20.00	28.50
CLAIRE 10.5% '17	40.50	29.50	36.50	35.50	26.00	13.50	17.00	19.00	15.50	26.00	33.00
DDS 6.625% '18	72.50	70.75	70.00	62.00	48.00	42.00	35.50	34.00	36.00	36.00	41.50
DG 10.625% '15	98.00	100.25	100.25	98.50	92.50	89.50	95.50	99.25	100.25	99.75	104.00
DG 11.875% '15	93.00	94.00	95.00	92.50	82.00	79.50	85.50	92.00	96.75	99.00	103.50
DRD 9.75% '11	88.50	87.50	88.50	83.00	60.50	54.00	53.00	54.00	54.00	57.00	68.00
EYCA10.75% '15	103.50	102.00	103.00	103.50	101.00	92.00	95.00	93.00	92.00	91.00	93.00
GMEUS 8% '12	102.50	102.50	104.75	99.25	92.75	86.13	93.00	99.00	99.50	101.00	101.50
GNC 10.75% '15	85.50	84.25	86.75	79.00	61.50	57.50	56.00	69.00	70.00	72.00	80.00
MIK 10% '14	85.63	79.75	73.00	61.00	46.00	31.50	45.50	44.50	33.50	47.13	60.50
MIK 11.375% '16	79.00	72.00	62.00	46.00	36.00	22.50	33.00	29.50	23.50	37.00	49.50
NBTY 7.125% '15	95.50	94.50	94.00	92.25	75.00	74.00	71.00	79.25	80.00	81.25	90.00
NEBRK 8.625% '15	82.50	81.50	80.75	75.00	64.00	50.00	45.00	50.00	52.00	56.00	70.00
NEBRK 11% '15	88.00	88.00	88.00	78.50	78.50	40.13	40.63	39.00	40.38	38.38	47.00
NMG 9% '15	98.88	97.75	97.50	82.50	69.00	44.38	45.00	43.75	38.50	32.13	55.00
NMG 10% '15	99.50	98.00	98.50	83.25	69.00	41.50	43.50	45.50	41.00	32.00	55.00
RAD 6.875% '15	60.00	60.50	60.00	45.00	33.00	26.00	28.50	23.00	16.00	15.00	48.00
RAD 8.625% '15	65.50	64.00	64.50	51.00	37.00	28.00	34.50	27.50	23.50	22.50	50.50
RAD 9.375% '15	65.00	65.00	64.50	51.00	37.00	28.50	35.00	28.00	25.00	24.00	50.50
RAD 7.5% '17	80.00	81.00	83.00	75.00	64.00	57.50	65.00	58.50	54.00	52.50	74.00
RAD 9.5% '17	65.00	64.25	64.50	50.00	37.00	28.50	34.75	28.00	24.50	24.00	50.50
RAD 7.7% '27	49.00	50.00	50.00	39.00	24.00	18.00	18.50	19.00	11.00	13.00	28.00
RAD 6.875% '28	47.50	46.00	48.00	36.00	24.00	18.00	18.50	19.00	11.00	13.00	28.00
RCII 7.5% '10	96.50	97.50	98.38	97.25	93.75	93.00	92.00	93.00	94.88	97.75	100.25
SBH 9.25% '14	95.00	97.00	101.00	94.75	79.00	75.00	86.50	91.50	94.50	94.75	100.50
SBH 10.5% '16	94.50	96.25	101.00	93.63	73.50	58.00	68.50	82.00	85.50	87.50	96.50
SKS 9.875% '11	104.00	101.00	101.25	101.00	95.00	78.00	79.00	80.00	67.50	73.00	94.00
TOY 7.625% '11	89.25	88.50	87.25	83.25	63.00	54.63	48.50	41.50	39.00	40.13	69.00
TOY 7.875% '13	81.25	80.00	79.00	77.50	62.00	48.00	39.00	37.00	34.00	35.50	60.00
TOY 7.375% '18	74.00	73.00	70.00	66.00	53.00	40.00	36.00	34.00	32.00	35.25	52.00
YCC 8.5% '15	76.75	73.00	77.00	71.00	57.00	46.00	46.75	49.50	51.00	55.00	70.50
YCC 9.75% '17	70.50	57.50	63.00	55.50	49.50	37.00	42.00	43.00	45.00	48.00	64.50
Avg M/M decline	(5.45)	(2.59)	0.00	(7.48)	(12.23)	(10.56)	2.20	0.75	(2.10)	2.33	14.72
Cumulative	(5.45)	(8.05)	(8.05)	(15.52)	(27.75)	(38.31)	(36.10)	(35.36)	(37.46)	(35.14)	(20.42)

Source: J.P. Morgan Index.

April same store sales better than feared

April same store sales mark the end of the quarter for many retailers, so as we watched them, the more important takeaways revolve around Q1 earnings revisions.

- There were surprisingly few revisions. Target said earnings would be significantly better than originally anticipated, JCPenney raised Q1 guidance for a 3rd time, Macy's put out Q1 guidance that was above the Street. The equity markets were looking for more (and greater) upward revisions, or sold on the news; equities traded off on the reports.
- Discount retailers continued to outperform, with Wal-Mart and Target beating estimates. We believe this demonstrates the consumer is "restocking."
- High-end retailers continued to underperform (Saks and Neiman Marcus the weakest of the group, down 32.0% and 22.5%, respectively).

Table 8: Same store sales comps from May 2008 to April 2009

	Apr-09	Mar-09	Feb-09	Jan-09	Dec-08	Nov-08	Oct-08	Sep-08	Aug-08	Jul-08	Jun-08	May-08
Costco Companies, Inc.	(3.0%)	(2.0%)	(3.0%)	(2.0%)	(4.0%)	(5.0%)	(1.0%)	7.0%	9.0%	10.0%	9.0%	9.0%
Target Corp	0.3%	(6.3%)	(4.1%)	(3.3%)	(4.1%)	(10.4%)	(4.8%)	(3.0%)	(2.1%)	(1.2%)	0.4%	0.4%
Wal-Mart - Total	5.0%	1.4%	5.1%	2.1%	1.7%	3.4%	2.4%	2.4%	(3.0%)	3.0%	5.8%	5.8%
Wal-Mart Stores	5.9%	0.6%	5.0%	2.1%	1.9%	3.4%	2.2%	2.0%	2.8%	3.0%	6.1%	6.1%
Sam's Club	0.3%	6.2%	5.9%	2.4%	0.1%	3.5%	3.6%	4.6%	4.2%	3.5%	4.6%	4.6%
Bon-Ton	(5.1%)	(11.2%)	(8.5%)	(8.2%)	(5.8%)	(16.0%)	(11.1%)	(4.6%)	(10.3%)	(6.5%)	(6.5%)	(6.5%)
Dillard's	(6.0%)	(19.0%)	(13.0%)	(12.0%)	(5.0%)	(9.0%)	(9.0%)	(12.0%)	(7.0%)	(5.0%)	(5.0%)	(5.0%)
Macy's Group	(9.1%)	(9.2%)	(8.5%)	(4.5%)	(4.0%)	(13.3%)	(6.3%)	NA	NA	NA	NA	NA
Nordstrom	(10.8%)	(13.5%)	(15.4%)	(11.4%)	(10.6%)	(15.9%)	(15.7%)	(9.6%)	(7.9%)	(6.1%)	(18.6%)	(18.6%)
Saks Incorporated	(32.0%)	(23.6%)	(26.0%)	(23.7%)	(19.8%)	(5.2%)	(16.6%)	(10.9%)	(5.9%)	1.9%	1.9%	1.9%
J.C. Penney - Total	(6.6%)	(7.2%)	(8.8%)	(16.4%)	(8.1%)	(11.9%)	(13.0%)	(12.4%)	(4.9%)	(6.5%)	(2.4%)	(2.4%)
Kohl's	(6.2%)	(4.3%)	(1.6%)	(13.4%)	(1.4%)	(17.5%)	(9.0%)	(5.5%)	(5.8%)	(10.4%)	2.3%	2.3%
The Gap	(4.0%)	(8.0%)	(12.0%)	(23.0%)	(14.0%)	(10.0%)	(16.0%)	(11.0%)	(8.0%)	(11.0%)	(7.0%)	(7.0%)
Gap	(10.0%)	(14.0%)	(12.0%)	(18.0%)	(12.0%)	(11.0%)	(14.0%)	(3.0%)	(5.0%)	(6.0%)	(5.0%)	(5.0%)
Old Navy	1.0%	0.0%	(13.0%)	(22.0%)	(16.0%)	(9.0%)	(20.0%)	(24.0%)	(9.0%)	(16.0%)	(10.0%)	(10.0%)
Banana Republic	(8.0%)	(16.0%)	(16.0%)	(34.0%)	(15.0%)	(11.0%)	(17.0%)	(4.0%)	(14.0%)	(8.0%)	(5.0%)	(5.0%)
International	(2.0%)	(5.0%)	(6.0%)	0.0%	(5.0%)	(6.0%)	(5.0%)	(3.0%)	(2.0%)	(9.0%)	(7.0%)	(7.0%)
Limited Brands	(6.0%)	(9.0%)	(7.0%)	(9.0%)	(10.0%)	(12.0%)	(9.0%)	(6.0%)	(7.0%)	(5.0%)	(9.0%)	(9.0%)
Victoria's Secret - Stores	(8.0%)	(10.0%)	(9.0%)	(15.0%)	(9.0%)	(9.0%)	(10.0%)	(7.0%)	(8.0%)	(6.0%)	(12.0%)	(12.0%)
Bath and Body Works	1.0%	(6.0%)	(3.0%)	(9.0%)	(10.0%)	(16.0%)	(7.0%)	(7.0%)	(5.0%)	(5.0%)	(8.0%)	(8.0%)
La Senza	(19.0%)	(12.0%)	(12.0%)	0.0%	(11.0%)	(12.0%)	(7.0%)	(4.0%)	(5.0%)	3.0%	5.0%	5.0%
Neiman Marcus	(22.5%)	(29.9%)	(20.9%)	(24.4%)	(27.5%)	(11.9%)	(26.8%)	(12.9%)	(0.5%)	(2.4%)	(2.4%)	(2.4%)
TJX Companies	3.0%	2.0%	(2.0%)	(4.0%)	0.0%	(6.0%)	(6.0%)	(1.0%)	0.0%	3.0%	5.0%	5.0%

Source: Company reports.

Retail spread performance and relative value

Table 9: High-grade retail issuers' intermediate-term notes

Ranked by spread over Treasury within sub sector grouping

Issuer	Ticker	Rating/Outlook	Maturity	Coupon	Amount (\$MN)	05/15/09 SOT	change 1wk	1m	ytd	1yr
Discounters										
Wal-Mart	WMT	Aa2/AA-/S/S	04/05/17	5.38%	\$1,000	128	(15)	(25)	(78)	26
Target	TGT	A2/A+/-/N/N	05/01/17	5.38%	\$1,000	218	9	(58)	(177)	43
Specialty Retailers										
Lowe's	LOW	A1/A+/-/S/N	10/15/16	5.40%	\$550	223	5	(81)	(160)	73
AutoZone	AZO	Baa2/BBB-/S/S	11/15/15	5.50%	\$300	470	0	0	25	243
Home Depot	HD	Baa1/BBB+/-/S/S	03/15/16	5.40%	\$3,000	485	0	0	(130)	243
Limited Brands	LTD	Ba2/BB-/URD/N	07/15/17	6.90%	\$700	629	37	(150)	(642)	168
Jones Apparel	JNY	Ba3/BB-/S/N	11/15/14	5.13%	\$250	1465	NA	NA	323	980
Food/Drug Retail										
Kroger	KR	Baa2/BBB-/S/P	08/15/17	6.40%	\$600	257	5	(59)	(148)	98
Safeway	SWY	Baa2/BBB -/-/S/NR	08/15/17	6.35%	\$500	249	(3)	(77)	(146)	74
CVS	CVS	Baa2/BBB+/-/P/S	08/15/16	6.13%	\$700	333	0	0	(145)	148
Delhaize	DELBB	Baa3/BBB-/S/S	06/15/17	6.50%	\$450	392	(0)	(77)	(191)	180
Restaurants										
McDonald's	MCD	A3/A-/S/S	03/15/17	5.30%	\$400	171	2	(11)	(89)	20
YUM! Brands	YUM	Baa3/BBB-/S/S	04/15/16	6.25%	\$300	351	(4)	(115)	(198)	97
Department Stores										
Kohl's	KSS	Baa1/BBB+/-/S/N	12/15/17	6.20%	\$650	362	(2)	(133)	(334)	106
JCPenney	JCP	Ba1/BB-/S/S	02/15/18	5.75%	\$300	417	117	(298)	(522)	110
Macy's Group	M	Ba2/BB-/S/S	12/01/16	5.97%	\$1,100	586	39	(306)	(607)	178

Source: J.P. Morgan. 1. Spread over Treasury.

Table 10: High-yield retail issuers' intermediate-term notes

Issuer	Ticker	Rating	Maturity	Coupon	Amount (\$MN)	05/15/09 SOT	change 1wk	1m	ytd	1yr
Department Stores										
	SKS	B+	10/01/11	9.88%	Nts	1189	16	(1002)	(794)	539
	DDS	BB	01/15/18	6.63%	Nts	1675	(155)	(592)	(602)	1006
	NMG	B-	10/15/15	10.38%	Sr Sub Nts	2704	531	(273)	(205)	2072
	BONT	B-	03/15/14	10.25%	Sr Nts	4203	828	(2334)	(5216)	2782
Drugstores										
	DRD	B-	08/01/11	9.75%	FRNs	2657	(93)	(960)	(1347)	1671
	RAD	BB-	08/15/13	6.88%	Nts	2340	137	(2850)	(1986)	1122
Specialty										
	RCII	B+	05/01/10	7.50%	Sr Sub Nts	759	7	37	(627)	103
	GME	BB-	10/01/12	8.00%	Guar Nts	677	49	66	(231)	368
	NTY	B+	10/01/15	7.13%	Sr Sub Nts	656	23	(213)	(555)	255
	EYCA	CCC+	02/15/15	10.75%	Sr Sub Nts	1034	17	(75)	12	352
	DLRAMA	B-	08/15/12	8.88%	Sr Sub Nts	980	55	(262)	(771)	248
	NEBRK	CCC	03/15/12	8.63%	Sr Disc	2017	21	(874)	(1970)	1125
					Nts					
	TOY	CCC+	08/01/11	7.63%	Nts	2319	172	(1290)	(1772)	1414
	BBI	CCC	09/01/12	9.00%	Sr Sub Nts	3041	25	(890)	(339)	1851

Source: J.P. Morgan.

Table 11: High-grade retail issuers' long-term notes

Ranked by spread over Treasury within subsector grouping

Issuer	Ticker	Rating/Outlook	Maturity	Coupon	Amount (\$MN)	05/15/09 SOT	change 1wk	1m	ytd	1yr
Discounters										
Wal-Mart	WMT	Aa2/AA;S/S	09/01/35	5.25%	\$2,500	223	0	0	(35)	68
Target	TGT	A2/A+;N/N	11/01/32	6.35%	\$600	395	0	0	(100)	198
Specialty Retailers										
Lowe's	LOW	A1/A+;S/N	10/15/35	5.50%	\$500	323	0	0	(150)	118
Home Depot	HD	Baa1/BBB+;S/S	12/15/36	5.88%	\$3,000	412	35	(63)	(96)	156
Jones Apparel	JNY	Ba3/BB-;S/N	11/15/34	6.13%	\$250	953	0	0	0	0
Limited Brands	LTD	Ba2/BB;URD/N	07/15/37	7.60%	\$300	608	0	(386)	(736)	141
Food/Drug Retail										
Safeway	SWY	Baa2/BBB *-;S/NR	02/01/31	7.25%	\$500	270	(40)	(50)	(75)	78
Kroger	KR	Baa2/BBB-;S/P	04/01/31	7.50%	\$600	270	(40)	(50)	(90)	78
Delhaize	DELB BB	Baa3/BBB-;S/S	04/15/31	9.00%	\$900	404	0	(46)	(211)	NA
Department Stores										
Kohl's	KSS	Baa1/BBB+;S/N	12/15/37	6.88%	\$350	398	(17)	(162)	(320)	89
JCPenney	JCP	Ba1/BB;S/S	10/15/36	6.38%	\$700	474	41	(185)	(324)	162
Macy's Group	M	Ba2/BB;S/S	03/15/37	6.38%	\$500	533	24	(194)	(347)	129

Source: J.P. Morgan. 1. Spread over Treasury.

Table 12: High-grade retail 5-year credit default swap levels

Ranked by 5-year CDS level within subsector grouping

Issuer	Ticker	Rating/Outlook	05/15/09 5yr CDS	change 1wk	1m	ytd	1yr
Discounters							
Wal-Mart	WMT	Aa2/AA;S/S	110	35	25	5	77
Target	TGT	A2/A+;N/N	165	70	40	(75)	100
Specialty Retailers							
Gap Inc	GPS	/BB+;S	80	35	20	(25)	(10)
AutoZone	AZO	Baa2/BBB;S/S	135	60	34	(5)	65
Lowe's	LOW	A1/A+;S/N	165	70	50	25	110
RadioShack	RSH	Ba1/BB;S/S	265	114	92	55	105
Home Depot	HD	Baa1/BBB+;S/S	215	115	74	(33)	115
Staples	SPLS	Baa2/BBB;S/S	290	189	144	(96)	190
Limited Brands	LTD	Ba2/BB;URD/N	685	443	342	150	395
Jones Apparel	JNY	Ba3/BB-;S/N	950	642	368	139	649
Food/Drug Retail							
Kroger	KR	Baa2/BBB-;S/P	130	45	29	35	75
Safeway	SWY	Baa2/BBB *-;S/NR	115	29	24	14	62
CVS	CVS	Baa2/BBB+;P/S	100	40	15	(5)	45
Restaurants							
McDonald's	MCD	A3/A;S/S	62	10	2	(3)	37
YUM! Brands	YUM	Baa3/BBB-;S/S	125	50	24	(45)	45
Darden Restaurants	DRI	Baa3/BBB;S/S	250	139	109	(33)	100
Wendy's	WEN	/B+;/CWN	275	149	103	(78)	50
Department Stores							
Kohl's	KSS	Baa1/BBB+;S/N	235	140	114	(45)	130
Nordstrom	JWN	Baa2/BBB+;N/S	510	304	217	(10)	418
JCPenney	JCP	Ba1/BB;S/S	535	323	210	31	356
Macy's Group	M	Ba2/BB;S/S	850	598	330	172	620

Source: J.P. Morgan.

Table 13: HY retail CDS performance

Issuer	Ticker	Rating	05/15/09 5yr CDS	change 1wk	1m	ytd	1yr
Department Stores							
	DDS	BB	771	30	(591)	(819)	238
	SKS	B+	877	63	(944)	(755)	461
	NMG	B-	1601	339	(779)	344	1227
Drugstores							
	RAD	BB-	2170	0	(2144)	(3147)	1092
Specialty							
	TOY	CCC+	1524	245	(892)	(785)	734

Source: J.P. Morgan.

Table 14: JULI sector performance

I-spread (treasury, bp)

Industry	15-May-08	31-Dec-08	14-Apr-09	15-May-09	Spread Change		
					1m	ytd	1yr
Electronics/Electrical	241	305	229	233	4	(71)	(8)
Aerospace/Def	161	332	279	249	(31)	(84)	88
Health/Pharm	192	368	295	262	(33)	(106)	70
Beverages	156	374	349	285	(65)	(89)	129
Cons Prods	167	366	304	290	(15)	(76)	122
Capital Goods	170	399	353	299	(54)	(100)	129
Food/Drug Retail	207	445	359	299	(60)	(145)	92
NonFood Retail	215	475	411	313	(98)	(162)	98
Divers Indus	167	427	372	315	(57)	(112)	148
Railway & Freight Svc	206	433	376	316	(60)	(117)	110
Utilities	212	497	398	317	(81)	(180)	105
Eng/Machinery	173	407	404	319	(84)	(87)	147
Consumer Noncyclicals	194	447	376	330	(47)	(117)	135
Food Products	204	450	359	331	(28)	(119)	127
Energy	218	547	447	341	(106)	(205)	123
Telecoms	233	513	429	374	(55)	(140)	141
Chemicals	192	391	425	383	(42)	(8)	191
Technology	192	455	420	386	(33)	(69)	194
JULI Index	231	528	498	410	(88)	(118)	179
Tobacco	180	548	472	433	(40)	(115)	253
Auto Parts/Equip	217	941	697	463	(234)	(478)	246
Media/Ent	249	597	536	466	(70)	(131)	217
Banks	222	435	575	483	(92)	48	261
Fin Svcs	267	625	656	484	(173)	(141)	217
Metals/Mining	238	739	611	526	(85)	(213)	288
Auto Mfrs	214	947	706	593	(114)	(355)	379
REITS	348	1279	919	632	(287)	(647)	284
Paper/Pkging	293	835	815	670	(145)	(165)	377
Insurance	237	681	823	710	(113)	29	473
Bldg Mat/Constr	341	1094	980	885	(95)	(209)	543

Source: J.P. Morgan.

Table 15: HY industry spreads

Industry	15-May-08	31-Dec-08	16-Apr-09	15-May-09	Spread Change		
					1m	ytd	1yr
Utility	419	1025	950	854	(96)	(171)	436
Food & Drug	559	1424	1039	881	(158)	(543)	322
Cable/Wireless Video	679	1780	846	891	46	(889)	213
Healthcare	571	1208	982	902	(80)	(306)	331
Wireline Telecommunications	577	1283	933	915	(18)	(368)	338
Metals/Minerals	485	1313	1031	915	(115)	(398)	431
Wireless Telecommunications	658	1219	1031	980	(51)	(239)	322
Food/Tobacco	651	1589	1109	985	(124)	(604)	335
Energy	503	1511	1179	1038	(141)	(474)	534
Manufacturing	622	1478	1315	1132	(183)	(346)	511
Aerospace	479	1272	1290	1164	(126)	(108)	685
Forest Prod/Containers	751	1725	1487	1191	(295)	(534)	440
JPMorgan HY Index	676	1725	1406	1208	(197)	(516)	532
Information Technology	648	2018	1508	1285	(223)	(732)	637
Consumer Products	782	1991	1532	1299	(233)	(692)	517
Retail	800	2089	1563	1346	(216)	(743)	547
Chemicals	562	1909	1487	1352	(135)	(556)	790
Service	703	1894	1622	1389	(233)	(505)	686
Gaming/Leisure	811	2390	2119	1438	(681)	(952)	628
Housing	973	2074	1725	1497	(228)	(577)	524
Financial	967	2086	1953	1619	(335)	(467)	652
Diversified Media	1032	2843	2075	1800	(274)	(1043)	769
Transportation	759	2636	2435	1819	(617)	(817)	1060
Broadcasting	849	4169	3437	2882	(555)	(1287)	2033

Source: J.P. Morgan.

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