

February Retail Sector Focus

No love for Valentine's Day

January same store sales were weak, but no weaker than expected, continuing December trends. The bigger fear around comp reporting was that the retailers would revise down 2009 guidance. We did not see as many revisions as expected, partly because we saw very little guidance, given the lack of visibility.

'09 is all about costs cuts, conserving cash, managing inventory carefully. We summarize what we have learned from our universe so far, but comment that from November 1 to January 30, we have heard of nearly 80,000 layoffs from the broader retail universe. We updated our 2008 forecasts after receiving 4Q sales from most retailers; in HY retail the only material change was Neiman Marcus, whose holiday EBITDA estimate we lowered to \$25 million from \$87 million, on weaker sales and expected weaker margins.

We continue to recommend an Underweight on the HG Non-Food Retail sector based on our cautious view of consumer spending. Spread performance in the sector has been roughly in-line with the overall high-grade market. We do not believe that this is justified given the challenging fundamental outlook for the retail sector going forward. We continue to recommend a barbell approach to the sector, with Overweight positions in WMT, COST, and M.

We continue to recommend an Underweight on the HY Retail sector, as we see little possibility of upside amongst expected negative 4Q results and weak macro data points over the coming 3-6 months. We expect our next retail data points to be negative (4Q earnings), with the greatest pressure on luxury department stores (Neiman Marcus, and Saks). We remain Underweight Saks, but Neutral Neiman. Our **Overweight** recommendations remain focused on more defensive credits— Blockbuster, Dollar General, GNC, Eye Care, Nebraska Book, and Rite Aid. We also like bank debt at these companies, as well as Sally Beauty and Toys R Us.

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Outlooks are getting more blurry

We had hoped that with January sales under their belts, that retailers would provide 2009 guidance from companies. In the investment-grade space, JCP, M, KSS, TGT, COST, KSS, and GPS gave earnings guidance. KSS indicated that 4Q earnings would come in ahead of current consensus, while M and GPS gave guidance that was ahead of their previous forecast. JCP lowered the top part of its earnings guidance. TGT and COST noted that earnings would come in below the current consensus estimates. We believe the reason we are not hearing more about 2009 is that the visibility is very low. January was similarly weak to December, and February and March are less important retail months in general. March may appear particularly weak because Easter shifts into April this year (April may look stronger, but that feels like years away at this point). We expect retailers to remain quiet about guidance, given low visibility into the consumer.

Following December same store sales, several retailers had lowered their 4Q08 earnings outlooks on heightened promotional activity. With January same store sales under our belt, we now have sales for the complete quarter, and have had time to see street estimates also come down.

We forecast the average HY retailer will post an EBITDA decline in the 18% range. The more seasonally dependent businesses will be the hardest hit (department stores, particularly Saks and Neiman Marcus). Some defensive businesses may show EBITDA growth (Dollar General, Eye Care Centers, GameStop, GNC). Both Rent-A-Center and Sally Beauty already reported results, showing EBITDA gains (more so at Rent-A-Center). The table below shows our 4Q and FY09 EBITDA estimates for the retailers we cover.

Table 1: HY Retail - 4Q08 earnings targets

Company	Adj. EBITDA			Net Lev			Comments	Date
	JPM Rating	JPM 4Q08E	YOY % Chg	JPM FY08E	JPM 4Q08E	Actual 4Q07		
Blockbuster, Inc. (1)	OW	\$137.1	-11.7%	\$300.0	6.3x	7.1x	Street EBITDA est \$126 mn for 4Q, mgmt \$118-133mn	Early March
Bon-Ton Stores, Inc.	N	\$174.9	-30.9%	\$161.2	7.4x	5.5x	No street estimates	11-Mar-09
Burlington Coat Factory (2)	N	\$112.8	-13.4%	\$259.2	6.7x	6.0x	Est for 3Q ended Feb and FY ended May	April
Claire's Stores	N	\$114.0	-21.3%	\$220.1	9.4x	7.8x	No street estimates, not public	Early April
Dillard's, Inc.	N	\$178.4	-57.0%	\$193.7	7.0x	3.5x	Street EBITDA est \$79 mn for 4Q	Early March
Dollar General	OW	\$250.3	11.2%	\$908.7	5.4x	7.2x	No street estimates, not public	Early March
Duane Reade Inc. (1)	N	\$25.5	-6.4%	\$87.4	7.4x	7.8x	No street estimates, not public	Early March
Eye Care Centers of America (1)	OW	\$12.0	4.8%	\$92.2	4.5x	4.7x	No street estimates, not public	Early April
Finlay Fine Jewelry Corp.	N	\$41.4	-5.7%	\$6.9	NA	NA	No street estimate	18-Mar-09
GameStop Corp.	N	\$333.2	19.2%	\$797.1	NA	1.8x	Street EBITDA est \$397 mn for 4Q	Mid March
GNC Corp. (1)	OW	\$45.5	2.4%	\$215.2	5.8x	6.8x	No street estimates, not public	Early March
Michaels Stores, Inc.	N	\$264.2	-15.1%	\$488.6	7.4x	7.0x	No street estimates, not public	12-Mar-09
NBTY, Inc. (3)	N	\$87.1	-31.1%	\$367.9	3.2x	2.0x	Missed Dec qtr ests by about \$4mn	reported Q4
Nebraska Book Company (4)	OW	(\$6.8)	NA	\$72.9	6.8x	6.7x	Ests are 3Q end Dec and FY end Mar	13-Feb-09
Neiman Marcus Group, Inc. (5)	N	\$187.3	-86.4%	\$685.8	6.5x	4.3x	Ests are 2Q end Jan and FY end July	11-Mar-09
Rent-A-Center, Inc. (1)	N	\$82.7	5.9%	\$376.7	3.0x	2.5x	Met street est of \$83mn for 4Q	reported Q4
Rite Aid, Inc. (6)	OW	\$277.1	-2.4%	\$977.6	7.3x	7.1x	Street EBITDA est \$270 mn for 4Q	09-Apr-09
Saks, Inc.	UW	\$91.9	-103.2%	\$86.7	7.6x	3.6x	Street EBITDA est (\$22) mn for 3Q	25-Feb-09
Sally Beauty Holdings, Inc. (3)	N	\$87.2	0.9%	\$352.4	6.0x	6.3x	Missed est for Dec qtr by \$6mn	rept Dec Q
Toys R Us, Inc.	N	\$776.0	-12.8%	\$971.6	6.5x	6.3x	No street estimates, not public	Late April
Yankee Candle (1)	N	\$103.2	-1.0%	\$186.4	6.2x	6.1x	No street estimates, not public	Late Feb

1. FYE December. 2. BCF FYE May. 3. FYE Sept. 4. NEBRK FYE Mar. 5. NMG FYE Jul. 6. FYE Feb.

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

Cost cuts are the focus for '09

Since December, we have heard from nearly every one of the companies we cover, with either sales updates, guidance revisions for FY08, or '09 cost cuts. We expect more cost cuts to come, but here is a summary of what we have learned so far. One common theme among the news below is that we saw retailers balance negative sales news with positive news that they were going to focus on cost cuts. It will be a few quarters to see if the cuts are enough to offset the top line weakness. We are skeptical of gross margin improvements, but believe that layoffs (which should reduce SG&A costs), capex cuts, and reductions in working capital will be more tangible.

Table 2: HY Retail

Retail guidance revisions and other key events - December 2008, January 2009		Tone
Blockbuster	Reiterated FY08 guidance of \$300-315mn EBITDA	positive
Bon-Ton Stores, Inc.	4Q sss down 9.7%, slightly better than our -10% target. No material change to our EBITDA forecast Cutting 1,150 jobs (3.5% of full timers), elim '08 exec bonus, elim '09 merit-based wage increases to save \$70mn/yr	neutral
Burlington Coat Factory	Plan to reduce costs in 3Q and 4Q (end May) by \$45mn, estimated about \$75-80mn/yr	neutral
Claire's Stores	no updates since last qtr	neutral
Dillard's, Inc.	4Q sss down 8%, cutting 500 jobs (< 1% of workforce), no material change to our EBITDA forecast	neutral
Dollar General	4Q sss up 9.4%; total sales \$50mn better than our target. We raised 4Q EBITDA to \$278mn from \$274mn	positive
Duane Reade Inc.	Reiterated FY08 guidance of \$90-95mn EBITDA	positive
Eye Care Centers of America	no updates since last qtr	neutral
Finlay Fine Jewelry Corp.	Nov/Dec sss declined 20.8%, 11-month sss down 12.3%	negative
GameStop Corp.	Holiday sss up 10%, raised low end of 4Q EPS guidance	positive
General Nutrition Centers, Inc.	Vitamin category remains up high-single digits through December	positive
Michaels Stores, Inc.	2 rounds of cost cuts: 295 corp. positions	neutral
NBTY, Inc.	Missed Dec qtr estimates, due to need to build Leiner inventory, buying raw materials at market	negative
Nebraska Book Company, Inc.	Mgmt expects low-single-digit increase in revenue for the Dec qtr, amended bank covenants	positive
Neiman Marcus Group, Inc.	Jan qtr (2Q) sss down 22.8%, expect to post net loss during the holiday quarter, announced 375 job cuts (2.3%) We lowered our 2Q EBITDA forecast to \$25mn from \$87mn	negative
Rent-A-Center, Inc.	Reported 4Q results in line with street and raised 1Q 2009 guidance	positive
Rite Aid, Inc.	Jan sales up 1%, slightly better than expectations, no material change to our EBITDA forecast	positive
Saks, Inc.	4Q sss down 15.3%, expect 4Q GM to be down more than 3Q (down 639bp), bringing down our EBITDA to (\$3mn) from (0) Cutting 1,100 (9%) corp jobs, elim '09 merit-based wage increases, suspension of 401K matching, to save \$50-60mn/yr	negative
Sally Beauty Holdings, Inc.	Reported Dec qtr slightly weak to street, but remain resilient relative to most retail	neutral
Toys R Us, Inc.	December sss up 1.9% domestically; Nov/Dec sss down 3.4% and int'l down 5.1%	neutral
Yankee Candle	Announced adding 600 Target doors beginning February 2009	positive

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

Beyond our universe, here is a summary of some significant cost cuts from retailers. The data was collected from November 1 through January 30th. We added a few names to the data from Challenger, Gray & Christmas and Bloomberg.

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Table 3: Retail layoffs

	Layoffs	Timeframe	
Circuit City	34,000	Jan-09	
KB Toys	15,000	Dec-08	
Circuit City stores	7,305	Nov-08	
Home Depot	7,000	Jan-09	
Starbucks	6,700	Jan-09	
Office Depot	2,200	Dec-08	
Bon-Ton	1,150	Jan-09	
Saks	1,100	Jan-09	
Target	1,100	Jan-09	
Oshkosh	1,050	Jan-09	total cuts 2,400
Walgreen	1,000	Jan-09	
Dillard's	500	Jan-09	
Neiman Marcus	375	Jan-09	
Rite Aid	60	Jan-09	
Total	78,540		

Source: Challenger, Gray & Christmas and Bloomberg - Excerpted from an article on BN Jan 30

High Grade: Recommendations

We continue to recommend an Underweight on the HG Non-Food Retail sector based on our cautious view of consumer spending. The sector is trading roughly in line with the broader high grade market, which we don't think is justified given the challenging fundamental outlook. We continue to recommend a barbell approach to positioning in the retail sector, with Overweight recommendations for WMT, COST, and M.

Table 4: High-Grade Non-Food Retail Recommendations

CDS (bp)

Ticker	% of JULI Non-food Retail Index	Cash spread relative to Index ¹	5yr CDS level	JPM Credit recommendation	Comment
WMT	38%	-	97	Overweight	High quality credit, relatively safe place to be in sector. Performance has been solid, benefiting from consumers trading down. Plus, International diversification (30% of revenues). Share repos have been suspended. Same-store sales performance has been sluggish relative to historical trends and WMT. Management has said it will not pursue Pershing Square's plan to monetize its real estate, but Ackman-related headline risk remains. TGT committed to an A1/P1 CP rating. Share repos have been suspended. \$1.25bn of bond maturities in 2009 may necessitate new bond issue.
TGT	20%	-	145	Neutral	Macro backdrop remains very weak for home improvement. EBITDA expected to decline another 25% in 2008. Expect demand to remain depressed through 2009. Macy's proactively renegotiated credit agreement in December, alleviating misplaced market concerns about the company's liquidity position. Macy's announced that they will end the 4Q with \$1.3 billion in cash. Using this cash, the company completed its tender offer for the \$950 million of maturities this year. SSS performance continues to outpace most primary competitors.
HD	15%	+	195	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. 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.
M	8%	+	710	Overweight	KSS has relatively low leverage and higher margins than JCP and M, giving it more cushion to weather the weaker macro environment. Sales performance has been solid compared with peers. CDS looks tight on relative basis.
LOW	8%	Even	140	Underweight	While AZO's operating performance has been relatively steady in the tough US macro environment, the company has been implementing a more aggressive capital structure policy. 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 \$272mn in F1Q09.
COST	4%	-	NA	Overweight	JCP's cash position of \$1.6bn at 3Q08 provides cushion in a weaker operating environment. Sales trends have deteriorated more than M and KSS.
KSS	2%	Even	230	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 is feeling the pinch from the weak stock market and general economic slowdown. In addition, competition is heating up with high end retailers Neimans and Saks heavy on inventory and more promotional.
AZO	2%	+	125	Underweight	Same-store sales trends have been very weak, negative for the past 13 months. We think LTD will need to get covenant relief in its credit agreement within the next quarter or two. Company continues to be shareholder friendly in repurchasing stock. Looks rich relative to M given its lower rating and higher leverage.
JCP	1%	+	490	Neutral	JNY's operating trends continue to be soft, and it is heavily exposed to US Department stores (55% of 2007 revenues). The macroeconomic environment and the lack of higher growth niche brands in JNY's portfolio are also headwinds. JNY recently renegotiated its bank agreement, getting some covenant relief. Liquidity should be adequate to repay \$250mn November bond maturity.
JWN	NMF	+	600	Neutral	
LTD	NMF	+	600	Underweight	
JNY	NMF	+	970	Underweight	

Source: J.P. Morgan.

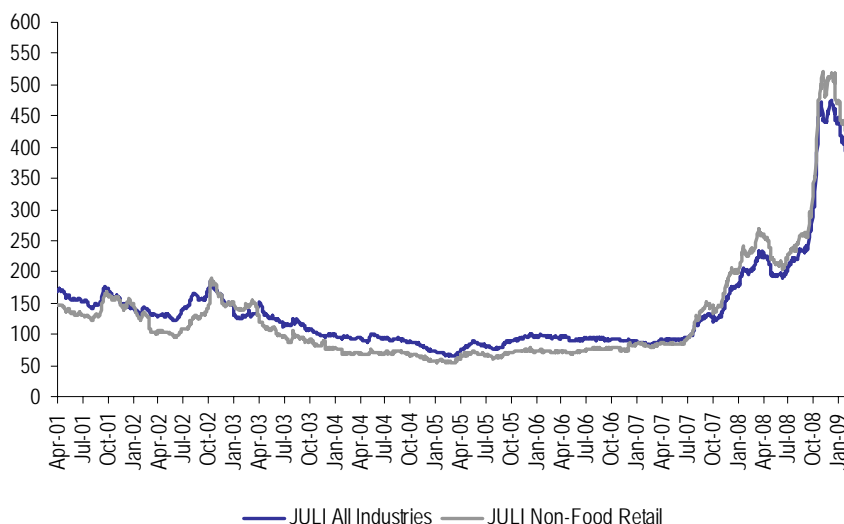
HG non-food retail valuation

Since the beginning of the year, high-grade spreads in the retail sector have tightened approximately 45bp. Currently, the non-food retail sector spread is 429bp, roughly 93bp tighter from the first trading day in November. While spreads have preformed well as of late, they are still well in excess of historical levels. Spreads in the non-food retail sector are still 160bp wider than the wides set in March of 2008. During the 2002 economic contraction, the non-food retail sector touched a wide of 189bp in October of that year. Currently, the sector is trading 240bp wide of that level.

The basis between the high-grade non-food retail sector and the JULI has moved significantly tighter since October 1, 2008 when the non-food retail sector traded 134bp inside of the JULI. Currently, the sector trades 40bp inside of the JULI. We attribute most of this basis convergence to the recent outperformance in the financial sector versus the non-food retail sector. The non-food retail sector still trades a fair amount inside of the positive 3bp basis reached in February of 2008. We note that prior to 2008, the average basis between the non-food retail sector and the JULI was (23bp). Over the course of 2008, this basis has averaged (28bp).

Figure 1: Historical Non-Food Retail JULI vs. JULI All-Industries

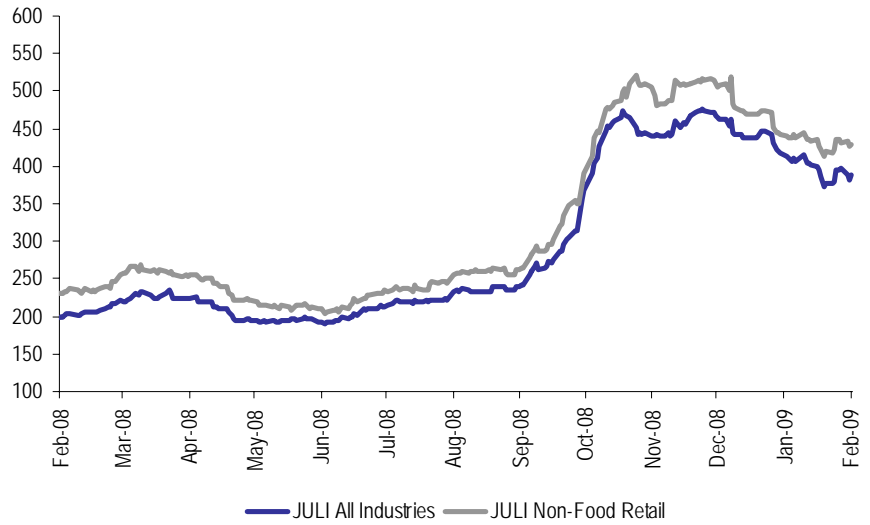
I-spread (treasury)



Source: J.P. Morgan.

Figure 2: Last Twelve Month JULI Non-Food Retail vs. JULI All-Industries

I-spread (treasury)



Source: J.P. Morgan.

High Yield: Recommendations

We remain Underweight HY Retail, as we fear an increasing flight to quality in HY, and expect negative headwinds as we get 4Q results and 2009 outlooks. We propose keeping retail exposure low, but not short selling it, as current levels make shorts expensive to carry unless bonds move off by a significant margin.

Table 5: HY Retail positives and negatives

Positives	Negatives
Average bond is off 29 points since March 2008	Over 50% of HY Retail is CCC or below, vs 13% for the JPM Index
Low liquidity risk through mid-2010	News flow should be negative around the holiday
Several defensive names could support the sector	Earnings estimates could come down further
	EV/2009 EBITDA are still rich for some

Source: J.P. Morgan.

Year end 2008 and 2009 leverage will increase significantly at Dillard's (+3.5x), Neiman Marcus (+2.2x), and Saks (+4.0x). Historical leverage at Dillard's and Saks had been reasonable (in the mid-3x range), but the magnitude of this year's EBITDA decline should more than double leverage. Many of the 2005-2007 LBO's will likely see leverage reach back to LBO levels or above (Bon-Ton, Burlington Coat, Claire's Stores, Michaels Stores, Toys R Us). We believe the market will continue to question whether these companies can support their debt levels or need to restructure the balance sheet, but without a vendor trigger, there are no covenants to trigger a restructuring.

Table 6: HY Retail - market value leverage

	BBI	BONT	BCF ACT	CLAIRE	DG	GNC	MIK	NMG	RCII	RAD	SBH	TOY	TOY Del
Face value of bank debt & sec	515	813	1,287	1,624	2,300	665	2,710	1,625	754	3,469	1,106	4,902	1,642
Face value of bonds & other	489	510	428	950	1,881	416	1,473	1,321	240	3,400	713	1,312	389
Face value of Debt	1,004	1,323	1,715	2,574	4,181	1,081	4,183	2,946	994	6,869	1,819	6,214	2,031
Market value of bank debt & Sec	396	813	789	680	1,920	485	1,812	1,154	679	2,406	951	3,144	984
Market value of bonds & other	285	59	191	139	1,872	262	384	622	231	1,229	668	499	389
MV of Debt	681	872	981	820	3,792	748	2,196	1,776	909	3,634	1,619	3,643	1,373
Cash	95	17	40	194	151	40	92	115	87	149	113	213	109
LTM EBITDA	316	215	254	246	881	212	517	614	364	984	336	1,064	631
Trough EBITDA	220	119	175	196	793	170	400	350	291	787	269	730	500
Bank debt ratios													
Book value bank/EBITDA (net)	1.3 x	3.7 x	4.9 x	5.8 x	2.4 x	2.9 x	5.1 x	2.5 x	1.8 x	3.4 x	3.0 x	4.4 x	2.4 x
MV Bank/EBITDA (net)	1.0 x	3.7 x	3.0 x	2.0 x	2.0 x	2.1 x	3.3 x	1.7 x	1.6 x	2.3 x	2.5 x	2.8 x	1.4 x
Total debt ratios													
Book value total debt/EBITDA (net)	2.9 x	6.1 x	6.6 x	9.7 x	4.6 x	4.9 x	7.9 x	4.6 x	2.5 x	6.8 x	5.1 x	5.6 x	3.0 x
MV total debt/EBITDA (net)	2.2 x	4.0 x	5.7 x	6.4 x	4.6 x	4.2 x	5.8 x	3.5 x	2.5 x	4.6 x	4.9 x	4.9 x	3.0 x
Mkt val ratios at trough EBITDA													
MV Bank/trough EBITDA (net)	1.4 x	6.7 x	4.3 x	2.5 x	2.2 x	2.6 x	4.3 x	3.0 x	2.0 x	2.9 x	3.1 x	4.0 x	1.7 x
MV total debt/trough EBITDA (net)	3.2 x	7.2 x	8.2 x	8.0 x	5.1 x	5.2 x	7.5 x	6.1 x	3.1 x	5.8 x	6.2 x	7.1 x	3.8 x

For the bank debt ratios, we assume the revolvers are at par, and term loans at market value. For the bond valuation, we assume bank debt is covered at par, but use market value of the bonds. Shaded areas denote valuations that we believe are above an appropriate market value.

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

Table 7: Retail Relative Value

Coupon	Desc.	Recom.	Maturity	Ratings	Amount Outst.	Recent Bid	Quotes YTW	Spread	LTM EBITDA	LTM EBITDAR/(Net Int+1/3 Rent)	LTM EBITDA-Capex)/(Net Int)	Adj Net Debt/ LTM EBITDAR
Department Stores												
Bon-Ton Stores, Inc. 10.250%	Sr Nts	Hold	15-Mar-14	Caa1/CCC	510.0	11 1/2	100.46%	9,869bp	\$215.2	2.4x	1.2x	6.7x
Dillard's, Inc.* 6.625%	Nts	Hold	15-Jan-18	B3/B+	100.0	35	25.29%	2,276bp	\$295.4	3.2x	0.7x	5.8x
7.130%	Nts	Hold	01-Aug-18	B3/B+	200.0	38	23.96%	2,132bp	\$295.4	3.2x	0.7x	5.8x
7.000%	Nts	Hold	01-Dec-28	B3/B+	150.0	33	21.92%	1,883bp	\$295.4	3.2x	0.7x	5.8x
Neiman Marcus Group, Inc. 7.125%	Debs	Hold	01-Jun-28	Ba3/BB	125.0	50	15.20%	1,212bp	\$613.6	2.6x	1.9x	2.8x
9.000%	Sr Nts	Hold	15-Oct-15	B3/B	700.0	45	27.01%	2,492bp	\$613.6	2.6x	1.9x	4.4x
10.375%	Sr Sub Nts	Hold	15-Oct-15	B3/B-	500.0	47 1/2	28.27%	2,619bp	\$613.6	2.6x	1.9x	5.1x
Saks, Inc. 9.875%	Nts	Sell	01-Oct-11	B2/B	141.6	71	25.72%	2,464bp	\$181.6	3.8x	1.2x	5.2x
Specialty and Other Retail												
Blockbuster, Inc. 9.000%	Sr Sub Nts	Buy	01-Sep-12	Caa2/CCC	300.0	53 1/2	31.81%	3,046bp	\$316.0	3.3x	2.9x	6.2x
Burlington Coat Factory 11.125%	Sr Nts	Hold	15-Apr-14	Caa1/CCC	305.0	28	52.73%	5,095bp	\$253.7	2.5x	1.6x	6.1x
Claire's Stores, Inc. 9.250%	Sr Nts	Hold	01-Jun-15	Ca/CCC+	250.0	22 1/2	51.37%	4,936bp	\$246.0	1.7x	0.9x	8.2x
10.375%	Sr Nts	Hold	01-Jun-15	Ca/CCC+	368.2	6	63.56%	6,155bp	\$246.0	1.7x	0.9x	8.2x
10.500%	Sr Sub Nts	Hold	01-Jun-17	Ca/CCC	335.0	18 3/4	59.04%	5,663bp	\$246.0	1.7x	0.9x	8.9x
Dollarama Group LP 8.875%	Sr Sub Nts	NR	15-Aug-12	B2/B-	200.0	81 1/2	15.99%	1,466bp	C\$ 152.1	2.7x	2.0x	4.9x
FRN's	Sr PIK Nts	NR	15-Aug-12	B3/B-	200.0	65	26.47%	2,515bp	C\$ 152.1	2.7x	2.0x	5.8x
Dollar General Corp. 10.625%	Sr Nts	Buy	15-Jul-15	Caa1/CCC+	1175.0	100 3/4	10.40%	882bp	\$880.8	2.4x	1.7x	5.0x
11.875%	Sr Sub Nts	Buy	15-Jul-17	Caa2/CCC+	725.0	96 3/4	12.51%	1,007bp	\$880.8	2.4x	1.7x	5.6x
Duane Reade, Inc. FRN's	Sr Sec Nts	Hold	15-Dec-10	Caa1/CCC+	210.0	77 1/2	18.73%	1,961bp	\$89.0	2.3x	1.0x	6.8x
9.750%	Sr Sub Nts	Hold	01-Aug-11	Caa3/CCC-	195.0	55	40.23%	3,919bp	\$89.0	2.3x	1.0x	7.4 x
Eye Care Centers of America, Inc. 10.750%	Sr Sub Nts	Buy	15-Feb-15	B2/B-	152.0	93	12.44%	1,049bp	\$91.6	3.6x	2.8x	4.3x
Finlay Enterprises, Inc. 8.375%	Sr Nts	Hold	01-Jun-12	Ca/CC	200.0	5	196.10%	9,999bp	\$9.2	1.7x	0.1x	11.3x
Gamestop Corp. 8.000%	Guar Nts	Hold	01-Oct-12	Ba1/BB+	580.0	100 1/2	7.78%	669bp	\$759.9	7.8x	16.5x	2.3x
GNC Corp. FRN's	Sr Nts	Buy	15-Mar-14	Caa1/CCC	300.0	60 1/2	15.28%	1,690bp	\$212.1	2.6x	1.9x	5.7x
10.750%	Sr Sub Nts	Buy	15-Mar-15	Caa2/CCC	110.0	69	19.71%	1,775bp	\$212.1	2.6x	1.9x	6.0x
HSN, Inc. 11.25%	Sr Sec Nts	NR	01-Aug-16	Ba2/BB	240.0	77	16.74%	1,529bp	\$198.4	5.2x	4.5x	2.5x

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Coupon	Desc.	Recom.	Maturity	Ratings	Amount Outst.	Recent Bid	Quotes YTW	Spread	LTM EBITDA	LTM EBITDAR/ (Net Int+1/3 Rent)	LTM EBITDA- Capex)/(Net Int)	Adj Net Debt/ LTM EBITDAR
Michael's Stores, Inc 10.000%	Sr Nts	Hold	01-Nov-14	Caa1/CCC	750.0	37	37.39%	3,550bp	\$517.0	1.9x	1.3x	7.1x
11.375%	Sr Sub Nts	Hold	01-Nov-16	Caa2/CCC	400.0	26	48.50%	4,620bp	\$517.0	1.9x	1.3x	7.9x
0.000%/13.000%	Sub Nts	Hold	01-Nov-16	Caa2/CCC	469.4	7	58.62%	5,633bp	\$517.0	1.9x	1.3x	7.9x
NBTY, Inc. 7.125%	Sr Sub Nts	Hold	01-Oct-15	B1/BB	200.0	78 1/2	11.90%	983bp	\$313.1	6.3x	7.9x	3.2x
Nebraska Book Co. (& NBC Acquisition Co.) 8.625%	Sr Sub Nts	Buy	15-Mar-12	Caa1/CCC	175.0	51	36.32%	3,511bp	\$73.5	2.1x	1.6x	5.3x
0.000%/11.000%	Sr Disc Nts	Buy	15-Mar-13	Caa1/CCC	77.0	40 1/8	43.60%	4,211bp	\$73.5	2.1x	1.6x	6.0x
Rent-A-Center, Inc. 7.500%	Sr Sub Nts	Hold	01-May-10	B2/B+	300.0	94 1/2	12.53%	1,187bp	\$363.6	4.9x	5.9x	4.1x
Rite Aid Corp. 10.375%	Sr Sec Nts	Buy	15-Jul-16	Caa2/B-	470.0	67	18.80%	1,656bp	\$984.2	2.4x	0.8x	6.2x
7.500%	Sr Sec Nts	Buy	01-Mar-17	Caa2/B-	500.0	59	17.05%	1,469bp	\$984.2	2.4x	0.8x	6.2x
8.625%	Sr Nts	Hold	01-Mar-15	Caa3/CCC	500.0	29	41.36%	3,940bp	\$984.2	2.4x	0.8x	7.0x
9.375%	Sr Nts	Hold	15-Dec-15	Caa3/CCC	410.0	31	38.60%	3,648bp	\$984.2	2.4x	0.8x	7.0x
9.500%	Sr Nts	Hold	15-Jun-17	Caa3/CCC	810.0	31	35.98%	3,356bp	\$984.2	2.4x	0.8x	7.0x
6.875%	Debs	Hold	15-Aug-13	Ca/CCC	200.0	23 1/2	52.98%	5,137bp	\$984.2	2.4x	0.8x	7.4x
7.700%	Debs	Hold	15-Feb-27	Ca/CCC	300.0	19	40.74%	3,771bp	\$984.2	2.4x	0.8x	7.4x
6.875%	Nts	Hold	15-Dec-28	Ca/CCC	150.0	19	36.27%	3,318bp	\$984.2	2.4x	0.8x	7.4x
Sally Holdings LLC 9.250%	Sr Nts	Hold	15-Nov-14	B3/B	430.0	98	9.71%	780bp	\$336.1	2.4x	1.9x	5.5x
10.500%	Sr Sub Nts	Hold	15-Nov-16	Caa1/B-	280.0	91	12.33%	1,003bp	\$336.1	2.4x	1.9x	6.1x
Toys R Us, Inc. 7.625%	Nts	Hold	01-Aug-11	Caa1/CCC+	500.0	43 1/2	50.06%	4,902bp	\$1,064.0	2.6x	1.5x	6.4x
7.875%	Nts	Hold	15-Apr-13	Caa1/CCC+	400.0	36	41.25%	3,973bp	\$1,064.0	2.6x	1.5x	6.4x
7.375%	Nts	Hold	15-Oct-18	Caa1/CCC+	400.0	36	25.42%	2,273bp	\$1,064.0	2.6x	1.5x	6.4x
Yankee Candle Co., Inc. 8.500%	Sr Nts	Hold	15-Feb-15	B3/B-	325.0	55	22.55%	2,060bp	\$187.8	2.1x	1.7x	5.6x
9.750%	Sr Sub Nts	Hold	15-Feb-17	Caa1/CCC+	200.0	50	24.15%	2,180bp	\$187.8	2.1x	1.7x	6.5x

Source: J.P. Morgan.

HY Retail rebounded again - modestly

While we believe there are many compelling opportunities in HY retail, we are not yet ready to increase sector exposure. The average HY Retail bond we cover is off 30 points from April 2008. The average retailer in the chart below is just over 66 cents on the dollar.

Table 8: Retail bond prices as of first trading day of each month: Apr 2008 to Present (lows shaded)

Date	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Current
BBI 9% '12	81.00	81.00	83.00	81.00	79.00	79.25	65.25	56.75	47.50	45.00	50.50	53.00
BONT 10.25% '14	67.00	77.50	71.50	65.00	53.00	46.75	36.50	17.00	14.00	12.00	15.25	11.25
CLAIRE 9.25% '15	63.25	69.75	67.00	52.50	43.00	41.50	41.50	31.00	18.00	21.00	24.00	22.50
CLAIRE 9.625% '15	52.13	60.00	58.25	43.25	30.00	28.38	29.00	18.50	10.00	9.00	7.00	6.00
CLAIRE 10.5% '17	44.13	55.50	52.25	40.50	29.50	36.50	35.50	26.00	13.50	17.00	19.00	17.50
DDS 6.625% '18	74.00	75.50	77.00	72.50	70.75	70.00	62.00	48.00	42.00	35.50	34.00	35.00
DG 10.625% '15	97.25	99.25	98.00	98.00	100.25	100.25	98.50	92.50	89.50	95.50	99.25	100.75
DG 11.875% '15	87.50	92.00	92.00	93.00	94.00	95.00	92.50	82.00	79.50	85.50	92.00	96.25
DRD 9.75% '11	83.50	92.50	92.00	88.50	87.50	88.50	83.00	60.50	54.00	53.00	54.00	55.00
EYCA10.75% '15	102.00	102.88	103.00	103.50	102.00	103.00	103.50	101.00	92.00	95.00	93.00	93.00
FNLY 8.375% '12	34.00	43.00	39.00	40.75	40.00	35.00	14.00	13.00	11.00	7.00	5.00	5.00
GMEUS 8% '12	105.50	106.50	105.50	102.50	102.50	104.75	99.25	92.75	86.13	93.00	99.00	100.25
GNC 10.75% '15	83.75	87.75	88.00	85.50	84.25	86.75	79.00	61.50	57.50	56.00	69.00	69.00
MIK 10% '14	87.00	96.75	92.50	85.63	79.75	73.00	61.00	46.00	31.50	45.50	44.50	37.00
MIK 11.375% '16	78.75	89.50	85.75	79.00	72.00	62.00	46.00	36.00	22.50	33.00	29.50	26.50
NBTY 7.125% '15	95.50	96.00	96.00	95.50	94.50	94.00	92.25	75.00	74.00	71.00	79.25	78.50
NEBRK 8.625% '15	89.50	91.00	86.00	82.50	81.50	80.75	75.00	64.00	50.00	45.00	50.00	53.50
NEBRK 11% '15	90.00	90.50	88.00	88.00	88.00	88.00	78.50	78.50	40.13	40.63	39.00	40.00
NMG 9% '15	99.75	104.25	102.25	98.88	97.75	97.50	82.50	69.00	44.38	45.00	43.75	45.25
NMG 10% '15	100.38	104.50	103.38	99.50	98.00	98.50	83.25	69.00	41.50	43.50	45.50	47.50
RAD 6.875% '15	66.00	70.50	69.50	60.00	60.50	60.00	45.00	33.00	26.00	28.50	23.00	23.50
RAD 8.625% '15	76.25	81.25	78.25	65.50	64.00	64.50	51.00	37.00	28.00	34.50	27.50	29.00
RAD 9.375% '15	78.00	81.25	78.00	65.00	65.00	64.50	51.00	37.00	28.50	35.00	28.00	31.00
RAD 7.5% '17	90.00	92.75	91.25	80.00	81.00	83.00	75.00	64.00	57.50	65.00	58.50	59.50
RAD 9.5% '17	78.00	81.75	78.00	65.00	64.25	64.50	50.00	37.00	28.50	34.75	28.00	30.50
RAD 7.7% '27	58.00	60.00	59.00	49.00	50.00	50.00	39.00	24.00	18.00	18.50	19.00	19.00
RAD 6.875% '28	53.00	56.00	54.00	47.50	46.00	48.00	36.00	24.00	18.00	18.50	19.00	19.00
RCII 7.5% '10	92.75	98.25	97.75	96.50	97.50	98.38	97.25	93.75	93.00	92.00	93.00	94.50
SBH 9.25% '14	99.75	100.50	99.50	95.00	97.00	101.00	94.75	79.00	75.00	86.50	91.50	97.00
SBH 10.5% '16	92.50	99.00	97.50	94.50	96.25	101.00	93.63	73.50	58.00	68.50	82.00	90.00
SKS 9.875% '11	100.00	101.50	104.50	104.00	101.00	101.25	101.00	95.00	78.00	79.00	80.00	75.00
TOY 7.625% '11	82.00	87.50	91.00	89.25	88.50	87.25	83.25	63.00	54.63	48.50	41.50	43.00
TOY 7.875% '13	76.25	80.50	84.50	81.25	80.00	79.00	77.50	62.00	48.00	39.00	37.00	36.00
TOY 7.375% '18	69.25	74.25	76.75	74.00	73.00	70.00	66.00	53.00	40.00	36.00	34.00	36.00
YCC 8.5% '15	81.00	84.50	81.50	76.75	73.00	77.00	71.00	57.00	46.00	46.75	49.50	55.00
YCC 9.75% '17	79.75	79.75	77.50	70.50	57.50	63.00	55.50	49.50	37.00	42.00	43.00	49.00
Avg M/M decline		4.35	(1.28)	(5.27)	(2.43)	0.00	(7.69)	(11.81)	(10.19)	1.90	0.72	0.91
Cumulative		4.35	3.07	(2.20)	(4.63)	(4.63)	(12.32)	(24.13)	(34.32)	(32.42)	(31.70)	(30.80)

Source: J.P. Morgan Index

The loan market could continue to drag down HY retail

There remains a large "discount for risk," as evidenced by the additional yield the market gets for a turn of leverage – currently over 500bps. The additional spread investors get today for adding one turn of leverage (from the bank debt into bonds) is 576bps when looking at senior notes and 542bps when measuring the spread to the subordinated issues, this is up considerably from the mid 300bps range in late 2008.

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 7: Bonds vs. bank debt relative value as of February 12, 2009

Ticker	Coupon	Maturity	Bank Lev	Total Lev	Bond Bid px	Bond Z-spd	Loan Ask px	Loan LIBOR Spd	Addl Leverage	Addl Spread	Theoretic fair spread	Differential (bp)
BBI	9.000	9/12	1.8 x	3.2 x	54.50	2904	74.00	2425	1.4 x	479	820	342
BCFACT	11.125	4/14	4.1 x	5.3 x	28.00	5047	43.00	2953	1.2 x	2094	682	(1,412)
CLAIRE	9.250	6/15	6.6 x	9.1 x	22.00	4991	34.00	2969	2.5 x	2022	1,441	(581)
CLAIRE	10.500	6/17	6.6 x	10.5 x	17.00	6199	34.00	2969	3.9 x	3230	2,095	(1,135)
DG	10.625	7/15	2.6 x	4.0 x	101.00	808	82.00	693	1.3 x	115	769	653
DG	11.875	7/17	2.6 x	4.7 x	97.00	962	82.00	693	2.1 x	269	1,154	885
GNC	FLOAT	3/14	3.2 x	4.6 x	59.50	1734	73.00	1016	1.4 x	718	808	90
GNC	10.75	3/15	3.2 x	5.1 x	69.50	1703	73.00	1016	1.9 x	687	1,042	355
MIKE	10.000	11/14	5.2 x	6.7 x	33.50	3840	61.00	1472	1.5 x	2368	836	(1,532)
MIKE	11.375	11/16	5.2 x	8.1 x	25.00	4776	61.00	1472	2.8 x	3304	1,544	(1,760)
NMG	9.000	10/15	2.8 x	4.0 x	45.00	2037	71.00	1096	1.1 x	941	657	(284)
NMG	10.375	10/15	2.8 x	4.8 x	48.00	2547	71.00	1096	2.0 x	1451	1,060	(390)
RCII	7.500	5/10	1.9 x	2.6 x	96.00	919	90.00	560	0.7 x	359	381	22
SBH	9.250	11/14	3.3 x	4.6 x	96.00	768	85.00	971	1.3 x	-203	737	940
SBH	10.500	11/16	3.3 x	5.4 x	90.00	985	85.00	971	2.1 x	14	1,146	1,132
TOY	7.375	10/18	4.3 x	5.6 x	35.00	2335	51.00	2719	1.3 x	-384	778	1,162
YCC	8.500	2/15	3.6 x	5.3 x	55.25	1993	56.00	1595	1.7 x	398	997	600
YCC	9.750	2/17	3.6 x	6.4 x	49.00	2199	56.00	1595	2.8 x	604	1,516	912
Average - senior notes and loans									1.4 x	810		
Average - sub notes and loans									2.5 x	1365		
Incremental spread/turn of leverage – senior									C	576		
Incremental spread/turn of leverage – sub									D	542		

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

HY Retail: this month's news

This month, we saw some refinancing action in retail that is somewhat encouraging (although expensive).

- Rite Aid refinanced its Accounts Receivable facility, replacing the \$650 million facility with a new \$450 million facility and a second lien (on the same receivables) facility that was sold to HY investors. We have not seen full documentation, but hear that the second lien was upsized to \$225 million from \$200 million and that the pricing was reduced from original talk of L+1,400 to L+1,200.
- Nebraska Book extended and downsized its revolver, and received a \$10 million equity infusion from its sponsor. The revolver was downsized from

\$85 million to \$65 million, and extended to May 2010. Covenants were amended and the rate was upped to L+600 from L+225.

In early February, we heard from a number of apparel and retail companies at our annual HY & Leveraged Finance Conference. Here are the key take-aways from the event. Please see our detailed note for bullet point highlights from each presentation. (6 February 2009: HY Conf Food, Consumer, Retail trends - Caution & Cash are king [Click here for pdf](#))

- Caution was the recurring theme coming from the food, consumer product, and retail presentations at the JPMorgan HY conference in Miami this week. Here are our top take-aways; we provide bullets for each presentation alphabetically on the pages that follow.
- Even the somewhat “defensive” food and consumer businesses seem to be managing cautiously, given the current economic environment: Chattem, Constellation (N), Del Monte (OW), and SuperValu all talk of cutting costs, consolidating manufacturing or operations were possible. For these businesses, we believe the biggest consumer risk is the trade-down risk, particularly where there is private label competition or a widening gap between brands and private label or lower-tier brands.
- We heard from a subset of retailers that are nicely recession resistant: NBTY (N), Nebraska Book (OW), Rent-A-Center (N), and even Blockbuster (OW). Even these retailers have a heightened focus on managing cautiously and cutting costs.
- Management understands the importance of a clean balance sheet, and contrary to past years, we heard a number of teams discuss their financing plans for maturities that were more than a year to 18 months in the future. Nebraska Book closed a bank extension the day the conference began; Blockbuster said it is going through its options to refinance its bank line this year. Constellation said it has cash and revolver availability to take out its '09 maturity. Duane Reade (N), SuperValu, and Tyson all commented on maturities through 2010, without giving specifics of how they expected to meet them.
- Apparel and apparel retailers still seem to be searching for the bottom in the consumer environment. Apparel companies – Hanesbrands, Perry Ellis, Phillips-Van Heusen (OW), Warnaco (OW) – seem to be managing inventories and receivables carefully, and are not yet tightening terms on retailers even though they admit that we may see further retail bankruptcies this year. Neiman Marcus (N) is still reducing inventory purchases to bring inventory in line with weaker sales.
- Yankee Candle (N) had the biggest positive news, announced at the conference, that it is adding 600 Target doors this year, with the prospect of rolling out to additional stores if this goes well.

Also in Miami, we hosted store tours:

- Saks Fifth Avenue at Bal Harbour had very little clearance merchandise, but was fully stocked with spring merchandise. The store was not all that busy (Monday evening). We worry that spring arrivals (which just keep coming) are not moving as fast as planned, and may be marked down soon. The store is up year over year, and is driving traffic from tourists (from new regions, less Europe, more Latin America and Russia), as well as partnering with hotels in the area for events. Store management has seen average price points come down in areas like handbags and shoes, with designers catering more to a cash-strapped consumer with new lower-price point items. The new customer management software is also helping connect directly with customers about new items in store, etc.
- Neiman Marcus in Coral Gables is a beautiful store, filled with mostly new spring merchandise, but still some winter clearance. The store continues to focus on adding space for key designers or lines (the new Fendi store within the store was beautiful). Store management said that it has not seen any major change in price points (i.e. are people buying cheaper bags?). Management was excited about the new "perks" program, but it is too early to say whether it is benefiting sales. Similar to Saks, both are trying to manage the tough environment by reaching out to customers with more personalized events and services.

The discount-focused Dolphin Mall stores we visited on Wednesday afternoon were considerably busier than Bal Harbour (Monday night) and Merrick Park (Tuesday night).

- Burlington Coat Factory (N) store looked better this year than last, particularly the back room. Inventory management seems to have improved markedly over the year. Store and regional managers talked about initiatives to continue improve product mix, merchandising, and cost cutting efforts. The biggest take away was that they think store labor can be cut from 11% of sales to industry norms in the 3-5% of sale range and are starting to work toward that.
- Quiksilver (OW) store management said that they have been told by senior management of their company that the company is NOT FOR SALE. We still question whether a brand (like DC Shoes) may be for sale.
- Saks Off Fifth looked better than last year, and had a good mix of Saks Fifth Avenue goods (25-30%), as well as direct from vendor goods (70-75%, as opposed to Neiman Marcus, which seems to source more goods from its stores). Neither store seemed over-inventoried, which was our fear given how weak sales have been in December and January.

January same-store sales review

In January, same store sales outperformed expectations at the investment grade level, while comps at the high-yield level underperformed consensus. WMT continued to lead to pack with the only positive comp during the month. Other standouts were Macy's, Limited Brands, and Nordstrom. Both Costco and Target announced that the

current fourth quarter (fiscal 2Q for Costco) eps will come in below the current street consensus.

Table 9: January SSS Summary

Company	Guidance	Street	Actual	Delta (bps)	Mgmt Dec. Comp View
Bon-Ton		(10.0%)	(8.2%)	180bp	
Costco		(3.7%)	(2.0%)	170bp	
Dillard's		(6.7%)	(12.0%)	(530bp)	
The Gap		(15.0%)	(23.0%)	(800bp)	
JCPenney	Low double digit decline	(12.1%)	(16.4%)	(430bp)	Mid teen decline
Kohl's	Mid-high teen decline	(15.5%)	(13.4%)	210bp	
Macy's		(7.4%)	(4.5%)	290bp	
Nordstrom		(14.5%)	(11.4%)	310bp	
Limited Brands	Mid-high teen decline	(16.1%)	(9.0%)	710bp	Mid-teen decline
Neiman Marcus		(20.0%)	(24.4%)	(440bp)	
Saks		(18.3%)	(23.7%)	(540bp)	
Target	Wide range around mid single digit decline	(5.2%)	(3.3%)	190bp	Wide range around mid single digit decline
Wal-Mart	flat to up 2%	1.2%	2.1%	110bp	

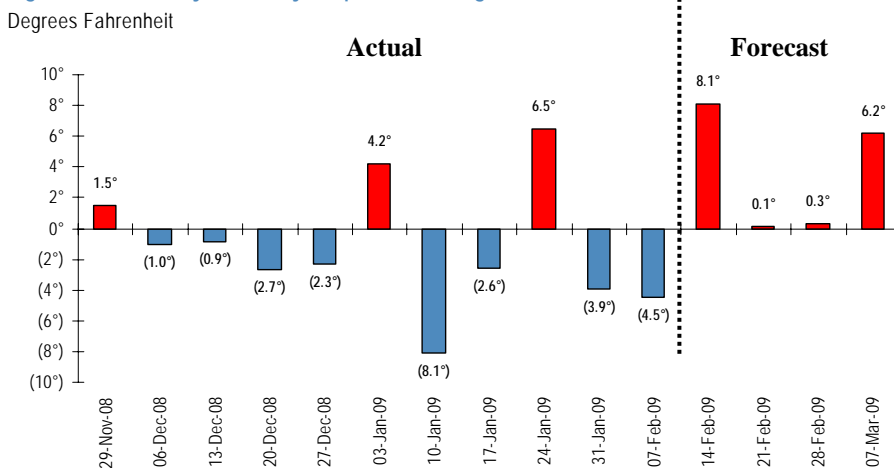
Source: Company reports.

Table 10: Monthly comp detail

	Product		Geographical Location	
	Strong	Weak	Strong	Weak
BONT	Men's sportswear, children's, outerwear, intimate apparel and accessories, especially cold-weather related merchandise	Furniture and ladies' apparel	n/a	n/a
COST	Fruit, sundries, fresh foods, toys, sporting goods, tvs, food court	Hardlines, softlines, hardware, garden, housewares, domestics, home, jewelry	Canada, Japan, UK, Taiwan	California
DDS	Shoes, men's apparel and accessories	Ladies' apparel and accessories and juniors' and children's apparel	Central	Eastern and Western
JCP	New brands, clearance items	Fine jewelry	internet, some home categories	Northwest
JWN	Women's apparel, juniors apparel, cosmetics	n/a	South, Mid-Atlantic, Northwest	n/a
KSS	Home	Women's	Southwest	n/a
NMG	Women's apparel and men's furnishings in Neiman Marcus Direct	All geographies and merchandise categories in Specialty Retail Stores	n/a	n/a
SKS	Eveningwear, cosmetics, fragrances, and men's shoes	Women's apparel, men's apparel and accessories, outerwear, fashion jewelry, women's shoes and handbags	n/a	n/a
TGT	Food, healthcare, electronics	Apparel, home, holiday, decorative home, entertainment	Upper Midwest, Northern CA	GA, FL, AZ, NV, Southern CA
WMT	Flat panel tvs, baking, cooking, cold weather, automotive, optical	Home, entertainment, hardlines	West, Northeast	South, Midwest
Sam's Club	Food, consumables, baby care, pet food	Furniture, office supplies	n/a	n/a

Source: Company reports and J.P. Morgan Equity Research.

Figure 3: Year-over-year weekly temperature change



Source: Weather Trends International

Discounters

Costco (COST) reported January same-store sales of down 2%, ahead of consensus estimates of down 3.7%. COST's January comp was negatively impacted by falling gasoline prices and a stronger US dollar, which contributed to 350bp and 400bp of comp erosion, respectively. The company noted that California trended down a bit, but excluding gasoline, the comp for the month was positive. The major bright spot in the month was the company's traffic, which was up over 4% compared to last year. Internationally, Canada was the strongest performer, with Japan, U.K., and Taiwan also performing well. In terms of merchandise categories, foods and sundries products (food, frozen, cooler, and deli) range in the mid to high single digits (ex-fx impact). The company's non-foods business (hardlines and softlines) was down in the mid single digit for the month. COST also gave earnings guidance for its upcoming fiscal 2Q earnings, and noted that it anticipates eps to come in significantly below the current consensus estimate of \$0.70 per share.

Target's (TGT) same-store sales of negative 3.3% beat consensus of down 5.2%. TGT's comp was a bit ahead of the company's guidance for January same-store sales to be down mid-single digits. In the company's December sales release, the company noted that additional markdown activity during the quarter would likely weight on profitability. As a result, TGT noted that 4Q08 eps will likely come in below the current consensus estimate of \$0.86 per share. Similar to last month, the strongest categories were non-discretionary healthcare (high single digit pace) and food (low single digit growth), while the home assortment and apparel categories experienced high single digit declines. Women's apparel declined more than 20% for the month. The best performing region was the Midwest, while stores in Georgia, Florida, Arizona, Nevada, and portions of California lagged. The company indicated that its inventory remained in very good condition. TGT expects February SSS to come in within a wide range of a mid-single digit decline.

Wal-Mart (WMT) reported January same-store sales of +2.1%, which was ahead of street consensus of +1.2% and the company's guidance of flat to up 2%. Same-store sales at Wal-Mart Stores were up 2.1%, driven by higher traffic for the fourth straight month. Regional performance in January included stronger results in the West and Northeast regions and soft results in the Southeast and Midwest regions. Groceries and health and wellness continued to be the strongest business categories, with additional strength in the month coming from home, entertainment, and hardlines. Sam's Club January SSS grew 2.4%. Sales of food, consumables, and basics were the strongest performing categories during the month. Furniture, home-related products, and office supplies were the softest categories for the comp period. Lower fuel prices continue to hold back sales at Sam's. For the month, gasoline deflation lowered the company's comp sales by 3.9%. The company changed its monthly comp guidance policy to no longer provide these estimates. WMT did give 1Q09 SSS guidance, which it expects to be up between 1-3%.

Department stores

Bon-Ton (BONT) reported January same-store sales of -8.2%, beating the consensus estimate of -10.0%. Men's sportswear, children's, outerwear, intimate apparel and accessories, especially cold-weather related merchandise were the best performers. The weakest performing segments were furniture and ladies' apparel. BONT's inventories at the end of the month were down 13% on a comparable basis. The company reduced previously announced fiscal 2008 guidance for gross margin by 80 bps on account of increased promotional activity and resulting markdowns. The company ended December with excess borrowing capacity of \$269 million under its revolver, which is down from \$351 million a year ago, which we attribute to the company paying some vendors quicker to take advantage of discounts.

Dillard's (DDS) posted a same-store sales decline of 12% missing -6.7% consensus estimates. Sales were above company trends in the Eastern region, flat in Western region and below trends in the Central regions. The shoes and men's apparel and accessories categories outperformed while the ladies' apparel and accessories, juniors' and children's apparel, home and furniture underperformed.

JCPenney (JCP) same-store sales in January slid 16.4%, below consensus estimates of a 12.1% decline and below the company's guidance of a low double digit decline. Rather than giving a monthly sales call, JCP updated investors with an open Q&A conference call. As a result, specific details on the monthly comp breakdown were pretty opaque. The company did mention that while promotional activity during the quarter was extreme, it was able to manage its margins in such a way as to bring 4Q eps into the low end of its previous stated range of \$0.90-\$1.05 per share. The company gave an updated eps guidance for 4Q08 of \$0.90-\$0.93. JCP anticipates a mid-teen decrease in its February SSS results.

Kohl's (KSS) reported a January same-store sales decline of 13.4%, which was ahead of street consensus of a 15.5% decline. Kohl's CEO, Kevin Mansell, that sales for the month were negatively impacted by significantly lower seasonal clearance inventory levels. For the month, the Southwest region led the company, while the all of the company's other regions lagged. Home was the strongest performing category in the month, while women's trailed. The company's inventory

is down significantly and for the year, KSS anticipates its inventory to be down high single digits compared to 2008. Given its successful inventory management, KSS anticipates that its 4Q eps will come in ahead of the consensus estimate of \$0.99 per share.

Neiman Marcus (NMG) posted comps of -24.4%, worse than both SKS (down 18.3%) and JWN down 11.4%. Neiman's comp performance at the Specialty Retail Stores and Neiman Marcus Direct were down 25.8% and down 18.3%, respectively. Women's apparel and men's furnishings in Neiman Marcus Direct outperformed while all geographies and merchandise categories in the Specialty Retail store segment showed weakness. The company commented that gross margins would be significantly negatively impacted by increased promotional activity, and NMG expects to report a net loss for the second quarter. Neiman Marcus ended the second quarter with \$220 million in cash, and \$576 million of revolver availability. The company commented it was re-evaluating its capex plan for fiscal year 2009. We reduced our 2Q EBITDA target to ~\$25 million from the mid \$80 million range, on the sales and margin comments.

Nordstrom (JWN) reported same-store sales of down 11.4%, beating expectations of down 14.5%. Regionally, the South, Mid-Atlantic, and Northwest were the leaders. The company's strongest performing merchandise categories for the month were women's, juniors' apparel, and cosmetics. For 2008, JWN noted that preliminary SSS were down 9%.

Macy's reported a January same-store sales result of (4.5%), versus street consensus at (7.4%). The company continues to emphasize its inventory management, and for 2008, the company's inventory was 7.4% lower on a comparable store basis. The company expects to end the quarter with \$1.3 billion in cash and no borrowings on its \$2 billion revolver. M also guided to 4Q08 eps of \$1.20-\$1.22 per share, compared with its previous guidance of \$1.10-\$1.20 (excluding all asset impairments and one-time items).

Saks (SKS) same-store sales declined 23.7%, below consensus expectations of negative 18.3%. The strongest segments at Saks Fifth Avenue were eveningwear, cosmetics, fragrances, and men's shoes. The weakest segments were women's apparel, men's apparel and accessories, outerwear, fashion jewelry, women's shoes, and handbags. The company commented that it will report a significant decline in gross margins for the fourth quarter year-over-year due to large amount of markdowns as customers shift purchases from regular price to clearance priced merchandise. During its 3Q call, it said that the 4Q margin decline should be greater than the 3Q 640bps decline.

Specialty retail

Gap, Inc. (GPS) same-store sales were down 23% in January, well below street consensus at (15%). Gap North America same-store sales were down 18%, Banana Republic was down 22%, Old Navy declined 34%, and International was flat. Traffic was down 12% at Gap North America, down 12% at Banana Republic, and down 23% at Old Navy. Regionally, the West turned in the strongest performance while the Midwest had the weakest. Internationally, Europe outperformed Japan. While sales were down substantially, GPS managed inventory to drive margins that

were above last years levels. As a result, GPS increased its 4Q eps guidance to \$1.32-\$1.33, from its previous guidance of \$1.27-\$1.30.

Limited Brands (LTD) reported same-store sales of down 9% for January, ahead of street consensus of down 16.1% and better than the company's previous guidance for a mid to high teen decline. By division, Victoria's Secret was down 15%, Bath and Body Works (BBW) declined 9%, and La Senza was flat. Merchandise margins for the entire company were down for the month when compared to 2008. On a segment basis, margins were down significantly at Victoria's Secret, La Senza, and Bath and Body Works due to higher mark-down activity. Total combined inventories of Victoria's Secret, BBW, and La Senza were down 8% compared to last year on a per square-foot basis at cost. LTD expects February SSS to decline in the mid teen range.

Rite-Aid (RAD) posted January same-store sales of up 1.0% versus +0.6% consensus. Front-end sales were down 0.1% and pharmacy sales were up 1.5%. RAD sss excluding the acquired stores were up 2.1% with front-end up 0.1% and pharmacy up 3.1%. For comparison sake, Walgreen's January same-store sales came at +0.4%.

Table 11: Same store sales historical summary

	Jan-09		Dec-08		Nov-08		Jan-08	
	Total Sales	Comps	Total Sales	Comps	Total Sales	Comps	Total Sales	Comps
Costco Companies, Inc.	0.0%	(2.0%)	(2.0%)	(4.0%)	(3.0%)	(5.0%)	11.0%	7.0%
Target Corp. - Total	0.8%	(3.3%)	0.2%	(4.1%)	(6.1%)	(10.4%)	(16.1%)	(1.1%)
Wal-Mart - Total	1.8%	2.1%	0.1%	1.7%	1.6%	3.4%	7.9%	0.5%
Wal-Mart Stores		2.1%		1.9%		3.4%	3.5%	0.2%
Sam's Club		2.4%		0.1%		3.5%	6.0%	2.1%
Bon-Ton	(8.3%)	(8.2%)	(5.6%)	(5.8%)	(15.5%)	(16.0%)	(22.0%)	(1.3%)
Dillard's	(13.0%)	(12.0%)	(6.0%)	(5.0%)	(10.0%)	(9.0%)	(12.0%)	(12.0%)
Macy's Group	(4.7%)	(4.5%)	(4.7%)	(4.0%)	(14.1%)	(13.3%)	(28.4%)	(7.1%)
Nordstrom	(3.7%)	(11.4%)	(8.0%)	(10.6%)	(12.1%)	(15.9%)	(20.3%)	(6.6%)
Saks Incorporated	(22.7%)	(23.7%)	(18.9%)	(19.8%)	(4.2%)	(5.2%)	4.1%	4.1%
J.C. Penney - Total	(15.5%)	(16.4%)	(6.8%)	(8.1%)	(11.5%)	(11.9%)	2.0%	
J.C. Penney Stores							1.7%	(1.9%)
Catalog							3.6%	
Kohl's	(9.0%)	(13.4%)	3.6%	(1.4%)	(13.7%)	(17.5%)	(20.4%)	(8.3%)
The Gap	(19.0%)	(23.0%)	(12.0%)	(14.0%)	(10.0%)	(10.0%)	(21.7%)	(2.0%)
Gap		(18.0%)		(12.0%)		(11.0%)		(4.0%)
Old Navy		(22.0%)		(16.0%)		(9.0%)		(3.0%)
Banana Republic		(34.0%)		(15.0%)		(11.0%)		5.0%
International		0.0%		(5.0%)		(6.0%)		(5.0%)
Limited Brands	(5.5%)	(9.0%)	(5.7%)	(10.0%)	(12.0%)	(12.0%)	(41.0%)	(8.0%)
Victoria's Secret - Stores		(15.0%)		(9.0%)		(9.0%)		(8.0%)
Bath and Body Works		(9.0%)		(10.0%)		(16.0%)		(10.0%)
La Senza		0.0%		(11.0%)		(12.0%)		6.0%
Neiman Marcus	(23.1%)	(24.4%)	(26.4%)	(27.5%)	(10.2%)	(11.9%)	5.6%	3.3%
TJX Companies	(6.0%)	(4.0%)	(3.0%)	0.0%	(9.0%)	(6.0%)	7.0%	3.0%

Source: Company data.

High-grade retail spread performance and relative value

Table 16: High-grade retail issuers' intermediate-term notes

Ranked by spread over Treasury within sub sector grouping

Issuer	Ticker	Rating/Outlook	Maturity	Coupon	Amount (\$ mn)	12-Feb-09 SOT ¹	1wk	1m	Change ytd	1yr
Discounters										
Wal-Mart	WMT	Aa2/AA-/S/S	04/05/17	5.38%	\$1,000	159	(55)	(22)	(48)	34
Target	TGT	A2/A+/-S/S	05/01/17	5.38%	\$1,000	332	70	(16)	(63)	150
Specialty Retailers										
Lowe's	LOW	A1/A+/-S/S	10/15/16	5.40%	\$550	350	(6)	(8)	(33)	156
Home Depot	HD	Baa1/BBB+/-S/S	03/15/16	5.40%	\$3,000	615	0	0	0	363
AutoZone	AZO	Baa2/BBB-/S/S	11/15/15	5.50%	\$300	880	0	0	0	680
Limited Brands	LTD	Ba1/BB+/-S/S	07/15/17	6.90%	\$700	1051	30	(28)	(220)	665
Jones Apparel	JNY	Ba3/BB-/-S/N	11/15/14	5.13%	\$250	1535	NA	99	393	1106
Food/Drug Retail										
Kroger	KR	Baa2/BBB-/-S/P	08/15/17	6.40%	\$600	312	(30)	(62)	(94)	105
Safeway	SWY	Baa2/BBB-/S/S	08/15/17	6.35%	\$500	315	(19)	(80)	(80)	127
Delhaize	DELB BB	Baa3/BBB-/-S/S	06/15/17	6.50%	\$450	433	(0)	(149)	(149)	199
CVS	CVS	Baa2/BBB+/-P/S	08/15/16	6.13%	\$700	478	0	0	0	293
Restaurants										
McDonald's	MCD	A3/A-/S/S	03/15/17	5.30%	\$400	196	(15)	(24)	(64)	66
YUM! Brands	YUM	Baa3/BBB-/-S/S	04/15/16	6.25%	\$300	499	(28)	(46)	(50)	275
Department Stores										
Kohl's	KSS	Baa1/BBB+/-S/S	12/15/17	6.20%	\$650	466	(144)	(81)	(230)	201
JCPenney	JCP	Baa3/BBB-/-S/N	02/15/18	5.75%	\$300	851	551	9	(88)	550
Macy's Group	M	Baa3/BBB-/-N/N	12/01/16	5.97%	\$1,100	1171	38	29	(21)	792

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

Table 17: High-grade retail issuers' long-term notes

Ranked by spread over Treasury within sub sector grouping

Issuer	Ticker	Rating/Outlook	Maturity	Coupon	Amount (\$ mn)	12-Feb-09 SOT ¹	1wk	1m	Change ytd	1yr
Discounters										
Wal-Mart	WMT	Aa2/AA-/S/S	09/01/35	5.25%	\$2,500	258	0	0	0	86
Target	TGT	A2/A+/-S/S	11/01/32	6.35%	\$600	495	0	0	0	269
Specialty Retailers										
Home Depot	HD	Baa1/BBB+/-S/S	12/15/36	5.88%	\$3,000	461	10	2	(47)	165
Lowe's	LOW	A1/A+/-S/S	10/15/35	5.50%	\$500	473	0	0	0	244
Limited Brands	LTD	Ba1/BB+/-S/S	07/15/37	7.60%	\$300	762	(195)	(290)	(582)	344
Jones Apparel	JNY	Ba3/BB-/-S/N	11/15/34	6.13%	\$250	1057	0	0	0	0
Food/Drug Retail										
Safeway	SWY	Baa2/BBB-/S/S	02/01/31	7.25%	\$500	320	0	0	(25)	94
Kroger	KR	Baa2/BBB-/-S/P	04/01/31	7.50%	\$600	345	0	0	(15)	119
Delhaize	DELB BB	Baa3/BBB-/-S/S	04/15/31	9.00%	\$900	410	0	(205)	(205)	105
Department Stores										
Kohl's	KSS	Baa1/BBB+/-S/S	12/15/37	6.88%	\$350	599	(30)	(26)	(119)	284
JCPenney	JCP	Baa3/BBB-/-S/N	10/15/36	6.38%	\$700	699	(7)	(25)	(99)	389
Macy's Group	M	Baa3/BBB-/-N/N	03/15/37	6.38%	\$500	812	3	(76)	(68)	430

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

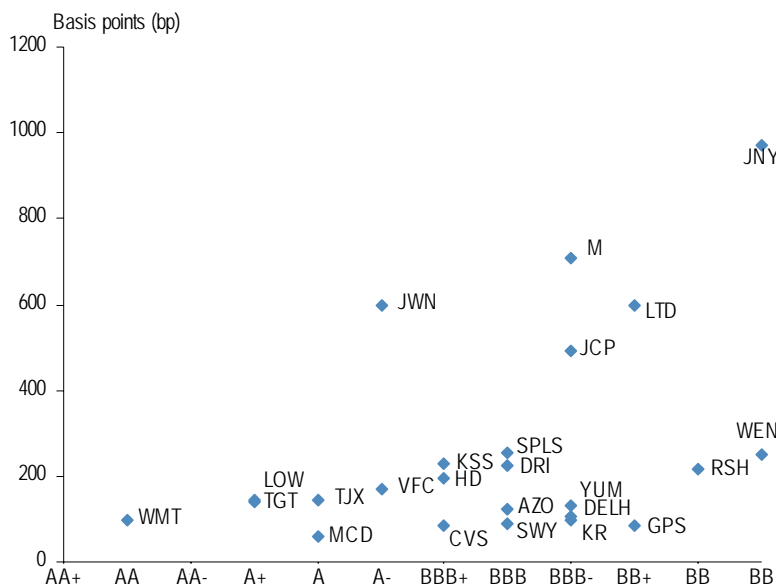
Table 18: High-grade retail 5-year credit default swap levels

Ranked by 5-year CDS level within subsector grouping

Issuer	Ticker	Rating/Outlook	12-Feb-09 5-yr CDS	1wk	1m	Change ytd	1yr
Discounters							
Wal-Mart	WMT	Aa2/AA;S/S	97	(8)	2	(8)	52
Target	TGT	A2/A+;S/S	145	(5)	(35)	(95)	35
Specialty Retailers							
Gap Inc	GPS	WR/BB+;S/S	85	(5)	(10)	(20)	(30)
AutoZone	AZO	Baa2/BBB;S/S	125	10	4	(15)	10
Lowe's	LOW	A1/A+;S/S	140	(0)	15	(0)	35
RadioShack	RSH	Ba1/BB;S/S	215	2	21	5	(95)
Home Depot	HD	Baa1/BBB+;S/S	195	(16)	(33)	(53)	20
Staples	SPLS	Baa2/BBB;S/S	255	(28)	(100)	(131)	165
Limited Brands	LTD	Ba1/BB+;S/S	600	(3)	51	65	259
Jones Apparel	JNY	Ba3/BB-;S/N	970	12	159	159	549
Food/Drug Retail							
Kroger	KR	Baa2/BBB-;S/P	98	7	7	3	16
Safeway	SWY	Baa2/BBB;S/S	88	(8)	(8)	(13)	4
CVS	CVS	Baa2/BBB+;P/S	85	(5)	(15)	(20)	31
Restaurants							
McDonald's	MCD	A3/A;S/S	58	3	(2)	(7)	23
YUM! Brands	YUM	Baa3/BBB-;S/S	105	(11)	(26)	(65)	(5)
Darden Restaurants	DRI	Baa3/BBB;S/S	225	(38)	(30)	(58)	30
Wendy's	WEN	Ba3/BB-;URD/CWN	250	(12)	(53)	(103)	0
Department Stores							
Kohl's	KSS	Baa1/BBB+;S/S	230	(21)	(57)	(50)	80
Nordstrom	JWN	Baa1/A-;N/N	600	(59)	16	80	485
JCPenney	JCP	Baa3/BBB-;S/N	490	(39)	(18)	(14)	248
Macy's Group	M	Baa3/BBB-;N/N	710	6	28	32	455

Source: J.P. Morgan.

Figure 4: 5 year high-grade CDS relative value



Source: J.P. Morgan.

Year to date, the Food/Drug Retail outperformed the JPMorgan US Liquid Index (JULI) by 30bp while the Non-Food Retail sector underperformed the broader index by 8bp. The JULI tightened 54bp to a 479 I-spread (treasury). Over the past month, the Food/Drug Retail outperformed the JULI Index by 30bp while the Non-Food Retail sector underperformed the JULI by 10bp.

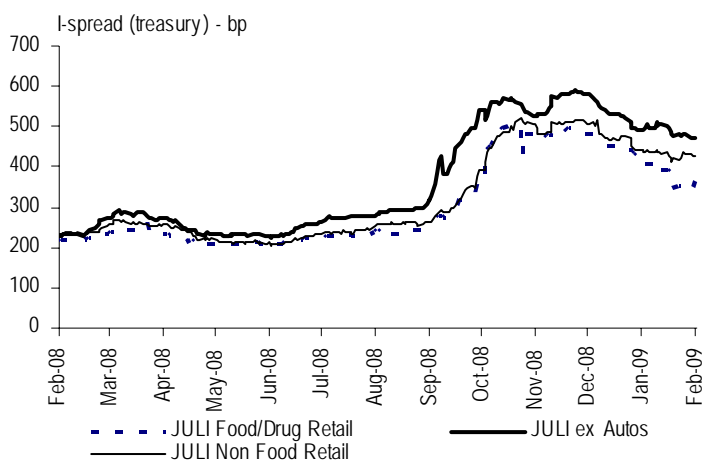
Table 19: JULI sector performance

I-spread (treasury, bp)

Industry	13-Feb-09	31-Dec-08	12-Jan-08	12-Feb-09	Spread Change		
					1m	ytd	1yr
Electronics/Electrical	194	305	298	225	(73)	(79)	31
Aerospace/Def	162	332	303	292	(11)	(40)	130
Health/Pharm	185	368	339	296	(43)	(72)	110
Cons Prods	171	366	340	328	(12)	(38)	157
Eng/Machinery	156	407	348	336	(12)	(71)	180
Beverages	156	374	362	345	(17)	(28)	189
Food/Drug Retail	216	445	411	360	(51)	(84)	144
Utilities	204	497	468	368	(100)	(129)	164
Capital Goods	165	399	360	372	12	(27)	207
Railway & Freight Svc	211	433	401	375	(26)	(57)	164
Consumer Noncyclicals	200	447	414	388	(26)	(58)	188
Chemicals	184	391	382	394	12	3	210
Food Products	210	450	424	403	(21)	(46)	193
Divers Indus	169	427	391	426	36	(1)	257
NonFood Retail	232	475	440	429	(11)	(46)	196
Telecoms	248	513	467	434	(33)	(79)	186
Energy	216	547	545	457	(88)	(90)	241
Technology	200	455	455	458	3	3	258
Banks	213	435	420	469	49	33	256
Tobacco	90	548	477	470	(6)	(78)	381
JULI Index	230	528	494	473	(21)	(54)	244
Media/Ent	267	597	564	531	(33)	(66)	264
Fin Svcs	254	625	577	585	7	(40)	331
Insurance	226	681	615	615	(0)	(66)	389
Metals/Mining	246	739	698	662	(36)	(77)	416
Auto Mfrs	200	947	758	710	(49)	(238)	510

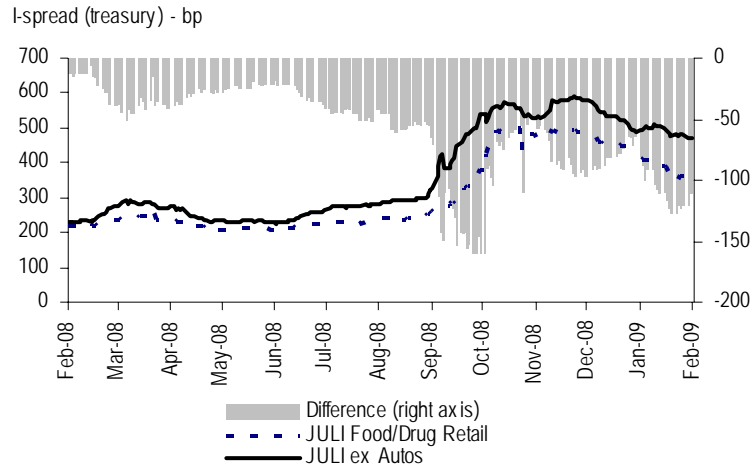
Source: J.P. Morgan.

Figure 5: JULI Retail sub sectors



Source: J.P. Morgan.

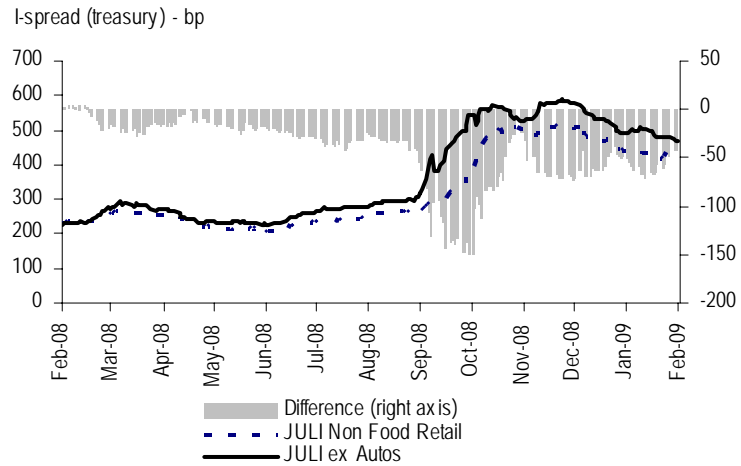
Figure 6: JULI food and drug retail sub sector



Source: J.P. Morgan.

: J.P. Morgan.

Figure 7: JULI non-food retail sub sector



Source: J.P. Morgan.

High-yield retail spread performance and relative value

One-month spread performance (through February 12)

- The best performing bonds were the NTY 7.125% notes, which tightened 134bps this month.
- The worst performing bonds this month were the BONT 10.25% notes, which widened 2615bps over the month, although from already very low levels (bonds went from mid teens to 11).
- CDS widened for all retailers with RAD widening the most (2226bps) over the month, pushed out by the new second lien AR facility, which came at L+1,200, re-pricing the rest of the structure.

Table 21: HY retail bond performance

Issuer	Ticker	Rating	Maturity	Coupon	Amount (\$MN)	02/12/09 SOT	change 1wk	1m	ytd	1yr
Department Stores										
	DDS	B2/B+	01/15/18	6.63%	\$100	2276	136	250	(1)	1622
	SKS	B2/B	10/01/11	9.88%	\$142	2464	281	804	481	1776
	NMG	B2/B+	10/15/15	10.38%	\$700	2619	(72)	226	(291)	1833
	BONT	Caa1/CCC	03/15/14	10.25%	\$510	9869	1428	2615	450	8158
Drugstores										
	DRD	Caa1/CCC+	08/01/11	9.75%	\$210	3919	28	80	(85)	2565
	RAD	Caa1/B-	08/15/13	6.88%	\$500	5137	(56)	293	811	3668
Specialty										
	GME	Ba1/BB+	10/01/12	8.00%	\$580	669	1	(95)	(238)	237
	NTY	B1/BB	10/01/15	7.13%	\$200	983	15	(134)	(227)	455
	EYCA	B2/B-	02/15/15	10.75%	\$152	1049	14	33	27	389
	RCII	B2/B+	05/01/10	7.50%	\$300	1187	73	(108)	(200)	158
	DLRAMA	B2/B-	08/15/12	8.88%	\$200	1466	13	(114)	(285)	693
	BBI	Caa2/CCC	09/01/12	9.00%	\$300	3046	(110)	(82)	(334)	1787
	NEBRK	Caa1/CCC	03/15/12	8.63%	\$175	3511	238	(35)	(477)	2757
	TOY	Caa1/CCC+	08/01/11	7.63%	\$500	4902	38	825	811	3491

Source: J.P. Morgan.

Table 22: HY retail CDS performance

Issuer	Ticker	Rating	02/12/09 5yr CDS	change 1wk	1m	ytd	1yr
Department Stores							
	DDS	B2/B+	1347	(60)	96	(243)	647
	NMG	B2/B+	1481	54	200	224	961
	SKS	B2/B	1847	63	497	215	1304
Drugstores							
	RAD	Caa1/B-	5316	(467)	2226	(1)	3812
Specialty							
	TOY	Caa1/CCC+	2715	(5)	547	406	1497

Source: J.P. Morgan.

Year to date, the retail index tightened 188bps and Food & Drug tightened 178bps, while the JPMorgan HY Index tightened 141bps.

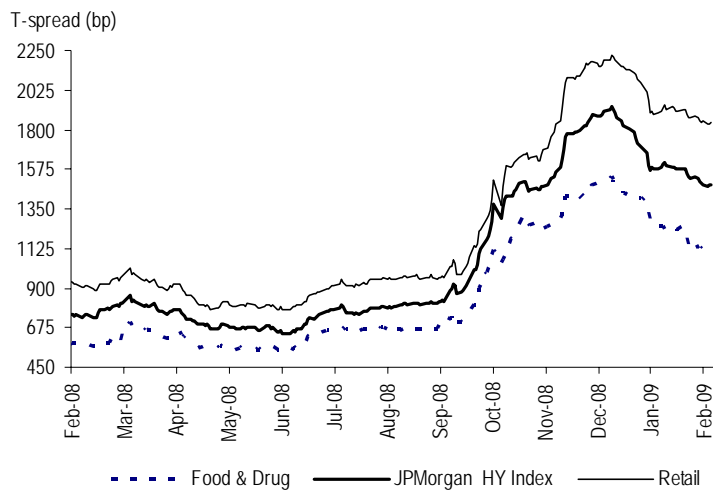
Over the past month, retail tightened 248bps, 11bps more than the overall index. The Food and Drug index tightened 310bp, 73bp more than the overall index.

Table 23: HY industry spreads

Industry	13-Feb-08	31-Dec-08	13-Jan-09	12-Feb-09	Spread Change		
					1m	ytd	1yr
Utility	479	1025	915	823	(92)	(201)	345
Healthcare	646	1208	1100	958	(142)	(250)	312
Wireline Telecommunications	617	1283	1111	968	(143)	(315)	351
Metals/Minerals	567	1313	1204	1068	(137)	(246)	500
Food & Drug	590	1424	1245	1114	(131)	(310)	524
Wireless Telecommunications	704	1219	1320	1172	(148)	(47)	468
Energy	570	1511	1317	1180	(137)	(331)	610
Aerospace	489	1272	1187	1186	(1)	(87)	697
Food/Tobacco	744	1589	1393	1229	(164)	(360)	485
Manufacturing	757	1478	1322	1339	17	(139)	582
JPMorgan HY Index	747	1725	1584	1487	(96)	(237)	741
Cable/Wireless Video	864	1780	1662	1508	(154)	(273)	644
Forest Prod/Containers	871	1725	1653	1540	(113)	(185)	669
Consumer Products	876	1991	1842	1641	(201)	(350)	765
Chemicals	635	1909	1785	1669	(117)	(240)	1033
Service	836	1894	1746	1683	(63)	(211)	847
Housing	1076	2074	1893	1805	(88)	(269)	730
Retail	929	2089	1902	1841	(61)	(248)	912
Financial	878	2086	1965	1874	(90)	(212)	996
Information Technology	687	2018	1880	1883	3	(135)	1196
Diversified Media	1136	2843	2577	2367	(210)	(476)	1231
Gaming/Leisure	845	2390	2131	2396	264	5	1551
Transportation	810	2636	2590	2771	181	135	1961
Broadcasting	891	4169	3613	3843	230	(326)	2951

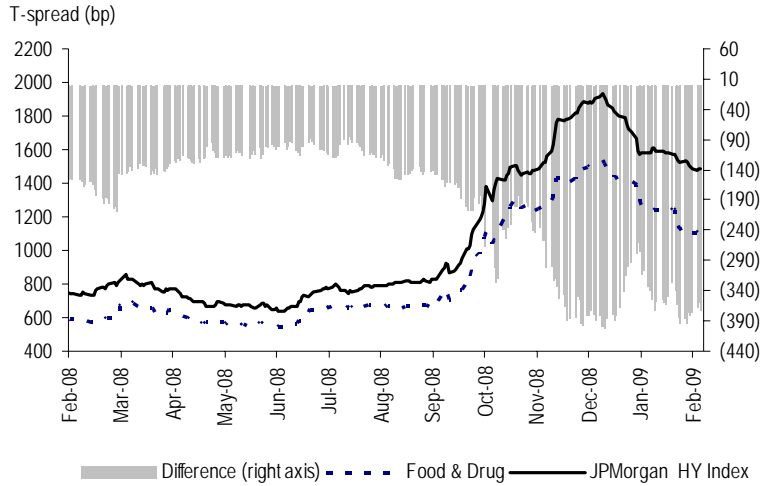
Source: J.P. Morgan.

Figure 13: High-yield retail sub sectors



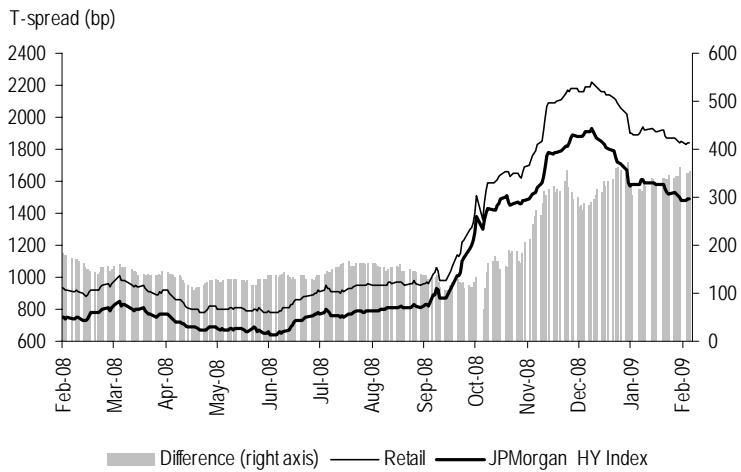
Source: J.P. Morgan.

Figure 14: High-yield food and drug sub sector



Source: J.P. Morgan.

Figure 15: High-yield retail sub sector



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