

Retail Geeks – Weekly Spin Cycle

November 28, 2011

Welcome to our second issue of the *Weekly Spin Cycle*. Each week, we'll deliver some news and commentary about the retail industry. Whether you're an industry insider, investor, or outside observer, the articles/commentary you read here are designed to enhance your understanding of the retail sector and the issues facing it.

In addition, we'll pay close attention to the "managerial spin" and will on occasion offer a contrarian view. You are encouraged to provide any feedback to info@RetailGeeks.com.

Hope Is Not a Strategy – BHAG at CHS Now a Pipedream

This week, **Chico's (CHS - \$10.11)** reported Q3 2011 earnings that fell well short of expectations. Three months ago, CHS management "hoped" that markdowns in 2H 2011 would be lower than LY. Investors that banked on that "hope" were burned.

On the quarterly conference call, CEO Dave Dyer essentially admitted that he made an aggressive inventory bet in 2H 2011. We're not used to management teams admitting failure, so his candor is appreciated.

Yet, before we give Mr. Dyer too much credit for accepting responsibility for his inventory bet, let's go back 9 months to the Q4 2010 conference call in February 2011.

In February 2011, CHS reported Q4 2010 EPS that fell two cents shy of consensus expectations (when excluding a beneficial tax rate boost). In addition, the company 'missed' its Q4 2010 GPM% guidance and announced bloated levels of inventory (with standard in-transit excuse).

But, here's where it gets interesting. At that time, Mr. Dyer decided to double-down on his previous pie in the sky \$1.00 EPS 'target' for FY 2011 by announcing a more ridiculous \$1.50 EPS 'target' for FY 2013.

On that day, Mr. Dyer successfully turned "lemons into lemonade." Clearly, Mr. Dyer knew the market would react negatively to an EPS 'miss' and, in our view, he came out on the February 2011 conference call with both guns blazing... glossing over Q4 2010's EPS/GPM% shortfall and introducing a FY 2013 EPS 'target' and a mid-teens EBIT margin goal.

Therefore, we're not overly impressed with Mr. Dyer's admission of a failed inventory bet this week. His BHAG of \$1.00 in FY 2011 appears to be out of reach for FY 2012 despite the 'bought' earnings (*Boston Proper* acquisition) and a large-scale share repurchases.

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PSS Management Performs Magic Trick – Inexplicably, EPS of \$0.13 Turns into \$0.61

Collective Brands (PSS - \$12.52) earned our respect last quarter when the new management issued a mea culpa and (finally) admitted that the company had ignored its core customer over the past few years.

Gone was the old CEO's foolish attempt to focus on an "expressive" customer. Instead, the remaining management team members appeared reinvigorated and excited that their strategic voice (of reason) could be heard. As analysts, we were excited that PSS management appeared to be entering a period of Glasnost and that the proverbial Berlin Wall had fallen.

So, just three months later, what does the new management team do? They try to convince folks that Q3 2011 non-GAAP EPS of \$0.13 (our estimate) equals \$0.61. The majority of the difference between reality (our \$0.13 estimate of a 'true' non-GAAP number) and \$0.61 appears to be related to a "catch-up" of the go forward tax rate in Q3 2011. The consensus EPS estimate going into the print was \$0.49.

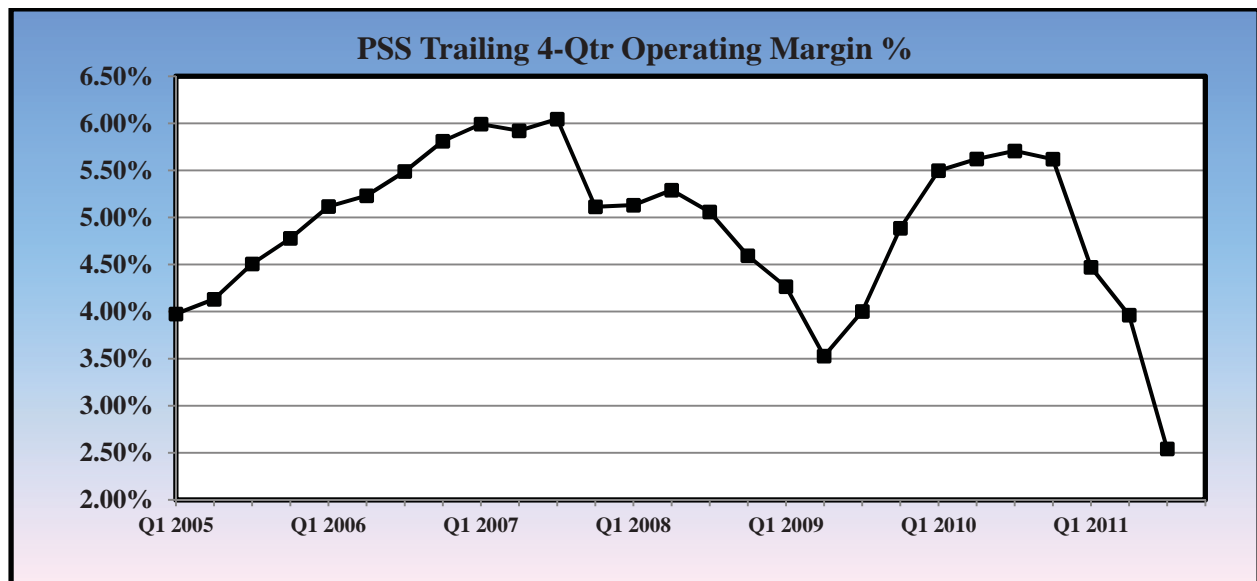
Let's ignore the non-GAAP EPS number and instead focus on non-disputable facts. The company's profitability has imploded this year. The core *Payless Domestic* division lost \$17.2 million (ex-items) over the trailing 4 quarters. The *PLG Retail* division lost \$3.3 million (ex-items) over the trailing 4 quarters. Not good.

Yet, despite positive comp sales at many of his peers, PSS CEO Michael Massey suggests that "we have seen signs that confirm we are on the right track." Uh, huh. Good luck with that.

Finally, on the quarterly earnings conference call, LuAnn Via, President/CEO of *Payless*, doubted that *Wal-Mart's* recent success with shoes "has had any impact on the *Payless* business."

Yes, it's wonderful that Ms. Via believes that *Payless* needs to focus on its core demographic and offer more "good" price points. But, her belief that *Wal-Mart* is having little impact on their business may be indicative that even more wholesale managerial changes are needed at PSS.

Check out the company's operating profitability implosion below:



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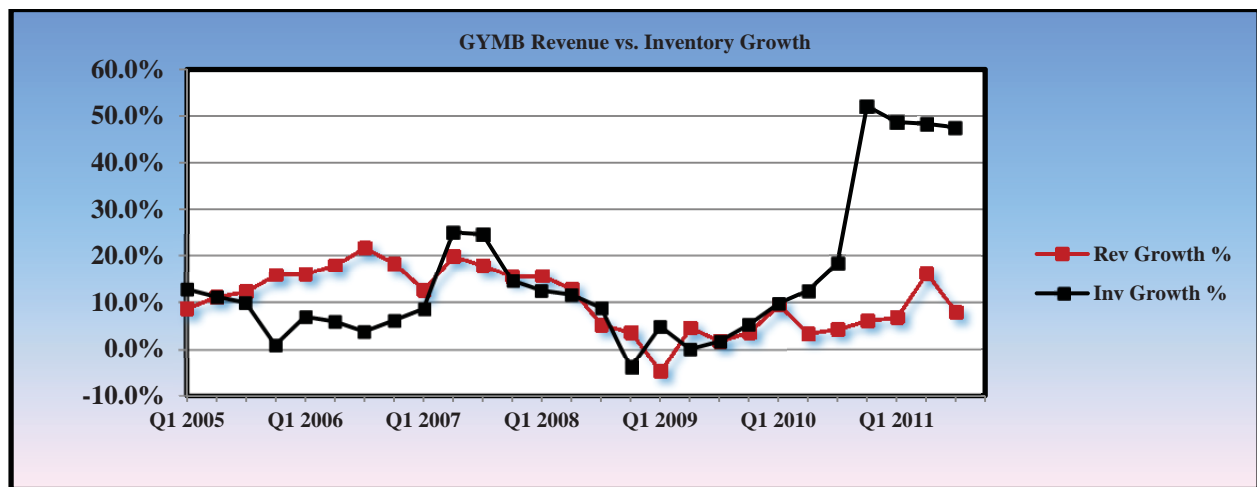
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Just When You Thought Gymboree's Inventory Situation Could Not Get Worse – Think Again

This week, **Gymboree (ex-GYMB)** reported its earnings for Q3 2011. Wow! Take a look at the company's bloated levels of inventory. It's still a major issue. Inventory growth has MATERIALLY exceeded sales growth in each of the past 6 fiscal quarters (see chart below).

What's hilarious is that management tried to blame "higher product costs" as the reason for the company's -530 Bps GPM% decline in Q3 2011 versus LY. Yep, that's it. Simply higher product costs. Nothing was said in the company's prepared remarks re: markdown levels and management (per conference call) feels "good about the overall mix of the inventory." Amazing.

We can't think of a more opportunistic sale of a retailer over the past decade. We're still of the belief that ex-GYMB management saw the ice cube to begin rapidly melting over a year ago prior to the sale to **Bain Capital**.



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