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**THE CASH FLOW GROWTH PROFILE™ AND THE RETAIL INDUSTRY:
SIGNS OF A SLOWING?**

EXECUTIVE SUMMARY

A slowing U.S. economy is impacting retail sales and hurting the retailers. The purpose of this study is to examine the extent to which problems seen at the macro level are hurting the retailers as a group and within four industry sub-groups, department stores (fashion), department stores (variety), warehouse stores and dollar stores. We look at the performance of 22 retailers using the Operating Growth Profile™ and Free Cash Growth Profile™, two metrics that are very useful in evaluating a firm's ability to generate cash flow as it grows.

While the Profile for the retail industry did improve each year between 2002 and 2006, a decline is noted in the twelve months ended with the third quarter of 2007. However, not all industries are declining. We noted modest improvements for the warehouse stores and dollar stores.

Data for this research was provided by Cash Flow Analytics, LLC, www.cashflowanalytics.com.
Charles Mulford is a principal in Cash Flow Analytics, LLC.

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Georgia Tech Financial Analysis Lab

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Because our Lab is housed within a university, all of our research reports have an educational quality, as they are designed to impart knowledge and understanding to those who read them. Our focus is on issues that we believe will be of interest to a large segment of stock market participants. Depending on the issue, we may focus our attention on individual companies, groups of companies, or on large segments of the market at large.

A recurring theme in our work is the identification of reporting practices that give investors a misleading signal, whether positive or negative, of corporate earning power. We define earning power as the ability to generate a sustainable stream of earnings that is backed by cash flow. Accordingly, our research may look into reporting practices that affect either earnings or cash flow, or both. At times, our research may look at stock prices generally, though from a fundamental and not technical point of view.

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Introduction

Slowing growth in U.S. consumer spending can be expected to have a direct effect on the retailers. A slow 2007 culminated with the weakest holiday sales period since 2002.¹ Such is not an environment in which to expect robust financial results. But retailers are not a homogenous lot. Upscale fashion retailers appeal to a different consumer group than the discounters, the warehouse outlets or the dollar stores. Each group could be affected differently by the changes observed at the macro level.

In this study we look at the retailers collectively and at selected sub-industry groups through the lens of the Cash Flow Growth Profile™. Our objective is to see the extent to which retail is being hurt by the slowing economy and whether some sub-industry groups are faring better than others.

The Cash Flow Growth Profile™ – A Definition

The Cash Flow Growth Profile™ measures the capacity of a firm to generate cash flow as it grows revenue. The metric is forward looking and reports the amount of incremental cash flow that can be expected for any measured amount of *growth* in revenue. In fact, next year's cash flow may be viewed as this year's amount plus the incremental cash flow effects of revenue growth applied to the Cash Flow Growth Profile™.

The Profile is reported as a percentage – a percentage of revenue. A firm with a positive Profile will produce increasing amounts of cash flow as it grows. A firm with a negative Profile will require other sources of cash to support growth. Obviously, for a profitable and growing company, a positive Profile is more appealing than a negative one. Though a Profile that is becoming progressively less negative indicates progress toward reaching positive cash flow.

Many financial analysts look for companies that are adept at growing revenue and earnings. Indeed, earnings growth is at the heart of many stock valuation models. However, earnings growth does not necessarily translate into cash flow growth. The Cash Flow Growth Profile™ is a measure of whether a firm can be expected to provide or consume cash as it grows.

Growth is often considered to be a cash drain. That is, while growth is desired, it is often viewed as something that needs to be financed. In this view, as growth increases, so does a company's need for capital. However, it is not necessarily the case that growth must be financed. In fact, a firm with a positive Cash Flow Growth Profile™ will actually generate increasing amounts of cash flow as growth accelerates.

There are two separate measures of a company's Cash Flow Growth Profile™, its Core Operating Growth Profile™ and its Free Cash Growth Profile™. The Core Operating Growth Profile™ measures the capacity of a firm to generate core operating cash flow as it grows. Core operating cash flow is cash flow provided by operations, but excludes non-core sources of cash flow, financing costs and taxes. A firm's core operating growth profile reflects a combination of its operating cushion (operating profit before non-cash depreciation and amortization) and operating working capital requirements, expressed as a percentage of revenue. It is measured as the operating cushion % (operating cushion to revenue) less operating working capital % (operating working capital to revenue). The metric reports the amount of core operating cash flow that can be expected for any measured amount of growth in revenue under the

¹ Source: Reuters.com, **WRAPUP 1-U.S. retailers post mostly gloomy December sales**, January 10, 2008.

assumption that a firm's current mix of operating cushion and operating working capital remains unchanged.

The Free Cash Growth ProfileTM measures the capacity of a firm to generate free cash flow as it grows. This metric incorporates taxes and capital expenditures into the calculations, two expenditures that are typically expected to grow with revenue. The free cash growth profile is measured as the core operating growth profile minus income taxes paid to revenue and minus capital expenditures to revenue. The metric measures the amount of free cash flow that can be expected for any measured amount of growth in revenue under the assumption that a firm's current mix of operating cushion, operating working capital, income taxes paid and capital expenditures, all as percentages of revenue, remain unchanged.²

The Cash Flow Growth ProfileTM and the Retail Industry

Because it measures a firm's ability to generate cash flow as it grows, the Cash Flow Growth ProfileTM and changes therein provides a valuable look into a firm's financial health. A positive and improving Profile indicates that a firm is not only generating cash as it grows, the firm's prospects are improving. A negative and declining profile indicates that a firm is consuming cash as it grows, but also that the firm's prospects are declining.

As an industry, there is ample reason to be concerned about the retailers. A slowdown in consumer spending, which comprises a significant portion of the U.S. economy, has hurt retail sales for several months. Slower sales growth can hurt margins which impacts directly the operating cushion. A slowing economy also slows receivable and inventory turns, increasing working capital requirements. All such factors impact the Core Operating Growth ProfileTM and lead to lower core operating cash flow. As business slows, firms may scale back store growth plans, reducing capital expenditures in an effort to help maintain free cash flow generation.

In this study we examine how the slowing economy is affecting retailers by examining changes over the past several years in their Core Operating Growth ProfileTM and Free Cash Growth ProfileTM. We look at retail collectively as a single industry and also examine carefully several retail industry sub-groups: department stores (fashion), department stores (variety), warehouse stores, and dollar stores. We provide industry medians for the Core Operating Growth ProfileTM and Free Cash Growth ProfileTM together with their component drivers for each of the four fiscal years ended 2003 through 2006 (typically, January 2004 through January 2007). We also provide results for the full year (twelve months) through the third quarter of 2007 and the third quarter of 2006. Understandably, in preparation for the holiday selling period, retailers are likely heavily invested in inventory as of the end of the third quarter of each year. Because it increases working capital requirements, such inventory needs will bias downward their Cash Flow Growth ProfileTM. However, we are still able to see a recent trend when results for the twelve months ended with the third quarter of 2007 are compared with similar results for 2006. Following the results for each industry median, we include individual company data for each firm included therein.

² Note that a company's core operating cash flow or free cash flow can be positive even when its core operating growth profile or free cash growth profile are negative. Core operating cash flow and free cash flow are measures of actual cash flow for the period just ended and reflect actual reported operating cushion, working capital changes, tax payments and capital expenditures. The Core Operating Growth ProfileTM and Free Cash Growth ProfileTM reflect the contribution to core operating cash flow and free cash flow for an incremental increase in revenue.

Retail (Overall)

In Table 1 below, we provide median results for the retail industry taken as a whole. The medians are calculated across the results for 22 firms taken from the four retail industry sub-groups.

Table 1. Cash Flow Growth Profile™ for Retail Industry (Overall)

Median Retail Industry	12 Mos Ending 3rd Qtr 2007	12 Mos Ending 3rd Qtr 2006	Fiscal Year 2006	Fiscal Year 2005	Fiscal Year 2004	Fiscal Year 2003
Gross margin (excl. deprec. and amort.) %	34.04%	34.99%	35.29%	34.99%	35.05%	34.06%
SG&A (excl. deprec. and amort.) %	26.93%	26.50%	26.68%	26.57%	26.28%	25.62%
Operating cushion %	7.11%	8.49%	8.61%	8.42%	8.77%	8.45%
Operating working capital to revenue %	9.29%	7.78%	7.41%	8.47%	9.95%	9.58%
Core operating growth profile™	-2.19%	0.71%	1.20%	-0.04%	-1.18%	-1.13%
Taxes paid %	1.32%	1.32%	1.21%	1.15%	0.94%	0.58%
Capital expenditures %	2.62%	2.57%	2.41%	2.69%	2.65%	2.68%
Free Cash Growth Profile™	-6.12%	-3.18%	-2.42%	-3.89%	-4.77%	-4.40%

In examining Table 1, we see that through fiscal 2006, the Free Cash Growth Profile™ for the retail industry, while negative, was improving. The median Free Cash Growth Profile™ was -2.42% in fiscal 2006, an improvement from -4.77% in fiscal 2004. However, in the twelve months ended with the third quarter of 2007, we see a worsening in the Free Cash Growth Profile™ for the retailers, as the metric declined to -6.12% in 2007 from -3.18% in 2006. Behind the decline was a worsening in operating cushion, caused primarily by a drop in gross margin, and an increase in operating working capital to revenue. Taxes paid and capital expenditures, both as a percent of revenue, remained relatively unchanged in 2007 from 2006.

Department Stores (Fashion)

In the department stores (fashion) industry sub-group, we include The Bon-Ton Stores, Inc., Dillard's, Inc., Gottschalks, Inc., Kohl's Corp., Macy's, Inc., J.C. Penney Co., Inc., Retail Ventures, Inc. and Saks, Inc. For this group of firms, the median Free Cash Growth Profile™ worsened to -9.20% during the twelve months ending with the third quarter of 2007 when compared with -5.26% in 2006. While the operating cushion actually improved slightly for the group to 7.83% in the twelve months ended with the third quarter of 2007 from 2006, a significant increase in operating working capital to revenue, led to a drop in the Core Operating Growth Profile™. Also contributing to a decline in the Free Cash Growth Profile™ was an increase in income taxes paid and capital expenditures, both as a percent of revenue.

Table 2. Cash Flow Growth Profile™ for Department Stores (Fashion)

Median Department Stores (Fashion)	12 Mos Ending 3rd Qtr 2007	12 Mos Ending 3rd Qtr 2006	Fiscal Year 2006	Fiscal Year 2005	Fiscal Year 2004	Fiscal Year 2003
Gross margin (excl. deprec. and amort.) %	37.23%	37.45%	38.72%	37.79%	38.84%	38.65%
SG&A (excl. deprec. and amort.) %	29.40%	30.00%	29.52%	30.74%	30.87%	30.42%
Operating cushion %	7.83%	7.45%	9.20%	7.04%	7.97%	8.22%
Operating working capital to revenue %	12.12%	8.90%	9.61%	10.78%	12.45%	16.67%
Core operating growth profile™	-4.30%	-1.45%	-0.41%	-3.74%	-4.48%	-8.45%
Taxes paid %	1.39%	0.92%	1.39%	1.02%	0.72%	0.09%
Capital expenditures %	3.52%	2.89%	3.36%	3.07%	2.74%	2.57%
Free Cash Growth Profile™	-9.20%	-5.26%	-5.16%	-7.82%	-7.93%	-11.11%

Among firms in the department stores (fashion) sub-group, only The Bon-Ton Stores, Inc. and Macy's, Inc. saw improvements in their Free Cash Growth Profile™ in the twelve months ended with the third quarter of 2007 from 2006. At The Bon-Ton Stores, the improvement was off a decidedly negative Profile of -13.78% in the twelve months ended with the third quarter in 2006. The company improved its operating cushion and operating working capital requirements. Macy's improved its Profile primarily with a reduction in working capital requirements. The other firms in the industry sub-group saw declines in the Free Cash Growth Profile™. The results for each of the firms in the industry sub-group are presented below.

The Bon-Ton Stores, Inc. Cash Flow Growth Profile	12 Mos Ending 31-Oct-07	12 Mos Ending 31-Oct-06	Fiscal Year 31-Jan-07	Fiscal Year 31-Jan-06	Fiscal Year 31-Jan-05	Fiscal Year 31-Jan-04
Gross margin (excl. deprec. and amort.) %	38.32%	38.99%	38.81%	38.45%	39.76%	39.62%
SG&A (excl. deprec. and amort.) %	30.30%	32.19%	29.82%	32.12%	34.39%	32.52%
Operating cushion %	8.02%	6.79%	8.99%	6.32%	5.37%	7.10%
Operating working capital to revenue %	15.24%	17.55%	13.45%	12.67%	17.52%	24.46%
Core operating growth profile™	-7.22%	-10.75%	-4.46%	-6.35%	-12.15%	-17.36%
Taxes paid %	.40%	0.07%	0.48%	0.76%	1.05%	-0.65%
Capital expenditures %	2.97%	2.95%	2.85%	2.00%	2.26%	1.88%
Free Cash Growth Profile™	-10.59%	-13.78%	-7.79%	-9.11%	-15.47%	-18.58%

Dillard's, Inc. Cash Flow Growth Profile	12 Mos Ending 31-Oct-07	12 Mos Ending 31-Oct-06	Fiscal Year 31-Jan-07	Fiscal Year 31-Jan-06	Fiscal Year 31-Jan-05	Fiscal Year 31-Jan-04
Gross margin (excl. deprec. and amort.) %	31.84%	35.45%	35.54%	34.60%	35.15%	34.21%
SG&A (excl. deprec. and amort.) %	28.35%	27.13%	27.28%	27.10%	27.85%	27.71%
Operating cushion %	3.49%	8.32%	8.26%	7.50%	7.30%	6.50%
Operating working capital to revenue %	12.79%	11.45%	11.48%	9.94%	9.43%	26.57%
Core operating growth profile™	-9.30%	-3.13%	-3.22%	-2.44%	-2.13%	-20.07%
Taxes paid %	1.41%	1.28%	1.41%	1.28%	0.47%	
Capital expenditures %	0.77%	4.22%	4.03%	4.57%	3.54%	2.49%
Free Cash Growth Profile™	-11.47%	-8.64%	-8.66%	-8.29%	-6.14%	-22.57%

Gottschalks Inc. Cash Flow Growth Profile	12 Mos Ending 31-Oct-07	12 Mos Ending 31-Oct-06	Fiscal Year 31-Jan-07	Fiscal Year 31-Jan-06	Fiscal Year 31-Jan-05	Fiscal Year 31-Jan-04
Gross margin (excl. deprec. and amort.) %	34.14%	35.29%	35.05%	35.39%	35.03%	34.47%
SG&A (excl. deprec. and amort.) %	31.35%	31.22%	30.72%	30.75%	31.11%	30.70%
Operating cushion %	2.80%	4.07%	4.32%	4.64%	3.92%	3.77%
Operating working capital to revenue %	17.13%	18.26%	15.57%	13.04%	12.30%	14.52%
Core operating growth profile™	-14.34%	-14.19%	-11.25%	-8.40%	-8.38%	-10.75%
Taxes paid %	0.27%	0.00%	0.27%	0.00%	-0.01%	-0.33%
Capital expenditures %	2.74%	2.82%	2.46%	3.28%	2.07%	0.66%
Free Cash Growth Profile™	-17.34%	-17.01%	-13.97%	-11.68%	-10.44%	-11.08%

Kohl's Corporation Cash Flow Growth Profile	12 Mos Ending 31-Oct-07	12 Mos Ending 31-Oct-06	Fiscal Year 31-Jan-07	Fiscal Year 31-Jan-06	Fiscal Year 31-Jan-05	Fiscal Year 31-Jan-04
Gross margin (excl. deprec. and amort.) %	36.78%	35.91%	36.29%	35.45%	35.08%	33.09%
SG&A (excl. deprec. and amort.) %	22.18%	21.94%	21.83%	22.02%	22.04%	20.76%
Operating cushion %	14.60%	13.98%	14.46%	13.43%	13.04%	12.32%
Operating working capital to revenue %	8.72%	5.84%	6.03%	18.23%	18.12%	18.83%
Core operating growth profile™	5.87%	8.13%	8.43%	-4.80%	-5.08%	-6.50%
Taxes paid %	3.65%	3.59%	3.65%	3.59%	2.39%	2.47%
Capital expenditures %	9.02%	7.41%	7.35%	5.96%	7.60%	8.09%
Free Cash Growth Profile™	-6.80%	-2.87%	-2.57%	-14.36%	-15.07%	-17.06%

Macy's, Inc. Cash Flow Growth Profile	12 Mos Ending 31-Oct-07	12 Mos Ending 31-Oct-06	Fiscal Year 31-Jan-07	Fiscal Year 31-Jan-06	Fiscal Year 31-Jan-05	Fiscal Year 31-Jan-04
Gross margin (excl. deprec. and amort.) %	39.97%	40.43%	40.35%	40.58%	42.23%	42.00%
SG&A (excl. deprec. and amort.) %	28.01%	29.74%	29.22%	27.49%	28.91%	28.90%
Operating cushion %	11.97%	10.69%	11.13%	13.09%	13.32%	13.10%
Operating working capital to revenue %	1.16%	6.34%	0.92%	5.65%	25.15%	23.08%
Core operating growth profile™	10.80%	4.35%	10.21%	7.44%	-11.83%	-9.99%
Taxes paid %	2.08%	2.15%	2.08%	2.15%	2.00%	0.38%
Capital expenditures %	3.47%	2.03%	2.37%	2.45%	2.74%	3.20%
Free Cash Growth Profile™	5.25%	0.17%	5.77%	2.84%	-16.56%	-13.57%

J.C. Penny Company, Inc Cash Flow Growth Profile	12 Mos Ending 31-Oct-07	12 Mos Ending 31-Oct-06	Fiscal Year 31-Jan-07	Fiscal Year 31-Jan-06	Fiscal Year 31-Jan-05	Fiscal Year 31-Jan-04
Gross margin (excl. deprec. and amort.) %	39.21%	41.63%	39.32%	41.25%	40.75%	39.44%
SG&A (excl. deprec. and amort.) %	27.47%	30.26%	27.57%	30.74%	31.50%	32.61%
Operating cushion %	11.74%	11.36%	11.74%	10.51%	9.24%	6.83%
Operating working capital to revenue %	12.58%	11.84%	7.73%	8.51%	8.14%	-6.03%
Core operating growth profile™	-8.4%	-0.47%	4.01%	2.00%	1.11%	12.86%
Taxes paid %	3.12%	2.86%	3.12%	2.86%	0.97%	0.28%
Capital expenditures %	5.72%	3.60%	3.88%	2.85%	2.24%	2.10%
Free Cash Growth Profile™	-9.68%	-6.93%	-2.98%	-3.71%	-2.10%	10.48%

Retail Ventures, Inc. Cash Flow Growth Profile	12 Mos Ending 31-Oct-07	12 Mos Ending 31-Oct-06	Fiscal Year 31-Jan-07	Fiscal Year 31-Jan-06	Fiscal Year 31-Jan-05	Fiscal Year 31-Jan-04
Gross margin (excl. deprec. and amort.) %	41.04%	41.12%	41.71%	40.13%	41.33%	40.99%
SG&A (excl. deprec. and amort.) %	36.91%	37.02%	36.98%	37.87%	38.60%	37.46%
Operating cushion %	4.13%	4.11%	4.73%	2.26%	2.73%	3.53%
Operating working capital to revenue %	6.11%	2.14%	-1.90%	0.22%	7.49%	9.20%
Core operating growth profile™	-1.98%	1.97%	6.63%	2.05%	-4.76%	-5.68%
Taxes paid %	1.36%	0.56%	1.36%	0.56%	0.46%	0.09%
Capital expenditures %	3.58%	1.54%	2.13%	1.59%	3.05%	2.64%
Free Cash Growth Profile™	-6.92%	-0.13%	3.14%	-0.10%	-8.27%	-8.41%

Saks Incorporated Cash Flow Growth Profile	12 Mos Ending 31-Oct-07	12 Mos Ending 31-Oct-06	Fiscal Year 31-Jan-07	Fiscal Year 31-Jan-06	Fiscal Year 31-Jan-05	Fiscal Year 31-Jan-04
Gross margin (excl. deprec. and amort.) %	39.25%	34.68%	38.63%	37.12%	37.91%	37.86%
SG&A (excl. deprec. and amort.) %	31.11%	28.82%	32.69%	31.67%	30.63%	30.14%
Operating cushion %	8.14%	5.86%	5.94%	5.45%	7.29%	7.72%
Operating working capital to revenue %	17.65%*	5.16%	13.78%	11.62%	12.59%	13.67%
Core operating growth profile™	-9.51%	.70%	-7.85%	-6.17%	-5.31%	-5.95%
Taxes paid %	1.17%	0.31%	1.17%	0.31%	0.03%	0.07%
Capital expenditures %	4.31%	2.36%	4.20%	3.75%	2.74%	2.73%
Free Cash Growth Profile™	-14.98%	-1.97%	-13.21%	-10.23%	-8.08%	-8.75%

*Impacted by business dispositions in 2007.

Department Stores (Variety)

In the department stores (variety) industry sub-group we include Duckwall-Alco Stores, Inc., Fred's, Inc, Sears Holdings Corp., Target Corp. and Wal-Mart Stores, Inc. For these firms, the Free Cash Growth Profile™, declined slightly to -8.45% from -7.16%, respectively, when measured for the twelve months ended with the third quarter of 2007 vs. 2006. The primary drivers in the decline were a modest increase in operating working capital needs and capital expenditures. The overall profitability of the group, measured with the operating cushion% and taxes paid% remained relatively flat in 2007 from 2006. Please refer to Table 3.

Table 3. Cash Flow Growth Profile™ for Department Stores (Variety)

Median Department Stores (Variety)	12 Mos Ending 3rd Qtr 2007	12 Mos Ending 3rd Qtr 2006	Fiscal Year 2006	Fiscal Year 2005	Fiscal Year 2004	Fiscal Year 2003
Gross margin (excl. deprec. and amort.) %	28.20%	28.26%	28.49%	28.07%	27.99%	30.09%
SG&A (excl. deprec. and amort.) %	22.68%	22.70%	22.54%	22.56%	22.30%	23.88%
Operating cushion %	5.52%	5.56%	5.95%	5.51%	5.68%	6.21%
Operating working capital to revenue %	10.26%	9.72%	7.08%	8.42%	9.68%	9.30%
Core operating growth profile™	-4.75%	-4.16%	-1.13%	-2.92%	-4.00%	-3.09%
Taxes paid %	1.28%	1.36%	1.21%	1.07%	0.92%	0.65%
Capital expenditures %	2.43%	1.65%	1.60%	2.54%	2.40%	3.69%
Free Cash Growth Profile™	-8.45%	-7.16%	-3.95%	-6.53%	-7.32%	-7.43%

In the department stores (variety) industry sub-group, Sears Holdings Corp. and Wal-Mart Stores, Inc. enjoy positive Free Cash Growth Profiles™. In its fiscal year ending January, 2006, Sears' Profile

reached a very respectable +10.54%, indicating that the firm generates 10.5 cents in incremental free cash flow for every dollar increase in revenue. A negative operating working capital to revenue measure of -6.11% in 2006 (indicating that the firm more than covers its needs for operating working capital assets (like receivables and inventory) with operating working capital liabilities (such as accounts payable, accrued expenses payable) contributed to the company's strong Profile. Sears' Profile declined to 6.91% in the year ended January 2007. For the twelve month ending with the third quarter of 2007, Sears' Profile was a respectable 5.53%, though down from 6.40% in the twelve months ended in the third quarter of 2006. Wal-Mart's Profile improved to 1.76% from 1.22% during the twelve months ended with the third quarter of 2007. An increase in operating cushion and a small reduction in capital expenditures contributed to the change. The results for each of the firms in the industry sub-group are presented below.

Duckwall-Alco Stores, Inc. Cash Flow Growth Profile	12 Mos Ending 31-Oct-07	12 Mos Ending 31-Oct-06	Fiscal Year 31-Jan-07	Fiscal Year 31-Jan-06	Fiscal Year 31-Jan-05	Fiscal Year 31-Jan-04
Gross margin (excl. deprec. and amort.) %	32.78%	30.90%	31.64%	31.88%	32.97%	33.16%
SG&A (excl. deprec. and amort.) %	29.30%	33.91%	27.61%	28.48%	29.55%	29.02%
Operating cushion %	3.48%	-3.01%	4.03%	3.39%	3.42%	4.14%
Operating working capital to revenue %	25.27%	23.97%	22.09%	21.17%	21.99%	21.02%
Core operating growth profileTM	-21.79%	-26.98%	-18.06%	-17.78%	-18.57%	-16.88%
Taxes paid %	1.28%	1.29%	1.21%	0.13%	0.92%	0.65%
Capital expenditures %	2.43%	0.97%	1.60%	2.54%	1.05%	0.72%
Free Cash Growth ProfileTM	-25.50%	-29.24%	-20.87%	-20.46%	-20.54%	-18.25%

Fred's, Inc. Cash Flow Growth Profile	12 Mos Ending 31-Oct-07	12 Mos Ending 31-Oct-06	Fiscal Year 31-Jan-07	Fiscal Year 31-Jan-06	Fiscal Year 31-Jan-05	Fiscal Year 31-Jan-04
Gross margin (excl. deprec. and amort.) %	28.06%	28.25%	27.80%	28.07%	27.99%	30.09%
SG&A (excl. deprec. and amort.) %	24.06%	24.10%	23.72%	23.77%	23.29%	24.23%
Operating cushion %	4.00%	4.15%	4.08%	4.30%	4.69%	5.86%
Operating working capital to revenue %	15.41%	15.53%	13.64%	13.51%	13.33%	12.28%
Core operating growth profileTM	-11.41%	-11.38%	-9.56%	-9.21%	-8.64%	-6.43%
Taxes paid %	0.95%	0.89%	0.95%		0.44%	0.58%
Capital expenditures %	1.77%	1.65%	1.50%	1.75%	2.40%	3.69%
Free Cash Growth ProfileTM	-14.13%	-13.92%	-12.01%	-10.96%	-11.48%	-10.70%

Sears Holdings Corporation Cash Flow Growth Profile	12 Mos Ending 31-Oct-07	12 Mos Ending 31-Oct-06	Fiscal Year 31-Jan-07	Fiscal Year 31-Jan-06	Fiscal Year 31-Jan-05	Fiscal Year 31-Jan-04
Gross margin (excl. deprec. and amort.) %	28.20%	28.26%	28.49%	27.72%	25.89%	24.24%
SG&A (excl. deprec. and amort.) %	21.99%	21.74%	21.57%	21.95%	21.05%	21.49%
Operating cushion %	6.21%	6.51%	6.92%	5.78%	4.84%	2.75%
Operating working capital to revenue %	-0.72%	-2.26%	-2.03%	-6.11%	6.26%	2.18%
Core operating growth profileTM	6.93%	8.77%	8.96%	11.88%	-1.43%	0.57%
Taxes paid %	0.27%	1.36%	1.08%	0.23%	0.03%	-0.01%
Capital expenditures %	1.14%	1.02%	0.97%	1.11%	1.17%	-0.58%
Free Cash Growth ProfileTM	5.53%	6.40%	6.91%	10.54%	-2.62%	1.16%

Target Corporation	12 Mos Ending	12 Mos Ending	Fiscal Year	Fiscal Year	Fiscal Year	Fiscal Year
Cash Flow Growth Profile	31-Oct-07	31-Oct-06	31-Jan-07	31-Jan-06	31-Jan-05	31-Jan-04
Gross margin (excl. deprec. and amort.) %	33.93%	33.70%	33.70%	33.58%	32.81%	33.92%
SG&A (excl. deprec. and amort.) %	22.68%	22.70%	22.54%	22.56%	22.30%	23.88%
Operating cushion %	11.25%	11.00%	11.15%	11.02%	10.50%	10.05%
Operating working capital to revenue %	10.26%	9.72%	7.08%	8.42%	9.68%	9.30%
Core operating growth profile™	0.98%	1.28%	4.07%	2.59%	0.83%	0.74%
Taxes paid %	3.06%	2.75%	3.06%	2.75%	3.72%	1.62%
Capital expenditures %	6.72%	6.49%	6.50%	6.33%	6.43%	6.06%
Free Cash Growth Profile™	-8.80%	-7.96%	-5.49%	-6.49%	-9.32%	-6.94%

Wal-Mart Stores, Inc.	12 Mos Ending	12 Mos Ending	Fiscal Year	Fiscal Year	Fiscal Year	Fiscal Year
Cash Flow Growth Profile	31-Oct-07	31-Oct-06	31-Jan-07	31-Jan-06	31-Jan-05	31-Jan-04
Gross margin (excl. deprec. and amort.) %	25.31%	25.16%	25.23%	24.79%	24.72%	24.21%
SG&A (excl. deprec. and amort.) %	18.49%	18.42%	18.42%	18.03%	17.86%	17.42%
Operating cushion %	6.82%	6.74%	6.81%	6.76%	6.85%	6.79%
Operating working capital to revenue %	-0.82%	-0.88%	-1.77%	-0.99%	-0.49%	-0.26%
Core operating growth profile™	7.64%	7.62%	8.58%	7.74%	7.35%	7.04%
Taxes paid %	1.93%	1.90%	1.93%	1.90%	1.95%	1.69%
Capital expenditures %	3.95%	4.50%	4.41%	4.65%	4.17%	3.82%
Free Cash Growth Profile™	1.76%	1.22%	2.23%	1.19%	1.22%	1.53%

Warehouse Stores

In the warehouse stores industry sub-group, we include the Costco Wholesale Corporation, Tuesday Morning Corporation, Cost-U-Less, Inc., BJ's Wholesale Club, Inc., Pricesmart, Inc. and Big Lots, Inc. For this group, the Free Cash Growth Profile™ has improved in each of the years studied. In the twelve months ending with the third quarter of 2007, it improved to a negative -.76%, from -2.18% in 2006. The companies in the group enjoyed an improving operating cushion, driven by an increase in gross margin and a decline in SG&A as a percent of revenue. The companies also reduced their working capital requirements. A slight reduction in capital spending in the twelve months ending with the third quarter of 2007 also added to the improvement in the Profile. Please refer to Table 4.

Table 4. Cash Flow Growth Profile™ for Warehouse Stores

Median Warehouse Stores	12 Mos Ending	12 Mos Ending	Fiscal Year	Fiscal Year	Fiscal Year	Fiscal Year
	3rd Qtr 2007	3rd Qtr 2006	2006	2005	2004	2003
Gross margin (excl. deprec. and amort.) %	19.13%	18.99%	18.97%	18.73%	18.69%	17.73%
SG&A (excl. deprec. and amort.) %	15.09%	15.15%	15.34%	16.59%	17.18%	17.03%
Operating cushion %	4.04%	3.84%	3.63%	2.14%	1.51%	0.70%
Operating working capital to revenue %	1.90%	2.84%	1.89%	2.66%	2.44%	4.18%
Core operating growth profile™	2.14%	1.00%	1.74%	-0.52%	-0.93%	-3.48%
Taxes paid %	1.12%	0.98%	0.89%	0.66%	0.63%	0.54%
Capital expenditures %	1.79%	2.20%	2.14%	1.73%	1.82%	2.36%
Free Cash Growth Profile™	-0.76%	-2.18%	-1.29%	-2.91%	-3.38%	-6.38%

Among the individual companies in this category, Costco Wholesale Corp. enjoys a positive Free Cash Growth Profile™ of approximately five percent and has reported a strong Profile for all of the years surveyed. For the twelve months ended with the third quarter of 2007, the company generated 5.08 cents of free cash flow for every dollar growth in revenue. Several companies in the group improved their Profile during the twelve months ended with the third quarter of 2007, including, Big Lots, Inc., BJ's Wholesale Club, Inc., Costco, Cost-U-Less, Inc., and Pricesmart, Inc. The results for each of the firms in the industry sub-group are presented below.

Big Lots, Inc. Cash Flow Growth Profile	12 Mos Ending 31-Oct-07	12 Mos Ending 31-Oct-06	Fiscal Year 31-Jan-07	Fiscal Year 31-Jan-06	Fiscal Year 31-Jan-05	Fiscal Year 31-Jan-04
Gross margin (excl. deprec. and amort.) %	39.66%	38.88%	39.76%	39.22%	40.57%	44.03%
SG&A (excl. deprec. and amort.) %	32.76%	34.16%	33.81%	35.75%	36.59%	38.16%
Operating cushion %	6.90%	4.72%	5.95%	3.47%	3.98%	5.87%
Operating working capital to revenue %	8.33%	11.20%	7.81%	11.23%	13.19%	12.54%
Core operating growth profile™	-1.42%	-6.48%	-1.85%	-7.76%	-9.21%	-6.66%
Taxes paid %	0.05%	0.00%	0.75%	0.23%	0.30%	0.99%
Capital expenditures %	0.92%	0.73%	0.65%	1.50%	3.09%	3.92%
Free Cash Growth Profile™	-2.38%	-7.21%	-3.26%	-9.49%	-12.59%	-11.58%

BJ's Wholesale Club, Inc. Cash Flow Growth Profile	12 Mos Ending 31-Oct-07	12 Mos Ending 31-Oct-06	Fiscal Year 31-Jan-07	Fiscal Year 31-Jan-06	Fiscal Year 31-Jan-05	Fiscal Year 31-Jan-04
Gross margin (excl. deprec. and amort.) %	11.00%	11.59%	11.31%	11.70%	11.62%	11.34%
SG&A (excl. deprec. and amort.) %	7.87%	7.90%	8.14%	7.80%	7.64%	7.57%
Operating cushion %	3.14%	3.69%	3.16%	3.90%	3.97%	3.77%
Operating working capital to revenue %	0.61%	1.89%	1.27%	1.08%	0.72%	0.90%
Core operating growth profile™	2.53%	1.80%	1.89%	2.82%	3.25%	2.87%
Taxes paid %	1.03%	1.15%	1.03%	1.15%	0.86%	0.40%
Capital expenditures %	1.26%	2.27%	2.25%	1.55%	1.80%	2.63%
Free Cash Growth Profile™	0.24%	-1.63%	-1.39%	0.11%	0.60%	-0.16%

Costco Wholesale Corporation Cash Flow Growth Profile	12 Mos Ending 30-Nov-07	12 Mos Ending 30-Nov-06	Fiscal Year 31-Aug-07	Fiscal Year 31-Aug-06	Fiscal Year 31-Aug-05	Fiscal Year 31-Aug-04
Gross margin (excl. deprec. and amort.) %	13.69%	11.79%	13.34%	13.17%	12.45%	13.42%
SG&A (excl. deprec. and amort.) %	9.40%	9.43%	9.48%	9.43%	9.50%	9.55%
Operating cushion %	4.29%	2.36%	3.86%	3.74%	2.94%	3.87%
Operating working capital to revenue %	-3.10%	-2.62%	-2.95%	-2.56%	-2.71%	-2.61%
Core operating growth profile™	7.38%	4.98%	6.81%	6.30%	5.65%	6.48%
Taxes paid %	.24%	0.91%	1.21%	0.91%	1.52%	0.68%
Capital expenditures %	2.06%	1.93%	2.11%	1.99%	1.84%	1.35%
Free Cash Growth Profile™	5.08%	2.14%	3.49%	3.40%	2.29%	4.45%

Cost-U-Less, Inc. Cash Flow Growth Profile	12 Mos Ending 30-Sep-07	12 Mos Ending 30-Sep-06	Fiscal Year 31-Dec-06	Fiscal Year 31-Dec-05	Fiscal Year 31-Dec-04	Fiscal Year 31-Dec-03
Gross margin (excl. deprec. and amort.) %	20.38%	19.83%	19.86%	19.48%	19.28%	18.82%
SG&A (excl. deprec. and amort.) %	17.35%	16.59%	16.66%	16.31%	16.09%	16.35%
Operating cushion %	3.03%	3.25%	3.20%	3.17%	3.19%	2.47%
Operating working capital to revenue %	1.32%	2.36%	1.75%	2.18%	1.52%	1.96%
Core operating growth profile™	1.71%	0.89%	1.45%	0.98%	1.67%	0.51%
Taxes paid %	0.34%	0.10%	0.44%	0.40%	0.41%	0.34%
Capital expenditures %	2.49%	2.64%	2.16%	2.84%	1.56%	1.12%
Free Cash Growth Profile™	-1.12%	-1.85%	-1.16%	-2.26%	-0.29%	-0.95%

Pricesmart, Inc. Cash Flow Growth Profile	12 Mos Ending 30-Nov-07	12 Mos Ending 30-Nov-06	Fiscal Year 31-Aug-06	Fiscal Year 31-Aug-05	Fiscal Year 31-Aug-04	Fiscal Year 31-Aug-03
Gross margin (excl. deprec. and amort.) %	17.87%	18.15%	18.08%	17.99%	18.10%	16.64%
SG&A (excl. deprec. and amort.) %	12.82%	13.72%	14.02%	16.87%	18.28%	17.71%
Operating cushion %	5.05%	4.44%	4.06%	1.12%	-0.18%	-1.07%
Operating working capital to revenue %	2.48%	3.33%	2.03%	3.14%	3.35%	8.56%
Core operating growth profile™	2.57%	1.11%	2.03%	-2.03%	-3.53%	-9.63%
Taxes paid %	1.81%	1.64%	0.26%	0.28%	0.27%	0.21%
Capital expenditures %	3.45%	2.80%	4.38%	1.74%	-0.16%	3.36%
Free Cash Growth Profile™	-2.69%	-3.33%	-2.61%	-4.04%	-3.65%	-13.21%

Tuesday Morning Corporation Cash Flow Growth Profile	12 Mos Ending 30-Sep-07	12 Mos Ending 30-Sep-06	Fiscal Year 31-Dec-06	Fiscal Year 31-Dec-05	Fiscal Year 31-Dec-04	Fiscal Year 31-Dec-03
Gross margin (excl. deprec. and amort.) %	37.37%	37.79%	39.45%	39.93%	39.44%	38.92%
SG&A (excl. deprec. and amort.) %	30.61%	27.85%	30.74%	27.56%	26.41%	25.55%
Operating cushion %	6.76%	9.94%	8.71%	12.37%	13.03%	13.37%
Operating working capital to revenue %	25.02%	19.08%	14.05%	13.61%	10.28%	6.39%
Core operating growth profile™	-18.26%	-9.14%	-5.34%	-1.24%	2.75%	6.98%
Taxes paid %	2.42%	3.91%	2.42%	3.91%	3.50%	3.79%
Capital expenditures %	1.53%	1.58%	1.72%	1.72%	2.56%	2.10%
Free Cash Growth Profile™	-22.21%	-14.63%	-9.48%	-6.88%	-3.32%	1.09%

Dollar Stores

In the Dollar stores sub-industry, we include Dollar Tree Stores, Inc., Family Dollar Stores, Inc. and 99 Cents Only Stores. Here the Free Cash Growth Profile™ has improved over past four years from a measure of (-6.70%) in 2002 to 2006 (-2.2%), driven primarily by reductions in working capital and capital spending. For the twelve months ending with the third quarter of 2007, the improvement in the Profile continued, although marginally, to -3.47% in 2007 from -3.78% in 2006. Please refer to Table 5.

Table 5. Cash Flow Growth Profile™ for Dollar Stores

Median Dollar Stores	12 Mos Ending 3rd Qtr 2007	12 Mos Ending 3rd Qtr 2006	Fiscal Year 2006	Fiscal Year 2005	Fiscal Year 2004	Fiscal Year 2003
Gross margin (excl. deprec. and amort.) %	38.12%	37.92%	38.09%	37.46%	39.05%	39.80%
SG&A (excl. deprec. and amort.) %	26.21%	25.87%	26.08%	26.03%	26.15%	25.69%
Operating cushion %	11.91%	12.06%	12.00%	11.43%	12.90%	14.11%
Operating working capital to revenue %	9.86%	9.22%	7.77%	8.16%	10.22%	9.85%
Core operating growth profile™	2.05%	2.83%	4.23%	3.27%	2.67%	4.26%
Taxes paid %	1.42%	2.19%	2.17%	2.74%	2.27%	2.85%
Capital expenditures %	4.09%	4.42%	4.26%	4.10%	5.82%	8.12%
Free Cash Growth Profile™	-3.47%	-3.78%	-2.20%	-3.57%	-5.41%	-6.70%

Among the three companies surveyed in this industry sub-group, at a positive .26% for the twelve months ending with the third quarter of 2007, Family Dollar Stores, Inc. has the best Free Cash Growth Profile™, up from -1.86% in 2006. For the company's full 2007 fiscal year, the company's Profile was a positive 2.67%. All three companies in the sub-group saw improvements in their Profile during the twelve months ended with the third quarter of 2007 from 2006. The results for each of the firms in the industry sub-group are presented below.

Dollar Tree Stores, Inc. Cash Flow Growth Profile	12 Mos Ending 31-Oct-07	12 Mos Ending 31-Oct-06	Fiscal Year 31-Jan-07	Fiscal Year 31-Jan-06	Fiscal Year 31-Jan-05	Fiscal Year 31-Jan-04
Gross margin (excl. deprec. and amort.) %	38.12%	37.92%	38.09%	38.59%	39.68%	39.80%
SG&A (excl. deprec. and amort.) %	26.21%	25.87%	26.08%	26.03%	26.15%	25.69%
Operating cushion %	11.91%	12.06%	12.00%	12.56%	13.53%	14.11%
Operating working capital to revenue %	9.86%	12.61%	7.77%	10.39%	12.33%	12.74%
Core operating growth profile™	2.05%	-0.55%	4.23%	2.17%	1.20%	1.37%
Taxes paid %	1.42%	1.86%	3.16%	3.35%	2.99%	2.51%
Capital expenditures %	4.41%	4.42%	4.42%	4.10%	5.82%	8.12%
Free Cash Growth Profile™	-3.79%	-6.83%	-3.35%	-5.29%	-7.61%	-9.26%

Family Dollar Stores, Inc. Cash Flow Growth Profile	12 Mos Ending 30-Nov-07	12 Mos Ending 30-Nov-07	Fiscal Year 31-Aug-07	Fiscal Year 31-Aug-06	Fiscal Year 31-Aug-05	Fiscal Year 31-Aug-04
Gross margin (excl. deprec. and amort.) %	33.90%	33.36%	33.98%	33.13%	32.90%	33.81%
SG&A (excl. deprec. and amort.) %	25.81%	25.09%	25.69%	24.94%	25.04%	24.18%
Operating cushion %	8.09%	8.27%	8.28%	8.19%	7.85%	9.63%
Operating working capital to revenue %	3.54%	4.89%	1.52%	3.76%	6.06%	5.61%
Core operating growth profile™	4.56%	3.38%	6.76%	4.42%	1.79%	4.02%
Taxes paid %	2.17%	2.74%	2.17%	2.74%	2.27%	2.85%
Capital expenditures %	2.12%	2.50%	1.91%	2.98%	3.90%	4.11%
Free Cash Growth Profile™	0.26%	-1.86%	2.67%	-1.29%	-4.37%	-2.94%

99 Cents Only Stores	12 Mos Ending	12 Mos Ending	Fiscal Year	Fiscal Year	Fiscal Year	Fiscal Year
Cash Flow Growth Profile	30-Sep-07	30-Sep-06	31-Mar-07	31-Mar-06	31-Dec-04	31-Dec-03
Gross margin (excl. deprec. and amort.) %	38.92%	39.45%	39.16%	37.46%	39.05%	40.08%
SG&A (excl. deprec. and amort.) %	35.69%	34.45%	35.13%	33.65%	31.48%	27.20%
Operating cushion %	3.23%	5.00%	4.03%	3.82%	7.56%	12.87%
Operating working capital to revenue %	11.22%	9.22%	9.87%	8.16%	10.22%	9.85%
Core operating growth profile™	-7.99%	-4.23%	-5.84%	-4.34%	-2.66%	3.03%
Taxes paid %	0.28%	2.19%	0.28%	2.19%	2.27%	4.08%
Capital expenditures %	4.09%	6.22%	4.26%	4.65%	5.89%	11.44%
Free Cash Growth Profile™	-12.36%	-12.64%	-10.38%	-11.18%	-10.81%	-12.49%

Conclusions

A slowing U.S. economy provides good reason to be concerned about the retailers. The Free Cash Growth Profile™, a measure of a firm's ability to generate free cash flow as it grows, provides one means of looking at the financial health of the group. What we found is that the retailers generally have a negative Profile and it has worsened over the twelve months ending with the third quarter of 2007 from 2006. A declining operating cushion, driven by a decrease in gross margin and an increase in SG&A spending, together with an increase in working capital needs, were the primary culprits.

Most of the industry sub-groups examined also showed a declining Profile. However, the warehouse stores and dollar stores did show modest improvements during the twelve months ending with the third quarter. Our intent is to take another look at the Retail industry using end-of-year data as it becomes available. Given the weakness seen in holiday sales, our expectation is for a continuing decline in the Free Cash Growth Profile™, likely driven by a drop in operating cushion%, and an expected increase in working capital to revenue.