

Retail Ventures, Inc.
1st Quarter Operating Results
Conference Call
June 10, 2003

Operator (Jill)

Thanks for holding, ladies and gentlemen, and welcome to the Value City's 1st Quarter Operating Results Conference Call. During the presentation, all lines will be on a listen-only mode. There will be an opportunity to ask questions, and instructions will be given at a later time. Thank you for your attention; I now turn the time over to your host, Mr. John Rossler.

John Rossler, President and CEO

Thank you, Jill. Good morning, everyone, and welcome to the Value City Department Stores 1st Quarter Fiscal 2003 Conference Call. Joining me today are Ed Kozlowski, our Chief Operating Officer; and Jim McGrady, our Chief Financial Officer. Before starting, I would like to remind everyone that during this discussion, we will make certain forward-looking statements based upon our current expectations or beliefs. We caution that actual events and results may differ materially from those anticipated, based upon the risk factors described in reports we file with the SEC, and we encourage you to read these filings. Jim will address the results of the quarter in greater detail in a few minutes, but let me make a few observations to put what happened into context.

The first quarter was very challenging. We experienced a large sales shortfall in February caused by primarily severe winter weather. The February sales shortfall caused higher markdowns in March and April. Continued expense controls could not overcome the gross margin shortfall that resulted from the quarter as a whole, resulting in an operating loss of \$12.8 million versus an operating profit of \$2.1 million last year. We're of course not the only retailer that felt the negative impact of severe winter weather during the first quarter. However, many of our stores across all three operating units are located in the areas of the Northeast and the Midwest that were hit hardest by the bad weather. Also, the economy's reluctance to show vitality in our geographic marketing areas continued to pose challenges. What we saw in the first quarter was an increase in the number of consumers wanting physical markdowns on the products they buy. There was also less impulse buying, particularly at DSW. Again, as the top line was squeezed, so were margins. That was particularly true at Value City Department Stores and Filene's Basement, less so with DSW.

On the positive side, we have been able to control our operating costs due to the business process changes that were implemented in fiscal 2002, and we are currently focused on substantial systems developments and upgrades that will enable us to continue to reap future efficiencies as they are implemented during fiscal 2003 and into fiscal 2004. To pick just two examples, we completed a new point-of-sale system in the first quarter for DSW. That will provide faster customer checkout with a return on investment of over 100 percent in the first year. At Value City, a new point-of-sale system will be implemented during the second and third quarters, to be ready for the holiday season. This system provides for

much-needed technology improvement, as well as a platform to improve our operating efficiencies and better merchandising flexibility.

We're also focused on improving the top line. The key to top line growth is increasing store traffic, and the key to increasing store traffic is brand awareness and effective merchandising. We've invested in proven senior merchandising talent at each of our three operating units, and it's beginning to pay off. The most recent example of this effort is the addition of Jerry Politzer, the former Vice Chairman of Melville, as Executive Vice President of Merchandising for Filene's Basement. Jerry is working very closely with Heywood Wilansky to upgrade Filene's Basement merchandising strategy and pricing to reflect its current market price positioning and brand qualities.

We've also brought in Cliff Freeman And Partners to address brand development at our Department Store and DSW units, with strong advertising campaigns, primarily using electronic media, both TV and radio. Those campaigns kicked off in the major markets just in time for Easter. Filene's Basement's campaign will be ready for the fall season. Ed will discuss our assessment of where we are with the advertising campaigns a little later.

The corporate reorganization is now well underway in terms of the consolidation and centralization of key support functions, and we've begun experiencing increased efficiencies across the operating units. The Retail Ventures, Inc. holding company structure, which was delayed for legal and tax considerations, will be in place by the end of the second quarter.

Finally, we remain optimistic about the balance of fiscal 2003. A year ago, we set five management targets: Return to operating profitability, reduce operating expenses,

reduce inventory and increase turn, bring in proven management and merchandising talent to the company, and return to positive comp store sales. We met four of those five goals in fiscal 2002. While the economic climate and the mood of the consumer are continuing issues, 2003 is the year we plan to accomplish the fifth, a return to positive comp sales for all three of our operating units. I will now ask Jim to discuss our results for the quarter in more detail.

Jim McGrady, Chief Financial Officer

Thank you, John. Yesterday we announced a net loss for the first quarter of \$13.2 million or 39 cents per share, versus a loss of \$4.8 million or 14 cents per share in the prior year. Remember the prior year's loss includes a change in accounting principles related to goodwill of \$2.1 million, or around 6 cents per share. The total sales for the first quarter increased \$2.6 million, about four-tenths of a percent, to \$588.5 million. Comp sales for the quarter declined 4.4 percent. Comp stores by business segment were: Department Stores, negative four; DSW, negative 3.6; Filene's Basement, negative 8.1.

Our Department Store sales decreased \$16.3 million to \$342.9 million. Our Department Store non-apparel comp store sales decreased five-tenths of a percent, while apparel sales decreased 6.1 percent. The three apparel divisions, children's, men's, and ladies', each recorded a negative comp for the quarter. Children's was down 8.8, men's down 5.3, and ladies' down 5.5. Shoe sales in the Department Store segment were also a negative 2.4 percent for the quarter.

As John noted, many of the market areas for the Department Stores, DSW, and Filene's Basement were negatively impacted by the severe cold weather and snow-related closings in the month of February through approximately mid-March. Our total comps in February, as you remember, were down 12.1 percent. DSW sales increased \$27.1 million to \$183.1 million. This is about a 17.4 percent increase in the quarter, which includes a net increase of 19 stores and 161 leased shoe departments. Filene's Basement's sales decreased \$8.1 million to about \$62.6 million, and comp stores, as I noted earlier, were down 8.1 percent. Filene's merchandise strategy is in the early phase of a strategic repositioning to promote in-store excitement on brand names and designer merchandise. Additionally, Filene's has initiated a slowdown in the use of point-of-sale discounts on regular-priced merchandise to enhance price credibility.

In the first quarter, gross profit as a percent of sales declined by 1.3 percent to 36.8 percent, in contrast to the 38.1 percent reported in fiscal 2002. This decline is attributable to increased markdowns in all segments. Total gross profit decreased \$6.5 million to \$216.7 million. As a percent of sales, gross profit by segment was: Value City Department Stores, 36.6; DSW, 38.6; Filene's Basement, 32.8.

Total SG&A expenses for the quarter increased by \$7.7 million to \$231 million; \$9.8 million of this increase is associated with the 19 new stores in operation at DSW, plus the 161 leased shoe departments. As a percent of sales, SG&A was 39.3 percent, compared to 38.1 percent in the first quarter of 2002. Included in the SG&A expense for the first quarter of the prior year was \$1.7 million for severance and \$1.1 million for store closing expenses. SG&A, as a percent of sales by division, were: Value City Department Stores, 40.8; DSW,

37.3; Filene's Basement, 36.7. Operating profits for the quarter decreased \$14.9 million, from a profit of \$2.1 million in the prior year, to a loss of \$12.8 million in fiscal 2003.

Debt interest expense for the quarter increased \$3.2 million to \$9.6 million. This increase is attributable to an increase of 395 basis points in our weighted average borrowing rate, offset by a \$19.7 million decline in weighted average borrowings. The increase in rate reflects the full effect of the term and senior debt we obtained during our refinancing in June of 2002.

Our effective tax rate for the three months is 41.2 percent versus 36.7 percent in the prior year. The change in the rate is due in part to the nondeductible warrant amortization that is included for the book income but excluded from tax.

Turning to our balance sheet, inventory totaled \$452.9 million at the end of the first quarter, versus \$417.4 million for the same period last year. The increase in the 19 new DSW stores and the 161 leased departments account for \$31 million of this increase, and inventory acquired for the new Filene's Basement store which recently opened in Atlanta added \$1.8 million.

Working capital, at the end of the quarter, was \$242.5 million, compared with \$213.8 million in the prior year. Cash used for capital expenditures was approximately \$10.8 million in the quarter, and depreciation and amortization totaled \$13.8 million, compared with \$13 million in the prior quarter. EBITDA in the first quarter was \$1 million.

At the end of the quarter, we are in compliance with the terms of our bank agreement. Availability under revolving credit agreement was \$174 million. Outstanding borrowings were comprised of direct borrowings of \$129 million, plus \$12 million in letter credits were issued and outstanding at that time. That concludes the review of the first quarter.

With respect to the remainder of fiscal 2003, we remain very cautious. We estimate our comp stores volume to be in the low single-digit range for the second quarter and for the balance of the fiscal year. As we experienced last year, and we continue to see during the current year, we are experiencing some very positive expense reductions based upon controls and just special programs we've put in place. As a result of these anticipated cost controls, combined with the positive comps, we estimate that we will have a loss in the second quarter and also have a profit for the balance of the total fiscal year.

That concludes the review of the financial statements. I would like to now turn it over to Ed Kozlowski.

Ed Kozlowski, Chief Operating Officer

As Jim and John have both talked about, we have continued to be successful in controlling operating costs because of the business process changes that occurred last year. This year, we are focusing on substantial systems development, which will allow us to continue further improvement on our operating efficiencies and further reduce costs.

There are five substantial system improvement projects underway now or already completed. All of them will positively impact both efficiencies, as well as customer

satisfaction and operational activity within the stores. Earlier, John discussed the impact of new point-of-sale systems for Value City Department Stores and DSW. They represent two of the major system upgrades. At DSW, we're currently working on a new planning and allocation system that will replace the largely home-grown system. The new system will be in place by Fall 2003, allowing us to use it in the Spring 2004 planning process. This upgrade will enable us to plan and allocate based on store attributes and quickly address consumer trends and integrate them into our merchandising. This should further enable us to further control the markdown rate at store level, by having more control over the knowledge of inventory at a store-by-store location.

At Department Stores, we are implementing new merchandising systems as well as new warehouse management systems. These will be in the development stage into 2004, with benefits beginning to accrue the latter half of next year. These two systems provide a solid base for Department Stores to build upon.

Let me touch on the marketing strategies and how we see them developing and where we are. While the ultimate goal of both existing campaigns is to increase store traffic, the sub-objectives differ a little bit. At Department Stores, the need is to change the stores' image, appealing to people who have not been in our stores for some time. What we've seen so far is strong and memorable, but does not necessarily deliver a compelling message to "try us now." We're in the creative stages of adding a greater sense of urgency to our message.

At DSW, the need is slightly different, and that is to increase brand awareness. So far, we're pleased, as it did move the needle in the first month following the beginning of the

campaign, but it's too soon to know to what extent that will translate into more first-time customers. Again, we are continuing to work closely with Cliff Freeman And Partners to make sure that it's right. Realistically, we won't be able to give you a definitive report on the success of these campaigns until later in the year. John, that's it for me.

John Rossler, President and CEO

Thank you, Ed. In closing, let me say that I know we have challenges ahead of us, and I can assure you that all of us in your management team remain fully committed to returning all three of our operating units to positive comp store sales this year. That's it for now. Jill, we would now like to open the lines for questions.

Operator

Thank you. To ask a question, please press a "1" followed a "4" on your touchtone phone. If for any reason you wish to retract your question, you can press a "1" followed by a "3". Once again, to ask a question, press a "1" followed by a "4" on your touchtone phone. (Pause) It appears there are no questions, sir.

John Rossler, President and CEO

All right, Jill. Thank you, everybody, for being with us this morning. Again, we will all be available for calls if you want to give us one, and thank you very much for your time. And we are focused on the operations of this business, and it will come to us. Thanks again, everybody. Have a good day.

Operator

This now concludes today's Value City conference call, and thank you for your participation.

(End of Conference Call)