

Retail Ventures, Inc.
2nd Quarter Earnings
September 8, 2004

Operator (Connie)

Thank you for holding, ladies and gentlemen, and welcome to the 2nd Quarter Earnings Conference Call for Retail Ventures, Incorporated. At this time, all lines are in a listen-only mode. There will be an opportunity to ask questions at the end of today's conference. Instructions for asking questions will be given at a later time. Today's conference is being recorded. If you do not wish to be recorded, you may disconnect at this time. I thank you for your attention, and now turn the conference over to our host, Mr. John Rossler.

John Rossler

Thank you, Connie. Good morning and welcome to Retail Ventures, Inc. second quarter fiscal 2004 conference call. I'm John Rossler, President and CEO. With me today is Ed Kozlowski, our Chief Operating Officer, and Jim McGrady, Chief Financial Officer. Before proceeding, I would like to restate for you the company's policy with respect to forward-looking information, pursuant to the Private Securities Litigation Reform Act of 1995. Statements made in the course of this call that are not purely historical, such as statements regarding the company's or management's intentions,

expectations or projections of the future, are forward-looking statements. Actual results could materially differ from the forward-looking statements. Factors that could cause or contribute to such differences include but are not limited to the factors and risks discussed in the company's annual report on Form 10K for the period ended January 31, 2004, and the other reports filed from time to time by the company with the Securities and Exchange Commission. Any forward-looking statements made during this call are based upon information presently available to the company, and the company assumes no obligation to update any such forward-looking statements.

RVI has just completed the first half of the final year of a three-year turnaround strategy. When we started this turnaround, our goal was to return to profitability and to build a strong foundation that could support and sustain a healthy, growing and prosperous company for many years to come. Based on the RVI second quarter 2004 operating results announced yesterday, it appears that we are well on our way to accomplishing our turnaround goal within the anticipated time frame.

The second quarter was very successful and exceeded our expectations. This was the fourth quarter in a row with improved sales and substantially improved profitability over the prior year. RVI had a positive net profit in the second quarter of this year, its first profitable second quarter since fiscal year 2000. Progress continues in all three retail divisions across numerous financial metrics. This is a positive sign that the strategic, financial, organizational and human capital investments RVI has made over the last two and a half years are beginning to pay off.

Highlighting some of the specific performance measures of second quarter 2004, when compared to 2003; total sales were up 4.5 percent. Gross profit as a percent to sales increased 200 basis points. Operating profit increased by nearly \$9 million. Jim will discuss more of the financial results later.

Regarding our individual business segments, in the Value City Department Store business segment, our financial performance for the second quarter continued the trend of improved performance that began in the third quarter of last year. Over the past two years, Value City has used consumer research experimentation to gain a better understanding of how to optimize the profit potential inherent within the Value City brand. We are now applying this knowledge to the Value City operational and merchandizing model. Some of these actions have had an immediate positive impact on performance, whereas others will be realized later this year and beyond. The immediate positive impact has come primarily from a renewed emphasis on inventory control and pricing.

Regarding pricing, Value City is moving away from solely promotional pricing to pricing that places greater emphasis on everyday extreme value. This new approach provides greater everyday price assurance to our customer, and allows us to achieve both higher average unit retail prices and higher initial markups. As you may recall from prior conference calls, low average unit retail prices and markups had been nagging issues for us in the past. These problems now appear to be behind us.

At the same time, increased inventory controls allowed Value City to weather the industry-wide slowdown in sales during June and July without any serious increase in markdowns. As a result, Value City's gross margin percent in the second quarter remained strong and actually grew over the prior year.

In the area of advertising, we experimented with a 15 percent reduction in advertising during the first half of the year. Although comparative store sales declined slightly during this time period, they did not decline anywhere near the levels of the reduction in advertising. In the process, we gained a better understanding of what types of advertising are effective for the Value City brand. For the remainder of the year, we're returning to historical levels of advertising spending. This should have a positive impact on Value City's second half performance.

Value City's second half will also benefit from merchandising improvements we have recently put into place. Value City has instituted programs to improve its fashion image by making strong fashion statements earlier in the season, putting a greater emphasis on selling fashion coordinated outfits rather than individual items, increasing the space devoted to the young men's and juniors fashion categories, and increasing the emphasis on home fashions. These changes are beginning to have their first real impact on merchandising results for the fall season. Further improvements will come from a renewed emphasis on ladies apparel, a category foundational to the historic success of Value City.

Value City is continuing its long-term investments in technology. New POS checkout terminals are now operational in all Value City stores. These new terminals will allow Value City to better and more profitably serve our customers in the near future. In addition, they provide the foundation for future retail software upgrades. This is just one piece of a larger program, which is underway to upgrade the technology within the supply chain. Our technology plan is well thought out and coordinated. We are confident that it will provide substantial benefits, both in the near term and beyond.

Turning now to the DSW segment, we saw continued overall improvement as a growth retailer. Sales, margins and profits all improved at DSW over the prior year. DSW is a proven successful format, which we continue to roll out nationally. During the second quarter, DSW opened seven new stores and began a licensed shoe business with Gordmans department stores. Gordmans is a 44-store chain located primarily in the Midwest. DSW will continue its new store expansion program during the second half of the year and beyond.

DSW has also been making long-term investments in both people and technology to improve the management of the entire supply chain. These investments will allow DSW to support its growth and continuing to improve its productivity. As we move into the remainder of fiscal 2004, DSW will be facing stronger comp store sales and margin comparisons with 2003. Although this will increase the challenge, we anticipate that our frontloaded investments, in combination with increased efficiencies, will allow us to continue our year-over-year improvements at DSW.

Filene's Basement used the 2003 year as a strategic recalibration year, returning to its legendary roots by increasing the quality of the fashion brand mix and shifting promotions to event-based marketing. The favorable results during the first half of this year indicate these efforts are having a positive impact. Comp store sales growth for Filene's Basement during the spring season were strong. Average unit retail price and initial markup percent also increased over the prior year. Filene's Basement continues to improve the quality and timeliness of its fashion offerings, which should allow us to continue this positive momentum.

Now that the business model recalibration appears on track, Filene's Basement is starting to turn its attention towards controlled growth and expansion. Three new stores opened in the first half of the year, raising total store count to 24. Filene's Basement will continue expansion in the second half of the year, including a store in Manhattan at Union Square.

At the corporate level, RVI has spent the last year strengthening its retail support expertise. As a result, the quality of retail support has improved greatly. This is already contributing to RVI's improved operating performance. Now our attention at the corporate level is focusing on ways to continue the improvement and the quality of retail support, while at the same time increasing the productivity of these investments. With the completion of the second quarter, RVI has now posted four consecutive quarters of improved performance over the prior year. Every brand is showing improvement. The change initiatives implemented over the past two and a half years are beginning to

positively impact operating results. Although this company's transformation is not yet complete, we are continuing to track in a positive direction and have momentum in our favor. Our goal for the remainder of the year will be to continue this trend by maintaining our focus on increasing sales, improving margins, strengthening our fashion image, and reducing cost. We are continuing to evaluate our alternatives to debt restructuring, and expect to have this matter resolved before the end of this year.

Thank you. I will now ask our CFO, Jim McGrady, to proceed with our financial review.

Jim McGrady

Thank you, John, and good morning everybody. As John said, today we announced a second quarter profit of \$1.2 million compared to a loss of \$3.6 million in the prior year quarter. Our basic and diluted earnings per share for the quarter were three cents, versus a loss of 11 cents in the prior year's quarter. For the six months, we're reporting a loss of \$400,000 compared to a prior year loss of \$16.8 million. Respectively, we had a one-cent loss and a 50-cent loss this year and in the prior year.

Total sales for the second quarter increased by \$27.1 million, or 4.5 percent, to \$631.7 million. By segment, we were at \$317.6 million for Value City, DSW was \$228.4 million, and Filene's Basement, \$85.6 million. Comparable store sales for the quarter decreased 1.7 percent. Comparable store sales by business segment were Value City negative 5.6, DSW plus 2.8, Filene's Basement plus 5.1. Value City's comparable

quarterly sales increased and non-apparel hardlines was up 0.1 percent while apparel decreased 7.7 percent, and jewelry decreased 13.9 percent. In our men's, ladies and children's division, we had decreases of 6.4, 9.4 and 6.0 percent, respectively. Shoes at the Value City segment were a negative 4.7 percent in the quarter, also.

DSW segment sales were up 18.8 percent increase in the quarter, which included a net increase of 27 stores and 43 leased shoe departments, along with the comp store sales increases I mentioned of 2.8 percent. DSW saw increases in women's, athletic, handbags and gifts, and children's during the quarter. Also during this year, we've opened 16 DSW stores.

Filene's Basement sales increased 13.1 percent to the \$85.6 million I mentioned before, and this includes the addition of three new stores and a comp store sales increase of 5.1 percent. The merchandise categories of men's, ladies, and children's all saw increases at Filene's, and shoes saw a positive 6.9. Jewelry was off slightly and was down 2.8 percent.

In the second quarter, gross profit as a percent of sales improved 200 basis points to 41.1 percent. Our total gross profit increased \$23.2 million to \$259.6 million due to higher initial markups and lower markdowns in all of our segments. Gross profit as a percent of sales by segment in the second quarter was at Department Stores 40.9 percent, DSW 43.3 percent, Filene's Basement 35.9 percent. Our total SG&A expenses for the comparative quarters increased by \$14.4 million to \$249.3 million, and as a percent of sales increased from 38.8 to 39.5 percent. Remember we have an additional 27 stores,

three Filene's Basement stores, and an increase of 43 leased shoe departments in comparison to the last year's quarter. Total SG&A expenses in these stores added an additional \$12.8 million expenses in the current year's quarter. Also included in the current year's SG&A expenses is \$1.4 million in pre-opening expenses for the new DSW stores. SG&A percent to sales for the second quarter were at Department Stores 42 percent, DSW 36.8, Filene's Basement 37.1.

The second quarter operating profit is \$11.9 million, which reflects improvement in the Value City and DSW segments. By operating segment, we are reporting an operating loss of \$2.5 million and \$600,000 at Value City and Filene's Basement, and operating profit of \$15 million for DSW. Last year's operating profit for the quarter was \$2.8 million and consisted of an operating loss of \$9.9 million at Value City and operating profits of \$11.1 and \$1.6 million at DSW and Filene's Basement, respectively.

Net interest expense for the quarter increased by about \$900,000, to \$9.9 million. The components of this change are an increase in the weighted average borrowings offset by a decrease of about 50 basis points in our weighted average borrowing rate due to the availability of lower market rates on our short-term LIBOR borrowings. For taxes, the effective tax rate for the three months is 40.7 percent, compared to the prior year of 42 percent. For the six-month period, it's 40.6 percent versus 41.4 percent last year.

As we turn to our balance sheet, our inventory total is \$517.5 million at July 31 of 2004 versus \$477.2 million last year. This is an increase of about 8.4 percent. The total increase includes approximately \$21.8 million for the new DSW locations and the 43 new

supply locations, plus about \$5.7 million for our new Filene's Basement stores. And also keep in mind we do have some pre-buying going on there for the new stores that are in the pipeline that I'll talk about a little bit later.

Our net working capital at July 31, 2004 was \$293.2 million, and this was compared to \$270.5 million in the prior year. Our current ratios were 1.9 and 1.8, respectively. Net cash used for capital expenditures was approximately \$30.8 million for the year to date, (inaudible) appreciation and amortization in 26 weeks totaled \$25.6 million compared to \$25.8 million in the prior year.

EBITDA in the second quarter was \$25.3 million versus \$15.8 million for last year's comparable second quarter, and EBITDA for the 26 weeks is \$44.3 million versus \$16.7 million for last year. We have, in fact, reclassified in the prior year statements, and you will see this in comparing operating profit, the amortization of some debt costs. And what we've done is we've added those to interest and taken them out of SG&A expense in the prior year's quarters' numbers for comparability purposes for this year. I would also point out that availability under our revolving credit agreement at July 31 was \$96 million, and the cash was \$2.7 million. That is the conclusion of the review of the second quarter.

As we take a look going forward with respect to the remainder of 2004, we expect comp store sales volumes to be in the low single-digit range of one to two percent, and that our margin rate will remain stable for the balance year, and we will be able to improve the leverage we're seeing in our SG&A expenses. Our EPS expectation for the

remainder of the year remains unchanged at 42 to 47 cents per diluted share. By quarter, we would expect the third quarter to be in the 11- to 15-cent range and the fourth quarter to be in the 25- to 30-cent range. Our estimate for interest expense in 2004 is still about \$33 to \$35 million, and our tax rate is estimated to be between 40 and 41 percent. We anticipate opening approximately 16 to 19 additional DSW stores during the balance of the year, and as John mentioned, our one new Filene's Basement store. We do not have any Value City stores presently on the schedule.

That concludes our financial review, and I would now like to turn it back over to Connie to open the lines for any questions.

Operator

All right, thank you. To ask a question, please press a "1" followed by a "4" on your touchtone phone, and if for any reason you need to retract your question, you may press a "1" followed by a "3". All questions will be taken in the order they are received. Once again, to ask a question, please press a "1" followed by a "4" on your touchtone phone at this time. And it looks like our first question comes from Mr. David Mann with Johnson Rice. Go ahead, please.

David Mann, Johnson Rice

Good morning, guys.

John Rossler

Good morning, David.

Jim McGrady

Hi, David.

David Mann, Johnson Rice

First question on SG&A, can you just elaborate a little more on what's going on there? It looked a little bit better than I was projecting.

Jim McGrady

Yeah, actually, we did see some leverage coming out of the SG&A at our warehouse operations in Value City and also at DSW. Plus we did see a small improvement at actual Value City Department Stores at the store level itself, and we also did see some benefit that was in there for – in fact, some of the actuarial assumptions that we had made with our workers compensation but, really, the driving force behind it was the work that we were able to do to save some costs in our warehouse and store operations.

David Mann, Johnson Rice

Okay. In terms of the remerchandising, you're talking about, John, can you just give us any signs of things that are working. I mean, candidly, your comps at Value City

have been I would believe a little weaker than you were looking for, yet you're starting to talk about comps I guess being better in the back half. What signs are there that we should see some improvement in comps from the remerchandising?

John Rossler

As I had said, David, over the past couple of years, we initiated some market research, consumer research, and asking customers what they want and experimenting and watching closely what is selling and not selling. We feel that we got too far away from current merchandise at more reasonable average unit retails, and we had really gotten into maybe merchandise of the two-year old variety and more cheap discount-type grade merchandise. And what we're finding, again from the research and the experimentation with what's selling better, we're selling today's newspaper a lot better than yesterday's newspaper cheap. So that's where we're set up with for fall is more of the current colors and styles of fashion throughout the store, and that gives us better average unit retail. We still have extreme values on the price points, and the early read is that our experimentation, you know, it was correct that that's what the customer is looking for is more of today's newspaper rather than yesterday's, and they're willing to pay an extra buck for it.

David Mann, Johnson Rice

Are you able to perhaps elaborate a little more on what these early reads are maybe in some of the back-to-school categories?

John Rossler

I'm sorry. I didn't hear that question, David.

David Mann, Johnson Rice

I'm sorry. Can you elaborate a little more on some of the early reads that you're talking about, perhaps in let's say the back-to-school area?

John Rossler

Yes, the earliest read that we have is with our juniors and young men's, which we got out in front of probably about six to eight weeks earlier than the balance of soft goods. And we are very pleased with the strength of those two categories and, again, it's a real transformation into the styles and colors that that customer is looking for.

David Mann, Johnson Rice

Okay, and then one last question. Jim, perhaps you can just give us a sense on the guidance you gave for the third quarter. It's slightly lower than what you said last quarter. What would be the main culprit for that?

Jim McGrady

Well, I think really the main culprit for that is we've taken down our expectations for the top line a little bit in our Value City operations, and we made up some of that through the maintenance of the margin improvement that we've seen. So I think that's

really the main change that's out there, but I also believe that we'll be able to see some leverage out of our expenses as well as we get even more and more efficient as time goes along in our warehouse operations. So that's really the crux of the change that we're seeing there.

David Mann, Johnson Rice

Okay, great. Thank you very much.

Operator

Thank you. Our next question comes from Mr. Arnold {Brief} with Goldsmith & Harris. Go ahead, please.

John Rossler

Good morning, Arnold.

Arnold Brief, Goldsmith & Harris

Good morning. I'm sort of a little bit surprised at the timing of the change in the quarterly estimate. I don't want to push you too far in this. But seemingly just when you're getting the benefit of the change in merchandising in soft goods at Value City, and you should be benefiting from that in sales and margin, you're lowering the estimate and the sales expectation. It seems to be sort of a contradiction.

John Rossler

Yeah, it is, and actually, another piece of that is when we're going to open stores out there as well in our DSW operations, compared to where we originally had some expectations. So that's part of it. I think that even though we do see strength in where we have done remerchandising and focused our operations on the top line, in fact, that's something that we're going to have to put in throughout the balance of the chain, and that's not an overnight process. And it's going to take time, so we're just being what I would call very realistic about what we're seeing. And when we originally did this, perhaps we didn't expect that the gas prices would stay where they're at right now and that the election is really –

Arnold Brief, Goldsmith & Harris

Well, I guess that's what I'm sort of trying to get at a little bit. To what extent are you making a macroeconomic call in this forecast?

John Rossler

What kind of an economic call?

Arnold Brief, Goldsmith & Harris

Macro – are you sort of making an adjustment in your sales expectations because of the overall economy?

John Rossler

Yeah. I mean, frankly, that's where it would be. We still see strength in our remerchandising efforts and everything like that, but we really just had to step back and take a real hard look at what's going on out there in the world today and what really people are saying about what the holiday season's going to look like and the remainder of what was the back-to-school season.

Arnold Brief, Goldsmith & Harris

Could you give me some idea how your sales went, let's say, in the last week of August into the first week of September? Have they improved versus the first three weeks in August?

Jim McGrady

Oh, without a doubt. The school openings this year were very staggered for us, where last year, we had a concentration in about a four-week period of the school openings in the districts that our Department Stores service. And this year, that's really gone over a six-week period and, frankly, is even going into this week. We have one week here where we've had 33 districts opening in comparison to last year. So I would say that definitely we saw a shift in that, how things were opening. We're just going to really have to look at it as a six-week period in total, once we get through this week, to really evaluate what the back-to-school looked like for us.

Arnold Brief, Goldsmith & Harris

And finally, on this subject, the remerchandising, getting out of – I'm oversimplifying this, but getting out of two-year-old merchandise into current merchandise, more fashion merchandise, I'm not quite sure that I understand how you did that and at the same time got higher gross margins, why there wasn't some necessity of cleaning out some of that older merchandise at a lower margin.

Jim McGrady

Well, we did our end-of-season clearance as we usually do, and we had some pretty good acceptance of that. We did make an investment to be forward with the season here in the fall season, and we tried to do a little bit of that in the spring. But really we got out in front of it here in the fall, and rather than being ready two weeks behind where our competition is, we're ready at the forefront of the season in the areas that we're concentrating with our remerchandising efforts on.

Arnold Brief, Goldsmith & Harris

So the change was really in the reordering for the fall season and changing your philosophy of what merchandise you're looking for for the fall season, and bringing it in earlier?

John Rossler

Hi, Arnold, it's John. A couple of changes. One is really the store today is more in sync with fashion than it was, for instance, the spring season. In the spring season, we didn't have all of the spring colors that were so popular. The stores are ready today with the new fall colors. And the other thing is we have transitioned it earlier. I would say that our stores are transitioned probably three weeks earlier this year than they were last fall, and they're transitioned quite a bit earlier than they were for the spring. So with the first cool weather, whenever that comes, we are set for the fall season and would hope to get full-price selling where, in the past, we would get our fashion-forward merchandise in maybe a few weeks too late, and we would miss that first – whenever that first good week of full-price selling, we usually would miss it. We wouldn't be transitioned early enough. But the stores are cleaned out, and they are transitioned for the fall.

Arnold Brief, Goldsmith & Harris

Okay. Is some of your conservatism for the last half of the year the fact that you're stepping up the advertising expense line substantially I guess versus the first half? And like all advertising, you're never quite sure what kind of impact it will have?

John Rossler

Well, as I had said, in the first half, we consciously chose to spend 15 percent less advertising than the spring season of 2003. We did experience some comp store sales decreases, not in proportion with the advertising reduction. But because of the strength

of the fall season and Thanksgiving and Christmas, we've chosen not to take that risk, and we've chosen to do the same advertising spend that we did in the second half of 2003.

Arnold Brief, Goldsmith & Harris

So it's up from the first half of 2004, obviously, because seasonally if no other reason, but it's the same as the last half of 2003?

John Rossler

That's correct, Arnold.

Arnold Brief, Goldsmith & Harris

So there's no negative impact on the comparison in terms of the SG&A?

Jim McGrady

No, there shouldn't be, Arnold.

Arnold Brief, Goldsmith & Harris

Okay. The timing on your refinancing has been pushed back and sort of pushed back again. Could you give us some information on what's going on there, and is it shaping up into anything you can talk about in terms of why the delay and the form it may take?

Jim McGrady

I really don't have anything that I can say about it at this point in time, Arnold. I can say that we are diligently working towards a resolution of this matter, got all parties that need to be involved are being involved as we speak in this. I do hope that this is resolved sooner than later, but it's in fact something that, at this point in time, we can't discuss. But I can assure you that we have quite a few people that are diligently working towards resolution of this issue.

Arnold Brief, Goldsmith & Harris

Is there anything you can discuss with us about the delay, why it's seemingly taking so much longer than expected?

Jim McGrady

Well, there are a lot of parties that are involved, as well as parties that – like are factors and things like that that we have to just keep everybody aware of what type of a transition that we might be interested in doing, and it just takes time to get resolution of individual issues for people for their concerns. And we want to make sure that this is absolutely the right thing that's going to work for the company on a go-forward basis and that it's going to be something that will hopefully permanently address all of our financing issues. Beyond that, I really can't say much more about where we're at at this point in time.

Arnold Brief, Goldsmith & Harris

I'm just going to push it one more step and then I'll move on. Since it has been delayed a couple of times, when you said "by the end of the year," is that sort of like an outside guess? Have you left some margin of error in there, so you expect it to be somewhat sooner?

Jim McGrady

I would say that our expectation is by the end of the fiscal year that we'll have this resolved. And whether there's a margin of error in there or not, I can't say. That's our expectation.

Arnold Brief, Goldsmith & Harris

Okay, I don't want to push any further. Just lastly, a broader issue, you focused on Value City quite a bit and I think done a good job of giving us some picture of what's going on, particularly in the merchandising area. Apart from merchandising, do you believe that there – you obviously don't believe, but do you see any structural problems at Value City in terms of competitive strengths or location of stores or the concept itself versus what's going on in the marketplace, I don't know, all the outlet malls and discount centers and the efficiency and pricing of a Wal-Mart. I mean, the competition has changed. The locations maybe aren't what they used to be. I'm not sure about that. Apart from the changes you're making in merchandise, is there any other competitive structural problems that you have to confront with {ISA}?

John Rossler

Arnold, I believe that we can do a good business in most of our Value City store locations. The thing probably structurally that bothers me the most, now that we feel that we're really getting our arms around, you know, through market research and experimentation, the merchandise that best works for Value City, I think the thing that bothers me the most is that we still don't have the systems tools in place to realize Value City's potential. As you know, like most retail chains, we have different sorts of locations, and it's very difficult on a day-to-day basis to keep the allocation of merchandise, you know, to get the right goods in the right store at the right time, without the sophisticated systems that Value City is entitled to. But as we mentioned and as we had mentioned a couple of years ago when we put the system redevelopment in place, that whole system redevelopment is probably a four-year project, and I would feel right now that we're probably halfway through it with the POS systems in place. We have the warehouse management systems, the core merchandise system, and the planning and allocation renovations well along the way. But until we get a little more passage of time and those systems are in place, that is really the thing that I think is really keeping us from being able to realize the potential within the Value City brand.

Arnold Brief, Goldsmith & Harris

So you feel pretty strongly that the earning power of Value City is dependent on your doing a better management job versus not so much dependent on the external variables, competition, etc. It's more a question of you getting this company in shape.

John Rossler

Competition's always a challenge within all of our brands.

Arnold Brief, Goldsmith & Harris

Well, of course.

John Rossler

But again, the thing I feel that's holding us back the most, realizing our Value City potential, is the lack of systems which, again, just requires the passage of a little more time, you know, a couple more years before all those systems are in place.

Arnold Brief, Goldsmith & Harris

Okay, just quickly, just housekeeping, could you give us – just to update the number to make sure it hasn't changed, depreciation, amortization for the year and capital expenditures for the year.

Jim McGrady

Yeah. Just a second, Arnold. Okay, let's see. Cap-ex spend for this year was \$30.8 million.

Arnold Brief, Goldsmith & Harris

No, that's for six months. I meant the estimate for the year.

Jim McGrady

Oh, for the year.

Arnold Brief, Goldsmith & Harris

Yeah.

Jim McGrady

Actually, it's going to be about \$55 million on cap-ex, and it'll probably be about \$53 million for D&A.

Arnold Brief, Goldsmith & Harris

Okay, thank you.

Jim McGrady

Okay.

Arnold Brief, Goldsmith & Harris

I'll give somebody else a turn.

Jim McGrady

Okay.

Operator

Thank you. Our next question comes Ms. Katherine Galligan with Aperion Group. Go ahead, please.

Jim McGrady

Good morning.

Katherine Galligan, Aperion Group

Yes, hi, how are you doing? I just have a question about your SG&A expense. And I can't help but notice that it just seems so much higher in comparison to some of your peers. And I was wondering what kind of initiatives do you have in place to bring that down at some point, and do you have sort of a time frame in mind?

Jim McGrady

Yeah, actually, that's a question that we get asked pretty regular, and a lot of times there are different things that affect the comparability. But as we take a look back at where we need to leverage and I think as John mentioned, as we can get more and more efficient on our systems and really start to realize some of the benefits that we'll see out of those, and those are not just inventory type of merchandising things, they're also warehouse management systems and just efficiencies that we'll see in the stores from the backrooms operations, even as one down to the time clock procedures and things like that. I think that's really where we need to focus upon and we are focusing upon, getting

benefits in our SG&A line, plus we take a real hard look monthly at our overhead allocations and things like that as they are in total compared to some of our peers that are out there. And we do recognize that there are some issues, but really the big piece of that are the efficiencies that we believe that we can achieve in the Value City – well, frankly across the chain but really in the Value City operations is a preponderance of it, getting the benefit out of that with some of the new systems that we've got scheduled to bring on board here in 2005.

Katherine Galligan, Aperion Group

But given your cash balance right now and as your cap-ex needs and your cash needs going forward, it's not really an area where you can devote a whole lot of attention right now?

Jim McGrady

Well, we are devoting a whole lot of attention to the systems right now. Is that your question?

Katherine Galligan, Aperion Group

Yeah, I guess I'm just wondering is there something that you – do you have to delay, just kind of given the state of your balance sheet and the priorities where you have to sort of devote your cash –

Jim McGrady

Oh, for our systems –

Katherine Galligan, Aperion Group

– once you earn it, that sort of thing.

Jim McGrady

For our systems implementation, no. As a matter of fact, we have said, I guess very early on or very late last year, that it would be 2005 as we really put the big step forward on our systems and the investment there. And no, right now, that's still our game plan is to go forward in 2005. We have been working on it throughout 2004. I mean, as John pointed out, we just put in an entirely new POS operation here at the Department Stores and are investing in some ancillary systems at this point in time, and we've also installed part of the planning allocation systems with DSW. So we're starting to really put pieces of this together, but 2005 is when the big – I don't want to call it the "big bang," but really the big push comes forward for us in starting to get these systems up and running and converted over.

Ed Kozlowski

This is Ed Kozlowski. The technology situation at Value City was such that we realized that it had to be phased in. First phase was to get point-of-sale so that whatever systems we put in the back office could be received at store level and could be used

efficiently. Second step was to get JDA and new warehouse management, new {planning} allocation up and running for the smallest division, which was the jewelry division, which we did in 2004. Now we're positioned to initiate the roll-out of soft lines and hard lines in two phases in the 2005 year.

In addition to that, we've had increased efficiencies as was asked earlier by David Mann about improved SG&A in the current quarter, improved efficiencies at Warehouse. Part of this is being driven by the control of inventory and the control of average unit retail, so that we're able to more productively move units through the system. Now we're focusing on addressing at the store level, now that we're getting less units, better throughput, now we want to go at the store level expense structure and create efficiencies there.

In addition, beginning in 2005, when we start to implement the hard lines and soft lines software technology, we will make additional expenditures in warehouse equipment and additional upgrade in the sorters to allow us to be more efficient and take advantage of these new systems. To make those expenditures in 2004 would have been fruitless, would have been no return on investment. One of the things we do have to maximize and watch is, you know, we do have capital expenditures because we have one chain that's in a turnaround, we have another chain that is a growth story. We're trying to make sure, and actually two that are now in the growth mode, so we want to make sure that we can handle the growth of those two chains while enabling Value City to continue its turnaround effort. Value City had really underspent in infrastructure needs for a decade,

and that is unfortunately a four-, maybe even a five-year total process. When you really look at Value City's project list, you know, new wireless point-of-sale was implemented. We're in the process of getting the scanners, the magnetic gift card, and bringing Value City into the 21st century to compete with everyone else who has the plastic gift card with the magnetic stripe. Value City couldn't even do that four months ago. And so now we're on the way to do that. We'll be moving to new cash office systems the beginning of next year.

So this is a step process. It's kind of one step at a time. And unfortunately, some of the steps require infrastructure spending that you really don't see on the surface. It really sets the platform. It's like building a house. Once the house is built, no one stands back and sees the footer in the foundation, but without it, the house won't stand. And what we've been doing over the last two and a half years is building the footers in the foundation, and now we're beginning to put in the things that you see. And as an example, the point-of-sale will enable us to get better throughput through the holiday season and better enable us to handle our customers' credit card transactions and things of that like.

Katherine Galligan, Aperion Group

Okay, that's fair enough. The house analogy that you just used, are you speaking specifically just for Value City, because if I were looking company-wide, I would say that you're trying to grow a concept while repair another major one, and it's a lot to undertake all at once.

Ed Kozlowski

Well, actually, all their technology needs are in different stages. At DSW, we had implemented a warehouse management system and a merchandising system 2001 and put in planning and allocation in 2003, and we're beginning enhancements for planning and allocation in 2004. In addition to that, we have a customer loyalty program, RYS, and we've been making enhancements to that program in 2004. So we're at a different stage of that "house building," if you will, in DSW.

At Filene's Basement, since it's a smaller chain, you're able to effect change a little more quickly. We've gone in and done some infrastructure change in basically data control, data lines, and things of that type of an infrastructure that will yield a half a million dollars in savings a year on a go-forward basis. We've restructured the reporting for Filene's Basement, customer traffic counters in all stores that we already have in DSW to enable us to really understand the traffic, the walk rate, and how we deal with things. We've moved to where we can print signs in the Filene's Basement so that the in-store toppers that go on rounders and floorways can be generated locally and therefore kept up-to-date and fresh, depending on the merchandise that they currently have. These are the types of things that have gone on at Filene's Basement.

And again, as I said at DSW, it was really one of where we are now making enhancements to the planning and allocation system that was installed in fall of 2003.

Katherine Galligan, Aperion Group

Okay. Okay, thank you, that's helpful. And then just one other thing, as far as your inventory planning, can you talk about what you're doing going forward just by segment? Are you planning your Value City inventories lower?

Jim McGrady

Overall, for the balance of this year, I would actually say that we are planning a lower inventory level. I think the timing of when our inventories will be received is going to be a little bit different from what we have historically seen because of the way that we're buying the goods right now. We want to be out in front of the seasons ready for it. So we might see, at a point in time, a little bit higher level than what we have on a historical basis. But overall, in the stores and things like that, our expectation is that our levels would be about the same overall in the number of dollars but fewer units.

Katherine Galligan, Aperion Group

Okay. Great, thank you very much.

Jim McGrady

Okay, thanks.

Operator

Thank you. Our next question comes from Mr. Arnold Brief with Goldsmith & Harris. Go ahead, please.

Arnold Brief, Goldsmith & Harris

Back again. Just to summarize the SG&A, would it be fair to say that a very high proportion of that SG&A is fixed and the real leverage in terms of reducing the percentage will be through increasing comp store sales?

Jim McGrady

That's a fair statement. That's pretty true throughout most of the SG&A expenses that we do have. I mean, we also can attack those fixed expense lines though, Arnold. You now, obviously we can't do anything in the short term about rent or anything like that, but some of the other fixed components that we have out there, we can take a real hard look at and try and reduce those over a period of time. But you're right, a big piece of that's going to come through the top line performance.

Arnold Brief, Goldsmith & Harris

Secondly, could you sort of review the DSW in terms of new stores? You focused a lot on Value City today and the turnaround, but the growth story at DSW is what has been consistent, pretty outstanding. I know you didn't have a big opening program last year, but are those stores on track in terms of the maturity cycle? How are the new stores

you opened this year performing? And maybe just a rough guesstimate of your opening program for next year. I know it's early, but maybe you can give us a ballpark.

Jim McGrady

No, we're looking for – you know, last year, you're right. We only opened 16 stores, but those stores have matured as expected. One of the things that, a very positive sign in DSW, has been the maturing of stores by year of opening. If I look at the 2003, 2002, 2001, as the passage of time, they have all, as a group, matured in a very positive trend in yielding the kind of return that we would expect. This year so far, we've opened 16 stores and expect to open roughly a like amount in the back half of the year, give us somewhere between 30 and 35 stores for the year. Next year, we're looking for a minimum of 30 stores for 2005.

Arnold Brief, Goldsmith & Harris

And finally, you opened this one up, so since the jewelry has gotten into the new systems earlier than some of the other categories, could you discuss what's going on there and the benefits that you see, or what you see happening to the jewelry department as a result of this?

Jim McGrady

What the systems do is they provide you with more visibility at what your inventory is, where your levels are, and where you're going. The most positive sign

that we've had is that this implementation has gone smoothly from the standpoint of executional of the warehouse management of the JDA and of the planning and allocation. Probably the piece that always is the most troublesome of any implementation is reporting, and we continue to try to address those needs as we move through the year and really change the way we look at information, rather than deal with the types of information we had. I think sometimes there's a tendency for people to want to continue to do what they've done in the past rather than a fresh look at things. But as we move forward, we've identified certain needs, and now that as we come through 2004 and get into 2005, when we do the hard lines, we'll be in a position we know executionally that the systems will come up, be on line in a timely and productive fashion, and then those are also very key. We don't want to have any missteps. We had no missteps with the conducting of business in jewelry, and we expect no missteps with the conducting of business, future implementations as well.

Arnold Brief, Goldsmith & Harris

I'm trying to recall the numbers, but your jewelry sales were down in the first half, weren't they?

Jim McGrady

Yes, they were, Arnold, and I'm not real sure that across the board in that line of business, anybody really saw what I want to call stellar performance in the jewelry business. It was just an off-time for them. There's been high signs and low signs in there

of recovery, and we just don't have right now exactly when that's going to come back to us.

Arnold Brief, Goldsmith & Harris

Have you seen any real benefits from the new systems in jewelry?

Jim McGrady

Yeah, I think actually we have seen some benefits. We've been able to control that inventory. We haven't got into a situation where we've got out in front of our expectations in any given category that's in there. And again, as we take a look at this for the performance of jewelry, some of that advertising reduction that we mentioned earlier on definitely affected them. They are promotional. It's a glitz-type of a business where people want to see the jewelry, the gold, the silver, the turquoise, things like that that are out there. So they actually saw some of that decline. They were probably more affected by that I would think than the other divisions. But overall, that's just been a slow-moving business at this point in time.

Arnold Brief, Goldsmith & Harris

But I would conjecture that jewelry, at the income of the consumer that you serve, is very discretionary and probably was hit pretty bad by the slowdown of the economy, gasoline prices. In fact, jewelry at the upper end has been fairly strong. But at your end,

I suspect that it's more discretionary and more volatile and probably got hit a little bit worse.

Jim McGrady

That's probably a very correct observation, and in fact, jewelry would probably be one of the lower items on anybody's agenda that was in – you know, a budget-type customer that we have. And I do agree that the upper end did see some movement, but I wasn't comparing ourselves to them.

John Rossler

Arnold, as Jim mentioned, I feel also that the advertising cutback hurt jewelry quite a bit. Quite a few of the weeks that we went through in the first half of the year, our weekly circulars a lot of times where we cut back from 12 pages last year to eight pages this year, one department that got a whack most every week was jewelry, and our customers are accustomed to seeing new jewelry promotions in that circular every week. And quite a few weeks, we skipped it this year, and there's no question jewelry took it on the chin for that. We'll see in the second half of the year, when we're matching up our advertising better this year to last year.

Arnold Brief, Goldsmith & Harris

Okay. Just one last question, and I'll get off again. DSW is growing extremely nicely. It's obviously outperforming its competitors by a wide margin in terms of sales.

But if I look back at the history a little bit, you know, we had a slow economy for a few years. There was a period of time a couple of years ago where you built some infrastructure in DSW. And then in this year, you had a sharp acceleration of your opening program, you know, just as the economy got a little bit better for a while. I mean, you have the opening expenses and new store losses, which have depressed margins. So we have a pretty good idea of what's going on with sales and sales per store and the success of the stores in terms of where we're going. What I'm not quite sure of in DSW is if I look two, three, four years out, what do you think normalized operating margin's going to be for this company? What kind of target would you have on a long-term basis? I'm not looking at next year or even the year after that. But once your opening program sort of gets normalized in relation to comparisons and the revenue model, and you've got the infrastructure in place and it starts to leverage down a little bit in the SG&A line, is this a business that can do a five or six percent operating margin?

Jim McGrady

I'll tell you that that is an expectation that we could reasonably have about that business, without a doubt. I would not really want to look beyond a year out or so, to be honest with you, but I would think that as we model this thing out and really take a hard look at it, that our expectation could very well be in that area.

Arnold Brief, Goldsmith & Harris

Okay. Thank you.

Operator

Thank you. Our next question comes from Mr. {Jonas Girtsel with Jonas Capital Partners}. Go ahead please.

Jonas Girtsel, Jonas Capital Partners

Hi, guys, nice job. You spent a lot of time discussing systems. I wondered if you could just discuss two other areas, (a) reconfiguration of the Value City stores. Are you taking more space away from one category and adding more to furniture or hardlines or whatever? Well, you can answer that first.

John Rossler

Jonas, hi, it's John. One of the things, as I mentioned earlier, that a couple of years ago, when we jumped into the Value City turnaround, {backing} was market research. And some of you that over the years that we've talked on the DSW know with the DSW brand, we're accustomed to investing in consumer research, and the continuous evolution of the DSW brand is driven by consumer research. So over the past couple of years, we have invested in Value City an awful lot of research to try to determine what the customer really wants to see, that with experimentation. And what we have learned is what I mentioned earlier in my comments, that the customer really wants today's fashion, even the entry-level budget customer. So I guess one comment I would say to you is that we're much more focused on current fashion.

Jonas Girtsel, Jonas Capital Partners

But what about real estate?

John Rossler

And then, within the box itself, as far as you said, allocating, is we have chosen this season to allocate more space to juniors and young men's. We feel that that was a tremendous opportunity for us, and we're extremely enthused about the results that we've seen over the past month or so. We've gotten a very, very good response to that category of the business by giving it a little more space. You know, we've seen nice improvement in that business.

The other thing is within our home goods, I think, and hard goods, we do some of our hard goods space, toys and sports and things, and added more space for home goods, for domestics, and that's been very successful for us so far, Jonas.

Jonas Girtsel, Jonas Capital Partners

Okay. And the other question, because at one time, you were trying to go a little higher priced and lower priced, have you settled on your price point as where you are now and where are you now, and is this where you're comfortable?

John Rossler

You know, you are right, Jonas. Over the years, it's almost felt like Value City one day's been like trying to be Neiman Marcus and the next day Wal-Mart. And through experimentation, we've even over the past couple of years, we've been up and down and a little bit, but narrowing in on it. And a year ago, last fall-winter season, we definitely were way, way low on our average unit retails, and we're up about a buck now on average unit retails, and we think we're pegged to where we need to be. We are able at that average unit retail to offer the better customer some of the nicer brands but, yet, unlike a couple of years ago when we went just too high, we've not walked away from our budget customer. We still have the entry-level price with today's fashion.

Jonas Girtsel, Jonas Capital Partners

Yeah. My last comment, not a question, but more or less an editorial comment, as a long-term holder, a year and a half ago, when you were starting to talk about refinancing and everything, I could see why it could take a while. I mean, the health of the company was clearly in question at that time. Now you're a totally different company, it's taking extremely long. There are many companies out there that aren't in the shape you are, where it doesn't take that long. And to me, since you're not going into detail, it comes up as stubbornness on somebody's part, because this should be done, and it's important to be done. Of course, for the perception of the stock to the investment community, I think it would make a world of difference.

John Rossler

Jonas, it's John. I agree with your concern, and I can tell you that there are good choices available to us, and we are a very methodical management group, and we are being very careful to make sure that the restructuring of our situation, financial situation, is such that it ends up being in the best interests of our shareholders and our business. And again, you know, there are good alternatives, and we're making sure we land in the right spot. And it's just a situation, I know there's a lot of impatience. I'm impatient, also, but I think it's more important that we land in the right spot than we do it as quick as we would all like to see. But I can assure you we are on it. We share your concern.

Jonas Girtsel, Jonas Capital Partners

Okay, thank you.

Operator

Thank you. Once again, if you have a question, please press a "1" followed by a "4" on your touchtone phone at this time. And it appears we have no further questions at this time.

John Rossler

All right. Thank you everybody for listening in with us this morning, and we'll be talking with you here when the results for the third quarter are available. Everybody have a good day and, again, thank you.

Operator

This concludes today's conference call. Thank you for your participation.

(End of Conference Call)