



Yale SCHOOL of MANAGEMENT

Food Retail: Company Report
December 5, 2005

Initiate Coverage

Wild Oats Market, Inc. (OATS)

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Price: \$12.34

Target: \$14.30

*Initiating Coverage with a rating of Buy*¹

- Price target of \$14.30 represents 16% upside
- Pains from infrastructure build-out and supplier switches are in the past, leaving room for margin expansion
- Private label has far exceeded expectations
- Partnerships providing increased brand awareness and high margin sales
- Take-out potential provides downside resistance
- But threat of bankruptcy too large to ignore

¹ Please see important disclaimer at the end of this report.

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INVESTMENT THESIS

We are initiating coverage on Wild Oats Market with a buy rating. Our price target of \$14.30 is based on an APV analysis, acquisition analysis, and Monte Carlo simulation. We believe Wild Oats has finally put the infrastructure in place to begin sales growth and margin expansion, the impacts of which are already coming to bear in the third and fourth quarter. We expect this momentum to continue as Wild Oats benefits from strong industry growth – growth we believe is strong enough for both Wild Oats and Whole Foods to benefit without stealing share from one another. Considering these factors, our outlook is bullish; further, adjusting for the likelihood of bankruptcy, we conclude that Wild Oats represents a buy.

OVERVIEW

Wild Oats Market Inc. (NASDAQ: OATS) owns and operates the third largest natural foods supermarket chain in North America, measured by sales.² The Company had sales of \$1.048 billion in fiscal year 2004 and operated from 108 stores in 24 states in the U.S. and British Columbia, Canada under several names, including Wild Oats Natural Marketplace (nationwide), Henry's Farmer's Market (southern California and Phoenix, Arizona), Sun Harvest Farms (Texas), and Capers Community Market (British Columbia, Canada).³

In 2004, Wild Oats had a net increase in stores of 5 new stores, with 12 additions, 6 closures and 1 store sold. As of the most recent conference call, the company operates 113 stores. Wild Oats sales were approximately 8% of total organic foods sales in 2004.⁴

Wild Oats Store Map



² Hoover's website: www.premium.hoovers.com

³ Wild Oats Market Inc. 2004 Form 10K. As of October 1, 2005, Wild Oats operated 112 stores. Source: Wild Oats Form 10Q.

⁴ Using data from the OTA 2004 Manufacturer Survey Overview and author's calculations

Industry Definition

Wild Oats is a chain of grocery stores which specializes in organic and natural products. Organic food is defined as food grown without herbicides, pesticides, fungicides, or genetic engineering. Natural foods are not organic. Natural foods are defined as those which generally contain no artificial additives and are prepared with minimal processing.⁵

It is also important to note that in 2002, the USDA's "Organic Rule" was implemented into Federal Law. The rule requires that all products labeled "organic" must be certified by the USDA and that all retailers which handle, store, or sell organic products must implement measures which:

- prevent the commingling of organic and conventional products,
- protect organic products from contact with prohibited substances,
- ensure organic products are clearly and properly labeled, and
- require proper record keeping regarding organic handling procedures and vendor relationships.

Wild Oats also carries non-food items such as supplements and body and house care products. Like the food they carry, these products are also natural, and Wild Oats further ensures that the products are not tested in ways that are harmful to animals.

Business Model

Wild Oats' stated objective is to become the 'grocery store of choice both for natural food shoppers and quality-conscious consumers in each of their markets by emphasizing the core elements of their operational strategy, which include their store formats and locations, high product standards and competitive pricing. The basic idea is to provide high quality natural foods to health-conscious consumers in an educational and entertaining store environment at competitive prices. Below are the core components of Wild Oats' business model:

Store design and location: Wild Oats has two basic store formats: natural foods supermarkets under the Wild Oats Market and Capers Community Market banners, which emphasize gourmet, natural, and organic products and high-quality service; and farmer's market stores under the Henry's Farmer's Market and Sun Harvest banners, which emphasize fresh produce, natural living products and price value.⁶ Wild Oats prototype stores range from 30,000 to 35,000 square feet, and offer a wide range of natural food products in every category found in a conventional supermarket.

The farmer's market stores currently represent about 35 of Wild Oats' 113 stores, or about 31%. These stores, because of their pricing strategies, provide slightly lower margins than the natural foods supermarket stores. Currently, the company's stores in development represent about a 60/40 split in favor of the natural foods concept, which represents an

⁵ "Shopping Quiz: Which of these products can be found in your local grocery store?" Omaha World-Herald. September 29, 2005.

⁶ Ibid.

increase in the percentage of store base under the farmer's market concept. Though the relative impact on store base will be slow, we see the long-term impact of store mix as a reduction in gross margins of 100 basis points versus 2005 run-rates of 30%.

It is also important to note that we do not see a reversion to the acquisition-happy growth strategy that significantly hurt the company in the late 1990s and early 2000s. Wild Oats grew in number of stores from 39 at its IPO date in 1996 to 107 at the end of 2001, a CAGR of 22.3%.⁷ Its growth in the years following the IPO was through an aggressive program of store acquisitions of natural store chains, predominantly in the West and Southern U.S. Growth in recent years has been more deliberate, with a focus on the western United States, and new (since 2001) management has been much more disciplined.

Purchasing and Distribution: Wild Oats entered into a 5-year primary distribution agreement with United Natural Foods Inc., the largest supplier of natural foods in the U.S. (and the primary distributor to Whole Foods Market Inc.) in January 2004. UNFI is Wild Oats' single largest supplier, with purchases from UNFI representing 38% of Wild Oats' cost of goods sold in 2004.⁸ Wild Oats accounted for 11% of UNFI's net sales in 2004.⁹ The reason for this selection was the propensity for stock-outs under former distributor, Tree of Life. Most transition interruptions are now in the past, and we feel the new arrangement should allow for an increase in the same-store sales growth run rates over the past five years.

Wild Oats also operates bakeries, commissary kitchens and a new 241,000 square foot distribution center that supplies 70 of its stores, with plans to add nine stores to its distribution base in 2005.¹⁰ The new distribution center is already running at 100% capacity on a single-shift basis, with the ability to run on up to three shifts.¹¹ This facility has significantly decreased stock-outs and also allows Wild Oats to save money through self-distribution. This should also positively affect same-store sales growth, and the economies of scale provided are expected to expand gross margins. Some analysts see this as a 200 to 300 basis point opportunity, though we have modeled it as a 100 basis point improvement.

Product Range: Wild Oats' offerings include grocery, juices, wines, produce, meats and poultry, seafood, bakery, gourmet and ethnic foods. Other products are floral services, pet food, and an extensive range of private-brand products. Wild Oats generally does not offer well-known national conventional brands and focus on a selection of natural products within each category. However, Wild Oats has recently introduced a handful of more traditional products such as Tide, Clorox, and Parson's Ammonia in an effort to overcome the fact that many patrons of stores like Wild Oats and Whole Foods also have to shop at traditional groceries for certain items.¹² Wild Oats is trying to achieve balance with these traditional items, and will only stock traditional items that meet its natural standards (there are traditional items which meet natural standards, but often customers are shocked to learn

⁷ Wild Oats Form 10K's: 2000 – 2004.

⁸ Ibid.

⁹ UNFI's 2005 Form 10K. UNFI's financial year-end is July 31.

¹⁰ Wild Oats 2004 Form 10K.

¹¹ Wild Oats 3Q 2005 conference call.

¹² "Shopping Quiz: Which of these products can be found in your local grocery store?" Omaha World-Herald. September 29, 2005.

this). Most customers seem understanding of the move once they learn that it increases the reach of the organic/natural concept by bringing in non-traditional customers. We feel that this is a good strategy only if Wild Oats does not compromise current standards. Many customers of stores like Wild Oats patronize these companies because they “read the labels for you.” If compromise occurs, Wild Oats could quickly become another commodity-type supermarket, losing its cache as a store where customers know that no matter what they grab off the shelf, it is good for them. In light of this, we believe the company is committed to maintaining its standards, and as such, feel that stocking selected traditional products can increase market basket size going forward, driving improvements in same-store sales growth over current run rates. That said, traditional products carry lower margins than natural/organics. Based on Safeway’s gross margins, we estimate these products have margins approximately 10% below Wild Oats’ average. Assuming traditional products grow to 5% of Wild Oats’ sales, this represents gross margin contraction of approximately 50 basis points.

Wild Oats is also currently expanding its ‘Wild Oats’ and ‘Henry’s’ private label programs in order to build brand loyalty to specific products. Through this program, the company has introduced a number of high-quality, unique, natural and organic private label products, such as cereals, breads, salad dressings, vitamins, chips, salsa, pretzels, cookies, juices, Italian sodas, pasta, pasta sauces, oils, tuna, and frozen products, such as pizza and veggie burgers. In fiscal 2004, Wild Oats introduced 581 new and reformulated private label products, and to date in 2005, they have introduced over 1,100 additional private label products.¹³ As of 3Q 2005, Wild Oats’ private label brands were the top brand in their franchise, representing an average of 30% share in each represented product category and 10% of company sales. Sales of private label products have increased 40% in 2005. Private label products typically carry a 300 to 600 basis point margin advantage,¹⁴ and assuming the company can reach 20% of sales represented by private label products, total margin expansion should be approximately 45 basis points. We forecast that this gain will occur by 2010.

In addition, the company is currently expanding its prepared foods and value-added items (such as marinated or stuffed meats and seafood) and in-store cafe environment, to provide an added service to its customers, broaden its customer base and further differentiate its stores from conventional supermarkets and traditional natural foods stores (Whole Foods).¹⁵ Prepared foods currently represent 17% of Wild Oats’ sales and carry margins 15 – 20% higher than the corporate average.¹⁶ We expect Wild Oats’ efforts and the growing popularity of organic market cafes to increase prepared foods to 20% of sales by 2010, representing a 51 basis point increase in gross margins.

Finally, the holistic health departments’ sales, which represent Wild Oats’ most profitable segment, have been growing quickly. Unfortunately, we do not know what percentage of sales holistic health represents, and thus cannot quantify gross margin impact.

¹³ Wild Oats 3Q 2005 conference call.

¹⁴ KeyBanc Report, November 14, 2005.

¹⁵ Ibid. Italics: Authors.

¹⁶ KeyBanc Report, November 14, 2005.

Marketing and Advertising: Wild Oats advertises actively in traditional media outlets such as radio, newspapers, television, outdoor and direct mail to gain new customer trial and repeat business. The company introduced television commercials for Wild Oats Natural Marketplace stores in 2004, as well as new print and outdoor advertising for both Wild Oats and Henry's Farmers Market formats. During 2004, they launched the Wild Oats magazine. The farmers market format stores primarily use flyers and 'weekly specials' advertising to generate consumer interest and drive customer traffic.¹⁷ This strategy is very different from competitor Whole Foods, who relies almost exclusively on word of mouth advertising and does not promote specials. We feel that Wild Oats will continue its current policy into the future, but not have relative increases or decreases. Under this assumption, we do not see specific margin impacts, though we note that this use of advertising leads us to believe Wild Oats will never have operating margins as high as those of Whole Foods. As a point of reference, Whole Foods' operating margins have recently been approximately 5.5%, while we model Wild Oats' operating margins to average 2.7%.

Competitive Pricing: Wild Oats seeks to offer products at prices that are competitive with those of other natural foods stores and conventional markets. Their 'Wild Buy program offers a large weekly selection of unadvertised, in-store specials, while their flyer continues to offer aggressive advertised specials on items that we believe their customers want most. They believe these pricing programs broaden their consumer appeal and encourage their customers to fulfill more of their shopping needs at their stores.¹⁸ A randomly selected basket of goods in 2004 found Wild Oats' prices to be about 1% less than Whole Foods, in spite of the fact that both companies have the same distributor.¹⁹ As mentioned in the advertising section, this creates a bound on Wild Oats' operating margins with Whole Foods' margin of 5.5% serving as a cap.

SALES DRIVERS AND RISK ANALYSIS

Management's stated growth strategy is to focus on growth through new store development in areas where Wild Oats already has a market presence, although the company is beginning to look at new markets as well.²⁰ Below is an analysis of value drivers for Wild Oats and potential risks the company faces.

Strengths	Weaknesses
Strong industry trends	Competitive pricing
Purchasing and distribution	Reliance on promotional activity
Holistic Health	May still carry baggage from prior management
Opportunities	Threats
Private label	Competition
Peapod and 'Store in a store'	Potential for unionization
Acquisition target (?)	Organics turn out to be a trend

¹⁷ Wild Oats 2004 Form 10K and 3Q 2005 conference call.

¹⁸ Wild Oats 2004 Form 10K.

¹⁹ From the website: <http://www.louisvillehotbytes.com/wholefoods.shtml>

²⁰ Wild Oats 2004 Form 10K.

Strengths and Opportunities

a) Demographic desires: The aging U.S. population and increasing concern about the purity and safety of food due to the presence of pesticide residues, growth hormones, artificial ingredients and other chemicals, and genetically engineered ingredients should continue to drive sales of organic food stores in the U.S. in the near future.

Below is a table that shows the organic food industry vis-à-vis the conventional food industry.

Year	Organic Food Sales	Organic Food Growth	Total Food Sales	Total Food Growth
2000	6,104	-	589,900	-
2001	7,359	20.6	618,300	4.8
2002	8,624	17.2	627,400	1.5
2003	10,381	20.4	639,800	2.0
2004 (E)	12,450	20	650,000	1.6

Source: The OTA 2004 Manufacturer Survey Overview and author's calculations

The industry is projected to maintain its historic CAGR of about 20% over the near term.²¹ As a reasonableness check on our valuation, we examine the impact of our assumptions on Wild Oats' market position over the model period (See Exhibit 1). To model the growth in the organic food industry, we used the consensus of multiple data sources which resulted in growing the organic model by 20% per year for five years and then slowly trending growth to a terminal rate of 5% by 2017. This results in the organic market growing to a 6.6% share of the total U.S. food market (versus slightly more than 2% currently), a reasonable scenario in our opinion.

As the market grows, Wild Oats has two methods to take advantage of these trends: new store expansion, and same-store sales growth. We modeled store growth in the short-run based on signed leases and company guidance. In the mid-term, we followed company-stated goals for 10% year-over-year square footage growth, which we feel is reasonable given prior execution and the expected growth in the organic/natural marketplace. In the long-term, growth slows to conform with our model's terminal growth assumption of 4%. Same-store sales growth was first modeled based on historical data and trends. We then incorporated the effects outlined in this report to guide any deviations from past performance. All results were put to the sanity check mentioned above.

b) Stable price premiums of organic products over conventional produce: A recent study found that these price premiums have remained steady or increased in some cases, in spite of rapid growth in the size of the industry. Such premiums drive production, contribute to growth in certified organic farmland, and, ultimately, drive market expansion in

²¹ 'USDA National Organic Program – Value through Verification', a presentation by Barbara Robinson, Deputy Administrator, USDA, 2004.

an industry that was formerly supply constrained.²² Although the laws of supply and demand suggest that these premiums cannot exist as the market matures in the long run, the study suggests that these premiums will exist in the short to medium term, which is the time frame of our analysis. We noted above that Wild Oats' use of promotional activity will limit its ability to derive Whole Foods-like margins. However, the premium in the natural/organic market also allows us to set a lower bound, as Wild Oats should be more profitable than a conventional commodity-based grocer. As a point of reference, Safeway has gross margins of 30.5%, operating margins of 4.4%, and net margins of 1.2%, while Whole Foods' margins are 34.7%, 5.5%, and 3.3%, respectively. We model Wild Oats margins at 30.4%, 2.7%, and 1.4%, respectively – the lower side of the boundaries one would expect.

c) Innovative sales platforms: Wild Oats recently concluded a pilot program to sell its private label brands on the Peapod platform in Chicago. Wild Oats is paid royalties for sales of its branded products on this website, giving them relatively higher revenues without significantly adding to its costs. Already, Wild Oats private label brands represent the #1 organic/natural brand sold through Peapod.²³ The program has been judged 'very successful' by Management, which is in discussions with Peapod to expand the scheme to other cities.²⁴ This is an opportunity for Wild Oats to open up the currently untapped e-commerce sales platform for organic foods, particularly in densely populated cities like New York and Chicago. In addition to providing a rationale to continue sales growth, this incremental revenue is royalty-based, and as such, carries high margins.

Wild Oats is also partnering with Stop & Shop to promote the 'store in a store' concept, with Wild Oats stores grafted into Stop and Shop outlets. The small 'store in a stores' provide natural supplements and body care products, focusing on the holistic health segment, Wild Oats' most profitable business segment. This can give Wild Oats easier access to the New England area without significantly adding to its costs, potentially improving margins.²⁵

Current data on sales represented by these two programs is not yet available; therefore, no particular impacts were added to our model. On a best case scenario, we see these plans improving gross margins by 20 basis points, a potential upside of \$1.10 per share.

d) Improvements in IT and emergence from high investment period: In the last two years, Wild Oats has significantly upgraded its IT management, allowing for better inventory control, reduced shrink, and better control over labor statistics. Also, the company has closed many unproductive stores, incurring material restructuring and impairment charges. Finally, the company made a large investment in its new distribution facility. We believe, and management has guided as such, that capex will decline as the company has finally completed its infrastructure restructuring. Also, as mentioned in the purchasing and

²² *Culled from our previous report on Whole Foods Market Inc.* Price Premiums Hold on as U.S. Organic Produce Market Expands, Lydia Oberholtzer, Carolyn Dimitri, and Catherine Greene, USDA Publication, VGS-308-01, May 2005

²³ Wild Oats 3Q 2005 conference call.

²⁴ Wild Oats 2004 Form 10K/A.

²⁵ Ibid.

distribution section, we see future margin expansion and increase same-store sales growth as a result of these efforts.

e) Potential takeover target: Wild Oats has long been rumored to be a target of a takeover by one of the large, conventional grocery stores. Yucaipa, which specializes in turning around and selling grocery stores, announced that it owns a 9.2% stake in Wild Oats in March 2005, making Yucaipa the largest single shareholder in Wild Oats.²⁶ It has long been speculated that Kroger's or Safeway could be potential buyers.²⁷ Furthermore, Dutch giant Ahold owns both Peapod and Stop and Shop, and several observers feel that "acquiring Wild Oats would help Ahold grow outside its traditional East Coast footprint," giving the grocer a national presence.²⁸ Our model includes a take-over model and a probability-weighted scenario valuation. It is important to note that acquisition is not a foregone conclusion – the original rumor of a Kroger's takeout were in August 2003, and never materialized.

Weaknesses and Risks

Competitors

Wild Oats main publicly-traded competitor in the natural foods space is Whole Foods Market Inc. Trader Joe's is the other primary competitor, and is privately-owned.

Other competition comes from cross-over purchases from traditional grocers like Kroger's, Albertsons, Safeway, Winn-Dixie, Pathmark Stores, etc.

a) Entry by conventional grocery retailers: As conventional operators and mass retailers add organic SKUs to their product offerings, the resulting competition could drive prices down and create gross margin erosion. The mere fact that Wal-Mart, despite whether or not they choose to move forward today, is considering introducing organic products should be unsettling.²⁹ That said, we feel this risk is very limited. First, part of the appeal of stores such as Wild Oats and Whole Foods is their dedication to "safe" products, allowing customers to forego label scanning to ensure that what they are buying is up to their standards. Second, the stores specializing in organic/natural products have considerably more depth and breadth than would be feasible for a traditional store to offer. Along with this, Wild Oats and Whole Foods have considerably better trained staff who specialize in organic and natural products. This expertise is important to many of the "foodie" customers that frequent these stores. Third, we feel through market observation that there is a certain "status" effect associated with Wild Oats and Whole Foods shoppers. Most of these people do not fit into Wal-Mart's demographic (Wild Oats and Whole Foods customers have a considerably higher median income and education level than Wal-Mart's average customer),

²⁶ Proxy filings, 2005.

²⁷ It is interesting to note that Ron Burkle, the CEO of Yucaipa, was Chairman of Fred Meyer stores when Kroger's acquired it in 1999. He was also CEO of Smith's Food and Drugs when Fred Meyer acquired it in 1997. Besides this, Wild Oats' current Chairman, Bob Miller, was COO of Kroger when Kroger acquired Fred Meyer. Wild Oats' current CFO, who was appointed in April, 2005, is a one-time CFO of Kroger's Western Region.

²⁸ "Ripe for Acquisition; Reaping their Wild Oats." The Patriot Ledger. June 7, 2005.

²⁹ Wal-Mart CEO signal future entry: <http://www.organicconsumers.org/organic/walmart.cfm>

and many would not be caught dead in a Wal-Mart to begin with. Finally, we do not feel it is efficient for traditional outlets to stock many of the gourmet items carried at a Wild Oats, as shelf space and inventory turns are so dear. While many people focus on using the words “organic” and “natural” when discussing Wild Oats, we believe the word “gourmet” is equally important, as many “foodies” frequent Wild Oats to obtain what they believe is better product (not to mention it does not seem efficient for Wal-Mart or Kroger to stock \$95/lb morel mushrooms). It is also important to note that Wild Oats has felt no impact from the presence of Safeway’s “Lifestyle” stores.

b) Competition from Whole Foods: Although there are numerous competitors operating formats dedicated to natural/organic products, Whole Foods deserves separate mention. Whole Foods competitive openings have the capacity to negatively impact Wild Oats sales and, in the past, have been a source of pressure. In fact, when Whole Foods moved into Wild Oats’ home market of Boulder, Whole Foods CEO John Mackey sent then Wild Oats CEO Michael Gilliland the game of Risk with a note reading “Forewarned is forearmed.”³⁰

We believe that Wild Oats has experienced both success and failures with respect to direct competition from Whole Foods, however, given the quality of the new store formats, we expect Wild Oats to compete much more effectively with Whole Foods in the future. Whole Foods currently operates in roughly 75% of Wild Oats markets.³¹ We believe that, over time, the ability of Wild Oats to withstand Whole Foods competitive openings represents a key variable to success. In addition, although there remains considerable overlap in terms of the potential customer base, we believe that Whole Foods focuses more on the price insensitive urban consumer. Lastly, we believe the competition between Wild Oats and Whole Foods does not have to be a zero sum game in the rapidly growing natural and organic market segment and there should be enough market opportunity for both retailers to grow significantly. In fact, in many markets where the two co-exist, both have grown, stealing share from conventional supermarkets.³² Bottom line, with Whole Foods and Wild Oats only accounting for less than 40% of the organic/natural market, we feel that no material margin compression will occur in the near to mid-term.

c) Potential for labor unions: Unlike traditional grocers, Wild Oats has been able to remain union-free. However, there have been a handful of attempts by unions to organize certain stores, and Wild Oats does not seem as dead-set against unionization as John Mackey does at Whole Foods. While unlikely, we consider the unionization of Wild Oats’ workforce a significant threat to profitability and morale, and model this threat as a 20 basis point increase in direct store expenses.

d) The organic explosion may be a fad: There is a risk that, like many other “health kicks” such as the Atkins Diet and the home fitness craze, the popularity of organic food could be temporary. Further, if significant scientific evidence showed that organic and natural foods had no impact on health, the entire organic foods industry could be in jeopardy. We believe this risk is extremely low; however, if the organic wave is as sustainable as we believe, it is likely that more players will want their share.

³⁰ Hoover’s Wild Oats company history.

³¹ Author’s calculations.

³² Wild Oats 3Q 2005 conference call.

e) Organic goes mainstream: In the event that organic foods can be supplied at conventional grocery store prices, there would be a boom in sales in the industry, but a corresponding collapse in gross margins. Thus, Wild Oats would suffer loss in value due to thinner free cash flows and become another commodity supplier, losing the competitive advantage it currently holds over conventional grocery stores. We believe this risk is small and is somewhat negated by the “gourmet” shoppers (again, Wal-Mart is not going to stock caviar); however, ConAgra Foods and Kraft do offer a limited range of organic products.³³

f) Threat of bankruptcy: Wild Oats’ debt is currently rated CCC+. Historically, approximately 40% of CCC+ rated companies have defaulted on debt obligations within 10 years of issuance. We are bullish on Wild Oats’ prospects, but given the risk of distress, we believe bankruptcy must be accounted for. All of the aforementioned strengths, weaknesses, opportunities, and threats are modeled in our going-concern APV which serves as a guideline for value without bankruptcy. We use this APV model as the basis for our Monte Carlo analysis, which we use to incorporate the risk of bankruptcy.

Bottom Line

The following table summarizes the impacts we have discussed above in the Company Overview and Sales Drivers and Risks sections of our report. These statistics were incorporated into our APV valuation under the assumption that the fully incorporated effects will trend toward a run rate in ten years (2016).

Driver	Effect	Degree
Same-Store Sales		
Purchasing/Distribution	Positive	Market Share Guidance
Product Mix	Positive	Market Share Guidance
New Stores in Comp Base	Positive	Market Share Guidance
<i>Net Measurable Effect</i>		<i>Market Share Guidance</i>
Gross Margin		
Store Mix - Oats/Henry's	Negative	-1.00%
Purchasing/Distribution	Positive	1.00%
Product Mix	Negative	-0.50%
Private Label	Positive	0.45%
Prepared Foods	Positive	0.51%
Holistic Health	Positive	Unknown
<i>Net Measurable Effect</i>		<i>0.46%</i>
Operating Margin		
Marketing/Promotions	Negative	Industry Guidance
Potential for Unionization	Negative	-0.20%
<i>Net Measurable Effect</i>		<i>-0.20%</i>

³³ “Shopping Quiz: Which of these products can be found in your local grocery store?” Omaha World-Herald. September 29, 2005.

The effects of these factors may seem small, but the significant leverage from same-store sales growth is extremely important. In Wild Oats' case, these slight changes increased share price from \$9.55 to \$14.43 in our going-concern APV.

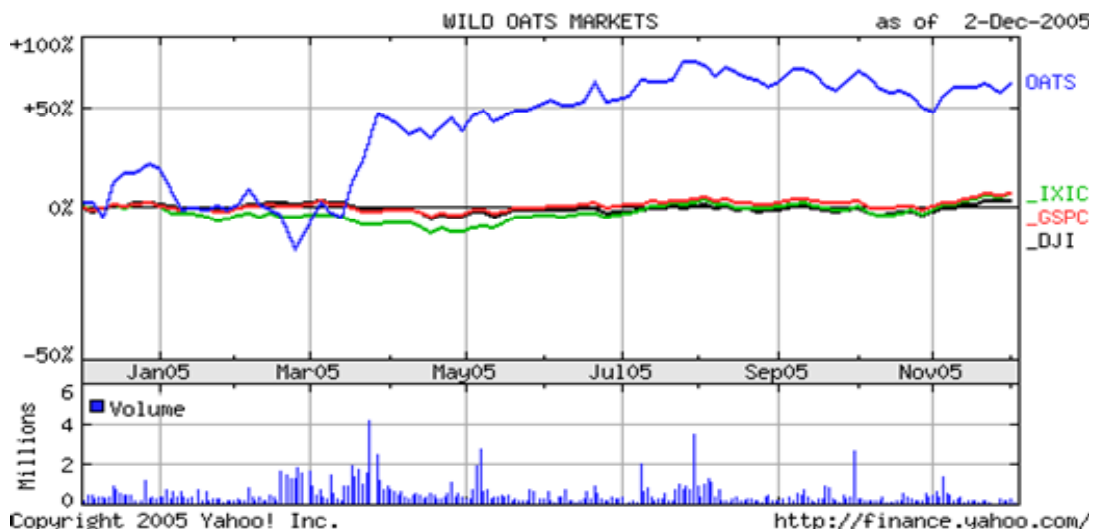
COMPANY STATISTICS

Stock Statistics

Wild Oats' stock price has been on an upward path since March 2005, when Yucaipa announced that it had taken a 9.2% stake in the company. Wild Oats traded at a split-adjusted price of \$6.89 on March 1 and had a 54% increase in price during the month. The price has traded in the \$10 - \$14 range since then and closed at \$12.34 on December 2nd.



Wild Oats has outperformed the DJIA, S&P 500, and the NASDAQ indexes over the past 9 months. An indexed-chart comparing Wild Oats to the DJIA, S&P and the NASDAQ over the last 12 months is shown below:



Wild Oats is followed by 12 analysts, who, most recently, were evenly split between 'Buy' and 'Hold' recommendations. Wild Oats has missed earnings expectations in 2 of the last 5 quarters, and met them in the last quarter.

Below is a chart showing some pertinent stock data:

Share Statistics

Average Volume (3 month)	402,770
Average Volume (10 day)	208,825
Shares Outstanding:	29.03M
Float:	21.96M
% Held by Insiders	20.91%
% Held by Institutions	82.60%
Shares Short (as of 10-Nov-05)	3.77M
Short Ratio (as of 10-Nov-05)	9.6
Short % of Float (as of 10-Nov-05)	13.70%
Shares Short (prior month)	4.34M
Projected EPS	\$0.055/share
Insider trading – most recent 45 days	None

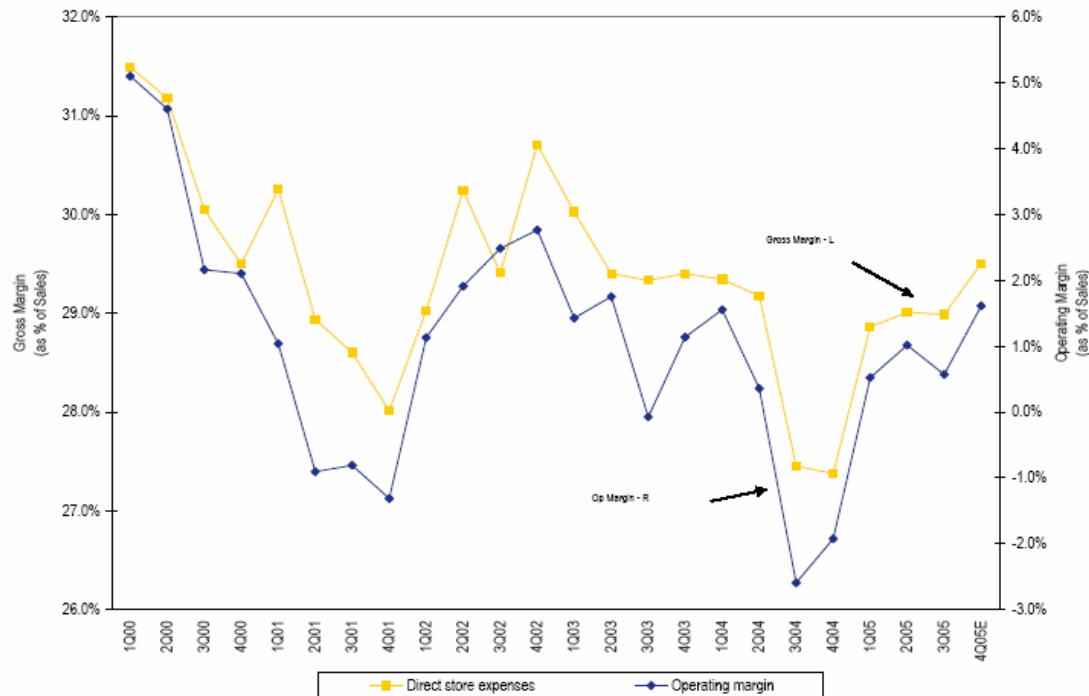
Sources: Yahoo! Finance and Bloomberg; as of 2 December 2005

The float is an indication that we can make significant moves in Wild Oats stock without major price changes.

Company Statistics

Gross Margin and Operating Margin Recovery Progressing

Gross Margin and Operating Margin Trends



Source: Company reports; Bear, Stearns & Co. Inc. estimates.

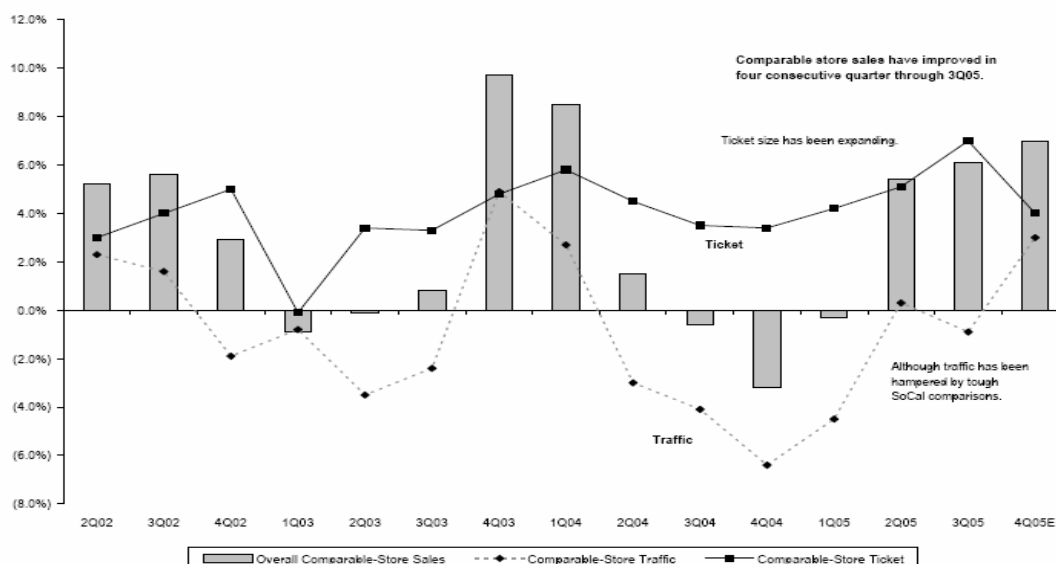
We are pleased with the recent turnaround in margins; however, it is important to note that margins have been volatile and to substantiate our claim that the bad days are really behind Wild Oats. Three primary factors caused the substantial margin erosion in recent years: First, Wild Oats closed many underperforming stores. These stores were largely in sub-optimal areas or the result of prior managements' acquisition craze. As new stores come into the comp base, the quality of the base should improve. We believe Wild Oats has completed the closure of most of its underperforming store base, and that current management does not intend to revert to a spurious acquisition-driven growth strategy. Also, management has indicated a new policy on new store openings that, like Whole Foods, is based on area demographics and high-traffic markets. That said, the current focus is on markets where Whole Foods is not a dominant presence.

Second, the poor recent margins reflect certain difficulties encountered when switching from Tree of Life to UNFI and the stock-outs under Tree of Life. With the new distribution facility and UNFI relationship, we feel these days are past.

Finally, margins suffered as a result of aggressive promotional activity during the California conventional supermarket strike. Wild Oats advertised aggressively to lure customers away from the traditional players, and it seems that this strategy may have paid off with the retention of new customers.

Comparable Store Sales Improves for Four Consecutive Quarters

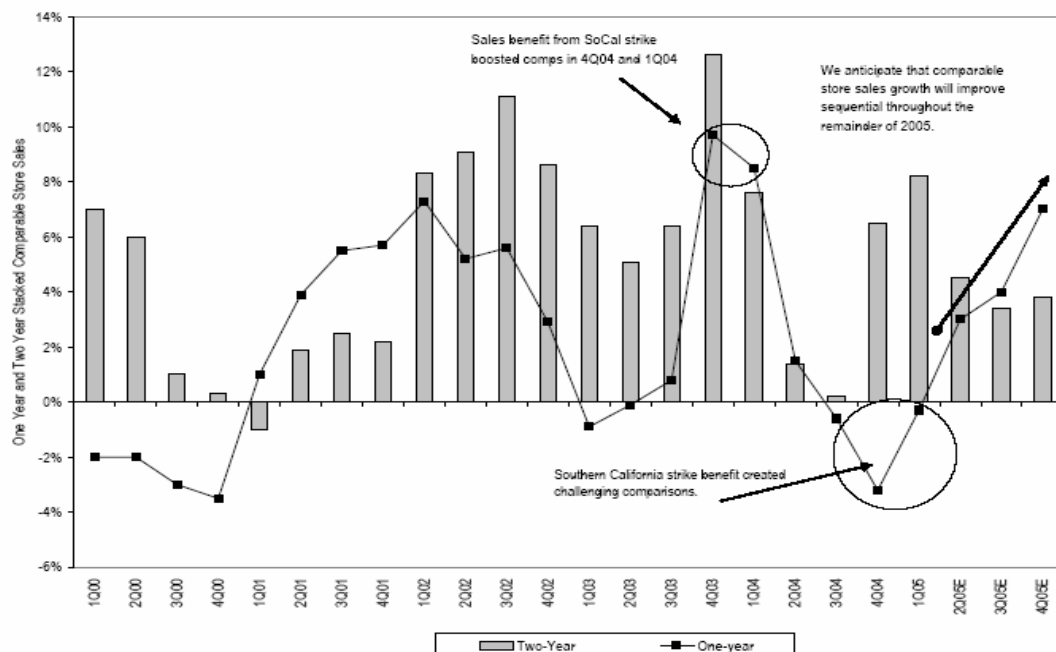
Comparable Store Sales: Overall, Ticket, Traffic



Source: Company reports; Bear, Stearns & Co. Inc. estimates.

Comparable Store Sales Performance Spiked and Fell Materially Around Strike

Quarterly Year over Year and Two-Year Stacked Comparable Store Sales



Source: Company reports, Bear, Stearns & Co. Inc. estimates.

These two graphs demonstrate two factors that we believe the company is recovering from. First, increased sales from the California promotional period distorted comps on a year over year basis. Excluding California, comps have continued to be positive, and now that the

company has cycled through this effect, we expect historical comps are obtainable *before the effects of our growth assumptions*.

A second discouraging trend is the decline in traffic. However, this has been more than offset with an increased market basket. Nonetheless, we would like to see both metrics trending positive. According to management, the recent data displays the impact of increased fuel prices: customers are making fewer trips, but buying more to stock up. If fuel prices decline, we feel traffic will regain a positive trend.

VALUATION

We used a combination of two methods to assess the value of Wild Oats' equity – APV and acquisition comps. The APV served as our primary model, and we accounted for our acquisition analysis on a probability-weighted basis through sensitivity analysis. The APV valuation shown in our appendix is our going-concern case. In addition to this, we performed a Monte Carlo analysis through our APV to account for bankruptcy risk.

APV Assumptions (Going-concern Case)

Our APV was primarily driven by sales, which were largely dependent on assumptions about new store openings and comparable sales growth. To model store growth, we looked primarily to company and analyst guidance, though the final numbers were based on an evaluation of Wild Oats' implied market share (See Exhibit 1). We initially grew stores based on signed lease data and company-stated goals of 10% annual square footage growth. During the model period, store count grew from 113 to 221 in 2018. As a reference point, Whole Foods is expected to have 206 stores at the end of 2006. We also looked at historical data to separate the effects of new and existing stores. Based on our analysis, we found that new stores average approximately \$5.55 per square foot per week, while existing stores account for over \$8 per foot per week. For modeling purposes, the \$5.55 per foot per week was used to model new store sales under guidance that target stores will be 30,000 to 35,000 square feet, while existing store sales were modeled based on the number of stores in the comp base and using same-store sales growth assumptions. The current run-rate for comp sales is 4% (2005), which we used as a starting point. Using our analysis in this report, we modeled same-store sales growth to grow to 6% in 2007 before declining steadily to a terminal rate of 4%, which we based on data about the overall organic market. Sensitivity analysis was performed on this assumption (See Exhibit 7).

By separating revenue into existing and new stores, we were also able to model cost of goods sold by store type. New stores are generally not profitable during the first year, so we modeled a 100% cost for these stores. Existing store cost of goods was modeled using historical data and the assumptions discussed previously in this report. Particularly, these costs were modeled to improve by 46 basis points over the first ten years of the model period. Rental expense (a component of COGS) was assumed to be \$15.25 per square foot, based on historical data.

Operating expenses were based on historical averages and our assumption of a 20 basis point increase in direct store expenses due to the potential for unionization. We also

trended SG&A costs down slightly to mimic traditional grocer levels (Wild Oats currently has higher operating expenses than a conventional grocer as a percent of sales). We believe this assumption to be conservative.

Balance sheet items were modeled line-by-line using historical relationships to sales. The main exception to this was PP&E. Wild Oats relies almost exclusively on operating leases, so we grew PP&E at a rate below sales growth during the earlier years of the model. This also reflects the fact that a retailer should be able to derive leverage through same-store sales growth without necessarily expanding PP&E as quickly. Our model assumes capex will slow versus 2003 and 2004 levels since most major capex projects have been completed; nonetheless, we do assume capex at a rate commensurate with store expansion. In addition, intangibles and goodwill were held constant. In modeling capital structure, we assumed a constant dollar level of debt based on the 2004 number, as the company's debt balance has remained fairly steady the last two years. The company has given no guidance on its plans for financing. Regardless, our APV approach allowed us to separate financing effects which, in our going-concern model, account for \$1.51 in share value (i.e. even without the debt tax shield, the company is worth \$12.92 per share, on the high side of a hold recommendation before considering takeout potential or bankruptcy). We discounted the debt tax shield at the cost of debt, which we placed at 6.51% based on the company's CCC+ rating. All assumptions detailed in Exhibit 2. Projected income statements, common-sized income statements, and balance sheets can be found in Exhibits 3 through 5.

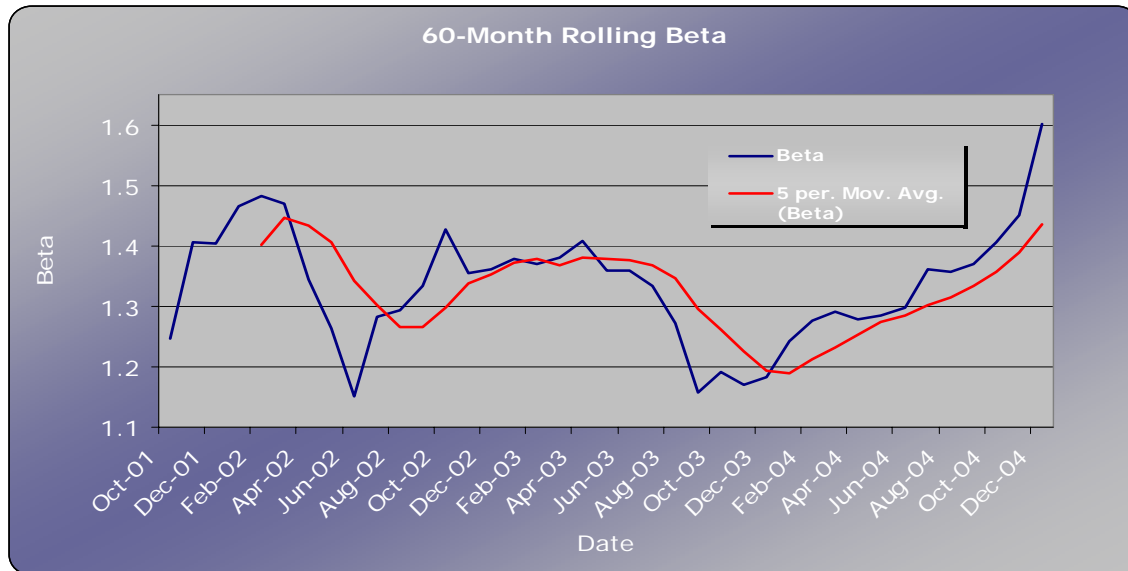
The following are the key points of our assumptions:

- Sales growth peaks at 13.54%
- Based on sales, our model projects Wild Oats' share of the organic segment to decrease from 8.4% to 7.0% by 2021. In the interim, share fluctuates in a narrow band. We believe this is conservative.
- Gross margin improves from end of 2005 run-rates of 30.0% to 30.4% by 2016. As a benchmark, Whole Foods has gross margins of 34.7% while Safeway has gross margins of 30.5%. We feel we are at the low end of a feasible range.
- Operating margin improves from 80 basis points to 2.9%. As a guideline, Whole Foods has operating margins of 5.5% while Safeway has operating margins of 4.4%.
- Net margins increase from 20 basis points in 2005 to 1.6%. Whole Foods' net margin in 3.3%, while Safeway has 1.2% net margins.

Cost of Capital

Our projections were used to drive our APV model. The following cost of capital assumptions were made:

Using excess stock returns and excess market returns based on the CRSP value-weighted S&P/AMEX/NASDAQ index, we computed and plotted rolling 60-month betas to visually inspect for structural changes or short-term deviations. The results, along with a 5-period moving average, are shown below:



Data Source: CRSP

As the graph shows, Wild Oats' beta has been incredibly volatile. Since there was absolutely no indication of a steady-state beta, we used 1.60 as our levered equity beta, representing the most recent 60-month period in CRSP. We unlevered this equity beta using Wild Oats' market cap and book debt at the end of 3Q 2005, arriving at an unlevered beta of 1.21. Using this beta, the ten-year risk-free rate of 4.51%, and an equity risk premium of 5%, we arrived at an unlevered cost of capital of 10.54%.

Cost of Capital

Target pre-tax D/D+E (in MV)	32.91%	r_f (10 year Treasury)	4.51%
Pre-tax E/D+E (in MV)	67.09%	Risk premium (for beta=1)	5.00%
Tax rate	40.00%		
		r_D (Wild Oats' debt is rated CCC+)	6.51%
β_D	0.40	r_E	12.51%
β_E	1.60	Unlevered WACC	10.54%
β_A	1.21	After-tax levered WACC	9.68%

In addition, current option overhang was deducted to arrive at enterprise value, and future options grants were modeled to be 20% of forecasted operating income. Equity value was

then adjusted for receipt (because cash flows don't really come at year-ends only) and discounted back by one month to today's date.

The going-concern APV (see Exhibit 6) resulted in a per share value of \$14.43, 16.9% above current market levels. Several sensitivity analyses were performed and are exhibited in the appendices.

Potential Upside and Downside in Our Model

- **Margin expansion:** As mentioned, our modeled margins are at the low end of the gap between Whole Foods and traditional grocers.
- **New store growth:** If the company continues its positive turnaround trajectory, we would expect to see more store development than we have modeled. Keep in mind, though, that this expansion would likely require higher capex than we have modeled.
- **Same-store sales growth:** Given the growth trends in the organic segment, we feel our same-store sales growth is conservative. There is no reason to believe that a well-run company couldn't benefit from riding the wave. That said, the wave has been here, and Wild Oats has not taken advantage as well as Whole Foods.
- **Unionization:** We have modeled a very small probability of unionization. Unionization could significantly hamper Wild Oats' future profitability.
- **Inappropriate balance of products:** If Wild Oats goes too far in their attempt to bring some mainstream products online, they could suffer severe backlash and loss of their core customer base. If this occurs, we do not believe Wild Oats has the footprint necessary to survive in the conventional grocery sector.

We believe our model represents a fair going-concern case for Wild Oats.

Acquisition Analysis

In addition to our APV, we looked at comparable transaction multiples for acquisitions in the grocery industry. The following chart shows acquisition comps from 1995 to 2001:

Exhibit 4: Food Industry Acquisitions (1995 - Present)

US\$ in millions, unless otherwise stated

DATE OF CLOSING	ACQUIROR / TARGET	ENTERPRISE VALUE ¹ (\$MM)	ENTERPRISE VALUE / LTM		
			SALES	EBIT	EBITDA
Apr-01	Delhaize Group / Delhaize America	\$6,947	0.51 X	11.62 X	5.90X
Jul-00	Delhaize / Hannaford Bros.	3,643	1.05 X	18.55 X	12.16 X
Sep-99	Safeway / Randall's	1,719	0.66 X	15.92 X	10.13 X
Jun-99	Albertson's / American Stores	11,865	0.59 X	13.3 X	8.58 X
Jun-99	J. Sainsbury / Star Markets	476	0.45 X	22.14 X	10.14 X
May-99	Kroger / Fred Meyer	12,466	0.84 X	14.99 X	10.8 X
Apr-99	Safeway / Carr-Gottstein	330	0.55 X	10.5 X	6.8 X
Nov-98	Safeway / Dominick's	1,855	0.76 X	17.9 X	10.92 X
Oct-98	Ahold / Giant Food	2,684	0.62 X	17.68 X	10.95 X
Oct-98	Albertson's / Buttrely	167	0.43 X	23.7 X	9.28 X
Mar-98	Fred Meyer / QFC	1,556	0.83 X	16.81 X	12.45 X
Mar-98	Fred Meyer / Ralph's	3,048	0.52 X	15.8 X	7.83 X
Nov-97	Jitney-Jungle / Delchamps	259	0.23 X	14.56 X	6.24 X
Sep-97	Richfood Holdings / Farm Fresh	253	0.36 X	19.03 X	6.95 X
Sep-97	Fred Meyer / Smiths Food & Drug	1,966	0.63 X	11.17 X	7.01 X
Aug-97	Giant Eagle / Riser Foods	467	0.35 X	12.61 X	8.3 X
Jul-97	KKR / Randall's	640	0.27 X	23.1 X	8.36 X
Apr-97	Safeway / Vons	3,337	0.62 X	13.84 X	9.79 X
Mar-97	Quality Food Centers / Hughes Family Markets	393	0.40X	15.70X	9.20X
Dec-96	Food Lion / Kash-n-Karry	339	0.33 X	11.38 X	6.19 X
Jul-96	Ahold / Stop & Shop	2,891	0.65 X	12.24 X	8.39 X
May-96	Smith's Food & Drug / Smitty's	214	0.40X	14.10X	7.40X
Nov-95	BRS / Jitney-Jungle	379	0.30X	9.20X	5.70X
Aug-95	KKR / Bruno's	1,155	0.4 X	N/A	9.02 X
Jul-95	Ahold / Mayfield SuperMarkets	188	0.30X	14.50X	7.60X
Jun-95	Food 4 Less / Ralph's	1,469	0.53 X	10.34 X	6.7 X
Apr-95	Stop & Shop / Purity Supreme	266	0.30X	NM	7.10X
Mar-95	Yucaipa / Dominick's	750	0.30X	13.90X	7.00X
INDUSTRY AVERAGES		2,029	0.51 X	15.32 X	8.56 X

¹ Includes any assumed debt

Source: Company data, CSFB estimates.

Using industry average comps, Wild Oats' implied values are shown below:

<u>Metric</u>	<u>Multiple</u>	<u>Implied</u> <u>OATS</u> <u>Enterprise</u> <u>Value</u>	<u>Less Debt and</u> <u>Options</u>	<u>Implied</u> <u>OATS Equity</u> <u>Value</u>	<u>Price Per</u> <u>Share</u>
EV / Sales	0.51	584,058.66	(163,662.25)	420,396.42	14.48
EV / EBIT	15.32	140,096.55	(163,662.25)	(23,565.69)	(0.81)
EV / EBITDA	8.56	329,560.00	(163,662.25)	165,897.75	5.71
<i>Average</i>					<i>6.46</i>

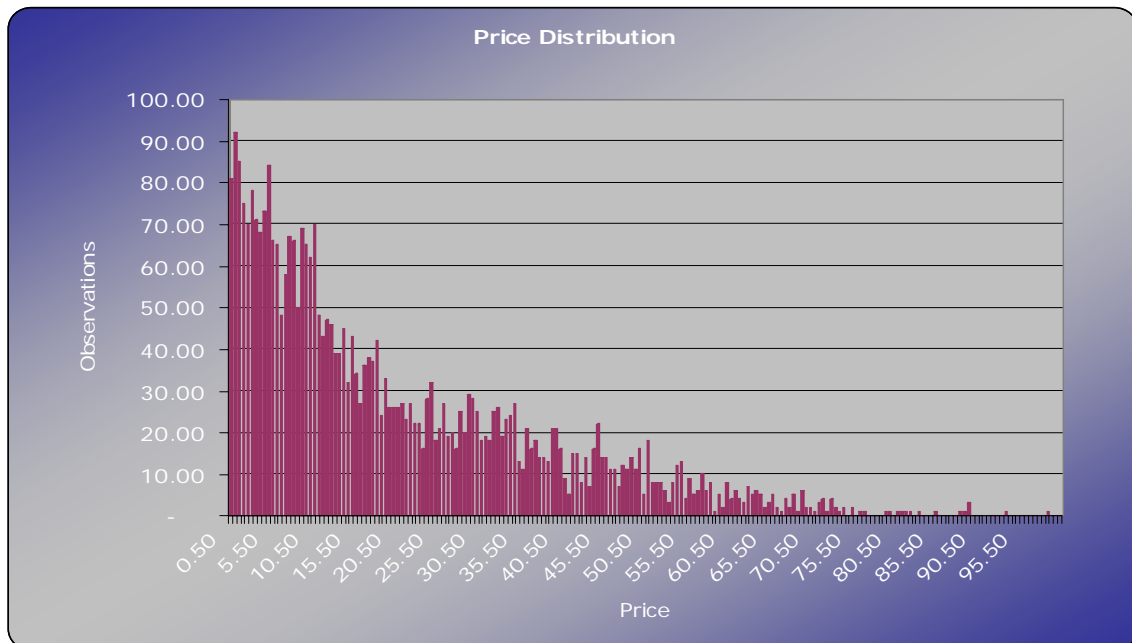
As two of the comps are below current share price (and one is negative), we also considered a simpler scenario in which Wild Oats simply fetched a 20% premium to current share price. This implied a value of \$14.81. Using the more conservative EV/Sales ratio and a 10% probability of acquisition, the probability-weighted value (using our going-concern APV valuation) is \$14.47 per share, a 16.4% premium to current market prices. A full sensitivity analysis is provided in Exhibit 7.

Monte Carlo Scenario Analysis

Because Wild Oats' debt is rated CCC+, it is important to consider the potential for bankruptcy. Historically, firms with CCC+ rated debt have defaulted within 10 years of issuance with a probability of approximately 40%. To capture this possibility, we used Monte Carlo analysis with the following assumptions:

- Our projected income statements in the analysis were based on our APV projected income statements. Revenues were assumed to be normally distributed with a mean equal to that derived in our expected case APV analysis. Standard deviation was assumed to be 25% of expected-case annual revenue. We chose 25% in order to arrive at a probability of bankruptcy of approximately 40%.
- Cost of goods sold were modeled at percentages implied from our expected-case APV (see Exhibit 4 for these percentages). The rationale behind this assumption was that COGS are relatively variable, and should adjust to sales levels.
- SG&A expenses were kept at the levels in our expected-case APV, as these costs are more fixed or semi-fixed, and cannot be changed quickly in response to fluctuations in sales.
- The projected balance sheets were adjusted to respond to income statement changes. As in our expected-case, balance sheet items were primarily modeled based on sales. In the Monte Carlo balance sheets, we maintained PP&E and total capital at the levels in our expected-case; the primary difference is that cash was used as the balancing item. This allowed us to model the effect of simulations on cash. A bankruptcy event was defined as a simulation in which Wild Oats' cash balance was reduced to (or below) zero.

The Monte Carlo income statements and balance sheets drove a Monte Carlo APV. In cases where the cash balance turned negative, free cash flows were modeled at zero from that point forward. Of course, the resultant share price was determined as the maximum of zero and the model output. We ran 5,000 simulations of this model. The two histograms below show the results of our simulations. The first covers the entire range of output, while the second only shows non-zero results so the reader can evaluate the resultant distribution.



Price Target

Our target price is based on a combination of our Monte Carlo analysis and our take-out analysis. That is, we feel our going-concern APV provides the correct guideline for value prior to considering bankruptcy and/or take-out, and in order to arrive at a fair value for Wild Oats, we must incorporate the risk of bankruptcy through our Monte Carlo analysis and the opportunity for take-out through a probability-weighted sensitivity analysis. Using the mean from our Monte Carlo analysis (\$14.30) and a 10% probability of take-out at \$14.43, we arrived at a price target for Wild Oats of \$14.30 per share. Below are sensitivity tables which rely on our Monte Carlo analysis and our take-out analysis. The take-out price range in the tables ranges from a 10% premium to current share price to a 30% premium, with the center column representing the enterprise value-to-sales value discussed in the acquisition section of the report. We have also boxed the area representing the acquisition price range which we feel is most likely. Green-shaded values represent prices which exceed a 10% advance from current market prices; amber represents a price target between plus or minus 10%, and red represents a value more than 10% below current prices. The colors correspond to buy, hold, and sell ratings, respectively.

Probability-Weighted Value With Takeout (Mean)

		Takeout Price						
		16.04	15.47	14.91	14.34	14.08	13.83	13.57
Probability of Takeout	10%	14.47	14.41	14.35	14.30	14.27	14.26	14.23
	20%	14.65	14.53	14.42	14.30	14.25	14.20	14.15
	30%	14.83	14.65	14.48	14.31	14.23	14.16	14.08
	40%	14.99	14.77	14.54	14.31	14.21	14.11	14.01
	50%	15.17	14.88	14.60	14.32	14.19	14.07	13.93
	60%	15.34	15.00	14.66	14.33	14.17	14.02	13.86
	70%	15.52	15.12	14.73	14.33	14.15	13.97	13.79
	80%	15.69	15.24	14.78	14.33	14.13	13.92	13.72
	90%	15.87	15.36	14.85	14.34	14.11	13.88	13.65

OTHER POINTS & INVESTMENT RECOMMENDATION

In arriving at a buy rating, we considered what factors may be to blame for Wild Oats' undervaluation by the market. The key points we identified were:

- Small-cap stocks often trade at discounts due to low liquidity. Wild Oats has an average daily volume less than half that of Whole Foods.
- Retail stocks trade dramatically on news of comp sales, and area Wild Oats has suffered in recently. We believe that now that California effects have cycled out, comps should improve.
- Wild Oats had two misses in the last five quarters due to problems with stock-outs. Management must prove to investors that this is in the past, as earnings misses are severely punished.
- Management, since coming aboard in 2001, has not made significant headway in improving margins, and investors' patience may be wearing thin. We believe it has simply taken time to identify and close stores as well as implement necessary capital

projects with IT and distribution. With these finished, investors should start seeing the margin improvement they've waited for.

In determining our investment recommendation, we relied most heavily upon our Monte Carlo APV analysis. In addition to the number our model provided, we relied heavily on our sensitivity analysis, which showed a clear bias toward our buy recommendation. Though we do not place a high probability on an acquisition in the near-term, we do believe the potential provides the stock with some downside resistance. As investors begin to see the performance they've waited for, we believe Wild Oats will provide strong returns.

Exhibit 1: Projected Market

Wild Oats Market - Statistics									
	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
Wild Oats Actual and Projected Sales	1,048,164	1,145,213	1,286,897	1,461,189	1,645,550	1,835,774	2,047,054	2,271,796	2,506,683
Total Forecasted US Retail Food Sales	650,000,000	664,812,536	679,625,071	693,192,785	706,760,498	720,941,268	734,803,880	748,287,824	761,776,477
US Organic Food Sales	12,457,200 20%	14,948,640 20%	17,938,368 20%	21,526,042 20%	24,970,208 16%	27,966,633 12%	30,763,297 10%	33,531,993 9%	36,214,553 8%
US Organic as a percent of Total US Food	1.92%	2.25%	2.64%	3.11%	3.53%	3.88%	4.19%	4.48%	4.75%
Wild Oats Share of Organic Food Sales	8.4%	7.7%	7.2%	6.8%	6.6%	6.6%	6.7%	6.8%	6.9%
	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>
Wild Oats Actual and Projected Sales	2,730,655	2,952,673	3,150,235	3,331,768	3,506,150	3,672,634	3,819,540	3,972,321	4,131,214
Total Forecasted US Retail Food Sales	775,265,136	788,753,789	802,242,441	816,522,357	831,056,455	845,849,260	860,905,377	876,229,492	891,826,377
US Organic Food Sales	38,749,571 7%	41,074,546 6%	43,456,869 6%	45,890,454 6%	48,368,539 5%	50,883,703 5%	53,427,888 5%	56,099,282 5%	58,904,246 5%
US Organic as a percent of Total US Food	5.00%	5.21%	5.42%	5.62%	5.82%	6.02%	6.21%	6.40%	6.60%
Wild Oats Share of Organic Food Sales	7.0%	7.2%	7.2%	7.3%	7.2%	7.2%	7.1%	7.1%	7.0%

Exhibit 2: Assumptions

Income Statement Assumptions

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
<u>Revenue Drivers</u>											
Stores at beginning of year	63	110	106	107	99	103	108	113	122	132	142
Stores opened (new)	8	11	4	1	7	9	6	9	10	10	11
Stores opened (relocated)	5	3	-	-	1	3	2	2	2	2	2
Net new stores	13	14	4	1	8	12	8	11	12	12	13
Acquired stores	40	2	-	-	-	-	-	-	-	-	-
Closed stores (final)	(1)	(17)	(3)	(9)	(3)	(4)	(1)	-	-	-	-
Closed stores (relocated)	(5)	(3)	-	-	(1)	(3)	(2)	(2)	(2)	(2)	(2)
Stores at end of year	110	106	107	99	103	108	113	122	132	142	153
Average Square Footage per New Store			47,358	57,570	26,856	30,963	36,007	32,500	33,000	33,500	34,000
Total Square Footage		2,100,000	2,230,000	2,100,000	2,230,000	2,450,000	2,670,000	2,980,243	3,327,387	3,678,972	4,069,155
Average Square Footage per Store		19,811	20,841	21,212	21,650	22,685	23,628	24,428	25,207	25,908	26,596
Sales	721,091	838,131	893,179	919,130	969,204	1,048,164		11.62%	11.65%	10.57%	10.61%
Average annual sales per store (based on average store base)	6,771	7,689	8,387	8,924	9,596	9,935					
Underperformers	80,573	16,147	52,836	18,740	26,869	6,955					
Sales per Underperformer	4,740	5,382	5,871	6,247	6,717	6,955					
Comparable store sales increase	6.2%	-2.6%	4.0%	5.2%	2.4%	1.4%	4.0%	5.0%	6.0%	6.0%	5.0%
Stores in comp base		93	103	98	96	99	107	113	122	132	142
Mature store sales		623,865	854,863	884,041	922,000	955,528	1,082,858	1,202,474	1,364,111	1,548,861	1,727,828
Sales from stores to be closed		16,147	52,836	18,740	26,869	6,955					
Sales from new stores		214,266	38,316	35,089	47,204	92,636	62,355	84,423	97,078	96,690	107,946
Sales per mature store		6,708	8,300	9,021	9,604	9,652					
Sales per new store		16,482	9,579	35,089	6,743	10,293					
Annual sales per foot, mature stores			418.93	432.84	452.77	445.80					
Annual sales per foot, new stores			202.27	609.50	251.10	332.43					
Weeks in fiscal year (assumed 52.5 after 2010)		52	52	52	52	53	52	52	53	52	52
Average weekly sales per square foot, existing stores			8.06	8.32	8.71	8.41	8.50	8.66	8.64	8.95	9.03
Average weekly sales per square foot, new stores			3.89	11.72	4.83	6.27	5.55	5.55	5.55	5.55	5.55
Total Revenue	721,091	838,131	893,179	919,130	969,204	1,048,164	1,145,213	1,286,897	1,461,189	1,645,550	1,835,774
<u>Cost of Goods Sold</u>											
Cost of Goods Sold		547,480	597,031	611,569	649,580	715,714					
Cost of Goods Sold, existing stores		333,214	558,715	576,480	602,376	623,078	706,788	773,191	877,123	995,917	1,110,993
Cost of Goods Sold, new stores		214,266	38,316	35,089	47,204	92,636	62,355	84,423	97,078	96,690	107,946
Rent		34,500	37,600	32,200	33,900	35,600	39,036	43,078	48,090	53,417	59,073
Total Cost of Goods Sold		581,980	634,631	643,769	683,480	751,314	808,179	900,692	1,022,292	1,146,025	1,278,072
Cost of Goods Sold, existing stores (Percent of Sales)		53.41%	65.36%	65.21%	65.33%	65.21%	65.27%	64.30%	64.30%	64.30%	64.30%
Cost of Goods Sold, new stores (Percent of Sales)		100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Rent per square foot		16.43	17.37	14.87	15.66	15.21	15.25	15.25	15.25	15.25	15.25
<u>Operating Expenses</u>											
Direct store expenses (Percent of Sales)			23.81%	21.58%	21.55%	22.46%	22.01%	21.90%	21.92%	21.94%	21.96%
General and administrative expenses (Percent of Sales)			5.47%	6.00%	6.67%	5.96%	5.90%	5.90%	5.85%	5.80%	5.75%
Pre-opening and relocation costs (per new store)	212.85	234.93	390.50	2,737.00	436.25	438.75	377.75	417.58	417.58	417.58	417.58
Total Operating Expenses	27.63%	32.07%	35.60%	27.80%	28.67%	29.17%	28.63%	362,371	410,804	461,507	514,142
<u>Corporate Tax Rate</u>							40.0%				
<u>Long-term Growth Rate</u>							4.0%				

Exhibit 2 (cont.)

Income Statement Assumptions

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
<u>Revenue Drivers</u>												
Stores at beginning of year	153	165	177	189	199	208	214	218	221	223	223	223
Stores opened (new)	12	12	12	10	9	6	4	3	2	-	-	-
Stores opened (relocated)	2	2	2	2	2	2	2	2	2	2	2	2
Net new stores	14	14	14	12	11	8	6	5	4	2	2	2
Acquired stores	-	-	-	-	-	-	-	-	-	-	-	-
Closed stores (final)	-	-	-	-	-	-	-	-	-	-	-	-
Closed stores (relocated)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)	(2)
Stores at end of year	165	177	189	199	208	214	218	221	223	223	223	223
Average Square Footage per New Store	34,500	35,000	35,500	36,000	36,500	37,000	37,500	37,500	37,500	37,500	37,500	37,500
Total Square Footage	4,498,964	4,934,431	5,375,675	5,750,789	6,094,492	6,331,891	6,497,715	6,625,603	6,715,643	6,730,413	6,745,050	6,759,557
Average Square Footage per Store	27,266	27,878	28,443	28,898	29,300	29,588	29,806	29,980	30,115	30,181	30,247	30,312
Sales	10.56%	9.68%	8.94%	6.98%	5.98%	3.90%	2.62%	1.97%	1.36%	0.22%	0.22%	0.22%
Average annual sales per store (based on average store base)												
Underperformers												
Sales per Underperformer												
Comparable store sales increase	5.0%	5.0%	4.9%	4.8%	4.6%	4.5%	4.4%	4.3%	4.1%	4.0%	4.0%	4.0%
Stores in comp base	153	165	177	189	199	208	214	218	221	223	223	223
Mature store sales	1,927,563	2,149,407	2,382,546	2,625,750	2,856,948	3,085,543	3,288,057	3,473,368	3,650,779	3,819,540	3,972,321	4,131,214
Sales from stores to be closed												
Sales from new stores	119,491	122,389	124,137	104,905	95,725	64,691	43,710	32,783	21,855	-	-	-
Sales per mature store												
Sales per new store												
Annual sales per foot, mature stores												
Annual sales per foot, new stores												
Weeks in fiscal year (assumed 52.5 after 2010)	52	52.5	52.5	52.5	52.5	52.5	52.5	52.5	52.5	52.5	52.5	52.5
Average weekly sales per square foot, existing stores	9.11	9.10	9.20	9.30	9.46	9.64	9.89	10.18	10.50	10.83	11.24	11.67
Average weekly sales per square foot, new stores	5.55	5.55	5.55	5.55	5.55	5.55	5.55	5.55	5.55	5.55	5.55	5.55
<u>Total Revenue</u>	<u>2,047,054</u>	<u>2,271,796</u>	<u>2,506,683</u>	<u>2,730,655</u>	<u>2,952,673</u>	<u>3,150,235</u>	<u>3,331,768</u>	<u>3,506,150</u>	<u>3,672,634</u>	<u>3,819,540</u>	<u>3,972,321</u>	<u>4,131,214</u>
<u>Cost of Goods Sold</u>												
Cost of Goods Sold												
Cost of Goods Sold, existing stores	1,239,423	1,382,069	1,531,977	1,688,357	1,837,017	1,984,004	-	-	-	-	-	-
Cost of Goods Sold, new stores	119,491	122,389	124,137	104,905	95,725	64,691	-	-	-	-	-	-
Rent	65,325	71,922	78,606	84,830	90,310	94,741	-	-	-	-	-	-
<u>Total Cost of Goods Sold</u>	<u>1,424,239</u>	<u>1,576,379</u>	<u>1,734,720</u>	<u>1,878,092</u>	<u>2,023,053</u>	<u>2,143,436</u>	<u>69.6%</u>	<u>69.6%</u>	<u>69.6%</u>	<u>69.6%</u>	<u>69.6%</u>	<u>69.6%</u>
Cost of Goods Sold, existing stores (Percent of Sales)	64.30%	64.30%	64.30%	64.30%	64.30%	64.30%	64.30%	64.30%	64.30%	64.30%	64.30%	64.30%
Cost of Goods Sold, new stores (Percent of Sales)	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Rent per square foot	15.25	15.25	15.25	15.25	15.25	15.25	15.25	15.25	15.25	15.25	15.25	15.25
<u>Operating Expenses</u>												
Direct store expenses (Percent of Sales)	21.98%	22.00%	22.02%	22.04%	22.06%	22.08%	22.10%	22.10%	22.10%	22.10%	22.10%	22.10%
General and administrative expenses (Percent of Sales)	5.70%	5.65%	5.60%	5.55%	5.50%	5.45%	5.40%	5.40%	5.40%	5.40%	5.40%	5.40%
Pre-opening and relocation costs (per new store)	417.58	417.58	417.58	417.58	417.58	417.58	417.58	417.58	417.58	417.58	417.58	417.58
<u>Total Operating Expenses</u>	<u>572,490</u>	<u>634,016</u>	<u>698,208</u>	<u>758,412</u>	<u>818,359</u>	<u>870,605</u>	<u>918,742</u>	<u>966,279</u>	<u>1,011,645</u>	<u>1,051,209</u>	<u>1,093,223</u>	<u>1,136,919</u>

Exhibit 2 (cont.)

Balance Sheet Assumptions

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Current Assets											
Cash (Percent of Sales)		1.49%	2.11%	1.24%	1.80%	2.93%	5.00%	5.00%	5.00%	4.78%	4.56%
Inventories (Percent of Sales)		6.59%	6.05%	5.13%	4.81%	5.24%	5.24%	5.24%	5.24%	5.24%	5.24%
A/R (Percent of Sales)		0.47%	0.33%	0.27%	0.42%	0.37%	0.37%	0.37%	0.37%	0.37%	0.37%
Prepaid expenses		0.24%	0.32%	0.24%	0.56%	0.55%	0.55%	0.55%	0.55%	0.55%	0.55%
Current Liabilities											
A/P (Percent of Sales)		4.77%	4.46%	3.79%	5.21%	5.19%	5.00%	5.10%	5.10%	5.10%	5.10%
Book overdraft (Percent of Sales)		1.98%	2.58%	2.48%	2.76%	2.23%	1.90%	1.90%	1.90%	1.90%	1.90%
Accrued liabilities (Percent of Sales)		4.47%	4.43%	4.13%	4.57%	5.07%	5.00%	5.04%	5.04%	5.04%	5.04%
Property, Plant & Equipment		227,433	210,734	218,046	267,409	302,245	311,498	333,303	355,634	378,395	401,477
Growth			-7.34%	3.47%	22.64%	13.03%	3.06%	7.00%	6.70%	6.40%	6.10%
Accumulated depreciation		66,819	81,812	95,687	109,965	124,415	135,934	142,731	149,725	156,911	164,286
Growth			22.44%	16.96%	14.92%	13.14%	9.3%	5.0%	4.90%	4.80%	4.70%
Goodwill		0.00%	11.91%	11.58%	10.98%	10.12%	9.18%	FLAT			
Intangible assets		14.60%	0.88%	0.81%	0.69%	0.62%	0.54%	FLAT			
Deposits and other assets		0.48%	0.33%	0.39%	0.30%	0.80%	0.54%	0.54%	0.54%	0.54%	0.54%
Other long-term liabilities		0.30%	2.17%	1.95%	2.60%	2.33%	2.33%	2.33%	2.33%	2.33%	2.33%
Net Deferred Tax Asset							0.0%				
Debt											
Market Value of Equity (Year End)	510,135	98,375	245,926	306,081	388,715	250,988	303,529				
Target debt/value (market) - Includes notes payable and long-term debt (inc. current portions)		55.9%	33.6%	12.4%	14.2%	37.3%	32.9%	32.91%	32.91%	32.91%	32.91%
Valuation Time Adjustment (months)							(1)				
Dividends Paid During Interim							-				

Balance Sheet Assumptions

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Current Assets												
Cash (Percent of Sales)	4.33%	4.11%	3.89%	3.67%	3.44%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
Inventories (Percent of Sales)	5.24%	5.24%	5.24%	5.24%	5.24%	5.24%	5.24%	5.24%	5.24%	5.24%	5.24%	5.24%
A/R (Percent of Sales)	0.37%	0.37%	0.37%	0.37%	0.37%	0.37%	0.37%	0.37%	0.37%	0.37%	0.37%	0.37%
Prepaid expenses	0.55%	0.55%	0.55%	0.55%	0.55%	0.55%	0.55%	0.55%	0.55%	0.55%	0.55%	0.55%
Current Liabilities												
A/P (Percent of Sales)	5.10%	5.10%	5.10%	5.10%	5.10%	5.10%	5.10%	5.10%	5.10%	5.10%	5.10%	5.10%
Book overdraft (Percent of Sales)	1.90%	1.90%	1.90%	1.90%	1.90%	1.90%	1.90%	1.90%	1.90%	1.90%	1.90%	1.90%
Accrued liabilities (Percent of Sales)	5.04%	5.04%	5.04%	5.04%	5.04%	5.04%	5.04%	5.04%	5.04%	5.04%	5.04%	5.04%
Property, Plant & Equipment	424,762	448,124	471,427	494,527	517,275	539,518	561,098	583,542	606,884	631,159	656,406	682,662
Growth	5.80%	5.50%	5.20%	4.90%	4.60%	4.30%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
Accumulated depreciation	171,843	179,576	187,478	195,539	203,752	212,106	220,590	229,413	238,590	248,134	258,059	268,381
Growth	4.60%	4.50%	4.40%	4.30%	4.20%	4.10%	4.00%	4.0%	4.0%	4.0%	4.0%	4.0%
Goodwill												
Intangible assets												
Deposits and other assets	0.54%	0.54%	0.54%	0.54%	0.54%	0.54%	0.54%	0.54%	0.54%	0.54%	0.54%	0.54%
Other long-term liabilities	2.33%	2.33%	2.33%	2.33%	2.33%	2.33%	2.33%	2.33%	2.33%	2.33%	2.33%	2.33%
Net Deferred Tax Asset												
Debt												
Market Value of Equity (Year End)												
Target debt/value (market) - Includes notes payable and long-term debt (inc. current portions)	32.91%	32.91%	32.91%	32.91%	32.91%	32.91%	32.91%	32.91%	32.91%	32.91%	32.91%	32.91%
Valuation Time Adjustment (months)												
Dividends Paid During Interim												

Exhibit 3: Historical and Projected Income Statements

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Sales	721,091	838,131	893,179	919,130	969,204	1,048,164	1,145,213	1,286,897	1,461,189	1,645,550	1,835,774
Cost of Goods Sold	499,627	581,980	634,631	643,769	683,480	751,314	808,179	900,692	1,022,292	1,146,025	1,278,012
Gross Profit	221,464	256,151	258,548	275,361	285,724	296,850	337,034	386,205	438,897	499,526	557,762
Operating Expenses											
Direct store expenses	155,869	190,986	212,642	198,379	208,908	235,425	252,034	281,851	320,313	361,054	403,156
Selling, general, and administrative expenses	27,939	32,480	48,864	55,186	64,659	62,454	67,568	75,927	85,480	95,442	105,557
Loss on disposal of assets, net	-	-	-	21	2,087	187	87	-	-	-	-
Pre-opening expenses	2,767	3,289	1,562	2,737	3,490	5,265	3,800	3,758	4,176	4,176	4,593
Restructuring and asset impairment charges (income), net	12,642	42,066	54,906	(775)	(1,259)	2,461	4,400	-	-	-	-
Total Operating Expenses	199,217	268,821	317,974	255,548	277,885	305,792	327,889	361,536	409,969	460,672	513,307
Operating Income	22,247	(12,670)	(59,426)	19,813	7,839	(8,942)	9,145	24,669	28,929	38,854	44,455
Loss on early extinguishment of debt	-	(2,060)	(228)	-	(186)	-	(559)	-	-	-	-
Investment and other income	304	117	990	778	780	1,070	1,200	-	-	-	-
Interest expense	(4,584)	(8,967)	(10,437)	(11,855)	(5,746)	(6,309)	(7,000)	(9,695)	(9,695)	(9,695)	(9,695)
Earnings Before Income Taxes	17,967	(23,580)	(69,101)	8,736	2,687	(14,181)	2,786	14,974	19,234	29,159	34,760
Income Taxes	5,198	(8,559)	(25,189)	3,666	1,094	25,838	700	5,990	7,693	11,663	13,904
Net Earnings	12,769	(15,021)	(43,912)	5,070	1,593	(40,019)	2,086	8,984	11,540	17,495	20,856

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Sales	2,047,054	2,271,796	2,506,683	2,730,655	2,952,673	3,150,235	3,331,768	3,506,150	3,672,634	3,819,540	3,972,321	4,131,214
Cost of Goods Sold	1,424,239	1,576,379	1,734,720	1,894,777	2,054,324	2,191,777	2,318,079	2,439,406	2,555,237	2,657,446	2,763,744	2,874,294
Gross Profit	622,815	695,417	771,963	835,878	898,350	958,458	1,013,689	1,066,745	1,117,397	1,162,093	1,208,577	1,256,920
Operating Expenses												
Direct store expenses	449,962	499,813	551,987	601,849	651,369	695,577	736,321	774,859	811,652	844,118	877,883	912,998
Selling, general, and administrative expenses	116,682	128,356	140,374	151,551	162,397	171,688	179,915	189,332	198,322	206,255	214,505	223,086
Loss on disposal of assets, net	-	-	-	-	-	-	-	-	-	-	-	-
Pre-opening expenses	5,011	5,011	5,011	4,176	3,758	2,506	1,670	1,253	835	-	-	-
Restructuring and asset impairment charges (income), net	-	-	-	-	-	-	-	-	-	-	-	-
Total Operating Expenses	571,655	633,180	697,373	757,576	817,524	869,770	917,906	965,444	1,010,810	1,050,373	1,092,388	1,136,084
Operating Income	51,160	62,236	74,591	78,301	80,825	88,688	95,782	101,301	106,588	111,720	116,189	120,836
Loss on early extinguishment of debt	-	-	-	-	-	-	-	-	-	-	-	-
Investment and other income	-	-	-	-	-	-	-	-	-	-	-	-
Interest expense	(9,695)	(9,695)	(9,695)	(9,695)	(9,695)	(9,695)	(9,695)	(9,695)	(9,695)	(9,695)	(9,695)	(9,695)
Earnings Before Income Taxes	41,466	52,541	64,896	68,606	71,130	78,993	86,088	91,606	96,893	102,025	106,494	111,141
Income Taxes	16,586	21,017	25,958	27,442	28,452	31,597	34,435	36,642	38,757	40,810	42,598	44,457
Net Earnings	24,879	31,525	38,937	41,164	42,678	47,396	51,653	54,963	58,136	61,215	63,896	66,685

Exhibit 4: Common-Sized Income Statements, Historical and Projections

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Sales	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of Goods Sold	69.3%	69.4%	71.1%	70.0%	70.5%	71.7%	70.6%	70.0%	70.0%	69.6%	69.6%
Gross Profit	30.7%	30.6%	28.9%	30.0%	29.5%	28.3%	29.4%	30.0%	30.0%	30.4%	30.4%
Operating Expenses											
Direct store expenses	21.6%	22.8%	23.8%	21.6%	21.6%	22.5%	22.0%	21.9%	21.9%	21.9%	22.0%
Selling, general, and administrative expenses	3.9%	3.9%	5.5%	6.0%	6.7%	6.0%	5.9%	5.9%	5.9%	5.8%	5.8%
Loss on disposal of assets, net	0.0%	0.0%	0.0%	0.0%	0.2%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Pre-opening expenses	0.4%	0.4%	0.2%	0.3%	0.4%	0.5%	0.3%	0.3%	0.3%	0.3%	0.3%
Restructuring and asset impairment charges (income), net	1.8%	5.0%	6.1%	-0.1%	-0.1%	0.2%	0.4%	0.0%	0.0%	0.0%	0.0%
Total Operating Expenses	27.6%	32.1%	35.6%	27.8%	28.7%	29.2%	28.6%	28.1%	28.1%	28.0%	28.0%
Operating Income	3.1%	-1.5%	-6.7%	2.2%	0.8%	-0.9%	0.8%	1.9%	2.0%	2.4%	2.4%
EBIT	3.1%	-1.5%	-6.7%	2.2%	0.8%	-0.9%	0.8%	1.9%	2.0%	2.4%	2.4%
Loss on early extinguishment of debt	0.0%	-0.2%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Investment and other income	0.0%	0.0%	0.1%	0.1%	0.1%	0.1%	0.1%	0.0%	0.0%	0.0%	0.0%
Interest expense	-0.6%	-1.1%	-1.2%	-1.3%	-0.6%	-0.6%	-0.6%	-0.8%	-0.7%	-0.6%	-0.5%
Earnings Before Income Taxes	2.5%	-2.8%	-7.7%	1.0%	0.3%	-1.4%	0.2%	1.2%	1.3%	1.8%	1.9%
Income Taxes	0.7%	-1.0%	-2.8%	0.4%	0.1%	2.5%	0.1%	0.5%	0.5%	0.7%	0.8%
Net Earnings	1.8%	-1.8%	-4.9%	0.6%	0.2%	-3.8%	0.2%	0.7%	0.8%	1.1%	1.1%

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Sales	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of Goods Sold	69.6%	69.4%	69.2%	69.4%	69.6%	69.6%	69.6%	69.6%	69.6%	69.6%	69.6%	69.6%
Gross Profit	30.4%	30.6%	30.8%	30.6%	30.4%	30.4%	30.4%	30.4%	30.4%	30.4%	30.4%	30.4%
Operating Expenses												
Direct store expenses	22.0%	22.0%	22.0%	22.0%	22.1%	22.1%	22.1%	22.1%	22.1%	22.1%	22.1%	22.1%
Selling, general, and administrative expenses	5.7%	5.7%	5.6%	5.6%	5.5%	5.5%	5.4%	5.4%	5.4%	5.4%	5.4%	5.4%
Loss on disposal of assets, net	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Pre-opening expenses	0.2%	0.2%	0.2%	0.2%	0.1%	0.1%	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%
Restructuring and asset impairment charges (income), net	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Total Operating Expenses	27.9%	27.9%	27.8%	27.7%	27.7%	27.6%	27.6%	27.5%	27.5%	27.5%	27.5%	27.5%
Operating Income	2.5%	2.7%	3.0%	2.9%	2.7%	2.8%	2.9%	2.9%	2.9%	2.9%	2.9%	2.9%
EBIT	2.5%	2.7%	3.0%	2.9%	2.7%	2.8%	2.9%	2.9%	2.9%	2.9%	2.9%	2.9%
Loss on early extinguishment of debt	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Investment and other income	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Interest expense	-0.5%	-0.4%	-0.4%	-0.4%	-0.3%	-0.3%	-0.3%	-0.3%	-0.3%	-0.3%	-0.2%	-0.2%
Earnings Before Income Taxes	2.0%	2.3%	2.6%	2.5%	2.4%	2.5%	2.6%	2.6%	2.6%	2.7%	2.7%	2.7%
Income Taxes	0.8%	0.9%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.1%	1.1%	1.1%	1.1%
Net Earnings	1.2%	1.4%	1.6%	1.5%	1.4%	1.5%	1.6%	1.6%	1.6%	1.6%	1.6%	1.6%

Exhibit 5: Historical and Projected Balance Sheets

	2000	2001	2002	2003	2004	2005Q3	2005	Adjusted 2005	2006	2007	2008	2009
Assets												
Current Assets												
Cash & cash equivalents	12,457	18,840	11,367	17,400	30,671	51,373	56,291	56,291	64,345	73,059	78,621	83,630
Short-term investments	-	-	-	-	11,144	-	-	-	-	-	-	-
Merchandise inventories	55,258	54,058	47,175	46,621	54,960	59,819	60,049	60,049	67,478	76,617	86,284	96,258
Trade accounts receivable	3,936	2,906	2,524	4,038	3,860	3,400	4,248	4,248	4,756	5,400	6,082	6,785
Income tax receivable	9,973	4,186	250	-	-	-	-	-	-	-	-	-
Prepaid expenses and other current assets	2,004	2,858	2,163	5,438	5,741	5,811	6,273	6,273	7,049	8,003	9,013	10,055
Deferred tax asset	1,989	5,378	4,656	12,795	-	258	258	258	-	-	-	-
Total current assets	85,617	88,226	68,135	86,292	106,376	120,661	127,117	127,117	143,627	163,080	179,999	196,727
Gross property and equipment	227,433	210,734	218,046	267,409	302,245	309,793	311,498	311,498	333,303	355,634	378,395	401,477
Less accumulated depreciation and amortization	(66,819)	(81,812)	(95,687)	(109,965)	(124,415)	(133,138)	(135,934)	(135,934)	(142,731)	(149,725)	(156,911)	(164,286)
Net property and equipment	160,614	128,922	122,359	157,444	177,830	176,655	175,564	175,564	190,572	205,910	221,483	237,191
Goodwill	-	106,404	106,404	106,404	106,084	105,124	105,124	105,124	105,124	105,124	105,124	105,124
Intangible assets, net of amortization	122,382	7,892	7,415	6,707	6,491	6,193	6,193	6,193	6,193	6,193	6,193	6,193
Deposits and other assets	4,019	2,992	3,622	2,932	8,361	6,137	6,137	6,137	6,896	7,830	8,818	9,838
Deferred tax asset	-	18,990	15,650	13,649	418	-	-	-	-	-	-	-
Total Assets	372,632	353,426	323,585	373,428	405,560	414,770	420,135	420,135	452,413	488,137	521,618	555,072
Liabilities and Stockholders' Equity												
Current Liabilities												
Trade accounts payable	39,969	39,796	34,819	50,514	54,428	56,443	57,261	57,261	65,585	74,467	83,863	93,557
Bank overdraft	16,587	23,056	22,777	26,727	23,325	21,728	21,759	21,759	24,451	27,763	31,265	34,880
Accrued liabilities	37,434	39,526	37,943	44,316	53,154	54,265	57,261	57,261	64,803	73,579	82,863	92,442
Current maturities of long-term debt	7,729	12,338	146	293	405	628	628	-	-	-	-	-
Total current liabilities	101,719	114,716	95,685	121,850	131,312	133,064	136,908	136,280	154,838	175,809	197,991	220,879
Long-term debt and capital lease obligations, less current	116,839	112,291	43,075	64,042	148,675	148,296	148,296	148,924	148,924	148,924	148,924	148,924
Other long-term liabilities	2,510	19,404	17,923	25,163	24,472	27,390	26,738	26,738	30,046	34,115	38,419	42,861
Total Liabilities	221,068	246,411	156,683	211,055	304,459	308,750	311,942	311,942	333,808	358,848	385,335	412,664
Stockholders' Equity												
Common stock	23	25	30	30	30	31	31	31	31	31	31	31
Treasury stock	-	-	-	-	(24,999)	(24,999)	(24,999)	(24,999)	-	-	-	-
Additional paid-in capital	149,764	160,736	213,482	217,400	221,029	226,274	226,274	226,274	-	-	-	-
Note receivable, related party	-	(9,660)	(10,200)	(10,815)	(11,416)	(11,889)	(11,889)	(11,950)	-	-	-	-
Retained earnings/(deficit)	1,635	(42,277)	(35,368)	(44,490)	(84,509)	(84,657)	(82,423)	(82,423)	(87,588)	(92,792)	(99,909)	(107,556)
Accumulated other comprehensive income	142	(1,809)	(1,042)	248	966	1,260	1,260	1,260	-	-	-	-
Total Stockholders' Equity	151,564	107,015	166,902	162,373	101,101	106,020	108,193	108,193	118,604	129,288	136,283	142,409
Total Liabilities and Stockholders' Equity	372,632	353,426	323,585	373,428	405,560	414,770	420,135	420,135	452,413	488,137	521,618	555,072

Exhibit 5: Projected Balance Sheets (cont.)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Assets												
Current Assets												
Cash & cash equivalents	88,706	93,396	97,482	100,124	101,703	94,507	99,953	105,185	110,179	114,586	119,170	123,936
Short-term investments	-	-	-	-	-	-	-	-	-	-	-	-
Merchandise inventories	107,336	119,121	131,437	143,181	154,822	165,181	174,700	183,843	192,573	200,276	208,287	216,618
Trade accounts receivable	7,565	8,396	9,264	10,092	10,912	11,643	12,314	12,958	13,573	14,116	14,681	15,268
Income tax receivable	-	-	-	-	-	-	-	-	-	-	-	-
Prepaid expenses and other current assets	11,212	12,443	13,730	14,956	16,172	17,254	18,249	19,204	20,116	20,920	21,757	22,627
Deferred tax asset	-	-	-	-	-	-	-	-	-	-	-	-
Total current assets	214,820	233,356	251,913	268,353	283,610	288,585	305,215	321,190	336,441	349,899	363,895	378,450
Gross property and equipment	424,762	448,124	471,427	494,527	517,275	539,518	561,098	583,542	606,884	631,159	656,406	682,662
Less accumulated depreciation and amortization	(171,843)	(179,576)	(187,478)	(195,539)	(203,752)	(212,106)	(220,590)	(229,413)	(238,590)	(248,134)	(258,059)	(268,381)
Net property and equipment	252,919	268,548	283,949	298,988	313,523	327,412	340,509	354,129	368,294	383,026	398,347	414,281
Goodwill	105,124	105,124	105,124	105,124	105,124	105,124	105,124	105,124	105,124	105,124	105,124	105,124
Intangible assets, net of amortization	6,193	6,193	6,193	6,193	6,193	6,193	6,193	6,193	6,193	6,193	6,193	6,193
Deposits and other assets	10,970	12,174	13,433	14,633	15,823	16,882	17,854	18,789	19,681	20,468	21,287	22,138
Deferred tax asset	-	-	-	-	-	-	-	-	-	-	-	-
Total Assets	590,026	625,395	660,612	693,291	724,273	744,196	774,895	805,425	835,733	864,710	894,846	926,187
Liabilities and Stockholders' Equity												
Current Liabilities												
Trade accounts payable	104,325	115,779	127,749	139,164	150,479	160,547	169,799	178,686	187,170	194,657	202,443	210,541
Bank overdraft	38,894	43,164	47,627	51,882	56,101	59,854	63,304	66,617	69,780	72,571	75,474	78,493
Accrued liabilities	103,081	114,398	126,226	137,504	148,684	158,632	167,774	176,555	184,938	192,336	200,029	208,030
Current maturities of long-term debt	-	-	-	-	-	-	-	-	-	-	-	-
Total current liabilities	246,300	273,341	301,602	328,550	355,263	379,034	400,876	421,857	441,889	459,564	477,947	497,065
Long-term debt and capital lease obligations, less current	148,924	148,924	148,924	148,924	148,924	148,924	148,924	148,924	148,924	148,924	148,924	148,924
Other long-term liabilities	47,794	53,041	58,525	63,754	68,938	73,550	77,788	81,860	85,747	89,177	92,744	96,453
Total Liabilities	443,018	475,305	509,051	541,228	573,125	601,508	627,588	652,641	676,559	697,665	719,614	742,442
Stockholders' Equity												
Common stock	31	31	31	31	31	31	31	31	31	31	31	31
Treasury stock	-	-	-	-	-	-	-	-	-	-	-	-
Additional paid-in capital	-	-	-	-	-	-	-	-	-	-	-	-
Note receivable, related party	-	-	-	-	-	-	-	-	-	-	-	-
Retained earnings/(deficit)	(115,998)	(124,557)	(133,005)	(142,022)	(152,057)	(166,435)	(171,227)	(175,033)	(177,832)	(179,251)	(180,162)	(180,513)
Accumulated other comprehensive income	-	-	-	-	-	-	-	-	-	-	-	-
Total Stockholders' Equity	147,008	150,090	151,561	152,062	151,148	142,688	147,307	152,783	159,174	167,045	175,231	183,745
Total Liabilities and Stockholders' Equity	590,026	625,395	660,612	693,291	724,273	744,196	774,895	805,425	835,733	864,710	894,846	926,187

Exhibit 6: Adjusted Present Value Valuation – Going Concern

	2005	2006	2007	2008	2009	2010	2011	2012	2013
FCF to Debt & Equity - APV									
Sales	1,145,213	1,286,897	1,461,189	1,645,550	1,835,774	2,047,054	2,271,796	2,506,683	2,730,655
<i>Y/Y Growth</i>		12.37%	13.54%	12.62%	11.56%	11.51%	10.98%	10.34%	8.93%
COGS	808,179	900,692	1,022,292	1,146,025	1,278,012	1,424,239	1,576,379	1,734,720	1,894,777
<i>% of Sales</i>		69.99%	69.96%	69.64%	69.62%	69.58%	69.39%	69.20%	69.39%
Operating Expenses	327,889	361,536	409,969	460,672	513,307	571,655	633,180	697,373	757,576
<i>% of Sales</i>		28.09%	28.06%	28.00%	27.96%	27.93%	27.87%	27.82%	27.74%
EBIT	9,145	24,669	28,929	38,854	44,455	51,160	62,236	74,591	78,301
<i>EBIT Margin</i>		1.92%	1.98%	2.36%	2.42%	2.50%	2.74%	2.98%	2.87%
EBIT adjusted for disclosed permanent differences		24,669	28,929	38,854	44,455	51,160	62,236	74,591	78,301
Pre-tax Options		4,934	5,786	7,771	8,891	10,232	12,447	14,918	15,660
EBIT adjusted for all permanent differences		19,735	23,143	31,083	35,564	40,928	49,789	59,672	62,641
Preliminary Taxes		7,894	9,257	12,433	14,226	16,371	19,916	23,869	25,056
Adjusted NOPAT		16,775	19,671	26,420	30,229	34,789	42,321	50,722	53,245
<i>NOPAT Margin</i>		1.30%	1.35%	1.61%	1.65%	1.70%	1.86%	2.02%	1.95%
<i>NOPAT Growth</i>			17.27%	34.31%	14.42%	15.08%	21.65%	19.85%	4.97%
Plus (D+E) _{BEG}		145,800	156,211	166,895	173,890	180,016	184,615	187,697	189,168
Minus (D+E) _{END}		(156,211)	(166,895)	(173,890)	(180,016)	(184,615)	(187,697)	(189,168)	(189,669)
FCF to Debt & Equity - APV		6,364	8,988	19,426	24,103	30,190	39,239	49,250	52,743
<i>Y/Y Growth</i>			41.23%	116.14%	24.08%	25.25%	29.97%	25.51%	7.09%
Interest tax shield		3,878	3,878	3,878	3,878	3,878	3,878	3,878	3,878
Present Value of FCF		5,757	7,356	14,384	16,147	18,296	21,514	24,429	23,668
Present Value of Interest tax shield		3,508	3,174	2,871	2,598	2,350	2,126	1,924	1,740
		2014	2015	2016	2017	2018	2019	2020	2021
Sales		2,952,673	3,150,235	3,331,768	3,506,150	3,672,634	3,819,540	3,972,321	4,131,214
<i>Y/Y Growth</i>		8.13%	6.69%	5.76%	5.23%	4.75%	4.00%	4.00%	4.00%
COGS		2,054,324	2,191,777	2,318,079	2,439,406	2,555,237	2,657,446	2,763,744	2,874,294
<i>% of Sales</i>		69.58%	69.58%	69.58%	69.58%	69.58%	69.58%	69.58%	69.58%
Operating Expenses		817,524	869,770	917,906	965,444	1,010,810	1,050,373	1,092,388	1,136,084
<i>% of Sales</i>		27.69%	27.61%	27.55%	27.54%	27.52%	27.50%	27.50%	27.50%
EBIT		80,825	88,688	95,782	101,301	106,588	111,720	116,189	120,836
<i>EBIT Margin</i>		2.74%	2.82%	2.87%	2.89%	2.90%	2.92%	2.92%	2.92%
EBIT adjusted for disclosed permanent differences		80,825	88,688	95,782	101,301	106,588	111,720	116,189	120,836
Pre-tax Options		16,165	17,738	19,156	20,260	21,318	22,344	23,238	24,167
EBIT adjusted for all permanent differences		64,660	70,950	76,626	81,041	85,270	89,376	92,951	96,669
Preliminary Taxes		25,864	28,380	30,650	32,416	34,108	35,750	37,180	38,668
Adjusted NOPAT		54,961	60,308	65,132	68,884	72,480	75,970	79,008	82,169
<i>NOPAT Margin</i>		1.86%	1.91%	1.95%	1.96%	1.97%	1.99%	1.99%	1.99%
<i>NOPAT Growth</i>		3.22%	9.73%	8.00%	5.76%	5.22%	4.81%	4.00%	4.00%
Plus (D+E) _{BEG}		189,669	188,755	180,295	184,914	190,390	196,781	204,652	212,838
Minus (D+E) _{END}		(188,755)	(180,295)	(184,914)	(190,390)	(196,781)	(204,652)	(212,838)	(221,352)
FCF to Debt & Equity - APV		55,875	68,768	60,513	63,408	66,089	68,098	70,822	73,655
<i>Y/Y Growth</i>		5.94%	23.07%	-12.00%	4.78%	4.23%	3.04%	4.00%	4.00%
Interest tax shield		3,878	3,878	3,878	3,878	3,878	3,878	3,878	3,878
Present Value of FCF		22,684	25,257	20,107	19,061	17,973	16,755	15,764	14,832
Present Value of Interest tax shield		1,574	1,424	1,289	1,166	1,055	954	863	781
Cumulative PV of FCF	269,152								
Cumulative PV of Interest tax shield	28,617								
Terminal Value of FCF	1,127,068								
PV of Terminal Value of FCF	250,869								
Terminal Value of Interest tax shield	59,341								
PV of Terminal Value of interest tax shield	13,208								
Present Value	520,020								
Plus Excess Cash	-								
Base-case Enterprise Value	520,020								
Plus Debt-tax Shield	41,825								
Adjusted Present Enterprise Value	561,845								
Less Value of Debt	(148,924)								
Less Options Overhang	(14,738)								
Value of Equity	398,183								
Receipt Adjustment	423,089								
Timing Adjustment	418,954								
Shares outstanding	29,031								
Value per share	\$ 14.43								

Exhibit 7: Sensitivity Analysis (Based on Going Concern Model)

APV

		Unlevered Cost of Capital						
		8.50%	9.18%	9.86%	10.54%	11.19%	11.85%	12.50%
Terminal Growth Rate	1.0%	17.38	15.04	13.08	11.42	10.04	8.85	7.80
	2.0%	19.03	16.30	14.06	12.19	10.66	9.35	8.21
	3.0%	21.27	17.96	15.31	13.16	11.43	9.97	8.72
	4.0%	24.51	20.26	17.00	14.43	12.42	10.75	9.35
	4.7%	27.60	22.35	18.48	15.52	13.25	11.40	9.86
	5.3%	31.98	25.17	20.40	16.88	14.26	12.18	10.47
	6.0%	38.68	29.16	22.98	18.65	15.55	13.14	11.21

Same Store Sales

		Unlevered Cost of Capital						
		8.50%	9.18%	9.86%	10.54%	11.19%	11.85%	12.50%
Same-Store Sales	2.0%	20.71	17.17	14.45	12.29	10.60	9.19	7.99
	3.0%	22.55	18.67	15.69	13.33	11.48	9.95	8.65
	4.0%	24.51	20.26	17.00	14.43	12.42	10.75	9.35
	5.0%	26.59	21.94	18.39	15.60	13.41	11.61	10.09
	6.0%	28.80	23.73	19.87	16.83	14.47	12.51	10.87
	7.0%	31.15	25.63	21.44	18.14	15.58	13.47	11.70
	8.0%	33.64	27.65	23.10	19.53	16.76	14.48	12.57

Debt

		Unlevered Cost of Capital						
		8.50%	9.18%	9.86%	10.54%	11.19%	11.85%	12.50%
Debt	-	22.99	18.74	15.48	12.92	10.90	9.24	7.83
	49,641	23.50	19.25	15.99	13.42	11.41	9.74	8.34
	99,283	24.01	19.75	16.49	13.93	11.91	10.25	8.84
	148,924	24.51	20.26	17.00	14.43	12.42	10.75	9.35
	165,949	24.68	20.43	17.17	14.60	12.59	10.93	9.52
	182,975	24.86	20.60	17.35	14.78	12.77	11.10	9.70
	200,000	25.03	20.78	17.52	14.95	12.94	11.27	9.87

Probability-Weighted Value With Takeout

		Takeout Price						
		16.04	15.63	15.22	14.81	14.40	13.99	13.57
Probability of Takeout	10%	14.59	14.55	14.51	14.47	14.43	14.39	14.35
	20%	14.75	14.67	14.59	14.51	14.42	14.34	14.26
	30%	14.91	14.79	14.67	14.54	14.42	14.30	14.17
	40%	15.08	14.91	14.75	14.58	14.42	14.25	14.09
	50%	15.24	15.03	14.83	14.62	14.41	14.21	14.00
	60%	15.40	15.15	14.90	14.66	14.41	14.16	13.92
	70%	15.56	15.27	14.98	14.69	14.41	14.12	13.83
	80%	15.72	15.39	15.06	14.73	14.40	14.07	13.75
	90%	15.88	15.51	15.14	14.77	14.40	14.03	13.66

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