



Neiman Marcus

Future Outlook Analysis

Credit Rating: C1 (On Review for Downgrade)

History & Overview:

Neiman Marcus was founded in 1907 by Herbert Marcus and A.L. Neiman in Dallas Texas. The Company didn't open a second store until 1955 and operated only three stores in 1968 when it was acquired by Carter Hawley Hale. In 1987 there was a hostile takeover attempt of Cater Hawley Hale which led to a spinoff of its specialty division as a publicly traded firm. The specialty division consisted of Neiman Marcus, Bergdorf Goodman and Contempo Casuals. In 1995, the Company sold Contempo Casuals to Wet Seal Inc. After years of record sales and earnings in April 2005 the Company was taken private in a \$5.10 billion LBO transaction by an investor group led by Texas Pacific Group and Warburg Pincus. The Company maintained its impressive operating momentum during the first year after the buyout producing strong EBITDA earnings and reducing debt. Although it took a while, the consumer slowdown finally hit the luxury sector as the Company's comparable store sales and EBITDA declined in the third and fourth quarters. Neiman Marcus looked like it was headed for an IPO in 2009; but with the turmoil in the equity markets that appears highly unlikely. With its balance sheet still leveraged from the LBO and the economy sinking into recession it is imperative that we take a look at Neiman Marcus' future outlook.

Recent Initiatives

Neiman Marcus' current initiatives are related to steering the Company through the current economic downturn. In response to lower consumer demand the Company established initiatives to; stimulate sales through promotional and other events; reduce inventory purchases; and implement expense controls. Management doesn't anticipate a near-term improvement in macro-economic conditions so while it expects the top line will continue to be soft it is seeking to limit gross margin erosion by controlling inventory. The Company is also testing a new store concept. It currently operates five stores under the CUSP name; it targets a younger, fashion savvy, more contemporary customer in a specialty store format. Neiman Marcus' current demographic is skewed towards a much older consumer. The Company plans to open four to six more CUSP stores over the next 12 to 15 months. The Company is still evaluating the concept and has yet to make a decision on its long-term viability.

Competition Analysis:

Neiman Marcus competes in the luxury fashion sector. Direct competitors include Saks Fifth Avenue, Nordstrom, and Barney's New York along with numerous local and regional retailers. In addition, the Company competes with specialty retailers, traditional department stores, national apparel chains, boutiques and direct marketing firms. The Company differentiates itself from other national retailers by its distinct more upscale merchandise assortment, excellent customer service, prime real estate locations, and elegant shopping environment. It also differentiates itself from regional and local retailers through a more diverse product selection, strong national brands and vendor relationships that allow it to offer the top merchandise from each vendor and prime shopping locations. The following chart compares the Company's recent performance against several of its competitors. Neiman Marcus achieved the highest EBITDA margin aided by the lowest SG&A margin but its leveraged balance sheet gives it a distinct competitive disadvantage, especially in light of the credit crunch which would most likely inhibit its ability to borrow additional funds.

	Sales		Yr/Yr	YTD Comps	
	TTM 8/08	TTM 8/07	% Change	2008	2007
Saks	\$3,327.4	\$3,138.9	5.7%	2.7%	13.9%
Nordstrom	\$8,650.6	\$8,846.7	-2.2%	-6.2%	7.5%
Macy's	\$25,965.0	\$26,858.0	-3.3%	-2.2%	-1.1%
Neiman Marcus	\$4,663.3	\$4,455.8	4.7%	1.7%	6.7%

	TTM EBITDA		Yr/Yr	EBITDA Margin	
	2008	2007	% Change	2008	2007
Saks	\$333.8	\$285.4	17.0%	10.0%	9.1%
Nordstrom	\$1,145.1	\$1,253.3	-8.6%	13.2%	14.2%
Macy's	\$3,108.0	\$3,148.0	-1.3%	12.0%	11.7%
Neiman Marcus	\$772.3	\$773.3	-0.1%	16.6%	17.4%

Cash Flow & Liquidity Scenarios:

Neiman Marcus does not issue earnings guidance and as a privately held company is not followed by analysts. The Company commented that it expected the weak sales environment to continue, that inventory levels were higher than anticipated and that margins will be under pressure in the second half of the year. The Company reported that October same store sales plunged 28.8% and have declined 14.5% for the first two months of fiscal 2009. We assume in our three scenarios that October comps were an aberration, due to the markets imploding during the month, and we model comps moderating somewhat. However, even in our high-end scenario credit metrics are stressed. The Company did provide capital expenditure guidance and estimated that capex would be in a range of \$155 to \$165 million, down from \$183.5 million in fiscal 2008. For our model we projected cap ex at \$160 million, the middle of the range. The Company has made expense control a top priority, however, with four new stores opening we assume SG&A expense will increase by the same \$30 million it increased in fiscal 2008.

Scenario 1 presents our low-end scenario, we assume that Q1 sales trends continue and sales drop 18%. We also assume that gross margin remains under pressure and drops 300 basis points. Under this scenario EBITDA drops 75% to \$195 million. Credit metrics deteriorate with interest coverage only at 0.76x and debt/EBITDA at 16.27, both in dangerous territory. Our projections indicate that the Company would need to tap into its revolver and have approximately \$350 million available on its \$600 million revolver, still well above its minimum availability covenant.

Scenario 2 is a mid-range scenario that assumes that sales and gross margin decline at the current year-to-date rates. We consider this the most likely scenario, and we anticipate that EBITDA will drop more than 50% to \$313 million and cash flow would move into negative territory. We project bank availability would be approximately \$477. Interest coverage and debt/EBITDA are 1.27 x and 9.73, respectively, well below current levels.

Finally, **scenario 3** is a high-end scenario which assumes that the economy stabilizes somewhat and sales and gross margin decline more modestly. Again, SG&A expenses are the same as in the other scenarios. Here EBITDA dips to \$435.7 million, with cash flow moving into slightly positive territory. Credit measures continue to be problematic with interest coverage at 1.84 x and debt/EBITDA is at 6.68. The Company doesn't tap into the revolver at all except to use the LC line for direct sourcing purchases

		<u>Scenario 1</u>	<u>Scenario 2</u>	<u>Scenario 3</u>
Net Sales Δ		-18%	-13%	-8%
Gross Margin Δ		-3.0%	-2.0%	-1.0%
SG&A Expenses Δ		\$30.0	\$30.0	\$30.0

	8/2/2008	TTM 8/1/2009 Estimates (\$ in millions)			
	Actual fiscal				
Actual/Estimated Sales	\$ 4,666.30	\$ 3,826.37	\$ 4,059.68	\$ 4,293.00	
Gross Margin	36.2%	33.2%	34.2%	35.2%	
SG&A Margin	22.4%	28.10%	26.49%	25.05%	
add back Dep. & Amortization	\$ 220.60	\$ 220.60	\$ 220.60	\$ 220.60	
EBITDA	\$ 772.30	\$ 194.95	\$ 313.01	\$ 435.73	
EBITDA Margin	16.55%	5.10%	7.71%	10.15%	
Estimated Interest Expense(income)	\$ 239.80	\$ 256.45	\$ 246.89	\$ 236.93	
Total Inventory	\$ 978.00	\$ 1,036.00	\$ 1,036.00	\$ 1,036.00	
Total Stores	65	69	69	69	
Less Capital Expenditures	\$ 184	\$ 160.00	\$ 160.00	\$ 160.00	
Cash Flow	\$ 349.00	\$ (226.54)	\$ (98.92)	\$ 33.76	
Net Debt	\$ 2,706.90	\$ 2,933.44	\$ 2,805.82	\$ 2,673.14	
Bank Debt	\$ -	\$ 226.54	\$ 98.92	\$ -	
Estimated Borrowing Base	\$ 600.00	\$ 600.00	\$ 600.00	\$ 600.00	
Outstanding LC's	\$ 24.00	\$ 24.00	\$ 24.00	\$ 24.00	
Availability	\$ 576.00	\$ 349.46	\$ 477.08	\$ 576.00	
Credit Measures					
Interest Coverage	3.22	0.76	1.27	1.84	
Debt/EBITDA	3.81	16.27	9.73	6.68	

Asset & Debt Analysis:

The Company currently operates 40 Neiman Marcus full-line stores and two Bergdorf Goodman stores on Fifth Avenue in New York City. The Company owns five stores outright and another 12 stores that are owned and subject to a ground lease. The owned stores are mortgaged to secure the Company's senior secured credit facilities and the 2028 Debentures. The Company owns approximately 41 acres of land in Longview, Texas where its primary distribution facility is located. The Company also utilizes a regional distribution facility in Dayton New Jersey and five regional service centers. The Company owns approximately 50 acres of land in Irving, Texas where its Direct Marketing operating headquarters and distribution facility is located. The Company lists \$1.07 billion in net property and equipment assets on its year-end balance sheet.

In light of the credit crunch it is important to note that the Company's \$600.0 million secured revolver doesn't expire until October 2010 and can be increased to \$800.0 million subject to certain conditions and lender approval and still subject to borrowing base limitations. There are no financial covenants on the agreement unless availability falls below \$60.0 million; at that point the Company must maintain a pro-forma ratio of consolidated EBITDA to consolidated fixed charges of 1.1 to 1. Availability has not fallen below \$570.0 million since the agreement was established. The Company has no mandatory principle payments on its debt until 2013, important given the uncertainty in the credit markets. The Company might have difficulty in the current environment if it chose to issue new debt, however with modest expansion plans and no principle payments due that would seem unlikely.

Conclusion:

We expect Neiman Marcus's sales to be pressured in the near-term as the weak economy takes its toll. The luxury sector should be the first to recover when the retail economy begins to turn around but it will also one of the hardest hit sectors over the next couple of quarters. In response, the Company has taken steps to drive sales as much as possible in the current environment and reduce inventory to limit markdown exposure. In light of the Company's leveraged balance sheet, and the state of the credit markets, the fact that it has no principle payments due on its debt until 2013 is significant. In all three of our scenarios EBITDA shrinks fairly substantially, cash flow is either negative or just slightly positive and interest coverage is a concern, as it ranges from 0.78 x in scenario 1 to 1.74 x in scenario 3. With a leveraged balance sheet, in the face of a recession and a credit crunch Neiman Marcus should be watched closely, especially if the retail economy continues to weaken. We will closely monitor the Company as new financial information becomes available. To the extent that Neiman Marcus' actual performance varies from our three operational scenarios, we will update our model and redistribute.

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