

## Teen and Specialty Retailing

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### July Comps Preview: Status Quo Remains Dreary Despite Start of Fashion Newness

Company	Ticker	Price	Rating	Target/Return	2Q07E EPS	Year-Ago EPS
Aeropostale	ARO	\$35.65	Hold	NA	\$0.28	\$0.13
bebe	BEBE	\$13.01	Hold	NA	\$0.19	\$0.24
Wet Seal	WTSLA	\$6.18	Buy	\$8/86%	\$0.07	\$0.04
Wilsons	WLSN	\$1.93	Hold	NA	(\$0.35)	(\$0.63)

Company	Ticker	2007E EPS (P/E)	2008E EPS (P/E)	2007E July Comp	2006 July Comp	3-Year Comp. SSS Growth
Aeropostale	ARO	\$2.39 (14.9x)	\$2.67 (13.4x)	+1% - +3%	-1.9%	+6.9%
bebe	BEBE	\$0.78* (16.7x)	\$1.00* (13.0x)	-7% - -5%	+10.0%	+50.8%
Wet Seal	WTSLA	\$0.42 (10.2x)	\$0.61 (7.0x)	-5% - -3%	+6.4%	+37.0%
Wilsons	WLSN	(\$0.85) (NM)	\$0.10 (19.3x)	-18% - -15%	-18.3%	+7.5%

\* 3QFY07E, 3QFY06A, FY07E, FY08E, respectively.

#Untaxed.

Source: Company reports, Brean Murray, Carret & Co. estimates

- ❖ July, especially with the shift in the calendar to a week ahead of last year, marks the full start of the back-to-school selling season and the initial stages of fall; as such, the month is an important signpost for the rest of the year.
- ❖ While we believe there have been a number of key fashion positives, including continued strong demand for dresses and a shift to more flaired denim, there has been a continued lack of traffic in the mall; we believe the current low-growth, Darwinian environment will remain, at least for the near term.
- ❖ Given the relatively weak economic and mall traffic picture, we believe there is limited upside to our comp projections; we would not be surprised if bebe provided a dismal outlook for the remainder of the fall season.
- ❖ Aeropostale has reverted to very aggressive discounting and promotions to drive traffic in what should be, given the very easy comparisons, a time of material growth; we believe this bodes poorly for the remainder of the back-to-school season.
- ❖ July did not provide any respite for bebe, which continues to struggle with a series of fashion missteps and inventory problems.
- ❖ Wet Seal's top line was affected by tough comparisons, school opening shifts in key markets, and limited inventory levels at Arden B.; we believe 2Q07 earnings remain secure.
- ❖ Wilsons is nearing the next major test with the full rollout of branded jackets set for fall.

July 2007 (the four weeks ending August 4) will provide consumers with initial results for the key back-to-school season and the start of the fall fashion season; as has been *de rigueur* for 2007, there are a number of distorting factors in July: (1) the shift in the retail calendar by a week has added an additional period of core back-to-school selling in the July month, but (2) the pushback of the start of school in Texas and Florida has provided a somewhat mitigating factor. That said, the weather, while colder than last year, should not be much of a factor either way. While there has been more than enough fashion newness for the season, highlighted by flaired denim, empire dresses and lots of color and patterns, we believe economic pressures remain against the consumer, even the back-to-school teen; we note the bulk of back-to-school shopping is done by parents, who increasingly are not a limitless supply of discretionary spending. We continue to view the environment, at best, as a low-growth, Darwinian arena, where investors should primarily focus on companies with internal drivers and appealing core markets versus top-line-only growth stories; we reiterate our Buy rating on WTSLA.

**Aeropostale: Estimated July comps of +1% to +3%.** Despite relatively easy comparisons, we believe Aeropostale struggled to drive traffic, as its somewhat price driven customer has been affected by the economic slowdown; during July tops were on sale at 50% off virtually the entire period, and the company also was aggressive in offering “friends and family” coupons, which resulted in even further discounting. In addition, we believe Aero’s new denim displays were somewhat weak, as the product was materially too expensive, especially in comparison to key competitors American Eagle and Hollister. While the calendar shift will provide the company with higher margins, we believe Aeropostale’s challenges, in terms of both margins and anniversary key periods of discounting, will only increase in the coming months.

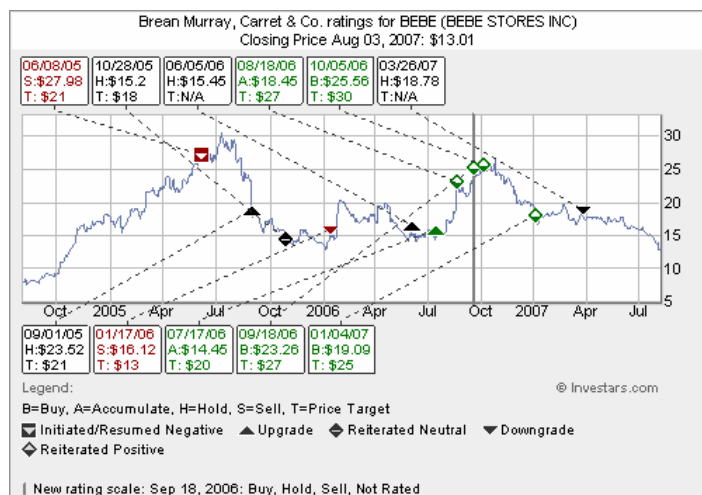
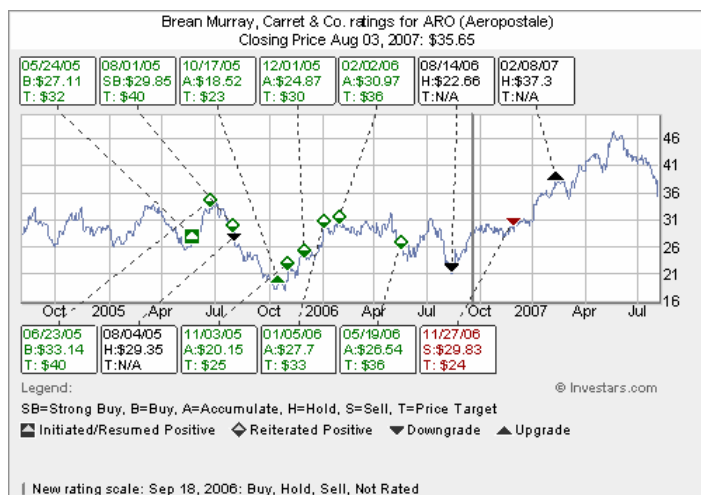
**bebe: Estimated July comps of -7% to -5%.** Once again, we are disappointed in bebe, as the new fall items, highlighted by colored trench coats and skinny leg black denim are uninspiring; in the case of the trench coats, we see no point in rolling out a somewhat late fall items as the key catalyst for the start of the season. Perhaps more importantly, there remains ample inventory of weak spring items that have to be cleared out. We believe, by any stretch, the company has continued to lose market share and fashion leadership to key competitors such as Marciano, a division of GUESS? (GES \$46.37, Buy), and Arden B., a division of Wet Seal (WTSLA \$4.30, Buy). When coupled with extremely difficult comparisons in the beginning of the fall season, we believe the company faces an extremely difficult period; we would not be surprised to see bebe materially reduce already sagging Wall Street expectations when it announces 4Q07 (June) results on April 23.

**Wet Seal: Estimated July comps of -5% to -3%.** The somewhat lackluster comp (which is within management’s prior guidance) reflects: (1) back-to-school calendar shifts at the Wet Seal unit and (2) a continuing lack of sales items in Arden B., which has enjoyed strong responses to their Spring items; we note Wet Seal has also aggressively cut back on its inventory exposure. As such, while 2Q07 same store will probably be below management’s original projection, we also believe gross margins will register a material improvement (which has been even further helped by a shift to more international sourcing at Arden B.), which should allow the company to achieve its bottom-line targets. We continue to view Wet Seal as ideally positioned for the remainder of the year, as there remains material opportunities for margin improvement from internal shifts, the company’s Arden B. unit remains on track for solid top-line expansion and the Wet Seal unit is beginning to anniversary the beginning of their store expansion, which should ameliorate the effect of store opening costs (which were a key drag in 1H07).

Our \$8 target price translates to 20.0x our fully taxed 2008 EPS estimate. Risks to our target price include: (1) the company’s customer base remains fashion-oriented – a fashion miss could result in poor results; (2) Wet Seal competes with players with greater financial resources; (3) Wet Seal’s store base is almost entirely mall-based and, consequently, changes in mall traffic could substantially affect results; and (4) the company is in the midst of a turnaround, with limited infrastructure.

**Wilsons: Estimated July comps of -18% to -15%.** The company continues to “tread water” as it waits for the heart of the fall selling season, when the next chance to drive material customer traffic, via more braded jackets, appears; we are already seeing Calvin Klein, GUESS? and Sean John jackets begin to appear in the stores. As always, the concern remains in driving store traffic; we remain on the sidelines until there is some conclusive proof of a change in consumer behavior at Wilsons.

Important Disclosures



All prices in this report are as of market close 08/03/07.

Brean Murray, Carret & Co., LLC makes a market in the securities of bebe Stores, Cache, Wet Seal and Wilsons.

Brean Murray, Carret & Co. Stock Rating System		
	Expected Performance	% of Coverage Universe/ % That Are IB Clients
Buy	Expected to appreciate by at least 10% within the next 12 months.	64.7/12.8
Hold	Fully valued, not expected to appreciate or decline materially within the next 12 months.	27.1/5.6
Sell	Expected to decline by at least 10% within the next 12 months.	8.3/18.2
Not rated	--	0.0/0.0

Note: Stock price volatility may cause temporary non-alignment of some ratings with some target prices.

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**Wet Seal:** Our \$8 target price translates to 20.0x our fully taxed 2008 EPS estimate. Risks to our target price include: (1) the company's customer base remains fashion-oriented – a fashion miss could result in poor results; (2) Wet Seal competes with players with greater financial resources; (3) Wet Seal's store base is almost entirely mall-based and, consequently, changes in mall traffic could substantially affect results; and (4) the company is in the midst of a turnaround, with limited infrastructure.

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