

Absolute Values

Sub-Working-Capital & Low Multiplier-Buys

Greenwich Investment Research, Inc.

www.hacketts.com

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Citi Trends, Inc.

(buy)

Year	EBITDA/ assets	(tan assets - CL+ST debt)	EBIT/ assets	Earnings/ assets	Earnings/ equity
2010	17.0%		14.7%	6.8%	10.2%
2009	17.1%		15.5%	7.0%	10.9%
2008	16.3%		13.9%	7.2%	11.0%
2007	14.9%		12.9%	6.8%	10.3%
2006	19.7%		24.0%	10.9%	18.1%
2005	18.5%		24.2%	9.6%	17.0%
2004	24.6%		37.5%	10.3%	30.5%
2003	28.9%		43.6%	12.0%	35.8%
2002	31.6%		50.1%	13.9%	47.4%
2001	24.3%		44.9%	8.3%	42.8%
mean	21.3%		28.1%	9.3%	23.4%
median	19.1%		24.1%	9.0%	17.5%

Ticker:	CTRN
Share price:	\$15.91
Market capitalization:	\$244 million
Enterprise value, sans leases:	\$151 million
Enterprise value, with leases:	\$265 million
Mrk cap / GAAP earnings (TTM):	12x
Mrk cap / adjusted FCF ¹ (TTM):	9 – 11x
Mrk cap / tangible BV:	1.1x
EV sans leases / EBITDA (TTM):	2.9x
EV with leases / EBITDAR (TTM):	3.1x

Thesis

Citi Trends, Inc. (CTRN) operates 473 clothing stores located in strip malls throughout the Southeastern United States. They sell “urban fashion apparel for the entire family” and their target market is low-income African-Americans. Though their capital returns have fallen in recent years, CTRN continues to generate respectable returns (note that they generated 10% return on equity with net cash of \$6.10 / share) and the company may be bought for less than 3x trailing EBITDA, about 10x trailing free cash flow and 1.1x tangible book value. The combination of modest valuation (possibly on depressed earnings due to the economic distress of their customers), respectable returns and solid balance sheet makes CTRN a compelling investment. We plan to buy CTRN shares in the near future.

¹ We calculate free cash flow as GAAP earnings plus depreciation less capital expenditures. In this instance, we adjusted FCF to remove expansion capital. Without this adjustment, CTRN was slightly FCF negative for the 12 months ending 4/30/11. All store expansion is financed by operating cash flow; CTRN had net cash of \$93.6 million (\$6.10 / share) as of 4/30/11.

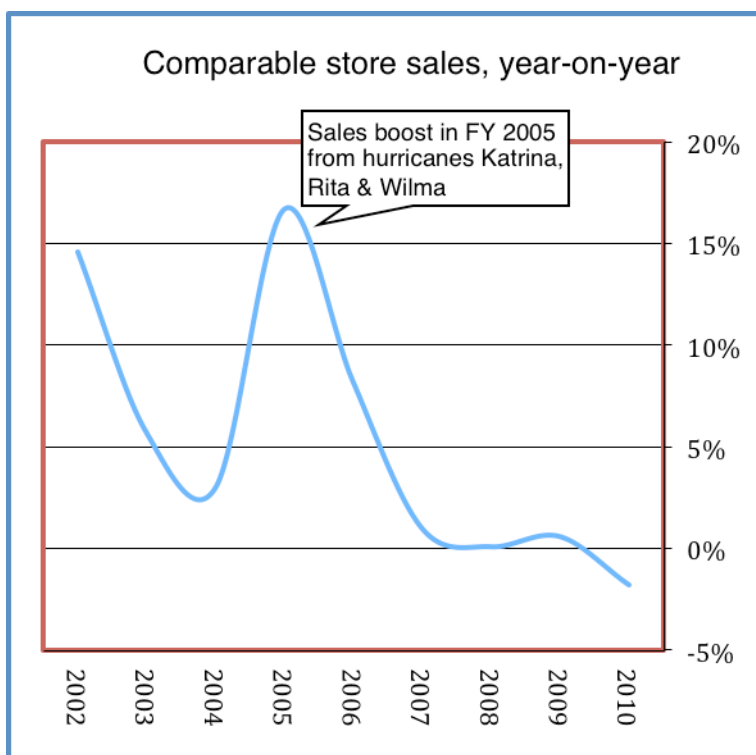
Valuation and capital structure

The following table summarizes CTRN's current valuation and capital structure.

(000 except share price)		dilution	
Common shares outstanding, 5/16/11	14,973		
Options, 1/29/11	83	0.6%	WASP= \$26.88
Non-vested restricted stock grants, 1/29/11	295	2.0%	
	diluted share count		
	15,350		
Share price, 7/14/11	15.91		
Market capitalization	244,219		
Cash, 4/30/11	93,671		
Operating lease obligations, 1/29/11	114,857		
Debt, 4/30/11	-		
Enterprise value, excluding leases, net	150,548		
Enterprise value including leases, net	265,405		

The bad news

CTRN's comparable store sales growth peaked in fiscal 2005 (fiscal 2010 ended 1/29/11) and has been negative over the last 18 months. The following chart summarizes CTRN comparable store sales since 2002.



The following table summarizes CTRN's revenue by type of merchandise sold; note that women's apparel and, to a lesser extent, men's apparel, have been falling as a percent of revenue since 2005.

Merchandise class	2010	2009	2008	2007	2006	2005	2004
Women's	33%	34%	35%	35%	36%	38%	38%
Children's	28%	29%	29%	27%	26%	25%	27%
Men's	20%	21%	22%	22%	22%	22%	21%
Accessories	17%	14%	12%	14%	14%	13%	13%
Home décor	2%	2%	2%	2%	2%	2%	1%
	100%	100%	100%	100%	100%	100%	100%

The following tables give more detail on CTRN's recent same store sales performance.

Merchandise class	2010	2009	2008	2007	2006	2005	2004
Women's	-5.0%	-2.0%	-3.0%	0.0%			
Children's	-5.0%	2.0%	8.0%	4.0%			
Men's	-4.0%	-2.0%	-2.0%	-1.0%			
Accessories	13.0%	11.0%	-8.0%	-2.0%			
Home décor	8.0%	6.0%	5.0%	1.0%			
overall	-1.8%	0.6%	0.1%	1.0%	8.2%	16.7%	3.0%

Merchandise class	3 ME 4/30/11	3 ME 5/1/10
Women's	-8.0%	8.0%
Children's	-6.0%	4.0%
Men's	-12.0%	8.0%
Accessories	2.0%	25.0%
Home décor	-4.0%	15.0%
overall	-6.9%	9.6%

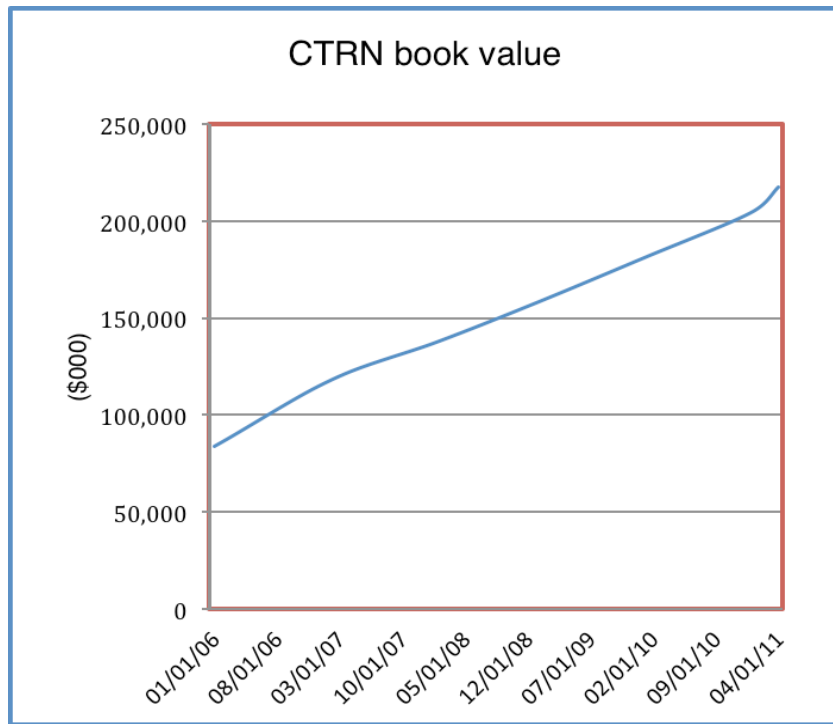
There are several possible explanations for the variation of comparable store sales including:

- **Hurricanes.** The comparable store sales spike in 2005 is probably attributable to hurricanes Katrina, Rita and Wilma. People displaced by the hurricanes apparently received government checks, part of which were spent at CTRN.
- **Economic distress.** CTRN's target customers have low to moderate incomes, thus they are particularly sensitive to the vagaries of the economy.
- **Merchandising mistakes.** There is a fashion element to CTRN's sales and, by definition, fashions change. George Bellino, CTRN's former president and highly respected chief merchant, retired in the spring of 2008. It is possible that CTRN is struggling to fill Bellino's shoes. Worse yet, it is possible Bellino retired because of vulnerabilities he saw in CTRN's strategy. A more likely explanation is that he retired at 60 because he had made a chunk of money on his CTRN stock options - \$7.5 million at the IPO price of \$14 and the stock soared in the quarters after the IPO.

The good news

We don't know why the same store sales are deteriorating, but mitigating the deterioration are the following observations:

1. **CTRN's customers are likely to continue to buy apparel.** This being the case, it is probably just a matter of time before management improves their merchandising (fashion retailers tend to produce cyclical results as they hit or miss their market from season to season). Sales may also pick-up due to demographic growth, i.e., a sustained poor economy is likely to increase the number of people who trade-down to shopping at CFTN. At less than \$16 dollars per share, we are not being asked to pay for any improvement, i.e. we get a free option on improvement.
2. **Solid balance sheet plus growing tangible book value (even during bad times).** CTRN management has time. CTRN had \$93.7 million of cash (\$6.10 / diluted share) as of 4/30/11 and the business generates cash year after year (though much of the cash is spent on expansion). The following chart shows CTRN's growth in book value since 2006 (intangible assets were \$1.4 million as of 4/30/11).



3. **Unique strategy / high ROI.** To our knowledge, CTRN is the only public company focused on selling off-price urban fashion apparel targeting low-income African-Americans. As the chart at the top of page one shows, CTRN is able to generate respectable returns on capital pursuing this business plan. In fact, CTRN's recent returns are somewhat understated in that CTRN has a growing cash hoard (38% of their current market capitalization is cash), which we have not adjusted for when calculating their returns. Management also opened a 460,000 ft² distribution center in Roland, OK during the spring 2011- the costs (\$5 million of equipment costs during the quarter ended

4/30/11) of the Roland facility have been incurred but the benefits have yet to be reflected in the company's returns.

Valuation multiples

The following table summarizes CTRN's valuation multiples based on \$15.91 / share.

	No adjustment for large cash balance			EV sans leases/ EBIT	EV sans leases/ EBITDA
	Mrk cap / earnings	Mrk cap/ FCF (no adjust)	Mrk cap / adj FCF		
12 ME 4/30/11	11.9	(62.3)	8.7	4.9	2.9
12 ME 1/29/11	11.7	395.2	8.9	4.8	2.9
12 ME 1/30/10	12.4	15.2	9.4	5.1	3.1
12 ME 1/31/09	14.0	26.3	10.6	6.5	3.8
12 ME 2/02/08	17.2	(74.1)	14.2	8.1	4.8
12 ME 2/03/07	11.4	17.4	11.4	5.0	3.9
12 ME 1/28/06	17.2	28.0	18.4	7.1	5.5
12 ME 1/29/05	33.7	69.8	39.8	12.0	8.6
12 ME 1/31/04	41.3	63.7	47.7	14.7	10.6

While we made no adjustment for the company's large cash balance (38% of current market capitalization is cash), we offer two free cash flow multiples in the above table: one with no allowance for capital used to expand the business and the second with an adjustment for expansion capital. According to figures published in CTRN's most recent slide deck (irritatingly, they failed to date the slides), it cost \$420,000 to build-out a new CTRN store. Multiplying \$420,000 times the number of stores built in a year, then netting this against total capex for the year results in a maintenance capex figure of about \$30k / year / store – this is what was used to generate the adjusted FCF multiples (the yellow-highlighted column). If we were to increase the estimated maintenance capex to \$42 k / year / store (1/10th of the cost of opening a new store, i.e., assuming they need to rebuild the store after ten years), CTRN is currently trading at 10.9x trailing free cash flow. This second assumption is not only a reasonable reality check, but also is corroborated by CTRN's Citi Lights initiative where they spend approximately \$40 k per store to upgrade it. We conclude that CTRN is trading for between 9 and 11x trailing free cash flow. Of course, it is trading for much less than this if we adjust for its over-capitalized balance sheet.

Background

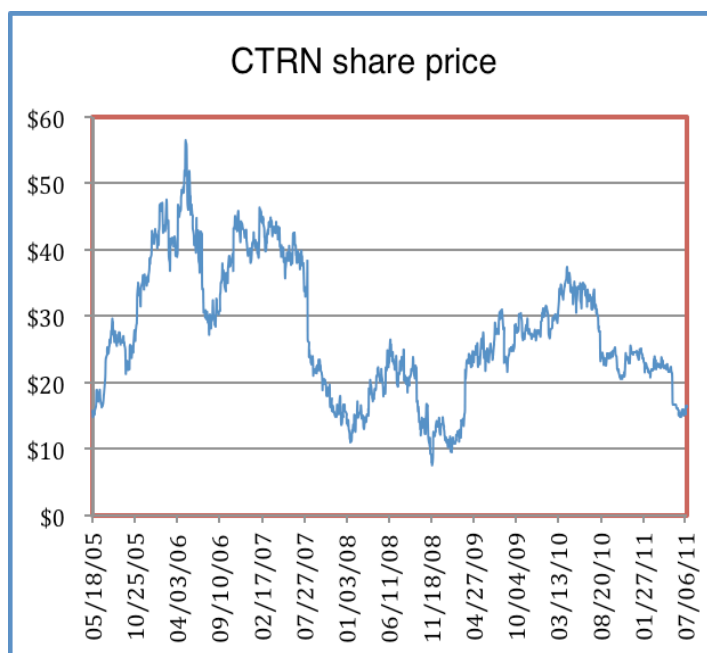
Savannah Wholesale was established in 1948 as a distributor of ladies hosiery and undergarments sold to department stores in the Southeast. The company changed its name to Allied Department Stores and opened its first retail store in 1958. By 1989, Allied had grown to 106 stores and was purchased by Variety Wholesalers, a privately held retailer based in North Carolina.

In January 1997, George Bellino was named president and chief merchant of Allied. Bellino led an initiative to update the stores and changed the name to *Allied Fashion for Less*. Bellino orchestrated a management buy-out from Variety Wholesalers in April 1999. The buyout was financed by Hampshire Equity Partners; at the time, Allied operated 85 stores. In February 2000, Bellino began launching new stores in a larger format (10,000 ft²) under the name *Citi Trends Fashion for Less*. The company generated net income of \$1.2 million from 115 stores in 2000 and officially changed its name to *Citi Trends* in July 2001. In November 2001, Edward Anderson, formerly the CFO of Variety Stores, was brought-in as CEO; at this point, Anderson became Bellino's boss.

On 5/18/05, Hampshire and a group of managers sold 1.15 million shares and CTRN issued an additional 2.7 million new shares to the public at \$14 dollars per share. The following table summarizes shareholdings immediately prior to and after the IPO.

Name	Position	Shares owned prior to IPO (000)	Shares sold in IPO	Shares owned after IPO	% shares owned after IPO	Value @ \$14 / share (000)
Edward Anderson	CEO	529	62	467	3.6%	7,399
George Bellino	President	557	65	491	3.8%	7,791
Thomas Stoltz	CFO	78	9	69	0.5%	1,092
James Dunn	VP, ops.	65	8	57	0.4%	910
Tracy Noll	Director	90		90	0.7%	1,261
Other managers		125	13	112	0.9%	1,744
Hampshire	PE fund	8,894	993	7,901	60.6%	124,511
Public - existing shares		-	1,150	1,150	8.8%	16,100
Public - new shares		-	2,700	2,700	20.7%	37,800
				13,036	100.0%	198,608

Anderson and Bellino’s shares owned prior to the IPO included options. As the table indicates, each owned shares and options worth about \$7.5 million (at \$14 per share) and Hampshire retained shares worth \$125 million. The following chart shows CTRN’s share price subsequent to the IPO.

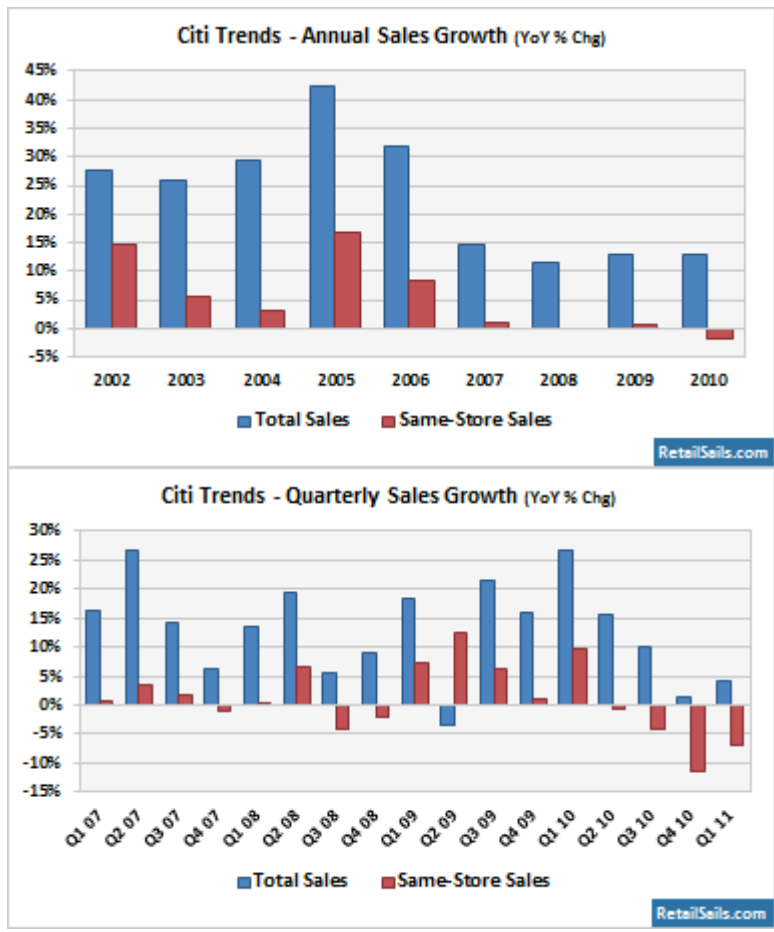


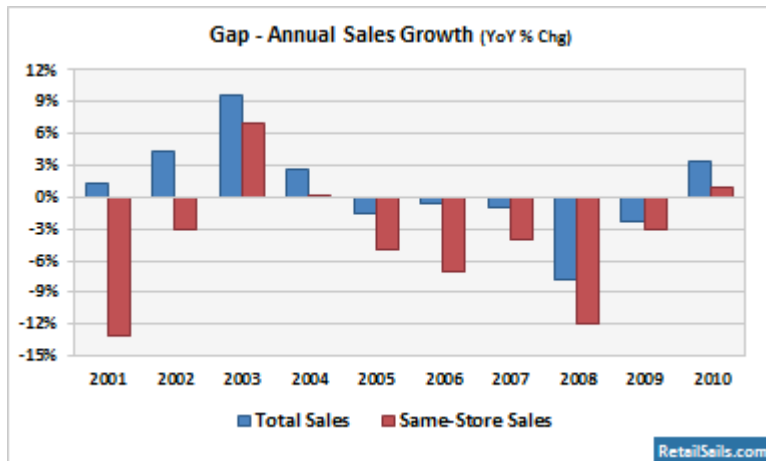
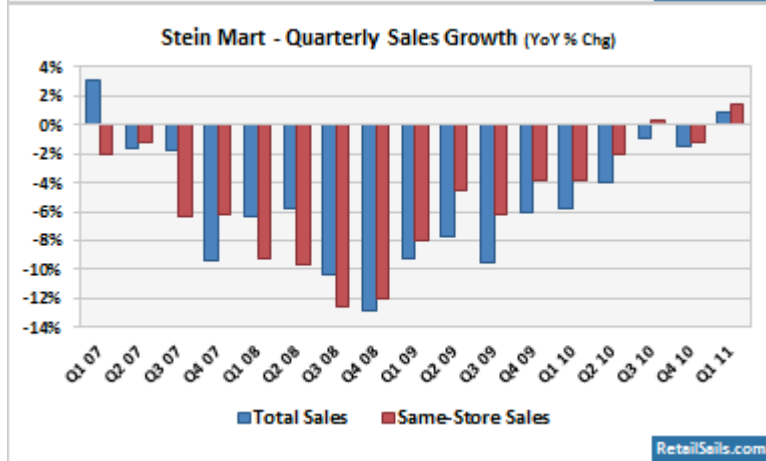
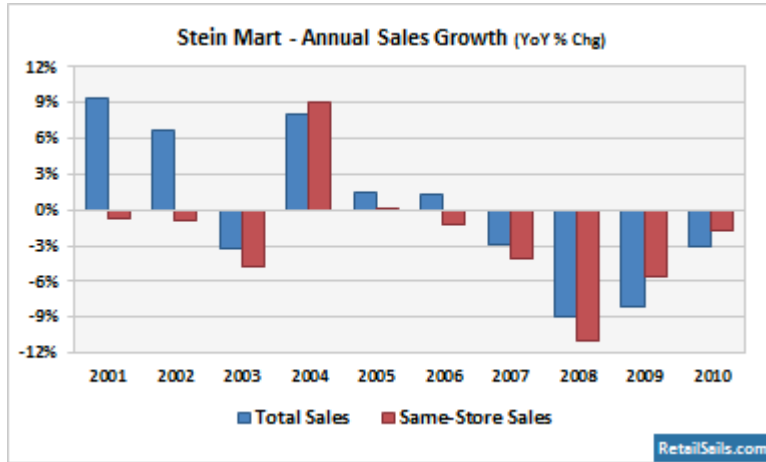
The 2005 hurricane season was a boon to CTRN’s business and its share price soared. Hampshire began selling their remaining shares in the open market; Greg Flynn, principal of Hampshire, resigned from his positions of director and Chairman of CTRN effective 5/1/06 at which point Anderson became Chairman while retaining CEO title. On 12/11/07 Hampshire filed a Form 4 indicating they had sold their remaining CTRN shares. The following day Bellino

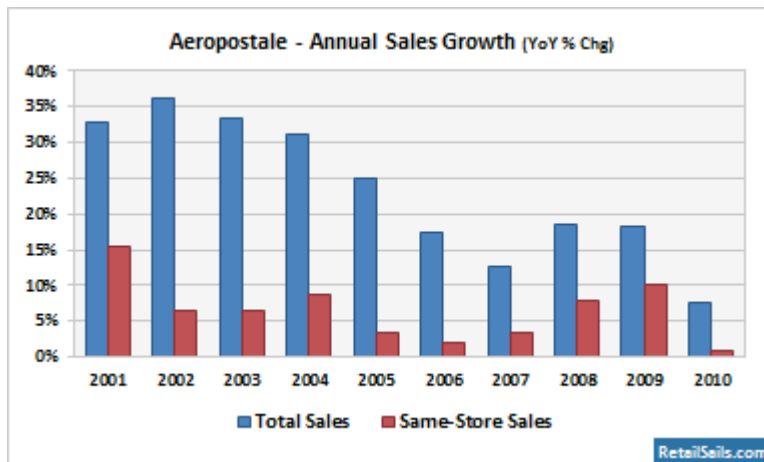
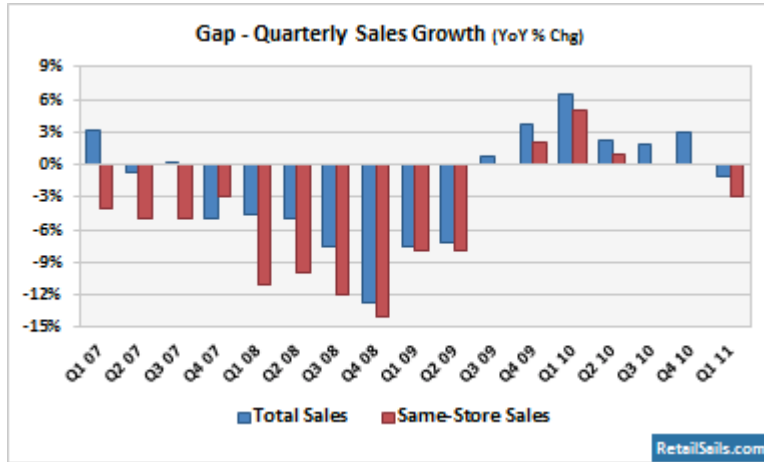
announced that he would retire; he was 60. Elizabeth Feher was named Chief Merchandising Officer on 4/2/08 – she had previously worked in merchandising roles at Value City Department Stores and Bon Ton Stores. On 4/15/09, David Alexander was named president and CEO and Anderson became non-executive chairman. From 2005 – 2007, Alexander had been the CEO of Portrait Corporation of America (PCA, an operator of photo studios in Wal-Mart stores). PCA filed Chapter 11 on 8/31/06. Prior to PCA, Alexander was president and CEO of Family Dollar Stores. CTRN has a classified board but no shareholder rights plan.

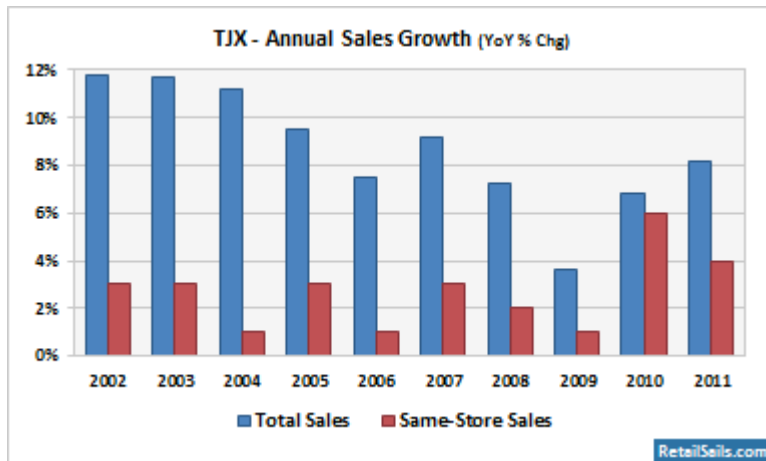
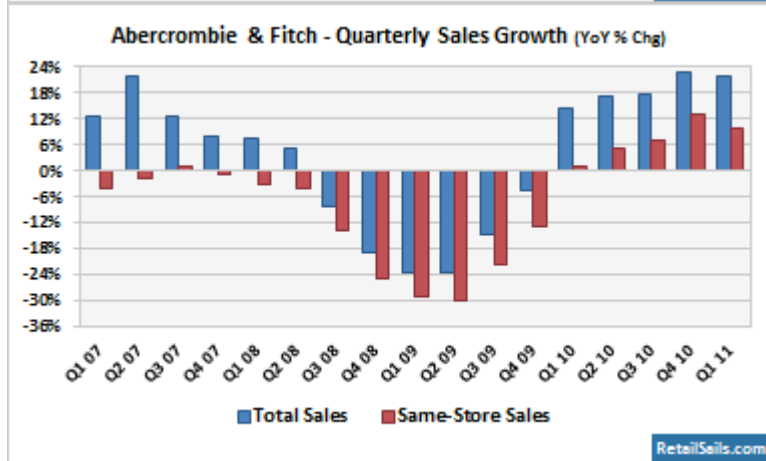
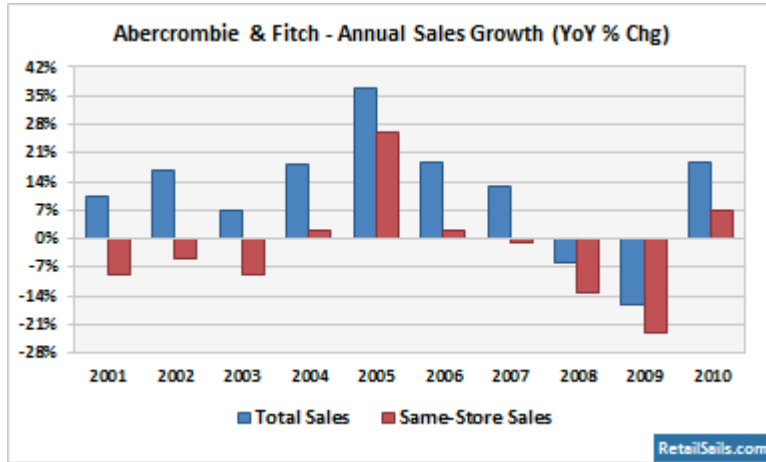
Half empty or half full?

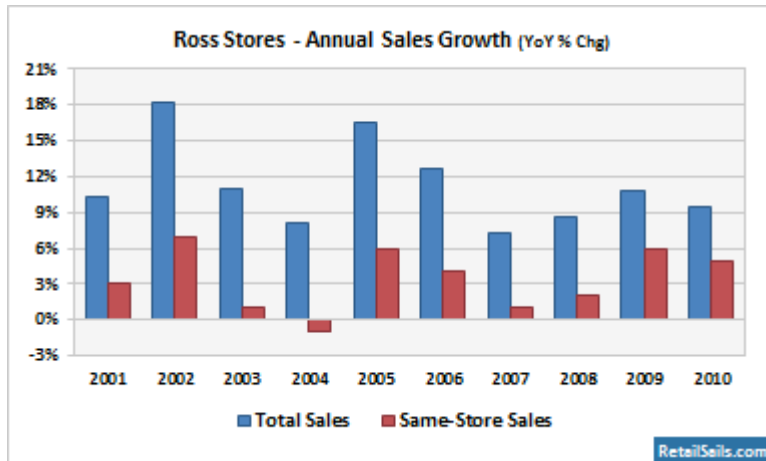
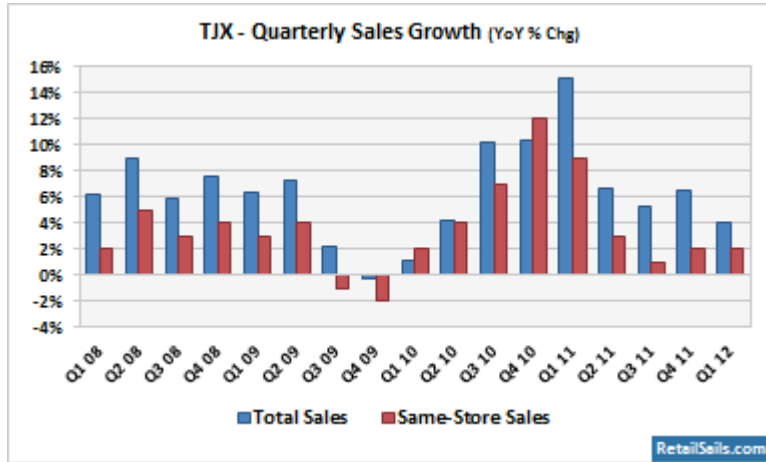
Our concern with CTRN is that they appear to be in a merchandising slump. If this is the problem, it is not unusual and, given that the business consistently generates cash and their balance sheet is over-capitalized, it is not likely to be terminal. The following tables show the same stores sales for CTRN and a number of comparable retailers. Note that the fashion-oriented retailers typically have quarters and, in many cases, years, with same-store sales down. Also note that CTRN is the least expensive retailer of the group (possibly the least expensive retailer in the country), has the best balance sheet of the group and has a unique market niche. We think the glass is half full and plan to purchase CTRN shares in the near future.











CTRN Balance Sheets

(000)	4/30/11	1/29/11	1/30/10	1/31/09
Assets				
Cash & securities	76,847	69,817	96,018	33,516
Inventory	113,380	121,432	100,874	86,259
Prepaid	10,771	11,238	10,409	10,625
Income tax receivable		524		
Deferred tax asset	5,057	4,907	4,518	3,447
total CA	206,055	207,918	211,819	133,847
PP&E, net	91,175	85,299	63,791	58,861
Long-term investment securities	16,824	9,205		43,825
Intangible assets	1,371	1,371	1,371	1,371
Deferred tax assets	1,150	2,001	2,488	2,480
Other	611	608	517	405
total assets	317,186	306,402	279,986	240,789
Liabilities				
A/P	58,988	67,934	62,706	52,295
Accrued expenses	16,373	14,587	12,773	11,478
Accrued compensation	6,997	8,597	9,500	7,514
Current debt / lease obligations				1,403
Income tax payable	4,295		3,024	682
Layaway deposits	1,928	444	645	564
total CL	88,581	91,562	88,648	73,936
LT capital leases / debt				
Preferred shares				
Other LT liabilities	10,778	10,036	9,995	8,646
total liabilities	99,359	101,598	98,643	82,582
Shareholders' equity	217,827	204,804	181,343	158,207
Tangible BV	216,456	203,433	179,972	156,836
Net cash & securities	93,671	79,022	96,018	77,341
Return on capital metrics				
EBITDA / assets		17.0%	17.1%	16.3%
EBITDA / tangible assets		17.0%	17.2%	16.4%
EBIT / (assets - CL+ST debt)		14.7%	15.5%	13.9%
Earnings / assets		6.8%	7.0%	7.2%
Earnings / tangible assets		6.8%	7.1%	7.3%
Earnings / equity		10.2%	10.9%	11.0%
Earnings/ tangible equity		10.3%	11.0%	11.1%
CA - all liabilities	106,696	106,320	113,176	51,265
tangible assets	315,815	305,031	278,615	239,418
tangible assets - CL+ short-term debt	227,234	213,469	189,967	165,482
cash + securities / share	6.10	5.15	6.26	5.04

CTRN Income Statement

(000 except store count & rent/ft)	13 weeks ending 4/30/11	FY 2010 12 ME 1/29/11	13 weeks ending 1/29/11	13 weeks ending 10/30/10	13 weeks ending 7/31/10	13 weeks ending 5/1/10
Net sales	189,168	622,528	172,043	140,037	129,042	181,406
COGS	(114,099)	(383,318)	(105,184)	(88,356)	(80,762)	(109,016)
Gross profit	75,069	239,210	66,859	51,681	48,280	72,390
SG&A	(42,428)	(153,531)	(38,687)	(38,818)	(36,001)	(40,025)
Rent	(8,644)	(33,700)	(8,425)	(8,425)	(8,425)	(8,425)
D+A	(5,584)	(20,535)	(5,692)	(5,324)	(4,769)	(4,750)
Unrealized gain (loss) on securities						
Interest, net	50	150	27	33	39	51
Income taxes	(6,370)	(10,742)	(4,718)	459	309	(6,792)
Earnings, GAAP	12,093	20,852	9,364	(394)	(567)	12,449
D+A	5,584	20,535	5,692	5,324	4,769	4,750
Total capex (include expansion capex)	11,902	40,769	12,121	10,565	11,197	6,886
Estimated maintenance capex	3,548	13,830	3,458	3,458	3,458	3,458
FCF (based on raw capex)	5,775	618	2,935	(5,635)	(6,995)	10,313
FCF (based on est. maintenance capex)	14,130	27,557	11,599	1,473	745	13,742
EBIT	18,413	31,444	14,055	(886)	(915)	19,190
EBITDA	23,997	51,979	19,747	4,438	3,854	23,940
EBITR	27,057	65,144	22,480	7,539	7,510	27,615
EBITDAR	32,641	85,679	28,172	12,863	12,279	32,365
Sales / store	1,333	1,350				
EBITDA / store	110	113				
EBITDA / ft ²	8.5	8.7				
Sales / ft ²	102	104				
Valuation metrics						
Market capitalization / earnings	11.9	11.7				
Market capitalization / FCF (no adjustment)	(62.3)	395.2				
Market capitalization / FCF (adjusted)	8.7	8.9				
Market capitalization / book value	1.1	1.2				
Market capitalization / tangible book value	1.1	1.2				
Market capitalization / (CA-all liabilities)	2.3	2.3				
EV sans leases / EBIT	4.9	4.8				
EV sans leases / EBITDA	2.9	2.9				
EV with leases / EBITR	4.1	4.1				
EV with leases / EBITDAR	3.1	3.1				

CTRN Income Statement

(000 except store count & rent/ft)	FY 2009	13 weeks	13 weeks	13 weeks	13 weeks
	12 ME 1/30/10	ending 1/30/10	ending 10/30/09	ending 8/1/09	ending 5/2/09
Net sales	551,869	169,811	127,356	111,605	143,097
COGS	(338,898)	(104,258)	(79,720)	(69,011)	(85,909)
Gross profit	212,971	65,553	47,636	42,594	57,188
SG&A	(136,966)	(37,000)	(34,939)	(31,944)	(33,083)
Rent	(28,200)	(7,050)	(7,050)	(7,050)	(7,050)
D+A	(18,431)	(4,752)	(4,851)	(4,455)	(4,373)
Unrealized gain (loss) on securities		0	57	671	(728)
Interest, net	312	69	68	77	98
Income taxes	(9,969)	(5,569)	(315)	38	(4,123)
Earnings, GAAP	19,717	11,251	606	(69)	7,929
D+A	18,431	4,752	4,851	4,455	4,373
Total capex (include expansion capex)	22,097	5,042	7,797	5,333	3,925
Estimated maintenance capex	12,090	3,023	3,023	3,023	3,023
FCF (based on raw capex)	16,051	10,961	(2,340)	(947)	8,377
FCF (based on est. maintenance capex)	26,058	12,981	2,435	1,364	9,280
EBIT	29,374	16,751	853	(184)	11,954
EBITDA	47,805	21,503	5,704	4,271	16,327
EBITR	57,574	23,801	7,903	6,866	19,004
EBITDAR	76,005	28,553	12,754	11,321	23,377
Sales / store	1,369				
EBITDA / store	119				
EBITDA / ft ²	9.2				
Sales / ft ²	106				
Valuation metrics					
Market capitalization / earnings	12.4				
Market capitalization / FCF (no adjustment)	15.2				
Market capitalization / FCF (adjusted)	9.4				
Market capitalization / book value	1.3				
Market capitalization / tangible book value	1.4				
Market capitalization / (CA-all liabilities)	2.2				
EV sans leases / EBIT	5.1				
EV sans leases / EBITDA	3.1				
EV with leases / EBITR	4.6				
EV with leases / EBITDAR	3.5				