RESTRUCTURING ZALE CORPORATION

TURNAROUND MANAGEMENT ASSOCIATION

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Sudhanshu Jain

UNIVERSITY OF TEXAS AT DALLAS

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Executive Summary

Overview

Cash-strapped Zale Corporation, one of the largest jewelry retail in the U.S., has been struggling for the past three years. Zale has about 1,890 stores that produce annual revenue of $1,600 million. The economic downturn and poor holiday sales left the once-largest U.S. jewelry retailer without the cash it needed to pay suppliers. It canceled orders and took the unusual step of asking vendors to purchase inventory for cash. In mid-January 2010, top three executives left the Company after holiday sales fell 12 percent. The present key executives have good retail industry experience, but lack jewelry industry experience. Zale's stock price took a hit in 2008-2009 when it dropped from $28 per share to $1.20 per share. The stock now trades at $3.25. With 32.1 million shares outstanding, Zale lost approximately $1 billion of market capitalization in less than six months.

Zale Corporation, whose stores are typically located within shopping malls, encountered challenging conditions in 2007 when it tried to go more upscale, but had to heavily discount its merchandise due to competition, which hurt its profits. Zale sold its high-end Bailey Bank and Biddle chain to Finlay Jewelers. It also closed hundreds of stores in 2008 and 2009. One of the biggest drains on Zale's cash is the large number of lease payments the company makes on space leased in poor performing malls throughout the country. Zale Corporation still needs to close several hundred underperforming stores to return to profitability.

Financial analysis of Zale Corporation shows that one of the factors which put the company in disadvantage is high SG&A expense compared to the industry average. Zale is highly leveraged compared to its competitors. The company's high debt-to-equity ratio has been responsible for a huge cash outflow in the form of interest payments. Zale had $26 million cash and $125 million available under a $600 million line of credit. If the amount available on that credit line falls below $50 million, Zale will be in default on its covenants.

Store-level observation of Zale and its competitors revealed that sales people in the store lack proper training and experience, which is one of the critical success factors in the jewelry industry. Zale also lacks a good bridal program and special holiday season programs compared to its competitors, such as Helzberg Diamonds.

Recommendations

Zale Corporation should consider a comprehensive restructuring plan to address its various issues:

- To deal with the issue of stores in loss, Zale should consider closing down its underperforming stores. The company should consider implementing four-wall EBITDA analysis to select the unprofitable stores to be closed.
- To address its high SG&A expenses, Zale should consider changing its corporate structure.
- To drive sales up, Zale should introduce special bridal programs, new product lines, and designer jewelry, and should increase its direct marketing efforts to create brand awareness.
- To address the issue of its unskilled sales people, Zale should stress more on employee training.
- Zale should focus more on a few brands and divest others. It should consider selling its unprofitable or less profitable brands, which will help to increase brand value.
- Hire at least a few key executives with extensive experience in the jewelry industry to address the issue of management's lack of industry experience.
- Zale is highly leveraged and most of the debt is due in 2013 and 2014. The company should consider debt refinancing and a debt-to-equity swap. Debt refinancing will cause minimal business disruption and management can remained focused on implementing turnaround plans. Reduced debt level after completion of exchange would reduce interest burden on the company and would free up additional liquidity.

Jewelry Industry Overview

The U.S. retail jewelry industry is composed of five main segments: bridal jewelry (30%), fashion jewelry (22%), watches (18%), precious stones (15%) and precious metals (15%). Bridal jewelry is considered a necessary component of jewelry retail and is less influenced by economic conditions than fashion jewelry, which is considered a luxury good. Precious metals include gold, silver, platinum and palladium. Precious stones come in over 130 varieties, around 50 of which are commonly sold by retail jewelers.

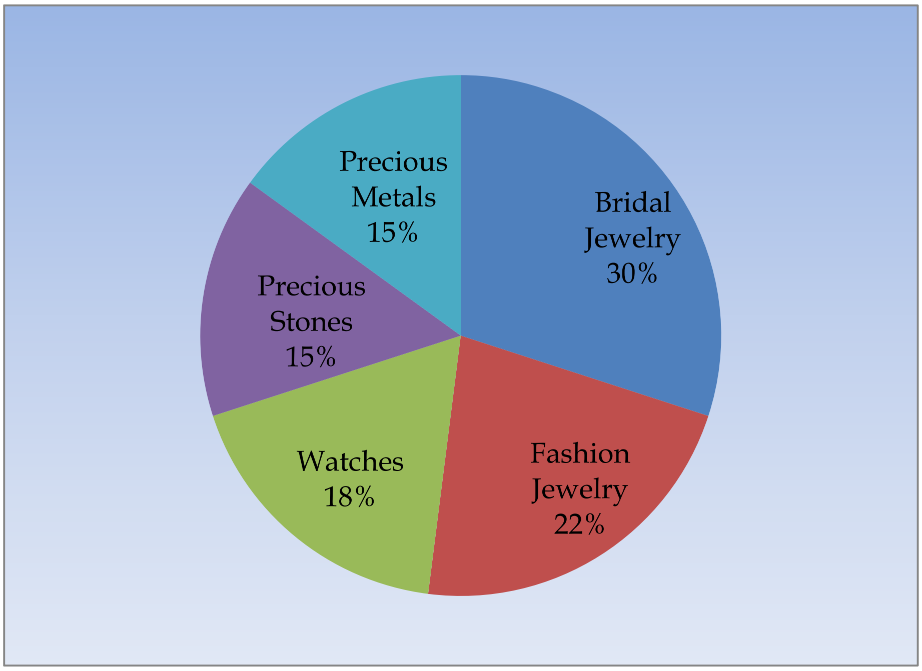


Chart: US Retail Jewelry Industry's Five Segments

The U.S. jewelry retail industry is highly fragmented, with the top 50 jewelry chains generating less than one-half the revenue and the top 10 jewelry chains comprising less than 25% of the market. No retailer claims more than a 6% market share.

The U.S. jewelry retail industry includes about 28,000 specialty stores with combined annual revenue of about $30 billion. The industry employs approximately 200,000 individuals. Wal-Mart is the largest retailer in the

U.S. Major companies include Zale, Tiffany, and Sterling Jewelers. U.S. retailers account for 15% of worldwide sales in the industry.

Competitive Landscape

The demand for jewelry is largely determined by the consumers' disposable income. Sales depend on the number of affluent individuals, working women, double-income households, and fashion-conscious men. When the raw material prices fall, jewelry becomes more affordable and consumer demand rises. Small jewelers can compete effectively with large chains because price is not the main factor that determines sales. Profitability depends on merchandising and effective marketing.

Jewelry is not only sold by specialized jewelry retailers, but also by department stores and mass merchants. Because regular gross margins are very high, often 50 percent, mass merchants have been able to cut prices and take market share.

Over the past decade, online jewelry sales have risen steadily. This development has forced retail merchants to adapt and many moved some components of their operations online. Increasing numbers of manufacturers and wholesalers are also conducting business online. Because jewelry is seldomly branded, product differentiation is a key point of competition among retailers. Good designers are valued.

Seasonality and Cyclicality

Jewelry sales are both seasonal and cyclical in nature, with 40 percent of revenue and the majority of profits generated in the fourth quarter and 25 percent of annual jewelry sales occurring in December. Jewelry sales are high during the Christmas season and during the weeks proceeding Valentine's Day. Mother's Day experiences a spike in sales as well. Overall sales can be affected by mineral availability, fashion trends, environmental regulations, and international tariffs. Gold, silver, platinum and palladium are all exchangeable commodities, and fluctuations in market price directly affect sales volume.

Products, Operations & Technology

Jewelry is often classified as bridal merchandise (engagement, bridal, and anniversary rings - about 35 percent of the market); fashion jewelry (rings, bracelets, earrings, pins, gold chains); and watches, silver flatware, and other giftware. Diamond jewelry and loose diamonds account for the largest share of total jewelry store sales (46 percent); gold jewelry for 11 percent; colored gemstone jewelry (rubies, sapphires, emeralds, etc.) 9 percent; and watches 4 percent.

Jewelry is expensive, intimidating, and difficult for consumers to evaluate. Purchases, therefore, require a good deal of service and professional expertise. Consumers are most likely to buy jewelry from a merchant they feel is trustworthy. Large retailers, such as Wal-Mart and Tiffany, benefit from this industry peculiarity; local jewelers with community roots and good reputations benefit as well.

Jewelers' operations consist of buying jewelry from manufacturers and wholesalers, training sales staff, and marketing products through various channels. Many jewelers also operate repair services, which can account for 10 percent of annual revenue. Company buyers must be both technically skilled and aware of fashion trends. Most retailers buy merchandise that is fully finished from many different manufacturers. Some retailers create pieces themselves. Retailers also sell merchandise on consignment from manufacturers.

Sales & Marketing

Because jewelry retailers must present an upscale appearance, store location, furnishings and professional staff are significant operating expenses. Companies may cater to various demographics, but an elegant and professional appearance is considered vital. Most retailers market through print advertising, although mail and email campaigns are also utilized. These campaigns are narrowly focused, and use demographic information gleaned from market research.

Finance & Regulation

Merchandise inventories are high, often more than 50 percent of annual sales, and inventory controls must be tight to prevent embezzlement. Accounts receivable are very high for companies that offer their own credit card. Because jewelry is expensive, credit is a key issue for retail jewelers. The average cash purchase is usually much lower than the average credit sale. About 50 percent of a typical jeweler's sales are financed on credit cards. The introduction of in-house credit cards, which are offered by large retailers in conjunction with banks, has served to boost sales by providing customers with lower interest rates and better terms. Most small retailers avoid risk by taking only third-party credit cards.

Such as other retailers, jewelers must adhere to standard fair trade and credit laws. The Federal Trade Commission requires that jewelers accurately advertise and describe gemstones, especially if they have been treated to change color.

Regional & International Issues

Most jewelry sold in U.S. stores is imported. Imports have increased rapidly in recent years. The largest sources of jewelry imports in 2009, excluding costume jewelry, were India, China, Thailand, and Canada. Israel and Belgium are major centers for converting rough diamonds into finished gemstones. The three largest markets for U.S. exports of precious metal jewelry are Switzerland, Japan and Thailand.

Human Resources

Employees of higher-priced jewelry stores usually require special training and may be bonded for security reasons. Due to the special expertise required, most workers at high-end stores work full time. Sales people often work on commission. Average hourly industry wages are moderately lower than the national average. Retail jewelry stores have an exceptionally good safety record.

(Source: First Research, S&P Net Advantage, and Business and Company Resource Center)

Jewelry Industry Trends

- **Creating Brand Names**: To increase consumer confidence, retailers and manufacturers are trying to establish brand names. Although branding has been successful for signature pieces from famous retailers such as Tiffany, gemstone branding has had little impact so far. Branding has been most successful for watches.
- **Prices of Gold Rising**: The price of gold has risen dramatically, which has made gold fall out of favor with many customers and retailers. Some stores have started carrying more pieces that contain a mix of gold and less expensive silver or are made from lightweight "lacey" gold.
- **Platinum Jewelry Enjoys Brisk Sales:** Despite significantly higher prices for the metal, platinum jewelry is still enjoying higher sales volume, due primarily to the new technology that is allowing designers to create lighter weight pieces at lower prices and also due to new promotional strategies that are enticing new customer groups, such as younger adults, into the market.
- **Business Sales and other Products**: In addition to selling jewelry to individuals, some companies, such as Tiffany, sell items like cups, pens, watches, and pins to business accounts for use in employee programs. Nearly 15 percent of Tiffany's sales come from non-jewelry items.
- **Shrinking Number of Stores**: The number of retail jewelry shops is on the decline. The number of stores fell by more than 1,000 between 2002 and 2007, which was a 3.5 percent drop. The industry is losing stores as a result of consolidation and companies cutting back on expansion plans to focus on existing stores in light of slipping sales.
- **Growing Internet Sales**: Although most jewelers believe it is easiest to sell merchandise in person, the growing online market has attracted many vendors. Online sales now account for about 17% of total jewelry industry sales. Some consumers are wary of spending thousands of dollars on a diamond ring through a website; however, many are not. Therefore, it is necessary for a retailer to showcase jewelry, to educate consumers, and to inspire them to visit the brick-and-mortar stores.

- **Changing Demographics**: About 39% of the U.S. adult population purchases fine jewelry each year, and consumers from age 18 to 24 have the highest incidence of fashion jewelry purchases. The population demand between age group 45 to 65 for high-end jewelry is the highest, and the demographic picture for retail jewelry markets is strong.
- **Private Credit Cards**: Retailers with private credit cards have had some success in marketing services such as credit insurance to customers. Almost one-half of all cardholders purchase some form of insurance from their jeweler and cards also have been used to market promotional materials. Jewelers view cards as a means of engineering themselves to customers, and may use them to bundle promotional materials related to the store.

Critical Success Factors for Jewelry Stores

For jewelry retailers to be successful, they should know what their customers want from a purchase and should take steps to gather important information about shoppers' taste and preferences. Various critical factors to achieve success in jewelry stores industry are as follows:

- **Training of Sales People:** The companies should train their sales team to "feel out" customers to determine if they want to be helped or if they are just looking. If customers want to be helped, sales people should be able to tailor their presentations to each customer's concerns rather than taking the same approach with each customer. It is very important to understand and cater to the true needs of a customer in the jewelry store industry.
- **Taking Customers' Feedback:** It is a very crucial in the jewelry store industry to ask customers what they think of a product they just purchased or about their overall shopping experience in the store. The customer should be given incentives to encourage them to answer. In-store surveys, email questionnaires, and other types of feedback help determine the right mix of products in a variety of price points and bring retailers "closer to their customer."

- **Taking Decisions Based on Marketing Research Tools:** Jewelry stores should make decisions based on trend reports, sales performance figures, competitive analysis, market demand forecasts and focus groups.
- **Advertising and Marketing:** One of the very important factors to build awareness, to generate traffic, and to promote the store's "brand value" is advertising and effective marketing. Due to the emotional factor attached with jewelry, it is also important to reach out to the community by sponsoring charity events or sports teams, or by hosting concerts and art shows. These are some of the good ways to attract new prospects for a reasonable investment.

  Some of the characteristics mentioned in the advertising that motivates potential customers to call, or to make them feel comfortable in doing business with the store are mentioned in the table below:

Guarantees/warranties	Repairs Done on Premises
Member, American Gem Society, BBB, Jewelers of America	Watchmaker/Appraiser/Goldsmith on Premises
"Highest Price Paid"	Expert Ring Sizing
Skilled Designers/Award-Winning Designs	Confidentiality/Privacy/Discretion
Registered Jeweler/Master Diamond Cutter	Certified Appraisal/Onsite Manufacturer
Family-Owned and Operated	Master Jeweler
Location Data/Maps	Mail/ Phone orders
Rings Sized While-U-Wait	Repairs While-U-Wait
"Qualified Free Estimates"	Open 6/7 Days/Evenings
Credit Cards/Financing/Layaway	Invitation/Inducements to Visit Website
Instant Cash/ Free Appraisals	"View Inventory Online"
Number of Engagement Rings	Low Prices(Loan Forfeits)

Table: Some of the confidence characteristics mentioned in Jewelry Store Advertisements

(Source: IndustryIQ.biz)

- **Understanding Emotional Factors That Drive Sales:** Customers' jewelry shopping experience has mostly an emotional factor attached. The retailer should be able to understand that emotional excitement properly. This type of emotional excitement often leads to the purchase of "add-ons" such as jewelry cleaner, jewelry boxes or travel pouches.

- **Running Special Programs:** Special programs, such as bridal programs and valentine special programs, help jewelry retailers drive their sales up.
- **Other Factors:** Other critical factors, including inventory control, cost management, pricing policy, and location strategy, plays an important role in the jewelry industry.

Challenges Faced by the Jewelry Industry

- **Dependence on Key Suppliers**: With the world diamond supply primarily controlled by De Beers, retailers find themselves at the mercy of the giant cartel's pricing and distribution decisions. Synthetic diamonds have begun to replace the De Beers monopoly.
- **Exposure of Credit Risk**: The practice of extending credit to well-known customers expands in periods of economic strength because collection proves easier. Extending credit affords smaller retailers with another competitive tool, although the possibility of customer default always exists.
- **Crime Exposure**: Because merchandise is valuable, retailers are prominent targets for potential thieves. Employees must be screened and security is important. The industry loses over $100 million yearly to crime.
- **Competition from Mass Merchants**: With sales by mass merchants nearing 50 percent of total retail sales, independent jewelers and department stores are scrambling to compete. In particular, Wal-Mart has presented stiff challenges to smaller U.S. retailers.
- **Sales Linked to Economic Health**: Disposable income and consumer confidence are key determinants in the success of retail jewelers. High-end sales in particular suffer in times of economic drought.

Business Description

Zale Corporation operates as a specialty retailer of fine jewelry. The company operates through three segments: Fine Jewelry, Kiosk Jewelry, and All Other segment (insurance and reinsurance).

Fine Jewelry Segment

The Fine Jewelry segment operates under five brands. The Zales Jewelers brand provides diamond jewelry primarily in the bridal and fashion segments through 693 stores in 50 states and Puerto Rico. The Gordon Jewelers brand provides jewelry in 202 stores in 31 states of the United States and Puerto Rico. The Peoples Jewelers and Mappins Jewelers brands offer gold jewelry, gemstone jewelry, and watches through 212 stores in Canada. The Zale's Outlet brand offers branded watches, gemstones, gold merchandise, and diamond fashion and solitaire products through 140 stores in 36 states and Puerto Rico. The Fine Jewelry segment also sells its products through e-commerce sites, such as zales.com and gordonsjewelers.com. This segment targets the middle-class consumer, and products can be found online as well as in stores. Zales Jewelers is the company's brand name and consumers can buy jewelry at moderate prices through this brand. Most of the jewelry sold at these stores is designed by the company and is offered at different price points.

Kiosk Jewelry Segment

The Kiosk Jewelry segment provides gold and silver products, such as bracelets, earrings, charms, rings, 14-karat and 10-karat gold chains, and silver and diamond jewelry primarily under Piercing Pagoda, Plumb Gold, and Silver and Gold Connection brand names, through 684 mall-based kiosks. These kiosks can be mostly found in malls and mainly target teens and other fashion-oriented customers who prefer low-level prices. These kiosks are strategically placed in high-traffic areas where they are visible and accessible for customers who are strolling in the mall.

All Other Segment (Insurance and Reinsurance)

The All Other segment provides insurance and reinsurance facilities for various types of insurance coverage, such as merchandise replacement coverage, credit insurance coverage, and discontinued lines of insurance. Credit insurance coverage gives protection to the cardholder and creditor for losses due to a disability, unemployment, or even death of the cardholder. Zale has a connection with Citibank USA, which provides customers with insurance and payments for insurance products.

Zale Corporation was founded in 1989 and is headquartered in Irving, Texas.

(Source: Capital IQ and Mergent Online)

SWOT Analysis

Strength

1. The company has comprehensive wedding, bridal, engagement and anniversary collections, which gives it a competitive edge over its competitors.
2. Another competitive advantage comes from a large variety of men's, women's and children's jewelry.
3. Financing options through Zale's credit card.
4. Large retail network of Zale Corporation in North America.
5. The company's trademarks and trade names help to sustaining its competitive position in the jewelry industry.
6. Diverse brand portfolio is also one of the strength of the company.

Weakness

1. Poor financial performance in 2008, 2009, and 2010 shows the company has suffered from the financial crisis more than any of its competitors.

2. The company has a very high debt-to-equity ratio compared to industry average, which means Zale uses a lot of leverage and does not have a very strong equity position.
3. Zale's ability to generate internal funds and its borrowing capacity has weakened the last couple of years.
4. Zale has a very concentrated customer base. The locations of the company's stores are limited to North America. This is a disadvantage because most of Zale's competitors are more geographically diversified. Although the company has expanded its business online, it has mostly expanded its business in North America. Competitors, such as Blue Nile and Tiffany, now operate in countries in Europe and Asia through a web portal, which makes it easier to reach a broader specter of customers. By focusing mainly on regions in North America, the company increases its risk and limits growth at the same time.

<u>Opportunity</u>

1. Strongly performing e-commerce business. Through its website, customers can get information about various stones, maintenance advice, and help on product purchases. The website also allows consumers to design their own jewelry, such as rings and wedding bands. Internet sales accounted for 3 percent of Zale's revenue in 2009.
2. Cost-reduction initiatives would help to reduce SG&A expenses and thus help the company to become profitable again.
3. Changing demographics. The number of Americans aged 45 to 64, the segment of the population that typically has the highest income, is forecast to increase by about 4 percent between 2010 and 2020 compared to a 10 percent increase in the population overall. Many jewelry stores rely on higher-income customers for much of their business.

Threat

1. If the general economy performs poorly, discretionary spending on goods that are, or are perceived to be, "luxuries" may not grow and may decrease.
2. Increased competition can affect the sales of the company in future.
3. Increased minimum wages also put a threat in front of the company.
4. The concentration of a substantial portion of sales in three relatively brief selling periods (Christmas Holidays, Valentine Day and Mother's Day) means that performance is more susceptible to disruptions.
5. Sudden decrease in cash flow and earnings makes the company more "vulnerable" in the sense that the company is not generating enough money itself and will rely more on borrowing.
6. The Diamond Trading Company, which is the number one supplier of diamonds, can affect prices and supply of diamonds.
7. Zale is more vulnerable to economic downturns than its high-end competitors. Traditionally, discretionary purchases, such as fine jewelry, are the first to suffer when the economy takes a downturn and consumer spending slows. Since a majority of the store brands under the Zale's Fine Jewelry segment targets the middle-income consumer base, the company is also more vulnerable to economic downturns than the higher-end jewelry sellers.

Company Overview

Time Line / History of the Company

1920s-1950: First Zale Jewelers store was opened in Texas in 1924. Between 1925 and 1950, Zale launched a revolutionary marketing strategy with a credit plan of "a penny down and a dollar a week," making jewelry and other merchandise affordable to the average working American. Zale opened roughly one new store each year in Oklahoma and Texas. A cooperative buying system was established to centralize the purchase and distribution of merchandise for all stores, which enabled the company to buy in larger quantities at lower prices.

Zale acquired Corrigan's of Houston, its first fine jewelry store in 1944, which eventually led to the launch of the Bailey Banks & Biddle brand. In 1957, Zale Jewelers broadened its reach by opening the first store in a shopping center, which was a major shift from operating only in downtown locations. The same year, Zale also announced the initial public offering of its stock (ZLC) and begins trading its public shares on the American Stock Exchange the following year.

1960s-1990: Following the discovery of synthetic diamond technology, the company diversified and branched out into shoes, sporting goods, drug stores, furniture, and catalog stores. To reflect this diversity, the company name became Zale Corporation. The company acquired the 890-carat "Incomparable Diamond," the largest internally flawless diamond in the world. In 1989, the leveraged buyout of Zale by Peoples Jewelers of Canada and Swarovski International of Austria took place. In 1989, the company acquired all the outstanding common stock of Gordon Jewelry Corporation.

In 1992, the company reduced its long-term debt, rejected unfavorable long-term leases, and consolidated substantially all its retail operations into its wholly owned subsidiary, Zale Delaware. The plan of reorganization resulted in the elimination, through merger or liquidation, of 17 of the company's former subsidiaries. In 1993, the company emerged from Chapter 11 bankruptcy law proceedings after a federal court approved a revised distribution formula for its reorganization plan. In 1996, the company acquired Karten's Jewelers. In 1997, the company consummated the sale of the majority of the assets of its Diamond Park Fine Jewelers Division. In 1999, the company purchased substantially all the assets of Peoples Jewelers Corporation.

2000-2010: In 2000, Zale sold its private-label credit card operations and its outstanding accounts receivable, without recourse, to Associates Credit Card Services, Inc. In 2000, Zale acquired all the shares of Piercing Pagoda. In 2007, the company sold its wholly owned business unit, Bailey Banks & Biddle, to Finlay Fine

Jewelry Corporation. In 2008, Zale created a new management team under the leadership of CEO Neal Goldberg that included veteran Zale executives and new talent with significant retail experience. In 2009, an SEC investigation was launched against a few accounting mistakes in the company's financial statements. In 2010, Zale secured a $150-million, five-year senior secured loan that was provided by the private equity firm, Golden Gate Capital.

Recent Turnarounds and M&A

Zale Corporation and Golden Gate Capital

In June 2010, Zale secured a $150-million, five-year senior secured loan that was provided by the private equity firm, Golden Gate Capital.

Zale will pay a steep price for the loan. Zale will see a much higher interest expense on the Golden Gate loan starting in 2011. The loan carries an enormous 15 percent annual interest rate. The deal cost Zale $25 million in origination fees. More expensive to stakeholders in the long run, the desperate deal allowed Golden Gate Capital to have warrants to buy 25% of the company.

Interest expense has gone up dramatically and is expected to go up even more in the future. Upon any loan covenant violation, Golden Gate Capital can force a bankruptcy filing. In a bankruptcy, Golden Gate Capital could restructure leases, "hair-cut" vendors, and take Zale private. Because Zale is likely to violate multiple covenants with the Golden Gate Capital term loan, Golden Gate Capital is obviously comfortable with taking and holding Zale private. The biggest losers in bankruptcy will be the Zale vendors because Golden Gate Capital is secured and senior to the vendors' claims. The shareholders will also become wiped out in any bankruptcy.

Overview of Zale's Online Store

Features: Zale's website is markedly less aesthetically adventurous than the more glamorous, boutique-style jewelry outlets such as Blue Nile or Swarovski. This is not a negative because Zale targets a demographic concerned with quality at an affordable price. The website's fully indexed and intuitive search features make finding the item customer has in his mind's eye before visiting the site surprisingly easy.

The Zale site is divided into subcategories by jewelry type and features two sections: the "wedding" and "clearance" sub sites. The "clearance" site conglomerates all items currently on sale at Zale, which is an inestimable time saver for the bargain hunter. The "wedding" section of zales.com offers useful information on jewelry, engagement, wedding traditions, and even offers up anecdotal love stories to get into the spirit of things.

One of the good features on the Zale site is its informational material, such as frequently asked questions and articles that function as crash courses in everything from specific gem types to pearl care and maintenance. If a customer is feeling trepidation about investing in a diamond, Zale provides information that will help the customer make a decision with confidence. The articles on diamonds detail the meaning of carat, types of cuts, clarity and color.

Although shopping online is more convenient than driving around town to inspect individual items, a customer cannot get the same feel for an item through the screen as he can in person. Zale takes detailed photos of every item to ensure that the customer has an accurate idea of what to expect on his doorstep after completing an order.

Inventory: Zale's primary strength is the sheer size of its collection. Thousands of rings, charms, bracelets, earrings, necklaces and brooches fitted with precious gems of every description can be found at Zale. Zale specializes in gold and sterling silver above all else, but a customer can also find jewelry wrought from tungsten, titanium, platinum and brass.

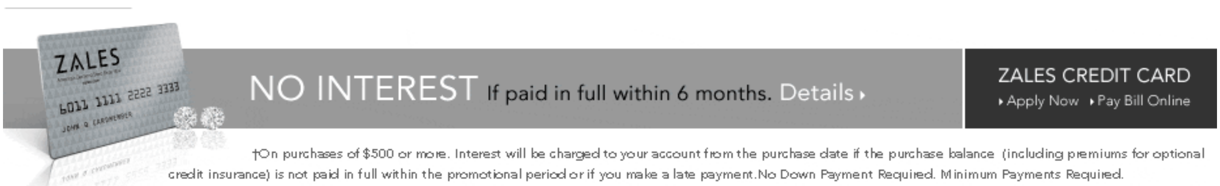
Although an in-store visit offers a more tactile experience, the online exclusive items that Zale has give the site an increased relevance. The online featured pieces range from $90 last-minute gifts to $100,000 unique creations.

Shoppers interested in acquiring loose stones can find a small variety of small carat diamonds at zales.com.

Up against Tiffany and Co., big designer names are not as well represented in Zale inventory, but there is no shortage of stylish jewelry. Designer names and big brands are, however, quite visible in its inventory of wristwatches: Bulova, Citizen, Ed Hardy, Hello Kitty and Wittnauer are staples of its wristwatch collection.

<u>Price Range</u>: Zale is unrivalled when it comes to the sheer variety of jewelry it has available. Zale also has competitive prices. From diamond stud earrings to gemstone pendants, Zale has options available for every budget. Zale has hundreds of items for under $200 that makes it an irresistible option for the frugal jewelry shopper.

<u>Security</u>: Zale uses secure servers for credit card transactions. A customer can also pay via a pre-existing PayPal account.



<u>Customer Support</u>: Zale has telephone and email support staff available all day. In the event a customer changes his mind about an item, Zale allows customers 30 days to return purchases for a full refund. Zale offers free FedEx shipping on items purchases over $149. For gifts, Zale can arrange a gift box with a customized message.

(Source: Reviews available at http://online-jewelry-review.toptenreviews.com)

Management and Corporate Governance

Key Executives

The key executives of Zale Corporation include:

- Theo Killion, Chief Executive Officer
- Matthew W. Appel, Chief Administrative Officer and Chief Financial Officer
- Gilbert P. Hollander, Executive Vice President, Chief Merchant & Sourcing Officer
- Richard A. Lennox, Executive Vice President, Chief Marketing Officer

(For Detailed Bios and Responsibilities of Key Executives, refer Exhibit VIII)

Key Observations

- Zale has had three chief executive officers in the past seven years. Termination of executives causes a huge cash outflow as compensation and other benefits. The average tenure of Zale's chief executive officer is shorter than the industry average.
- Most of the management personnel have experience in retail industry and not in jewelry retail industry. The jewelry industry is a specialty retail industry that functions in very different way compared with the general retail industry. Average experience in jewelry industry is about three years per executive.
- In mid-January 2010, top three executives including ex-CEO Neal Goldberg left the firm, after holiday sales fell 12 percent.

- The company's executive ranks have been in flux for several years. Interim CEO Theo Killion is the company's seventh CEO in 15 years.
- A Zale CEO's compensation is very high compared to its competitors and the industry average, as shown in the chart below:

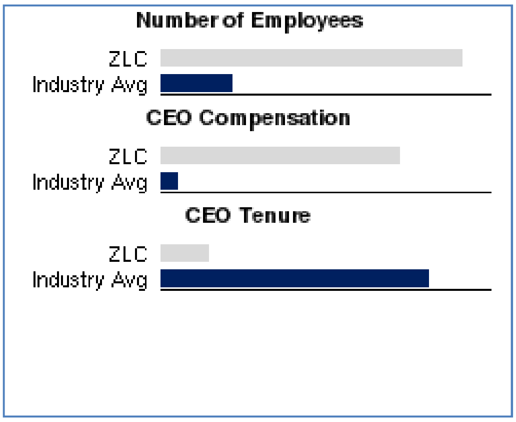


Chart: Comparison of Number of employees, CEO Compensation and CEO tenure with industry average

- There has been a dramatic decline in ZLC's stock price after most of the current key executives took over their position as shown in the chart below:

Chart: ZLC stock performance with significant management change

(Source: Mergent Online)

Other Employees:

Zale has been cutting its number of employees continuously since 2007. In 2007, the company had around 17,500 employees. In 2010, this employee number decreased to around 12,800. The layoff was good with respect to the economic scenario, the company had been facing. However, compared to the industry average, Zale's total number of employees is much higher.

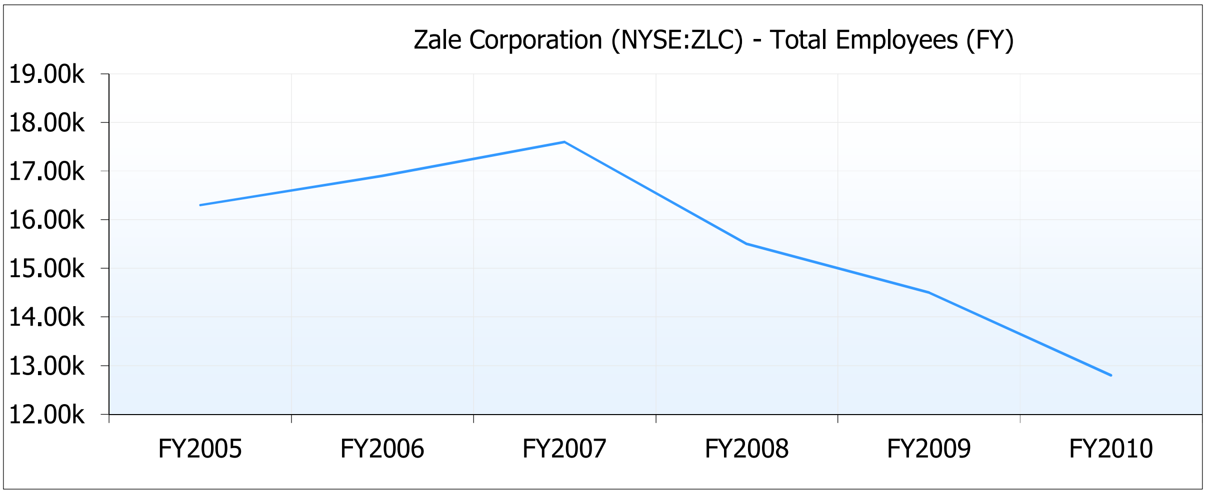


Chart: Change in the number of employees from 2005 to 2010

Financial Analysis

Historic Stock Performance

Zale's stock price peaked at $34.20 on July 20, 2005, and then dropped. The stock now trades at $3.25. With 32.1 million shares outstanding, Zale lost approximately $1 billion of market capitalization in less than six months.

The biggest drop happened from September 2008 to February 2009, when Zale's stock dropped from $28 per share to $1.20 per share. The stock price increased to $5.70 in January 2011, but then again dropped to current market price of $3.25

The following charts show the evolution of Zale's stock price in the last three years, and since 1993.

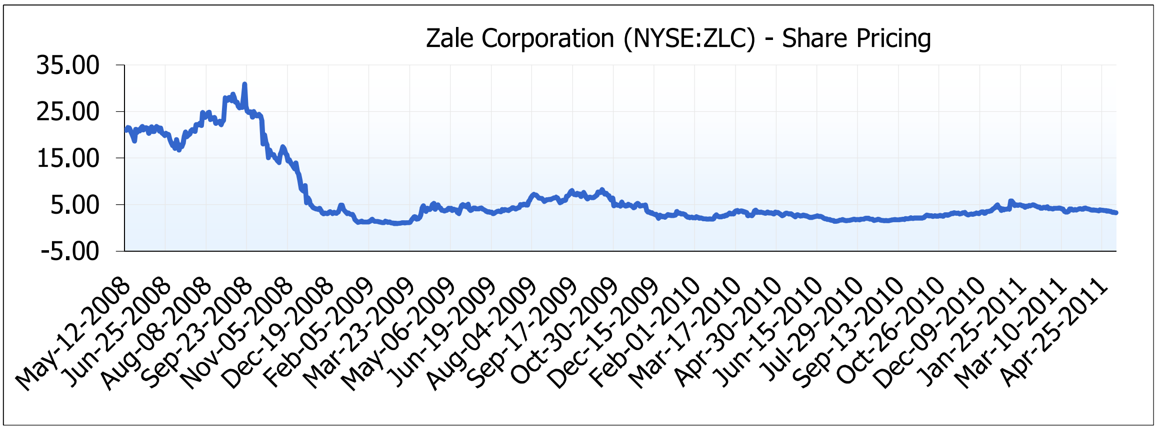


Chart: Three year ZLC Stock Performance

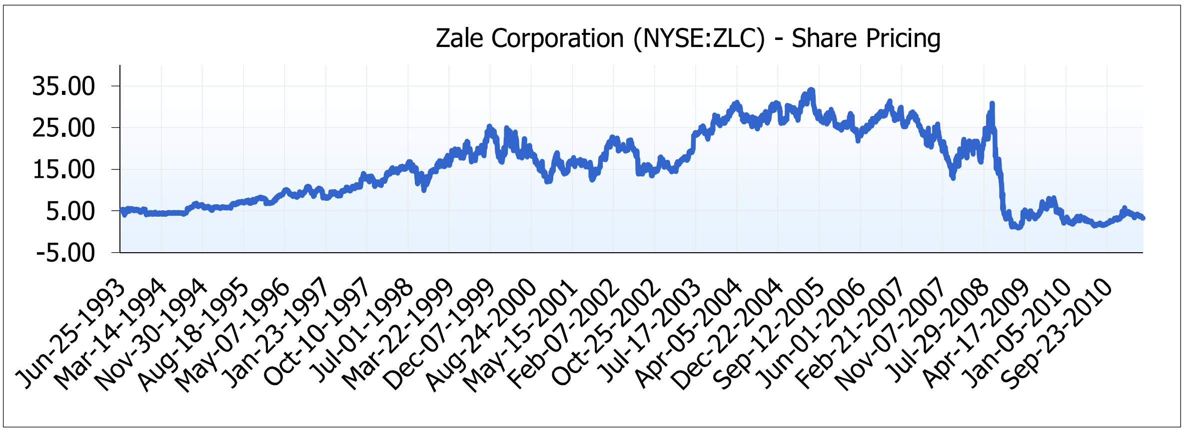


Chart: ZLC Stock Performance since 1993

The table below presents the analyst's opinion on Zale's stock in past five years.

Date	Research Firm	Action	From	To
9-Apr-10	Soleil	Downgrade	Hold	**Sell**
7-Dec-09	Soleil	Downgrade	Hold	**Sell**
25-Nov-08	CL King	Downgrade	Accumulate	**Neutral**
11-Jan-07	WR Hambrecht	Initiated		**Sell**
13-Jun-06	KeyBanc Capital Mkts / McDonald	Downgrade	Buy	**Hold**
12-Jun-06	KeyBanc Capital Mkts / McDonald	Upgrade	Hold	**Buy**
8-Jun-06	Goldman Sachs	Upgrade	Underperform	**In-Line**
9-Nov-05	Goldman Sachs	Downgrade	In-Line	**Underperform**
3-Nov-05	JP Morgan	Downgrade	Neutral	**Underweight**
18-Feb-05	KeyBanc Capital Mkts / McDonald	Upgrade	Underweight	**Hold**

Table: Analyst Opinion in the Past 5 years

(Source: Yahoo Finance)

Altman Z-Score Analysis

The Altman Z-Score model combines five different financial ratios to determine the likelihood of bankruptcy amongst companies. The company's Altman Z-Score is between 1.8 and 2.99, which means there are good chances of the company going bankrupt within two years of operations from the date of financial figures given. The chart below shows the Altman Z-Score for the last five years. The decrease in the Altman Z-Score was due primarily to the decrease in market value of equity, decrease in revenue, increase in debt, and negative earnings before interest and taxes.

(Refer Exhibit XI for Altman - Score Analysis)

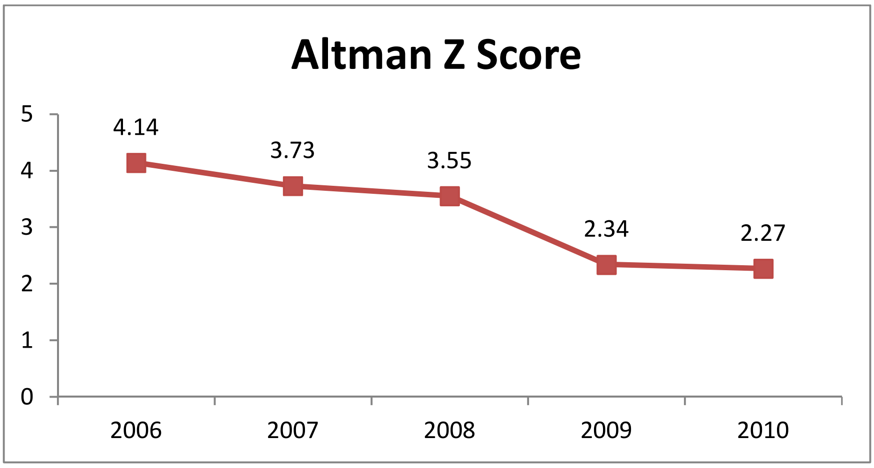


Chart: Altman Z-Score (2006-2010)

Profitability & Margin Analysis

Zale's total revenue decreased from $2,138 million in 2008 to $1,780 million in 2009, and then to $1,616 million in 2010. The primary reason for this decrease in revenue was the economic recession that started in the year 2008. The operating income margins in the years 2009 and 2010 were negative due primarily to the increased SG&A expenses. SG&A expenses increased from 46.4% in 2008 to 52.5% in 2009, and then remained the same in the year 2010. The EBIT margins in 2008, 2009 and 2010 were 0.4%, -9.2% and -5.1%, respectively. The five-year average EBIT margin and three-year average EBIT margins were -1.0% and -4.6%, respectively.

(Refer Exhibit X for Profit Margin Analysis)

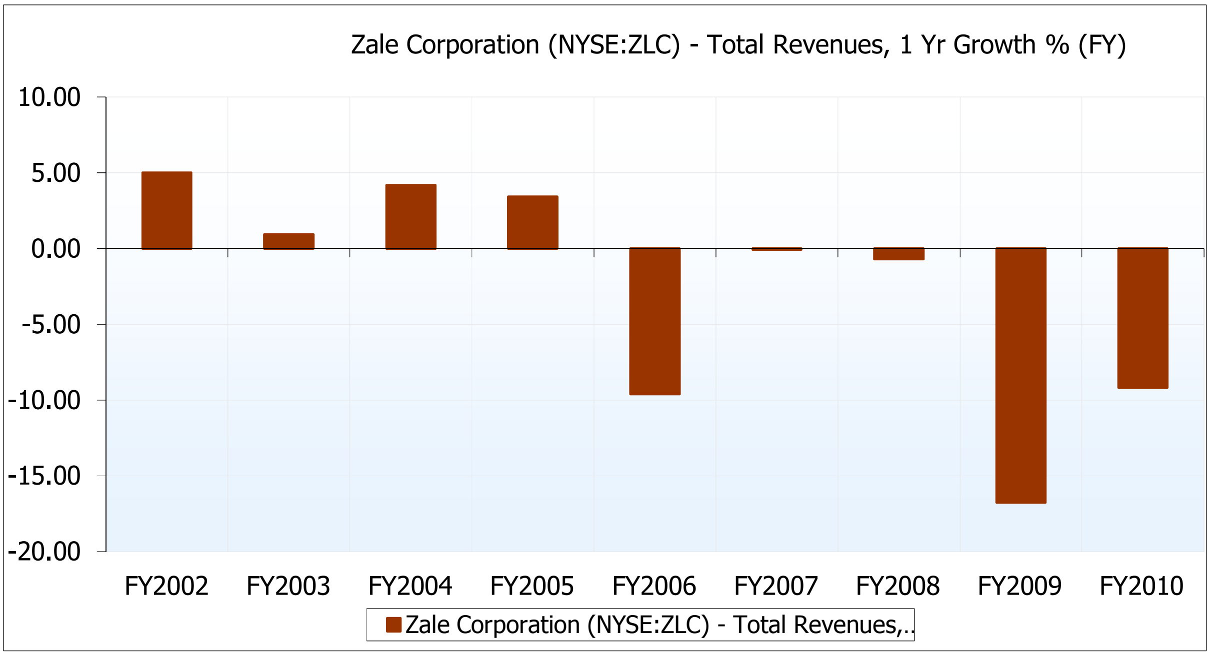


Chart: Growth in Total Revenue from 2002 to 2010

In 2010, return on equity and return on assets were -4.3% and -28.1%, respectively. Negative ROE and ROA were due to the negative earnings in 2009 and 2010.

Zale Corp.
Profitability Analysis

	Jul-06	Jul-07	Jul-08	Jul-09	Jul-10
Return on Assets %	4.4%	3.6%	0.4%	(7.7%)	(4.3%)
Return on Capital %	6.4%	5.2%	0.6%	(12.9%)	(8.0%)
Return on Equity %	7.4%	5.6%	(0.9%)	(35.4%)	(28.1%)
Return on Common Equity %	7.4%	5.6%	(0.9%)	(35.4%)	(28.1%)

(Source: Capital IQ)

Liquidity Analysis

Zale's current ratio decreased from 2.7X in 2008 to 2.3X in 2009, and further decreased to 2.0X in 2010. The five-year average current ratio was 2.6X. Zale's quick ratio was 0.1X. The quick ratio was more conservative than the current ratio because it excluded inventory from current assets. Inventory is excluded because some companies have difficulty turning their inventory into cash, which means current assets are composed mainly of inventories. A very low quick ratio compared to current ratio indicates the company's current assets are composed mainly of inventories.

(Refer Exhibit X for Liquidity Analysis)

	Jul-06	Jul-07	Jul-08	Jul-09	Jul-10
Avg. Days Inventory Out.	304.9	338.8	305.7	296.2	328.4
Avg. Days Payable Out.	59.2	64.2	70.9	57.1	67.2

(Source: Capital IQ)

Inventories were slashed from $903.3 in 2006 to $703.1 million in 2010, which resulted in $200 less millions in available stock. Zale took the very unusual step of asking diamond merchants and other vendors to buy back old jewelry, including products they did not manufacture, in exchange for a pledge of future orders. The chart below shows the inventory on balance sheet from 2006 to 2010, in millions of dollars:

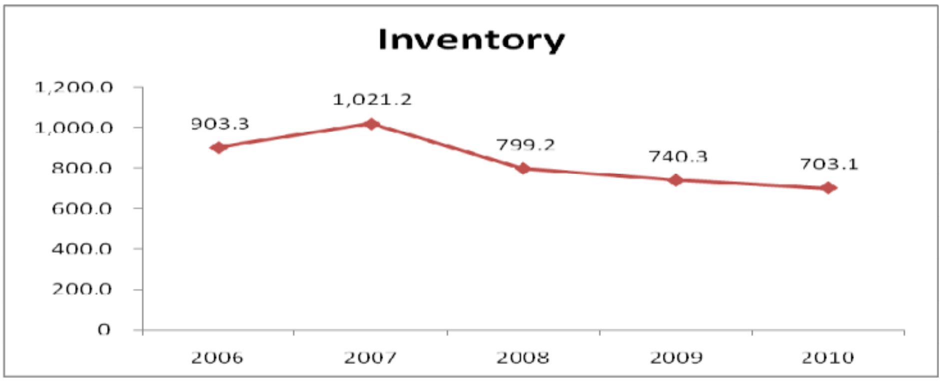


Chart: Inventory on balance sheet from 2006 to 2010

Cash Burn Analysis

Zale's EBITDA as of the LTM (April 1, 2011) was $16.1 million. In the LTM, the company had a capital expenditure of $12 million and a change in working capital of $56.9 million. Therefore, the company's free cash flow was -$52.8 million in the LTM. This implies that the monthly cash burn rate was about $4.4 million. Zale had cash of $36.9 million on the balance sheet as of the LTM. Assuming the company does not borrow money, Zale's cash will last for about nine months. This implies the company will run out of cash by December 2011.

(In Million $)	Apr-11	May-11	Jun-11	Jul-11	Aug-11	Sep-11	Oct-11	Nov-11	Dec-11
Beginning Cash Balance	36.9	32.5	28.1	23.7	19.3	14.9	10.5	6.1	1.7
Less Net Cash Flow (Monthly)	-4.4	-4.4	-4.4	-4.4	-4.4	-4.4	-4.4	-4.4	-4.4
Ending Cash Balance	32.5	28.1	23.7	19.3	14.9	10.5	6.1	1.7	-2.7

Table: Projected Monthly Cash Burn

Leverage Analysis

Zale had total long-term liabilities of $464 million. Zale's current liabilities as a percentage of total assets was 33.5%. The total long-term liabilities as a percent of total assets was 40.0%. The company was highly leveraged compared to the industry average. In 2010, Zale's interest coverage ratio was -5.2X due to the negative earnings before interest and taxes. The lower the ratio, the more the company is burdened by debt expense. Also, when the interest coverage ratio is less than 1, its ability to meet interest expense is questionable. A low interest coverage ratio indicates the company is not generating enough revenue to satisfy interest expenses.

(Refer Exhibit X for Leverage Analysis)

Activity Ratio Analysis

Zale's inventory turnover ratio and account payable turnover ratios decreased in 2010 compared to 2009. A decrease in inventory turnover implies poor sales, thus excess inventory. High inventory levels are unhealthy for the company because they represent an investment with a rate of return of zero. It also opens up the company to trouble should prices begin to fall. A decrease in account payable turnover gives an indication that the company is taking longer to pay off its suppliers than it was before.

(Refer Exhibit X for Activity Ratio Analysis)

Revenues by Segments

Zale suffered primarily in the Fine Jewelry segment from 2008 to 2010. The Fine Jewelry segment's revenue decreased from $1876.2 million in 2008 to $1378.5 million in 2010. The Kiosk Jewelry segment, which offers bracelets, earrings, charms, rings, and 14-karat and 10-karat gold chains, did not suffer much from 2008 to 2010 during a recession. The table below shows segment-wise revenue earned by Zale. The Fine jewelry segment generated about 85% of the revenue, while the remaining 15% represented sales from the Kiosk segment.

(In Million $)	**2006**	**2007**	**2008**	**2009**	**2010**
Fine Jewelry	1,864.2	1,876.6	1,876.2	1,535.6	1,378.5
All Other	13.1	13.6	12.4	11.3	11.6
Kiosk Jewelry	276.6	262.6	249.5	232.8	226.2
Total Revenues	2,154.0	2,152.8	2,138.0	1,779.7	1,616.3

(Source: Capital IQ)

Operating Income by Segments

Zale had negative operating income in 2009 and 2010. The table below shows segment operating income earned by Zale.

(In Million $)	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Fine Jewelry	147.4	117.0	104.4	18.9	(192.7)	(84.8)
All Other	6.8	6.4	6.8	5.6	5.7	4.7
Corporate	(5.5)	(52.8)	(32.9)	(27.3)	(24.5)	(48.5)
Kiosk Jewelry	29.0	20.4	6.6	9.9	2.5	13.1
Total Operating Income	177.8	91.1	84.9	7.2	(209.0)	(115.4)

(Source: Capital IQ)

Same-Store Sales Analysis

Zale's same-store sales analysis shows the company had no organic growth in the last five-year period. The company's same-store sales were -16.6% and -6.6% in 2009 and 2010, respectively. Negative same-store sales shows the company's strategy is not working well and its merchandise is not fresh.

Year	**2006**	**2007**	**2008**	**2009**	**2010**
Stores at Beginning	2,345	2,276	2,194	2,135	1,931
Stores Opened	112	63	47	14	6
Stores Closed	77	145	106	218	47
Total Stores	2,276	2,194	2,135	1,931	1,890
Total Same-store Sales Growth	0%	0.5%	0%	(16.6%)	(6.6%)

(Source: Capital IQ)

Fixed Assets Analysis

The book value of net property and equipment fell from $283.7 million in 2006 to $173.4 million in 2010, which was a reduction of $129 million of the company's fixed assets. The chart below shows the net property and equipment on balance sheet from 2006 to 2011, in millions of dollars.

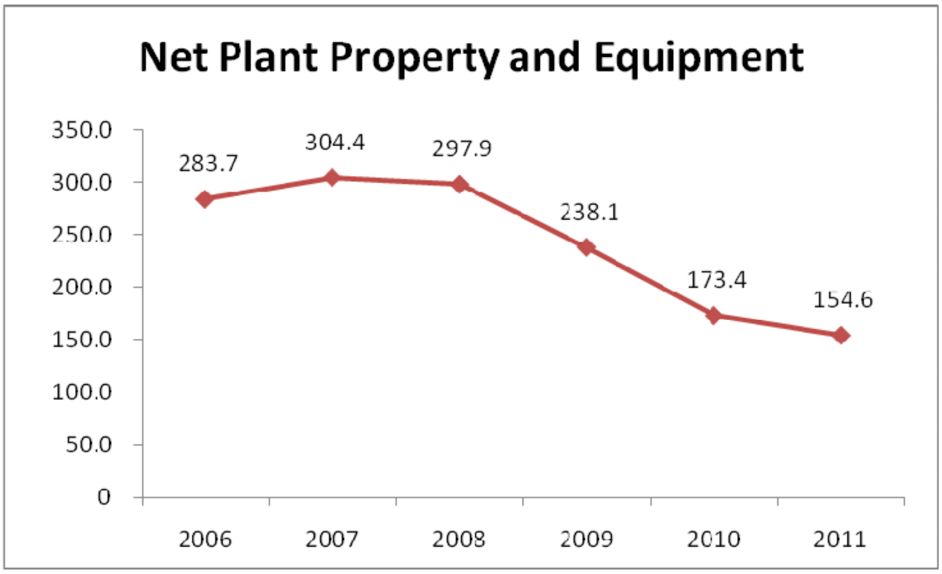


Chart: Net PPE on balance sheet from 2006 to 2011

Peer Comparison

Zale Corporation is Sandwiched between High-end and Discount Retailers

Given the number of companies and the commodity-like nature of the product being sold, the retail jewelry business is extremely competitive and fragmented. Zale faces increased competition from the growth of mass merchant retailers, such as Wal-Mart, the largest jewelry retailer in the combined U.S. and Canadian market. Discount retailers, such as Wal-Mart, have aggressively pursued and captured a large portion of the price-sensitive consumer jewelry market. At the upper end, Zale must compete with stores such as Tiffany, a company that has more successfully associated its brand with high-end jewelry items. Moreover, Zale must also deal with increasing competition from internet vendors, such as Blue Nile and BIDZ. Internet retailers are often able to sell the same product for much lower prices due to very low brick-and-mortar cost.

(For Detailed Business Description of Comparable Companies, Refer Exhibit IX)

Stock Price Comparison

The following chart shows the comparison in stock price movement for Zale, Signet, Blue Nile, and Tiffany in the last three years. The stock price of competitors took a similar decline in 2008, which highlights the industry-specific rather than the company-specific nature of the challenges. The drop in Zale's stock price was more than its competitors. The stock price development since 2009, however, shows that Signet, Blue Nile, and Tiffany have recovered considerably from their lows, but Zale has not recovered.

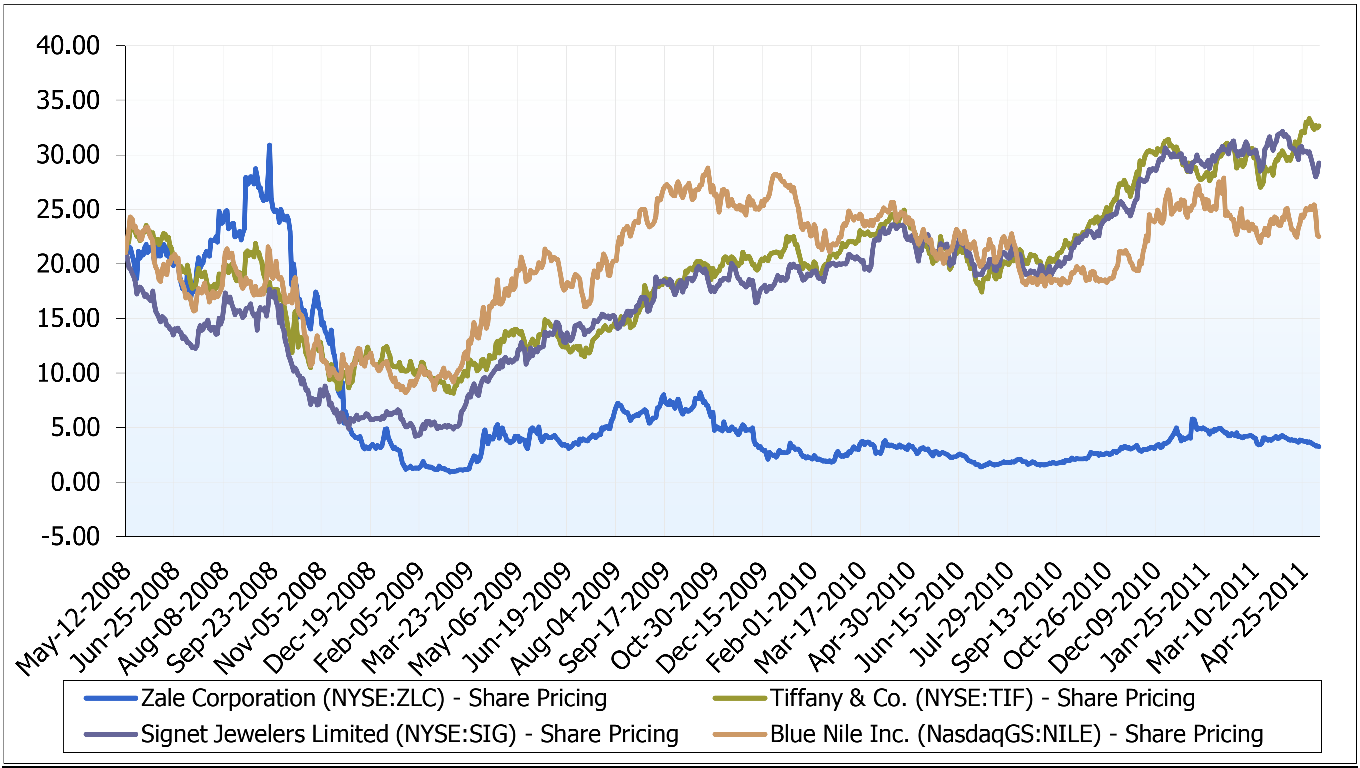
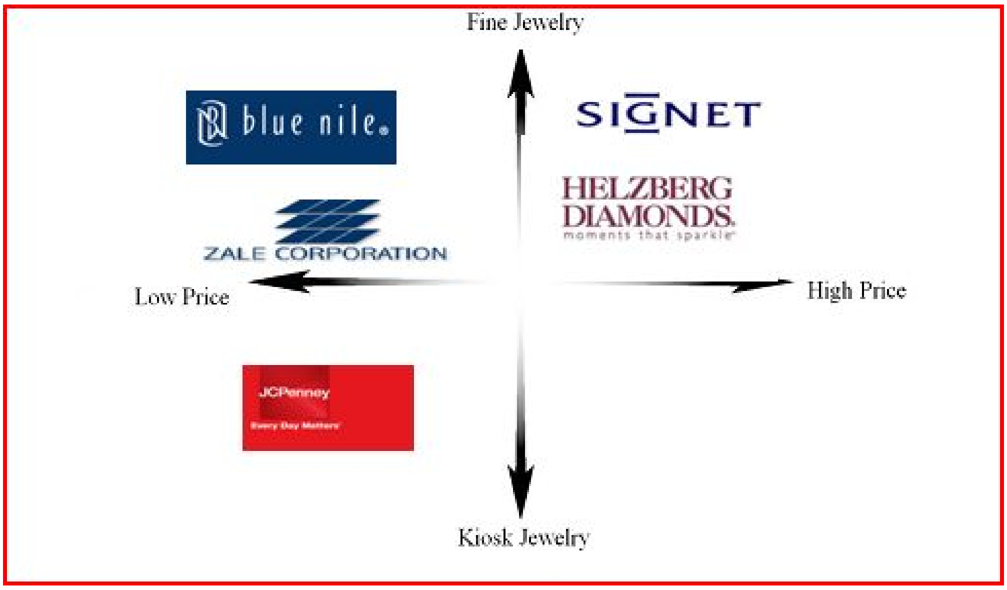


Chart: Stock Performance of Zale Vs Competitors

Market Positioning Map Analysis

The market-positioning map clearly shows that the Zale has a better perception in the mind of consumers because it is offering a medium to high-quality product at lower prices. That is why its market standings are better than other companies. In the figure below, prices are measured on X-axis and quality on Y-axis, where Zale is offering a medium to high-quality diamond jewelry at lower prices.

Mass merchants, such as JC Penney and Wal-Mart, fall in the third quadrant, i.e., low prices and low to medium quality jewelry. Signet is a high-end jeweler that primarily sells fine jewelry at higher prices. Blue Nile is an online retailer of fine jewelry.



BCG Matrix Analysis

- The BCG Matrix is used to rank the business units (or products) on the basis of their relative market shares and growth rates. Zale lies in the Question Mark's quadrant. If nothing is done, a question mark will simply absorb great amount of cash and later as the growth stops becomes a dog.
- The BCG Matrix analysis shows that Zale should concentrate on few brands and divest others to survive in the current market conditions.

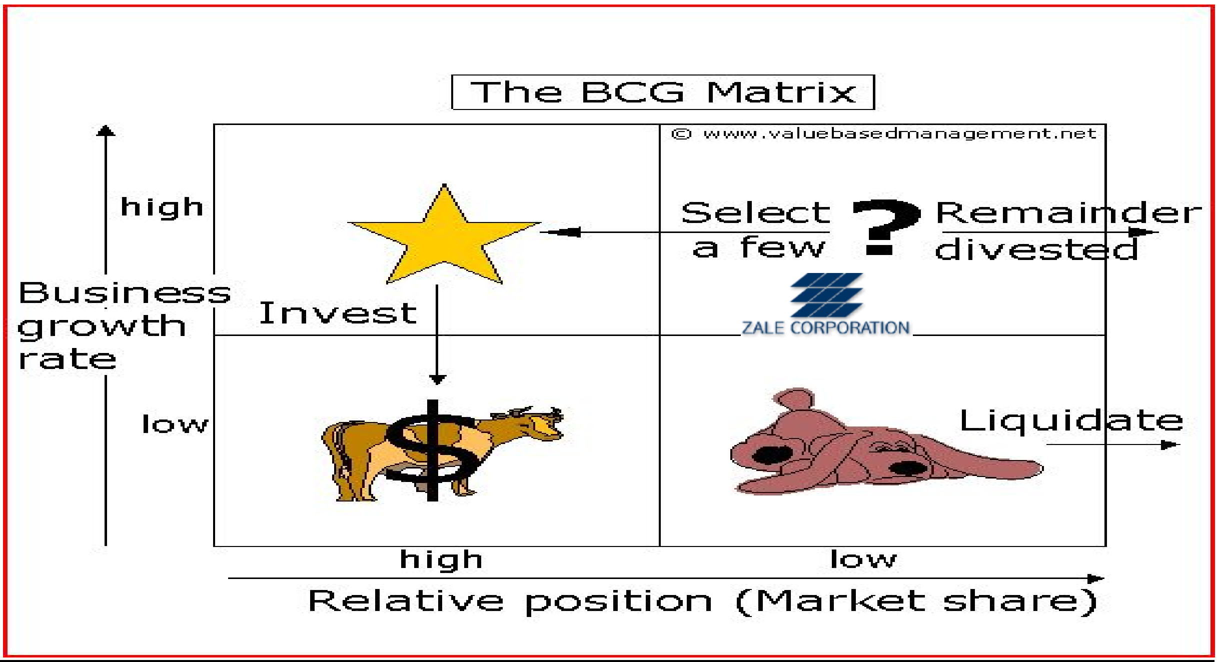


Chart: BCG Matrix showing ZLC's Position

Financial Ratios Comparison

Profitability Comparison

Zale had the lowest profitability margin compared to its competitors. In 2010, the most profitable company in this industry was Tiffany, with an EBITDA margin of 24.65%. Zale's EBITDA margin was 0.05%, which was lowest for a brick-and-mortar jewelry company. In 2010, Zale had an operating margin of -2.65% due to the negative operating income that was due primarily due to the high SG&A expenses compared with the industry average. Zale's SG&A expenses as a percent of sales were 50.9% compared to the industry average of 27.2%. The operating margin for Blue Nile, Tiffany, and Signet were 6.40%, 19.85%, and 7.59%, respectively. Among the selected guideline companies, Zale had the lowest return on equity and return on assets. Due to the Zale's negative net income in 2010, both ROE and ROA were negative, whereas most of the competitors had positive ROE and ROA.

Zale Corp.
Comparable Company Analysis

Company Name	Ticker	Stock Price($)	Debt/Equity	Interest Cov.	EBITDA Margin	Operating Margin	Profit Margin	Asset Turnover	Assets/Equity	ROE	ROA
Zale Corp.	ZLC	4.67	1.58	-0.58	0.05%	-2.65%	-6.71%	1.38	4.94	-45.61%	-9.24%
Blue Nile	NILE	59.11	0.02	NA	6.88%	6.40%	4.24%	2.19	3.09	28.72%	9.29%
Tiffany & Co.	TIF	58.13	0.32	11.28	24.65%	19.85%	11.94%	0.83	1.72	16.92%	9.86%
Signet Jewelers	SIG	42.48	0.02	3.59	10.20%	7.59%	5.83%	1.11	1.59	10.34%	6.49%
BIDZ.com	BIDZ	1.21	0.00	NA	-0.86%	-1.53%	-1.34%	2.20	1.62	-4.76%	-2.94%

Table: Comparable Company Analysis

Comparison of brick-and-mortar jewelry stores, i.e. Zales Jewelers, Signet Jewelers and Tiffany and Co., shows that in 2010 Zale's revenue per store was only $0.88 million compared with $13.20 million for Tiffany and $1.85 million for Signet.

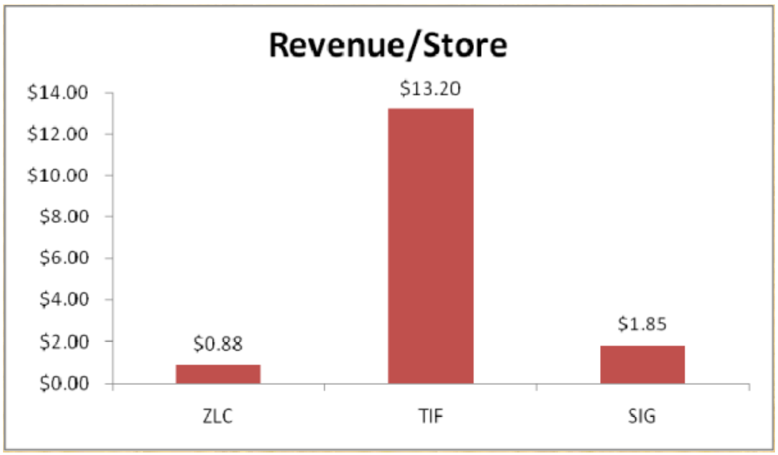


Chart: Comparison of Zale's revenue per store with Tiffany and Signet Jewelers

Comparison of revenue per employee was also lowest for Zale compared to the industry average. Lower revenue per employee was due primarily to the high number of employees compared to other companies in the industry. The higher number of employees was one of the reasons for higher SG&A expenses due to the higher expenses in wages and salary.

Zale Corp. Comparable Company Analysis			
Company Name	**Ticker**	**SG&A as % of sales**	**Revenue per Employee**
Zale Corp.	ZLC	50.9%	$ 126,000
Blue Nile	NILE	15.2%	$ 1,727,000
Tiffany & Co.	TIF	39.2%	$ 335,000
Signet Jewelers	SIG	28.5%	$ 212,000
BIDZ.com	BIDZ	25.8%	$ 592,000
Industry Avg.		27.2%	$ 716,000

Table: Comparable Company's SG&A and Revenue per Employee Analysis

Same-Store Sales Comparison

In 2009, industry as a whole was going through a bad time due to which the same-store sales declined for most of the companies. But decline in Zale's same-store sales was highest. In 2009, Zale's same-store sales declined by 16.6%, whereas same-store sales of Tiffany and Co. and Signet Jewelers declined by only 7.0% and 0.4%, respectively. In 2010, same-store sales of Tiffany and Co. and Signet Jewelers grew by 10.0% and 6.7%, respectively, compared with a -6.6% for Zale's same-store sales.

Zale Corp. Same Store Sales Comparison					
Year	**2006**	**2007**	**2008**	**2009**	**2010**
Zales Corp.	0.0%	0.5%	0.0%	-16.6%	-6.6%
Tiffany and Co.	0.0%	0.0%	8.0%	-7.0%	10.0%
Signet Jewelers	4.8%	-0.7%	-8.1%	-0.4%	6.7%
(Source: Capital IQ)					

Table: Same-store Sales Comparison

Leverage Comparison

In 2010, Zale was highly leveraged due to the high level of debt. Zale's debt-to-equity ratio was 1.58X compared to 0.32X for Tiffany. Other competitors, i.e., Signet, Blue Nile and Bidz.com, had either no debt or very low debt. Due to the negative EBIT, Zale's interest coverage ratio was negative. The negative debt coverage ratio shows the company was in distress in 2010.

Store Level Observation and Comparison

Visits were made to Zale and its competitors' stores in the Dallas area, and several points of differentiation were noticed, which will be pointed out in the Competitive Analysis. Visits were made on Saturday to keep the level of analysis uniform for all stores.

Locations visited:

- Northpark Center, 8687 North Central Expressway, Dallas, Texas 75225
- Collin Creek Mall, 811 North Central Expressway, Plano, Texas 75075
- Galleria Dallas, 13350 Dallas Parkway, Dallas Texas 75240

	Galleria Dallas	NorthPark Center	Collin Creek Mall
Zales	X	X	X
Kay Jewelers			X
Tiffany and Co.	X	X	
Macy's	X	X	X
Helzberg Diamonds			X
Crown Jewelers			X
J C Penny			X
Benson's Jewelers			X
Gordon's Jewelers		X	X
Blue Nile	Online		
BIDZ	Online		

Table: Locations visited and observed

Key Observations

Zales Jewelers – Zales Jewelers is still looking for ways to define its brand. The emphasis on "Back to Basics" seems to be not working well. Its stores were either empty or were observed with a small number of customers. Zales Jewelers offers good value. A big question mark is its lack of experienced store personnel and effect on upper-end diamond sales. Zales Jewelers faces very tough competition from the entire distribution channel. The store environment was observed to be dull. The catalog was colorful and full of details. The lack of trained jewelry professional in the store seems to be an important factor that would have negatively impacted bridal and high-end sales.

Helzberg Diamonds - The emphasis in the store was on designer jewelry and its special "Expressions Silver Charm Program" program to drive traffic. Another positive observation was the store personnel was experienced and trained. The bridal jewelry collection was very good. The company also added 'Judith Ripka Bridal and Memoir" to its list of bridal designers and has expanded its loose diamond inventory. Helzberg Diamonds has built fashion collections by adding the "I am Loved and Mirabella" collections and "Love, Help and Hope Collection."

Kay Jewelers - Kay Jewelers had a very good collection of bridal jewelry collection. The biggest additions were the "Neil Lane Designer Bridal Collection" and the "Tolkowsky Ideal Cut Diamond" to add excitement in the bridal collections. The emphasis was on the new and improved collection and its bridal program. The catalog was detailed and colorful. Compared to Zales Jewelers, the store environment was better.

Crown Jewelers - Crown Jewelers lacked a good store environment. Its emphasis was on low prices and its bridal program. The Crown Jewelers' catalogue was detailed but not colorful. The store personnel lacked experience, but were helpful. Crown Jeweler's bridal collection was better than Zales Jewelers, but was worse than Helzberg Diamonds.

Gordon Jewelers - Gordon Jewelers emphasized its designer and fashion jewelry. The catalogue was detailed and colorful. The store environment was better than Zales Jewelers. It has a higher-end brand. The number of customers was low in the store.

Competitive Benchmark	Zales	Helzberg Diamonds	Kay Jewelers	Crown Jewelers	Gordon Jewelers
No. of Customers at Store	Low	Moderate	Moderate	Moderate	Low
Catalog	Detailed and Colorful	Detailed and Colorful	Detailed and Colorful	Detailed	Detailed and Colorful
Store Personnel	Lack Training and Experience	Experienced and Trained	Experienced and Trained	Were helpful	Were helpful
Bridal Collection	Bad collection	Very good collection	Moderate	Moderate	Moderate
Store Environment	Dull	Good	Moderate	Dull	Moderate
Emphasis	Low price	Designer jewelery	New and improved collection	Price	Designer Jewelery
Programs	Back to Basics Program	Expressions Silver Charm Program	Bridal Program	Bridal Program	Fashion Focus

Table: Store Level Observations

Range of Restructuring Alternatives

Liquidation

One alternative for the company is to wind down the business through an orderly liquidation because some businesses are worth more dead than alive. Therefore, it is important to look at a liquidation scenario.

The table below summarizes the potential proceeds from the liquidation of the business.

Zale Corporation (ZLC) Hypothetical Liquidation Analysis January 31, 2011 Balance Sheet ($ In Millions)		Estimated Recovery Rate			Estimated Liquidation Proceeds		
		Low	Base Case	High	Low	Base Case	High
Current Assets:							
Cash and cash equivalents	$ 31.40	100%	100%	100%	$ 31.40	$ 31.40	$ 31.40
Inventory	$ 776.90	30%	40%	50%	$ 233.07	$ 310.76	$ 388.45
Other current assets	$ 38.40	10%	20%	30%	$ 3.84	$ 7.68	$ 11.52
Discontinued assets for sale	$ 153.00	10%	20%	30%	$ 15.30	$ 30.60	$ 45.90
Fixed Assets:							
Plant, property and equipments	$ 154.60	10%	20%	30%	$ 15.46	$ 30.92	$ 46.38
Other Assets:							
Goodwill	$ 100.60	0%	0%	0%	$ -	$ -	$ -
Long term investments	$ 27.70	10%	15%	20%	$ 2.77	$ 4.16	$ 5.54
Deffered tax assets	$ 60.40	0%	0%	0%	$ -	$ -	$ -
Deffered charges	$ 13.00	0%	0%	0%	$ -	$ -	$ -
Other long term assets	$ 1.90	10%	15%	20%	$ 0.19	$ 0.29	$ 0.38
Total Assets (Million $)					$ 301.84	$ 415.52	$ 529.19
Less:							
Wind Down Expenses (5%)					$ (15.09)	$ (20.78)	$ (26.46)
Net Assets Available for Distribution					$ 286.75	$ 394.74	$ 502.73

Table: Liquidation Analysis

A summary of our assumptions is as follows:

Inventory: We believe that finished goods and raw materials could be liquidated anywhere between 30% and 50% of book value, which is expected to be recorded at the lower of cost or market under U.S. GAAP.

Prepaid Expenses: We assumed the company would not be able to get its prepaid expenses back.

Property, Plant and Equipment: We assumed that all leasehold improvements would have no recovery value because the improvements are likely connected to the leased property and would, therefore, be returned to the landlord upon liquidation/lease termination. As it pertains to machinery & equipment, we assumed a low recovery value, somewhere between 10% and 30%.

Other Current Assets: We do not know the components of this balance. We assumed the recovery rate would be moderate, somewhere between 10% and 30%.

Other Assets: Given the nature of other assets accounts, we assumed the recovery rate for long-term assets and long-term investments would be extremely low, somewhere between 10% and 20%. We assumed the recovery rate for goodwill and deferred assets would be 0%.

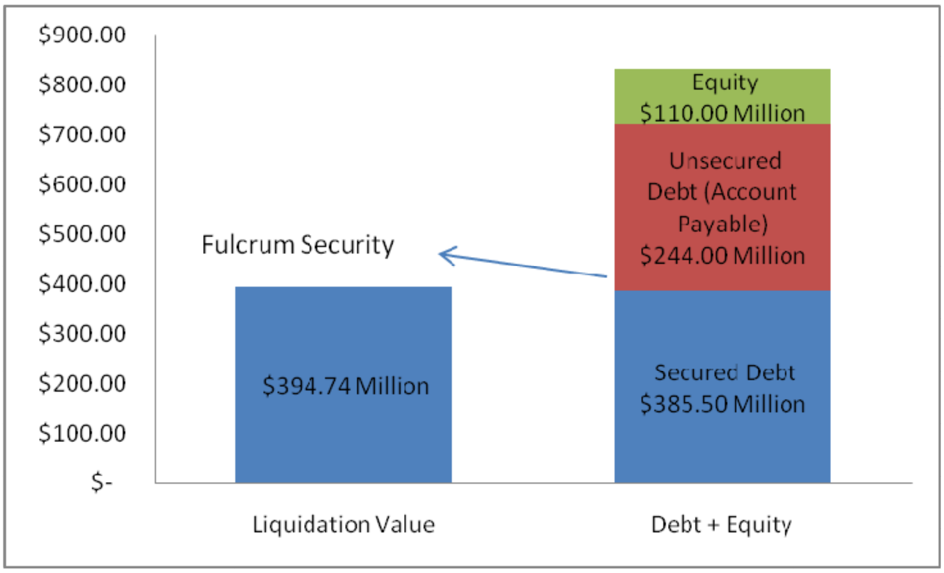


Chart: Liquidation Value and Fulcrum Security

Is It An Alternative for Zale?

Even the best case scenario of the liquidation analysis shows the total liquidation value is lower than the sum of equity and debt. The fulcrum security lies in the unsecured debt (account payable) region. Due to such a low value, other alternatives should be considered.

Going Concern/Status Quo

Going concern implies if the company maintains current capital structure and maintains business under current operating conditions. In status quo, the company should continue to make debt service payments and maintain sufficient liquidity to allow for execution of the current business plan and wait until economic conditions improve. The primary advantage of this alternative is minimal business disruption which will allow management to focus on executing a turnaround plan.

Is It An Alternative for Zale?

The success will largely depend on future cash flows of the business and ability to make debt service payments. It seems difficult for the Zale to be able make such debt service payments as a going concern because its interest coverage is negative and a cash burn analysis indicates company will not be left with enough cash next year. Going concern is not an alternative also because it does not de-lever the business. The company will still have a burdensome capital structure when the economic recovery begins and the company's performance will not likely materially improve before the current senior debt matures in July 2013 and July 2014. If it does not work, and the company drains its remaining liquidity in the process, Zale will be left with few restructuring alternatives and the business would suffer serious harm during the ultimate liquidity crisis.

Valuation as a Going Concern

Valuation was performed using the enterprise value multiple approach. First, the guideline comparable companies were selected: Blue Nile, Tiffany, Signet Jewelers and Bidz.com. The average EV/EBITDA of the guideline companies was calculated as 8.65X. In 2010, Zale's EBITDA was $0.8 million, so the five-year average EBITDA ($42.02 million) was used to calculate the going concern value of the company. The total enterprise value was calculated as $406.74 million, which means that the fulcrum security lies in the unsecured debt (account payable) region. Because of such a low value, other alternatives should also be considered.

(For detailed Multiple Valuation Approach, please refer Exhibit XIV)

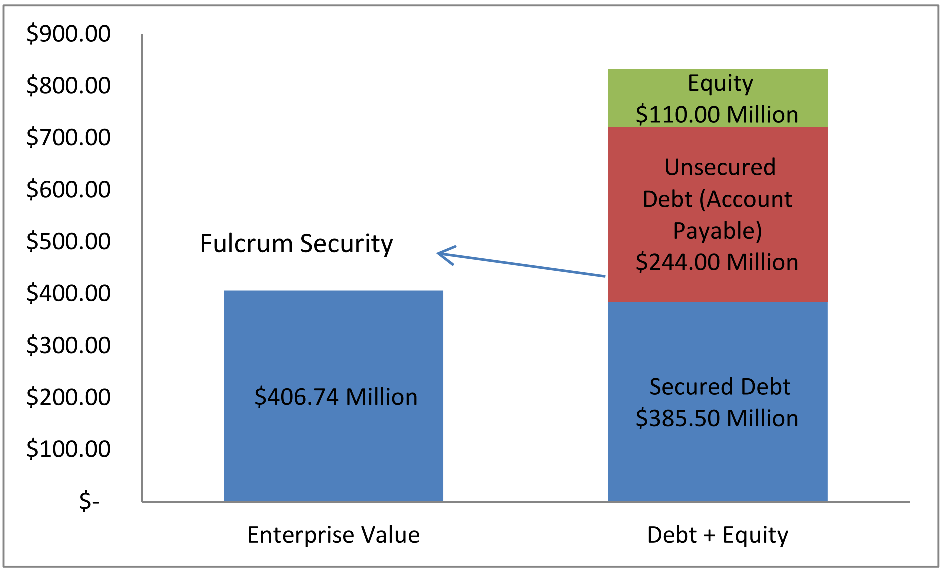


Chart showing Fulcrum Security in Going Concern Valuation

Restructure Balance Sheet/ Debt-to-Equity Swap

An alternate way to restructure the company is to develop an optimal capital structure to meet cash flow of the business and to avoid future liquidity problems, which can be achieved by offering cash, debt, and equity to capital structure participants in exchange for their securities.

Benefits: The primary advantage of this method is that it will reduce debt level after completion of a debt-equity exchange, which will reduce interest burden on the company and free up additional liquidity. This method also allows management to move beyond issues that arise from problems with capital structure and focus on core business.

Issues: Depending on the differing agenda among the capital structure participants, the restructuring plan would have to be implemented through a Chapter 11 filing. Also, existing equity will likely lose control without providing new capital to help effectuate a restructuring. The appetite of investors to make a new money investment will be driven by a variety of factors, including terms of restructuring, long-term view of the company, and availability of capital.

Strategic Buyout or Merger

An option for Zale to consider is selling itself to a strategic buyer. A large player, or a similar-sized company that would create scale in a combined company, could help Zale improve its competitive situation. Issues that could potentially be addressed in a scale include: gaining scale in operation and distribution, expanded locations, enhanced marketing strategy, experienced management team, improved access to the consumer markets, and a lower cost of capital.

Benefits: The primary advantages include certainty and finality of the process. By doing a strategic buyout, the company would be able to perform on an expedited basis, thus eliminating the risks associated with a lengthy restructuring process.

Issues: Strategic buyers are facing their own issues and may not be able to participate. Also, if buyers perceive a forced sale, it may be difficult to maximize enterprise value.

We evaluated three types of strategic buyers:

- **Small Strategic Jewelry Retail Company: Signet Jewelers**

  It will help to expand the brand and increase sales.

- **Large Strategic Jewelry Retail Company: Tiffany and Co.**

  The company will become the giant of the jewelry retail industry.

- **Large Strategic Diversified Retail Company: J.C. Penney and Co.**

  The company will have scale expansion and will be more diversified.

We assumed the strategic buyout deal will be paid by cash only or in exchange of the acquirer's stock. By comparing several different scenarios, we chose the least EPS change payment methods for each buyer, which were stated in the following table. The acquisition by J.C. Penney will cause minimum EPS dilution and will be the preferred strategic buyout.

(For detailed Strategic Buyout analysis, Refer Exhibit XVI)

Strategic Alternative	Acquirer	Payment	Purchase Price/ Share Premium to Market Share	$4.70 0%	$5.00 6.38%	$5.30 12.77%	$5.60 19.15%	$5.90 25.53%	$6.20 31.91%
Sell to Strategic : Large Player	JC Penny	Cash	Accretion/(Dilution)/Share	(0.04)	(0.04)	(0.04)	(0.05)	(0.05)	(0.05)
			% Accrection/(Dilution)/Share	-6.34%	-6.74%	-7.15%	-7.55%	-7.96%	-8.36%
Sell to Strategic : Large Player	Tiffany and Co.	Stock	Accretion/(Dilution)/Share	(1.02)	(1.03)	(1.03)	(1.04)	(1.05)	(1.06)
			% Accrection/(Dilution)/Share	-35.43%	-35.74%	-36.04%	-36.34%	-36.64%	-36.94%
Sell to Strategic : Small Player	Signet Jewelers	Stock	Accretion/(Dilution)/Share	(1.39)	(1.40)	(1.40)	(1.41)	(1.41)	(1.42)
			% Accrection/(Dilution)/Share	-59.97%	-60.22%	-60.47%	-60.72%	-60.96%	-61.20%

Table: Three scenarios of Strategic buyout and expected dilution in each scenario

Transaction Multiple Valuation of Zale Corporation

Valuation was performed using the transaction multiple approach. First, the previous transactions were selected using *Capital IQ*. The average EV/Revenue multiple of the previous transactions was calculated as 0.57X. Other multiples were not selected due to lack of sufficient data. In 2010, Zale's revenue was $1649 million. The total enterprise value was calculated as $939.92 million.

(For detailed Transaction Multiple Approach, please refer Exhibit XVII)

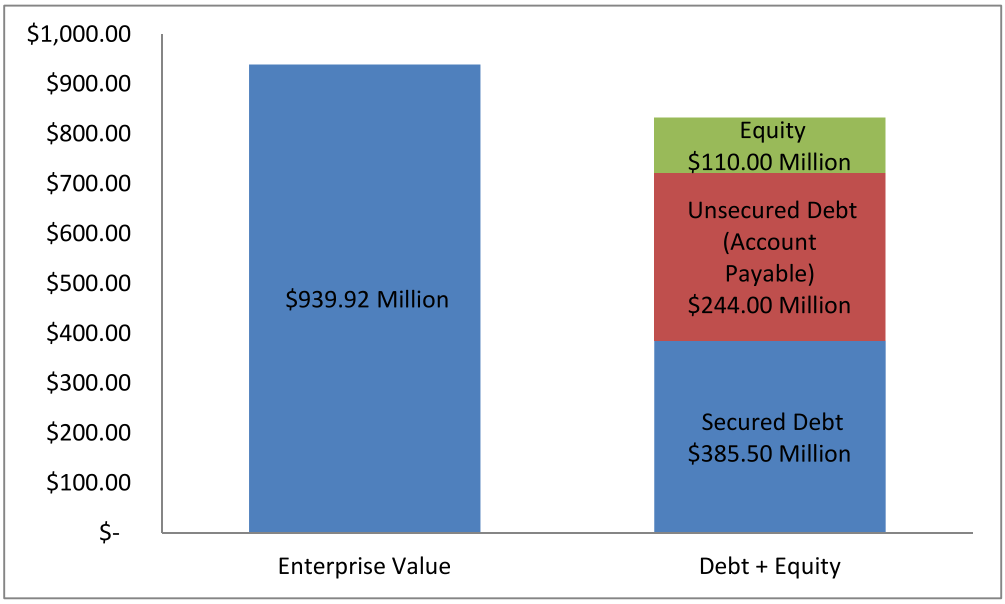


Chart showing value of Zale using Transaction Multiple Valuation

Debt Refinancing and Amendment

Long-term debt amendment will maintain current capital structure and operate business under current conditions. It can be achieved by extending the debt expiration and making changes in the debt terms so that the company can perform to the terms and maintain sufficient liquidity to ride out the business cycle. It causes minimal business disruption and management can stay focused on running the business. Also, it allows existing equity to maintain control and position in the capital structure. The primary disadvantage of the long-term debt amendment is it does not de-lever the balance sheet and the business will still be overleveraged when the economy recovers.

Recommendation

Zale requires a detailed and structured approach to its turnaround; therefore, the recommended plan of action is a combination of following strategies:

A) **Close Down Unprofitable Stores**

Zale should consider closing down its underperforming stores. Specifically, at least 20% of its current stores are operating at significant losses without reasonable hope of improvement. A Four Wall EDITDA Analysis (Store Profitability Analysis) should be performed before making a decision to close down unprofitable stores. For example: Stores with declining sales and a soon-expiring lease term should be closed first.

B) **Cost Reduction Plan**

In 2010, Zale's SG&A expense as percent of sales was about 52% compared to the industry average of 28%, so Zale should right-size its SG&A expenses by changing its corporate structure according to industry norms.

Staff Reduction: Staffing within stores could be scaled back to more accurately match anticipated store traffic. Number of employees should be cut back to the industry average.

Store Placement: Perform a more thorough due diligence before opening new stores to avoid future relocation, closing expenses, and cannibalism of revenue.

Stock-based Compensation: Partial stock based compensation should be considered in place of cash payroll to reduce SG&A expense.

C) **Marketing-Led Strategy and Special Programs**

Driving customer demand is critical in all retail industries. One possible strategy for Zale would be to increase direct marketing efforts dramatically to create brand awareness while investing in store updates and new product lines. Zale should consider introducing an aggressive bridal program similar to that used by Helzberg. This strategy would clearly be extremely aggressive and would accelerate the cash burn-out rate in the very near term, but would likely offer the greatest upside if successful.

D) **Employee Training**

Zale should stress more on employee training because it is one of the most important factors in driving sales up. Sales people should be able to determine if a customer wants to be helped. In the jewelry retail industry, the store manager plays a most important role in sales; therefore, the store manager should be trained and experienced to understand each customer's need.

E) **Focus on Few Brands, Divest Others and Increase Designer Jewelry**

BCG Analysis shows the company should concentrate only on profitable brands and divest unprofitable brands. This will also help the company to increase its brand value. Restructuring options Zale could pursue range from selling off its Canadian stores or its Piercing Pagoda chain to merging with its rival, Signet Jewelers Ltd., owner of Kay Jewelers and Jared The Galleria of Jewelry. It could also sell its Gordon Jewelers division. Due to the demographic changes and increase in the proportion of the wealthy population, Zale should consider introducing high-end designer jewelry similar to what Helzberg Diamonds sells at a few locations. Designer jewelry will help the company to drive sales up.

F) **Hiring Management/Key people with extensive experience in Jewelry Industry**

As mentioned earlier, present management does not have sufficient jewelry industry experience, so Zale should consider adding few key personnel with extensive experience in the jewelry industry. This step will add value to the company.

G) **Debt Refinancing**

Amend debt terms so the company can perform to the terms and maintain sufficient liquidity to ride out the business cycle. The current senior debt matures in July 2013 and July 2014. Debt refinancing will cause minimal business disruption and management can stay focused on implementing turnaround plans.

H) **Debt Reduction by Debt-Equity Swap**

Develop optimal capital structure to meet cash flow of the business and avoid future liquidity problems. Offer cash, debt, and equity to capital structure participants in exchange for their securities. De-lever the balance sheet through a partial exchange of debt for equity. A reduced debt level after completion of the exchange would reduce interest burden on the company and free up additional liquidity.

Valuation for the Recommended Plan of Action Scenario

Valuation for the proposed plan of action was performed using the DCF approach. Assumption was made that there will be no growth in revenue for new two years due to restructuring. In 2010, the company's total revenue was $1649 million. After the closing of about 20% of the unprofitable stores, its total revenue would decrease, but revenue per store would increase. Current revenue per store is $0.88 million. We assumed that after closing its 20% non-profitable stores, revenue per store would increase to about $1.00 million, so we assumed that its remaining 1,500 stores would earn approximately $1500 million in revenue in 2012. We projected this revenue with a 5% interim growth rate and a 3% terminal growth rate.

We also assumed that after implementing recommended cost-reduction plan, Zale's SG&A expenses as a percent of sales would decrease, but would remain higher than the industry average. We assumed SG&A expenses as a percent of sales to be 35% for the next five years and then 30% in the terminal year.

A WACC of 17% was used to discount the future cash flows.

(Please refer Exhibit XV for detailed WACC Calculation)

We concluded the total enterprise value of the company to be $1,300 million using discounted cash flow method.

(Please Refer Exhibit XIX for detailed DCF Calculation)

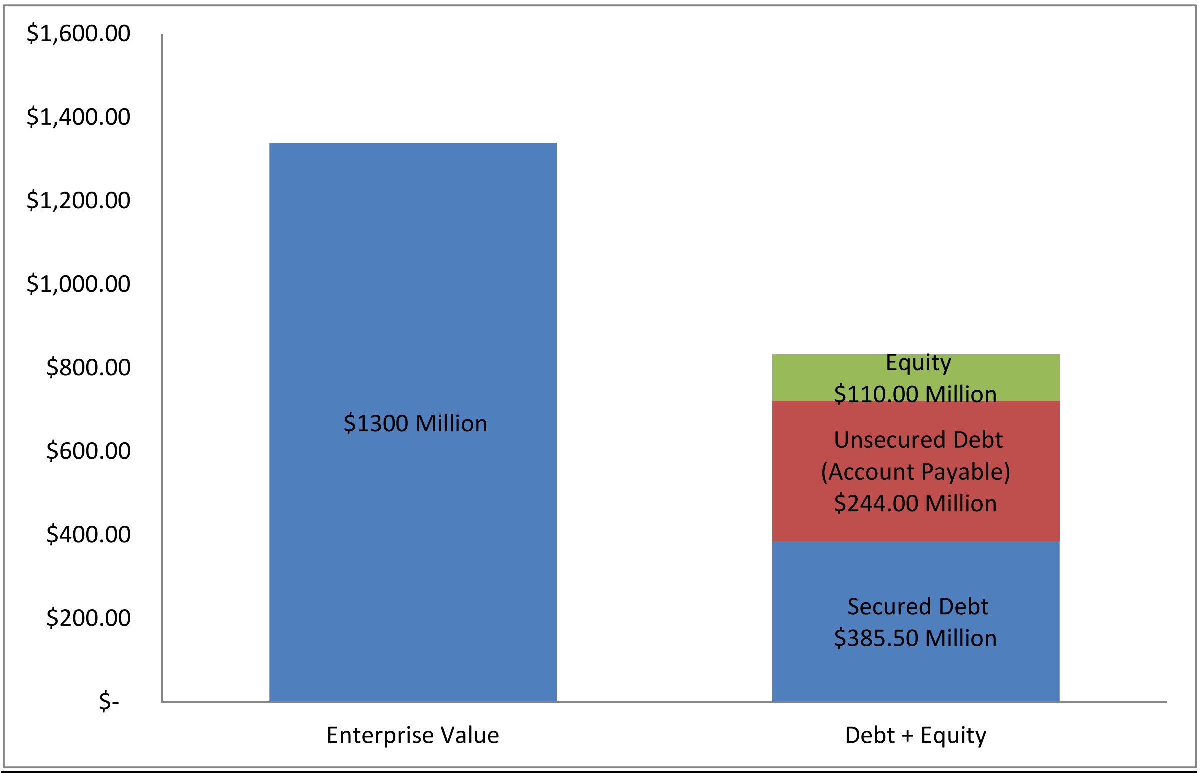


Chart: Valuation for the recommended plan of action

Sensitivity Analysis

We also performed a sensitivity analysis on DCF by using Monte Carlo Simulation with a thousand iterations. The following assumptions were made in the Monte Carlo Simulation:

- Uncertainty in sales was introduced by converting it to a normal distribution with a standard deviation of 5%
- Uncertainty in COGS was introduced by converting it to a triangular distribution with a minimum 40%, a maximum 50%, and most likely 45% COGS as percent of sales.
- Uncertainty in SG&A was introduced by converting it to a normal distribution with a mean of 35%and standard deviation of 5% SGA as percent of sales.

We ran 1,000 iterations and determined the mean enterprise value was $1,485 million.

(Refer Exhibit XX for detailed Monte Carlo Analysis)

Exhibit I: Historic Income Statement

Zale Corporation

Income Statement

For the Fiscal Period Ending	12 months	12 months	12 months	12 months	12 months
	Jul-31-2006	Jul-31-2007	Jul-31-2008	Jul-31-2009	Jul-31-2010
Currency (Million)	*USD*	*USD*	*USD*	*USD*	*USD*
Revenue	2,154.0	2,152.8	2,138.0	1,779.7	1,616.3
Total Revenue	**2,154.0**	**2,152.8**	**2,138.0**	**1,779.7**	**1,616.3**
Cost Of Goods Sold	1,051.8	1,036.5	1,089.6	948.6	802.2
Gross Profit	**1,102.2**	**1,116.3**	**1,048.5**	**831.2**	**814.1**
Selling General & Admin Exp.	946.3	963.7	991.8	934.2	846.2
Depreciation & Amort.	54.7	56.6	60.2	58.9	50.0
Other Operating Expense/(Income)	1.7	7.2	(12.6)	0.9	-
Other Operating Exp., Total	**1,002.6**	**1,027.4**	**1,039.4**	**994.1**	**896.2**
Operating Income	**99.6**	**88.8**	**9.1**	**(163.0)**	**(82.1)**
Interest Expense	(11.2)	(19.0)	(12.4)	(10.4)	(15.7)
Interest and Invest. Income	-	-	-	-	-
Net Interest Exp.	**(11.2)**	**(19.0)**	**(12.4)**	**(10.4)**	**(15.7)**
Other Non-Operating Inc. (Exp.)	-	-	-	-	6.6
EBT Excl. Unusual Items	**88.4**	**69.9**	**(3.3)**	**(173.4)**	**(91.2)**
Impairment of Goodwill	-	-	-	(5.0)	-
Gain (Loss) On Sale Of Assets	-	-	3.5	-	-
Asset Writedown	(9.8)	(2.5)	(1.9)	(23.8)	(29.9)
Legal Settlements	-	(1.5)	-	-	-
Other Unusual Items	1.3	-	-	(17.2)	(3.4)
EBT Incl. Unusual Items	**79.9**	**65.9**	**(1.7)**	**(219.4)**	**(124.5)**
Income Tax Expense	20.2	17.8	4.8	(53.0)	(28.8)
Earnings from Cont. Ops.	**59.7**	**48.1**	**(6.5)**	**(166.3)**	**(95.8)**
Earnings of Discontinued Ops.	(6.1)	11.1	7.1	(23.2)	2.1
Net Income	**53.6**	**59.3**	**0.6**	**(189.5)**	**(93.7)**

(Source: Capital IQ)

Exhibit II: Historic Balance Sheet

Zale Corporation
Balance Sheet

	Jul-31-2006	Jul-31-2007	Jul-31-2008	Jul-31-2009	Jul-31-2010
Currency (Millions)	*USD*	*USD*	*USD*	*USD*	*USD*
ASSETS					
Cash And Equivalents	42.6	37.6	61.3	25.0	26.2
Total Cash & ST Investments	**42.6**	**37.6**	**61.3**	**25.0**	**26.2**
Other Receivables	-	-	-	12.5	8.6
Total Receivables	**-**	**-**	**-**	**12.5**	**8.6**
Inventory	903.3	1,021.2	799.2	740.3	703.1
Prepaid Exp.	16.5	24.0	22.5	20.8	20.1
Other Current Assets	86.9	89.5	83.9	18.7	13.3
Total Current Assets	**1,049.2**	**1,172.3**	**966.9**	**817.2**	**771.3**
Gross Property, Plant & Equipment	678.3	743.6	734.8	690.7	693.8
Accumulated Depreciation	(394.6)	(439.2)	(436.9)	(452.6)	(520.4)
Net Property, Plant & Equipment	**283.7**	**304.4**	**297.9**	**238.1**	**173.4**
Long-term Investments	21.9	25.0	27.5	24.8	26.3
Goodwill	96.3	100.7	103.7	94.6	98.4
Deferred Tax Assets, LT	-	1.3	10.9	51.5	64.7
Deferred Charges, LT	-	-	-	1.4	22.8
Other Long-Term Assets	11.3	10.2	8.4	3.2	3.5
Total Assets	**1,462.6**	**1,613.9**	**1,415.3**	**1,231.0**	**1,160.4**
LIABILITIES					
Accounts Payable	224.2	182.0	154.1	124.4	157.2
Accrued Exp.	59.2	60.8	70.0	64.8	56.8
Curr. Port. of LT Debt	-	-	-	-	11.3
Curr. Income Taxes Payable	26.5	29.7	21.6	17.1	15.0
Unearned Revenue, Current	28.1	28.4	41.8	60.2	78.1
Def. Tax Liability, Curr.	61.9	73.5	65.7	46.4	59.1
Other Current Liabilities	-	-	-	43.5	10.8
Total Current Liabilities	**400.0**	**374.5**	**353.2**	**356.3**	**388.3**
Long-Term Debt	202.8	227.3	326.3	310.5	284.7
Unearned Revenue, Non-Current	12.5	69.5	131.2	150.0	140.7
Def. Tax Liability, Non-Curr.	3.8	-	-	-	-
Other Non-Current Liabilities	39.1	40.1	38.1	40.3	38.6
Total Liabilities	**658.2**	**711.4**	**848.8**	**857.2**	**852.4**
Common Stock	0.5	0.5	0.5	0.5	0.5
Additional Paid In Capital	111.4	138.0	144.5	147.3	160.6
Retained Earnings	808.9	868.1	847.2	657.7	564.0
Treasury Stock	(150.0)	(150.0)	(476.7)	(469.0)	(465.6)
Comprehensive Inc. and Other	33.6	45.9	51.0	37.3	48.4
Total Common Equity	**804.4**	**902.6**	**566.5**	**373.8**	**308.0**
Total Equity	**804.4**	**902.6**	**566.5**	**373.8**	**308.0**
Total Liabilities And Equity	**1,462.6**	**1,613.9**	**1,415.3**	**1,231.0**	**1,160.4**

(Source: Capital IQ)

Exhibit III: Historic Cash Flow Statement

Zale Corporation Cash Flow Statement					
For the Fiscal Period Ending	**12 months Jul-31-2006**	**12 months Jul-31-2007**	**12 months Jul-31-2008**	**12 months Jul-31-2009**	**12 months Jul-31-2010**
Currency (Million)	*USD*	*USD*	*USD*	*USD*	*USD*
Net Income	**53.6**	**59.3**	**0.6**	**(189.5)**	**(93.7)**
Depreciation & Amort.	55.8	57.6	60.2	58.9	50.0
Depreciation & Amort., Total	**55.8**	**57.6**	**60.2**	**58.9**	**50.0**
Other Amortization	-	-	0.7	0.7	3.4
(Gain) Loss From Sale Of Assets	4.3	2.7	3.5	2.7	1.0
Asset Writedown & Restructuring Costs	9.8	2.5	1.9	28.8	29.9
Stock-Based Compensation	6.4	6.1	4.4	5.7	3.9
Net Cash From Discontinued Ops.	29.1	1.4	(21.6)	-	(15.4)
Other Operating Activities	(16.1)	(5.4)	(34.3)	(37.9)	(8.7)
Change In Inventories	(64.9)	(97.0)	71.1	53.2	42.4
Change in Acc. Payable	35.3	(34.6)	(34.5)	1.6	24.2
Change in Other Net Operating Assets	(31.4)	48.2	60.8	78.5	(0.1)
Cash from Ops.	**82.1**	**40.6**	**113.0**	**2.7**	**36.9**
Capital Expenditure	(76.4)	(79.3)	(85.1)	(28.4)	(14.7)
Invest. in Marketable & Equity Securt.	1.2	(3.2)	(2.2)	3.1	(0.6)
Other Investing Activities	(6.3)	(7.2)	225.1	-	-
Cash from Investing	**(81.6)**	**(89.6)**	**137.7**	**(25.3)**	**(15.2)**
Long-Term Debt Issued	2,264.8	3,977.6	3,630.8	5,107.2	4,615.1
Total Debt Issued	**2,264.8**	**3,977.6**	**3,630.8**	**5,107.2**	**4,615.1**
Long-Term Debt Repaid	(2,191.8)	(3,953.1)	(3,531.8)	(5,123.0)	(4,610.6)
Total Debt Repaid	**(2,191.8)**	**(3,953.1)**	**(3,531.8)**	**(5,123.0)**	**(4,610.6)**
Issuance of Common Stock	10.7	17.8	2.0	6.2	-
Repurchase of Common Stock	(100.0)	-	(326.7)	-	-
Other Financing Activities	1.1	1.4	0.1	0.2	(25.5)
Cash from Financing	**(15.2)**	**43.7**	**(225.7)**	**(9.4)**	**(21.0)**
Foreign Exchange Rate Adj.	1.8	0.3	0.2	(4.3)	0.5
Net Change in Cash	**(12.9)**	**(5.0)**	**25.2**	**(36.4)**	**1.2**

(Source: Capital IQ)

Exhibit IV: Common Sized Balance Sheet

Zale Corporation Common Sized Balance Sheet					
Balance Sheet as of:					
	Jul-31-2006	**Jul-31-2007**	**Jul-31-2008**	**Jul-31-2009**	**Jul-31-2010**
	Percent	*Percent*	*Percent*	*Percent*	*Percent*
ASSETS					
Cash And Equivalents	2.9%	2.3%	4.3%	2.0%	2.3%
Total Cash & ST Investments	**2.9%**	**2.3%**	**4.3%**	**2.0%**	**2.3%**
Other Receivables	-	-	-	1.0%	0.7%
Total Receivables	**-**	**-**	**-**	**1.0%**	**0.7%**
Inventory	61.8%	63.3%	56.5%	60.1%	60.6%
Prepaid Exp.	1.1%	1.5%	1.6%	1.7%	1.7%
Other Current Assets	5.9%	5.5%	5.9%	1.5%	1.1%
Total Current Assets	**71.7%**	**72.6%**	**68.3%**	**66.4%**	**66.5%**
Gross Property, Plant & Equipment	46.4%	46.1%	51.9%	56.1%	59.8%
Accumulated Depreciation	(27.0%)	(27.2%)	(30.9%)	(36.8%)	(44.8%)
Net Property, Plant & Equipment	**19.4%**	**18.9%**	**21.0%**	**19.3%**	**14.9%**
Long-term Investments	1.5%	1.5%	1.9%	2.0%	2.3%
Goodwill	6.6%	6.2%	7.3%	7.7%	8.5%
Deferred Tax Assets, LT	-	0.1%	0.8%	4.2%	5.6%
Deferred Charges, LT	-	-	-	0.1%	2.0%
Other Long-Term Assets	0.8%	0.6%	0.6%	0.3%	0.3%
Total Assets	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**
LIABILITIES					
Accounts Payable	15.3%	11.3%	10.9%	10.1%	13.5%
Accrued Exp.	4.0%	3.8%	4.9%	5.3%	4.9%
Curr. Port. of LT Debt	-	-	-	-	1.0%
Curr. Income Taxes Payable	1.8%	1.8%	1.5%	1.4%	1.3%
Unearned Revenue, Current	1.9%	1.8%	3.0%	4.9%	6.7%
Def. Tax Liability, Curr.	4.2%	4.6%	4.6%	3.8%	5.1%
Other Current Liabilities	-	-	-	3.5%	0.9%
Total Current Liabilities	**27.4%**	**23.2%**	**25.0%**	**28.9%**	**33.5%**
Long-Term Debt	13.9%	14.1%	23.1%	25.2%	24.5%
Unearned Revenue, Non-Current	0.9%	4.3%	9.3%	12.2%	12.1%
Def. Tax Liability, Non-Curr.	0.3%	-	-	-	-
Other Non-Current Liabilities	2.7%	2.5%	2.7%	3.3%	3.3%
Total Liabilities	**45.0%**	**44.1%**	**60.0%**	**69.6%**	**73.5%**
Common Stock	0.0%	0.0%	0.0%	0.0%	0.0%
Additional Paid In Capital	7.6%	8.6%	10.2%	12.0%	13.8%
Retained Earnings	55.3%	53.8%	59.9%	53.4%	48.6%
Treasury Stock	(10.3%)	(9.3%)	(33.7%)	(38.1%)	(40.1%)
Comprehensive Inc. and Other	2.3%	2.8%	3.6%	3.0%	4.2%
Total Common Equity	**55.0%**	**55.9%**	**40.0%**	**30.4%**	**26.5%**
Total Equity	**55.0%**	**55.9%**	**40.0%**	**30.4%**	**26.5%**
Total Liabilities And Equity	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

(Source: Capital IQ)

Exhibit V: Common Sized Income Statement

Zale Corporation Income Statement					
For the Fiscal Period Ending	**12 months Jul-31-2006** *Percent*	**12 months Jul-31-2007** *Percent*	**12 months Jul-31-2008** *Percent*	**12 months Jul-31-2009** *Percent*	**12 months Jul-31-2010** *Percent*
Revenue	100.0%	100.0%	100.0%	100.0%	100.0%
Total Revenue	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**
Cost Of Goods Sold	48.8%	48.1%	51.0%	53.3%	49.6%
Gross Profit	**51.2%**	**51.9%**	**49.0%**	**46.7%**	**50.4%**
Selling General & Admin Exp.	43.9%	44.8%	46.4%	52.5%	52.4%
Depreciation & Amort.	2.5%	2.6%	2.8%	3.3%	3.1%
Other Operating Expense/(Income)	0.1%	0.3%	(0.6%)	0.1%	-
Other Operating Exp., Total	**46.5%**	**47.7%**	**48.6%**	**55.9%**	**55.4%**
Operating Income	**4.6%**	**4.1%**	**0.4%**	**(9.2%)**	**(5.1%)**
Interest Expense	(0.5%)	(0.9%)	(0.6%)	(0.6%)	(1.0%)
Net Interest Exp.	**(0.5%)**	**(0.9%)**	**(0.6%)**	**(0.6%)**	**(1.0%)**
Other Non-Operating Inc. (Exp.)	-	-	-	-	0.4%
EBT Excl. Unusual Items	**4.1%**	**3.2%**	**(0.2%)**	**(9.7%)**	**(5.6%)**
Impairment of Goodwill	-	-	-	(0.3%)	-
Gain (Loss) On Sale Of Assets	-	-	0.2%	-	-
Asset Writedown	(0.5%)	(0.1%)	(0.1%)	(1.3%)	(1.9%)
Legal Settlements	-	(0.1%)	-	-	-
Other Unusual Items	0.1%	-	-	(1.0%)	(0.2%)
EBT Incl. Unusual Items	**3.7%**	**3.1%**	**(0.1%)**	**(12.3%)**	**(7.7%)**
Income Tax Expense	0.9%	0.8%	0.2%	(3.0%)	(1.8%)
Earnings from Cont. Ops.	**2.8%**	**2.2%**	**(0.3%)**	**(9.3%)**	**(5.9%)**
Earnings of Discontinued Ops.	(0.3%)	0.5%	0.3%	(1.3%)	0.1%
Net Income	**2.5%**	**2.8%**	**0.0%**	**(10.6%)**	**(5.8%)**

(Source: Capital IQ)

Exhibit VI: Balance Sheet Growth Analysis

Zale Corp.

Growth Analysis Balance Sheet

	Fiscal Years Ended, July 31,				Compound Growth	
	2007	2008	2009	2010	3-Year	5-Year
ASSETS						
Current assets:						
Cash	-11.7%	63.0%	-59.2%	4.8%	-34.6%	-11.4%
Inventories	13.1%	-21.7%	-7.4%	-5.0%	-6.2%	-6.1%
Prepaid expenses	45.5%	-6.3%	-7.6%	-3.4%	-5.5%	5.1%
Other current assets	3.0%	-6.3%	-77.7%	-28.9%	-60.2%	-37.5%
Total current assets	11.7%	-17.5%	-15.5%	-5.6%	-10.7%	-7.4%
Fixed assets:						
Gross Fixed Assets	9.6%	-1.2%	-6.0%	0.4%	-2.8%	0.6%
Fixed assets	9.6%	-1.2%	-6.0%	0.4%	-2.8%	0.6%
less accumulated depreciation	-11.3%	0.5%	-3.6%	-15.0%	NMF	NMF
Fixed assets, net	7.3%	-2.1%	-20.1%	-27.2%	-23.7%	-11.6%
Other assets:						
Goodwill	4.6%	3.0%	-8.8%	4.0%	-2.6%	0.5%
Long-term Investments	14.2%	10.0%	-9.8%	6.0%	-2.2%	4.7%
Loans Receivable Long-Term	NA	NA	NA	NA	NMF	NMF
Other Long-Term Assets	-9.7%	-17.6%	-45.2%	471.7%	76.9%	23.5%
Total other assets	5.9%	9.7%	16.6%	22.9%	19.7%	13.6%
TOTAL ASSETS	10.4%	-12.3%	-13.0%	-5.7%	-9.5%	-5.6%
LIABILITIES & EQUITY						
Current liabilities:						
Accounts payable	-18.8%	-15.3%	-19.3%	26.4%	1.0%	-8.5%
Current portion L-T debt	NA	NA	NA	NA	NMF	NMF
Income taxes payable	12.1%	-27.3%	-20.8%	-12.3%	-16.7%	-13.3%
Deferred tax liabilities, current	18.7%	-10.6%	-29.4%	27.4%	-5.2%	-1.2%
Accrued expenses	2.7%	15.1%	-7.4%	-12.3%	-9.9%	-1.0%
Unearned Revenue	1.1%	47.2%	44.0%	29.7%	36.7%	29.1%
Other current liabilites	NA	NA	NA	-75.2%		
Total current liabilities	-6.4%	-5.7%	0.9%	9.0%	4.9%	-0.7%
Long-term liabilities:						
Long-term debt	12.1%	43.6%	-4.8%	-8.3%	-6.6%	8.9%
Unearned revenue, LT	456.0%	88.8%	14.3%	-6.2%	3.6%	83.2%
Deferred tax liabilities	NA	NA	NA	NA	NMF	NMF
Other long-term liabilities	2.6%	-5.0%	5.8%	-4.2%	0.7%	-0.3%
Total long-term liabilities	30.5%	47.1%	1.0%	-7.3%	-3.2%	15.8%
Total liabilities	8.1%	19.3%	1.0%	-0.6%	0.2%	6.7%
Equity:						
Common stock	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Additional paid-in capital	23.9%	4.7%	1.9%	9.0%	5.4%	9.6%
Retained earnings (deficit)	7.3%	-2.4%	-22.4%	-14.2%	-18.4%	-8.6%
Treasury stock	0.0%	-217.8%	1.6%	0.7%	NMF	NMF
Other equity items	36.6%	11.1%	-26.9%	29.8%	-2.6%	9.6%
Total equity	12.2%	-37.2%	-34.0%	-17.6%	-26.3%	-21.3%
TOTAL LIABILITIES & EQUITY	10.3%	-12.3%	-13.0%	-5.8%	-9.5%	-5.6%

Exhibit VII: Income Statement Growth Analysis

Zale Corp.
Growth Analysis Income Statement

	Fiscal Years Ended, July 31,				Compound Growth	
	2007	2008	2009	2010	3-Year	5-Year
Revenues:						
Revenue	-0.1%	-0.7%	-16.8%	-9.2%	-13.1%	-6.9%
Total revenues	-0.1%	-0.7%	-16.8%	-9.2%	-13.1%	-6.9%
Cost of goods sold	-1.5%	5.1%	-12.9%	-15.4%	-14.2%	-6.5%
Gross profit	1.3%	-6.1%	-20.7%	-2.0%	-11.9%	-7.3%
Operating expenses:						
Selling, general & admin.	1.8%	2.9%	-5.8%	-9.4%	-7.6%	-2.8%
Depr. & amort. expense	3.5%	6.4%	-2.2%	-15.1%	-8.9%	-2.2%
Other Operating expenses	323.5%	-275.0%	107.1%	NA	NMF	NMF
Total operating expenses	2.5%	1.2%	-4.4%	-9.8%	-7.1%	-2.8%
Operating income	-10.8%	-89.9%	-1910.0%	49.6%	NMF	NMF
Other income (expense):						
Interest (expense)	-69.6%	34.7%	16.1%	-51.0%	NMF	NMF
Unusual income (expense)	52.9%	140.0%	-2975.0%	27.6%	NMF	NMF
Total other income (expense)	-16.8%	53.0%	-422.2%	13.1%	NMF	NMF
Pretax income	-17.5%	-102.7%	-12083.3%	40.2%	NMF	NMF
Income tax expense	-11.9%	-73.0%	-1204.2%	45.7%	NMF	NMF
Income before extraordinary gain	-19.5%	-113.8%	-2419.7%	38.5%	NMF	NMF
Discontinued operations	282.0%	-36.0%	-426.8%	109.1%	-45.6%	NMF
Net income	10.5%	-99.2%	-38000.0%	47.1%	NMF	NMF
Depreciation & amortization	3.5%	6.4%	-2.2%	-15.1%	-8.9%	-2.2%
EBITDA	-5.7%	-52.4%	-250.3%	69.1%	NMF	NMF
EBIT	-10.8%	-89.9%	-1910.0%	49.6%	NMF	NMF
Gross cash flow	6.9%	-47.5%	-315.2%	61.6%	NMF	NMF
Total debt	12.1%	43.6%	-4.8%	-4.7%	-4.8%	9.9%
Capital expenditures	3.8%	7.3%	-66.6%	-48.2%	-58.4%	-33.8%

Exhibit VIII: Key Executives

Theophlius Killion - Chief Executive Officer, President and Director

Theophlius Killion has been the Chief Executive Officer of Zale Corporation since September 23, 2010, and has been the President since August 2008. He served as an Interim Chief Executive Officer of Zale Corporation from January 13, 2010 to September 23, 2010. Mr. Killion has 30 years of experience. Mr. Killion served as Executive Vice President of Human Resources, Legal and Corporate Strategy for Zale Corporation from January 2008 to August 2008. Previously, Mr. Killion worked at executive recruiting firm Berglass Associates, and focused on companies in the retail, consumer goods and fashion industries. Prior to Berglass Associates, Mr. Killion served as an Executive Vice President of Human Resources Division of Hilfiger Tommy Corp. since January 2005 and for its subsidiary, Tommy Hilfiger USA Inc., since March 2004. His responsibilities entailed worldwide HR strategies and initiatives that included recruitment and retention, training and development, compensation and benefits and performance management. He served as the Vice President of Human Resources of The Limited Brands from January 1996 to March 2004 and also served as its Corporate Vice President of HR for Merchandising and Design. He held senior human resource roles at Macy’s East and The Home Shopping Network. He has been a Director of Zale Corporation since September 23, 2010. Mr. Killion holds graduate degree in Marketing from the School of Management at Boston University.

Matthew W. Appel - Chief Financial Officer and Executive Vice President

Matthew Appel has been the Chief Financial Officer of Zale Corporation since June 15, 2009, and the Executive Vice President since May 27, 2009. Mr. Appel served as the Principal Accounting Officer of Exlservice Holdings, Inc. and its Chief Financial Officer from March 31, 2007 to May 15, 2009 and Vice President from February 28, 2007 to May 15, 2009. He has 30 years of professional experience in finance and Business Process Outsourcing (“BPO”) and worked with Electronic Data Systems Corporation from 2006 to 2007 as Vice President, BPO Product Management where he was responsible for strategy and business plan development and investment prioritization for EDS' BPO product portfolio. From 2003 to 2005, he served as Vice President of Finance and Administration BPO at EDS. From 2001 to 2003, he served as Senior Vice President of Finance and Accounting BPO at Affiliated Computer Services, Inc. where he was responsible for the general management of the finance and accounting BPO business. Previously, he worked for Tenneco Inc., served as its Vice President of Financial Analysis and Planning as well as the President of Tenneco Business Services, its shared services captive. He also served as Controller, Treasurer and Director of Internal Audit for Tenneco's wholly owned subsidiary Newport News Shipbuilding. He started his career at Arthur Andersen, where he worked in its audit practice. Mr. Appel is a Certified Public Accountant and Certified Management Accountant, and he holds an MBA in Accounting and a BA in Business Administration from Rutgers University.

Gilbert P. Hollander - Chief Merchandising Officer, Chief Sourcing Officer and Executive Vice President

Gilbert Hollander has been Executive Vice President and Chief Sourcing Officer of Zale Corporation since September 2007, and also been its Chief Merchandising Officer since January 2010. Mr. Hollander has been Senior Vice President of Merchandise Purchasing of Piercing Pagoda, Inc. since February 2000. He served as President of Piercing Pagoda of Zale Corporation since January 2005 to August 2006 and its Group Senior Vice President since January 2005. Mr. Hollander joined Piercing Pagoda Inc., in May 1997 as Director of New Business Development. Mr. Hollander served as Vice President of Divisional Merchandise for Piercing Pagoda, to which he was appointed in August 2003. Mr. Hollander served as Senior Vice President of Merchandising for Piercing Pagoda from February 2000 to August 2003. He increased product innovation and improved merchandise assortments targeted to Piercing Pagoda's fashion-forward customer. He had a vast experience of 19 years in the jewelry kiosk business. Prior to joining Piercing Pagoda Inc., Mr. Hollander held various senior management positions with Silver & Gold Connection, a kiosk-based jewelry retailer, and has owned and operated his own wholesale and retail jewelry business.

John Legg - Senior Vice President of Supply Chain

John Legg has been Senior Vice President of Supply Chain of Zale since September 14, 2010. Mr. Legg served as Managing Director for Management Services International, LLC, a global consulting services company he formed to assess, design and launch supply chain solutions in support of restructuring, process improvement and inventory management initiatives. Prior to that, he served as Senior Vice President of Global Distribution and Logistics for Warnaco, Inc. and Vice President of International Distribution and Logistics for Liz Claiborne, Inc. Mr. Legg is a graduate of Northeastern University.

Richard A. Lennox - Chief Marketing Officer & E-Commerce Officer and Executive Vice President

Richard Lennox has been Executive Vice President and Chief Marketing Officer & E-Commerce Officer of Zale Corporation since August 17, 2009. Mr. Lennox joined Zale from J. Walter Thompson-New York, where he served as Executive Vice President and Director of the De Beers Group "A diamond is forever" marketing campaign since 1998. He served as Director of US at JWT since August 2009. He was the principal architect of programs that helped grow US diamond jewelry sales significantly for over ten years. Mr. Lennox started at JWT in 1989 and has held various senior level marketing positions. He began his career in 1987 with AGB-London. He has received many accolades, including eight Effie awards for marketing effectiveness, and was recognized as one of *Ad Age's* 50 most influential U.S. marketers in 2001. Mr. Lennox is a graduate of the University of Reading.

(Source: Zale's website and Capital IQ)

Exhibit IX: Business Description of Comparable Companies

Signet Jewelers Limited (NYSE:SIG)

Signet Jewelers Limited operates as a specialty jewelry retailer in the United States, the United Kingdom, the Republic of Ireland, and the Channel Islands. It engages in the retail of jewelry and watches, as well as offers associated services. The company operates retail stores under various brands, including Kay Jewelers, Jared The Galleria of Jewelry, H. Samuel, and Ernest Jones. As of March 25, 2010, it operated 1,400 stores in the United States. As of January 30, 2010, the company operated 552 stores in the United Kingdom, including 14 in the Republic of Ireland; and three in the Channel Islands. Signet Jewelers Limited was founded in 1950 and is based in Hamilton, Bermuda.

Tiffany & Co. (NYSE:TIF)

Through its subsidiaries, Tiffany & Co. engages in the design, manufacture, and retail of fine jewelry. Its jewelry products include gemstone jewelry, gemstone band rings, diamond rings, wedding bands for brides and grooms, non-gemstone, gold or platinum jewelry, and sterling silver jewelry. The company also offers *Tiffany & Co.*-brand merchandise, including timepieces and clocks; sterling silver merchandise, including flatware, hollowware, trophies, key holders, picture frames, and desk accessories; crystal, glassware, china, and other tableware; custom engraved stationery; writing instruments; eyewear; leather goods; and fashion accessories. In addition, it provides fragrance products sold under the trademarks, including *Tiffany*, *Pure Tiffany*, and *Tiffany for Men*. The company serves its customers through retail sales, internet and catalog sales, business-to-business sales, and wholesale distribution primarily in the Americas, the Asia-Pacific, and Europe. It also sells its products through *Tiffany & Co.* stores as well as through department store boutiques in Japan. As of January 31, 2010, Tiffany & Co. operated approximately 220 retail stores worldwide. The company was founded in 1837 and is based in New York, New York.

Blue Nile Inc. (Nasdaq:NILE)

Blue Nile, Inc. and its subsidiaries operate as an online retailer of diamonds and fine jewelry worldwide. Its fine jewelry selection includes diamond, gemstone, platinum, gold, pearl, and sterling silver jewelry and accessories as well as settings, wedding bands, earrings, necklaces, pendants, and bracelets. The company also offers a range of other fine jewelry products and watches to complement its selection of customized diamond jewelry. It offers its products under the brand name *Blue Nile* through its websites, bluenile.com, bluenile.co.uk and bluenile.ca. The company was formerly known as Internet Diamonds, Inc., and the name was changed to Blue Nile, Inc. in November 1999. Blue Nile, Inc. was founded in March 1999 and is headquartered in Seattle, Washington.

Bidz.com Inc. (Nasdaq:BIDZ)

Bidz.com, Inc. operates as an online retailer of jewelry in the United States and internationally. It operates a website, bidz.com, for the purpose of selling merchandise, utilizing an online sales auction platform; and a fixed price online store at www.buyz.com. The company's product inventory includes gold, platinum, and silver jewelry sets with diamonds, rubies, emeralds, sapphires, and other precious and semi-precious stones; and a selection of jewelry, including rings, necklaces, earrings, bracelets, jewelry sets, watches and accessories, and brand-name merchandises. It also acts as an agent in the sale of certified merchant merchandise owned by third parties. The company was founded in 1998 and is headquartered in Culver City, California.

Helzberg Diamonds

Helzberg Diamond Shops, Inc., doing business as Helzberg Diamonds, engages in the jewelry business. The company provides jewelry, such as rings, necklaces, earrings, and bracelets. It also offers diamond and gold jewelry, jewelry for men and baby, colored gems, wedding bands, watches, and various gifts. The company was founded in 1915 and is headquartered in North Kansas City, Missouri. It has stores in the United States.

(Source: Capital IQ)

Exhibit X: Ratio Analysis

Zale Corp.
Ratio Analysis

	Fiscal Years Ended July 31,					Fiscal Year-End Averages	
	2006	2007	2008	2009	2010	3-Year Avg.	5-Year Avg.
LIQUIDITY							
Current ratio	2.6	3.1	2.7	2.3	2.0	2.3	2.6
Quick ratio	0.1	0.1	0.2	0.1	0.1	0.1	0.1
Working capital turnover	3.3	2.7	3.5	3.9	4.2	3.9	3.5
LEVERAGE							
Total liabilities/Total assets	0.4	0.4	0.6	0.7	0.7	0.7	0.6
Interest coverage	8.9	4.7	0.7	(15.7)	(5.2)	(6.7)	(1.3)
ACTIVITY							
Accounts receivable turnover	NA	NA	NA	142.4	187.9	165.2	165.2
Accts rec. collection period	NA	NA	NA	3	2	2	2
Inventory turnover	1.2	1.0	1.4	1.3	1.1	1.3	1.2
Accounts payable turnover	4.7	5.7	7.1	7.6	5.1	6.6	6.0
Fixed asset turnover	7.6	7.1	7.2	7.5	9.3	8.0	7.7
Total asset turnover	1.5	1.3	1.5	1.4	1.4	1.4	1.4
PROFIT MARGIN							
Gross profit margin	51.2%	51.9%	49.0%	46.7%	50.4%	48.7%	49.8%
EBITDA/sales	7.2%	6.8%	3.2%	-5.8%	-2.0%	-1.5%	1.9%
EBIT/sales	4.6%	4.1%	0.4%	-9.2%	-5.1%	-4.6%	-1.0%
Net income/sales	2.5%	2.7%	0.0%	-10.6%	-6.2%	-5.6%	-2.3%
Net income/net total assets	3.7%	3.7%	0.0%	-15.4%	-8.6%	-8.0%	-3.3%
Pretax net income/total assets	5.5%	4.1%	-0.1%	-17.8%	-11.3%	-9.7%	-3.9%
Gross cash flow/sales	5.0%	5.4%	2.8%	-7.3%	-3.1%	-2.5%	0.6%
Effective tax rate	25.3%	27.1%	-266.7%	24.2%	22.0%	-73.5%	-33.6%
DEPRECIATION							
Net income/depreciation	0.98	1.04	0.01	(3.22)	(2.00)	(1.74)	(0.64)
Capital expenditures/sales	3.5%	3.7%	4.0%	1.6%	0.9%	2.2%	2.7%
Depreciation/sales	2.54%	2.63%	2.82%	3.31%	3.09%	3.07%	2.88%
Depreciation/capital expend.	72%	71%	71%	207%	340%	206%	152%
DUPONT CALCULATIONS							
Net income / pretax income	0.7	0.9	(0.3)	0.9	0.8	0.5	0.6
Pretax income/ sales	0.0	0.0	(0.0)	(0.1)	(0.1)	(0.1)	(0.0)
Times sales / assets	1.5	1.3	1.5	1.4	1.4	1.4	1.4
Equals pretax return on assets	5.5%	4.1%	-0.1%	-17.8%	-11.3%	-9.7%	-3.9%
Times assets / equity	1.8	1.8	2.5	3.3	3.8	3.2	2.6
Equals pretax return on equity	9.9%	7.3%	-0.3%	-58.7%	-42.6%	-33.9%	-16.9%

Exhibit XI: Altman Z-Score Analysis

Zale Corporation Altman Z-Score Calculation					
Year	2006	2007	2008	2009	2010
Balance Sheet Items:					
Current Assets	1,049,244.00	1,172,318.00	966,863.00	817,217.00	771,314.00
Current Liabilities	400,025.00	374,458.00	353,198.00	356,332.00	388,308.00
Total Liabilities	658,215.00	711,373.00	848,789.00	857,179.00	852,361.00
Total Assets	1,462,568.00	1,613,946.00	1,415,260.00	1,230,972.00	1,160,381.00
Retained Earnings	808,859.00	868,111.00	847,185.00	657,682.00	564,010.00
Market Value of Equity	1,249,972.88	1,033,773.62	937,025.32	188,842.08	56,429.12
Income Statement Items:					
EBIT	99,593.00	88,835.00	9,081.00	(162,971.00)	(82,077.00)
Sales	2,153,955.00	2,152,785.00	2,138,041.00	1,779,744.00	1,616,305.00
T1 (Working Capital/Total Assets)	0.44	0.49	0.43	0.37	0.33
T2 (Retained Earning/Total Assets)	0.55	0.54	0.60	0.53	0.49
T3 (EBIT/Total Assets)	0.07	0.06	0.01	-0.13	-0.07
T4 (MV of Equity/Total Liabilities)	1.90	1.45	1.10	0.22	0.07
T5 (Sales/Total Assets)	1.47	1.33	1.51	1.45	1.39
Altman Z-Score = 1.2T1 + 1.4T2 + 3.3T3 + 0.6T4 + .999T5	4.14	3.73	3.55	2.34	2.27

Zones of Discrimination:

Z > 2.99 -"Safe" Zone

1.8 < Z < 2.99 -"Grey" Zone

Z < 1.80 -"Distress" Zone

Exhibit XII: Comparable Company Data

Zale Corp.
Comparable Company Data

				Public Comps			
Subject Company	**Zale Corp.**	**MEDIAN**	**MEAN**	**Blue Nile**	**Tiffany & Co.**	**Signet Jewelers**	**BIDZ.com**
Ticker	**ZLC**			**NILE**	**TIF**	**SIG**	**BIDZ**
Data date	1/31/2011			1/2/2011	1/31/2011	1/29/2011	12/31/2010
CURRENT MARKET DATA							
Price per share ($)	4.67	50.3	40.2	59.11	58.13	42.48	1.21
Shares outstanding (mm)	32.10	53.6	62.7	15.10	128.40	86.40	20.80
FINANCIAL DATA (mm$)							
Revenue	1,658.3	1,709.1	1,740.1	332.9	3,085.3	3,437.4	104.8
EBITDA	0.8	186.8	283.3	22.9	760.4	350.7	(0.9)
EBIT	(44.0)	141.2	223.3	21.3	612.5	261.0	(1.6)
Net income (E)	(111.3)	107.3	145.4	14.1	368.4	200.4	(1.4)
Gross cash flow (CF)	(66.5)	152.9	205.4	15.7	516.3	290.1	(0.7)
Interest expense	76.5	27.2	31.8	0.0	54.3	72.8	0.0
Depreciation and amortization	44.8	45.7	60.0	1.6	147.9	89.7	0.7
CAPITALIZATION (mm$)							
Total Assets	1205.0	1,620.8	1,756.2	151.8	3,735.7	3,089.8	47.6
Book Value of Equity (BV)	244.0	994.1	1,048.8	49.1	2,177.5	1,939.0	29.4
Market value of equity (MVE)	149.9	2,281.4	3,013.0	892.6	7,463.9	3,670.3	25.2
+ Total debt (book value)	385.5	15.9	180.0	0.8	688.2	31.0	0.0
+ Book value of Preferred stock	0.0	0.0	0.0	0.0	0.0	0.0	0.0
- Cash and Cash equivalent	31.4	207.7	276.3	113.3	681.6	302.1	8.1
Enterprise Value (EV)	504.0	2,089.6	2,916.7	780.1	7,470.5	3,399.2	17.1
MARKET MULTIPLE DATA							
EV/Revenue	0.3	1.7	1.5	2.3	2.4	1.0	0.2
EV/ EBITDA	630.0	9.8	8.7	34.1	9.8	9.7	(19.0)
EV/ EBIT	(11.5)	12.6	12.8	36.6	12.2	13.0	(10.7)
P / CF	(2.3)	13.6	12.0	56.9	14.5	12.7	(36.0)
P / E	(1.3)	19.3	21.0	63.3	20.3	18.3	(18.0)
P / BV	0.6	2.7	6.1	18.2	3.4	1.9	0.9

Exhibit XIII: Comparable Company Multiples

Zale Corp.
Comparable Company Multiples

Company Name	Ticker	Average TEV/Revenue			Average TEV/EBITDA			Average TEV/EBIT		
		2008	2009	2010	2008	2009	2010	2008	2009	2010
Zale Corp.	ZLC	0.39	0.24	0.25	8.86	7.50	-	31.17	-	-
Blue Nile	NILE	1.81	2.09	2.15	25.24	33.32	31.40	26.86	37.20	34.20
Tiffany & Co.	TIF	1.67	1.57	2.20	8.05	7.52	10.13	10.07	9.92	13.26
Signet Jewelers	SIG	3.85	0.60	0.80	32.74	8.38	10.13	43.83	15.85	17.33
BIDZ.com	BIDZ	1.01	0.42	0.28	8.84	4.13	23.55	9.07	4.34	10.86

Company Name	Ticker	Average P/CF			Average P/E			Average P/BV		
		2008	2009	2010	2008	2009	2010	2008	2009	2010
Zale Corp.	ZLC	5.87	3.33	1.14	73.95	-	-	0.94	0.29	0.27
Blue Nile	NILE	47.07	73.83	44.40	42.12	60.52	59.41	19.06	26.00	20.17
Tiffany & Co.	TIF	44.41	53.79	17.34	14.69	20.98	23.64	2.69	2.30	3.15
Signet Jewelers	SIG	28.39	9.67	8.41	7.79	4.11	14.77	0.98	0.95	1.50
BIDZ.com	BIDZ	25.39	8.42	12.96	12.84	7.91	29.99	6.70	2.18	1.13

Exhibit XIV: Going Concern Valuation

Zale Corp. Multiples Valuation Summary						
Performance Measure	**Multiples**			**Enterprise Value Range (Million Dollars)**		
	Low	**Average**	**High**	**Low**	**Average**	**High**
EV/EBITDA	-18.96	8.65	34.06	-891.33	406.74	1601.00
Estimated Enterprise Value (mm$)				-891.33	406.74	1601.00
Selected Enterprise Value (mm$)					406.74	

Note: EBITDA used here is five year average EBITDA i.e. $47.02 millions

Exhibit XV: Weighted Average Cost of Capital

Zale Corp.
Weighted Average Cost of Capital

Company Name	Ticker	BV of Debt(mm$)	BV of Preferred (mm$)	Total MVE (mm$)	Total MVIC (mm$)	Debt to Capital	Equity to Capital	Effective Tax Rate	Levered Beta [F6]	Unlevered Beta
Zale Corp.	ZLC	385.50	0.00	149.91	504.01	76.49%	29.74%	35.00%	3.21	1.20
Blue Nile	NILE	0.80	0.80	892.56	780.06	0.10%	114.42%	35.00%	1.55	1.55
Tiffany & Co.	TIF	688.20	0.00	7463.89	7470.49	9.21%	99.91%	35.00%	1.73	1.63
Signet Jewelers	SIG	31.00	0.00	3670.27	3399.17	0.91%	107.98%	35.00%	2.06	2.05
BIDZ.com	BIDZ	0.00	0.00	25.17	17.07	0.00%	147.46%	35.00%	1.43	1.43

Average						17.34%	99.90%	35.00%		1.57
Median						0.91%	107.98%	35.00%		1.55
Selected						17.34%	82.66%	35.00%		1.57

Unlevered Equity Beta	1.57	
Debt to Equity	0.21	
Selected Subject Tax Rate	0.35	
Relevered Equity Beta	1.79	
Risk Free Rate	4.27%	[F1]
Equity Risk Premium	6.00%	[F2]
Levered Equity Beta	1.79	
Cost of Capital	14.99%	
Unsystematic Risk Factors	4.55%	[F3]
Subject's Cost of Equity Capital	19.54%	
Credit Rating of Debt	-	[F4]
Subjects Estimated Pre-tax Cost of Debt Capital	6.04%	[F5]
Selected Subject Tax Rate	35.00%	
After Tax Cost of Debt Capital	3.93%	
Debt to Capital	17.34%	
Equity to Capital	82.66%	
Conclusion	16.83%	
Weighted Average Cost of Capital	**17.00%**	

NOTES:

[F1] 20-Year U.S Treasury as of the valuation date. Source: Federal Reserve Website.
http://www.federalreserve.gov/releases/H15/current/

[F2]Source: Ibbotson Year Book 2010

[F3] Includes the consideration of small stock premium and company specific risk premium
Source: Ibbotson Yearbook 2010

[F4] Morningstar Website

F5] Based on Baa rated bond. Source: Federal Reserve Website.
http://www.federalreserve.gov/releases/H15/current/

[F6] Source: Capital IQ

Exhibit XVI: Strategic Buyout Analysis

	Zale Corp.	JC Penny	Tiffany and Co.	Signet Jewelers
Net Income	-111.3	389.0	368.4	200.4
Market Shares outstanding	32.1	238.0	128.4	86.4
Pre-Deal EPS	-3.5	1.6	2.9	2.3
Pre-Deal P/E	-1.3	19.6	20.3	18.3
Market Share Price	4.7	32.1	58.1	42.5

Using Stock to buy 100% Zale's shares outstanding

	Premium	JC Penny	Stock exchange	New Issues	Total New Shares	Expected EPS	Expected Share Price	EPS Dilutive	EPS Difference
0%	$4.70		0.147	34.88	272.88	1.02	19.97	-37.74%	(0.62)
6.38%	$5.00		0.156	37.11	275.11	1.01	19.81	-38.24%	(0.63)
12.77%	$5.30		0.165	39.33	277.33	1.00	19.65	-38.74%	(0.63)
19.15%	$5.60		0.175	41.56	279.56	0.99	19.49	-39.22%	(0.64)
25.53%	$5.90		0.184	43.79	281.79	0.99	19.34	-39.70%	(0.65)
31.91%	$6.20		0.193	46.01	284.01	0.98	19.19	-40.18%	(0.66)
	Premium	Tiffany and Co.	Stock exchange	New Issues	Total New Shares	Expected EPS	Epected Share Price	EPS Dilutive	EPS Difference
0%	$4.70		0.081	10.38	138.78	1.85	37.53	-35.43%	(1.02)
6.38%	$5.00		0.086	11.04	139.44	1.84	37.35	-35.74%	(1.03)
12.77%	$5.30		0.091	11.71	140.11	1.84	37.18	-36.04%	(1.03)
19.15%	$5.60		0.096	12.37	140.77	1.83	37.00	-36.34%	(1.04)
25.53%	$5.90		0.101	13.03	141.43	1.82	36.83	-36.64%	(1.05)
31.91%	$6.20		0.107	13.69	142.09	1.81	36.66	-36.94%	(1.06)
	Premium	Signet Jewelers	Stock exchange	New Issues	Total New Shares	Expected EPS	Epected Share Price	EPS Dilutive	EPS Difference
0%	$4.70		0.111	9.56	95.96	0.93	17.01	-59.97%	(1.39)
6.38%	$5.00		0.118	10.17	96.57	0.92	16.90	-60.22%	(1.40)
12.77%	$5.30		0.125	10.78	97.18	0.92	16.79	-60.47%	(1.40)
19.15%	$5.60		0.132	11.39	97.79	0.91	16.69	-60.72%	(1.41)
25.53%	$5.90		0.139	12.00	98.40	0.91	16.58	-60.96%	(1.41)
31.91%	$6.20		0.146	12.61	99.01	0.90	16.48	-61.20%	(1.42)

Using Cash to buy 100% Zale's shares outstanding

	Premium	JC Penny	Paid Cash	New Net Income	Expect EPS	EPS Dilutive	EPS Difference
0.00%	$4.70		$150.87	$373.91	1.57	-3.88%	(0.06)
6.86%	$5.00		160.5	$372.95	1.57	-4.13%	(0.07)
13.46%	$5.30		170.13	$371.99	1.56	-4.37%	(0.07)
22.69%	$5.60		179.76	$371.02	1.56	-4.62%	(0.08)
31.93%	$5.90		189.39	$370.06	1.55	-4.87%	(0.08)
45.12%	$6.20		199.02	$369.10	1.55	-5.12%	(0.08)
	Premium	Tiffany and Co.	Paid Cash	New Net Income	Expect EPS	EPS Dilutive	EPS Difference
0.00%	$4.70		$150.87	$353.31	2.75	-4.10%	(0.12)
6.86%	$5.00		160.5	$352.35	2.74	-4.36%	(0.13)
13.46%	$5.30		170.13	$351.39	2.74	-4.62%	(0.13)
22.69%	$5.60		179.76	$350.42	2.73	-4.88%	(0.14)
31.93%	$5.90		189.39	$349.46	2.72	-5.14%	(0.15)
45.12%	$6.20		199.02	$348.50	2.71	-5.40%	(0.16)
	Premium	Signet Jewelers	Paid Cash	New Net Income	Expect EPS	EPS Dilutive	EPS Difference
0.00%	$4.70		150.87	185.3	2.14	-7.53%	(0.17)
6.86%	$5.00		160.5	184.4	2.13	-8.01%	(0.19)
13.46%	$5.30		170.13	183.4	2.12	-8.49%	(0.20)
22.69%	$5.60		179.76	182.4	2.11	-8.97%	(0.21)
31.93%	$5.90		189.39	181.5	2.10	-9.45%	(0.22)
45.12%	$6.20		199.02	180.5	2.09	-9.93%	(0.23)

Exhibit XVII: Transaction Multiple Valuation Approach

Zale Corp.
Transaction Multiple Valuation

			Enterprise Value Multiples			Price Multiples		
Announcement Date	**Target Name**	**Acquirer Name**	**Sales**	**EBITDA**	**EBIT**	**Revenue**	**Earning**	**Book Value**
2/13/2007	MOC Corp.	Goldman Sachs Group Inc.				0.63	22.20	7.30
11/1/2007	Brinkhaus Jewelers	Birks and Mayors Inc.	1.01	-	-			
11/8/2006	L. Congress Inc.	Finlay Fine Jewelry Corp.	0.70	-	-			
11/16/2007	Roger Ltd. Inc.	Gitanjali Gems Ltd.	0.218					
1/29/2004	Reeds Jewelers	-	0.34	10.43	38.95			
2/13/2008	JBR Inc.	Renaissance Jewelry Inc.	0.57					

(Source: Capital IQ)

	Sales	EBITDA	EBIT	Revenue	Earning	Book Value
High	1.01	10.43	38.95	0.63	22.20	7.30
Low	0.22	10.43	38.95	0.63	22.20	7.30
Median	0.57	10.43	38.95	0.63	22.20	7.30
Average	0.57	10.43	38.95	0.63	22.20	7.30
Selected Multiple	0.57	10.43	38.95	0.63	22.20	7.30
Enterprise Value (Million $)	939.92	8.344	-1713.8	1404.74	-2116.76	2135.30
Selected Enterprise Value (Million $)					939.92	

Exhibit XVIII: Valuation Assumption for Recommended Plan of Action

Zale Corp. DCF Assumptions	
Revenue Growth for 5 years	5%
Terminal Growth	3%
COGS as % of Sales (5 years)	50%
COGS as % of Sales (Terminal)	45%
SG&A as % of Sales (5 years)	35%
SG&A as % of Sales (Terminal)	30%
Depreciation and Amortization as % of Sales (5 years)	3%
Depreciation and Amortization as % of Sales (Terminal)	3%
Income tax Rate	35%
Capital Expenditure as % of Sales (5 years)	3%
Capital Expenditure as % of Sales (Terminal)	3%
Working Capital as % of Incremental Revenue	3%
Valuation date	01/31/11

Exhibit XIX: Valuation for the Recommended Plan of Action

Zale Corp.
Discounted Cash Flow

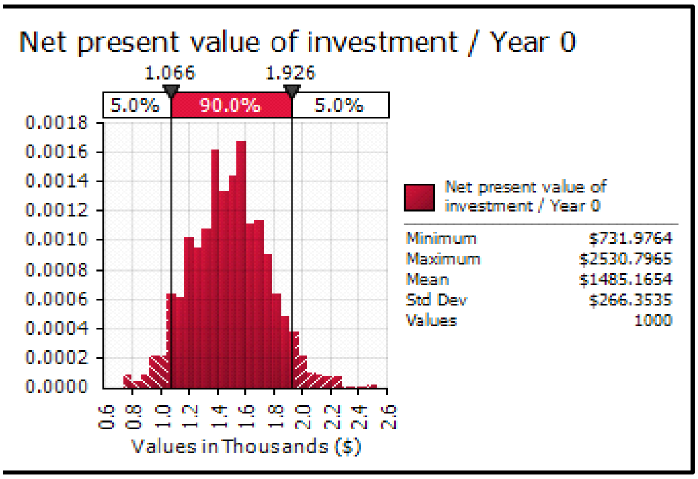
		Fiscal Year Ending						
		Actual	Projected					
		07/31/10	07/31/11	07/31/12	07/31/13	07/31/14	07/31/15	Terminal Period
	Revenue	$1,658	$ 1,658	$ 1,500	$ 1,575	$ 1,654	$ 1,736	$ 1,789
	Revenue Growth		*0.0%*		*5.0%*	*5.0%*	*5.0%*	*3.0%*
Less:	COGS		829.15	750.00	787.50	826.88	868.22	804.84
	COGS as % of Sales		*50.0%*	*50.0%*	*50.0%*	*50.0%*	*50.0%*	*45.0%*
Less:	SG&A		580.41	525.00	551.25	578.81	607.75	536.56
	SG&A as % of Sales		*35.0%*	*35.0%*	*35.0%*	*35.0%*	*35.0%*	*30.0%*
Equals:	EBITDA		248.75	225.00	236.25	248.06	260.47	447.13
Less:	Depreciation & Amortization		49.75	45.00	47.25	49.61	52.09	53.66
	D&A as % of Sales		*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*
Equals:	EBIT		199.00	180.00	189.00	198.45	208.37	393.48
	EBIT Margin		*12.0%*	*12.0%*	*12.0%*	*12.0%*	*12.0%*	*22.0%*
Less:	Income Tax at 35.0%		69.65	63.00	66.15	69.46	72.93	137.72
Equals:	**After-Tax Profit**		129.35	117.00	122.85	128.99	135.44	255.76
Calculation of Cash Flows								
	Net Profit After Tax		$ 129	$ 117	$ 123	$ 129	$ 135	$ 256
Plus:	Depreciation & Amortization		50	45	47	50	52	54
Less:	Capital Expenditures		50	45	47	50	52	54
	CapEx as % of Sales		3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
Less:	Incremental Working Capital at 3.0%		-	(5)	2	2	2	2
Equals:	**Net Cash Flow From Operations**		129	122	121	127	133	254
Capitalized Value of Terminal Period Earnings,								
	Terminal Period Multiplier @							6.8966
	Period Discounting		0.25	0.7479	1.7479	2.7479	3.7479	4.7479
Times:	WACC at 17.5%		0.9608	0.8864	0.7544	0.6420	0.5464	0.4650
Equals:	**Discounted Net Cash Flow from Operations**		$ 124	$ 108	$ 91	$ 81	$ 73	$ 815
	Indicated Fair value of Invested Capital				$ 1,292			
Equals:	**Indicated Value of Invested Capital Marketable, Controlling Interest Basis (Rounded)**				**$ 1,300**			

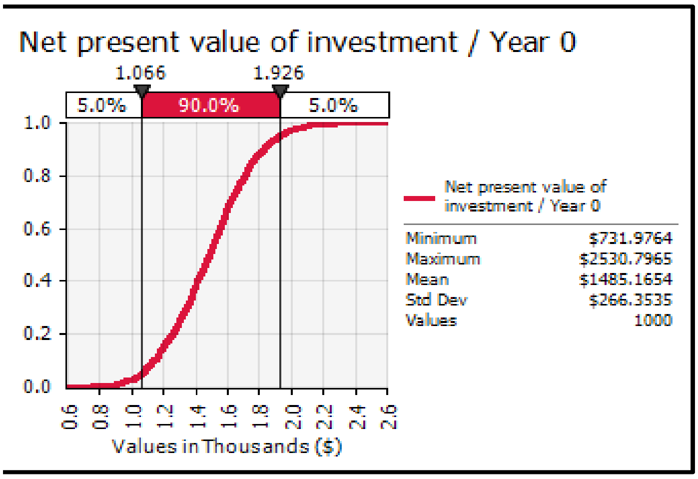
XX: Monte Carlo Simulation (Sensitivity) Result

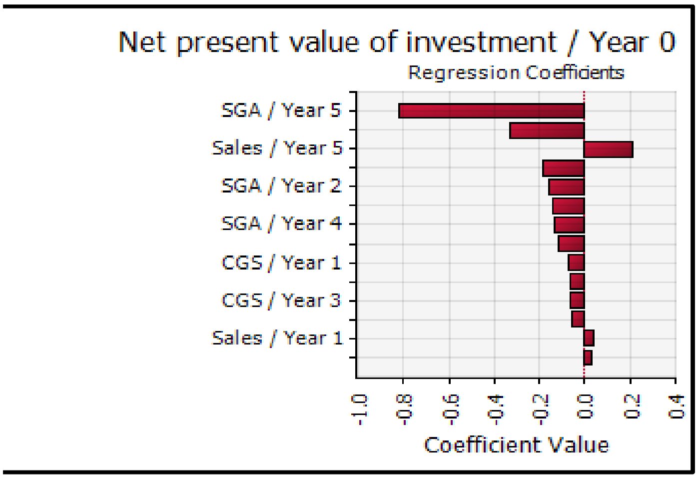
@RISK Output Report for Net present value of investment / Year 0

Performed By: Sudhanshu Jain

Date: Monday, June 27, 2011 4:12:17 AM







Simulation Summary Information	
Workbook Name	monte carlo.xlsx
Number of Simulations	1
Number of Iterations	1000
Number of Inputs	23
Number of Outputs	2
Sampling Type	Latin Hypercube
Simulation Start Time	6/27/11 4:11:55
Simulation Duration	00:00:04
Random # Generator	Mersenne Twister
Random Seed	1995707508

Summary Statistics for Net present value of inves

Statistics		Percentile	
Minimum	$732	**5%**	$1,066
Maximum	$2,531	**10%**	$1,138
Mean	$1,485	**15%**	$1,197
Std Dev	$266	**20%**	$1,255
Variance	70944.17044	**25%**	$1,295
Skewness	0.119268016	**30%**	$1,346
Kurtosis	3.054965921	**35%**	$1,381
Median	$1,488	**40%**	$1,409
Mode	$1,294	**45%**	$1,452
Left X	$1,066	**50%**	$1,488
Left P	5%	**55%**	$1,520
Right X	$1,926	**60%**	$1,553
Right P	95%	**65%**	$1,584
Diff X	$860	**70%**	$1,618
Diff P	90%	**75%**	$1,662
#Errors	0	**80%**	$1,710
Filter Min	Off	**85%**	$1,749
Filter Max	Off	**90%**	$1,827
#Filtered	0	**95%**	$1,926

Regression and Rank Information for Net present

Rank	Name	Regr	Corr
1	SGA / Year 5	-0.817	-0.814
2	CGS / Year 5	-0.333	-0.417
3	Sales / Year 5	0.208	0.154
4	SGA / Year 1	-0.180	-0.170
5	SGA / Year 2	-0.161	-0.154
6	SGA / Year 3	-0.145	-0.158
7	SGA / Year 4	-0.130	-0.119
8	Other operating	-0.115	-0.146
9	CGS / Year 1	-0.073	-0.061
10	CGS / Year 2	-0.065	-0.070
11	CGS / Year 3	-0.060	-0.056
12	CGS / Year 4	-0.053	-0.086
13	Sales / Year 1	0.037	0.046
14	Sales / Year 3	0.034	0.053

<u>Disclosures:</u>

The author of this report holds no financial interest in the securities of the subject company. The author of this report knows of no existence of any conflict of interest that might bias the content of this report. The author does not serve as an officer, director or advisory board member of the subject company.

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