

SECURITIES AND EXCHANGE COMMISSION

FORM 10-K

Annual report pursuant to section 13 and 15(d)

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FILER

GOTTSCHALKS INC

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SIC: **5311** Department stores

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(MARK ONE)

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended February 2, 2008

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM _____ TO _____

Commission file number 1-09100



[Gottschalks Inc.](#)

(Exact name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction of Incorporation or Organization)

77-0159791
(I.R.S. Employer Identification Number)

**7 River Park Place East
Fresno, California 93720**

(Address of Principal Executive Offices including Zip Code)

(559) 434-4800

(Registrant's Telephone Number, Including Area Code)

Title of Each Class

Name of each exchange on which registered

Common Stock, \$.01 Par Value

New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ☐ YES ☒ NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. ☐ YES ☒ NO

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file reports), and (2) has been subject to such filing requirements for the past 90 days. ☒ YES ☐ NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐ Smaller reporting company ☐
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). ☐ YES ☒ NO

The aggregate market value of the voting stock held by non-affiliates of the Registrant as of August 4, 2007: Common Stock, \$.01 par value: \$72,084,447.

On March 28, 2008 the Registrant had outstanding 13,282,958 shares of Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive proxy statement with respect to its Annual Stockholders' Meeting scheduled to be held on June 25, 2008, which will be filed pursuant to Regulation 14A, are incorporated by reference into Part III of this Form 10-K.

Gottschalks Inc.
2007 ANNUAL REPORT ON FORM 10-K
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PART I

Item 1. BUSINESS

GENERAL

Gottschalks Inc. (the "Company") is a regional department and specialty store chain based in Fresno, California. As of February 2, 2008, the Company operated 59 full-line "Gottschalks" department stores located in 6 Western states, with 39 stores located in California, 7 in Washington, 5 in Alaska, 4 in Oregon, 2 in Nevada and 2 in Idaho. The Company also operates 4 "Village East" and "Gottschalks" specialty stores, which carry a limited selection of merchandise. The Company is incorporated in the State of Delaware.

The Company's department stores typically offer a wide range of better to moderate brand-name and private-label merchandise, including men's, women's, juniors' and children's apparel; cosmetics, shoes, fine jewelry and accessories; and home furnishings including china, housewares, domestics, small electric appliances and, in selected locations, furniture and mattresses. The majority of the Company's department stores range from 40,000 to 150,000 gross square feet, and are generally anchor tenants of regional shopping malls or strategically located strip centers.

The Company has operated continuously for 103 years since it was founded by Emil Gottschalk in 1904. At the time the Company initially offered its stock to the public in 1986, the Company operated 10 department stores. Since then, a net total of 49 department stores have been added, 18 through acquisitions.

OPERATING STRATEGY

Merchandising Strategy

The Company's merchandising strategy is directed at offering and promoting moderate to better priced brand-name merchandise recognized by its customers for style and value. Brand-name merchandise is complemented with offerings of private-label. Brand-name apparel, shoes, cosmetics and accessories lines carried by the Company include Estee Lauder, Lancome, Clinique, Chanel, Dooney & Bourke, Nine West, Liz Claiborne, Calvin Klein, Nautica, Karen Kane, Ralph Lauren, Columbia, Fossil, Levi Strauss, Southpole, Izod, Quicksilver, Roxy, Woolrich and Carters. Brand-name merchandise carried for the home includes Simmons, Lenox, Krups, Kitchenaid and Samsonite.

The Company has also directed considerable effort towards improving the quality and increasing the penetration of private-label merchandise in its overall merchandise mix. The Company's most well recognized private-label is "Shaver Lake," currently carried in the women's, men's and home departments and the second largest volume private-label brand is "Taylor and Henry" carried in women's and men's departments. The "Shaver Lake" brand is exclusively offered in Gottschalks stores, and provides an opportunity to increase Gottschalks' brand acceptance and promote competitive differentiation. The Company plans to expand its private label offerings in men's and women's casual clothing in fiscal 2008.

The Company purchases merchandise from numerous suppliers. No single vendor accounted for more than 5% of the Company's net purchases in fiscal 2007. The Company's merchandising activities are conducted centrally from its corporate office in Fresno, California.

The Company's merchandise mix as a percentage of total sales (including leased department sales) is reflected in the following table:

	Fiscal Years									
	2007		2006		2005		2004		2003	
Women's Apparel	29.0	%	28.3	%	28.2	%	28.6	%	28.1	%
Cosmetics, Shoes & Accessories	27.6		26.9		25.8		25.3		24.3	
Home	16.7		17.9		18.7		18.9		20.1	
Men's Apparel	12.4		12.7		12.8		12.8		13.3	
Junior's and Children's Apparel	11.1		10.8		11.0		10.8		10.6	
Leased Departments	3.2		3.4		3.5		3.6		3.6	
Total Sales	100.0	%	100.0	%	100.0	%	100.0	%	100.0	%

Store Locations

The Company's stores are located primarily in diverse, growing, non-major metropolitan or suburban areas in the western United States where management believes there is strong demand and fewer competitors offering similar better to moderate brand-name merchandise and a high level of customer service. The Company has historically avoided expansion into the center of major metropolitan areas that are served by the Company's larger competitors and has instead sought to open new stores in nearby suburban or secondary market areas.

The Company's department stores are generally anchor tenants of regional shopping malls or strategically located strip centers. Other anchor tenants in the malls or strip centers generally complement the Company's goods with a mixture of competing and non-competing merchandise and serve to increase customer foot traffic. With new enclosed regional shopping mall construction on the decline, the Company's strategy is to open stores in smaller and more diverse locations that may not be served by its larger competitors, who adopt a more standardized approach to expansion, and in "Lifestyle Centers" that feature a variety of retailers, upscale restaurants and, typically, multi-screen movie theatre.

The Company opened 1 new store in fiscal 2007. On November 7, 2007 the Company opened a 58,387 square foot store in Elk Grove, California. Future new store openings will focus on sites that will serve to "fill in" geographical areas between existing stores. Management believes this strategy will improve the Company's ability to leverage advertising, transportation and other operating costs more effectively. In addition to opening individual store locations, the Company may also pursue additional selective strategic acquisitions as stores may become available as a result of competitor consolidations.

The Company has continued to invest in the renovation and refixturing of its existing store locations in an attempt to maintain and improve market share in those market areas. Store renovation projects can range from updating décor and improving in-store lighting, fixturing, wall merchandising and signage, to more extensive remodeling and expansion projects. The Company sometimes receives reimbursement from mall owners and vendors for certain of its new store construction costs and costs associated with the renovation and refixturing of existing store locations. Such contributions have enhanced the Company's ability to enter into attractive market areas that are consistent with the Company's long-term expansion plans.

The Company closed one underperforming store in Wasilla, Alaska in April 2007 and closed one store in Tacoma, Washington in September 2007. However, the Company continues to operate stores in these respective market areas.

The following tables present selected data related to the Company's stores for the fiscal years indicated:

	Fiscal Years				
	2007	2006	2005	2004	2003
Stores open at year-end:					
Department stores	59 (1)	60 (2)	63 (3)	63	63 (4)
Specialty stores (5)	4	5	6	6	11
Total	63	65	69	69	74
Gross store square footage(6) (in thousands):					
Department stores	5,298	5,446	5,435	5,406	5,406
Specialty stores	11	27	30	30	42
Total	5,309	5,473	5,465	5,436	5,448

(1) The Company closed 2 stores, 1 of which was underperforming, and opened 1 new store in fiscal 2007.

(2) The Company closed 4 stores, 2 of which were underperforming, and opened 1 new store in fiscal 2006.

(3) The Company closed 3 stores, 2 of which were underperforming, and opened 3 new stores in fiscal 2005.

(4) The Company closed 6 stores in fiscal 2003, all of which were acquired in the Lamonts acquisition in July 2000.

(5) The Company has continued to close certain free-standing Village East stores as their leases expire and incorporate those stores as separate departments into nearby Gottschalks department stores.

(6) Reflects total store square footage, including office space, storage, service and other support space, and selling space.

Following is a summary of the Company's department store locations by store size:

	# of stores open
Larger than 200,000 gross square feet	2
150,000 - 199,999 gross square feet	8
100,000 - 149,999 gross square feet	9
40,000 - 99,999 gross square feet	32
20,000 - 39,999 gross square feet	8
Total	59

Marketing Strategy

The Company's marketing strategy is based on a multi-media approach, using newspapers, television, radio, direct mail, internet, and catalogs to highlight seasonal promotions, selected brand-name merchandise and frequent storewide sales events. Advertising efforts are focused on communicating the branded merchandise offered by the Company, and the high levels of quality, value and customer service available in the Company's stores. In its efforts to improve the effectiveness of its advertising expenditures, the Company uses data captured through its private-label credit card to develop segmented advertising and promotional events targeted at specific customers who have established purchasing patterns for certain brands, departments or store locations.

The Company's sales promotion strategy also focuses on special events such as fashion shows, bridal shows and wardrobing seminars in its stores and in the communities in which they are located to convey fashion trends to its customers. The Company receives reimbursement for certain of its promotional activities from some of its vendors.

The Company offers selected merchandise, a Bridal & Gift Registry service, and other general corporate information on the World Wide Web at

<http://www.gottschalks.com>, and sells merchandise through its mail order department. The information on the Company's website is not part of this annual report.

Customer Service

Management believes one way the Company can differentiate itself from its competitors is to provide a consistently high level of customer service. The Company has a "Four Star" customer service program, designed to continually emphasize and reward high standards of customer service in the Company's stores. Sales associates are encouraged to keep notebooks of customers' names, clothing sizes, birthdays, and major purchases, to telephone customers about promotional sales and to send thank-you notes and other greetings to their customers during their normal working hours. Product seminars and other training programs are frequently conducted in the Company's stores and its corporate headquarters to ensure that sales associates will be able to provide useful product information to customers. The Company also offers opportunities for management training and leadership classes for those associates identified for promotion within the Company. Various financial incentives are offered to the Company's sales associates for reaching sales performance goals.

In addition to providing a high level of personal sales assistance, management believes that well-stocked stores, a liberal return and exchange policy, frequent sales promotions and a conveniently located and attractive shopping environment enhance its customers' shopping experience and increase customer loyalty. Management also believes that maintaining appropriate staffing levels in its stores, particularly at peak selling periods, is essential for providing a high level of customer service.

Management focus for fiscal 2008 continues to include an increased effort to attract and service the 30 to 55 year old age group, as well as the Hispanic customer that continues to be a growing segment of the customer base in many current markets.

Distribution of Merchandise

The Company operates a 420,000 square foot distribution center located in Madera, California. The facility, constructed in 1989, is located near the Company's corporate headquarters in Fresno, California. The facility serves all of the Company's store locations, with timely distributions of merchandise to all stores, including its stores located in states outside California.

The Company has continued to improve its logistic systems, focusing on the adoption of new technology and operational best practices, with the goals of receiving, processing and distributing merchandise to stores at a faster rate and at a lower cost per unit. The Company's logistic systems enable the Company to "cross dock" the majority of its merchandise, thereby processing merchandise through the distribution center in several minutes as compared to the several days timeframe required in the past. The Company has formal guidelines for vendors with respect to shipping, receiving and invoicing for merchandise. Vendors that do not comply with the guidelines are charged specified fees depending upon the degree of non-compliance. Such fees are intended to offset higher costs associated with the processing of and payment for such merchandise.

Private-Label Credit Card

Sale of Receivables

On January 31, 2003, the Company sold its proprietary credit card accounts and accounts receivable to HSBC Bank Nevada, N.A. ("HSBC") and entered into a Credit Card Program Agreement (the "CCA"). The CCA set forth the terms and conditions under which HSBC issued Gottschalks private-label credit cards and paid the Company for sales made on the cards. Under the terms of the CCA, the Company was required to perform certain duties, including the duties to receive in-store customer payments on behalf of HSBC and remit such payments to HSBC. The CCA had an initial term of five (5) years, expiring January 31, 2008, and was cancelable by either party under certain circumstances.

On February 4, 2007, the Company and HSBC entered into a new Credit Card Program Agreement which has a term of six (6) years and is cancelable by either party under certain circumstances. This amended agreement provides the Company will be paid a percentage of Net Cardholder Charges and a percentage of Other Revenue (as such terms are defined in the CCA). In addition, a percentage of net credit card sales (as defined in the CCA) will be used by HSBC and the Company to fund marketing programs to support the private-label credit card.

Management believes the private-label credit card enhances the Company's ability to generate and retain market share as well as increase sales. Private-label credit card sales as a percentage of total sales were 43.2%, 41.7% and 40.0% in fiscal 2007, 2006 and 2005, respectively. The increase in the private-label credit card penetration is due to marketing programs established by the Company and HSBC and sales associate incentive programs rewarding the opening of new accounts. Efforts are underway between the Company and HSBC to increase the private-label credit card penetration further in 2008.

The Company has a variety of credit-related programs which management believes improve customer service and encourage credit-sales. Such programs include:

- An "Instant Credit" program, through which successful credit applicants receive a discount ranging from 10% to 50% (depending on the results of the Instant Credit scratch-off card) on their first purchase and 10% on additional purchases made the remainder of the day the account is opened;
- A "Plus Program" (formerly "55+"), charge account program, which offers additional merchandise and service discounts to customers 55 years of age and older;
- Various credit-card related promotional events throughout the year; and
- The "Gottschalks Treasure Rewards" program, which has two components. The first component is a program which offers one point for every one dollar in net annual spending using the Company's private label credit card. At the end of each calendar year qualifying customers are sent a merchandise certificate for up to 5% of the total points accumulated, up to a maximum of 10,000 points. Using a "points-based" system allows the Company to offer "double point" opportunities for opening new accounts and other promotions periodically throughout each year. The second component offers a 3-tier membership element where top customers spending \$2,000 or more annually receive a Diamond card with the highest level of benefits, including Free Designer Gift Wrap, Priority Customer Service Line and No Coupons Needed Ever. The middle tier customers spending \$1,000-\$1,999 annually receive a Sapphire card with middle level benefits and customers spending less than \$1,000 per year receive a Treasure card with card benefits, which all three customer tiers receive.

Competition and Seasonality

See Part I, Item 1A, "Risk Factors - We Face Significant Competition From Other Retailers" and "Risk Factors - Our Business Is Susceptible To Economic Conditions And Other Factors That Affect Our Markets, Some Of Which Are Beyond Our Control".

Employees

As of February 2, 2008, the Company had approximately 4,800 employees, including 2,300 employees working part-time (less than 35 hours per week on a regular basis). As of February 3, 2007, the Company had approximately 5,800 employees (including 1,700 working part-time). The decrease in the number of employees from the prior year is primarily due to staffing reductions in view of an uncertain general economy. The increase in part-time employees from the prior year is due to reductions in hours for the same reason. Also, the variances are partially attributable to one fewer store. The Company hires additional temporary employees and increases the hours of part-time employees during seasonal peak selling periods. Management considers its employee relations to be good.

ACQUISITIONS

The Company has completed two significant acquisitions in its operating history, including the acquisition of 8 stores from The Harris Company ("Harris") in fiscal 1998, and an additional 34 store locations from Lamont's Apparel, Inc. ("Lamonts") in fiscal 2000. The Company continues to operate 12 of the original 34 stores acquired from Lamonts, some of which have continued to perform below expectations. In the event the Company is unable to improve the performance of such underperforming stores, the Company may consider the sale, sublease or closure of these stores in the future.

Special Strategic Committee and Value Improvement Program

In the fourth quarter of fiscal 2006, the Company announced that its Board of Directors formed a special strategic committee comprised of the Board's six independent directors to review business opportunities and alternatives. The Company also announced that the Board of Directors had retained UBS Investment Bank to assist its special strategic committee in exploring various alternatives available to the Company. The Company continued to use the financial advisory services of Financo, Inc.

The Committee conducted a review of various strategic alternatives to maximize shareholder value, including a revised business plan, operating partnerships, joint ventures, strategic alliances, share repurchase, recapitalization, and the sale or merger of the Company. On August 30, 2007, the Company announced that the Committee had concluded its evaluation of strategic alternatives and determined it was in the best interest of Gottschalks' shareholders to aggressively focus on a revised business plan. With this decision, the strategic committee was dissolved.

In connection with the conclusion of the strategic alternatives review process, the Company announced its new Value Improvement Program (V.I.P.). Goals of the V.I.P. include increasing top line performance, improving operating margin, and maximizing shareholder value. The V.I.P., developed with the assistance of Financo Inc., includes opening new stores, new creative and targeted marketing programs, significant enhancements to information technology systems and a plan to better utilize the Company's owned real estate. In line with the V.I.P., the Company plans to construct a 55,000 square foot store in Bend, Oregon, which will open to business in late fall 2008. The Company also plans to accelerate closings of poor performing stores, including the closing of two stores at their lease expirations in the second quarter of fiscal 2008. Under the V.I.P., the Board of Directors also implemented a share repurchase program that is funded through the Company's cash and credit facility. The Company began repurchasing shares in the third quarter of fiscal 2007.

The V.I.P. will be carried out into fiscal 2008 and the future, and will be funded through the refinancing of the Company's credit facility with General Electric Capital Corporation. The Company anticipates seeing near-term benefits to its top and bottom lines in the second half of fiscal 2008 with results more fully realized in fiscal 2009.

Available Information

Gottschalks' internet address is

<http://www.gottschalks.com>. We have made available, free of charge through our website, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Forms 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after such documents are electronically filed with, or furnished to, the Securities and Exchange Commission.

Executive Officers of the Registrant

Information relating to the Company's executive officers is included in Part III, Item 10 of this report and is incorporated herein by reference.

FORWARD-LOOKING STATEMENTS

This Form 10-K contains certain "forward-looking statements" regarding activities, developments and conditions that the Company anticipates may occur or exist in the future relating to things such as:

- the Company's ability to meet debt obligations and adhere to the restrictions and covenants imposed under its various debt agreements;
- the timely receipt of merchandise and the Company's ability to obtain adequate trade credit from its key factors and vendors;
- the Company's ability to either improve the operating results and cash flows of underperforming stores, or to sell, sublease or close those stores that continue to be underperforming;
- the impact of higher interest rates;
- the impact of higher operating costs, including workers' compensation, property and casualty insurance, unemployment compensation, health care and energy costs;
- future capital expenditures;
- the Company's competitive strategy, competitive pricing and other competitive pressures;
- the effect of the adoption of new accounting standards by the Company;

- the realization of the Company's deferred tax assets;
- the Company's assumptions and expectations underlying its critical accounting policies (see Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations");
- the overall level of consumer spending and demand for the products offered;
- general economic conditions;
- the impact of sales promotions and customer service programs on consumer spending;
- lease extensions and suitable alternative store locations; and
- the future cost and utilization of consumer credit programs under the CCA.

Such forward-looking statements can be identified by words such as: "believes," "anticipates," "expects," "intends," "seeks," "may," "will," "projects," "forecasts," "plans" and "estimates". The Company bases its forward-looking statements on its current views and assumptions. As a result, those statements are subject to risks and uncertainties that could cause actual results to differ materially from those predicted. Some of the factors that could cause the Company's results to differ from those predicted include the risk factors discussed under Item 1A, "Risk Factors", as well as other risks and uncertainties discussed in other documents filed by the Company with the Securities and Exchange Commission. In addition, the Company typically earns a disproportionate share of its operating income in the fourth quarter because of seasonal buying patterns, which are difficult to forecast with certainty. While the Company believes that its assumptions are reasonable, it cautions that it is impossible to predict the impact of such factors which could cause actual results to differ materially from predicted results.

Item 1A. RISK FACTORS

Our business is subject to certain risks, and those risks should be considered while evaluating our business and financial results. Any of the risks discussed below could materially and adversely affect our operating results and financial condition, as well as the projections and beliefs about our future performance. Accordingly, our results could differ materially from those projected in our forward-looking statements. In addition, the preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts and timing of revenue and expenses, the reported amounts and classification of assets and liabilities and the disclosure of contingent assets and liabilities. Actual results could differ materially from our estimates and assumptions. (See Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies".)

Our Sources of Liquidity Are Limited

Our working capital requirements are currently met through a combination of cash generated by operations, borrowings under our senior revolving credit facility, short-term trade and factor credit, and by proceeds from external financings and sale transactions. In the event these sources of liquidity are not adequate, we may be required to pursue one or more alternative sources, which could include the sale of stores or the issuance of additional equity or equity-linked securities. If the estimates or assumptions relative to any one of these sources of liquidity are not realized, our business, financial condition and results of operations may be materially adversely affected.

Although we have significantly improved our leverage position, the ability to obtain additional or alternative sources of financing in the future for working capital, capital expenditures, new store openings, acquisitions and other general corporate purposes may be limited. This limited financial flexibility may result in increased vulnerability to general adverse economic and industry conditions, a more limited ability to react to changes in the business environment and the industry in which we compete, and being at a competitive disadvantage with competitors that have less debt and greater access to capital resources.

Our existing debt agreements impose operating and financial restrictions that limit our ability to make dividend payments and grant liens, among other matters.

We are Highly Dependent on Key Relationships with Vendors and Factors

The success of our business is highly dependent upon the adequacy of trade credit offered by key vendors and factors to the Company's vendors, the vendors' ability and willingness to sell its products at favorable prices and terms, and the willingness of vendors to ship merchandise on a timely basis. Restrictions to the amount of trade credit granted by key factors and vendors can adversely impact the volume of merchandise we are able to purchase. Any significant reduction in the volume of merchandise we are able to purchase, or a prolonged disruption in the

timing of when merchandise is received, would have a material adverse affect on our business, liquidity position, and results of operations.

We Face Significant Competition From Other Retailers

The retail business is highly competitive, and if we fail to compete effectively, we could lose market share. Our primary competitors include national, regional and local chain department and specialty stores, general merchandise stores, discount and off-price retailers and outlet malls. Increased use and acceptance of the internet and other home shopping formats also creates increased competition. Some of these competitors offer similar or better-branded merchandise and have greater financial resources to purchase larger quantities of merchandise at lower prices. Our ability to counteract these competitive pressures depends on our ability to:

- offer merchandise which reflects the different regional and local needs of our customers;
- differentiate and market ourselves as a home-town, locally-oriented store (as opposed to our more nationally focused competitors); and
- continue to offer adequate quantities of better to moderately priced branded and private label merchandise at comparable profit margins.

Our Business Is Susceptible To Economic Conditions and Other Factors That Affect Our Markets, Some of Which Are Beyond Our Control

General Economic and Market Conditions

. Our stores are located primarily in non-major metropolitan, suburban and agricultural areas in the western United States. A substantial portion of the stores are located in California and Washington. Our success depends upon consumer spending, which may be materially and adversely affected by any of the following events or conditions:

- the downturn in the national economy;
- the downturn in the local California and Pacific Northwest economies where the stores are located;
- the decline in consumer confidence;
- an increase in interest rates;
- inflation or deflation;
- consumer credit availability;
- consumer debt levels;
- higher energy costs in California and the Pacific Northwest;
- higher healthcare and workers' compensation insurance costs;
- higher property and casualty insurance costs;
- tax rates and policy; and
- unemployment trends.

Seasonality and Weather

. Seasonal influences affect our sales and profits. We experience our highest levels of sales and profits during the Christmas selling months of November and December, and, to a lesser extent, during the Easter holiday and Back-to-School seasons. We have increased working capital needs prior to the Christmas season to carry significantly higher inventory levels and generally increase our selling staff levels to meet anticipated demands. Any substantial decrease in sales during our traditional peak selling periods could materially adversely impact our business, financial condition and results of operations.

We also depend on normal weather patterns across our markets. Historically, unusual weather patterns have significantly impacted our business.

Consumer Trends.

Our success partially depends on our ability to anticipate and respond to changing consumer preferences and fashion trends in a timely manner. However, it is difficult to predict what merchandise consumers will demand, particularly merchandise that is trend driven. Failure to accurately predict constantly changing consumer tastes, preferences and spending patterns could adversely affect short and long-term results.

War and Acts of Terrorism.

The involvement of the United States in war or other conflicts have had an adverse impact on us by, among other things, adversely affecting retail sales as a result of reduced consumer spending, and by causing substantial increases

in fuel prices thereby increasing the costs of doing business. Any war, political conflict or significant act of terrorism on U.S. soil or elsewhere could have an adverse effect on us and could impede the flow of imports or domestic products to the Company.

We May Face Higher Operating Costs

Approximately 78% of our debt at February 2, 2008 has underlying variable interest rates, which may result in higher interest expense in the event interest rates are raised. (See Item 7A "Qualitative and Quantitative Disclosures about Market Risk")

A substantial portion of our stores are located in California and Washington. As a result, we are particularly sensitive to negative occurrences in those states. Our inability to adequately address such problems could have a material adverse affect on our financial position and results of operations. In addition, we are facing higher unemployment compensation, health insurance and property and casualty insurance costs in the market areas in which we operate. There can be no assurance that we will be able to fully offset the negative impact of such higher costs.

We Depend On Attracting and Retaining Quality Employees

We depend on attracting and retaining a large number of qualified employees to maintain and increase sales and to execute our customer service programs. Many of our employees are in entry level or part-time positions with historically high levels of turnover. Our ability to meet our employment needs is dependent on a number of factors, including the following factors which affect our ability to hire or retain qualified employees:

- unemployment levels;
- minimum wage legislation;
- rising health care costs; and
- changing demographics in the local economies where stores are located.

Item 1B. UNRESOLVED STAFF COMMENTS

None

Item 2. PROPERTIES

Corporate Office and Distribution Center

The Company's corporate headquarters is located in an office building in Fresno, California. The building was constructed in 1991 and is owned by a limited partnership in which the Company holds a 36% interest as the sole limited partner. The Company leases 89,000 square feet of the 176,000 square foot building under a twenty-year lease expiring in 2011. The lease contains two consecutive ten-year renewal options. The Company has financed its interest in the partnership at a fixed interest rate of 7.5% due in February 2010. The Company believes that its current office space is adequate to meet its office space requirements for the foreseeable future.

The Company's distribution center, constructed in 1989, is a 420,000 square foot distribution facility located in Madera, California, which is in close proximity to the Company's corporate headquarters. The facility was originally designed to provide for the future growth of the Company and its processing capacity and physical size is readily expandable. The Company leases the distribution facility from an unrelated party under a 20-year lease expiring in the year 2009, with six consecutive five-year renewal options.

Store Leases and Locations

The Company owns six of its 59 department stores and leases the remaining 53 department stores and all of its 4 specialty stores. The Company's department store leases expire in various years through 2025, and have renewal options for one or more periods ranging from five to 10 years. While there is no assurance that the Company will be able to negotiate further extensions of any particular lease, management believes that satisfactory extensions or suitable alternative store locations will be available.

Certain of the department and specialty store leases provide for the payment of additional contingent rentals based on a percentage of sales, require the payment of property taxes, insurance and maintenance costs, and, in certain cases, also provide for rent abatements and scheduled rent increases during the lease terms. The Company leases three of its department stores from ECI, an affiliate of the Company, and one department store from River Park

Properties VII, also a related party (see Note 15 to the Financial Statements). Additional information pertaining to the Company's store leases is included in Note 8 to the Financial Statements.

The following table contains additional information about the Company's stores open as of the end of fiscal 2007:

State	# of Stores	Gross Square Footage(1)
Department Stores:		
California	39	4,076,961
Washington	7	366,401
Alaska	5	293,796
Oregon	4	281,798
Nevada	2	208,411
Idaho	2	71,150
Total	59	5,298,517

Specialty Stores:

California	3	7,729
Nevada	1	3,211
Total	4	10,940

(1) Reflects total store square footage, including office space, storage, service and other support space, and selling space.

Item 3. LEGAL PROCEEDINGS

None. The Company is party to legal proceedings and claims which have arisen during the ordinary course of business. In the opinion of management, the ultimate outcome of such litigation and claims is not expected to have a material adverse effect on the Company's financial position or results of its operations.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITIES HOLDERS

No matters were submitted to a vote of security holders of the Company during the fourth quarter of the fiscal year covered in this report.

PART II

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Company's common stock is listed for trading on the New York Stock Exchange ("NYSE"). The following table sets forth the high and low sales prices per share of common stock as reported on the NYSE Composite Tape under the symbol "GOT" during the periods indicated:

Fiscal Quarters	2007		2006	
	High	Low	High	Low
1st Quarter	\$ 14.80	\$ 10.48	\$ 9.80	\$ 8.60
2nd Quarter	\$ 13.90	\$ 7.01	\$ 9.35	\$ 6.29

3rd Quarter	\$ 7.05	\$ 4.16	\$ 9.33	\$ 7.85
4th Quarter	\$ 4.16	\$ 2.04	\$ 11.89	\$ 9.25

On March 28, 2008, the Company had 661 stockholders of record, some of which were brokerage firms or other nominees holding shares for multiple stockholders. The closing price of the Company's common stock as reported by the NYSE on March 28, 2008 was \$2.87 per share.

The Company has not paid a cash dividend since its initial public offering in 1986. The Board of Directors has no present intention to pay cash dividends in the foreseeable future, and will determine whether to declare cash dividends in the future depending on the Company's earnings, financial condition and capital requirements. In addition, the Company's senior revolving credit agreement and certain of its other debt agreements prohibit the Company from paying dividends without prior written consent from those lenders. (See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations.")

The following table presents information with respect to the Company's purchases of common stock during the fourth quarter of 2007:

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased Under Publicly Announced Program	Maximum Number of Shares Remaining Under the Program (1)
	(thousands)		(thousands)	(thousands)
Month #1 (November 4 - December 1)	97	\$ 3.91	97	1,811
Month #2 (December 2 - January 5)	148	3.55	148	1,663
Month #3 (January 6 - February 2)	81	2.26	81	1,582

(1) On September 11, 2007, the Company's Board of Directors approved the repurchase of up to two million shares of its common stock, which the Company announced to the public on September 17, 2007. The authorization for this share repurchase expires on September 11, 2008.

The following table provides information as of February 2, 2008 about the Company's common stock that may be issued upon the exercise of options granted to employees or members of the Board of Directors under all of the Company's existing equity compensation plans.

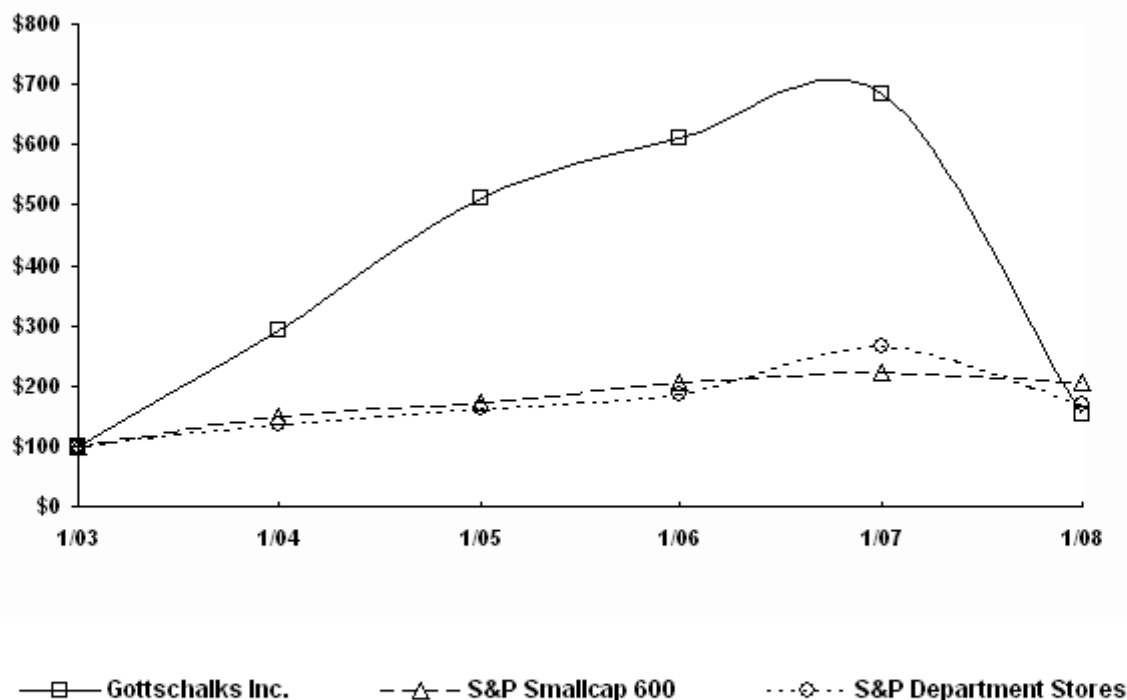
Plan Category	(a) Number of securities to be issued upon exercise of outstanding options	(b) Weighted- average exercise price of outstanding options	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	1,026,250	\$6.52	1,432,500
Equity compensation plans not approved by security holders	N/A	N/A	N/A
Total	1,026,250	\$6.52	1,432,500

Performance Graph

The following graph compares the cumulative total return on the Company's common stock with the cumulative total return of the S & P Smallcap 600 Index and the S & P Department Stores Index for the five-year period commencing January 31, 2003. The stock price performance shown on the graph below is not necessarily indicative of future price performance.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

Among Gottschalks Inc., The S&P Smallcap 600 Index
And The S&P Department Stores Index



* \$100 invested on 1/31/03 in stock or index-including reinvestment of dividends.
Fiscal year ending January 31.

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www.researchdatagroup.com/S&P.htm

Item 6. SELECTED FINANCIAL DATA

The Company reports on a 52/53 week fiscal year ending on the Saturday nearest to January 31. The fiscal years ended February 2, 2008, February 3, 2007, January 28, 2006, January 29, 2005 and January 31, 2004 are referred to herein as fiscal 2007, 2006, 2005, 2004 and 2003, respectively. All fiscal years noted include 52 weeks with the exception of fiscal 2006 which includes 53 weeks.

The selected unaudited financial data below should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and the Financial Statements of the Company and related notes included elsewhere herein.

	Fiscal Years				
	2007	2006	2005	2004	2003
	(In thousands of dollars, except share data)				
RESULTS OF OPERATIONS:					
Net sales	\$ 628,550	\$ 680,966	\$ 665,460	\$ 650,256	\$ 649,087
Net credit revenues	4,868	3,087	3,084	3,106	3,729
Net leased department revenues (1)	3,000	3,428	3,506	3,515	3,525
Total revenues	<u>636,418</u>	<u>687,481</u>	<u>672,050</u>	<u>656,877</u>	<u>656,341</u>
Costs and expenses:					
Cost of sales	420,887	446,619	434,387	424,775	427,221
Selling, general and administrative expenses (2)	209,552	212,355	204,945	201,073	198,069
Depreciation and amortization	15,173	15,276	13,242	12,830	14,026
Gain on sale of aircraft (3)	-	(946)	-	-	-
Loss on disposal of assets	418	-	-	-	-
VEBA litigation (4)	-	60	1,811	-	-
New store opening costs (5)	485	376	688	-	-
Total costs and expenses	<u>646,515</u>	<u>673,740</u>	<u>655,073</u>	<u>638,678</u>	<u>639,316</u>
Operating income (loss)	<u>(10,097)</u>	<u>13,741</u>	<u>16,977</u>	<u>18,199</u>	<u>17,025</u>
Other (income) expense:					
Interest expense	10,807	10,058	9,242	9,509	13,296
Miscellaneous income	(489)	(1,389)	(1,515)	(1,565)	(2,262)
	<u>10,318</u>	<u>8,669</u>	<u>7,727</u>	<u>7,944</u>	<u>11,034</u>
Income (loss) from continuing operations before income taxes	(20,415)	5,072	9,250	10,255	5,991
Income tax expense (benefit)	<u>(7,982)</u>	<u>1,631</u>	<u>3,107</u>	<u>3,676</u>	<u>2,097</u>
Income (loss) from continuing operations	(12,433)	3,441	6,143	6,579	3,894
Discontinued operations:					
Loss from operation of closed stores	-	(1,102)	(1,609)	(1,935)	(3,060)
Gain (loss) on store closures	-	(98)	180	(31)	(789)
Income tax benefit	-	408	486	668	1,309

Loss on discontinued operations	-	(792)	(943)	(1,298)	(2,540)
Net income (loss)	\$ (12,433)	\$ 2,649	\$ 5,200	\$ 5,281	\$ 1,354

		Fiscal Years				
		2007	2006	2005	2004	2003
		(In thousands of dollars, except share data)				
Net income (loss) per common share						
Basic:						
Income (loss) from continuing operations		\$ (0.91)	\$ 0.26	\$ 0.46	\$ 0.51	\$ 0.30
Loss on discontinued operations		-	(0.06)	(0.07)	(0.10)	(0.20)
Net income (loss) per common share		(0.91)	0.20	0.39	0.41	0.10
Diluted:						
Income (loss) from continuing operations		(0.91)	0.25	0.45	0.49	0.30
Loss on discontinued operations		-	(0.06)	(0.07)	(0.09)	(0.20)
Net income (loss) per common share		\$ (0.91)	\$ 0.19	\$ 0.38	\$ 0.40	\$ 0.10
Weighted-average number of common shares outstanding:						
Basic		13,601	13,428	13,245	12,922	12,830
Diluted		13,601	13,758	13,797	13,352	12,919

	Fiscal Years				
	2007	2006	2005	2004	2003
	(In thousands of dollars)				
SELECTED BALANCE SHEET DATA:					
Receivables, net	\$7,049	\$ 8,198	\$ 7,284	\$ 6,920	\$ 9,145
Merchandise inventories (6)	149,310	168,702	159,986	152,753	156,552
Property and equipment, net	137,931	134,696	133,545	126,509	127,561
Total assets	331,994	350,066	335,022	321,253	326,137
Working capital	105,291	117,301	96,930	94,439	58,444
Long-term obligations, less current portion (7)	105,948	97,354	76,906	71,403	41,302
Subordinated note payable to affiliate	18,180	19,180	20,180	21,180	22,180
Stockholders' equity	111,945	124,592	119,904	112,356	106,368

	Fiscal Years									
	2007		2006		2005		2004		2003	
	(In thousands of dollars, except percentages, ratios and per square foot data)									
OTHER SELECTED DATA:										
Sales growth:										
Total store sales (8)(10)	(6.6)	%	(0.3)%		2.3%		(0.7)%		(3.5)%	
Comparable store sales (9)(10)	(5.1)	%	0.6%		1.2%		0.2%		(0.7)%	
Comparable stores data (9)(11):										
Sales per selling square foot	\$155		\$ 155		\$ 149		\$ 149		\$ 149	
Selling square footage	4,053		4,400		4,499		4,451		4,451	

Capital expenditures	\$20,662	\$ 21,100	\$ 22,227	\$ 13,745	\$ 4,363
Current ratio	2.42:1	2.38:1	2.06:1	2.10:1	1.46:1

- (1) Net leased department revenues consist of sales totaling \$21.0 million, \$23.9 million, \$24.4 million, \$24.3 million, and \$24.5 million, in fiscal 2007, 2006, 2005, 2004, and 2003, respectively, less cost of sales.
- (2) The Company implemented SFAS No. 123R in fiscal 2006, as such, \$417,000 and \$810,000 of share-based compensation expense is included in selling, general and administrative expenses in fiscal 2007 and 2006, respectively.
- (3) Represents the sale of a corporate aircraft for \$1,037,000 (net of selling costs) that resulted in a gain of \$946,000.
- (4) Represents reserves and increases in the estimated settlement of a class action complaint alleging violation of California law regarding payment of accrued vacation upon termination of employment. See Note 16 to the Financial Statements.
- (5) Represents new store pre-opening costs such as payroll and fringe benefits for store associates, store rents, temporary storage, utilities, travel, grand opening advertising, credit solicitation and other costs incurred prior to the opening of a store.
- (6) The decrease in inventory from 2006 to 2007 is primarily related to decreased sales and a planned reduction in inventory levels. The increase in inventory from 2005 to 2006 is primarily related to one additional week's receipts owing to the 53rd week ending February 3, 2007. The increase in inventory from fiscal 2004 to 2005 is related to new store openings net of store closures and the timing on certain spring receipt flows. The decrease in inventory from fiscal 2003 to 2004 is primarily due to the reduction of inventory levels to more closely reflect selling trends, and to store closures.
- (7) Excludes Subordinated Note Payable to Affiliate, which is separately stated.
- (8) Total store sales include sales from stores reported in discontinued operations.
- (9) Comparable stores are defined as stores which have been open for at least 12 full months and which remain open as of the applicable reporting date. However, reflecting the effects of the opening of the River Park store on other Fresno area stores, such stores are excluded from the comparable store base in fiscal 2006 and fiscal 2005.
- (10) For comparative purposes, sales growth percentages exclude the effect of 53rd week sales in fiscal 2006.
- (11) Includes leased department sales in order to facilitate an understanding of the Company's sales relative to its selling square footage.

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Following is management's discussion and analysis of significant factors that have affected the Company's financial position and its results of operations for the periods presented in the accompanying financial statements.

Fiscal 2007 and 2005 results include 52 weeks. Fiscal 2006 results include 53 weeks.

Overview

The Company is a regional department and specialty store chain completing its 103rd year of operation. As of February 2, 2008, the Company operated 59 full-line "Gottschalks" department stores located in six Western states, with the majority of those stores located in California. The Company also operates 4 "Village East" specialty stores which carry a limited selection of merchandise.

The Company's department stores typically offer a wide range of better to moderate brand-name and private-label merchandise, including men's, women's, juniors' and children's apparel; cosmetics, shoes, fine jewelry and accessories; and home furnishings including china, housewares, domestics, small electric appliances and, in selected locations, furniture and mattresses.

In the fourth quarter of fiscal 2006, the Company announced that its Board of Directors formed a special strategic committee to identify and evaluate various strategic alternatives to maximize shareholder value, including, a revised business plan, operating partnerships, joint ventures, strategic alliances, share repurchases, a recapitalization, and the sale or merger of the Company. The special strategic committee was comprised of the Board's six independent directors. The Company also announced that the Board of Directors retained UBS Investment Bank to assist its special strategic committee in exploring various alternatives available to the Company. The Company continued to use the financial advisory services of Financo, Inc.

On August 30, 2007, the Company announced that the Committee had concluded its evaluation of strategic alternatives and determined it was in the best interest of Gottschalks' shareholders to aggressively focus on a revised business plan. With this decision, the strategic committee was dissolved.

In connection with the conclusion of the strategic alternatives review process, the Company announced its new Value Improvement Program (V.I.P.). Goals of the V.I.P. include increasing top line performance, improving operating margin, and maximizing shareholder value. The V.I.P., developed with the assistance of Financo Inc., includes opening new stores, new creative and targeted marketing programs, significant enhancements to information technology systems and a plan to better utilize the Company's owned real estate. In line with the V.I.P., the Company also plans to accelerate closings of poor performing stores, including the closing of two stores at their lease expirations in the second quarter of fiscal 2008. The Company plans to construct a 55,000 square foot store in Bend, Oregon which will open for business in late fall, fiscal 2008.

The V.I.P. will be carried out into fiscal 2008 and the future, and will be funded through the Company's refinanced credit facility with General Electric Capital Corporation. The Company anticipates seeing near-term benefits to its top and bottom lines in the second half of fiscal 2008 with results more fully realized in fiscal 2009.

The Company's Board of Directors announced its share repurchase program in September 2007, which allows for the repurchase of up to 2 million shares over 12 months subject to certain pricing conditions. During fiscal 2007, the Company repurchased 417,800 shares for \$1,487,000, at an average cost of \$3.56 per share including commissions. Such shares are reflected as treasury stock in the stockholder's equity section of the condensed balance sheet. Purchases may be made at management's discretion in the open market and in privately negotiated transactions as market and business conditions warrant. There were no share repurchases in fiscal 2006 and 2005.

The retail industry is highly competitive. The Company experiences competitive pressures from department stores, specialty stores, mass merchandisers and other retail channels, and from general consumer spending levels, including the impact of employment levels and other economic conditions. Eighty percent of the Company's revenues are concentrated in California markets that were heavily impacted by the current mortgage credit crisis. These markets continue to endure abnormally high mortgage foreclosure rates, which has had a significant adverse effect on consumer spending.

During fiscal 2007 the Company closed 2 stores, 1 of which was underperforming, and opened 1 store in Elk Grove, California. The store gross margin dollars lost by these closures were somewhat offset by incremental gross margin dollars generated from a successful new store opening.

The Company signed a second Amended and Restated Credit Agreement with General Electric Capital Corporation to refinance its existing credit facility on September 26, 2007. The new credit facility consists of a \$200 million senior secured revolving credit facility (including a \$20 million letter of credit sub-facility). Borrowings under the revolving credit facility are limited to the sum of (a) a specified percentage of eligible credit card receivables, (b) a specified percentage of the net recovery value of eligible inventory, as determined by periodic valuation performed by an independent appraiser, and (c) 65% of the fair market value of the Company's real estate. Such borrowings are further limited by a requirement to maintain a minimum of \$15 million of excess availability at all times, and other reserves. Substantially all of the Company's assets, including its merchandise inventories, are pledged under the credit facility.

The new credit facility contains restrictive financial and operating covenants, including the requirement to maintain a fixed charge coverage ratio of 1:1 (as defined in the agreement) if the Company's excess borrowing availability is below \$20 million. As of February 2, 2008, management believes the Company was in compliance with all restrictive financial covenants applicable to the credit facility. The agreement has a five year term expiring September 26, 2012.

From January 26, 2006 to September 26, 2007, the credit facility, as amended on January 26, 2006, consisted of a revolving credit facility of up to \$172 million (including a \$20 million letter of credit sub-facility) and a fully funded term loan of \$9 million. Borrowings under the revolving credit facility, as amended, were limited to the sum of (a) a specified percentage of eligible credit card receivables, (b) the lesser of specified percentages of (i) the cost of eligible inventory and (ii) the net recovery value of the inventory, as determined by periodic valuation performed by an independent appraiser, and (c) the lesser of (i) up to 60% of the fair market value of the designated properties and (ii) \$21.6 million. Such borrowings were further limited by a requirement to maintain a minimum of \$5 million of excess availability at all times, and other reserves that were in effect. Substantially all of the Company's assets, including its merchandise inventories, were pledged under the credit facility.

As a result of its stable performance and continued improvement in debt structure, the Company plans to increase its efforts to refresh the presentation of its core store base as well as continue to explore opportunities for controlled new store growth.

Critical Accounting Policies

The Company's significant accounting policies are described in Note 1 to the Financial Statements included in Part IV, Item 15 of this Form 10-K. The Company's discussion and analysis of its financial condition and results of operations are based upon the Company's financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to its revenue recognition policy, the carrying value of its merchandise inventories, the adequacy of its workers' compensation insurance reserves, and the valuation of its long-lived assets, including goodwill, and its deferred tax assets. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. In the past, actual results have not been materially different from the Company's estimates.

Some of the Company's significant accounting policies involve a higher degree of judgment or complexity than its other accounting policies. The policies described below have been identified as critical to the Company's business operations and the understanding of its results of operations. The impact and associated risks related to these policies on the Company's business operations are discussed throughout Management's Discussion and Analysis of Financial Condition and Results of Operations.

Revenue Recognition Policy

Net retail sales are recognized at the point-of-sale, net of estimated sales returns and allowances and exclusive of sales tax. Net retail sales also include all amounts billed to a customer in a sale transaction for shipping and handling, including customer delivery charges. Revenues on special order sales are recognized when the merchandise is delivered to the customer. The Company's policy with respect to gift cards is to record revenue as the gift cards are redeemed for merchandise. Prior to their redemption, the gift cards are recorded as a liability. The liability remains recorded until the earlier of redemption, escheatment, or 60 months. It is the Company's historical experience that the likelihood of redemption after 60 months is remote.

The Company has a private-label credit card agreement with HSBC for which the Company received an upfront program fee in addition to a percentage of net credit card sales. The percentage of net credit card sales associated with the Company's private-label credit card program are recognized as actual net private-label credit card sales occur. Net credit card sales represent gross credit card sales less returns and chargebacks. The prepaid program fee is amortized on a straight-line basis over the life of the Credit Card Program Agreement with HSBC.

The Company records an allowance for estimated sales returns in the period that the related sale occurs. These estimates are based primarily on historical sales returns. If the historical data used to calculate these estimates does not properly reflect future returns, adjustments to the allowance for estimated sales returns may be necessary.

Inventory Valuation

Merchandise inventory, which consists of merchandise held for resale, is valued at the lower of LIFO (last-in, first-out) cost or market using the retail inventory method ("RIM") of accounting. Inherent in the RIM calculation are various judgments and estimates including, among others, merchandise markon, markups, markdowns and shrinkage, which significantly impact the ending inventory valuation at cost, as well as resulting gross margins. The Company applies various methodologies to ensure that the application of the RIM is consistent for all periods presented. Such methodologies include the development of consistent cost-to-retail ratios and the grouping of homogenous classes of merchandise. Estimated inventory shrinkage between physical inventory dates is based on historical experience. Should actual inventory shrinkage results differ from the Company's estimate, year-end revisions to inventory shrinkage expense recognized on an interim basis may be required.

Estimating the market value of the Company's merchandise inventory requires assumptions about future demand and market conditions. Such estimates are based on actual and forecasted sales trends, current inventory levels and aging information by merchandise categories. The Company records markdowns to value merchandise inventories at net realizable value. If forecasted sales are not achieved, or if other indicators of impairment are present, additional markdowns may be needed in future periods to clear excess or slow-moving merchandise, which may result in lower gross margins.

Impairment of Long-Lived Assets

The Company's long-lived assets consist primarily of property and equipment, goodwill, leasehold interests and other long-term assets. Long-lived assets, including intangible assets other than goodwill, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. The Company performs an evaluation of whether an impairment charge should be recorded whenever a store experiences unfavorable operating performance. A store's assets are evaluated for impairment by comparing its estimated undiscounted cash flows over its estimated remaining lease term to its carrying value. If the cash flows are not sufficient to recover the carrying value, a loss equal to the difference between the carrying value and the estimated fair value of the asset is recognized. Estimates of future cash flows are based on a variety of factors, including historical experience in similar locations, changes in merchandising, promotional or operating strategy that may affect the profitability of a particular location, knowledge of the market area and in some cases, expected sale proceeds or sublease income,

and independent appraisals. Goodwill and intangible assets having indefinite lives are not being amortized to earnings, but instead are subject to periodic testing for impairment. Goodwill and other intangible assets of a reporting unit are tested for impairment on an annual basis and more frequently if certain indicators are encountered. The Company has three geographical regions that it considers reporting units and operating segments, as the Company manages operations based on these regions. Various uncertainties, including but not limited to changes in consumer preferences, increased competition or a general deterioration in economic conditions could adversely impact the expected cash flows to be generated by an asset or group of assets. If actual performance or fair value estimates for store locations are less favorable than management's projections, future asset

impairment charges may be necessary. Similar procedures are used when analyzing other corporate assets for impairment. The Company did not impair any assets in fiscal 2007 as all the impairment tests were performed and no impairment was indicated.

Income Taxes

The carrying value of the Company's net deferred tax assets assumes that the Company will be able to generate sufficient future taxable income to realize the value of these assets. In determining the appropriate valuation allowance, management considers all available evidence for the deferred tax assets, including tax credits, net operating loss and capital loss carryforwards that would likely expire prior to their utilization. The Company has established valuation allowances that relate primarily to certain state tax credit carryforwards the realization of which is uncertain. Although these credits do not expire, the utilization is extremely limited and is available only to the extent the Company generates sufficient taxable income apportionable to the respective location. The Company has historically generated the credits at a substantially more rapid rate than it has been able to utilize them. The resulting utilization period is, therefore, unusually long. Although the Company has had, prior to the fiscal 2007 loss, recent profitability, there can be no certainty that the Company will continue to generate sufficient taxable income apportioned to specific locations for an indefinite period of time to fully utilize the state tax credit carryforwards, especially given the cyclical nature of the Company's business. Further, there is no certainty that the Company will operate in these specific locations for an extended period. To the extent that the Company no longer operates within these locations, the tax credits cannot be utilized. The Company considers it appropriate to release this valuation allowance after at least three years of continued operating profits, limited to the projected utilization of the state tax credits based on assumed operation in the specific locations of not more than ten years. In addition, the Company has generated certain capital losses for which there is currently no carryback opportunity available. Based on the Company's current operating strategy it appears more likely than not that there will be no opportunity available during the remaining carryforward period to generate offsetting capital gains. Accordingly the Company considers it appropriate to establish a valuation allowance against such carryforwards. Management believes it is more likely than not that the Company will generate sufficient future taxable income in the appropriate carryforward periods to realize the benefit of its remaining net deferred tax assets. However, if the available evidence were to change in the future, an adjustment to the valuation allowance may be required, resulting in additional income tax expense or benefit.

In June 2006, the Financial Accounting Standards Board (FASB) issued Financial Interpretation No. (FIN) 48, "Accounting for Uncertainty in Income Taxes," which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." The interpretation prescribes a "more likely than not" recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 applies to all tax positions related to income taxes subject to SFAS 109 and creates a single model to address accounting for uncertainty in tax positions. FIN 48 requires that tax positions accounted for under SFAS 109 be evaluated for recognition based solely on technical merits and the resulting tax benefits be measured using a cumulative probability assessment and the Company's plan for settlement. The Company adopted FIN 48 effective February 4, 2007. The adoption of FIN 48 did not have a material effect on the Company's consolidated financial position or results of operations (see Note 10 to the Financial Statements).

Results of Operations

The following table sets forth for the periods indicated certain items from the Company's Statements of Operations, expressed as a percent of net sales. The two stores closed in fiscal 2007 were recorded as continuing operation. The Company has reclassified the results of operations of certain stores closed in fiscal 2006 to discontinued operations in fiscal 2006 and 2005.

	Fiscal Years					
	2007		2006		2005	
Net sales	100.0	%	100.0	%	100.0	%
Net credit revenues	0.8		0.4		0.5	
Net leased department revenues	0.5		0.5		0.5	
Total revenues	101.3		100.9		101.0	
Costs and expenses:						
Cost of sales	67.0		65.6		65.2	
Selling, general and administrative expenses	33.3		31.2		30.8	
Depreciation and amortization	2.4		2.2		2.0	
Gain on sale of aircraft	-		(0.1)		-	
Loss on disposal of assets	0.1		-		-	
VEBA litigation	-		-		0.3	
New store opening costs	0.1		-		0.1	
Total costs and expenses	102.9		98.9		98.4	
Operating income (loss)	(1.6)		2.0		2.6	
Other (income) expense:						
Interest expense	1.7		1.5		1.4	
Miscellaneous income	(0.1)		(0.2)		(0.2)	
	1.6		1.3		1.2	
Income (loss) before income taxes	(3.2)		0.7		1.4	
Income tax expense (benefit)	(1.2)		0.2		0.5	
Income (loss) from continuing operations	(2.0)		0.5		0.9	
Discontinued operations:						
Loss from operation of closed stores	-		(0.2)		(0.2)	
Income tax benefit	-		0.1		0.1	
Loss on discontinued operations	-		(0.1)		(0.1)	
Net income (loss)	(2.0)	%	0.4	%	0.8	%

Fiscal 2007 Compared to Fiscal 2006

Net Sales

Net sales from continuing operations decreased by approximately \$52.4 million, or 7.7%, to \$628.6 million in the 52-week fiscal 2007 as compared to \$681.0 million in the 53-week fiscal 2006. Total sales for fiscal 2007 excluding the additional week in fiscal 2006 decreased 6.6%. Same store sales for the comparable 52-week fiscal year period decreased 5.1% from fiscal 2006. The fiscal year 2007 sales decrease is primarily attributable to the weak economic environment driven by the mortgage banking crisis and the high price of gasoline, with the greatest impact in the Company's California locations which produce 80% of sales volume. In the Company's Pacific Northwest locations, store-for-store sales increased over fiscal 2006.

The best performing merchandise categories of fiscal 2007, as compared to the comparable 52 week fiscal 2006, were women's accessories such as handbags, cold weather, and fashion accessories; plus size apparel grew by 5% driven by the addition of GW (Gottschalks Women's) Attitude for the junior plus size customer; and sales in dresses grew by 5% in both misses' and juniors'. Sales in home departments continued to erode with comparable 52 week sales in furniture down 13% and textiles down 18%, to the respective fiscal 2006 sales.

The Company operated 59 department stores and 4 specialty stores as of the end of fiscal 2007 as compared to 60 department stores and 5 specialty stores as of the end of fiscal 2006. As described more fully in Note 9 to the accompanying financial statements, during fiscal 2007 the Company closed 2 stores, 1 of which was underperforming, and opened 1 new store in Elk Grove, California.

Net Credit Revenues

As described more fully in Note 2 to the accompanying financial statements, in January 2003, pursuant to the terms of a Purchase and Sale Agreement, the Company sold its private label credit card accounts and accounts receivable to HSBC. In connection with the sale, the Company entered into a Credit Card Program Agreement (the "CCA"). The CCA provides that the Company will be paid a percentage of Net Cardholder Charges and a percentage of Other Revenue (each as defined in the CCA). All amounts received under the CCA, including amortization of prepaid program revenue, are reflected in net credit revenues. The CCA had an initial term of five (5) years expiring January 31, 2008 and was cancelable earlier by either party under certain circumstances. On February 4, 2007, the Company and HSBC entered into a new Credit Card Program Agreement which has a term of six (6) years and is cancelable by either party under certain circumstances. The new Credit Card Program Agreement provides the Company will be paid a percentage of Net Credit Card Sales and a percentage of Other Revenue (each as defined in the CCA). In addition, the Company is guaranteed a percentage of net credit card sales (as defined in the CCA) will be used by HSBC to fund marketing programs.

Net credit revenues related to the program in fiscal 2007 was \$4.9 million in fiscal 2007 as compared to \$3.1 million in fiscal 2006, an increase of 57.7%. As a percent of net sales, net credit revenues were 0.8% of net sales in fiscal 2007 and 0.4% of net sales in fiscal 2006. This increase was attributable to enhanced revenue sharing under the new agreement and a higher credit sales to total sales penetration rate compared to fiscal 2006, but was somewhat offset by lower credit sales year over year.

Net Leased Department Revenues

Net rental income generated by the Company's various leased departments was \$3.0 million in fiscal 2007, compared to \$3.4 million in fiscal 2006. Leased department sales are presented net of the related costs for financial reporting purposes. Sales generated in the Company's leased departments, consisting primarily of fine jewelry departments and beauty salons, totaled \$21.0 million in fiscal 2007 as compared to \$23.9 million in fiscal 2006.

Cost of Sales

Cost of sales from continuing operations, which includes costs associated with the buying, handling and distribution of merchandise, decreased by approximately \$25.7 million to \$420.9 million in fiscal 2007 as compared to \$446.6 million in fiscal 2006, a decrease of 5.8%. The decrease is primarily due to the decrease in sales volume. The Company's gross margin percentage in fiscal 2007 was 33.0% compared to 34.4% in fiscal 2006. The 1.4% decrease was primarily due to increased promotional discounts in all merchandise areas in a very soft and competitive retail environment.

Selling, General and Administrative Expenses

Selling, general and administrative expenses from continuing operations decreased approximately \$2.8 million, or 1.3%, to \$209.6 million in fiscal 2007 as compared to \$212.4 million in fiscal 2006. As a percentage of net sales, selling, general and administrative expenses increased 2.1% to 33.3% in fiscal 2007 as compared to 31.2% in fiscal 2006. The rate increase is primarily attributable to increases in selling payroll costs which were somewhat offset by reduced workers' compensation expense and a non-recurring \$1.1 million increase in the vacation pay reserve in fiscal year 2006 to comply with the VEBA litigation settlement. In addition, higher outside services and increased professional fees, primarily due to legal and other fees of \$0.6 million incurred during the strategic review process, contributed to the increase in selling, general and administrative expenses in 2007. Net advertising spending rate has also increased relative to net sales owing to efforts to attract more customers in a slow economy.

Depreciation and Amortization

Depreciation and amortization expense, which includes the net amortization (accretion) of intangible assets other than goodwill, decreased by approximately \$0.1 million or 0.7%, to \$15.2 million in fiscal 2007 as compared to \$15.3 million in fiscal 2006. As a percent of net sales, depreciation and amortization expense was 2.4% in fiscal 2007 and 2.2% in fiscal 2006. The dollar decrease is a result of merchandising software becoming fully depreciated in June 2007, offset by the depreciation of capital additions related to the Company's new stores and major remodel projects at certain existing stores. The Company also made substantial upgrades to its planning and allocations and point of sale systems, which were placed in service at various dates during the end of fiscal 2006 and beginning of 2007, respectively.

Gain on Sale of Aircraft

The Company sold a corporate aircraft on June 30, 2006 for \$1,037,000 (net of selling costs) that resulted in a gain of \$946,000. The gain is reflected in operating income as the aircraft was reported as an operating asset.

VEBA Litigation

The Company accrued an additional \$60,000 in fiscal 2006 related to a reserve for settlement of a class action complaint alleging violation of California law regarding payment of accrued vacation upon termination of employment. The Company had accrued \$1.8 million in the fourth quarter of fiscal 2005 for estimated legal fees and costs. The Company believed settlement of this matter was in its best interests and entered into a memorandum of understanding for class settlement, which was given final court approval in September 2006. All payments were made in December 2006 and final accounting for actual expenses took place in fiscal 2007.

New Store Opening Costs

New store opening costs, which are expensed as incurred, typically include costs such as payroll and fringe benefits for store associates, store rents, temporary storage, utilities, travel, grand opening advertising, credit solicitation and other costs incurred prior to the opening of a store. The Company recognized new store opening costs totaling \$0.5 million in connection with the opening of a new store in Elk Grove, California, which opened November 7, 2007. In fiscal 2006, the Company recognized \$0.4 million in new store opening costs related to the opening of a new store in Eugene, Oregon.

Interest Expense

Interest expense, which includes the amortization of deferred financing costs, increased by approximately \$0.7 million to \$10.8 million in fiscal 2007 compared to \$10.1 million in fiscal 2006, an increase of 7.4%. As a percent of net sales, interest expense increased to 1.7% in fiscal 2007 as compared to 1.5% in fiscal 2006. These increases are primarily due to a \$0.6 million unfavorable fair value adjustment on the Company's \$25 million notional amount interest swap compared to a \$0.2 million favorable fair value adjustment in fiscal year 2006. Increased borrowings under

the Company's GE revolving line of credit were offset by declining interest rates. The weighted average interest rate applicable to the revolving credit facility was 6.9% in fiscal 2007 (5.9% at February 2, 2008) as compared to 7.1% in fiscal 2006.

Miscellaneous Income

Miscellaneous income, which consists of income from the Company's investment in a partnership and other miscellaneous non- operating income, decreased by approximately \$0.9 million to \$0.5 million in fiscal 2007 as compared to \$1.4 million in fiscal 2006. Miscellaneous income does not include any material offsetting expense items. As a percent of net sales, miscellaneous income was 0.1% in fiscal 2007 and 0.2% in fiscal 2006.

Income Taxes

The Company's effective tax rate for continuing operations is 39.1% in fiscal 2007 as compared to 32.2% in fiscal 2006. Including the tax benefit reported in discontinued operations in fiscal 2006, the Company's effective tax rate is 39.1% in fiscal 2007 as compared to 31.6% in fiscal 2006. In fiscal 2007, the Company increased its valuation allowance associated with certain tax credit carryforwards that the Company determined were not more likely than not to be realized, attributable primarily to a reduction in the Company's assessment of future income. In fiscal 2006, the Company benefited from the release of a portion of its valuation allowance associated with certain tax credit carryforwards that the Company determined were more likely than not to be realized. In addition, the increase in effective tax rate is also due to the impact of tax credits. The tax benefit on the fiscal year 2007 loss is increased by tax credits and the tax expense on fiscal year 2006 income is reduced by tax credits.

Income (Loss) From Continuing Operations

As a result of the foregoing, the Company reported a loss from continuing operations of \$12.4 million, or \$0.91 per diluted share, in fiscal 2007 as compared to income of \$3.4 million, or \$0.25 per diluted share, in fiscal 2006.

Discontinued Operations

The Company closed one underperforming store in the Seattle metro-area during the third quarter of fiscal 2006 and one underperforming store in the Seattle/Tacoma market during the first quarter of fiscal 2006. These closures are reported as discontinued operations due to the Company's exit from the respective market areas. The loss from operations of discontinued stores includes only revenues generated from, and expenses directly associated with, the operations of such stores and consists of the following:

(In thousands)	Fiscal Years	
	2007	2006
Net sales from closed stores	\$ -	\$ 2,921
Cost of sales	-	2,421
Selling, general and administrative expenses	-	1,533
Depreciation and amortization	-	69
Total costs and expenses	-	4,023
Loss from operations of closed stores	\$ -	\$ (1,102)

The loss on store closures of \$98,000 includes a net gain on the sale of the building associated with the store closed during the first quarter of fiscal 2006 of approximately \$147,000, offset by a loss on disposal of assets of \$139,000 related to the store closed during the third quarter of fiscal 2006, and store closure costs of approximately \$106,000 related to both stores closed in fiscal 2006, primarily consisting of severance and other incremental costs associated with the store closings.

In addition, the Company closed one store in Wasilla, Alaska during the first quarter of fiscal 2007, one store in Tacoma, Washington during the third quarter of fiscal 2007, and closed one store in Danville, California and one

store in Moscow, Idaho during the third quarter and fourth quarter of fiscal 2006. These closures are not reported as discontinued operations due to the shift of revenues to other stores in the respective markets.

Certain of the Company's stores may perform below expectations from time to time. In the event the Company is unable to improve the operating performance of such underperforming stores, the Company may consider the sale, sublease or closure of those stores in the future.

Net Income (Loss)

As a result of the foregoing, the Company reported net loss of \$12.4 million in fiscal 2007 as compared to net income of \$2.6 million in fiscal 2006. On a per diluted share basis net loss was \$0.91 per share in fiscal 2007 compared to net income of \$0.19 per share in fiscal 2006.

Fiscal 2006 Compared to Fiscal 2005

Net Sales

Net sales from continuing operations increased by approximately \$15.5 million, or 2.3%, to \$681.0 million in fiscal 2006 as compared to \$665.5 million in fiscal 2005. The fiscal 2006 sales increase is primarily attributable to the opening of the Company's 120,876 square foot store in Eugene, Oregon. Promotional activity helped drive the sales increases through a continuing soft general economic environment and continuing competitive pressures in much of the Company's market areas. The Company also achieved a 0.6% comparable store sales increase in fiscal 2006 driven predominantly by sales increases in the Company's more fashion forward merchandise categories. Comparable store sales includes sales for stores open for the full period in both years. However, reflecting the effects of the opening of the River Park store in fiscal 2005 on other Fresno area stores, such stores have been excluded from the Company's comparable store base. The Company's 2006 fiscal year consisted of 53 weeks as compared to its 2005 fiscal year, which consisted of 52 weeks. Total sales for fiscal 2006 excluding the additional week decreased 0.3% to \$675.2 million. Same store sales for the comparable 52-week fiscal year period increased 0.6% from fiscal 2005.

The Company operated 60 department stores and 5 specialty stores as of the end of fiscal 2006 as compared to 63 department stores and 6 specialty stores as of the end of fiscal 2005. As described more fully in Note 9 to the accompanying financial statements, during fiscal 2006 the Company closed 4 stores, 2 of which were underperforming, and opened 1 new store in Eugene, Oregon.

Net Credit Revenues

As described more fully in Note 2 to the accompanying financial statements, in January 2003, pursuant to the terms of a Purchase and Sale Agreement, the Company sold its private label credit card accounts and accounts receivable to HSBC. In connection with the sale, the Company entered into a Credit Card Program Agreement (the "CCA"). The CCA provides that the Company will be paid a percentage of Net Cardholder Charges and a percentage of Other Revenue (each as defined in the CCA). All amounts received under the CCA, including amortization of prepaid program revenue, are reflected in net credit revenues. The CCA had an initial term of five (5) years expiring January 31, 2008 and was cancelable earlier by either party under certain circumstances. On February 4, 2007, the Company and HSBC entered into a new Credit Card Program Agreement which has a term of six (6) years and is cancelable by either party under certain circumstances. The new Credit Card Program Agreement provides the Company will be paid a percentage of Net Credit Card Sales and a percentage of Other Revenue (each as defined in the CCA). In addition, the Company is guaranteed a percentage of net credit card sales (as defined in the CCA) will be used by HSBC to fund marketing programs.

Net credit revenues related to the program in fiscal 2006 were essentially even with fiscal 2005 at \$3.1 million. As a percent of net sales, net credit revenues were 0.4% of net sales in fiscal 2006 and 0.5% of net sales in fiscal 2005.

Net Leased Department Revenues

Net rental income generated by the Company's various leased departments was \$3.4 million in fiscal 2006, compared to \$3.5 million in fiscal 2005. Leased department sales are presented net of the related costs for financial reporting purposes. Sales generated in the Company's leased departments, consisting primarily of fine jewelry departments and beauty salons, totaled \$23.9 million in fiscal 2006 as compared to \$24.4 million in fiscal 2005.

Cost of Sales

Cost of sales from continuing operations, which includes costs associated with the buying, handling and distribution of merchandise, increased by approximately \$12.2 million to \$446.6 million in fiscal 2006 as compared to \$434.4 million in fiscal 2005, an increase of 2.8%. The increase is primarily due to the increase in sales volume. The Company's gross margin percentage in fiscal 2006 was 34.4% compared to 34.7% in fiscal 2005.

Selling, General and Administrative Expenses

Selling, general and administrative expenses from continuing operations increased approximately \$7.4 million, or 3.6%, to \$212.4 million in fiscal 2006 as compared to \$204.9 million in fiscal 2005. As a percentage of net sales, selling, general and administrative expenses increased 0.4% to 31.2% in fiscal 2006 as compared to 30.8% in fiscal 2005. The increase is primarily attributable to increases in payroll costs and fringe benefits, including a non-recurring \$1.1 million increase in the vacation reserve to comply with the VEBA litigation settlement, and \$0.8 million in stock-based compensation. The vacation expense increase was offset by decreases in worker's compensation and health insurance expenses. In addition, higher energy costs, increased professional fees and higher freight surcharges contributed to the increase in selling, general and administrative expenses. Gross advertising spending has also increased relative to the increase in net sales. These increases are partially offset by \$0.4 million received as a member of a class of a settled lawsuit against VISA U.S.A. Inc. and MasterCard International Incorporated. The Company expects to see a continuation of higher fuel and energy costs for the foreseeable future.

Depreciation and Amortization

Depreciation and amortization expense, which includes the net amortization (accretion) of intangible assets other than goodwill, increased by approximately \$2.0 million, or 15.4%, to \$15.3 million in fiscal 2006 as compared to \$13.2 million in fiscal 2005. As a percent of net sales, depreciation and amortization expense was 2.2% in fiscal 2006 and 2.0% in fiscal 2005. This increase includes \$0.2 million related to accelerated depreciation of assets due to the closing of the Danville, California store in August 2006. The dollar increase is also a result of capital additions related to the Company's new store, major remodel projects at certain existing stores and upgrades to the planning and allocation and point of sale systems.

Gain on Sale of Aircraft

The Company sold a corporate aircraft on June 30, 2006 for \$1,037,000 (net of selling costs) that resulted in a gain of \$946,000. The gain is reflected in operating income as the aircraft was reported as an operating asset.

VEBA Litigation

The VEBA litigation costs represent a reserve for settlement of a class action complaint alleging violation of California law regarding payment of accrued vacation upon termination of employment. The Company believed settlement of this matter was in its best interests and entered into a memorandum of understanding for class settlement, which was given final court approval in September 2006. The Company accrued \$1.8 million in the fourth quarter of fiscal 2005 for estimated legal fees and costs and an additional \$60,000 in the fourth quarter of fiscal 2006. All payments were made in December 2006 and final accounting for actual expenses took place in fiscal 2007.

New Store Opening Costs

New store opening costs, which are expensed as incurred, typically include costs such as payroll and fringe benefits for store associates, store rents, temporary storage, utilities, travel, grand opening advertising, credit solicitation and other costs incurred prior to the opening of a store. The Company recognized new store opening costs totaling \$0.4 million in connection with the opening of a new store in Eugene, Oregon, which opened August 31, 2006. In fiscal 2005, the

Company recognized \$0.7 million in new store opening costs related to the opening of new stores in each of Fresno, California and Albany, Oregon, and the reopening of the Pocatello, Idaho store.

Interest Expense

Interest expense, which includes the amortization of deferred financing costs, increased by approximately \$0.8 million to \$10.1 million in fiscal 2006 compared to \$9.2 million in fiscal 2005, an increase of 8.8%. As a percent of net sales, interest expense increased to 1.5% in fiscal 2006 as compared to 1.4% in fiscal 2005. These increases are primarily due to continued increases in interest rates charged on the Company's variable rate debt and include a charge of \$0.2 million related to the early termination of the Company's 9.39% mortgages. These increases were partially offset by a \$0.2 million favorable fair value adjustment on the Company's \$25 million notional amount interest swap. The Company anticipates that its interest rate swap will continue to provide protection against rising interest rates for the near term. The weighted average interest rate applicable to the revolving credit facility was 7.1% in fiscal 2006 (7.3% at February 2, 2008) as compared to 6.0% in fiscal 2005. During the third quarter of fiscal 2005, due to the Company's involvement in the construction of the building at its River Park store and other factors, the Company recorded \$10.2 million in buildings and equipment under capital leases and \$6.0 million in capital lease obligations associated with landlord reimbursements received. Accordingly, fiscal 2006 also includes interest charges of \$0.9 million, compared to \$0.4 million in fiscal 2005, related to the accounting for rental payments as repayment of the related construction reimbursements utilizing the effective interest method.

Miscellaneous Income

Miscellaneous income, which consists of the amortization of long-term deferred credits recorded upon receipt of donated land, income from the Company's investment in a partnership, and other miscellaneous non-operating income decreased by approximately \$0.1 million to \$1.4 million in fiscal 2006 as compared to \$1.5 million in fiscal 2005. Miscellaneous income does not include any material offsetting expense items. As a percent of net sales, miscellaneous income was 0.2% in fiscal 2006 and in fiscal 2005.

Income Taxes

The Company's effective tax rate for continuing operations is 32.2% in fiscal 2006 as compared to 33.6% in fiscal 2005. Including the tax benefit reported in discontinued operations, the Company's effective tax rate is 31.6% in fiscal 2006 as compared to 33.5% in fiscal 2005. In both fiscal 2006 and fiscal 2005, the Company benefited from the release of a portion of its valuation allowance associated with certain tax credit carryforwards that the Company determined were more likely than not to be realized.

Income From Continuing Operations

As a result of the foregoing, the Company reported income from continuing operations of \$3.4 million, or \$0.25 per diluted share, in fiscal 2006 as compared to \$6.1 million, or \$0.45 per diluted share, in fiscal 2005.

Discontinued Operations

The Company closed one underperforming store in the Seattle metro-area during the third quarter of fiscal 2006 and one underperforming store in the Seattle/Tacoma market during the first quarter of fiscal 2006. During fiscal 2005, the Company closed two underperforming stores in the Seattle/Tacoma market. These closures are reported as discontinued operations due to the Company's exit from the respective market areas. The loss from operations of discontinued stores includes only revenues generated from, and expenses directly associated with, the operations of such stores and consists of the following:

(In thousands)	Fiscal Years	
	2006	2005
Net sales from closed stores	\$ 2,921	\$ 11,480

Cost of sales	2,421	7,442
Selling, general and administrative expenses	1,533	5,235
Depreciation and amortization	<u>69</u>	<u>412</u>
Total costs and expenses	<u>4,023</u>	<u>13,089</u>
Loss from operations of closed stores	<u>\$ (1,102)</u>	<u>\$ (1,609)</u>

The loss on store closures of \$98,000 includes a net gain on the sale of the building associated with the store closed during the first quarter of fiscal 2006 of approximately \$147,000, offset by a loss on disposal of assets of \$139,000 related to the store closed during the third quarter of fiscal 2006, and store closure costs of approximately \$106,000 related to both stores closed in fiscal 2006, primarily consisting of severance and other incremental costs associated with the store closings.

In addition, the Company closed one store in Danville, California and one store in Moscow, Idaho during the third quarter and fourth quarter of fiscal 2006. The Company also closed one store in Fresno, California during the first quarter of fiscal 2005. These closures are not reported as discontinued operations due to the shift of revenues to other stores in the respective markets. The Company has a written agreement with the landlord to close the Wasilla, Alaska store in April 2007. This closure is not considered a discontinued operation as the Company has remaining stores in the market area.

Certain of the Company's stores may perform below expectations from time to time. In the event the Company is unable to improve the operating performance of such underperforming stores, the Company may consider the sale, sublease or closure of those stores in the future.

Net Income

As a result of the foregoing, the Company reported net income of \$2.6 million in fiscal 2006 as compared to \$5.2 million in fiscal 2005. On a per diluted share basis net income was \$0.19 per share in fiscal 2006 compared to \$0.38 per share in and fiscal 2005.

Liquidity and Capital Resources

The Company's working capital requirements are currently met through a combination of cash provided by operations, borrowings under its senior revolving credit facility, short-term trade and factor credit, and by proceeds from external financings.

In fiscal 2007, the Company generated positive cash flow from operations of \$11.0 million as compared to negative cash flow of \$4.8 million in fiscal 2006 and positive cash flow of \$19.6 million in fiscal 2005. The \$15.8 million increase in cash provided by operating activities in fiscal 2007 relative to fiscal 2006 was primarily due to the significant reductions of merchandise inventory which was somewhat offset by reductions in related accounts payables. The increase in cash provided was further offset by the net loss in fiscal 2007 compared to net income in fiscal 2006. Inventory decreased as a result of decreased sales and a planned reduction in inventory levels as compared to fiscal 2006. The Company does not plan any further reductions in inventory levels in fiscal 2008.

Net cash used in investing activities amounted to \$20.1 million, \$16.9 million, and \$21.9 million in fiscal 2007, 2006, and 2005 respectively. The net cash outflow in fiscal 2007 and fiscal 2005 increased from fiscal 2006 due to increased capital expenditures for store remodeling and new store construction (see "Uses of Liquidity"), partially offset in fiscal 2006 by the sale of the Silverdale, Washington store location and the sale of a corporate aircraft.

Net cash provided by financing activities was \$7.0 million in fiscal 2007 and primarily the result of increased borrowing on the Company's revolving credit facility to fund inventory purchases and capital expenditures, and somewhat offset by payments on long-term debt and repurchase of the Company's stock. Net cash provided by financing activities was \$22.4 million in fiscal 2006 and primarily the result of increased borrowing to fund inventory and capital expenditures and also the pay-off of the 9.39% mortgages on four of the Company's owned properties of approximately \$16.6 million. Net cash provided by financing activities of \$2.1 million in fiscal 2005 was primarily the result of the \$6.0 million landlord reimbursement, offset by repayment of long-term obligations.

Sources of Liquidity

New Senior Secured Credit Facility

The Company signed a second Amended and Restated Credit Agreement with General Electric Capital Corporation to refinance its existing credit facility on September 26, 2007. The new credit facility consists of a \$200 million senior secured revolving credit facility (including a \$20 million letter of credit sub-facility). Borrowings under the revolving credit facility are limited to the sum of (a) a specified percentage of eligible credit card receivables, (b) a

specified percentage of the net recovery value of eligible inventory, as determined by periodic valuation performed by an independent appraiser, and (c) 65% of the fair market value of the Company's real estate. Such borrowings are further limited by a requirement to maintain a minimum of \$15 million of excess availability at all times, and other reserves. Substantially all of the Company's assets, including its merchandise inventories, are pledged under the credit facility.

As of February 2, 2008, outstanding borrowings under the new credit facility totaled \$93.9 million, and availability for additional borrowings under the credit facility, after the deduction of the minimum availability requirement and other reserves, was \$40.2 million. Interest charged on amounts borrowed under the credit facility is at the prime rate, or at the Company's option, at the applicable LIBOR rate plus 1.25% per annum. In addition, the Company pays an unused commitment fee equal to 0.20% per annum on the average unused daily balance of the credit facility. The interest rate is adjusted upwards or downwards on a quarterly basis based on a pricing matrix, which is tied to the Company's daily average excess availability for the preceding fiscal quarter (as defined in the agreement). Under the pricing matrix, the applicable interest rate could range from a rate as low as prime or LIBOR plus 1.25%, to as high as prime plus 0.5%, or LIBOR plus 2.5%.

The new credit facility contains restrictive financial and operating covenants, including the requirement to maintain a fixed charge coverage ratio of 1:1 (as defined in the agreement) if the Company's excess borrowing availability is below \$20 million. As of February 2, 2008, the Company was in compliance with all restrictive financial covenants applicable to the credit facility. The agreement has a five year term expiring September 26, 2012.

The Company is exposed to market risk associated with changes in interest rates. To provide some protection against potential rate increases associated with its variable-rate facilities, the Company has entered into a derivative financial transaction in the form of an interest rate swap. This interest rate swap, used to hedge a portion of the underlying credit facility, matures in February 2009.

Old Senior Revolving Credit Facility

From January 26, 2006 to September 26, 2007, the credit facility, as amended on January 26, 2006, consisted of a revolving credit facility of up to \$172 million (including a \$20 million letter of credit sub-facility) and a fully funded term loan of \$9 million. Borrowings under the revolving credit facility, as amended, were limited to the sum of (a) a specified percentage of eligible credit card receivables, (b) the lesser of specified percentages of (i) the cost of eligible inventory and (ii) the net recovery value of the inventory, as determined by periodic valuation performed by an independent appraiser, and (c) the lesser of (i) up to 60% of the fair market value of the designated properties and (ii) \$21.6 million. Such borrowings were further limited by a requirement to maintain a minimum of \$5 million of excess availability at all times, and other reserves that were in effect. Substantially all of the Company's assets, including its merchandise inventories, were pledged under the credit facility.

On September 26, 2007, interest charged on amounts borrowed under the revolving portion of the credit facility were at the prime rate, or at the Company's option, at the applicable LIBOR rate plus 1.25% per annum, and interest charged on the term loan was a fixed rate of 6.6% per annum. In addition, the Company paid an unused commitment fee equal to 0.375% per annum on the average unused daily balance of the revolving portion of the credit facility. The interest rate applicable to the revolving portion of the credit facility was adjusted upwards or downwards on a quarterly basis based on a pricing matrix which was tied to the Company's daily average excess availability for the preceding fiscal quarter (as defined in the agreement). Under the pricing matrix, the applicable interest rate could have ranged from a rate as low as prime or LIBOR plus 1.25%, to as high as prime plus 0.5%, or LIBOR plus 2.5%.

The credit facility, as amended, contained restrictive financial and operating covenants, including the requirement to maintain a fixed charge coverage ratio of 1:1 (as defined in the agreement) if the Company's excess borrowing availability was below \$15 million.

Transactions with Affiliate

El Corte Ingles ("ECI") of Spain, and Harris, a wholly owned subsidiary of ECI, became affiliates of the Company in fiscal 1998 when the Company acquired substantially all of the assets and business of Harris. The Company issued a Subordinated Note to Harris, in the principal amount of \$22,179,000 as partial consideration for the Harris acquisition (the "Original Note"). The Original Note bore interest at a fixed rate of 8%. On December 7, 2004 a new Subordinated Note due May 30, 2009 superseded the Original Note. The new Subordinated Note bears interest at a fixed rate of 8% payable semi-annually and provides for principal payments of up to \$8.0 million prior to its maturity. Such payments are subject to certain liquidity restrictions under the revolving credit facility. The

Company made principal payments of \$1.0 million each upon execution of the new Subordinated Note, on February 20, 2005, February 20, 2006, February 20, 2007, as scheduled. A principal payment of \$2.0 million was made subsequent to fiscal year-end on February 20, 2008 and a principal payment of \$2.0 million is scheduled for February 20, 2009, with the balance due at maturity subject to the payment in full of the revolving credit facility.

Trade Credit

The success of the Company's business is dependent in part upon the adequacy of trade credit offered by key factors and vendors, the vendors' ability and willingness to sell its products at favorable prices and terms, and the willingness of vendors to ship merchandise on a timely basis. The Company has been able to purchase adequate levels of merchandise to support its operations and expects the level of trade credit to be sufficient to support its operations in the foreseeable future.

Other Financings

On February 14, 2005, the Company amended and extended the financing of its ownership interest in the partnership that owns the Company's corporate headquarters building. The related note payable of \$3.7 million, which originally provided for interest only payments at a variable rate of interest of prime plus 1.5% per annum, and was due in full upon maturity on May 24, 2005, has been modified to a fully amortizing note bearing interest at a fixed rate of 7.50% per annum and maturing on February 24, 2010. There is no prepayment penalty associated with the note.

The Company may consider various other sources of liquidity in the future, including but not limited to the issuance of additional securities that might have a dilutive effect on existing shareholders or incurring additional indebtedness which would increase the Company's leverage.

Uses of Liquidity

The Company's primary uses of liquidity are for working capital, debt service requirements, and capital expenditures. Capital expenditures in fiscal 2007, of \$20.7 million, were primarily related to the construction and fixturing of the Company's new Elk Grove store and renovation and refixturing of certain existing locations, and to certain information system enhancements.

As of February 2, 2008, the Company had issued a total of \$1.5 million of standby letters of credit and documentary letters of credit totaling \$1.3 million. The standby letters of credit were issued to provide collateral for workers' compensation insurance policies. Management believes that the likelihood of any draws under the workers' compensation standby letters of credit is remote. Documentary letters of credit are issued in the ordinary course of business to facilitate the purchase of merchandise from overseas suppliers. The supplier draws against the documentary letter of credit upon delivery of the merchandise.

Contractual Obligations

The following tables set forth certain information concerning the Company's debt obligations and commitments to make future payments under contracts, such as debt and lease agreements, and under contingent commitments.

Contractual Obligations:

	Payments due by period (1)					
	(In thousands)					
	Fiscal 2008	Fiscal 2009	Fiscal 2010	Fiscal 2011	Fiscal 2012	There- after Total
Long-term debt	\$ 1,275	\$ 1,317	\$ 575	\$ 539	\$ 576	\$ 1,067 \$ 5,349

Capitalized lease obligations	1,376	1,376	1,417	1,476	1,476	14,110	21,231
Subordinated note payable to affiliate	2,000	16,180	-	-			18,180
Non-cancelable operating leases	23,412	22,096	20,005	18,544	15,534	100,717	200,308
Purchase obligations (2)	944	624	239	74	52	144	2,077
Interest (3)	<u>7,147</u>	<u>6,539</u>	<u>5,541</u>	<u>5,455</u>	<u>3,932</u>	<u>7,767</u>	<u>36,381</u>
Total contractual cash obligations	<u>\$ 36,154</u>	<u>\$ 48,132</u>	<u>\$ 27,777</u>	<u>\$ 26,088</u>	<u>\$ 21,570</u>	<u>\$ 123,805</u>	<u>\$ 283,526</u>

Amount of commitment expiration by period

(In thousands)

	Fiscal 2008	Fiscal 2009	Fiscal 2010	Fiscal 2011	Fiscal 2012	There- after	Total
Senior revolving credit facility (4)	\$ -	\$ -	\$ -	\$ -	\$ 93,899	\$ -	\$ 93,899
Standby letters of credit	1,486	-	-	-	-	-	1,486
Documentary letters of credit	1,339	-	-	-	-	-	1,339
	<u>\$ 2,825</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 93,899</u>	<u>\$ -</u>	<u>\$ 96,724</u>

(1) See Notes 5, 7 and 8 to the accompanying financial statements.

(2) Purchase obligations include agreements to purchase goods or services that are enforceable and legally binding and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Agreements that are cancelable without penalty have been excluded. Purchase obligations relate primarily to service and maintenance agreements and information technology contracts.

(3) Interest payments in future periods have been reflected based on debt levels and fixed interest rates as of fiscal year ended February 2, 2008. The rate on variable interest debt is reflected at the effective interest rate as of February 29, 2008. Interest on capital lease obligations is included in the total due under capital lease obligations.

(4) Represents outstanding borrowings under the Company's senior revolving credit facility as of February 2, 2008. The table presents that amount as due at September 26, 2012, the end of the commitment period for the facility.

In the fourth quarter of fiscal 2007, the Company signed a ground lease for a new store in Bend, Oregon. The Company plans to construct a 55,000 square foot store at a cost of \$6.8 million, including fixtures. The Company will own the building and anticipates that it will open in late fall 2008. This building will be financed through cash flow from operations and borrowings on the credit facility.

In the ordinary course of business, the Company enters into arrangements with vendors to purchase merchandise up to twelve months in advance of expected delivery. These purchase orders do not contain any significant termination payments or other penalties if cancelled.

The Company has approximately \$1.2 million of unrecognized tax benefits not included in the table above that have been recorded as liabilities in accordance with Financial Interpretation No. 48, and management is uncertain as to if, or when, such amounts may be settled. In addition, the Company has also recorded a liability for potential interest of approximately \$0.2 million, related to the unrecognized tax benefits.

Cash generated by operations, together with liquidity provided by the credit facility, and other financial resources are expected to adequately finance the Company's planned cash requirements for fiscal 2008.

New Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurement. SFAS 157 does not require any new fair value measurement and the Company is currently evaluating the impact, if any, of SFAS 157 on its financial position, results of operations and cash flows. SFAS 157 requires prospective application for fiscal years beginning after November 15, 2007.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities," (SFAS 159). This statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to reduce fluctuation in reported earnings caused by measuring related assets and

liabilities differently without having to apply complex hedge accounting provisions. Most of the provisions of SFAS 159 apply only to entities that elect the fair value option. However, the amendment to FASB Statement No. 115, "Accounting for

Certain Investments in Debt and Equity Securities," applies to all entities with available-for-sale and trading securities. SFAS 159 is effective for the Company on February 3, 2008. The Company is currently evaluating the impact, if any, of SFAS 159 on its financial position, results of operations and cash flows.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities," (SFAS 161). This statement changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS 161 is effective for the Company on February 1, 2009. The Company

is currently evaluating the impact, if any, of SFAS 161 on its financial position, results of operations and cash flows.

Inflation

Although inflation has not been a material factor in the Company's operations during the past several years, the Company has experienced increases in the costs of certain merchandise, salaries, employee benefits and other general and administrative costs, including utilities, supplies, and transportation costs. The Company is generally able to offset these increases by adjusting its selling prices or by modifying its operations. The Company's ability to adjust selling prices is limited by competitive pressures in its market areas.

The Company values its merchandise inventories at the lower of LIFO cost or market using the retail inventory method of accounting. Under the LIFO method, which is determined by using the department store price indices published by the Bureau of Labor Statistics, the cost of products sold reported in the financial statements approximates current costs and thus reduces the impact of inflation due to increasing costs on reported income. The valuation of the Company's merchandise inventories under the LIFO method is currently equal to that as determined by the first-in, first-out (FIFO) method of accounting.

Seasonality

The Company's business, like that of most retailers, is subject to seasonal influences, with the major portion of net sales, gross profit and operating income realized during the Christmas selling months of November and December of each year, and, to a lesser extent, during the Easter and Back-to-School selling seasons. The Company's results may also vary from quarter to quarter as a result of, among other things, the timing and level of the Company's sales promotions, weather, fashion trends and the overall health of the economy, both nationally and in the Company's market areas. Working capital requirements also fluctuate during the year, increasing substantially prior to the Christmas selling season when the Company must carry significantly higher inventory levels.

The following table sets forth unaudited quarterly results of operations for fiscal 2007 and 2006 (in thousands, except per share data). The Company has reclassified the results of operations of certain stores closed in fiscal 2006 to discontinued operations for all periods presented.

Results of Operations

Quarter Ended	Fiscal 2007			
	(In thousands, except per share data)			
	May 5	August 4	November 3	February 2
Net sales from continuing operations	\$ 141,788	\$ 144,982	\$ 137,352	\$ 204,428
Gross profit	46,584	48,655	47,050	65,374
Income (loss) from continuing operations	(4,668)	(4,774)	(4,124)	1,133
Net income (loss)	(4,668)	(4,774)	(4,124)	1,133
Net income (loss) per common share:				
Basic				
Income (loss) from continuing operations	\$ (0.34)	\$ (0.35)	\$ (0.30)	\$ 0.08
Net income (loss)	\$ (0.34)	\$ (0.35)	\$ (0.30)	\$ 0.08
Diluted				
Income (loss) from continuing operations	\$ (0.34)	\$ (0.35)	\$ (0.30)	\$ 0.08
Net income (loss)	\$ (0.34)	\$ (0.35)	\$ (0.30)	\$ 0.08
Weighted-average number of common shares outstanding:				
Basic	13,606	13,682	13,684	13,432
Diluted	13,606	13,682	13,684	13,493
Quarter Ended	Fiscal 2006			
	(In thousands, except per share data)			
	April 29	July 29	October 28	February 3
Net sales from continuing operations	\$ 142,163	\$ 152,757	\$ 147,897	\$ 238,149
Gross profit	47,440	54,268	53,727	78,912
Income (loss) from continuing operations	(3,696)	600	(2,335)	8,872
Loss on discontinued operations, net of tax	(265)	(114)	(413)	-
Net income (loss)	(3,961)	486	(2,748)	8,872
Net income (loss) per common share:				
Basic				
Income (loss) from continuing operations	\$ (0.28)	\$ 0.04	\$ (0.17)	\$ 0.66
Loss on discontinued operations	\$ (0.02)	\$ -	\$ (0.03)	\$ -
Net income (loss)	\$ (0.30)	\$ 0.04	\$ (0.20)	\$ 0.66
Diluted				
Income (loss) from continuing operations	\$ (0.28)	\$ 0.04	\$ (0.17)	\$ 0.64
Loss on discontinued operations	\$ (0.02)	\$ -	\$ (0.03)	\$ -
Net income (loss)	\$ (0.30)	\$ 0.04	\$ (0.20)	\$ 0.64
Weighted-average number of common shares outstanding:				
Basic	13,371	13,399	13,423	13,514
Diluted	13,371	13,685	13,423	13,885

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risks in the normal course of business due to changes in interest rates on borrowings under its senior revolving credit facility. To provide some protection against potential rate increases associated with its variable-rate facilities, the Company entered into a derivative financial transaction in the form of an interest rate swap. The interest rate swap is used to hedge a portion of the underlying variable-rate facility. The Company currently holds a "variable-to-fixed" rate swap with a notional amount of \$25.0 million with one financial institution. The notional amount does not represent amounts exchanged by the parties; rather, it is used as the basis to calculate amounts due and to be received under the rate swap. Although the swap essentially provides for matched terms to its underlying, and effectively mitigates its variability, it currently does not qualify for hedge accounting under SFAS No. 133. Accordingly, changes in fair value of the derivative instrument are recorded in interest expense. During fiscal 2007 and 2006, the Company did not enter into or hold derivative financial instruments for trading purposes, nor does it engage in financial transactions for speculative or trading purposes. All contracts and purchase obligations are denominated in US dollars and accordingly the Company is not subject to foreign exchange rate risk.

As of February 2, 2008, borrowings subject to variable interest rates represented 78% of the Company's total outstanding borrowings. The interest payable on the Company's senior revolving credit facility is based on variable interest rates and is therefore affected by changes in market interest rates. An increase of 70 basis points on existing floating rate borrowings (a 10% change from the Company's weighted- average interest rate as of February 2, 2008) would reduce the Company's pre-tax income and cash flow by approximately \$0.6 million over a one year period. This 70 basis point increase in interest rates would not materially effect the fair value of the Company's fixed rate financial instruments. (See Note 1 to the accompanying financial statements.)

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The response to this item is set forth under Part IV, Item 15, included elsewhere herein.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

Item 9A. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

The Company maintains "disclosure controls and procedures," as such term is defined in Rules 13a-14 and 15d-14 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), that are designed to ensure that information required to be disclosed in the Company's reports, pursuant to the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding the required disclosures. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurances of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost benefit relationship of possible controls and procedures.

The Company's Chief Executive Officer and Chief Financial Officer (its principal executive officer and principal financial officer, respectively), with the participation of the Company's management, have carried out an evaluation of the effectiveness of the Company's disclosure controls and procedures, as of February 2, 2008 and have concluded that such disclosure controls and procedures are effective at the reasonable assurance level.

(b) Management's Report on Internal Control Over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit

preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Management assessed the Company's internal control over financial reporting as of February 2, 2008, the end of the Company's fiscal year. Management based its assessment on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Management's assessment included evaluation of such elements as the design and operating effectiveness of key financial reporting controls, process documentation, accounting policies, and the Company's overall control environment. Based on its assessment, management has concluded that the Company's internal control over financial reporting was effective as of the end of the fiscal year to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with generally accepted accounting principles. The results of management's assessment were reviewed with the Audit Committee of the Company's Board of Directors.

BDO Seidman, LLP, the Company's independent registered public accounting firm, has issued a report on Company's internal control over financial reporting, that is included in Part IV Item 15(a)(1).

(c) Changes in Internal Control Over Financial Reporting

During the fourth quarter of fiscal 2007, there were no changes in the Company's internal controls over financial reporting identified during the evaluation referred to above that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

(d) Certifications

The certifications of the Company's Chief Executive Officer and Chief Financial Officer required under Section 302 of the Sarbanes-Oxley Act have been filed as Exhibits 31.1 and 31.2 to this report. Additionally, in fiscal 2007 the Company's Chief Executive Officer certified to the NYSE that he was not aware of any violation by the Company of the NYSE corporate governance listing standards.

Item 9B. OTHER INFORMATION

None.

PART III

Item 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by Item 10 of Form 10-K, other than the following information required by Paragraph (b) of Item 401 of Regulation S-K, is incorporated by reference from those portions of the Company's definitive proxy statement with respect to the Annual Stockholders' Meeting scheduled to be held on June 25, 2008, to be filed pursuant to Regulation 14A (the "2008 Proxy") under the headings "Nominees for Election as Director" and "Section 16(a) Beneficial Ownership Reporting Compliance."

As of March 28, 2008, the name, age and title of the executive officers of the Company are as follows:

Name	Age	Position
James R. Famalette	55	Chairman, President and Chief Executive Officer
J. Gregory Ambro	55	Executive Vice President and Chief Operating Officer
Daniel T. Warzenski	59	Vice President, Chief Financial Officer and Secretary
Michael J. Schmidt	66	Senior Vice President and Director of Stores
Scott G. Manson	54	Senior Vice President and General Merchandise Manager

James R. Famalette was appointed Chairman of the Board on August 9, 2007 and became President and Chief Executive Officer of the Company on June 25, 1999. Prior to this he served as President and Chief Operating Officer of the Company since April 14, 1997. Prior to joining the Company, Mr. Famalette was President and Chief Executive Officer of Liberty House, a department and specialty store chain based in Honolulu, Hawaii, from 1993 through 1997, and served in a variety of other positions with Liberty House from 1987 through 1993, including Vice President, Stores and Vice President, General Merchandise Manager. From 1975 to 1987 he served in a variety of senior level management positions with Village Fashions/Cameo Stores and Colonies, a specialty store chain.

J. Gregory Ambro was appointed Executive Vice President and Chief Operating Officer on August 9, 2007. Prior to this he served as Senior Vice President and Chief Administrative and Financial Officer of the Company since November 20, 2003. Prior to joining Gottschalks, Mr. Ambro served for three years as Senior Vice President and Chief Financial Officer of Bradlees, a regional discount department store in the Northeast. From 1995 to 2000 he served as Chief Financial Officer of Marshalls, an off-price retailer, Streamline, a grocery and consumer products retailer and Harris Teeter, an upscale supermarket chain in the Southeast. From 1978 to 1994 Mr. Ambro served in a variety of financial positions for Marshalls and the May Department Stores Co.

Daniel T. Warzenski became Vice President and Chief Financial Officer on August 9, 2007 after serving as Vice President Finance and Chief Accounting Officer of the Company since September 11, 2006. Mr. Warzenski also serves as Secretary. Prior to joining the Company, Mr. Warzenski was Vice President and Controller of Robinsons-May, a division of The May Department Stores Company, Inc., from 1996 to 2006, and served as Assistant Controller at Robinsons-May and May Company California from 1986 to 1996. From 1977 to 1986, he served in a variety of financial positions at Carter Hawley Hale Stores, Inc., The Harris Company, and HRT Industries, Inc.

Michael J. Schmidt became Senior Vice President and Director of Stores of the Company in 1985(1). From 1983 through 1985, he was Manager of the Company's Fresno, California Fashion Fair store. Prior to joining the Company, he held management positions with Liberty House, Allied Corporation and R.H. Macy & Co., Inc.

Scott G. Manson became Senior Vice President, General Merchandise Manager in 2004. He started with the Company in May 1999 as Vice President, Divisional Merchandise Manager of Ladies Sportswear and Dresses. Prior to joining the Company, he was Vice President Divisional Merchandise Manager for Dillard's Department stores from October 1998 to March 1999. From 1976 to 1998, Scott served in various senior level management positions for Mercantile Stores, including Vice President, General Merchandise Manager for the Joslins Department store in Denver and Vice President, General Merchandise Manager for the Jones Store in Kansas City.

(1) References to the Company prior to 1986 are more specifically to the Company's predecessor and former subsidiary, E. Gottschalk and Co., Inc.

Item 11. EXECUTIVE COMPENSATION

The information required by this item is incorporated by reference from those portions of the Company's 2008 Proxy under the headings "Executive Compensation" and "Director Compensation for Fiscal Year 2007."

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item is incorporated by reference from the portion of the Company's 2008 Proxy under the heading "Security Ownership of Certain Beneficial Owners and Management" and Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities in this report on Form 10-K.

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this item is incorporated by reference from the portion of the Company's 2008 Proxy under the heading "Certain Relationships and Related Transactions."

Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this item is incorporated by reference from the portion of the Company's 2008 Proxy under the heading "Information on Independent Public Accountants".

PART IV

Item 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)(1) The following financial statements of Gottschalks Inc. as required by Item 8 are included in this Part IV, Item 15:

Reports of Independent Registered Public Accounting Firms

Balance Sheets - As of February 2, 2008 and February 3, 2007

Statements of Operations - Fiscal years ended February 2, 2008, February 3, 2007 and January 28, 2006

Statements of Stockholders' Equity - Fiscal years ended February 2, 2008, February 3, 2007 and January 28, 2006

Statements of Cash Flows - Fiscal years ended February 2, 2008, February 3, 2007 and January 28, 2006

Notes to Financial Statements

(a)(2) The following financial statement schedule of Gottschalks Inc. is included in Item 15(d):

Schedule II - Valuation and Qualifying Accounts

All other schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are included in the Financial Statements, are not required under the related instructions or are inapplicable, and therefore have been omitted.

(a)(3) and (b) The following exhibits are required by Item 601 of Regulation S-K and Item 15(c):

EXHIBIT INDEX

Exhibit Number	Description	Incorporated by Reference From the Following Document
3.1	Certificate of Incorporation of the Registrant	Registration Statement on Form S-1 (File No. 33-3949)
3.2	<u>Second Amended and Restated Bylaws</u>	Current Report on Form 8-K dated December 4, 2007 (File No. 1-09100)
10.1	Gottschalks Inc. Retirement Savings Plan(*)	Registration Statement on Form S-1 (File No. 33-3949)
10.2	<u>Participation Agreement dated as of December 1, 1988 among Gottschalks Inc., General Foods Credit Investors No. 2 Corporation and Manufacturers Hanover Trust Company of California relating to the sale-leaseback of the Stockton and Bakersfield department stores and the Madera distribution facility</u>	Annual Report on Form 10-K for the year ended January 29, 1994 (File No. 1-09100)

10.3	<u>Lease Agreement dated December 1, 1988 by and between Manufacturers Hanover Trust Company of California and Gottschalks Inc. relating to the sale-leaseback of department stores in Stockton and Bakersfield, California and the Madera distribution facility</u>	Annual Report on Form 10-K for the year ended January 29, 1994 (File No. 1-09100)
10.4	<u>Ground Lease dated December 1, 1988 by and between Gottschalks Inc. and Manufacturers Hanover Trust Company of California relating to the sale-leaseback of the Bakersfield department store</u>	Annual Report on Form 10-K for the year ended January 29, 1994 (File No. 1-09100)
10.5	<u>Memorandum of Lease and Lease Supplement dated July 1, 1989 by and between Manufacturers Hanover Trust Company of California and Gottschalks Inc. relating to the sale-leaseback of the Stockton department store</u>	Annual Report on Form 10-K for the year ended January 29, 1994 (File No. 1-09100)
10.6	<u>Tax Indemnification Agreement dated as of August 1, 1989 by and between Gottschalks Inc. and General Foods Credit Investors No. 2 Corporation relating to the sale-leaseback of the Stockton and Bakersfield department stores and the Madera distribution facility</u>	Annual Report on Form 10-K for the year ended January 29, 1994 (File No. 1-09100)
10.7	<u>Ground Lease dated August 17, 1989 by and between Gottschalks Inc. and Manufacturers Hanover Trust Company of California relating to the sale-leaseback of the Madera distribution facility</u>	Annual Report on Form 10-K for the year ended January 29, 1994 (File No. 1-09100)
10.8	<u>Lease Supplement dated as of August 17, 1989 by and between Manufacturers Hanover Trust Company of California and Gottschalks Inc. relating to the sale-leaseback of the Madera distribution facility</u>	Annual Report on Form 10-K for the year ended January 29, 1994 (File No. 1-09100)
10.9	Agreement of Limited Partnership dated March 16, 1990, by and between River Park Properties I and Gottschalks Inc. relating to the Company's corporate headquarters	Annual Report on Form 10-K for the year ended February 2, 1991 (File No. 1-09100)
10.10	<u>Lease Agreement dated as of March 16, 1990 by and between Gottschalks Inc. and River Park Properties I relating to the Company's corporate headquarters</u>	Annual Report on Form 10-K for the year ended January 29, 1994 (File No. 1-09100)
10.11	<u>Form of Severance Agreement dated March 31, 1995 by and between Gottschalks Inc. and the following senior executives of the Company: Joseph W. Levy and Michael J. Schmidt (*)</u>	Annual Report on Form 10-K for the year ended January 28, 1995 (File No. 1-09100)
10.14	<u>Agreement of Sale dated June 27, 1995, by and between Gottschalks Inc. and Jack Baskin relating to the sale and leaseback of the Capitola, California property</u>	Quarterly Report on Form 10-Q for the quarter ended July 29, 1995 (File No. 1-09100)
10.15	<u>Lease and Agreement dated June 27, 1995, by and between Jack Baskin and Gottschalks Inc. relating to the sale and leaseback of the Capitola, California property</u>	Quarterly Report on Form 10-Q for the quarter ended July 29, 1995 (File No. 1-09100)

10.18	<u>Gottschalks Inc. 1998 Stock Option Plan(*)</u>	Registration Statement on Form S-8 (File #33-61471)
10.19	<u>Gottschalks Inc. 1998 Employee Stock Purchase Plan(*)</u>	Registration Statement on Form S-8 (File #33-61473)
10.20	<u>Asset Purchase Agreement dated as of July 21, 1998 among Gottschalks Inc., The Harris Company and El Corte Ingles, S. A. together with all Exhibits thereto</u>	Current Report on Form 8-K dated July 21, 1998 (File No. 1-09100)
10.22	<u>Registration Rights Agreement between The Harris Company and Gottschalks Inc. dated August 20, 1998</u>	Current Report on Form 8-K dated August 20, 1998 (File No. 1-09100)

10.23	Tradename License Agreement between The Harris Company and Gottschalks Inc. dated August 20, 1998	Current Report on Form 8-K dated August 20, 1998 (File No. 1-09100)
10.24	Stockholders' Agreement among El Corte Ingles, S. A., Gottschalks Inc., Joseph Levy and Bret Levy dated August 20, 1998	Current Report on Form 8-K dated August 20, 1998 (File No. 1-09100)
10.26	Store Lease Agreement between El Corte Ingles, S. A., and Gottschalks Inc. dated August 20, 1998 re: East Hills Mall, Bakersfield, California	Current Report on Form 8-K dated August 20, 1998 (File No. 1-09100)
10.27	Store Lease Agreement between El Corte Ingles, S. A., and Gottschalks Inc. dated August 20, 1998 re: Moreno Valley Mall at Towngate, Moreno Valley, California	Current Report on Form 8-K dated August 20, 1998 (File No. 1-09100)
10.28	Store Lease Agreement between El Corte Ingles, S. A., and Gottschalks Inc. dated August 20, 1998 re: Antelope Valley Mall at Palmdale, California	Current Report on Form 8-K dated August 20, 1998 (File No. 1-09100)
10.33	Employment Agreement dated June 25, 1999 by and between Gottschalks Inc. and James R. Famalette(*)	Quarterly Report on Form 10-Q for the quarter ended July 31, 1999 (File No. 1-09100)
10.42	Amendment to Employment Agreement dated December 3, 2001 by and between Gottschalks Inc. and James R. Famalette (*)	Annual Report on Form 10-K for the year ended February 2, 2002 (File No. 1-09100)
10.52	Purchase and Sale Agreement dated January 30, 2003 by and among Gottschalks Credit Receivables Corporation, Gottschalks Inc. and Household Bank (SB), N.A.	Current Report on Form 8-K dated January 31, 2003
10.53	Interim Servicing Agreement dated January 30, 2003 by and between Gottschalks Inc. and Household Bank (SB), N.A.	Current Report on Form 8-K dated January 31, 2003
10.54	Credit Card Program Agreement dated January 30, 2003 by and between Gottschalks Inc. and Household Bank (SB), N.A.	Current Report on Form 8-K dated January 31, 2003
10.55	Amendment to Amended and Restated Receivables Purchase Agreement dated January 31, 2003 by and between Gottschalks Inc. and Gottschalks Credit Receivables Corporation	Current Report on Form 8-K dated January 31, 2003
10.56	Second Amended and Restated Credit Agreement dated September 26, 2007, by and among Gottschalks Inc. and General Electric Capital Corporation	Filed electronically herewith

10.58	Form of Severance Agreement dated March 12, 2007 by and between Gottschalks Inc. and the following senior executives of the Company: J. Gregory Ambro and Michael J. Schmidt. (*)	Current Report on Form 8-K dated March 19, 2007
10.59	Amendment to Employment Agreement dated March 12, 2007 by and between Gottschalks Inc. and James R. Famalette. (*)	Current Report on Form 8-K dated March 19, 2007
10.60	Form of Severance Agreement dated March 25, 2008 by and between Gottschalks Inc. and Daniel T. Warzenski. (*)	Current Report on Form 8-K dated March 31, 2008
23.1	Consent of Independent Registered Public Accounting Firm PDF provided as courtesy	Filed electronically herewith
23.2	Consent of Independent Registered Public Accounting Firm PDF provided as courtesy	Filed electronically herewith

31.1	Rule 13a - 14(a) Certification of Chief Executive Officer PDF provided as courtesy	Furnished concurrently herewith
31.2	Rule 13a - 14(a) Certification of Chief Financial Officer PDF provided as courtesy	Furnished concurrently herewith
32.1	Certification of President and Chief Executive Officer Pursuant to 18 U.S.C. § 1350, As Adopted Pursuant to § 906 of the Sarbanes-Oxley Act of 2002. PDF provided as courtesy	Furnished concurrently herewith
32.2	Certification of Vice President and Chief Financial Officer Pursuant to 18 U.S.C. § 1350, As Adopted Pursuant to § 906 of the Sarbanes-Oxley Act of 2002. PDF provided as courtesy	Furnished concurrently herewith

(*) Management contract, compensatory plan or arrangement.

(**) These loans were retired with proceeds from a mortgage loan completed on March 22, 2002 (See Exhibit 10.46)

ANNUAL REPORT ON FORM 10-K

ITEM 8, 15(a)(1) and (2), (c) and (d)

FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

CERTAIN EXHIBITS

FINANCIAL STATEMENT SCHEDULE

YEAR ENDED FEBRUARY 2, 2008

GOTTSCHALKS INC.

FRESNO, CALIFORNIA

Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting

Board of Directors and Stockholders
Gottschalks Inc.
Fresno, California

We have audited Gottschalks Inc.'s internal control over financial reporting as of February 2, 2008, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Gottschalks Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Item 9A, *Management's Report on Internal Control Over Financial Reporting*. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Gottschalks Inc. maintained, in all material respects, effective internal control over financial reporting as of February 2, 2008, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the balance sheet of Gottschalks Inc. as of February 2, 2008, and the related statements of operations, stockholders' equity, and cash flows for the period ended February 2, 2008 and our report dated April 7, 2008 expressed an unqualified opinion thereon.

/s/ BDO Seidman, LLP

San Francisco, California
April 7, 2008

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
Gottschalks Inc.
Fresno, California

We have audited the accompanying balance sheet of Gottschalks Inc. as of February 2, 2008, and the related statements of operations, stockholders' equity, and cash flows for the fiscal year ended February 2, 2008. In connection with our audit of the financial statements, we have also audited the information for the fiscal year ended February 2, 2008 in the financial statement schedule listed in the accompanying index. These financial statements and the schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and the schedule based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Gottschalks Inc. at February 2, 2008, and the results of its operations and its cash flows for the fiscal year ended February 2, 2008, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the information for the fiscal year ended February 2, 2008 in the financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 10 to the financial statements, effective February 4, 2007, the Company adopted the provisions of FASB Interpretation Number 48, *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement 109*. Also, as discussed in Note 1 to the financial statements, effective January 29, 2006, the Company adopted the provisions of SFAS Number 123 (Revised), *Share Based Payment*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Gottschalks Inc.'s internal control over financial reporting as of February 2, 2008, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated April 7, 2008 expressed an unqualified opinion thereon.

/s/ BDO Seidman, LLP

San Francisco, California
April 7, 2008

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of
Gottschalks Inc.
Fresno, California

We have audited the accompanying balance sheet of Gottschalks Inc. (the "Company") as of February 3, 2007, and the related statements of income, stockholders' equity and cash flows for the years ended February 3, 2007 and January 28, 2006. Our audits also included the financial statement schedule for the years ended February 3, 2007 and January 28, 2006 listed in the Index at Item 15 (a) (2). The Company's management is responsible for these financial statements and financial statement schedule. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Gottschalks Inc. at February 3, 2007, and the results of its operations and its cash flows for the years ended February 3, 2007 and January 28, 2006 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein for the years ended February 3, 2007 and January 28, 2006.

As discussed in Note 1 to the financial statements, on January 29, 2006, the Company changed its method of accounting for share based payment arrangements to conform to Statement of Financial Accounting Standards Board Statement No. 123(R), *Share-Based Payment*.

/s/ Deloitte & Touche LLP

San Francisco, California
April 12, 2007

GOTTSCHALKS INC.
BALANCE SHEETS
(In thousands, except share and per share data)

	February 2, 2008	February 3, 2007
<u>ASSETS</u>		
CURRENT ASSETS:		
Cash	\$ 4,032	\$ 6,051
Receivables - net	7,049	8,198
Merchandise inventories	149,310	168,702
Other	18,984	19,421
Total current assets	179,375	202,372
PROPERTY AND EQUIPMENT - net	137,931	134,696
OTHER ASSETS:		
Goodwill	7,501	7,501
Other intangibles - net	616	487
Other	6,571	5,010
	14,688	12,998
TOTAL ASSETS	\$ 331,994	\$ 350,066
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
CURRENT LIABILITIES:		
Trade accounts payable and accrued liabilities	\$ 69,463	\$ 79,854
Current portion of long-term debt	1,276	1,243
Current portion of capitalized lease obligations	249	433
Deferred income taxes	3,096	3,541
Total current liabilities	74,084	85,071
REVOLVING LINE OF CREDIT	93,899	83,762
LONG-TERM OBLIGATIONS, less current portion	12,049	13,592
OTHER LIABILITIES	16,875	12,558
DEFERRED INCOME TAXES	4,962	11,311
SUBORDINATED NOTE PAYABLE TO AFFILIATE	18,180	19,180
COMMITMENTS AND CONTINGENCIES (Notes 8 and 16)		
STOCKHOLDERS' EQUITY:		
Common stock, par value of \$.01 per share; 30,000,000 shares authorized; 13,700,758 and 13,569,743 issued; 13,282,958 and 13,569,743 outstanding	137	136
Additional paid-in capital	77,822	76,527
Retained earnings	35,473	47,929
Less treasury stock, at cost	(1,487)	-
	111,945	124,592
TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY	\$ 331,994	\$ 350,066

See accompanying notes to financial statements.

GOTTSCHALKS INC.
STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	Fiscal Years Ended		
	February 2, 2008	February 3, 2007	January 28, 2006
Net sales	\$ 628,550	\$ 680,966	\$ 665,460
Net credit revenues	4,868	3,087	3,084
Net leased department revenues	3,000	3,428	3,506
Total revenues	636,418	687,481	672,050
Costs and expenses:			
Cost of sales	420,887	446,619	434,387
Selling, general and administrative expenses	209,552	212,355	204,945
Depreciation and amortization	15,173	15,276	13,242
Gain on sale of aircraft	-	(946)	-
Loss on disposal of assets	418	-	-
VEBA litigation	-	60	1,811
New store opening costs	485	376	688
Total costs and expenses	646,515	673,740	655,073
Operating income (loss)	(10,097)	13,741	16,977
Other (income) expense:			
Interest expense	10,807	10,058	9,242
Miscellaneous income	(489)	(1,389)	(1,515)
	10,318	8,669	7,727
Income (loss) from continuing operations before income tax	(20,415)	5,072	9,250
Income tax expense (benefit)	(7,982)	1,631	3,107
Income (loss) from continuing operations	(12,433)	3,441	6,143
Discontinued operations:			
Loss from operations of closed stores	-	(1,102)	(1,609)
Gain (loss) on store closures	-	(98)	180
Income tax benefit	-	408	486
Loss on discontinued operations	-	(792)	(943)
Net income (loss)	\$ (12,433)	\$ 2,649	\$ 5,200
Net income (loss) per common share:			
Basic			
Income (loss) from continuing operations	\$ (0.91)	\$ 0.26	\$ 0.46
Loss on discontinued operations	\$ -	\$ (0.06)	\$ (0.07)
Net income (loss) per common share	\$ (0.91)	\$ 0.20	\$ 0.39
Diluted			
Income (loss) from continuing operations	\$ (0.91)	\$ 0.25	\$ 0.45
Loss on discontinued operations	\$ -	\$ (0.06)	\$ (0.07)
Net income (loss) per common share	\$ (0.91)	\$ 0.19	\$ 0.38
Weighted average number of common shares outstanding			
Basic	13,601	13,428	13,245
Diluted	13,601	13,758	13,797

See accompanying notes to financial statements.

GOTTSCHALKS INC.
STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands, except share data)

	Common Stock		Additional	Retained	Treasury	
	Shares	Amount	Paid-in	Earnings	Stock	Total
			Capital			
BALANCE, JANUARY 29, 2005	13,030,269	\$ 130	\$ 72,146	\$ 40,080	\$ -	\$ 112,356
Net income				5,200	-	5,200
Stock options exercised	321,650	4	2,276		-	2,280
Shares issued under employee stock purchase plan	9,230	-	68	-	-	68
BALANCE, JANUARY 28, 2006	13,361,149	134	74,490	45,280	-	119,904
Net income				2,649	-	2,649
Stock options exercised	196,100	2	899	-	-	901
Shares issued under employee stock purchase plan	12,494	-	69	-	-	69
Stock-based compensation	-		810		-	810
Tax benefit from exercise of stock options	-	-	248	-	-	248
Tax effect of terminated stock options	-	-	11	-	-	11
BALANCE, FEBRUARY 3, 2007	13,569,743	136	76,527	47,929	-	124,592
Net loss	-	-	-	(12,433)	-	(12,433)
Cumulative effect of adoption of FIN 48	-	-	-	(23)	-	(23)
Stock options exercised	120,125	1	670	-	-	671
Shares issued under employee stock purchase plan	10,890	-	57	-	-	57
Stock-based compensation	-	-	417	-	-	417
Purchase of treasury shares	(417,800)	-	-	-	(1,487)	(1,487)
Tax benefit from exercise of stock options	-	-	143	-	-	143
Tax effect of terminated stock options	-	-	8	-	-	8
BALANCE, FEBRUARY 2, 2008	13,282,958	\$ 137	\$ 77,822	\$ 35,473	\$ (1,487)	\$ 111,945

See accompanying notes to financial statements.

GOTTSCHALKS INC.
STATEMENTS OF CASH FLOWS
(In thousands of dollars)

	Fiscal Years Ended		
	February 2, 2008	February 3, 2007	January 28, 2006
Net income (loss)	\$ (12,433)	\$ 2,649	\$ 5,200
Adjustments:			
Stock-based compensation	417	810	-
Excess tax benefits from exercise of stock options	(151)	(248)	-
Depreciation and amortization	15,173	15,345	13,654
Deferred income taxes	(6,794)	288	882
Amortization of deferred income and other deferred items	3,791	(1,375)	(1,955)
Store closure costs	111	142	120
Net (gain) loss from sale of assets	418	(978)	131
Distributions of earnings from investment in limited partnership	475	484	-
Changes in assets and liabilities:			
Receivables	1,033	(914)	(364)
Merchandise inventories	20,617	(7,230)	(5,790)
Other current and long-term assets	(360)	(4,115)	872
Trade accounts payable and accrued liabilities	(9,694)	(11,830)	9,587
Other current and long-term liabilities	(1,593)	2,137	(2,721)
Net cash provided by (used in) operating activities	<u>11,010</u>	<u>(4,835)</u>	<u>19,616</u>
INVESTING ACTIVITIES:			
Purchases of property and equipment	(20,662)	(21,100)	(22,227)
Proceeds from sale of building and aircraft	602	4,187	-
Distributions of earnings from investment in limited partnership	-	-	365
Net cash used in investing activities	<u>(20,060)</u>	<u>(16,913)</u>	<u>(21,862)</u>
FINANCING ACTIVITIES:			
Net proceeds under revolving credit facility	10,137	35,826	2,182
Proceeds from long-term obligations	-	3,000	6,000
Principal payments on long-term obligations	(2,694)	(20,472)	(4,156)
Purchase of treasury stock	(1,487)	-	-
Changes in cash management liability	1,434	2,891	(3,284)
Debt issuance costs	(1,238)	(41)	(232)
Proceeds from exercise of options	671	917	1,566
Proceeds from sale of stock under employee stock purchase plans	57	62	68
Excess tax benefits from exercise of stock options	151	248	-
Net cash provided by financing activities	<u>7,031</u>	<u>22,431</u>	<u>2,144</u>
INCREASE (DECREASE) IN CASH	<u>(2,019)</u>	<u>683</u>	<u>(102)</u>
CASH AT BEGINNING OF YEAR	<u>6,051</u>	<u>5,368</u>	<u>5,470</u>
CASH AT END OF YEAR	<u>\$ 4,032</u>	<u>\$ 6,051</u>	<u>\$ 5,368</u>

See accompanying notes to financial statements.

1.

NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

Gottschalks Inc. (the "Company") is a regional department and specialty store chain based in Fresno, California. As of February 2, 2008, the Company operated 59 full-line department stores located in six Western states, with 39 stores located in California, 7 in Washington, 5 in Alaska, 4 in Oregon, 2 in Nevada and 2 in Idaho. The Company also operated 4 specialty stores which carry a limited selection of merchandise. The Company's department stores typically offer a wide range of better to moderate brand-name and private-label merchandise, including men's, women's, juniors' and children's apparel, cosmetics, shoes and accessories, and also a wide array of home furnishings, including domestics, china, housewares, small electrics and, in certain locations, furniture and mattresses.

Use of Estimates

- The preparation of the financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. On an ongoing basis, the Company evaluates its estimates, including those related to its revenue recognition policy, the carrying value of its merchandise inventories, the adequacy of its workers' compensation insurance reserves, and the valuation of its long-lived assets, including goodwill, and its deferred tax assets. Such estimates and assumptions are subject to inherent uncertainties which may cause actual results to differ from reported amounts.

Fiscal Year

- The Company's fiscal year ends on the Saturday nearest January 31. Fiscal years 2007, 2006 and 2005 ended on February 2, 2008, February 3, 2007 and January 28, 2006, respectively. Fiscal 2006 included 53 weeks, and 2007 and 2005 each included 52 weeks.

Revenue Recognition

- Net retail sales are recorded at the point-of-sale and include sales of merchandise, net of estimated returns and exclusive of sales tax. Net retail sales also include all amounts billed to customers for shipping and handling, including customer delivery charges. Revenues on special order sales are recognized when the merchandise is delivered to the customer. The Company does not sell merchandise on layaway. The Company's policy with respect to gift cards is to record revenue as the gift cards are redeemed for merchandise. Prior to their redemption, the gift cards are recorded as a liability. The liability remains recorded until the earlier of redemption, escheatment, or 60 months. It is the Company's historical experience that the likelihood of redemption after 60 months is remote. The Company records an allowance for estimated sales returns in the period in which the related sale occurs. These estimates are based primarily on historical sales returns. If the historical data used to calculate these estimates does not properly reflect future returns, adjustments to the allowance for estimated sales returns may be necessary.

The Company offers its private label credit card customers a points based rewards program. The program offers one point for every one dollar in net annual spending using the Company's private label credit card. At the end of each calendar year qualifying customers are sent a merchandise certificate for up to 5% of the total points accumulated, up to a maximum of 10,000 points, or \$500. As points are earned throughout the year the Company accrues for the estimated costs of goods to be sold via redemption of the merchandise certificates based on historical redemption rates.

Net credit revenues consist primarily of a percentage of net private label credit card sales and the amortization of the prepaid program fee as provided for under the Credit Card Program Agreement with HSBC (Note 2). Net leased department revenues consist of rental income from lessees and sub-lessees and are based on a percentage of total sales generated in such leased departments during respective fiscal periods. Sales generated in such leased departments totaled \$21,027,000, \$23,923,000 and \$24,406,000 in 2007, 2006 and 2005, respectively.

Cash

- Amounts in-transit from banks for customer credit card, debit card and electronic benefit transfer transactions that process in less than seven days are classified as cash in our Balance Sheets. The banks process the majority of these

amounts within one to two business days. There was \$2.0 million and \$3.6 million of in-transits from banks included in cash as of February 2, 2008 and February 3, 2007, respectively.

Receivables

- As of February 2, 2008 and February 3, 2007, receivables consist of vendor claims of \$7,128,844, less allowances of \$80,000, and vendor claims of \$8,278,377, less allowances of \$80,000, respectively.

Merchandise Inventories

- Inventories, which consist of merchandise held for resale, are valued by the retail inventory method and are stated at last-in, first-out (LIFO) cost, which is not in excess of market. Current cost, which approximates replacement cost, under the first-in, first-out (FIFO) method is equal to the LIFO value of inventories at February 2, 2008 and February 3, 2007. The Company includes in inventory the capitalization of certain indirect buying, handling and distribution costs to better match these costs with the related sales.

Under the retail inventory method, inventory is segregated into departments of merchandise having similar characteristics, and is stated at its current retail selling value. Inventory retail values are converted to a cost basis by applying specific average cost factors for each merchandise department. Cost factors represent the average cost-to-retail ratio for each merchandise department based on beginning inventory and the fiscal year purchase activity. The retail inventory method inherently requires management judgments and estimates, such as the amount and timing of permanent markdowns to clear unproductive or slow-moving inventory, which may impact the ending inventory valuation as well as gross margins.

Permanent markdowns designated for clearance activity are recorded when the utility of the inventory has diminished. Factors considered in the determination of permanent markdowns include current and anticipated demand, customer preferences, age of the merchandise and fashion trends. When a decision is made to permanently mark down merchandise, the resulting gross margin reduction is recognized in the period the markdown is recorded.

Shrinkage is estimated as a percentage of sales for the period from the last inventory date to the end of the fiscal period. Such estimates are based on experience and the most recent physical inventory results. Physical inventories are taken within each merchandise department annually and inventory records are adjusted accordingly.

The Company receives cash or allowances from merchandise vendors as purchase price adjustments and in connection with cooperative advertising programs. Purchase price adjustments are credited to cost of sales and cooperative advertising allowances are credited against advertising expense in accordance with Emerging Issues Task Force ("EITF") Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor."

Workers' Compensation

- The Company has a pre-funded deposit and a liability relating to its workers' compensation claims. Liabilities associated with these losses include estimates of both losses reported and losses incurred but not yet reported, together referred to as "ultimate losses". We estimate our ultimate losses based on analysis of historical data and independent actuarial estimates.

Store Closure Costs

- In the event a store is closed before its lease has expired, the remaining lease obligation after the closing date (less anticipated sublease rental income or proceeds from lease settlements, if any) is expensed at the date the store ceases operations. Asset impairment charges, if any, related to furniture, fixtures and equipment, leasehold improvements, goodwill and leasehold interests are expensed in the period in which management adopts a plan to close the store if impairment is considered likely as a result of such planned store closure or at such other time as impairment becomes likely. Severance and other incremental costs associated with a store closure are expensed as incurred.

New Store Opening Costs

- New store opening costs are expensed as incurred and may vary significantly from year to year depending on the number of new stores opened.

Property and Equipment

- Depreciation of owned properties is provided primarily on a straight-line basis over the estimated asset lives, which range from 15 to 40 years for buildings and leasehold improvements and 3 to 15 years for furniture, fixtures and equipment. Buildings on leased land and leasehold improvements are amortized over the shorter of their economic lives or the lease term, beginning on the date the asset is put into use. The lease term, which includes all renewal periods that are considered to be reasonably assured, begins on the date the Company has access to the leased property. The amortization of buildings and equipment under capital leases is computed by the straight-line method over the term of the lease or the estimated economic life of the asset, depending on the criteria used to classify the lease, and such amortization is combined with depreciation in the accompanying statements of income.

Leases

- The Company recognizes operating lease minimum rentals on a straight-line basis over the lease term. The Company receives contributions from landlords to fund buildings and leasehold improvements. Such contributions

are primarily recorded as deferred rent and amortized as reductions to lease expense over the lease term. During fiscal 2005, due to the Company's involvement in the construction of the building at its River Park store and other factors, the Company recorded \$10.2 million in building and equipment under capital leases and \$6.0 million in capital lease obligations associated with landlord reimbursements received. Executory costs such as real estate taxes and maintenance, and contingent rentals such as those based on a percentage of sales are recognized as incurred. The lease term, which includes all renewal periods that are considered to be reasonably assured, began on the date the Company had access to the leased property. The excess in rent expense over actual cash paid is recorded as deferred rent.

Software Development Costs

- Costs associated with the acquisition or development of software for internal use that meet the criteria of AICPA Statement of Position No. 98-1, "Accounting for Costs of Computer Software Developed or Obtained for Internal Use" are capitalized and amortized over the expected useful life of the software, which generally ranges from 3 to 10 years. Software development costs capitalized under SOP No. 98-1 in fiscal 2007, 2006 and 2005 totaled \$50,000, \$191,000 and \$177,000, respectively. Amortization of such costs totaled \$205,000, \$425,000 and \$420,000 in fiscal 2007, 2006 and 2005, respectively.

Goodwill

- Goodwill and intangible assets having indefinite lives are not being amortized to earnings, but instead are subject to periodic testing for impairment. Goodwill and other intangible assets of a reporting unit are tested for impairment on an annual basis and more frequently if certain indicators are encountered. The Company has three geographical regions that it considers reporting units and operating segments, as the Company manages operations based on these regions. The Company has performed the required annual impairment review of goodwill for each of the fiscal years reported and concluded that there was no indication of impairment as of the respective measurement dates.

Investment in Partnership

- The Company has a 36% interest in a partnership which is accounted for using the equity method because the Company has the ability to exercise significant influence over the investee's operating and financial policies. The partnership owns the office building in which the Company's headquarters are located. See Note 15.

Leasehold Interests

- Leasehold interests associated with acquired leases are amortized on a straight-line basis over the respective lease terms, including option renewal periods if renewal of the lease is probable, which range from 1 to 20 years.

Cash Management Liability

- Under the Company's cash management program, checks issued by the Company and not yet presented for payment frequently result in overdraft balances for accounting purposes. Such amounts represent interest-free, short-term borrowings by the Company.

Miscellaneous Income

- Miscellaneous income consists of rental income from sub-leased properties, income from the Company's investment in a partnership, and miscellaneous non-operating income and expense. Miscellaneous income does not include any material offsetting expense items.

Advertising Costs

- Advertising costs, net of cooperative advertising allowances, totaling \$30,015,000, \$29,695,000 and \$28,946,000 in 2007, 2006 and 2005, respectively, are included in selling, general and administrative expenses for financial reporting purposes and are expensed when the related advertisement first takes place. Cooperative advertising allowances were \$11,008,000, \$12,965,000 and \$12,097,000 in 2007, 2006 and 2005 respectively.

Income Taxes

- Deferred tax assets and liabilities are generally recognized for the expected future tax consequences of events that have been included in the financial statements or tax returns, determined based on the differences between the financial statement and tax basis of assets and liabilities

and net operating loss and tax credit carryforwards, and by using enacted tax rates in effect when the differences are expected to reverse. A valuation allowance is recorded when it is more likely than not that the carrying amounts of deferred tax assets will not be fully realized.

In June 2006, the Financial Accounting Standards Board (FASB) issued Financial Interpretation No. (FIN) 48, "Accounting for Uncertainty in Income Taxes," which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." The interpretation prescribes a "more likely than not" recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 applies to all tax positions related to income taxes subject to SFAS 109 and creates a single model to address accounting for uncertainty in tax positions. FIN 48 requires that tax positions accounted for under SFAS

109 be evaluated for recognition based solely on technical merits and the resulting tax benefits be measured using a cumulative probability assessment and the Company's plan for settlement. The Company adopted FIN 48 effective February 4, 2007. The adoption of FIN 48 did not have a material effect on the Company's consolidated financial position or results of operations (see Note 10).

Stock-Based Compensation

- At February 2, 2008, the Company has two stock-based employee compensation plans, which are more fully described in Note 12. The Company accounts for these plans under SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123R"). The Company adopted SFAS No. 123R in the first quarter of 2006 using the modified prospective approach. Under the modified prospective method, compensation expense is recorded for the unvested portion of previously issued awards that remain outstanding at January 29, 2006 using the same estimate of the grant date fair value and the same attribution method used to determine the pro forma disclosure under SFAS No. 123. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options after January 26, 2006, be recognized in the financial statements as compensation cost based on the fair value on the date of grant.

Prior to the adoption of SFAS No. 123R, the Company accounted for its plans under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. No stock-based employee compensation cost is reflected in net income during 2005, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of the grant.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123R in fiscal 2005. The Company's calculations were made using the Black-Scholes option pricing model, which is more fully described in Note 13.

(In thousands, except per share data)	Fiscal Year 2005
Net income as reported	\$ 5,200
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	<u>(584)</u>
Pro forma net income	<u>\$ 4,616</u>
Earnings per share:	
As reported:	
Basic	\$ 0.39
Diluted	\$ 0.38
Pro-forma:	
Basic	\$ 0.35
Diluted	\$ 0.33

Long-Lived Assets

- The Company periodically evaluates the carrying value of long-lived assets to be held and used, including intangible assets other than goodwill, when events and circumstances warrant such a review. When the anticipated undiscounted cash flow from a long-lived asset is less than its carrying value, a loss is recognized based on the amount by which its carrying value exceeds its fair market value. Fair market value is determined primarily using the anticipated cash flows discounted at a rate commensurate with the risks involved, and in some cases, the expected proceeds from the sale or sublease of a particular asset, or independent appraisals. There were no asset impairment charges from continuing operations recognized in fiscal 2007, 2006 or 2005.

Discontinued Operations

- The Company has determined that certain store closures constitute discontinued operations based on whether the store closure results in the Company's exit from a market area. If a store closure, or closures, is determined to be a discontinued operation, as prescribed by SFAS No. 144, "Accounting for the Impairment or Disposal of Long-lived

Assets," results of operations of the closed store are excluded from continuing operations and reported separately in discontinued operations for all periods presented. Store closures in areas that continue to be served by other stores are not considered discontinued operations.

Fair Value of Financial Instruments

- The carrying value of the Company's cash and cash management liability, receivables, trade payables and other accrued expenses, and the revolving line of credit approximate their estimated fair values because of the short maturities or variable interest rates underlying those instruments. The carrying value of the Subordinated Note approximates its estimated fair value.

The fair values of the Company's mortgage loans and notes payable are estimated using discounted cash flow analysis, based on the Company's current incremental borrowing rates for similar types of borrowing arrangements. Borrowings with aggregate carrying values of \$5,349,000 and \$6,624,000 at February 2, 2008 and February 3, 2007, had estimated fair values of \$5,603,000 and \$6,596,000 at February 2, 2008 and February 3, 2007, respectively. The estimated fair value of the Company's derivative financial instrument is disclosed in Note 6.

Segment Reporting

- We have reviewed SFAS 131, *Disclosures about Segments of an Enterprise and Related Information*, and determined that we meet the aggregation criteria outlined as our regional operating segments have similar economic characteristics, products and services, and distribution channels. Therefore, the Company reports as one reportable segment.

Revenues are derived from merchandise sales from customers. The Company purchases merchandise from numerous suppliers; however, no single vendor accounted for more than 5% of the Company's net purchases in fiscal 2007. The Company's merchandising activities are conducted centrally from its corporate office in Fresno, California.

The Company's percentage of total sales (including leased department sales) by major product line is reflected in the following table:

	Fiscal Years					
	2007		2006		2005	
Women's Apparel	29.0	%	28.3	%	28.2	%
Cosmetics, Shoes & Accessories	27.6		26.9		25.8	
Home	16.7		17.9		18.7	
Men's Apparel	12.4		12.7		12.8	
Juniors' and Children's Apparel	11.1		10.8		11.0	
Leased Departments	3.2		3.4		3.5	
Total Sales	100.0	%	100.0	%	100.0	%

Comprehensive Income

- There were no items of other comprehensive income in 2007, 2006 or 2005, and therefore net income is equal to comprehensive income for each of those years.

New Accounting Pronouncements

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In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurement. SFAS 157 does not require any new fair value measurement and the Company is currently evaluating the impact, if any, of SFAS 157 on its financial position, results of operations and cash flows. SFAS 157 requires prospective application for fiscal years beginning after November 15, 2007.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities," (SFAS 159). This statement permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to reduce fluctuation in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Most of the provisions of SFAS 159 apply only to entities that elect the fair value option. However, the amendment to FASB Statement No. 115, "Accounting for

Certain Investments in Debt and Equity Securities," applies to all entities with available-for-sale and trading securities. SFAS 159 is effective for Gottschalks Inc. on February 3, 2008. The Company is currently evaluating the impact, if any, of SFAS 159 on its financial position, results of operations, and cash flows.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities," (SFAS 161). This statement changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about how and why an entity uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations, and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. SFAS 161 is effective for the Company on February 1, 2009. The Company is currently evaluating the impact, if any, of SFAS 161 on its financial position, results of operations and cash flows.

2. NET CREDIT REVENUES

In January 2003, the Company entered into a Credit Card Program Agreement (the "CCA") with HSBC.

The CCA sets forth the terms and conditions under which HSBC will issue credit cards to the Company's customers and pay the Company for sales made on the cards. Under the terms of the CCA, the Company is required to perform certain duties, including the duties to receive in-store customer payments on behalf of HSBC and remit such payments to HSBC. The CCA further provides the Company will be paid a percentage of Net Cardholder Charges and a percentage of Other Revenue (each as defined in the CCA). The CCA had an initial term of five (5) years expiring January 31, 2008 and was cancelable earlier by either party under certain circumstances.

On February 4, 2007, the Company and HSBC entered into a new Credit Card Program Agreement which has a term of six (6) years and is cancelable by either party under certain circumstances. This amended agreement provides the Company will be paid a percentage of net credit card sales, a percentage of other revenue and will be paid a one-time prepaid program fee (each as defined in the CCA). The prepaid program fee totaling \$1,500,000 is being amortized on a straight-line basis over the six year term of the agreement. In addition, a percentage of net credit card sales (as defined in the CCA) will be used by HSBC and the Company to support the private-label credit card to fund marketing programs.

Net credit revenues associated with the Company's private label credit card program currently consist primarily of a percentage of net credit card sales and the amortization of the prepaid program fee. Net credit revenues were \$4,868,000, \$3,087,000 and \$3,084,000 in fiscal 2007, 2006, and 2005, respectively.

3. PROPERTY AND EQUIPMENT

Property and equipment consists of the following:

(In thousands)	February 2, 2008	February 3, 2007
Furniture, fixtures and equipment	\$ 136,654	\$ 127,715
Buildings and leasehold improvements	101,219	96,698
Land	15,185	15,185
Buildings and equipment under capital leases	26,170	28,936
Construction in progress	2,835	1,872
	282,063	270,406
Less accumulated depreciation and amortization	(144,132)	(135,710)
	<u>\$ 137,931</u>	<u>\$ 134,696</u>

During the third quarter of fiscal 2005, due to the Company's involvement in the construction of the building at its River Park store and other factors, the Company recorded \$10.2 million in building and leasehold improvements under capital leases and \$6.0 million in capital lease obligations associated with landlord reimbursements received. The Company plans to construct a 55,000 square foot store at an approximate cost of \$6.8 million, including fixtures, in Bend, Oregon.

4. TRADE ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Trade accounts payable and accrued liabilities consist of the following:

(In thousands)	February 2, 2008	February 3, 2007
Trade accounts payable	\$ 14,426	\$ 27,545
Accrued liabilities	12,808	15,330
Gift and merchandise cards	9,372	9,542
Workers' compensation insurance reserves	6,175	7,296
Taxes, other than income taxes	11,232	3,991
Accrued payroll and related liabilities	8,926	9,400
Cash management liability	6,524	5,090
Federal and state income taxes payable	-	1,660
	<u>\$ 69,463</u>	<u>\$ 79,854</u>

5. DEBT

New Senior Secured Credit Facility

The Company signed a second Amended and Restated Credit Agreement with General Electric Capital Corporation to refinance its existing credit facility on September 26, 2007. The new credit facility consists of a \$200 million senior secured revolving credit facility (including a \$20 million letter of credit sub-facility). Borrowings under the revolving credit facility are limited to the sum of (a) a specified percentage of eligible credit card receivables, (b) a specified percentage of the net recovery value of eligible inventory, as determined by periodic valuation performed by an independent appraiser, and (c) 65% of the fair market value of the Company's real estate. Such borrowings are further limited by a requirement to maintain a minimum of \$15 million of excess availability at all times, and other reserves. Substantially all of the Company's assets, including its merchandise inventories, are pledged under the credit facility.

As of February 2, 2008, outstanding borrowings under the new credit facility totaled \$93.9 million, and availability for additional borrowings under the credit facility, after the deduction of the minimum availability requirement and other reserves, was \$40.2 million. Interest charged on amounts borrowed under the credit facility is at the prime rate, or at the Company's option, at the applicable LIBOR rate plus 1.25% per annum. In addition, the Company pays an unused commitment fee equal to 0.20% per annum on the average unused daily balance of the credit facility. The interest rate is adjusted upwards or downwards on a quarterly basis based on a pricing matrix, which is tied to the Company's daily average excess availability for the preceding fiscal quarter (as defined in the agreement). Under the pricing matrix, the applicable interest rate could range from a rate as low as prime or LIBOR plus 1.25%, to as high as prime plus 0.5%, or LIBOR plus 2.5%.

The new credit facility contains restrictive financial and operating covenants, including the requirement to maintain a fixed charge coverage ratio of 1:1 (as defined in the agreement) if the Company's excess borrowing availability is below \$20 million. As of February 2, 2008, the Company was in compliance with all restrictive financial covenants applicable to the credit facility. The agreement has a five year term expiring September 26, 2012.

Old Senior Revolving Credit Facility

From January 26, 2006 to September 26, 2007, the credit facility, as amended on January 26, 2006, consisted of a revolving credit facility of up to \$172 million (including a \$20 million letter of credit sub-facility) and a fully funded term loan of \$9 million. Borrowings under the revolving credit facility, as amended, were limited to the sum of (a) a specified percentage of eligible credit card receivables, (b) the lesser of specified percentages of (i) the cost of eligible inventory and (ii) the net recovery value of the inventory, as determined by periodic valuation performed by an independent appraiser, and (c) the lesser of (i) up to 60% of the fair market value of the designated properties and (ii) \$21.6 million. Such borrowings were further limited by a requirement to maintain a minimum of \$5 million of excess availability at all times, and other reserves that were in effect. Substantially all of the Company's assets, including its merchandise inventories, were pledged under the credit facility.

On September 26, 2007, interest charged on amounts borrowed under the revolving portion of the credit facility were at the prime rate, or at the Company's option, at the applicable LIBOR rate plus 1.25% per annum, and interest charged on the term loan was a fixed rate of 6.6% per annum. In addition, the Company paid an unused commitment fee equal to 0.375% per annum on the average unused daily balance of the revolving portion of the credit facility. The interest rate applicable to the revolving portion of the credit facility was adjusted upwards or downwards on a quarterly basis based on a pricing matrix which was tied to the Company's daily average excess availability for the preceding fiscal quarter (as defined in the agreement). Under the pricing matrix, the applicable interest rate could have ranged from a rate as low as prime or LIBOR plus 1.25%, to as high as prime plus 0.5%, or LIBOR plus 2.5%.

The credit facility, as amended, contained restrictive financial and operating covenants, including the requirement to maintain a fixed charge coverage ratio of 1:1 (as defined in the agreement) if the Company's excess borrowing availability was below \$15 million.

Long-Term Obligations

Long-term obligations consist of the following:

(In thousands)	February 2, 2008	February 3, 2007
Capital lease obligations	\$ 8,224	\$ 8,644
7.5% note payable due 2010	1,710	2,442
Other mortgage loans and notes payable	3,640	4,182
	13,574	15,268
Less current portion	(1,525)	(1,676)
	<u>\$ 12,049</u>	<u>\$ 13,592</u>

In fiscal 2006, the Company paid off \$16.6 million of 9.39% mortgage loans on February 1, 2006 with funds from the Company's revolving credit facility. Also in fiscal 2006, the Company financed a corporate aircraft with a 6.64% \$3.0 million note. The scheduled annual principal maturities of the Company's notes payable are \$1,275,000, \$1,317,000, \$575,000, \$539,000 and \$576,000 for 2008 through 2012, with \$1,067,000 payable thereafter.

Deferred debt issuance costs related to the Company's various financing arrangements are included in other current and long-term assets and are charged to income as additional interest expense over the life of the related indebtedness. Such costs, net of accumulated amortization, totaled \$1,885,000 at February 2, 2008 and \$1,181,000 at February 3, 2007.

Interest paid, net of amounts capitalized, was \$8,580,000 in 2007, \$9,842,000 in 2006, and \$8,466,000 in 2005. The Company capitalized \$21,000 in interest in connection with leasehold improvements at a new store and major remodels performed at two store locations in fiscal 2007. No interest was capitalized in 2006. In 2005, \$114,000 interest was capitalized. The weighted-average interest rate charged on the Company's revolving line of credit was 6.91% in 2007, 7.10% in 2006 and 5.98% in 2005.

Substantially all of the Company's assets, including its merchandise inventories, are pledged as collateral under the Company's various debt agreements. Certain of the Company's long-term debt agreements contain financial and other restrictive covenants, as well as cross-default provisions. Accordingly, the failure to comply with these restrictions and covenants, if not waived, would cause a cross-default under the majority of all of the Company's debt agreements, including the credit facility. The Company was in compliance with all applicable financial covenants as of February 2, 2008.

6. INTEREST RATE DERIVATIVE

On December 9, 2005 the Company entered into an interest rate swap agreement, effective December 14, 2005, to change the fixed/variable interest rate mix of the debt portfolio in order to maintain the percentage of fixed-rate and variable-rate debt within parameters set by management. The Company currently has an interest rate swap contract outstanding to effectively convert a portion of its variable-rate debt to fixed-rate debt. This contract entails the exchange of fixed-rate and floating-rate interest payments periodically over the agreement life. The following table indicates the notional amount as of February 2, 2008 and the range of interest rates paid and received by the Company during the fiscal year then ended:

Fixed swap (notional amount)	\$25,000,000
Range of receive rate	5.06% - 5.70%
Pay rate	4.99%

In accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS No. 133"), and SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," the Company recognizes all derivatives on the balance sheet at fair value. Although the swap essentially provides for matched terms to its underlying obligation, it does not qualify for hedge accounting under SFAS No. 133.

The \$25 million interest rate swap will expire February 2, 2009. The net income or expense from the exchange of interest rate payments is included in interest expense. The estimated fair value of the interest rate swap agreement, based on dealer quotes, at February 2, 2008 was a loss of \$526,000 and represents the amount the Company would pay if the agreement was terminated as of that date. Changes in the fair value of derivatives not designated as qualifying cash flow hedges are reported in interest expense. Accordingly, interest expense for fiscal 2007 includes losses related to the interest rate swap of \$624,000, and as of February 2, 2008 the Company reflected a derivative liability in other liabilities of \$526,000 to recognize the fair value of the interest rate swap. All credits recorded pursuant to SFAS No. 133 are considered non-cash items in the statements of cash flows.

7. SUBORDINATED NOTE PAYABLE TO AFFILIATE

El Corte Ingles ("ECI") of Spain, and Harris, a wholly owned subsidiary of ECI, became affiliates of the Company in fiscal 1998 when the Company acquired substantially all of the assets and business of Harris. The Company issued a Subordinated Note to Harris, in the principal amount of \$22,179,000 as partial consideration for the Harris acquisition (the "Original Note"). The Original Note bore interest at a fixed rate of 8%. On December 7, 2004 a new Subordinated Note due May 30, 2009 superseded the Original Note. The new Subordinated Note bears interest at a fixed rate of 8% payable semi-annually and provides for principal payments of up to \$8.0 million prior to its maturity. Such payments are subject to certain liquidity restrictions under the revolving credit facility. The Company made principal payments of \$1.0 million each upon execution of the note, on February 20, 2006, on February 20, 2007, and a principal payment of \$2.0 million subsequent to fiscal year end on February 20, 2008, as scheduled. An additional principal payment of \$2.0 million is scheduled for February 2009, with the balance due at maturity subject to the payment in full of the revolving credit facility. The Subordinated Note is unsecured, contains no restrictive financial covenants and is subordinate to the payment of all debt, including trade credit, of the Company. Interest paid to Harris totaled \$1,494,000 in 2007, \$1,574,400 in 2006, and \$1,679,500 in 2005.

8. LEASES

The Company leases certain retail department stores, specialty stores, land, furniture and fixtures and equipment under capital and noncancelable operating leases that expire in various years through 2025. Certain of the leases provide for the payment of additional contingent rentals based on a percentage of sales, require the payment of property taxes, insurance and maintenance costs and have renewal options for one or more periods ranging from five to twenty years. The Company leases three of its department stores from ECI, an affiliate of the Company. See Note 7. Rent paid or accrued to ECI totaled \$868,000 in 2007, \$888,000 in 2006, and \$874,000 in 2005. The Company plans to close two of these stores at the end of their lease terms during the second quarter of fiscal 2008.

Future minimum lease payments as of February 2, 2008, by year and in the aggregate, under capital leases and noncancelable operating leases with initial or remaining terms in excess of one year are as follows:

(In thousands)	Capital Leases	Operating Leases
2008	\$ 1,376	\$ 23,412
2009	1,376	22,096
2010	1,417	20,005
2011	1,476	18,544
2012	1,476	15,534
Thereafter	14,110	100,717
Total minimum lease payments	21,231	\$ 200,308
Amount representing interest	(13,007)	
Present value of minimum lease payments	8,224	
Less current portion	(249)	
	\$ 7,975	

Rental expense associated with operating leases consists of the following:

(In thousands)	Fiscal Years		
	2007	2006	2005
Buildings:			
Minimum rentals	\$ 22,360	\$ 23,352	\$ 23,430
Contingent rentals	2,673	3,579	3,175
Fixtures and equipment	1,985	2,039	2,057
	\$ 27,018	\$ 28,970	\$ 28,662

One of the Company's lease agreements contains a restrictive financial covenant pertaining to the debt to tangible net worth ratio that management believes the Company was in compliance with at February 2, 2008.

9. DISCONTINUED OPERATIONS

The Company closed one underperforming Seattle/Tacoma market during the first quarter of fiscal 2006 and one underperforming store in the Seattle metro-area during the third quarter of fiscal 2006. During fiscal 2005, the Company closed two underperforming stores in the Seattle/Tacoma market. These stores were determined to be either underperforming or inconsistent with the Company's long-term operating strategy and due to the Company's exit from the respective market areas are considered discontinued operations. The loss from operations of discontinued stores includes only revenues generated from, and expenses directly associated with, the operation of such stores and consists of the following:

(In thousands)	Fiscal Years		
	2007	2006	2005
Net sales from closed stores	\$ -	\$ 2,921	\$ 11,480
Cost of sales	-	2,421	7,442
Selling, general and administrative expenses	-	1,533	5,235
Depreciation and amortization	-	69	412
Total costs and expenses	-	4,023	13,089
Loss from operations of closed stores	\$ -	\$ (1,102)	\$ (1,609)

The loss on store closures of \$98,000 includes a net gain on the sale of the building associated with the store closed during the first quarter of fiscal 2006 of approximately \$147,000, offset by a loss on disposal of assets of \$139,000 related to the store closed during the third quarter of fiscal 2006, and store closure costs of approximately \$106,000 related to both stores closed in fiscal 2006, primarily consisting of severance and other incremental costs associated with the store closings.

Net costs associated with the closure of stores in fiscal 2005 were \$0.1 million, consisting of severance and other incremental costs associated with the store closings. Such costs were offset by \$0.3 million of income from an early termination fee received when the landlord exercised its right to terminate the lease. Net costs associated with the closure of stores were minor in fiscal 2004, primarily consisting of incremental costs associated with the closure of one store at January 31, 2004.

In addition, the Company closed one store in Wasilla, Alaska during the first quarter of fiscal 2007, one store in Tacoma, Washington during the third quarter of fiscal 2007, and one store each in Danville, California and Moscow, Idaho in the third and fourth quarters of fiscal 2006. The Company also closed one store in Fresno, California during the first quarter of fiscal 2005. These closures are not reported as discontinued operations due to the shift of revenues to other stores in the respective markets. The Company has plans to close two stores in California during the second quarter of 2008 at the end of their lease terms. These closures are not considered discontinued operations as the Company has remaining stores in the market areas.

Certain of the Company's stores may perform below expectations from time to time. In the event the Company is unable to improve the operating performance of such underperforming stores, the Company may consider the sale, sublease or closure of those stores in the future.

10. INCOME TAXES

The components of income tax expense (benefit) from continuing operations are as follows:

(In thousands)	Fiscal Years		
	2007	2006	2005
Current:			
Federal	\$ (2,145)	\$ 1,870	\$ 2,468
State	(79)	(127)	562
	<u>(2,224)</u>	<u>1,743</u>	<u>3,030</u>
Non Current:			
Federal	(935)	-	-
State	(209)	-	-
	<u>(1,144)</u>	<u>-</u>	<u>-</u>
Deferred:			
Federal	(3,664)	(445)	924
State	(950)	333	(847)
	<u>(4,614)</u>	<u>(112)</u>	<u>77</u>
	<u>\$ (7,982)</u>	<u>\$ 1,631</u>	<u>\$ 3,107</u>

Income tax expense varies from the amount computed by applying the statutory federal income tax rate to income from continuing operations before income taxes. The reasons for this difference are as follows:

	Fiscal Years		
	2007	2006	2005
Statutory rate	35.0 %	35.0 %	35.0 %
State income taxes, net of federal income tax benefit	4.0	3.5	(2.4)
General business credits	0.8	(5.6)	(2.6)
Valuation allowance	-	(6.1)	4.6
Increase in tax reserve	-	6.4	
Other items, net	(0.7)	(1.6)	(1.1)
Effective rate	39.1 %	31.6 %	33.5 %

The principal components of deferred tax assets and liabilities are as follows (in thousands):

	February 2, 2008		February 3, 2007	
	Deferred Tax Assets	Deferred Tax Liabilities	Deferred Tax Assets	Deferred Tax Liabilities
Current:				
Accrued employee benefits	\$ 1,216	\$	\$ 1,469	\$
Net operating loss and tax credit carryforwards	-		289	
State income taxes	360		355	
LIFO inventory reserve		(6,630)		(6,630)
Workers' compensation	2,612		3,086	
Legal reserve	106		160	
Deferred income	1,341		1,172	
Valuation allowance	(459)		(916)	
Other items, net	872	(2,514)	492	(3,018)
	<u>6,048</u>	<u>(9,144)</u>	<u>6,107</u>	<u>(9,648)</u>
Long-Term:				
Net operating loss and tax credit carryforwards	9,346	-	4,037	
State income taxes	-	(81)	226	
Property and equipment		(9,609)		(9,468)
Accounting for leases	2,024	(549)	1,066	(2,089)
Leasehold interests	109	-	192	
Deferred income	629	(4,641)	414	(4,316)
Acquisition costs	-	(1,670)	-	(1,435)
Valuation allowance	(2,071)		(772)	
Other items, net	1,790	(239)	999	(165)
	<u>11,827</u>	<u>(16,789)</u>	<u>6,162</u>	<u>(17,473)</u>
	<u>\$ 17,875</u>	<u>\$ (25,933)</u>	<u>\$ 12,269</u>	<u>\$ (27,121)</u>

As a result of certain realization requirements of SFAS 123(R), the table of deferred tax assets and liabilities shown above does not include certain deferred tax assets at February 2, 2008 that arose directly from tax deductions related to equity compensation in excess of compensation recognized for financial reporting. Equity will be increased by approximately \$350,000 if, and when, such deferred tax assets are ultimately realized.

The federal and state net operating loss carryforwards per the income tax returns included uncertain tax positions taken in prior years. The net operating loss and tax credit carryforwards in the table of deferred tax assets and liabilities shown above are presented on a tax return basis. All other deferred tax assets and liabilities included in the table above have been adjusted by the respective FIN 48 liabilities.

The carrying value of the Company's net deferred tax assets assumes that the Company will be able to generate sufficient future taxable income to realize the value of these assets. In determining the appropriate valuation allowance, management considers all available evidence for the deferred tax assets, including tax credits, net operating loss and capital loss carryforwards that would likely expire prior to their utilization. The Company has established valuation allowances that relate primarily to certain state tax credit carryforwards the realization of which is uncertain. Although these credits do not expire, the utilization is extremely limited and is available only to the extent the Company generates sufficient taxable income apportionable to the respective location. The Company has historically generated the credits at a substantially more rapid rate than it has been able to utilize them. The resulting utilization period is, therefore, unusually long. Although the Company has had, prior to the fiscal 2007 loss, recent profitability, there can be no certainty that the Company will continue to generate sufficient taxable income apportioned to specific locations for an indefinite period of time to fully utilize the state tax credit carryforwards, especially given the cyclical nature of the company's business. Further, there is no certainty that the Company will operate in these specific locations for an extended period. To the extent that the Company no longer operates within these locations, the tax credits cannot be utilized.

In addition, the Company has generated certain capital losses for which there is currently no carryback opportunity available. Based on the Company's current operating strategy it appears more likely than not that there will be no opportunity available during the remaining carryforward period to generate offsetting capital gains. Accordingly the Company considers it appropriate to establish a valuation allowance against such carryforwards. Management believes it is more likely than not that the Company will generate sufficient future taxable income in the appropriate carryforward periods to realize the benefit of its remaining net deferred tax assets. However, if the available evidence were to change in the future, an adjustment to the valuation allowance may be required, resulting in additional income tax expense or benefit. Certain valuation allowances were increased by approximately \$842,000 in the current year due primarily to a reduction in the Company's assessment of future income.

In June 2006, the Financial Accounting Standards Board (FASB) issued Financial Interpretation No. (FIN) 48, "Accounting for Uncertainty in Income Taxes," which clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." The interpretation prescribes a "more likely than not" recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 applies to all tax positions related to income taxes subject to FAS 109 and creates a single model to address accounting for uncertainty in tax positions. FIN 48 requires that tax positions accounted for under FAS 109 be evaluated for recognition based solely on technical merits and the resulting tax benefits be measured using a cumulative probability assessment and the Company's plan for settlement. The Company adopted FIN 48 effective February 4, 2007. The adoption of FIN 48 did not have a material effect on the Company's unrecognized tax benefit or retained earnings.

The Company has an unrecognized tax benefit at February 2, 2008 of approximately \$1.2 million, exclusive of interest, reported in the Balance Sheet in Other Liabilities. Of this amount, the amount that would impact the Company's effective tax rate, if recognized, is \$0.1 million. The Company estimates that the unrecognized tax benefit will not change significantly within the next twelve months. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

Unrecognized tax benefit - adoption opening balance	\$ 2,371
Gross Increase - tax positions in prior period	71
Gross Decrease - tax positions in prior period	(1,058)
Gross Increases - tax positions in current period	26
Settlements with taxing authorities	-
Lapse of statute limitations	(172)
Unrecognized tax benefit - ending balance	<u>\$ 1,238</u>

The Company's policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. Total accrued interest included in the FIN 48 liability was \$0.3 million and \$0.2 million at February 4, 2007 and February 2, 2008. No penalties were accrued at February 4, 2007 and February 2, 2008.

The Company files its tax returns as prescribed by the tax laws of the jurisdiction in which it operates. The Company is no longer subject to U.S. federal tax examinations for years before fiscal 2004 while the fiscal 2004 through 2006 tax years are subject to examination. For the various state jurisdictions, tax years from fiscal 2003 through 2006 remain open to examination as well, although the Company believes any potential assessment would not have a material impact on the Company's financial position or results of operations.

At February 2, 2008, the Company has, for federal tax purposes, net operating loss carryforwards of approximately \$2.2 million which expire in the year 2027, general business credits of approximately \$3.6 million that expire in the year 2010 through 2027, and alternative minimum tax credits of \$0.6 million which may be used for an indefinite period. At February 2, 2008, the Company also has, for state tax purposes, net operating loss carryforwards of approximately \$15.8 million which expire in the year 2016 and 2017 and \$3.0 million of state tax credits which may be used for an indefinite period. These carryforwards are available to offset future taxable income.

The Company paid income taxes, net of refunds, of \$449,000 in fiscal 2007, \$1,830,000 in fiscal 2006 and \$12,000 in fiscal 2005.

11. SHARE REPURCHASE PROGRAM

The Company's Board of Directors announced its share repurchase program in September 2007, which allows for the repurchase of up to 2 million shares over 12 months subject to certain pricing conditions. During fiscal 2007, the Company repurchased 417,800 shares for \$1,487,000, at an average cost of \$3.56 per share including commissions. Such shares are reflected as treasury stock in the stockholder's equity section of the condensed balance sheet. Purchases may be made at management's discretion in the open market and in privately negotiated transactions as market and business conditions warrant. There were no share repurchases in fiscal 2006 and 2005.

12.

WEIGHTED AVERAGE NUMBER OF SHARES

Net income/loss per common share is computed by dividing net income/loss by the weighted-average number of common shares outstanding during the period. Stock options represent potential common shares and are included in computing diluted earnings per share when the effect is dilutive and the Company reports net income. A reconciliation of the weighted-average shares used in the basic and diluted earnings per share calculation is as follows:

	Fiscal Years		
	2007	2006	2005
Basic calculation	13,600,718	13,428,279	13,245,321
Effect of dilutive shares - options	-	329,799	552,561
Diluted calculation	13,600,718	13,758,078	13,797,882

Options with an exercise price greater than the average market price of the Company's common stock during the period, or outstanding in a period in which the Company reports a net loss, are excluded from the computation of the weighted average number of shares on a diluted basis, as such options are antidilutive. The following shares were antidilutive and, therefore, not included in the computation of diluted earnings per share for the periods indicated:

	Fiscal Years		
	2007	2006	2005
Antidilutive shares - options	1,052,775	310,318	183,463

Certain of the shares noted above were excluded from the computation of dilutive shares solely due to the Company's net loss position during these periods. The following table shows the approximate effect of dilutive shares had the Company reported a profit for these periods:

	Fiscal Years		
	2007	2006	2005
Effect of dilutive shares - options	246,859	N/A	N/A

13.

STOCK OPTION AND STOCK PURCHASE PLANS

The Company has certain stock option plans and an Employee Stock Purchase Plan, as described below. All of these plans have been approved by the Company's stockholders.

Stock Option Plans

The Company has stock option plans for directors, officers and key employees which provide for the grant of non-qualified and incentive stock options. Under the plans, the option exercise price may not be lower than 100% of the fair market value of such shares at the date of the grant. Options granted generally vest on a ratable basis over four years and expire ten years from the date of the grant. At February 2, 2008, options for 1,432,500 shares were available for future grants under the plans.

Option activity under the plans is as follows:

	Fiscal Years					
	2007		2006		2005	
	Number of Shares	Weighted- Average Exercise Price	Number of Shares	Weighted- Average Exercise Price	Number of Shares	Weighted- Average Exercise Price
Options outstanding at beginning of year	1,159,375	\$ 6.43	1,400,475	\$ 6.19	1,547,750	\$ 4.99
Granted	5,000	4.26	2,500	8.60	310,000	10.37
Exercised	(120,125)	5.60	(196,100)	4.58	(319,400)	4.88
Cancelled	(18,000)	6.33	(47,500)	7.10	(137,875)	6.70
Options outstanding at end of year	1,026,250	\$ 6.52	1,159,375	\$ 6.43	1,400,475	\$ 6.19
Options exercisable at end of year	841,375	\$ 5.96	812,375	\$ 5.77	777,100	\$ 5.45

The intrinsic value of options exercised during fiscal 2007, 2006, and 2005 was \$890,600, \$898,100, and \$1,558,700, respectively.

A summary of the status of nonvested shares under the plans as of February 2, 2008, and changes during the year then ended, is presented below:

	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested at February 3, 2007	347,000	\$ 4.85
Granted	5,000	2.25
Vested	(161,625)	3.84
Forfeited	(5,500)	5.39
Nonvested at February 2, 2008	184,875	\$ 5.79

Additional information regarding options outstanding as of February 2, 2008 is as follows:

Range of Exercise Prices	Number Outstanding	Weighted- Average Remaining Contractual Life (yrs.)	Weighted- Average Exercise Price
\$1.13 to \$4.25	261,375	4.56	\$ 2.62
\$4.41 to \$6.03	298,875	4.10	\$ 5.47
\$6.19 to \$10.48	436,000	4.37	\$ 9.21
\$11.75 to \$11.75	30,000	7.39	\$ 11.75
\$1.13 to \$11.75	1,026,250	4.43	\$ 6.52

Employee Stock Purchase Plan

The Company also has a statutory Employee Stock Purchase Plan, which allows its employees to purchase Company common stock at a 15% discount. Employees can purchase stock under the Plan through payroll deductions ranging from 1% to 10% of their annual compensation, up to a maximum of \$21,250 per employee per year. A total of 500,000 shares were originally registered under the Plan, with 346,324 shares issued through February 2, 2008.

The 15% discount of the stock price makes the Plan compensatory. As such, the fair value of the discount, as determined under the Black-Scholes model, is expensed as compensation under the provisions of SFAS 123R. Compensation expense related to shares purchased under the Employee Stock Purchase Plan was \$19,800 and \$19,000 in fiscal 2007 and 2006, respectively.

Accounting for Stock Based Compensation

As discussed previously, the Company adopted SFAS 123R on January 29, 2006. SFAS 123R requires all share-based payments to employees be recognized in the financial statements as compensation expense based on the fair value on the date of grant.

The Company determines fair value of such awards using the Black-Scholes option-pricing model. The Company uses historical data to estimate expected term of the awards and forfeiture rates, stratified into separate groups based on similar exercise and termination patterns. Expected stock volatility is based upon historical volatility of the Company's stock and other factors. The risk-free interest rate is based on the yield curve in effect at the time the options are granted, using U.S. constant maturities over the expected life of the option. The Company has historically not paid dividends and does not anticipate paying dividends during the expected term. Accordingly, the expected dividend yield is zero. Options to purchase 5,000, 2,500, and 310,000 shares were granted during fiscal years 2007, 2006, and 2005, respectively. The estimated fair value of these option awards was calculated using the following weighted average assumptions:

	Fiscal Years					
	2007		2006		2005	
Risk-free interest rate	3.0	%	4.6	%	3.8	%
Expected dividend yield	-		-		-	
Expected volatility	42.3	%	42.2	%	56.1	%
Expected option life (years)	8.6		4.6		5.0	

The weighted average fair values of options on their grant date during fiscal 2007, 2006, and 2005, where the exercise price equaled the market price on the date of grant, were \$2.25, \$3.54, and \$6.39, respectively.

The Company recognized share-based compensation of approximately \$397,000 and \$791,000 in fiscal 2007 and 2006, respectively, as a component of selling, general, and administrative expense. As of February 2, 2008, there was \$224,000 of unrecognized compensation cost related to non-vested awards granted under the plans. That cost is expected to be recognized over a remaining term of approximately 2 years. The total fair value of shares vested during the years ended February 2, 2008, February 3, 2007, and January 28, 2006, was \$620,000, \$693,000, and \$344,000, respectively.

14. RETIREMENT SAVINGS PLAN

The Company has a Retirement Savings Plan ("Plan") which qualifies as an employee retirement plan under Section 401(k) of the Internal Revenue Code. Full-time employees meeting certain requirements are eligible to participate in the Plan and may elect to have up to 20% of their annual eligible compensation, subject to statutory limitations, deferred and deposited with a qualified trustee. Participants in the Plan may receive an employer matching contribution of up to 4% of the participants' eligible compensation, depending on the Company's quarterly and annual financial performance. Beginning 2001, the Company amended the Plan to provide for a guaranteed annual match of 3%, including the ability for participants to earn an additional 1% depending on the Company's annual financial performance. The Company recognized \$1,187,000, \$1,201,000, and \$1,139,000 in expense related to the Plan in fiscal 2007, 2006, and 2005, respectively.

15. RELATED PARTY TRANSACTIONS

The Company owns a 36% interest in Park 41, a limited partnership that owns, leases and operates the office building in which the Company's headquarters are located. River Park Properties I owns the remaining 64% interest in Park 41. River Park Properties I is also a limited partner in River Park Properties II, which wholly-owns River Park Properties VII. The Company leases a store in Fresno, California from River Park Properties VII. The Company receives cash distributions of approximately \$500,000, recognizes income of approximately \$300,000, and pays rents of approximately \$1.3 million annually related to its corporate office lease with the Park 41 partnership. The Company also paid rents of \$1.3 million in fiscal 2007 and 2006, and \$0.6 million in fiscal 2005, to River Park Properties VII related to the leased store in Fresno, California.

In the normal course of business, the Company purchases goods from Harris, an affiliate of the Company owning approximately 16% of common stock (see Note 7). These purchases totaled \$287,000 in fiscal 2007.

16.

COMMITMENTS AND CONTINGENCIES

On September 19, 2005, the Company became subject to a complaint filed in the Superior Court of California for the County of Santa Cruz alleging violation of California law regarding payment of accrued vacation upon termination of employment. The complaint seeks wage payments for employees who allegedly forfeited accrued vacation, waiting time penalties, interest, injunctive relief and costs. The Company believed settlement of this matter was in its best interest and entered into a memorandum of understanding for class settlement, which was given final court approval in September 2006. The Company accrued \$1.8 million during the fourth quarter of fiscal 2005 for estimated legal fees and settlement costs and an additional \$60,000 in the fourth quarter of fiscal 2006. All payments were made in December 2006 and final accounting for actual expenses took place in fiscal 2007.

The Company is party to other legal proceedings and claims which have arisen during the ordinary course of business. In the opinion of management, the ultimate outcome of such litigation and claims is not expected to have a material adverse effect on the Company's financial position or results of its operations.

In the fourth quarter of fiscal 2007, the Company signed a ground lease for a new store in Bend, Oregon. The Company plans to construct a 55,000 square foot store at a cost of \$6.8 million, including fixtures. The Company will own the building and anticipates that it will open in late fall 2008.

As of February 2, 2008, the Company had outstanding a total of \$1.5 million of standby letters of credit and documentary letters of credit totaling \$1.3 million. As of February 3, 2007, the Company had issued a total of \$1.5 million of standby letters of credit and documentary letters of credit totaling \$0.7 million. The standby letters of credit were issued to provide collateral for workers' compensation insurance policies. Management believes the likelihood of any draws under the workers' compensation standby letters of credit are remote. Documentary letters of credit are issued in the ordinary course of business to facilitate the purchase of merchandise from overseas suppliers. The supplier draws against the documentary letter of credit upon delivery of the merchandise.

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

GOTTSCHALKS INC.

COL. A	COL. B	COL. C	COL. D	COL. E	COL. F
Description	Balance at Beginning of Period	ADDITIONS		Deductions Describe	Balance at End of Period
		Charged to Costs and Expenses	Charged to Other Accounts Describe		
Year ended February 2, 2008:					
Deferred tax asset					
valuation allowance	\$ 1,688,000	\$ 584,000 (1)	\$ 258,000 (2)	\$ -	\$ 2,530,000
Allowance for vendor					
claims receivable	\$ 80,000	\$ -	\$ -	\$ -	\$ 80,000
Sales return reserve	\$ 248,000	\$ 224,000 (3)	\$ 1,059,000 (3)	\$ -	\$ 1,531,000
Year ended February 3, 2007:					
Deferred tax asset					
valuation allowance	\$ 1,864,000	\$ -	\$ -	\$ (176,000) (5)	\$ 1,688,000
Allowance for vendor					
claims receivable	\$ 90,000	\$ -	\$ -	\$ (10,000) (4)	\$ 80,000
Sales return reserve	\$ 98,000	\$ 150,000 (6)	\$ -	\$ -	\$ 248,000
Year ended January 28, 2006:					
Deferred tax asset					
valuation allowance	\$ 2,254,000	\$ -	\$ -	\$ (390,000) (5)	\$ 1,864,000
Allowance for vendor					
claims receivable	\$ 90,000	\$ -	\$ -	\$ -	\$ 90,000
Sales return reserve	\$ 87,000	\$ 11,000 (6)	\$ -	\$ -	\$ 98,000

1. Represents increases to valuation allowance related to the future utilization of state tax credits.
2. Represents an increase to valuation allowance for certain capital loss carryforwards determined under FIN 48.
3. In fiscal 2007, the Company revised its sales return reserve estimate to reflect gross sales that are expected to be returned in a future period. Previously, the reserve reflected the net margin effect of future returns. Accordingly, as of February 2, 2008, both inventory and the sales return reserve increased by \$1,059,000 representing the cost of the inventory to be returned.
4. Represents changes in estimate for the allowance for vendor claims receivable.
5. Represents decreases to the deferred tax asset valuation allowance as a result of a partial release of allowances related to certain of the Company's state tax credit carry forwards, partially offset by the addition of allowances related to the Company's capital loss carry forwards.
6. Represents changes in estimate for reserve of sales returns.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: April 10, 2008

GOTTSCHALKS Inc.

By: /s/ James R. Famalette

James R. Famalette

Chairman and Chief Executive Officer

Pursuant to the requirements of the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ James R. Famalette</u> James R. Famalette	Chairman and Chief Executive Officer (principal executive officer)	April 10, 2008
<u>/s/ Daniel T. Warzenski</u> Daniel T. Warzenski	Vice President and Chief Financial Officer (principal financial and accounting officer)	April 10, 2008
<u>/s/ Joseph W. Levy</u> Joseph W. Levy	Chairman emeritus	April 10, 2008
<u>/s/ Joseph J. Penbera</u> Joseph J. Penbera	Lead Director	April 10, 2008
<u>/s/ Sharon Levy</u> Sharon Levy	Director	April 10, 2008

<u>/s/ James L. Czech</u>	Director	April 10, 2008
James L. Czech		
<u>/s/ O. James Woodward III</u>	Director	April 10, 2008
O. James Woodward III		
<u>/s/ Frederick R. Ruiz</u>	Director	April 10, 2007
Frederick R. Ruiz		
<u>/s/ Philip S. Schlein</u>	Director	April 10, 2008
Philip S. Schlein		
<u>/s/ Thomas H. McPeters</u>	Director	April 10, 2008
Thomas H. McPeters		
<u>/s/ Dale D. Achabal</u>	Director	April 10, 2008
>Dale D. Achabal		
<u>/s/ Jorge Pont Sanchez</u>	Director	April 10, 2008
Jorge Pont Sanchez		

SECOND AMENDED AND RESTATED CREDIT AGREEMENT

Dated as of September 26, 2007

among

GOTTSCHALKS INC.

as Borrower,

THE OTHER CREDIT PARTIES SIGNATORY HERETO,

as Credit Parties,

THE LENDERS SIGNATORY HERETO

FROM TIME TO TIME,

as Lenders,

and

GENERAL ELECTRIC CAPITAL CORPORATION,

as Agent and Lender

THE CIT GROUP/BUSINESS CREDIT, INC.,

as Syndication Agent and Lender,

and

GECC CAPITAL MARKETS GROUP, INC.

as Lead Arranger

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This SECOND AMENDED AND RESTATED CREDIT AGREEMENT (this "Agreement"), dated as of September 26, 2007 among GOTTSCHALKS INC., a Delaware corporation ("Borrower"); the other Credit Parties signatory hereto; GENERAL ELECTRIC CAPITAL CORPORATION, a Delaware corporation (in its individual capacity, "GE Capital"), for itself, as a Lender, and as Agent for Lenders, THE CIT GROUP/BUSINESS CREDIT, INC., for itself, as a Lender and in its capacity as syndication agent ("Syndication Agent"), and the other Lenders signatory hereto from time to time.

RECITALS

WHEREAS, Borrower, Lenders and Agent have entered into that certain Amended and Restated Credit Agreement (as amended, modified or supplemented to date, the "Original Credit Agreement") dated as of March 1, 2004 pursuant to which the Lenders have made certain credit facilities available to Borrower of up to Two Hundred Million Dollars (\$200,000,000) in the aggregate for the purpose of refinancing certain indebtedness of the Borrower owed to Kimco Capital Corporation, providing a revolving credit facility of up to One Hundred Ninety-One Million Dollars (\$191,000,000), and for working capital financing and other general corporate financing purposes;

WHEREAS, as of September 26, 2007, the outstanding principal balance of the Loans under the Original Credit Agreement is \$102,605,505.42, maturing on February 2, 2009;

WHEREAS, Borrower has requested that Lenders continue to provide up to Two Hundred Million Dollars (\$200,000,000) of credit facilities to Borrower, consisting of a revolving credit facility of up to Two Hundred Million Dollars (\$200,000,000), including a letter of credit sub-facility of up to Twenty Million Dollars (\$20,000,000), to, upon the terms and conditions set forth herein, convert the term loan outstanding under the Original Credit Agreement into a portion of the Revolving Credit Advances outstanding under this Agreement, refinance the indebtedness under the New Subordinated Note owed to The Harris Company pursuant to the New Subordinated Note (as defined herein) pursuant to the terms hereof, repurchase its own publicly traded Stock and provide for working capital financing and other general corporate financing purposes;

WHEREAS, Borrower has agreed to secure all of its obligations under the Loan Documents by granting to Agent, for the benefit of Agent and Lenders, a security interest in and lien upon all of its existing and after-acquired personal and real property and by continuing the prior grant of a security interest in and lien upon all of Borrower's and each Credit Party's existing and after-acquired personal and real property for the benefit of Agent and Lenders;

WHEREAS, Borrower, Lenders and Agent now desire to amend and restate the Original Credit Agreement to, among other things, accomplish the matters set forth above on the terms and subject to the conditions set forth herein; and

WHEREAS, capitalized terms used in this Agreement shall have the meanings ascribed to them in Annex A and, for purposes of this Agreement and the other Loan Documents, the rules of construction set forth in Annex A shall govern. All Annexes, Disclosure Schedules, Exhibits and other attachments (collectively, "Appendices") hereto, or expressly identified to this

Agreement, are incorporated herein by reference, and taken together with this Agreement, shall constitute but a single agreement. These Recitals shall be construed as part of the Agreement.

NOW, THEREFORE, in consideration of the premises and the mutual covenants hereinafter contained, and for other good and valuable consideration, the parties hereto agree as follows:

1. AMOUNT AND TERMS OF CREDIT

1.1 Credit Facilities.

a. Revolving Credit Facility.

- i. Subject to the terms and conditions hereof, each Revolving Lender agrees to make available to Borrower from time to time until the Commitment Termination Date its Pro Rata Share of advances (each, a "Revolving Credit Advance"). The Pro Rata Share of the Revolving Loan of any Revolving Lender shall not at any time exceed its separate Revolving Loan Commitment. The obligations of each Revolving Lender hereunder shall be several and not joint. Until the Commitment Termination Date, Borrower may from time to time borrow, repay and reborrow under this Section 1.1(a); provided that the amount of any Revolving Credit Advance to be made at any time shall not exceed an amount equal to the Borrowing Availability at such time. Borrowing Availability may be reduced by Reserves imposed by Agent in its reasonable credit judgment. Each Revolving Credit Advance shall be made on notice by Borrower to one of the representatives of Agent identified in Schedule 1.1 at the address specified therein. Any such notice must be given no later than (1) 10:30 a.m. (Los Angeles time) on the Business Day of the proposed Revolving Credit Advance, in the case of an Index Rate Loan, or (2) 10:30 a.m. (Los Angeles time) on the date which is 3 Business Days prior to the proposed Revolving Credit Advance, in the case of a LIBOR Loan. Each such notice (a "Notice of Revolving Credit Advance") must be given in writing (by telecopy or overnight courier) substantially in the form of Exhibit 1.1(a)(i), and shall include the information required in such Exhibit and such other information as may be required by Agent. If Borrower desires to have the Revolving Credit Advances bear interest by reference to a LIBOR Rate, Borrower must comply with Section 1.5(e). It is understood and agreed that all "Revolving Credit Advances" (as defined in the Original Credit Agreement) outstanding as of the date hereof are converted into and deemed to be Revolving Credit Advances under this Agreement.
- ii. Except as provided in Section 1.12, Borrower shall execute and deliver to each Revolving Lender a note to evidence the Revolving Loan Commitments of that Revolving Lender. Each note shall be in the principal amount of the Revolving Loan Commitment of the applicable Revolving Lender, dated the Closing Date and substantially in the form of Exhibit 1.1(a)(ii) each a "Revolving Note" and, collectively, the "Revolving Notes"). Each Revolving Note shall represent the obligation of Borrower to pay the amount of the applicable Revolving Lender's Revolving Loan Commitment or, if less, such Revolving Lender's Pro Rata Share of the aggregate unpaid principal amount of all Revolving Credit Advances to Borrower together with interest thereon as prescribed in Section 1.5. The entire unpaid balance of the aggregate Revolving Loans and all other non-contingent Obligations shall

be immediately due and payable in full in immediately available funds on the Commitment Termination Date.

- iii. Anything in this Agreement to the contrary notwithstanding, at the request of Borrower, in its discretion Agent may (but shall have absolutely no obligation to), make Revolving Credit Advances to Borrower on behalf of Revolving Lenders in amounts that cause the outstanding balance of the aggregate Revolving Loan to exceed the Borrowing Base (less the Swing Line Loan) (any such excess Revolving Credit Advances are herein referred to collectively as "Overadvances"); provided that (A) no such event or occurrence shall cause or constitute a waiver of Agent's, the Swing Line Lender's or Revolving Lenders' right to refuse to make any further Overadvances, Swing Line Advances or Revolving Credit Advances, or incur any Letter of Credit Obligations, as the case may be, at any time that an Overadvance exists, and (B) no Overadvance shall result in a Default or Event of Default based on Borrower's failure to comply with Section 1.3(b)(i) for so long as Agent permits such Overadvance to be outstanding, but solely with respect to the amount of such Overadvance. In addition, Overadvances may be made even if the conditions to lending set forth in Section 2 have not been met. All Overadvances shall constitute Index Rate Loans, shall bear interest at the Default Rate and shall be payable on the earliest of demand, the Commitment Termination Date or the forty-fifth (45th) day after such Overadvance is first made. Agent shall not, without the consent of all Revolving Lenders, make an Overadvance if to do so would result in Overadvances outstanding for more than forty-five (45) days in any consecutive ninety (90) day period. Except as otherwise provided in Section 1.11(b), the authority of Agent to make Overadvances is limited to an aggregate amount not to exceed \$10,000,000 at any time, shall not cause the Revolving Loan (together with the Swing Loan) to exceed the Maximum Amount, and may be revoked prospectively by a written notice to Agent signed by Revolving Lenders holding more than 50% of the Revolving Loan Commitments.
- d. Term Loan. On the Closing Date, (i) the Term Loan (as defined in the Original Credit Agreement), and all accrued and unpaid interest due thereon, is converted into a Revolving Credit Advance under this Agreement and (ii) each Term Loan Lender's portion of the Term Loan is deemed converted into an equivalent portion of the Revolving Credit Commitment such that the aggregate Revolving Credit Commitments, on the Closing Date, are in the amounts set forth in Annex J. The Borrower acknowledges and agrees that as of September 26, 2007, the outstanding principal amount of the Term Loan is \$9,000,000 and the accrued and unpaid interest due on the Term Loan is \$37,950.
- e. Swing Line Facility.
 - i. Agent shall notify the Swing Line Lender upon Agent's receipt of any Notice of Revolving Credit Advance. Subject to the terms and conditions hereof, the Swing Line Lender may, in its discretion, make available from time to time until the Commitment Termination Date advances (each, a "Swing Line Advance") in accordance with any such notice. The provisions of this Section 1.1(c) shall not relieve Revolving Lenders of their obligations to make Revolving Credit Advances under Section 1.1(a); provided that if the Swing Line Lender makes a Swing Line Advance pursuant to any such notice, such Swing Line Advance shall be in lieu of any Revolving Credit Advance that otherwise may be made by Revolving Credit Lenders pursuant to such notice. The aggregate amount of Swing Line

Advances outstanding shall not exceed at any time the lesser of (A) the Swing Line Accommodation and (B) the lesser of the Maximum Amount and (except for Overadvances) the Borrowing Base, in each case, less the outstanding balance of the Revolving Loan at such time and less the Minimum Excess Availability ("Swing Line Availability"). Until the Commitment Termination Date, Borrower may from time to time borrow, repay and reborrow under this Section 1.1(c). Each Swing Line Advance shall be made pursuant to a Notice of Revolving Credit Advance delivered to Agent by Borrower in accordance with Section 1.1(a). Any such notice must be given no later than 10:30 a.m. (Los Angeles time) on the Business Day of the proposed Swing Line Advance. Unless the Swing Line Lender has received at least one Business Day's prior written notice from Requisite Revolving Lenders instructing it not to make a Swing Line Advance, the Swing Line Lender shall, notwithstanding the failure of any condition precedent set forth in Sections 2.2, be entitled to fund that Swing Line Advance, and to have each Revolving Lender make Revolving Credit Advances in accordance with Section 1.1(c)(iii) or purchase participating interests in accordance with Section 1.1(c)(iv). Notwithstanding any other provision of this Agreement or the other Loan Documents, the Swing Line Loan shall constitute an Index Rate Loan. Borrower shall repay the aggregate outstanding principal amount of the Swing Line Loan upon demand therefor by Agent.

- ii. Borrower shall execute and deliver to the Swing Line Lender a promissory note to evidence the Swing Line Accommodation. Such note shall be in the principal amount of the Swing Line Accommodation of the Swing Line Lender, dated the Closing Date and substantially in the form of Exhibit 1.1(c)(ii) (a "Swing Line Note"). The Swing Line Note shall represent the obligation of Borrower to pay the amount of the Swing Line Accommodation or, if less, the aggregate unpaid principal amount of all Swing Line Advances made to Borrower together with interest thereon as prescribed in Section 1.5. The entire unpaid balance of the Swing Line Loan and all other noncontingent Obligations shall be immediately due and payable in full in immediately available funds on the Commitment Termination Date if not sooner paid in full.
- iii. The Swing Line Lender, at any time and from time to time in its sole and absolute discretion, but no less frequently than once weekly, shall on behalf of Borrower (and Borrower hereby irrevocably authorizes the Swing Line Lender to so act on its behalf) request each Revolving Lender (including the Swing Line Lender) to make a Revolving Credit Advance to Borrower (which shall be an Index Rate Loan) in an amount equal to that Revolving Lender's Pro Rata Share of the principal amount of Borrower's Swing Line Loan (the "Refunded Swing Line Loan") outstanding on the date such notice is given. Unless any of the events described in Sections 8.1(h) or 8.1(i) has occurred (in which event the procedures of Section 1.1(c)(iv) shall apply) and regardless of whether the conditions precedent set forth in this Agreement to the making of a Revolving Credit Advance are then satisfied, upon Agent's request each Revolving Lender shall disburse directly to Agent, its Pro Rata Share of a Revolving Credit Advance on behalf of the Swing Line Lender prior to 12:00 p.m. (Los Angeles time) in immediately available funds on the Business Day next succeeding the date that notice is given. The proceeds of those Revolving Credit Advances shall be immediately paid to the Swing Line Lender and applied to repay the Refunded Swing Line Loan of Borrower.
- iv. If, prior to refunding a Swing Line Loan with a Revolving Credit Advance pursuant to Section 1.1(c)(iii), one of the events described in Sections 8.1(h) or

8.1(i) has occurred, then, subject to the provisions of Section 1.1(c)(v) below, each Revolving Lender shall, on the date such Revolving Credit Advance was to have been made for the benefit of Borrower, purchase from the Swing Line Lender an undivided participation interest in the Swing Line Loan to Borrower in an amount equal to its Pro Rata Share of such Swing Line Loan. Upon request, each Revolving Lender shall promptly transfer to the Swing Line Lender, in immediately available funds, the amount of its participation interest.

- v. Each Revolving Lender's obligation to make Revolving Credit Advances in accordance with Section 1.1(c)(iii) and to purchase participation interests in accordance with Section 1.1(c)(iv) shall be absolute and unconditional and shall not be affected by any circumstance, including (A) any setoff, counterclaim, recoupment, defense or other right that such Revolving Lender may have against the Swing Line Lender, Borrower or any other Person for any reason whatsoever; (B) the occurrence or continuance of any Default or Event of Default; (C) any inability of Borrower to satisfy the conditions precedent to borrowing set forth in this Agreement at any time or (D) any other circumstance, happening or event whatsoever, whether or not similar to any of the foregoing. If any Revolving Lender does not make available to Agent or the Swing Line Lender, as applicable, the amount required pursuant to Sections 1.1(c)(iii) or 1.1(c)(iv), as the case may be, the Swing Line Lender shall be entitled to recover such amount on demand from such Revolving Lender, together with interest thereon for each day from the date of non-payment until such amount is paid in full at the Federal Funds Rate for the first two Business Days and at the Index Rate thereafter.
- f. Reliance on Notices. Agent shall be entitled to rely upon, and shall be fully protected in relying upon, any Notice of Revolving Credit Advance, Notice of Conversion/Continuation or similar notice believed by Agent to be genuine. Agent may assume that each Person executing and delivering any notice in accordance herewith was duly authorized, unless the responsible individual acting thereon for Agent has actual knowledge to the contrary.

1.2 Letters of Credit.

Subject to and in accordance with the terms and conditions contained herein and in Annex B, Borrower shall have the right to request, and Revolving Lenders agree to incur, or purchase participations in, Letter of Credit Obligations in respect of Borrower. It is understood and agreed that all "Letters of Credit" and "Letter of Credit Obligations" (each as defined in the Original Credit Agreement) outstanding as of the date hereof are converted into and deemed to be Letters of Credit and Letter of Credit Obligations under this Agreement.

1.2A Swap Related Reimbursement Obligations.

- a. Borrower agrees to reimburse each Lender in immediately available funds in the amount of any payment made by such Lender under a Swap Related L/C (such reimbursement obligation, whether contingent upon payment by such Lender under the Swap Related L/C or otherwise, being herein called a "Swap Related Reimbursement Obligation"). No Swap Related Reimbursement Obligation for any Swap Related L/C may exceed the amount of the payment obligations owed by Borrower under the interest rate protection or hedging agreement or transaction supported by the Swap Related L/C.

- b. A Swap Related Reimbursement Obligation shall be due and payable by Borrower within one (1) Business Day after the date on which the related payment is made by the applicable Lender under the Swap Related L/C.
- c. Any Swap Related Reimbursement Obligation shall, during the period in which it is unpaid, bear interest at the rate per annum equal to the LIBOR Rate plus one percent (1.0%), as if the unpaid amount of the Swap Related Reimbursement Obligation were a LIBOR Loan, and not any otherwise applicable Default Rate. Such interest shall be payable upon demand. The following additional provisions apply to the calculation and charging of interest by reference to the LIBOR Rate:
 - i. The LIBOR Rate shall be determined for each successive one-month LIBOR Period during which the Swap Related Reimbursement Obligation is unpaid, notwithstanding the occurrence of any Event of Default and even if the LIBOR Period were to extend beyond the Commitment Termination Date.
 - ii. If a Swap Related Reimbursement Obligation is paid during a monthly period for which the LIBOR Rate is determined, interest shall be pro-rated and charged for the portion of the monthly period during which the Swap Related Reimbursement Obligation was unpaid. Section 1.13(b) shall not apply to any payment of a Swap Related Reimbursement Obligation during the monthly period.
 - iii. Notwithstanding the last paragraph of the definition of "LIBOR Rate", if the LIBOR Rate is no longer available from Telerate News Service, the LIBOR Rate shall be determined by Agent from such financial reporting service or other information available to Agent as in Agent's reasonable discretion indicates the applicable Lenders' costs of funds.
- Except as provided in the foregoing provisions of this Section 1.2A and in Section 11.3, Borrower shall not be obligated to pay to any Lender or any of its Affiliates any Letter of Credit Fee, or any other fees, charges or expenses, in respect of a Swap Related L/C or arranging for any interest rate protection or hedging agreement or transaction supported by the Swap Related L/C. The Lenders and their Affiliates shall look to the beneficiary of a Swap Related L/C for payment of any such letter of credit fees or other fees, charges or expenses and such beneficiary may factor such fees, charges, or expenses into the pricing of any interest rate protection or hedging arrangement or transaction supported by the Swap Related L/C.
- If any Swap Related L/C is revocable prior to its scheduled expiry date, the applicable Lenders agree not to revoke the Swap Related L/C unless the Commitment Termination Date or an Event of Default has occurred.
- The Lenders or any of their respective Affiliates shall be permitted to (i) provide confidential or other information furnished to it by any of the Credit Parties (including, without limitation, copies of any documents and information in or referred to in the Closing Checklist, Financial Statements and Compliance Certificates) to a beneficiary or potential beneficiary of a Swap Related L/C and (ii) receive confidential or other information from the beneficiary or potential beneficiary relating to any agreement or transaction supported

or to be supported by the Swap Related L/C. However, no confidential information shall be provided to any Person under this paragraph unless the Person has agreed to comply with the covenant substantially as contained in Section 11.8 of this Agreement.

- g. Agent shall have the right but not the obligation to establish Reserves in an amount not to exceed \$5,000,000 (based upon Agent's reasonable determination of the potential exposure of Borrower in respect of any transactions supported by a Swap Related L/C) in respect of any transactions supported by a Swap Related L/C then outstanding (such Reserves, the "Swap Related Reserve").

1.3 Prepayments.

- a. Voluntary Prepayments; Reductions in Revolving Loan Commitments.

Borrower may at any time on at least 10 days' prior written notice by Borrower to Agent terminate the Revolving Loan Commitment; provided that upon such termination, all Loans and other Obligations shall be immediately due and payable in full and all Letter of Credit Obligations shall be cash collateralized or otherwise satisfied in accordance with Annex B hereto. Any such voluntary prepayment and any such termination of the Revolving Loan Commitment must be accompanied by payment of the Fee required by Section 1.9(c), if any, plus the payment of any LIBOR funding breakage costs in accordance with Section 1.13(b), if any. Upon any such prepayment and termination of the Revolving Loan Commitment, Borrower's right to request Revolving Credit Advances, or request that Letter of Credit Obligations be incurred on its behalf, or request Swing Line Advances, shall simultaneously be permanently terminated.

- b. Mandatory Prepayments.

- i. If at any time the sum of the outstanding balances of the Revolving Loan and the Swing Line Loan exceeds the lesser of (A) the Maximum Amount and (B) the Borrowing Base (in each case for (A) and (B) less the Minimum Excess Availability) Borrower shall immediately repay the aggregate outstanding Revolving Credit Advances to the extent required to eliminate such excess. If any such excess remains after repayment in full of the aggregate outstanding Revolving Credit Advances, Borrower shall provide cash collateral for the Letter of Credit Obligations in the manner set forth in Annex B to the extent required to eliminate such excess. Notwithstanding the foregoing, any Overadvance made pursuant to Section 1.1(a)(iii) shall be repaid in accordance with Section 1.1(a)(iii).
- ii. Immediately upon receipt by any Credit Party of cash proceeds of any asset disposition (excluding proceeds of asset dispositions permitted by Sections 6.8(a)) or any sale of Stock of any Subsidiary of any Credit Party, Borrower shall prepay the Loans in an amount equal to all such proceeds, net of (A) commissions and other reasonable and customary transaction costs, fees and expenses properly attributable to such transaction and payable by Borrower in connection therewith (in each case, paid to non-Affiliates), (B) transfer and income taxes, and (C) amounts payable to holders of senior Liens (to the extent such Liens constitute Permitted Encumbrances hereunder), if any; provided, however,

with respect to (X) any disposition of Eligible Mortgaged Property, that portion of such net cash proceeds in excess of the amount of Revolving Credit Advances outstanding with respect to such Eligible Mortgaged Property immediately prior to such sale shall not be required to be used to prepay the Obligations pursuant to this Section 1.3(b)(ii) so long as: (1) no Default or Event of Default shall then have occurred and be continuing, (2) the aggregate proceeds of all such sales of Eligible Mortgaged Property since the date hereof do not exceed \$5,000,000 and (3) all such excess net cash proceeds are used by the Borrower to purchase assets used or useful in the Borrower's business within one (1) year after the initial receipt of such proceeds and (Y) any other disposition of assets which do not exceed, in the aggregate since the date hereof, \$20,000,000, the net cash proceeds of such disposition shall not be required to be used to prepay the Obligations to the extent (1) no Default or Event of Default shall then have occurred and be continuing and (2) such net cash proceeds are used by the Borrower to purchase assets used or useful in the Borrower's business within one hundred eighty (180) days after the initial receipt of such proceeds. Any prepayment pursuant to this Section 1.3(b)(ii) shall be applied in accordance with Section 1.3(c).

- iii. If Borrower issues Stock, no later than the Business Day following the date of receipt of any cash proceeds thereof, Borrower shall prepay the Loans in an amount equal to all such proceeds, net of underwriting discounts and commissions and other reasonable costs paid to non-Affiliates in connection therewith. Any such prepayment shall be applied in accordance with Section 1.3(c).

d. Application of Certain Mandatory Prepayments.

- i. So long as no Event of Default has occurred or is continuing, any prepayments made by Borrower pursuant to Sections 1.3(b)(ii) or (b)(iii) that consist of proceeds of Collateral shall be applied as follows: first, to Fees and reimbursable expenses of Agent then due and payable pursuant to any of the Loan Documents; second, to interest then due and payable on the Swing Line Loan; third, to the principal balance of the Swing Line Loan until the same has been repaid in full; fourth, to interest then due and payable on Revolving Credit Advances; fifth, to the outstanding principal balance of Revolving Credit Advances (first to Index Rate Loans and second to LIBOR Loans) until the same has been paid in full; and sixth, to any Letter of Credit Obligations to provide cash collateral therefor in the manner set forth in Annex B, until all such Letter of Credit Obligations have been fully cash collateralized in the manner set forth in Annex B.
- ii. [Intentionally Omitted.]
- iii. Neither the Revolving Loan Commitment nor the Swing Line Accommodation shall be permanently reduced by the amount of any such prepayments. At any time that an Event of Default has occurred or is continuing, any prepayments made by Borrower pursuant to Sections 1.3(b)(ii) or (b)(iii) above shall be applied in accordance with Section 1.11(a).

- Application of Prepayments from Insurance and Condemnation Proceeds. Prepayments from insurance or condemnation proceeds in accordance with Section 5.4(d) and the Mortgage(s), respectively, shall be applied to the Obligations in the order

set forth above in Section 1.3(c). At any time an Event of Default has occurred or is continuing, prepayments from insurance or condemnation proceeds in accordance with Section 5.4(d) and the Mortgage(s), respectively, shall be applied to the Obligations in the order set forth in Section 1.11(a). Neither the Revolving Loan Commitment nor the Swing Line Accommodation shall be permanently reduced by the amount of any such prepayments.

- e. No Implied Consent. Nothing in this Section 1.3 shall be construed to constitute Agent's or any Lender's consent to any transaction that is not permitted by other provisions of this Agreement or the other Loan Documents.

1.4 Use of Proceeds.

Borrower shall utilize the proceeds of the Revolving Loan and Swing Line Loan for (a) the financing of Borrower's ordinary working capital and general corporate needs and other lawful purposes not prohibited under this Agreement, (b) to refinance the Indebtedness under the New Subordinated Note to the extent permitted by Sections 6.3(b) and 6.14 and (c) to repurchase Borrower's own publicly traded Stock to the extent permitted by Section 6.14.

1.5 Interest and Applicable Margins.

- a. Borrower shall pay interest to Agent, for the ratable benefit of Lenders in accordance with the various Loans being made by each Lender, in arrears on each applicable Interest Payment Date, at the following rates: (i) with respect to the Revolving Credit Advances, the Index Rate plus the Applicable Revolver Index Margin per annum or, at the election of Borrower, the applicable LIBOR Rate plus the Applicable Revolver LIBOR Margin per annum; and (ii) with respect to the Swing Line Loan, the Index Rate plus the Applicable Revolver Index Margin per annum.

As of the Closing Date, the Applicable Margins shall be determined pursuant to the grids set forth below. The Applicable Margins identified below may hereafter be adjusted (up or down) prospectively on a quarterly basis as determined by the average Borrowing Availability for the most recently ended Fiscal Quarter, commencing with the first day of each Fiscal Quarter. Such adjustments in Applicable Margins shall be determined by reference to the following grids:

<u>If Borrowing Availability is</u> :	<u>Level of Applicable Margins:</u>
Less than \$10,000,000	Level I
Greater than or equal to \$10,000,000 but less than \$20,000,000	Level II
Greater than or equal to \$20,000,000, but less than \$30,000,000	Level III

Greater than or equal to \$30,000,000, but less than \$40,000,000				Level IV		
Greater than or equal to \$40,000,000, but less than \$50,000,000				Level V		
Greater than or equal to \$50,000,000				Level VI		
	<u>Level I</u>	<u>Level II</u>	<u>Level III</u>	<u>Level IV</u>	<u>Level V</u>	<u>Level VI</u>
Applicable Revolver Index Margin	0.50%	0.25%	0.00%	0.00%	0.00%	0.00%
Applicable Revolver LIBOR Margin	2.50%	2.25%	2.00%	1.75%	1.50%	1.25%
Applicable L/C Margin	<u>Documentary</u> 1.00%	<u>Documentary</u> 1.00%	<u>Documentary</u> 1.00%	<u>Documentary</u> 1.00%	<u>Documentary</u> 1.00%	<u>Documentary</u> 1.00%
	<u>Stand-by</u> 2.50%	<u>Stand-by</u> 2.25%	<u>Stand-by</u> 2.00%	<u>Stand-by</u> 1.75%	<u>Stand-by</u> 1.50%	<u>Stand-by</u> 1.25%
Applicable Unused Line Fee Margin	0.20%	0.20%	0.20%	0.20%	0.20%	0.20%

If there is a disparity between the Borrowing Availability as calculated by Agent and as calculated by Borrower, the calculation resulting in the greater level of Applicable Margins will prevail.

All adjustments in the Applicable Margins pursuant to the grids above shall be implemented quarterly on a prospective basis, commencing with the first day of each Fiscal Quarter. On each Business Day, Borrower shall deliver to Agent and Lenders a Borrowing Base Certificate as provided in Annex F. If a Default or an Event of Default has occurred and is continuing at the time any reduction in the Applicable Margins is to be implemented, that reduction shall be deferred until the first day of the first calendar month following the date on which such Default or Event of Default is waived or cured.

- b. If any payment on any Loan becomes due and payable on a day other than a Business Day, the maturity thereof will be extended to the next succeeding Business Day (except as set forth in the definition of LIBOR Period) and, with respect to payments of principal, interest thereon shall be payable at the then applicable rate during such extension.
- c. All computations of Fees calculated on a per annum basis and interest shall be made by Agent on the basis of a 360-day year, in each case for the actual number of days occurring in the period for which such interest and Fees are payable. The Index Rate is a floating rate determined for each day. Each determination by Agent of an interest rate and Fees hereunder shall be presumptive evidence of the correctness of such rates and Fees.

- d. So long as an Event of Default has occurred and is continuing under Section 8.1(a), (h) or (i) or so long as any other Event of Default has occurred and is continuing and at the election of Agent (or upon the written request of Requisite Lenders) confirmed by written notice from Agent to Borrower, the interest rates applicable to the Loans and the Letter of Credit Fees shall be increased by two percentage points (2%) per annum ("Default Rate") above the rates of interest or the rate of such Fees otherwise applicable hereunder, and all outstanding Obligations shall bear interest at the Default Rate applicable to such Obligations. Interest and Letter of Credit Fees at the Default Rate shall accrue from the initial date of such Event of Default until that Event of Default is cured or waived and shall be payable upon demand.
- e. Subject to the conditions precedent set forth in Section 2.2, Borrower shall have the option to (i) request that any Revolving Credit Advance be made as a LIBOR Loan, (ii) convert at any time all or any part of outstanding Loans (other than the Swing Line Loan) from Index Rate Loans to LIBOR Loans, (iii) convert any LIBOR Loan to an Index Rate Loan, subject to payment of LIBOR breakage costs in accordance with Section 1.13(b) if such conversion is made prior to the expiration of the LIBOR Period applicable thereto, or (iv) continue all or any portion of any Loan (other than the Swing Line Loan) as a LIBOR Loan upon the expiration of the applicable LIBOR Period and the succeeding LIBOR Period of that continued Loan shall commence on the first day after the last day of the LIBOR Period of the Loan to be continued. Any Loan or group of Loans having the same proposed LIBOR Period to be made or continued as, or converted into, a LIBOR Loan must be in a minimum amount of \$5,000,000 and integral multiples of \$500,000 in excess of such amount. Any such election must be made by 10:30 a.m. (Los Angeles time) on the 3rd Business Day prior to (1) the date of any proposed Advance which is to bear interest at the LIBOR Rate, (2) the end of each LIBOR Period with respect to any LIBOR Loans to be continued as such, or (3) the date on which Borrower wishes to convert any Index Rate Loan to a LIBOR Loan for a LIBOR Period designated by Borrower in such election. If no election is received with respect to a LIBOR Loan by 10:30 a.m. (Los Angeles time) on the 3rd Business Day prior to the end of the LIBOR Period with respect thereto (or if a Default or an Event of Default has occurred and is continuing or if the additional conditions precedent set forth in Section 2.2 shall not have been satisfied), that LIBOR Loan shall be converted to an Index Rate Loan at the end of its LIBOR Period. Borrower must make such election by notice to Agent in writing, by telecopy or overnight courier. In the case of any conversion or continuation, such election must be made pursuant to a written notice (a "Notice of Conversion/Continuation") in the form of Exhibit 1.5(e).
- f. Notwithstanding anything to the contrary set forth in this Section 1.5, if a court of competent jurisdiction determines in a final order that the rate of interest payable hereunder exceeds the highest rate of interest permissible under law (the "Maximum Lawful Rate"), then so long as the Maximum Lawful Rate would be so exceeded, the rate of interest payable hereunder shall be equal to the Maximum Lawful Rate; provided, however, that if at any time thereafter the rate of interest payable hereunder is less than the Maximum Lawful Rate, Borrower shall continue to pay interest hereunder at the Maximum Lawful Rate until such time as the total interest received by Agent, on behalf of Lenders, is equal to the total interest that would have been received had the interest rate payable hereunder been (but for the operation of this paragraph) the interest rate payable since the Closing Date as otherwise provided in this Agreement. In no event shall the total interest received by any Lender pursuant to the terms

1.6 Eligible Credit Card Receivables.

For purposes of this Agreement, "Eligible Credit Card Receivables" shall mean the Dollar amount of Credit Card Receivables (determined, without duplication, net of any credits, fees, rebates, charges, charge backs, "contra accounts" and any other amounts owed by a Credit Party to the Credit Card Issuer or Credit Card Processor, net of any commissions payable by any Credit Party to any third Persons in respect thereof, and net of unapplied cash and credits in respect thereof) owned by Borrower and reflected in the most recent Borrowing Base Certificate delivered by Borrower to Agent, except any Credit Card Receivables to which any of the exclusionary criteria set forth below applies. Agent shall have the right to establish, modify or eliminate Reserves against Eligible Credit Card Receivables from time to time in its reasonable credit judgment. In addition, Agent reserves the right, at any time and from time to time after the Closing Date, to adjust any of the criteria set forth below, to establish new criteria and to adjust advance rates with respect to Eligible Credit Card Receivables, in its reasonable credit judgment, subject to the approval of all of the Revolving Lenders in the case of changes in advance rates which have the effect of making more credit available. Eligible Credit Card Receivables shall not include any Credit Card Receivable that:

- a. is not owned by Borrower;
- b. does not represents a complete bona fide transaction;
- c. requires further acts on the part of Borrower to make such Credit Card Receivable payable by the Credit Card Issuer or Credit Card Processor;
- d. has been outstanding for more than five (5) Business Days;
- e. is evidenced by chattel paper or an instrument of any kind unless such chattel paper or instrument is in the possession of Agent, endorsed, if applicable, payable to the order of Agent;
- f. arises from a Credit Card Issuer or a Credit Card Processor or arises from an Account Debtor of a Credit Card Issuer or a Credit Card Processor that is the subject of any proceeding under any bankruptcy law or any other federal, state, or foreign (including any provincial) receivership, insolvency relief or other law or laws for the relief of debtors;
- g. is owed by a Credit Card Issuer or processed by a Credit Card Processor that is located outside of the U.S.;
- h. is not a valid, legally enforceable obligation of the applicable Credit Card Issuer or Credit Card Processor;
- i. such Credit Card Receivable is subject to any present or contingent (and no facts exist that are the basis for any future) offset, deduction or counterclaim, dispute or other defense on the part of the applicable issuer or in respect of the applicable Credit Card

Processor, unless any such offset, deduction or counterclaim, dispute or other defense is noted in the Borrowing Base Certificate and a reasonable amount satisfactory to Agent has been deducted from such Credit Card Receivable in respect thereof, provided that such deducted amount shall not exceed the Dollar amount (to the extent determinable) of such offset, deduction or counterclaim, dispute or other defense;

- j. is not subject to a first priority perfected security interest in favor of Agent;
- k. is not evidenced by a Credit Card Agreement in form and substance satisfactory to Agent or is not subject to a Credit Card Notice in form and substance satisfactory to Agent;
- l. Borrower is in breach of any express or implied representation, warranty, covenant or other agreement with respect to the Credit Card Receivable or the payment processing thereof;
- m. results from a Credit Card Issuer or Credit Card Processor located in any state denying creditors access to its courts in the absence of qualification to transact business in such state or the filing of a notice of business activities report or other similar filing, unless (i) Borrower has either qualified as a foreign corporation authorized to transact business in such state or has filed any such notice or similar filing with the applicable Governmental Authority for the then current year, or (ii) Borrower is not required to be so qualified as a condition to allowing its creditors access to such courts;
- n. does not comply with all applicable laws, including, without limitation, usury laws, the Federal Truth in Lending Act, and Regulation Z of the Board of Governors of the Federal Reserve System;
- o. has been or is required to be charged or written off as uncollectible in accordance with GAAP;
- p. is payable in currency other than Dollars;
- q. arises out of a contract that, by its terms, prohibits or makes void or unenforceable the grant of a security interest by Borrower in and to such Credit Card Receivable;
- r. is owed by an Affiliate of Borrower;
- s. results from a private label credit card issued or guaranteed by Borrower or its Affiliates;
- t. as to which any of the representations or warranties in the Loan Documents are untrue;
- u. is an obligation of a Credit Card Issuer or Credit Card Processor if 50% of more of the Dollar amount of all Credit Card Receivables owed by such Credit Card

- v. is an obligation of a Credit Card Issuer or Credit Card Processor that is unacceptable to Agent; or
- w. is otherwise unacceptable to Agent in its reasonable credit judgment.

1.7 Eligible Inventory.

All of the Inventory owned by Borrower and reflected in the most recent Borrowing Base Certificate delivered by Borrower to Agent shall be "Eligible Inventory" for purposes of this Agreement, except any Inventory to which any of the exclusionary criteria set forth below applies. Agent shall have the right to establish, modify or eliminate Reserves against Eligible Inventory from time to time in its reasonable credit judgment. In addition, Agent reserves the right, at any time and from time to time after the Closing Date, to adjust any of the criteria set forth below, to establish new criteria (including, without limitation, determining that custom or excess Inventory is partially or fully ineligible) and to adjust advance rates with respect to Eligible Inventory, in its reasonable credit judgment, subject to the approval of all of the Revolving Lenders in the case of changes in advance rates which have the effect of making more credit available. Eligible Inventory shall not include any Inventory of Borrower that:

- a. is not owned by Borrower free and clear of all Liens and rights of any other Person (including the rights of a purchaser that has made progress payments and the rights of a surety that has issued a bond to assure Borrower's performance with respect to that Inventory), except (i) the Liens in favor of Agent, on behalf of itself and Lenders, (ii) Permitted Encumbrances in favor of landlords and bailees to the extent permitted in Section 5.9 hereof or (iii) Permitted Encumbrances in favor of carriers, subject to, in the case of Permitted Encumbrances of landlords, bailees and carriers, Reserves established by Agent in accordance with Section 5.9 hereof;
- b. (i) is not located on premises owned, leased or rented by Borrower and set forth in Disclosure Schedule (3.2), or (ii) is stored at a leased location, unless Agent has given its prior consent thereto and unless (x) a reasonably satisfactory landlord waiver has been delivered to Agent, (y) Reserves reasonably satisfactory to Agent have been established with respect thereto in accordance with statutory requirements, or (z) Agent has agreed that Inventory at such location constitutes Eligible Inventory, or (iii) is stored with a bailee or warehouseman unless a reasonably satisfactory, acknowledged bailee letter has been received by Agent and Reserves reasonably satisfactory to Agent have been established with respect thereto, or (iv) is located at an owned location subject to a mortgage in favor of a lender other than Agent unless a reasonably satisfactory mortgagee waiver has been delivered to Agent, or (v) is located at any site not set forth on Disclosure Schedule (3.2) if the aggregate book value of Inventory at any such location is less than \$100,000 unless Agent has given its prior written consent with respect thereto under this Section 1.7(b)(v);

- c. is placed or accepted on consignment or is in transit, except for Eligible In-Transit Inventory in transit between locations of Credit Parties as to which Agent's Liens have been perfected at origin and destination;
- d. is covered by a negotiable document of title, unless such document has been delivered to Agent or to a custom broker for which Agent has received a custom brokerage agreement in form and substance acceptable to Agent, together with all necessary endorsements, free and clear of all Liens except those in favor of Agent and Lenders;
- e. is layaway, monogrammed, obsolete, shopworn, seconds, damaged or unfit for sale;
- f. consists of display items or packing or shipping materials, manufacturing supplies, work-in-process Inventory or replacement parts;
- g. consists of goods which have been returned by the buyer;
- h. is not of a type held for sale in the ordinary course of Borrower's business;
- i. is not subject to a first priority lien in favor of Agent on behalf of itself and Lenders, subject to Permitted Encumbrances;
- j. breaches any of the representations or warranties pertaining to Inventory set forth in the Loan Documents;
- k. consists of any and all internal expenses of Borrower or other expenses not included in landed costs as determined in accordance with GAAP whether or not classified by Borrower as "unicap";
- l. consists of Hazardous Materials or goods that can be transported or sold only with licenses that are not readily available;
- m. is not covered by casualty insurance reasonably acceptable to Agent;
- n. located in any store of Borrower which has been closed for business for more than 20 days in any Fiscal Quarter;
- o. does not meet standards, rules and regulations applicable to such goods for their use or sale imposed by any Person having regulatory authority over such matters;
- p. was produced in violation of Fair Labor Standards Act or subject to the so-called "hot goods" provision contained in Title 29, Chapter 8, U.S.C. 215(a);
- q. is not currently usable or merchantable and readily saleable to the public, at prices approximating at least the cost thereof, in the normal course of Borrower's business; or

r. is otherwise unacceptable to Agent in its reasonable credit judgment.

1.8 Cash Management Systems.

On or prior to the Closing Date, Borrower will establish and will maintain until the Termination Date, the cash management systems described in Annex C (the "Cash Management Systems").

1.9 Fees.

- Borrower shall pay to GE Capital, individually, the Fees specified in that certain fee letter dated as of September 26, 2007 among Borrower and GE Capital (the "GE Capital Fee Letter"), at the times specified for payment therein.
- As additional compensation for the Revolving Lenders, Borrower shall pay to Agent, for the ratable benefit of such Revolving Lenders, in arrears, on the first Business Day of each month prior to the Commitment Termination Date and on the Commitment Termination Date, a Fee for Borrower's non-use of available funds in an amount equal to the Applicable Unused Line Fee Margin per annum (calculated on the basis of a 360 day year for actual days elapsed) multiplied by the difference between (x) the Maximum Amount (as it may be reduced from time to time) and (y) the average for the period of the daily closing balances of the aggregate Revolving Loan and the Swing Line Loan outstanding during the period for which such Fee is due.
- If Borrower pays after acceleration or prepays the Revolving Loan and terminates the Revolving Loan Commitment, whether voluntarily or involuntarily and whether before or after acceleration of the Obligations, or if any of the Commitments are otherwise terminated, Borrower shall pay to Agent, for the benefit of Revolving Lenders as liquidated damages and compensation for the costs of being prepared to make funds available hereunder an amount equal to the Applicable Percentage (as defined below) multiplied by the Maximum Amount. As used herein, the term "Applicable Percentage" shall mean (i) 1%, in the case of a prepayment on or prior to the first anniversary of the Closing Date, (ii) .75%, in the case of a prepayment after the first anniversary of the Closing Date but on or prior to the second anniversary thereof, and (iii) 0.50%, in the case of a prepayment after the second anniversary of the Closing Date but on or prior to the Commitment Termination Date. The Credit Parties agree that the Applicable Percentages are a reasonable calculation of Revolving Lenders' lost profits in view of the difficulties and impracticality of determining actual damages resulting from an early termination of the Commitments. Notwithstanding the foregoing, no prepayment fee shall be payable by Borrower upon a mandatory prepayment made pursuant to Sections 1.3(b), 1.3(d) or 1.16(c); provided that Borrower does not permanently reduce or terminate the Revolving Loan Commitment upon any such prepayment and, in the case of prepayments made pursuant to Sections 1.3(b)(ii) or (b)(iii), the transaction giving rise to the applicable prepayment is expressly permitted under Section 6.
- Borrower shall pay to Agent, for the ratable benefit of Revolving Lenders, the Letter of Credit Fee as provided in Annex B.

1.10 Receipt of Payments.

Borrower shall make each payment under this Agreement not later than 11:00 a.m. (Los Angeles time) on the day when due in immediately available funds in Dollars to the Collection Account. For purposes of computing interest and Fees and determining Borrowing Availability as of any date, all payments shall be deemed received on the Business Day on which immediately available funds therefor are received in the Collection Account prior to 11:00 a.m. (Los Angeles time). Payments received after 11:00 a.m. (Los Angeles time) time on any Business Day or on a day that is not a Business Day shall be deemed to have been received on the following Business Day.

1.11 Application and Allocation of Payments.

Any amounts received by Agent or the Lenders (including any voluntary and mandatory prepayments at any time when an Event of Default shall have occurred and be continuing), shall be applied as follows: (A) first, to Fees due to the Revolving Lenders and Agent and reimbursable expenses of Agent then due and payable pursuant to any of the Loan Documents until paid in full; (B) second, to interest then due and payable on the Swing Line Loan until paid in full; (C) third, to the principal balance of the Swing Line Loan until the same shall have been paid in full; (D) fourth, to interest then due and payable on the Revolving Credit Advances and unpaid Swap Related Reimbursement Obligations (in an amount up to the amount of the Swap Related Reserve then extant), ratably in proportion to the interest accrued as to each Revolving Credit Advance and such unpaid Swap Related Reimbursement Obligations, as applicable, until paid in full; (E) fifth, to the principal balance of the Revolving Credit Advances and unpaid Swap Related Reimbursement Obligations (in an amount up to the Swap Related Reserve then extant), ratably to the aggregate, combined principal balance of the Revolving Credit Advances and such unpaid Swap Related Reimbursement Obligations, until paid in full; (F) sixth, to any Letter of Credit Obligations to provide cash collateral therefor in the manner set forth in Annex B; and (G) seventh, to all other Obligations including, without limitation, all unpaid Swap Related Reimbursement Obligations and expenses of the Lenders to the extent reimbursable under Section 11.3. So long as no Default or Event of Default shall have occurred and be continuing (i) voluntary prepayments shall be applied in accordance with the provisions of Section 1.3(a); and (ii) mandatory prepayments shall be applied as set forth in Sections 1.3(c) and 1.3(d). All payments and prepayments applied to a particular Loan shall be applied ratably to the portion thereof held by each Lender as determined by its Pro Rata Share. As to all payments made when a Default or Event of Default has occurred and is continuing or following the Commitment Termination Date, Borrower hereby irrevocably waives the right to direct the application of any and all payments received from or on behalf of Borrower, and Borrower hereby irrevocably agrees that Agent shall have the continuing exclusive right to apply any and all such payments against the Obligations of Borrower as set forth above notwithstanding any previous entry by Agent in the Loan Account or any other books and records.

1.12 Loan Account and Accounting.

Agent shall maintain a loan account (the "Loan Account") on its books to record: all Advances, all payments made by Borrower, and all other debits and credits as provided in this Agreement with respect to the Loans or any other Obligations. All entries in the Loan Account shall be made in accordance with Agent's customary accounting practices as in effect from time to time. The balance in the Loan Account, as recorded on Agent's most recent printout or other written statement, shall, absent manifest error, be presumptive evidence of the amounts due and owing to Agent and Lenders by

Borrower; provided that any failure to so record or any error in so recording shall not limit or otherwise affect Borrower's duty to pay the Obligations. Agent shall render to Borrower a monthly accounting of transactions with respect to the Loans setting forth the balance of the Loan Account as to Borrower for the immediately preceding month. Unless Borrower notifies Agent in writing of any objection to any such accounting (specifically describing the basis for such objection), within 60 days after the date thereof, each and every such accounting shall be presumptive evidence of all matters reflected therein. Only those items expressly objected to in such notice shall be deemed to be disputed by Borrower. Notwithstanding any provision herein contained to the contrary, any Lender may elect (which election may be revoked) to dispense with the issuance of Notes to that Lender and may rely on the Loan Account as evidence of the amount of Obligations from time to time owing to it.

1.13 Indemnity.

- a. Each Credit Party that is a signatory hereto shall jointly and severally indemnify and hold harmless each of Agent, Lenders and their respective Affiliates, and each such Person's respective officers, directors, employees, attorneys, agents and representatives (each, an "Indemnified Person"), from and against any and all suits, actions, proceedings, claims, damages, losses, liabilities and expenses (including reasonable attorneys' fees and disbursements and other costs of investigation or defense, including those incurred upon any appeal) that may be instituted or asserted against or incurred by any such Indemnified Person as the result of credit having been extended, suspended or terminated under this Agreement and the other Loan Documents and the administration of such credit, and in connection with or arising out of the transactions contemplated hereunder and thereunder and any actions or failures to act in connection therewith, including any and all Environmental Liabilities and legal costs and expenses arising out of or incurred in connection with disputes between or among any parties to any of the Loan Documents (collectively, "Indemnified Liabilities"); provided, that no such Credit Party shall be liable for any indemnification to an Indemnified Person to the extent that any such suit, action, proceeding, claim, damage, loss, liability or expense results from that Indemnified Person's gross negligence or willful misconduct. NO INDEMNIFIED PERSON SHALL BE RESPONSIBLE OR LIABLE TO ANY OTHER PARTY TO ANY LOAN DOCUMENT, ANY SUCCESSOR, ASSIGNEE OR THIRD PARTY BENEFICIARY OF SUCH PERSON OR ANY OTHER PERSON ASSERTING CLAIMS DERIVATIVELY THROUGH SUCH PARTY, FOR INDIRECT, PUNITIVE, EXEMPLARY OR CONSEQUENTIAL DAMAGES WHICH MAY BE ALLEGED AS A RESULT OF CREDIT HAVING BEEN EXTENDED, SUSPENDED OR TERMINATED UNDER ANY LOAN DOCUMENT OR AS A RESULT OF ANY OTHER TRANSACTION CONTEMPLATED HEREUNDER OR THEREUNDER.
- b. To induce Lenders to provide the LIBOR Rate option on the terms provided herein, if (i) any LIBOR Loans are repaid in whole or in part prior to the last day of any applicable LIBOR Period (whether that repayment is made pursuant to any provision of this Agreement or any other Loan Document or occurs as a result of acceleration, by operation of law or otherwise); (ii) Borrower shall default in payment when due of the principal amount of or interest on any LIBOR Loan; (iii) Borrower shall refuse to accept any borrowing of, or shall request a termination of, any borrowing of, conversion into or continuation of, LIBOR Loans after Borrower has given notice requesting the same in accordance herewith; or (iv) Borrower

shall fail to make any prepayment of a LIBOR Loan after Borrower has given a notice thereof in accordance herewith, then Borrower shall indemnify and hold harmless each Lender from and against all losses, costs and expenses resulting from or arising from any of the foregoing. Such indemnification shall include any loss (including loss of margin) or expense arising from the reemployment of funds obtained by it or from fees payable to terminate deposits from which such funds were obtained. For the purpose of calculating amounts payable to a Lender under this subsection, each Lender shall be deemed to have actually funded its relevant LIBOR Loan through the purchase of a deposit bearing interest at the LIBOR Rate in an amount equal to the amount of that LIBOR Loan and having a maturity comparable to the relevant LIBOR Period; provided, that each Lender may fund each of its LIBOR Loans in any manner it sees fit, and the foregoing assumption shall be utilized only for the calculation of amounts payable under this subsection. This covenant shall survive the termination of this Agreement and the payment of the Notes and all other amounts payable hereunder. As promptly as practicable under the circumstances, each Lender shall provide Borrower with its written calculation of all amounts payable pursuant to this Section 1.13(b), and such calculation shall be binding on the parties hereto unless Borrower shall object in writing within 30 Business Days of receipt thereof, specifying the basis for such objection in detail.

1.14 Access.

Each Credit Party that is a party hereto shall during normal business hours, from time to time upon two Business Day's prior notice as frequently as Agent reasonably determines to be appropriate: (a) provide Agent and any of its officers, employees and agents access to its properties, facilities, advisors and employees (including officers) of each Credit Party and to the Collateral, (b) permit Agent, and any of its officers, employees and agents, to inspect, audit and make extracts from any Credit Party's books and records, and (c) permit Agent, and its officers, employees and agents, to inspect, review, evaluate and make test verifications and counts of the Accounts, Inventory and other Collateral of any Credit Party; provided that inspections and audits shall be conducted by Agent or any officer, employee or agent of Agent no more frequently than two times in each Fiscal Year, provided, however, that (x) during the occurrence or continuance of any Default or Event of Default or (y) at any time that Borrowing Availability is less than \$20,000,000, Agent or any officer, employee or agent of Agent shall be permitted to conduct inspections or audits as often as it deems appropriate. Notwithstanding anything to contrary contained herein, if a Default or Event of Default has occurred and is continuing or if access is necessary to preserve or protect the Collateral as determined by Agent, each such Credit Party shall provide such access to Agent and to each Lender at all times and without advance notice. Furthermore, so long as any Event of Default has occurred and is continuing, Borrower shall provide Agent and each Lender with access to its suppliers and customers. Each Credit Party shall promptly make available to Agent and its counsel originals or copies of all books and records that Agent may reasonably request. Each Credit Party shall deliver any document or instrument necessary for Agent, as it may from time to time reasonably request, to obtain records from any service bureau or other Person that maintains records for such Credit Party and shall maintain duplicate records or supporting documentation on media, including computer tapes and discs owned by such Credit Party. Agent will give Lenders at least 5 Business Days' prior written notice of regularly scheduled audits. Representatives of other Lenders may accompany Agent's representatives on regularly scheduled audits at no charge to Borrower.

1.15 Taxes.

- a. Any and all payments by Borrower hereunder or under the Notes shall be made, in accordance with this Section 1.15, free and clear of and without deduction for any and all present or future Taxes. If Borrower shall be required by law to deduct any Taxes from or in respect of any sum payable hereunder or under the Notes, (i) the sum payable shall be increased as much as shall be necessary so that after making all required deductions (including deductions applicable to additional sums payable under this Section 1.15) Agent or Lenders, as applicable, receive an amount equal to the sum they would have received had no such deductions been made, (ii) Borrower shall make such deductions, and (iii) Borrower shall pay the full amount deducted to the relevant taxing or other authority in accordance with applicable law. Within 30 days after the date of any payment of Taxes, Borrower shall furnish to Agent the original or a certified copy of a receipt, copy of cancelled check or federal wire or other evidence satisfactory to Agent evidencing payment thereof. Agent and Lenders shall not be obligated to return or refund any amounts received pursuant to this Section.
- b. Each Credit Party that is a signatory hereto shall jointly and severally indemnify and, within 10 days of demand therefor, pay Agent and each Lender for the full amount of Taxes (including any Taxes imposed by any jurisdiction on amounts payable under this Section 1.15) paid by Agent or such Lender, as appropriate, and any liability (including penalties, interest and expenses) arising therefrom or with respect thereto, whether or not such Taxes were correctly or legally asserted.
- c. No person residing or organized under the laws of a jurisdiction outside the United States (a "Foreign Person") may become a Lender under this Agreement and, notwithstanding anything in this Agreement to the contrary, no Foreign Person may acquire any participation in any portion of a Lender's Loans or Commitments unless, on or prior to the date of the proposed assignment or sale, (i) all payments to be made under this Agreement or under the Notes to such Foreign Person or to such Lender on behalf of such Foreign Person are completely exempt from United States withholding tax under an applicable statute or tax treaty and (ii) such Foreign Person has provided to Borrower and Agent properly completed and executed copies of IRS Form W-8ECI or Form W-8BEN or other applicable form, certificate or document prescribed by the IRS or the United States or reasonably required by Borrower certifying as to such Foreign Person's entitlement to such exemption (a "Certificate of Exemption"). Any Foreign Person that seeks to become a Lender or purchase a participation from a Lender under this Agreement shall provide a Certificate of Exemption to Borrower and Agent prior to becoming a Lender or purchasing a participation hereunder. No Foreign Person may become a Lender or purchase a participation from a Lender hereunder if such Person fails to deliver a Certificate of Exemption in advance of becoming a Lender or purchasing a participation.

1.16 Capital Adequacy; Increased Costs; Illegality.

- a. If any law, treaty, governmental (or quasi-governmental) rule, regulation, guideline or order regarding capital adequacy, reserve requirements or similar requirements or compliance by any Lender with any request or directive regarding capital adequacy, reserve requirements or similar requirements (whether or not having the force of law), in each case, adopted after the Closing Date, from any central bank or other Governmental Authority increases or would have the effect of increasing the amount of capital, reserves or

other funds required to be maintained by such Lender and thereby reducing the rate of return on such Lender's capital as a consequence of its obligations hereunder, then Borrower shall from time to time upon demand by such Lender (with a copy of such demand to Agent) pay to Agent, for the account of such Lender, additional amounts sufficient to compensate such Lender for such reduction. A certificate as to the amount of that reduction and showing the basis of the computation thereof submitted by such Lender to Borrower and to Agent shall be presumptive evidence of the matters set forth therein.

- b. If, due to either (i) the introduction of or any change in any law or regulation (or any change in the interpretation thereof) or (ii) the compliance with any guideline or request from any central bank or other Governmental Authority (whether or not having the force of law), in each case adopted after the Closing Date, there shall be any increase in the cost to any Lender of agreeing to make or making, funding or maintaining any Loan, then Borrower shall from time to time, upon demand by such Lender (with a copy of such demand to Agent), pay to Agent for the account of such Lender additional amounts sufficient to compensate such Lender for such increased cost. A certificate as to the amount of such increased cost, submitted to Borrower and to Agent by such Lender, shall be presumptive evidence of the matters set forth therein. Each Lender agrees that it shall, as promptly as practicable after it becomes aware of any circumstances referred to above which would result in any such increased cost, to the extent not inconsistent with such Lender's internal policies of general application, use reasonable commercial efforts to minimize costs and expenses incurred by it and payable to it by Borrower pursuant to this Section 1.16(b).
- c. Notwithstanding anything to the contrary contained herein, if the introduction of or any change in any law or regulation (or any change in the interpretation thereof) shall make it unlawful, or any central bank or other Governmental Authority shall assert that it is unlawful, for any Lender to agree to make or to make or to continue to fund or maintain any LIBOR Loan, then, unless that Lender is able to make or to continue to fund or to maintain such LIBOR Loan at another branch or office of that Lender without, in that Lender's opinion, adversely affecting it or its Loans or the income obtained therefrom, on notice thereof and demand therefor by such Lender to Borrower through Agent, (i) the obligation of such Lender to agree to make or to make or to continue to fund or maintain LIBOR Loans shall terminate and (ii) Borrower shall forthwith prepay in full all outstanding LIBOR Loans owing by Borrower to such Lender, together with interest accrued thereon, unless Borrower, within 5 Business Days after the delivery of such notice and demand, converts all LIBOR Loans into Index Rate Loans, in each case with payment of any LIBOR breakage costs as described in Section 1.13(b).
- d. Within 15 days after receipt by Borrower of written notice and demand from any Lender (an "Affected Lender") for payment of additional amounts or increased costs as provided in Sections 1.15(a), 1.16(a) or 1.16(b), Borrower may, at its option, notify Agent and such Affected Lender of its intention to replace the Affected Lender. So long as no Default or Event of Default has occurred and is continuing, Borrower, with the consent of Agent, may obtain, at Borrower's expense, a replacement Lender ("Replacement Lender") for the Affected Lender, which Replacement Lender must be reasonably satisfactory to Agent. If Borrower obtains a Replacement Lender within 90 days following notice of its intention to do so, the Affected Lender must sell and assign its Loans and Commitments to such Replacement Lender for an amount equal to the principal balance of all Loans held by the Affected Lender and

all accrued interest and Fees with respect thereto through the date of such sale and such assignment shall not require the payment of an assignment fee to Agent; provided, that Borrower shall have reimbursed such Affected Lender for the additional amounts or increased costs that it is entitled to receive under this Agreement through the date of such sale and assignment. Notwithstanding the foregoing, Borrower shall not have the right to obtain a Replacement Lender if the Affected Lender rescinds its demand for increased costs or additional amounts within 15 days following its receipt of Borrower's notice of intention to replace such Affected Lender. Furthermore, if Borrower gives a notice of intention to replace and does not so replace such Affected Lender within 90 days thereafter, Borrower's rights under this Section 1.16(d) shall terminate with respect to such Affected Lender and Borrower shall promptly pay all increased costs or additional amounts demanded by such Affected Lender pursuant to Sections 1.15(a), 1.16(a) and 1.16(b).

- e. Borrower shall not be required to compensate a Lender pursuant to Section 1.16(a) or Section 1.16(b) for any increased cost or reduction in respect of a period occurring more than 180 days prior to the date that such Lender notifies Borrower of such Lender's intention to claim compensation therefor unless the circumstances giving rise to such increased cost or reduction became applicable retroactively, in which case no such time limitation shall apply so long as such Lender requests compensation within 180 days from the date such circumstances become applicable.

1.17 Single Loan.

All Loans to Borrower and all of the other Obligations of Borrower arising under this Agreement and the other Loan Documents shall constitute one general obligation of that Borrower secured, until the Termination Date, by all of the Collateral.

2. CONDITIONS PRECEDENT

2.1 Conditions to the Initial Loans.

No Lender shall be obligated to make any Loan or incur any Letter of Credit Obligations on the Closing Date, or to take, fulfill, or perform any other action hereunder, until the following conditions have been satisfied or provided for in a manner satisfactory to Agent, or waived in writing by Agent:

- a. Credit Agreement; Loan Documents. This Agreement or counterparts hereof shall have been duly executed by, and delivered to, Borrower, each other Credit Party, Agent and Lenders; and Agent shall have received such documents, instruments, agreements and legal opinions as Agent shall reasonably request in connection with the transactions contemplated by this Agreement and the other Loan Documents, including all those listed in the Closing Checklist attached hereto as Annex D, each in form and substance reasonably satisfactory to Agent.
- b. Approvals. Agent shall have received (i) satisfactory evidence that the Credit Parties have obtained all required consents and approvals of all Persons including all requisite Governmental Authorities, to the execution, delivery and performance of this Agreement and the other Loan Documents and the consummation of the Related Transactions or (ii) an officer's certificate in form and substance reasonably satisfactory to Agent affirming that no such consents or approvals are required.

- c. Opening Availability. After giving effect to the amendments set forth in this Agreement, the Eligible Credit Card Receivables and Eligible Inventory supporting the initial Revolving Credit Advance and the initial Letter of Credit Obligations incurred and the amount of the Reserves to be established on the Closing Date shall be sufficient in value, as determined by Agent, to provide Borrower with Borrowing Availability, after giving effect to the initial Revolving Credit Advance and the incurrence of any initial Letter of Credit Obligations (on a pro forma basis, with trade payables being paid currently, and expenses and liabilities being paid in the ordinary course of business and without acceleration of sales), of at least \$45,000,000.
- d. Payment of Fees. Borrower shall have paid the Fees required to be paid on the Closing Date in the respective amounts specified in Section 1.9 (including the Fees specified in the GE Capital Fee Letter), and shall have reimbursed Agent for all fees, costs and expenses of closing presented as of the Closing Date.
- e. Capital Structure; Other Indebtedness. The capital structure of each Credit Party and the terms and conditions of all Indebtedness of each Credit Party shall be acceptable to Agent in its sole discretion.
- f. Due Diligence. Agent shall have completed its business and legal due diligence, including a roll forward of its previous Collateral audit, with results reasonably satisfactory to Agent.
- g. Credit Card Proceeds. To the extent such arrangements have not previously been implemented and remain in effect, all Credit Card Issuers and Credit Card Processors shall have been irrevocably directed by Borrower and such Credit Card Issuers and Credit Card Processors shall agree that all proceeds of the Credit Card Receivables shall be remitted to a Concentration Account or the Collection Account.
- h. Cash Management Systems. To the extent such arrangements have not previously been implemented and remain in effect, Borrower shall have established its Cash Management System upon terms and conditions satisfactory to Agent.
- i. No Default under Original Credit Agreement. No Default or Event of Default shall have occurred or be continuing under the Original Credit Agreement.

2.2 Further Conditions to Each Loan.

Except as otherwise expressly provided herein, no Lender shall be obligated to fund any Advance, convert or continue any Loan as a LIBOR Loan or incur any Letter of Credit Obligation, if, as of the date thereof:

- a. (i) any representation or warranty by any Credit Party contained herein or in any other Loan Document is untrue or incorrect as of such date, except to the extent that such representation or warranty expressly relates to an earlier date and except for changes therein expressly permitted or expressly contemplated by this Agreement and (ii) Agent or Requisite Revolving Lenders have determined not to make such Advance, convert or continue any Loan as LIBOR Loan or incur such Letter of Credit Obligation as a result of the fact that such warranty or representation is untrue or incorrect;

- b. (i) any event or circumstance having a Material Adverse Effect has occurred since the Closing Date as determined by the Requisite Revolving Lenders, and (ii) Agent or Requisite Revolving Lenders have determined not to make such Advance, convert or continue any Loan as a LIBOR Loan or incur such Letter of Credit Obligation as a result of the fact that such event or circumstance has occurred;
- c. (i) any Default or Event of Default has occurred and is continuing or would result after giving effect to any Advance (or the incurrence of any Letter of Credit Obligation), and (ii) Agent or Requisite Revolving Lenders shall have determined not to make any Advance, convert or continue any Loan as a LIBOR Loan or incur any Letter of Credit Obligation as a result of that Default or Event of Default; or
- d. after giving effect to any Advance (or the incurrence of any Letter of Credit Obligations), the outstanding principal amount of the Revolving Loans would exceed the lesser of the Borrowing Base and the Maximum Amount, in each case, less the then outstanding principal amount of the Swing Line Loan and, in each case, less the Minimum Excess Availability.

The request and acceptance by Borrower of the proceeds of any Advance, the incurrence of any Letter of Credit Obligations or the conversion or continuation of any Loan into, or as, a LIBOR Loan shall be deemed to constitute, as of the date thereof, (i) a representation and warranty by Borrower that the conditions in this Section 2.2 (without reference to clauses (a)(ii), (b)(ii) and (c)(ii) of this Section 2.2 or any determination by Agent or any Lender with respect to any such condition) have been satisfied (including, without limitation, a representation and warranty as to the accuracy of representations and warranties (pursuant to terms of clause (a)(i) above), the absence of a Material Adverse Effect since the Closing Date and the absence of any Default or Event of Default (pursuant to terms of clause (c)(i) above)), and (ii) a reaffirmation by Borrower of the granting and continuance of Agent's Liens, on behalf of itself and Lenders, pursuant to the Collateral Documents.

3. REPRESENTATIONS AND WARRANTIES

To induce Lenders to make the Loans and to incur Letter of Credit Obligations, the Credit Parties executing this Agreement, jointly and severally, make the following representations and warranties to Agent and each Lender with respect to all Credit Parties, each and all of which shall survive the execution and delivery of this Agreement.

3.1 Corporate Existence; Compliance with Law.

Each Credit Party (a) is a corporation, limited liability company or limited partnership duly organized, validly existing and in good standing under the laws of its respective jurisdiction of incorporation or organization set forth in Disclosure Schedule (3.1); (b) is duly qualified to conduct business and is in good standing in each other jurisdiction where its ownership or lease of property or the conduct of its business requires such qualification, except where the failure to be so qualified would not result in exposure to losses, damages or liabilities in excess of \$250,000; (c) has the requisite power and authority and the legal right to own, pledge, mortgage or otherwise encumber and operate its properties, to lease the property it operates under lease and to conduct its business as now, heretofore and proposed to be conducted; (d) subject to specific representations regarding

Environmental Laws, has all material licenses, permits, consents or approvals from or by, and has made all material filings with, and has given all material notices to, all Governmental Authorities having jurisdiction, to the extent required for such ownership, operation and conduct; (e) is in compliance with its charter and bylaws or partnership or operating agreement, as applicable; and (f) subject to specific representations set forth herein regarding ERISA, Environmental Laws, tax and other laws, is in compliance with all applicable provisions of law, except where the failure to comply, individually or in the aggregate, could not reasonably be expected to have a Material Adverse Effect.

3.2 Executive Offices, Collateral Locations, FEIN.

As of the Closing Date, each Credit Party's name as it appears in official filings in its state of incorporation or organization, state of incorporation or organization, organization type, organization number, if any, issued by its state of incorporation or organization and the current location of each Credit Party's chief executive office and the warehouses and premises at which any Collateral is located are set forth in Disclosure Schedule (3.2), and none of such locations has changed within the four (4) months preceding the Closing Date. In addition, Disclosure Schedule (3.2) lists the federal employer identification number of each Credit Party.

3.3 Corporate Power, Authorization, Enforceable Obligations.

The execution, delivery and performance by each Credit Party of the Loan Documents to which it is a party and the creation of all Liens provided for therein: (a) are within such Person's power; (b) have been duly authorized by all necessary corporate, limited liability company or limited partnership action, as applicable; (c) do not contravene any provision of such Person's charter, bylaws or partnership or operating agreement as applicable; (d) do not violate any law or regulation, or any order or decree of any court or Governmental Authority; (e) do not conflict with or result in the breach or termination of, constitute a default under or accelerate or permit the acceleration of any performance required by, any indenture, mortgage, deed of trust, lease, agreement or other instrument to which such Person is a party or by which such Person or any of its property is bound; (f) do not result in the creation or imposition of any Lien upon any of the property of such Person other than those in favor of Agent, on behalf of itself and Lenders, pursuant to the Loan Documents; and (g) do not require the consent or approval of any Governmental Authority or any other Person, except those referred to in Section 2.1(c), all of which will have been duly obtained, made or complied with prior to the Closing Date. Each of the Loan Documents shall be duly executed and delivered by each Credit Party that is a party thereto and each such Loan Document shall constitute a legal, valid and binding obligation of such Credit Party enforceable against it in accordance with its terms.

3.4 Financial Statements and Projections.

Except for the Projections, all Financial Statements concerning Borrower and its respective Subsidiaries that are referred to below have been prepared in accordance with GAAP consistently applied throughout the periods covered (except as disclosed therein and except, with respect to unaudited Financial Statements, for the absence of footnotes and normal year-end audit adjustments) and present fairly in all material respects the financial position of the Persons covered thereby as at the dates thereof and the results of their operations and cash flows for the periods then ended.

- a. Financial Statements. The following Financial Statements attached hereto as Disclosure Schedule (3.4(a)) have been delivered on the Closing Date:

- i. The audited consolidated and consolidating balance sheets at February 3, 2007 and the related statements of income and cash flows of Borrower and its Subsidiaries for the Fiscal Years then ended, certified by the Chief Financial Officer.
 - ii. The unaudited balance sheet(s) at August 4, 2007 and the related statement(s) of income and cash flows of Borrower and its Subsidiaries for the twenty-eight weeks then ended.
- c. [Intentionally Omitted.]
- d. Projections. The Projections delivered on the Closing Date and attached hereto as Disclosure Schedule (3.4(c)) have been prepared by Borrower in light of the past operations of its businesses, and reflect projections for the one (1) year period beginning on February 3, 2008, on a month-by-month basis and for each year thereafter through its fiscal year 2010, on a yearly basis. The Projections are based upon the same accounting principles as those used in the preparation of the financial statements described above and the estimates and assumptions stated therein, all of which Borrower believes to be reasonable in light of current conditions and current facts known to Borrower and, as of the Closing Date, reflect Borrower's good faith and reasonable estimates of the future financial performance of Borrower for the period set forth therein.

3.5 Material Adverse Effect.

Between February 3, 2007 and the Closing Date except as otherwise disclosed by Borrower in writing to Agent: (a) none of the Credit Parties has incurred any obligations, contingent or noncontingent liabilities, liabilities for Charges, long-term leases or unusual forward or long-term commitments that, alone or in the aggregate, could reasonably be expected to have a Material Adverse Effect, (b) no contract, lease or other agreement or instrument has been entered into by any Credit Party or has become binding upon any Credit Party's assets and no law or regulation applicable to any Credit Party has been adopted that has had or could reasonably be expected to have a Material Adverse Effect, and (c) none of the Credit Parties is in default and to the best of Borrower's knowledge no third party is in default under any material contract, lease or other agreement or instrument to which any Credit Party is a party, that alone or in the aggregate could reasonably be expected to have a Material Adverse Effect. Since February 3, 2007, no event has occurred that alone or together with other events could reasonably be expected to have a Material Adverse Effect.

3.6 Ownership of Property; Liens.

As of the Closing Date, the real estate ("Real Estate") listed in Disclosure Schedule (3.6) constitutes all of the real property owned, licensed, leased, subleased, or used by any Credit Party. Each Credit Party owns good fee simple title to all of its owned Real Estate, and valid leasehold interests in all of its leased Real Estate, all as described on Disclosure Schedule (3.6), and copies of all such leases or a summary of terms thereof reasonably satisfactory to Agent have been delivered to Agent. Disclosure Schedule (3.6) further describes any Real Estate with respect to which any Credit Party is a lessor, sublessor or assignor as of the Closing Date. Each Credit Party also has good title to, or valid leasehold interests in, all of its personal property and assets. As of the Closing Date, none of the properties and assets of any Credit Party are subject to any Liens other than Permitted Encumbrances, and there are no facts, circumstances or conditions known to any Credit Party that may result in any Liens (including Liens arising under Environmental Laws) other than

Permitted Encumbrances. Each Credit Party has received all deeds, assignments, waivers, consents, nondisturbance and attornment or similar agreements, bills of sale and other documents, and has duly effected all recordings, filings and other actions necessary to establish, protect and perfect such Credit Party's right, title and interest in and to all such Real Estate and other properties and assets. Disclosure Schedule (3.6) also describes any purchase options, rights of first refusal or other similar contractual rights pertaining to any Real Estate. As of the Closing Date, no portion of any Credit Party's Real Estate has suffered any material damage by fire or other casualty loss that has not heretofore been repaired and restored in all material respects to its original condition or otherwise remedied. As of the Closing Date, all material permits required to have been issued or appropriate to enable the Real Estate to be lawfully occupied and used for all of the purposes for which it is currently occupied and used have been lawfully issued and are in full force and effect.

3.7 Labor Matters.

As of the Closing Date (a) no strikes or other material labor disputes against any Credit Party are pending or, to any Credit Party's knowledge, threatened; (b) hours worked by and payment made to employees of each Credit Party comply with the Fair Labor Standards Act and each other federal, state, local or foreign law applicable to such matters; (c) all payments due from any Credit Party for employee health and welfare insurance have been paid or accrued as a liability on the books of such Credit Party; (d) except as set forth in Disclosure Schedule (3.7), no Credit Party is a party to or bound by any collective bargaining agreement, management agreement, consulting agreement, employment agreement, bonus, restricted stock, stock option, or stock appreciation plan or agreement or any similar plan, agreement or arrangement (and true and complete copies of any agreements described on Disclosure Schedule (3.7) have been delivered to Agent); (e) there is no organizing activity involving any Credit Party pending or, to any Credit Party's knowledge, threatened by any labor union or group of employees; (f) there are no representation proceedings pending or, to any Credit Party's knowledge, threatened with the National Labor Relations Board, and no labor organization or group of employees of any Credit Party has made a pending demand for recognition; and (g) except as set forth in Disclosure Schedule (3.7), there are no material complaints or charges against any Credit Party pending or, to the knowledge of any Credit Party, threatened to be filed with any Governmental Authority or arbitrator based on, arising out of, in connection with, or otherwise relating to the employment or termination of employment by any Credit Party of any individual.

3.8 Ventures, Subsidiaries and Affiliates; Outstanding Stock and Indebtedness.

Except as set forth in Disclosure Schedule (3.8), as of the Closing Date, no Credit Party has any Subsidiaries, is engaged in any joint venture or partnership with any other Person, or is an Affiliate of any other Person; provided, however, that Disclosure Schedule (3.8) need not list individuals who are Affiliates solely by virtue of clause (d) of the definition of "Affiliate." All of the issued and outstanding Stock of each Subsidiary of each Credit Party is owned by each of the Stockholders and in the amounts set forth in Disclosure Schedule (3.8). Except as set forth in Disclosure Schedule (3.8) and except for common stock and options issued pursuant to stock option plans of Borrower described on Disclosure Schedule (3.8), there are no outstanding rights to purchase, options, warrants or similar rights or agreements pursuant to which any Credit Party may be required to issue, sell, repurchase or redeem any of its Stock or other equity securities or any Stock or other equity securities of its Subsidiaries. All outstanding

Indebtedness and Guaranteed Indebtedness of each Credit Party as of the Closing Date (except for the Obligations) is listed in Section 6.3 (including Disclosure Schedule (6.3)).

3.9 Government Regulation.

No Credit Party is an "investment company" or an "affiliated person" of, or "promoter" or "principal underwriter" for, an "investment company," as such terms are defined in the Investment Company Act of 1940. No Credit Party is subject to regulation under the Public Utility Holding Company Act of 1935, the Federal Power Act, or any other federal or state statute that restricts or limits its ability to incur Indebtedness or to perform its obligations hereunder. The making of the Loans by Lenders to Borrower, the incurrence of the Letter of Credit Obligations, the application of the proceeds thereof and repayment thereof and the consummation of the Related Transactions will not violate any provision of any such statute or any rule, regulation or order issued by the Securities and Exchange Commission.

3.10 Margin Regulations.

No Credit Party is engaged, nor will it engage, principally or as one of its important activities, in the business of extending credit for the purpose of "purchasing" or "carrying" any "margin stock" as such terms are defined in Regulation U of the Federal Reserve Board as now and from time to time hereafter in effect (such securities being referred to herein as "Margin Stock"). No Credit Party owns any Margin Stock, and none of the proceeds of the Loans or other extensions of credit under this Agreement will be used, directly or indirectly, for the purpose of purchasing or carrying any Margin Stock, for the purpose of reducing or retiring any Indebtedness that was originally incurred to purchase or carry any Margin Stock or for any other purpose that might cause any of the Loans or other extensions of credit under this Agreement to be considered a "purpose credit" within the meaning of Regulations T, U or X of the Federal Reserve Board. No Credit Party will take or permit to be taken any action that might cause any Loan Document to violate any regulation of the Federal Reserve Board.

3.11 Taxes.

All tax returns, reports and statements, including information returns, required by any Governmental Authority to be filed by any Credit Party have been filed with the appropriate Governmental Authority and all Charges have been paid prior to the date on which any fine, penalty, interest or late charge may be added thereto for nonpayment thereof (or any such fine, penalty, interest, late charge or loss has been paid), excluding Charges or other amounts being contested in accordance with Section 5.2(b). Proper and accurate amounts have been withheld by each Credit Party from its respective employees for all periods in full and complete compliance with all applicable federal, state, local and foreign laws and such withholdings have been timely paid to the respective Governmental Authorities. Disclosure Schedule (3.11) sets forth as of the Closing Date those taxable years for which any Credit Party's tax returns are currently being audited by the IRS or any other applicable Governmental Authority, and any assessments or threatened assessments in connection with such audit, or otherwise currently outstanding. Except as described in Disclosure Schedule (3.11), no Credit Party has executed or filed with the IRS or any other Governmental Authority any agreement or other document extending, or having the effect of extending, the period for assessment or collection of any Charges. None of the Credit Parties and their respective predecessors are liable for any Charges: (a) under any agreement (including any tax sharing agreements) or (b) to each Credit Party's knowledge, as a transferee. As of the Closing Date, no Credit Party has agreed or

been requested to make any adjustment under IRC Section 481(a), by reason of a change in accounting method or otherwise, which would have a Material Adverse Effect.

3.12 ERISA.

- Disclosure Schedule (3.12) lists (i) all ERISA Affiliates and (ii) all Plans and separately identifies all Pension Plans, including Title IV Plans, Multiemployer Plans, ESOPs and Welfare Plans, including all Retiree Welfare Plans. Copies of all such listed Plans, together with a copy of the latest IRS/DOL 5500-series form for each such Plan, have been delivered to Agent. Except with respect to Multiemployer Plans, each Qualified Plan has been determined by the IRS to qualify under Section 401 of the IRC, the trusts created thereunder have been determined to be exempt from tax under the provisions of Section 501 of the IRC, and nothing has occurred that would cause the loss of such qualification or tax-exempt status. Each Plan is in material compliance with the applicable provisions of ERISA and the IRC, including the timely filing of all reports required under the IRC or ERISA, including the statement required by 29 CFR Section 2520.104-23. Neither any Credit Party nor ERISA Affiliate has failed to make any contribution or pay any amount due as required by either Section 412 of the IRC or Section 302 of ERISA or the terms of any such Plan. Neither any Credit Party nor ERISA Affiliate has engaged in a "prohibited transaction," as defined in Section 406 of ERISA and Section 4975 of the IRC, in connection with any Plan, that would subject any Credit Party to a material tax on prohibited transactions imposed by Section 502(i) of ERISA or Section 4975 of the IRC.
- Except as set forth in Disclosure Schedule (3.12): (i) no Title IV Plan has any Unfunded Pension Liability; (ii) no ERISA Event or event described in Section 4062(e) of ERISA with respect to any Title IV Plan has occurred or is reasonably expected to occur; (iii) there are no pending, or to the knowledge of any Credit Party, threatened claims (other than claims for benefits in the normal course), sanctions, actions or lawsuits, asserted or instituted against any Plan or any Person as fiduciary or sponsor of any Plan; (iv) no Credit Party or ERISA Affiliate has incurred or reasonably expects to incur any liability as a result of a complete or partial withdrawal from a Multiemployer Plan; (v) within the last five years no Title IV Plan of any Credit Party or ERISA Affiliate has been terminated, whether or not in a "standard termination" as that term is used in Section 4041(b)(1) of ERISA, nor has any Title IV Plan of any Credit Party or any ERISA Affiliate (determined at any time within the last five years) with Unfunded Pension Liabilities been transferred outside of the "controlled group" (within the meaning of Section 4001(a)(14) of ERISA) of any Credit Party or ERISA Affiliate (determined at such time); (vi) all Plans satisfy all legal requirements with respect to the amount of Stock of all Credit Parties and their ERISA Affiliates held by each such Plan including, but not limited to, Section 407 of ERISA and Section 401(a)(22) of the IRC; and (vii) no liability under any Title IV Plan has been satisfied with the purchase of a contract from an insurance company that is not rated AAA by the Standard & Poor's Corporation or an equivalent rating by another nationally recognized rating agency.

3.13 No Litigation.

No action, claim, lawsuit, demand, investigation or proceeding is now pending or, to the knowledge of any Credit Party, threatened against any Credit Party, before any Governmental Authority or before any arbitrator or panel of arbitrators (collectively, "Litigation"), (a) that challenges any Credit Party's right or power to enter into or

perform any of its obligations under the Loan Documents to which it is a party, or the validity or enforceability of any Loan Document or any action taken thereunder, or (b) that has a reasonable risk of being determined adversely to any Credit Party and that, if so determined, could be reasonably be expected to have a Material Adverse Effect. Except as set forth on Disclosure Schedule (3.13), as of the Closing Date there is no Litigation pending or, to any Credit Party's knowledge, threatened, that seeks damages in excess of \$100,000 or injunctive relief against, or alleges criminal misconduct of, any Credit Party.

3.14 Brokers.

No broker or finder brought about the obtaining, making or closing of the Loans or the Related Transactions, and no Credit Party or Affiliate thereof has any obligation to any Person in respect of any finder's or brokerage fees in connection therewith.

3.15 Intellectual Property.

As of the Closing Date, each Credit Party owns or has rights to use all Intellectual Property necessary to continue to conduct its business as now or heretofore conducted by it or proposed to be conducted by it, and each Patent, Trademark, Copyright and License is listed, together with application or registration numbers, as applicable, in Disclosure Schedule (3.15). Each Credit Party conducts its business and affairs without infringement of or interference with any Intellectual Property of any other Person in any material respect. Except as set forth in Disclosure Schedule (3.15), no Credit Party is aware of any infringement claim by any other Person with respect to any Intellectual Property.

3.16 Full Disclosure.

No information contained in this Agreement, any of the other Loan Documents, Financial Statements or Collateral Reports or other written reports from time to time delivered hereunder or any written statement furnished by or on behalf of any Credit Party to Agent or any Lender pursuant to the terms of this Agreement contains or will contain any untrue statement of a material fact or omits or will omit to state a material fact necessary to make the statements contained herein or therein not misleading in light of the circumstances under which they were made. The Liens granted to Agent, on behalf of itself and Lenders, pursuant to the Collateral Documents will at all times be fully perfected first priority Liens in and to the Collateral described therein, subject, as to priority, only to Permitted Encumbrances.

3.17 Environmental Matters.

- Except as set forth in Disclosure Schedule (3.17), as of the Closing Date: (i) the Real Estate is free of contamination from any Hazardous Material except for such contamination that would not adversely impact the value or marketability of such Real Estate and that would not result in Environmental Liabilities that could reasonably be expected to exceed \$500,000; (ii) no Credit Party has caused or suffered to occur any Release of Hazardous Materials on, at, in, under, above, to, from or about any of its Real Estate; (iii) the Credit Parties are and have been in compliance with all Environmental Laws, except for such noncompliance that would not result in Environmental Liabilities which could reasonably be expected to exceed \$250,000; (iv) the Credit Parties have obtained, and are in compliance with, all Environmental Permits required by Environmental Laws for the operations of their respective businesses as presently conducted or as proposed to be conducted, except where the failure to so obtain or comply with such Environmental Permits would not result in Environmental Liabilities that could reasonably be expected to exceed \$250,000, and all such Environmental Permits are valid, uncontested and in good standing; (v) no Credit Party is involved in operations or knows of any

facts, circumstances or conditions, including any Releases of Hazardous Materials, that are likely to result in any Environmental Liabilities of such Credit Party which could reasonably be expected to exceed \$500,000, and no Credit Party has permitted any current or former tenant or occupant of the Real Estate to engage in any such operations; (vi) there is no Litigation arising under or related to any Environmental Laws, Environmental Permits or Hazardous Material that seeks damages, penalties, fines, costs or expenses in excess of \$250,000 or injunctive relief against, or that alleges criminal misconduct by, any Credit Party; (vii) no notice has been received by any Credit Party identifying it as a "potentially responsible party" or requesting information under CERCLA or analogous state statutes, and to the knowledge of the Credit Parties, there are no facts, circumstances or conditions that may result in any Credit Party being identified as a "potentially responsible party" under CERCLA or analogous state statutes; and (viii) the Credit Parties have provided to Agent copies of all existing environmental reports, reviews and audits and all written information pertaining to actual or potential Environmental Liabilities, in each case relating to any Credit Party.

- b. Each Credit Party hereby acknowledges and agrees that Agent (i) is not now, and has not ever been, in control of any of the Real Estate or any Credit Party's affairs, and (ii) does not have the capacity through the provisions of the Loan Documents or otherwise to influence any Credit Party's conduct with respect to the ownership, operation or management of any of its Real Estate or compliance with Environmental Laws or Environmental Permits.

3.18 Insurance.

Disclosure Schedule (3.18) lists all insurance policies of any nature maintained, as of the Closing Date, for current occurrences by each Credit Party, and Borrower has delivered certificates of all insurance policies showing Agent as an additional insured party, together with loss payable endorsements, to Agent.

3.19 Deposit and Disbursement Accounts.

Disclosure Schedule (3.19) lists all banks and other financial institutions at which any Credit Party maintains deposit or other accounts as of the Closing Date, including any Disbursement Accounts, and such Schedule correctly identifies the name, address and telephone number of each depository, the name in which the account is held, a description of the purpose of the account, and the complete account number therefor.

3.20 Government Contracts.

As of the Closing Date, no Credit Party is a party to any contract or agreement with any Governmental Authority and no Credit Party's Accounts are subject to the Federal Assignment of Claims Act (31 U.S.C. Section 3727) or any similar state or local law.

3.21 Customer and Trade Relations.

Except as set forth in Schedule 3.21, as of the Closing Date, there exists no actual or, to the knowledge of any Credit Party, threatened termination or cancellation of, or any material adverse modification or change in the business relationship of any Credit Party with any supplier or customer material to its operations.

3.22 Agreements and Other Documents.

As of the Closing Date, each Credit Party has provided to Agent or its counsel, on behalf of Lenders, accurate and complete copies (or summaries) of all of the following agreements or documents to which it is subject and each of

which is listed in Disclosure Schedule (3.22): supply agreements and purchase agreements not terminable by such Credit Party within 60 days following written notice issued by such Credit Party and involving transactions in excess of \$1,000,000 per annum (provided, however, that purchase orders entered into by Borrower in the ordinary course of business which are cancelable without penalty at any time prior to shipment need not be listed on Disclosure Schedule (3.22)); leases of Equipment having a remaining term of one year or longer and requiring aggregate rental and other payments in excess of \$500,000 per annum; licenses and permits held by the Credit Parties, the absence of which could be reasonably likely to have a Material Adverse Effect; all instruments and documents evidencing any Indebtedness or Guaranteed Indebtedness of such Credit Party and any Lien granted by such Credit Party with respect thereto; instruments and agreements evidencing the issuance of any equity securities (other than common stock certificates), warrants, rights or options to purchase equity securities of such Credit Party; agreements or arrangements with armored vehicle or other funds transportation service providers; and agreements or arrangements with respect to Credit Card Issuers and Credit Card Processors.

3.23 Solvency.

Both before and after giving effect to (a) the Loans and Letter of Credit Obligations to be made or incurred on the Closing Date or such other date as Loans and Letter of Credit Obligations requested hereunder are made or incurred, (b) the disbursement of the proceeds of such Loans pursuant to the instructions of Borrower; (c) the consummation of the Related Transactions; and (d) the payment and accrual of all transaction costs in connection with the foregoing, each Credit Party is and will be Solvent.

3.24 [Intentionally Omitted.]

3.25 [Intentionally Omitted.]

3.26 Subordinated Debt and Capital Leases.

As of the Closing Date, Borrower has delivered to Agent a complete and correct copy of the New Subordinated Note (including all schedules, exhibits, amendments, supplements, modifications, assignments and all other documents delivered pursuant thereto or in connection therewith) and of all Capital Leases to which Borrower is a party. Borrower has the corporate power and authority to incur the Indebtedness evidenced by the New Subordinated Note. The subordination provisions of the New Subordinated Note are enforceable against the holders of the New Subordinated Note by Agent and Lenders, and all Obligations, including the Letter of Credit Obligations, constitute senior Indebtedness entitled to the benefits of the subordination provisions contained in the New Subordinated Note. Borrower acknowledges that Agent and each Lender are entering into this Agreement and are extending the Commitments in reliance upon the subordination provisions of the New Subordinated Note and this Section 3.26.

4. FINANCIAL STATEMENTS AND INFORMATION

4.1 Reports and Notices.

- Each Credit Party executing this Agreement hereby agrees that from and after the Closing Date and until the Termination Date, it shall deliver to Agent or to

Agent and Lenders, as required, the Financial Statements, notices, Projections and other information at the times, to the Persons and in the manner set forth in Annex E.

- b. Each Credit Party executing this Agreement hereby agrees that, from and after the Closing Date and until the Termination Date, it shall deliver to Agent or to Agent and Lenders, as required, the various Collateral Reports (including Borrowing Base Certificates in the form of Exhibit 4.1(b)) at the times, to the Persons and in the manner set forth in Annex F.

4.2 Communication with Accountants.

Each Credit Party executing this Agreement authorizes (a) Agent and (b) so long as an Event of Default has occurred and is continuing, each Lender, to communicate directly with its independent certified public accountants, including Deloitte & Touche LLP, and authorizes and, at Agent's request, shall instruct those accountants and advisors to disclose and make available to Agent and each Lender any and all Financial Statements and other supporting financial documents, schedules and information relating to any Credit Party (including copies of any issued management letters) with respect to the business, financial condition and other affairs of any Credit Party.

5. AFFIRMATIVE COVENANTS

Each Credit Party executing this Agreement jointly and severally agrees as to all Credit Parties that from and after the Closing Date and until the Termination Date:

5.1 Maintenance of Existence and Conduct of Business.

Each Credit Party shall: do or cause to be done all things necessary to preserve and keep in full force and effect its corporate existence and its rights and franchises; continue to conduct its business substantially as now conducted or as otherwise permitted hereunder; at all times maintain, preserve and protect all of its assets and properties used or useful in the conduct of its business, and keep the same in good repair, working order and condition in all material respects (taking into consideration ordinary wear and tear) and from time to time make, or cause to be made, all necessary or appropriate repairs, replacements and improvements thereto consistent with industry practices; and transact business only in such corporate and trade names as are set forth in Disclosure Schedule (5.1).

5.2 Payment of Charges.

- Subject to Section 5.2(b), each Credit Party shall pay and discharge or cause to be paid and discharged promptly all Charges payable by it, including (i) Charges imposed upon it, its income and profits, or any of its property (real, personal or mixed) and all Charges with respect to tax, social security and unemployment withholding with respect to its employees, (ii) lawful claims for labor, materials, supplies and services or otherwise, and (iii) all storage or rental charges payable to warehousemen or bailees, in each case, before any thereof shall become past due.
- Each Credit Party may in good faith contest, by appropriate proceedings, the validity or amount of any Charges, Taxes or claims described in Section 5.2(a); provided, that (i) adequate reserves with respect to such contest are maintained on the books of such Credit Party, in accordance with GAAP; (ii) no Lien shall be imposed to secure payment of

such Charges (other than payments to warehousemen and/or bailees) that is superior to any of the Liens securing the Obligations and such contest is maintained and prosecuted continuously and with diligence and operates to suspend collection or enforcement of such Charges; (iii) none of the Collateral becomes subject to forfeiture or loss as a result of such contest; (iv) such Credit Party shall promptly pay or discharge such contested Charges, Taxes or claims and all additional charges, interest, penalties and expenses, if any, and shall deliver to Agent evidence reasonably acceptable to Agent of such compliance, payment or discharge, if such contest is terminated or discontinued adversely to such Credit Party or the conditions set forth in this Section 5.2(b) are no longer met; and (v) Agent has not advised Borrower in writing that Agent reasonably believes that nonpayment or nondischarge thereof could have or result in a Material Adverse Effect.

5.3 Books and Records.

Each Credit Party shall keep adequate books and records with respect to its business activities in which proper entries, reflecting all financial transactions, are made in accordance with GAAP and on a basis consistent with the Financial Statements attached as Disclosure Schedule (3.4(a)).

5.4 Insurance; Damage to or Destruction of Collateral.

- The Credit Parties shall, at their sole cost and expense, maintain the policies of insurance described on Disclosure Schedule (3.18) as in effect on the Closing Date or otherwise in form and amounts and with insurers reasonably acceptable to Agent. Such policies of insurance (or the loss payable and additional insured endorsements delivered to Agent) shall contain provisions pursuant to which the insurer agrees to provide 30 days prior written notice to Agent in the event of any non-renewal, cancellation or amendment of any such insurance policy. If any Credit Party at any time or times hereafter shall fail to obtain or maintain any of the policies of insurance required above, or to pay all premiums relating thereto, Agent may at any time or times thereafter obtain and maintain such policies of insurance and pay such premiums and take any other action with respect thereto that Agent deems advisable. Agent shall have no obligation to obtain insurance for any Credit Party or pay any premiums therefor. By doing so, Agent shall not be deemed to have waived any Default or Event of Default arising from any Credit Party's failure to maintain such insurance or pay any premiums therefor. All sums so disbursed, including reasonable attorneys' fees, court costs and other charges related thereto, shall be payable on demand by Borrower to Agent and shall be additional Obligations hereunder secured by the Collateral.
- Agent reserves the right at any time upon any change in any Credit Party's risk profile (including any change in the product mix maintained by any Credit Party or any laws affecting the potential liability of such Credit Party) to require additional forms and limits of insurance to, in Agent's opinion, adequately protect both Agent's and Lenders' interests in all or any portion of the Collateral and to ensure that each Credit Party is protected by insurance in amounts and with commercially reasonable and customary coverage for its industry. If reasonably requested by Agent, each Credit Party shall deliver to Agent from time to time a report of a reputable insurance broker, reasonably satisfactory to Agent, with respect to its insurance policies.
- Borrower shall deliver to Agent, in form and substance reasonably satisfactory to Agent, endorsements to (i) all casualty, property, "All Risk" and business

interruption insurance naming Agent, on behalf of itself and Lenders, as loss payee, and (ii) all general liability and other liability policies naming Agent, on behalf of itself and Lenders, as additional insured. Borrower shall promptly notify Agent of any loss, damage, or destruction to the Collateral in the amount of \$250,000 or more, whether or not covered by insurance. Borrower shall deposit any and all insurance proceeds in the Concentration Account for application to the Obligations.

- d. Borrower irrevocably makes, constitutes and appoints Agent (and all officers, employees or agents designated by Agent), so long as any Default or Event of Default has occurred and is continuing or the anticipated insurance proceeds exceed \$1,500,000, as Borrower's true and lawful agent and attorney-in-fact for the purpose of making, settling and adjusting claims under such casualty, property and "All Risk" policies of insurance, endorsing the name of Borrower on any check or other item of payment for the proceeds of such "All Risk" policies of insurance and for making all determinations and decisions with respect to such "All Risk" policies of insurance. Agent shall have no duty to exercise any rights or powers granted to it pursuant to the foregoing power-of-attorney. After deducting from such proceeds the expenses, if any, incurred by Agent in the collection or handling thereof, Agent may, at its option, apply such proceeds to the reduction of the Obligations in accordance with Section 1.3(d), or permit or require Borrower to use such money, or any part thereof, to replace, repair, restore or rebuild the Collateral in a diligent and expeditious manner with materials and workmanship of substantially the same quality as existed before the loss, damage or destruction. Notwithstanding the foregoing, if the casualty giving rise to such insurance proceeds could not reasonably be expected to have a Material Adverse Effect and such insurance proceeds do not exceed \$1,500,000 in the aggregate, Agent shall permit Borrower to replace, restore, repair or rebuild the property; provided that if Borrower has not completed or entered into binding agreements to complete such replacement, restoration, repair or rebuilding within 180 days of such casualty, Agent may apply such insurance proceeds to the Obligations in accordance with Section 1.3(d). All insurance proceeds that are to be made available to Borrower to replace, repair, restore or rebuild the Collateral shall be applied by Agent to reduce the outstanding principal balance of the Revolving Loan (which application shall not result in a permanent reduction of the Revolving Loan Commitment) and upon such application, Agent shall establish a Reserve against the Borrowing Base in an amount equal to the amount of such proceeds so applied. All insurance proceeds made available to any Credit Party that is not a Borrower to replace, repair, restore or rebuild Collateral shall be deposited in a cash collateral account. Thereafter, such funds shall be made available to Borrower to provide funds to replace, repair, restore or rebuild the Collateral as follows: (i) Borrower shall request a Revolving Credit Advance be made to Borrower in the amount requested to be released; (ii) so long as the conditions set forth in Section 2.2 have been met, Revolving Lenders shall make such Revolving Credit Advance or Agent shall release funds from the cash collateral account; and (iii) in the case of insurance proceeds applied against the Revolving Loan, the Reserve established with respect to such insurance proceeds shall be reduced by the amount of such Revolving Credit Advance. To the extent not used to replace, repair, restore or rebuild the Collateral, such insurance proceeds shall be applied in accordance with Section 1.3(d).

5.5 Compliance with Laws.

Each Credit Party shall comply with all federal, state, local and foreign laws and regulations applicable to it, including those relating to OSHA, ERISA and labor matters and Environmental Laws and Environmental Permits, except to the

extent that the failure to comply, individually or in the aggregate, could not reasonably be expected to have a Material Adverse Effect.

5.6 Supplemental Disclosure.

From time to time as may be reasonably requested by Agent (which request will not be made more frequently than once each year absent the occurrence and continuance of a Default or an Event of Default), the Credit Parties shall supplement any Disclosure Schedule hereto, or any representation herein or in any other Loan Document, with respect to any matter hereafter arising that, if existing or occurring at the date of this Agreement, would have been required to be set forth or described in such Disclosure Schedule or as an exception to such representation or that is necessary to correct any information in such Disclosure Schedule or representation which has been rendered inaccurate thereby (and, in the case of any supplements to any Disclosure Schedule, such Disclosure Schedule shall be appropriately marked to show the changes made therein); provided that (a) no such supplement to any such Disclosure Schedule or representation shall amend, supplement or otherwise modify any Disclosure Schedule or representation, or be or be deemed a waiver of any Default or Event of Default resulting from the matters disclosed therein, except as consented to by Agent and Requisite Lenders in writing, and (b) no supplement shall be required or permitted as to representations and warranties that relate solely to the Closing Date.

5.7 Intellectual Property.

Each Credit Party will conduct its business and affairs without infringement of or interference with any Intellectual Property of any other Person in any material respect.

5.8 Environmental Matters.

Each Credit Party shall and shall cause each Person within its control to: (a) conduct its operations and keep and maintain its Real Estate in compliance with all Environmental Laws and Environmental Permits other than noncompliance that could not reasonably be expected to have a Material Adverse Effect; (b) implement any and all investigation, remediation, removal and response actions that are appropriate or necessary to maintain the value and marketability of the Real Estate or to otherwise comply with Environmental Laws and Environmental Permits pertaining to the presence, generation, treatment, storage, use, disposal, transportation or Release of any Hazardous Material on, at, in, under, above, to, from or about any of its Real Estate; (c) notify Agent promptly after such Credit Party becomes aware of any violation of Environmental Laws or Environmental Permits or any Release on, at, in, under, above, to, from or about any Real Estate that is reasonably likely to result in Environmental Liabilities in excess of \$250,000; and (d) promptly forward to Agent a copy of any order, notice, request for information or any communication or report received by such Credit Party in connection with any such violation or Release or any other matter relating to any Environmental Laws or Environmental Permits that could reasonably be expected to result in Environmental Liabilities in excess of \$500,000, in each case whether or not the Environmental Protection Agency or any Governmental Authority has taken or threatened any action in connection with any such violation, Release or other matter. If Agent at any time has a reasonable basis to believe that there may be a violation of any Environmental Laws or Environmental Permits by any Credit Party or any Environmental Liability arising thereunder, or a Release of Hazardous Materials on, at, in, under, above, to, from or about any of its Real Estate, that, in each case, could reasonably be expected to have a Material Adverse Effect, then each Credit Party shall, upon Agent's written request (i) cause the performance of

such environmental audits including subsurface sampling of soil and groundwater, and preparation of such environmental reports, at Borrower's expense, as Agent may from time to time reasonably request, which shall be conducted by reputable environmental consulting firms reasonably acceptable to Agent and shall be in form and substance reasonably acceptable to Agent, and (ii) permit Agent or its representatives to have access to all Real Estate for the purpose of conducting such environmental audits and testing as Agent deems appropriate, including subsurface sampling of soil and groundwater. Borrower shall reimburse Agent for the costs of such audits and tests and the same will constitute a part of the Obligations secured hereunder.

5.9 Landlords' Agreements, Mortgagee Agreements, Bailee Letters and Real Estate Purchases.

- Each Credit Party shall use its commercially reasonable efforts to obtain, with respect to each warehouse, processor, converter or other such storage or staging facility leased or acquired by such Credit Party (each a "Specified Location") after the date hereof, a landlord's agreement, mortgagee agreement or bailee letter, containing a waiver or subordination of all Liens or claims that such Person may assert against the Collateral at such Specified Location, and shall otherwise be reasonably satisfactory in form and substance to Agent (each a "Collateral Access Agreement"). With respect to each leased or owned location listed on Disclosure Schedule 3.2, if Agent has not received a Collateral Access Agreement with respect to such location, Borrower's Eligible Inventory at such locations shall, in Agent's discretion, be excluded from the Borrowing Base absent compliance with the provisions of Section 1.7(b) and/or be subject to Reserves as may be established by Agent based upon statutory lien requirements, until such time, as to any such location, as Agent has received a Collateral Access Agreement. With respect to locations of Collateral leased or owned after the date hereof, other than with respect to Permitted Temporary Leases, if Agent has not received a Collateral Access Agreement as of the date such location is acquired or leased, Borrower's Eligible Inventory at that location shall, in Agent's discretion, be excluded from the Borrowing Base absent compliance with Section 1.7(b) and/or be subject to Reserves as may be established by Agent based upon statutory lien requirements, until such time, as to any such location, as Agent has received a Collateral Access Agreement. Each Credit Party shall timely and fully pay and perform its obligations under all leases and other agreements with respect to each Specified Location where any Collateral is or may be located.
- To the extent otherwise permitted hereunder, if any Credit Party proposes to acquire a fee ownership interest in Real Estate after the Closing Date for which the Borrower proposes to have such Real Estate be deemed Eligible Mortgaged Property, it shall first provide to Agent a mortgage or deed of trust granting Agent a Lien on such Real Estate, together with environmental audits, mortgage title insurance commitment, real property survey, local counsel opinion(s), and, if required by Agent, supplemental casualty insurance and flood insurance, and such other documents, instruments or agreements reasonably requested by Agent, in each case, in form and substance reasonably satisfactory to Agent.

5.10 [Intentionally Omitted].

5.11 Further Assurances.

Each Credit Party executing this Agreement agrees that it shall and shall cause each other Credit Party to, at such Credit Party's expense and upon request of Agent, duly execute and deliver, or cause to be duly executed and delivered, to Agent

such further instruments and do and cause to be done such further acts as may be necessary or proper in the reasonable opinion of Agent to carry out more effectively the provisions and purposes of this Agreement or any other Loan Document.

5.12 Leases.

- Store Leases. With respect to each Store Lease, the Credit Parties shall:
 - i. promptly perform and/or observe in all material respects all of the covenants and agreements required to be performed and/or observed by the lessee under each Store Lease and do all things necessary to preserve and to keep unimpaired its rights thereunder;
 - ii. promptly notify Agent of any alleged default by any Person under each Store Lease;
 - iii. promptly deliver to Agent a copy of each notice of default and other material notice to be provided or received in respect of any Store Lease; and
 - iv. use commercially reasonable efforts to enforce the performance and observance of all of the covenants and agreements required to be performed and/or observed by the lessor under each Store Lease unless, in each case, failure to do so would not result in a Material Adverse Effect.
- Space Leases. With respect to Space Leases encumbering a Mortgaged Property, the Credit Parties shall:
 - i. promptly perform and/or observe in all material respects all of the covenants and agreements required to be performed and/or observed by the lessor under each Space Lease and do all things necessary to preserve and to keep unimpaired its rights thereunder;
 - ii. promptly notify Agent of an alleged default by any Person under each Space Lease;
 - iii. promptly deliver to Agent a copy of each notice of default and other material notice to be provided or received in respect of any Space Lease; and
 - iv. use commercially reasonable efforts to enforce the performance and observance of all of the covenants and agreements required to be performed and/or observed by the lessee under each Space Lease. All Space Leases entered into by any Credit Party after the Closing Date shall be on commercially reasonable terms, and, other than renewals, on the form of such Credit Party.
- Right to Take Action. If any Credit Party shall fail to perform or observe (after the applicable notice and grace period) any of the covenants and/or agreements required to be performed and/or observed by it under any Store Lease or any Space Lease subject

to a Mortgage, including, without limitation, payment of all rent and other charges due thereunder, Agent may, 5 Business Days after Credit Party's receipt of written notice (except in emergencies and/or in situations where a failure sooner to perform or observe the same may result in a forfeiture under the Lease (in either of the foregoing cases, Agent shall give only such prior notice as is reasonable under the existing circumstances)), take such action as is appropriate to cause such covenants and/or agreements promptly to be performed and/or observed on behalf of the Credit Parties but no such action by Agent shall release any Credit Party from any of its obligations under the Loan Documents. Upon receipt by Agent from the counterparty under any Lease of any notice of default by the Credit Parties thereunder, Agent may rely thereon and take any action as aforesaid to cure such default even though the existence of such default or the nature thereof may be questioned or denied by the Credit Parties or by any party on behalf of the Credit Parties.

- d. Renewal Options. The Credit Parties shall provide at least 30 days prior written notice to Agent of the Credit Parties' intent not to renew any such Store Lease, together with a summary of the Credit Parties' intended plan for the sale, transfer or other disposition of all Collateral located in the premises subject of such Store Lease. From and after the occurrence of an Event of Default, if the Credit Parties shall fail to so exercise any option to renew or extend the term of any Store Lease, Agent shall have, and is hereby granted, the irrevocable right to exercise such option, either in its own name and behalf, or in the name and behalf of the Credit Parties, all as Agent shall determine.
- e. Written Statement. The Credit Parties shall, within 20 days after demand by Agent, deliver to Agent a written statement certifying as to any factual matter and providing representations as to any other matter in connection with any Store Lease which is reasonably requested by Agent.
- f. Arbitration or Appraisal Proceedings. The Credit Parties shall give Agent prompt notice of the commencement of any arbitration or appraisal proceeding in connection with or relating to any Real Estate. Agent shall have the right to intervene and participate in any such proceeding and the Credit Parties shall confer with Agent and its attorneys and experts and cooperate with them to the extent Agent deems reasonably necessary for the protection of Agent and Lenders.
- g. Additional Store Lease Covenants.
 - i. In the event any Store Lease shall be terminated by reason of a default thereunder by the applicable Credit Party and Agent shall acquire from the fee owner a new ground lease, the applicable Credit Party hereby waives any right, title and interest in and to such new ground lease or the leasehold estate created thereby, waiving all rights of redemption now or hereafter operable under any law.
 - ii. In the event of the bankruptcy of the lessor or sublessor under any Store Lease, during the occurrence and the continuance of an Event of Default, neither Borrower nor any other Credit Party shall agree to treat any Store Lease as terminated, canceled or surrendered pursuant to the applicable provisions of the Bankruptcy Code or otherwise (including, but not limited to, Section 365(h)(1) thereof) without Agent's prior written consent.

In addition, during the occurrence and continuance of an Event of Default, the applicable Credit Party shall, in the event of the bankruptcy of the lessor or sublessor under any Store Lease, reaffirm and ratify the legality, validity, binding effect and enforceability of the Store Lease and shall elect to remain in possession of the land and the leasehold estate, notwithstanding any rejection of such Store Lease, unless Agent otherwise directs. In the event of the bankruptcy of the lessor or sublessor under any Store Lease, if no Event of Default has occurred and is continuing, Borrower and any Credit Party may treat any Store Lease as terminated, canceled or surrendered pursuant to the applicable provisions of the Bankruptcy Code or otherwise (including, but not limited to Section 365(h)(1) thereof), provided, however, that the applicable Credit Party shall provide Agent with thirty (30) days written notice prior to rejecting any Store Lease and vacating the premises, together with a summary of such Credit Party's intended plan for the sale, transfer, or other disposition of Collateral located in the premises subject of such Store Lease.

- iii. During the continuance of an Event of Default under this Agreement, Agent shall have the right, but not the obligation, (i) to perform and comply with all obligations of the applicable Credit Party under the affected Store Lease without relying on any grace period provided therein, (ii) to do and take, without any obligation to do so, such action as Agent deems necessary or desirable to prevent or cure any default by the applicable Credit Party under the Store Lease, including, without limitation, any act, deed, matter or thing whatsoever that the applicable Credit Party may do in order to cure a default under the Store Lease and (iii) to enter in and upon the land or any part thereof to such extent and as often as Agent deems necessary or desirable in order to prevent or cure any default of the applicable Credit Party under the Store Lease. The applicable Credit Party shall, within five (5) days after written request is made therefor by Agent, execute and deliver to Agent or to any party designated by Agent, such further instruments, agreements, powers, assignments, conveyances or the like as may be reasonably necessary to complete or perfect the interest, rights or powers of Agent pursuant to this Section or as may otherwise be required by Agent.

5.13 Condition of the Real Estate.

The Credit Parties shall (a) not permit the Real Estate or any of the Mortgaged Properties (or any portion thereof) to be removed, demolished or materially altered, (b) subject to the provisions of Section 5.4(d) and Section 1.3(d), repair, replace and restore the Real Estate and other Mortgaged Properties (and any Collateral located thereat) now or hereafter damaged or destroyed by any casualty or other event (whether or not insured against and insurable) or affected by any Taking so that, when repaired, replaced and restored, the same shall be (i) at least equal in quality, usefulness and value as the Real Estate, or other Mortgaged Properties and/or Collateral which existed immediately prior to such casualty, event or Taking, as the case may be and (ii) of the same type and character as the type and character of the Collateral existing on the Closing Date and (c) perform any and all construction, equipping, alteration, repair, replacement and/or restoration in a good and workmanlike manner, free and clear of all Liens (except, in the case of improvements to any Real Estate or other Mortgaged Properties, for the Permitted Encumbrances).

5.14 Payments from Credit Card Issuers and Credit Card Processors.

Borrower shall cause all amounts payable to Borrower from any Credit Card Issuer and Credit Card Processor to be deposited in a Concentration Account or the Collection Account.

5.15 LI>Post-Closing Deliveries

. Within thirty (30) days (or such longer period as the Agent may consent to, in writing) after the date hereof, the Borrower shall deliver to the Agent: (a) a Credit Card Notice with respect to Borrower's credit card processing arrangement with HSBC, duly executed by both Borrower and HSBC; and (b) a duly executed termination and release, in form and substance satisfactory to the Agent, of all Liens of Kimco Capital Corporation on file with the United States Patent & Trademark Office respect to Borrower's intellectual property.

6. NEGATIVE COVENANTS

Each Credit Party executing this Agreement jointly and severally agrees as to all Credit Parties that from and after the Closing Date until the Termination Date:

6.1 Mergers, Subsidiaries, Etc.

No Credit Party shall directly or indirectly, by operation of law or otherwise, (a) form or acquire any Subsidiary, or (b) merge with, consolidate with, acquire all or substantially all of the assets or Stock of, or otherwise combine with or acquire, any Person.

6.2 Investments; Loans and Advances.

Except as otherwise expressly permitted by this Section 6 (including, without limitation, Sections 6.3 and 6.4), no Credit Party shall make or permit to exist any investment in, or make, accrue or permit to exist loans or advances of money to, any Person, through the direct or indirect lending of money, holding of securities or otherwise, except that:

(a) Borrower may hold investments comprised of notes payable, or Stock or other securities pursuant to negotiated agreements with respect to the settlement of an Account Debtor's Accounts in the ordinary course of business, Indebtedness or other claims due or owing to Borrower or any of its Subsidiaries; so long as the aggregate amount of such Accounts so settled by Borrower does not exceed \$250,000; and (b) Borrower and its Subsidiaries may receive and hold Stock, promissory notes and other non-cash consideration received in connection with any sale of an asset permitted by Section 6.8(c); and (c) Borrower may maintain its existing investments in its Subsidiaries as of the Closing Date.

6.3 Indebtedness.

- No Credit Party shall create, incur, assume or permit to exist any Indebtedness, except (without duplication) (i) Indebtedness secured by purchase money security interests and Capital Leases permitted in Section 6.7(c), (ii) the Loans and the other Obligations, (iii) unfunded pension fund and other employee benefit plan obligations and liabilities to the extent they are permitted to remain unfunded under applicable law, (iv) existing Indebtedness described in Disclosure Schedule (6.3) and refinancings thereof or amendments or modifications thereto that do not have the effect of increasing the principal amount thereof or changing the amortization thereof (other than to extend the same) and that are otherwise on terms and conditions no less favorable to any Credit Party, Agent or any Lender, as determined by Agent, than the terms of the Indebtedness being refinanced, amended or modified, (v) Indebtedness permitted by Section 6.17, and (vi) reimbursement obligations in respect of the surety bonds described in Schedule 6.3, copies of which have been or will be promptly provided to Agent as soon as available; upon commercially reasonable terms and conditions and renewals and extensions thereof upon commercially reasonable terms and conditions.

- b. No Credit Party shall, directly or indirectly, voluntarily purchase, redeem, defease or prepay any principal of, premium, if any, interest or other amount payable in respect of any Indebtedness, other than (i) the Obligations, (ii) the prepayment of an aggregate amount of up to \$18,179,598 of the principal amount of the New Subordinated Note, plus accrued interest thereon, so long as (A) immediately after giving effect to such payment, and on a pro forma basis for the twelve (12) consecutive fiscal months following such payment, average Borrowing Availability exceeds \$35,000,000 and (B) no Default or Event of Default exists both immediately prior to and after giving effect thereto and (iii) as a result of the making of scheduled payments of principal and interest on Indebtedness permitted under Section 6.3(a).

6.4 Employee Loans and Affiliate Transactions.

- Except as otherwise expressly permitted in this Section 6 with respect to Affiliates, no Credit Party shall enter into or be a party to any transaction with any other Credit Party or any Affiliate thereof except in the ordinary course of and pursuant to the reasonable requirements of such Credit Party's business and upon fair and reasonable terms that are no less favorable to such Credit Party than would be obtained in a comparable arm's length transaction with a Person not an Affiliate of such Credit Party. In addition, the terms of these transactions must be disclosed in advance to Agent and Lenders. All such transactions existing as of the Closing Date are described in Disclosure Schedule (6.4(a)).
- No Credit Party shall enter into any lending or borrowing transaction with any employees of any Credit Party, except loans to its respective employees in the ordinary course of business consistent with past practices for travel and entertainment expenses, relocation costs and similar purposes and stock option financing.
- From the occurrence and during the continuance of an Event of Default, no Credit Party shall increase the direct or indirect aggregate compensation (excluding stock options) of the ten most highly compensated employees of the Credit Parties, taken as a whole, by more than 10% per annum in excess of the then current compensation level for those employees, expressed as an aggregate dollar amount.

6.5 Capital Structure and Business.

No Credit Party shall (a) make any changes in any of its business objectives, purposes or operations that could in any way adversely affect the repayment of the Loans or any of the other Obligations or could reasonably be expected to have or result in a Material Adverse Effect, (b) make any change in its capital structure as described in Disclosure Schedule (3.8), other than the issuance or sale of any shares of common Stock, warrants, options or other securities convertible into common Stock so long as the net cash proceeds of any such issuance are paid to Agent for application to the Loans and Agent and Lenders obtain a first priority security interest (subject to Permitted Encumbrances) to any non-cash proceeds thereof or (c) amend its charter or bylaws in a manner that would adversely affect Agent or Lenders or such Credit Party's duty or ability to repay the Obligations. No Credit Party shall engage in any business other than the businesses currently engaged in by it or businesses reasonably related thereto.

6.6 Guaranteed Indebtedness.

No Credit Party shall create, incur, assume or permit to exist any Guaranteed Indebtedness except (a) by endorsement of instruments or items

of payment for deposit to the general account of any Credit Party, and (b) for Guaranteed Indebtedness incurred for the benefit of any other Credit Party if the primary obligation is expressly permitted by this Agreement.

6.7 Liens.

No Credit Party shall create, incur, assume or permit to exist any Lien on or with respect to its Accounts or any of its other properties or assets (whether now owned or hereafter acquired) except for (a) Permitted Encumbrances; (b) Liens in existence on the Closing Date and summarized on Disclosure Schedule (6.7) securing the Indebtedness described on Disclosure Schedule (6.3) and permitted refinancings, extensions and renewals thereof, including extensions or renewals of any such Liens; provided that the principal amount of the Indebtedness so secured is not increased and the Lien does not attach to any other property; and (c) Liens created after the Closing Date by conditional sale or other title retention agreements (including Capital Leases) or in connection with purchase money Indebtedness with respect to Equipment and Fixtures acquired by any Credit Party in the ordinary course of business, involving the incurrence of an aggregate amount of purchase money Indebtedness and Capital Lease Obligations which, when combined with all permitted transactions under Section 6.12(2), do not exceed \$2,000,000 on a trailing twelve month basis (provided that no Default or Event of Default has occurred or is continuing, that such Liens attach only to the assets subject to such purchase money debt and such Indebtedness is incurred within 20 days following such purchase, that such Indebtedness does not exceed 100% of the purchase price of the subject assets and that all net proceeds of such purchase money debt are paid to Agent for application to the Loans). In addition, no Credit Party shall become a party to any agreement, note, indenture or instrument, or take any other action, that would prohibit the creation of a Lien on any of its properties or other assets in favor of Agent, on behalf of itself and Lenders, as additional collateral for the Obligations, except operating leases, Capital Leases, Licenses or purchase agreements for sales otherwise permitted hereunder which prohibit Liens upon the assets that are subject thereto.

6.8 Sale of Stock and Assets.

No Credit Party shall sell, transfer, convey, assign or otherwise dispose of any of its properties or other assets, including the Stock of any of its Subsidiaries (whether in a public or a private offering or otherwise) or any of its Accounts, other than (a) the sale of Inventory in the ordinary course of business, (b) the sale, as a result of arm's length negotiations, of any Eligible Mortgaged Property so long as (1) no Default or Event of Default shall have occurred or be continuing or would result therefrom, (2) the net proceeds of such sale equal or exceed the amount of Revolving Credit Advances then outstanding with respect to such Eligible Mortgaged Property and (3) the net proceeds of such sale are paid to Agent or reinvested in the Borrower's business in accordance with Section 1.3(b)(ii) and (c) the sale, transfer, conveyance or other disposition by a Credit Party of other assets having a sales price not exceeding \$20,000,000 in the aggregate since the date hereof so long as no (1) Default or Event of Default has occurred or is continuing or would result therefrom, (2) such sale or disposition is to a non-Affiliate as a result of arm's length negotiations and (3) the net proceeds of such sale are paid to Agent or reinvested in the Borrower's business in accordance with Section 1.3(b)(ii). With respect to any disposition of assets or other properties permitted pursuant to clauses (b), or (c) above, subject to Section 1.3(b), Agent will on reasonable prior written notice release its Lien on such assets or other properties in order to permit the applicable Credit Party to effect such disposition and shall execute and deliver to Borrower, at Borrower's

expense, appropriate UCC-3 termination statements, reconveyances and other releases as reasonably requested by Borrower.

6.9 ERISA.

No Credit Party shall, or shall cause or permit any ERISA Affiliate to, cause or permit to occur an event that could result in the imposition of a Lien under Section 412 of the IRC or Section 302 or 4068 of ERISA or cause or permit to occur an ERISA Event to the extent such ERISA Event could reasonably be expected to have a Material Adverse Effect.

6.10 Financial Covenants.

Borrower shall not breach or fail to comply with any of the Financial Covenants.

6.11 Hazardous Materials.

No Credit Party shall cause or permit a Release of any Hazardous Material on, at, in, under, above, to, from or about any of the Real Estate where such Release would (a) violate in any respect, or form the basis for any Environmental Liabilities under, any Environmental Laws or Environmental Permits or (b) otherwise adversely impact the value or marketability of any of the Real Estate or any of the Collateral, other than such violations or Environmental Liabilities that could not reasonably be expected to have a Material Adverse Effect.

6.12 Sale-Leasebacks.

No Credit Party shall engage in any sale- leaseback, synthetic lease or similar transaction involving any of its assets except for: (a) any other such transactions which when combined with all permitted transactions under Section 6.7(c), do not exceed \$2,000,000 on a trailing twelve month basis so long as no Default or Event of Default shall have occurred or be continuing, and (b) all other such transactions with Agent's prior written consent, provided that in any case, the transaction meets each of the following criteria: (i) the transaction is a financing limited to specific equipment or Real Estate; (ii) the proceeds of any such transaction exceed 90% of the original cost of the equipment or Real Estate in question; (iii) the transaction is with a third party who is not an Affiliate and is the result of arms' length negotiations; and (iv) 100% of the net cash proceeds of any such transaction are paid to Agent for application to the Revolving Loans in the manner set forth in Section 1.3(c), and Agent obtains a perfected first priority security interest in any non-cash proceeds (subject to Permitted Encumbrances, other than Permitted Encumbrances as defined under clause (i) of the definition of "Permitted Encumbrances").

6.13 Cancellation of Indebtedness.

No Credit Party shall cancel any claim or debt owing to it, except for reasonable consideration negotiated on an arm's length basis and in the ordinary course of its business consistent with past practices.

6.14 Restricted Payments.

No Credit Party shall make any Restricted Payment, except (a) dividends and distributions by Subsidiaries of Borrower paid to Borrower, (b) employee loans permitted under Section 6.4(b), (c) scheduled payments of interest with respect to the New Subordinated Note so long as no Default or Event of Default has occurred and is continuing or would result after giving effect thereto, (d) scheduled payments of principal under the New Subordinated Note so long as (i) no Default or Event of Default has occurred and is continuing or would result after giving effect thereto and (ii) prior to making such payment and immediately after giving effect thereto, Borrowing Availability is at least \$15,000,000, (e)

open market purchases of Borrower's common Stock on a public exchange by Borrower in accordance with applicable laws; provided that: (i) no Default or Event of Default has occurred and is continuing or would result therefrom, and (ii) immediately after giving effect to such purchase, and on a pro forma basis for the twelve (12) consecutive fiscal months following such purchase, average Borrowing Availability exceeds \$35,000,000, or (f) full or partial pre-payment of the New Subordinated Note, prior to the Commitment Termination Date in an aggregate principal amount totaling not more than \$18,172,598, plus accrued interest thereon; provided that: (i) immediately after giving effect to such payment, and on a pro forma basis for the twelve (12) consecutive fiscal months following such payment, average Borrowing Availability exceeds \$35,000,000 and (ii) no Default or Event of Default exists both immediately prior to and after giving effect thereto.

6.15 Change of Corporate Name or Location; Change of Fiscal Year.

No Credit Party shall (a) change its name as it appears in official filings in the state of its incorporation or other organization (b) change its chief executive office, principal place of business, corporate offices or warehouses or locations at which Collateral is held or stored, or the location of its records concerning the Collateral, (c) change the type of entity that it is, (d) change its organization identification number, if any, issued by its state of incorporation or other organization, or (e) change its state of incorporation or organization, in each case without at least 30 days prior written notice to Agent and after Agent's written acknowledgment that any reasonable action requested by Agent in connection therewith, including to continue the perfection of any Liens in favor of Agent, on behalf of Lenders, in any Collateral, has been completed or taken, and provided that any such new location shall be in the United States. No Credit Party shall change its Fiscal Year.

6.16 [Intentionally Omitted].

6.17 No Speculative Transactions.

No Credit Party shall engage in any transaction involving commodity options, futures contracts or similar transactions, except solely to hedge against fluctuations in the prices of commodities owned or purchased by it and the values of foreign currencies receivable or payable by it and interest swaps, caps or collars without Agent's prior written consent.

6.18 Leases; Real Estate Purchases.

Except for leases permitted under Sections 6.7(e) and 6.12, no Credit Party shall enter into any operating lease for Equipment or lease for Real Estate, without the prior written consent of Agent, if the payments payable in any year would exceed \$500,000 for any lease or if the aggregate of all payments for all such leases in any year would exceed \$2,000,000.

6.19 Changes Relating to Subordinated Debt; Material Contracts.

- No Credit Party shall change or amend the terms of any Subordinated Debt, or any indenture, mortgage or agreement in connection with any such Indebtedness if the effect of such amendment is to: (i) increase the interest rate on such Indebtedness; (ii) change the dates upon which payments of principal or interest are due on such Indebtedness other than to extend such dates; (iii) change any default or event of default other than to delete or make less restrictive any default provision therein, or add any covenant with

respect to such Indebtedness; (iv) change the redemption or prepayment provisions of such Indebtedness other than to extend the dates therefor or to reduce the premiums payable in connection therewith; (v) grant any security or collateral to secure payment of such Indebtedness or (vi) change or amend any other term if such change or amendment would materially increase the obligations of the Credit Party thereunder or confer additional material rights on the holder of such Indebtedness in a manner adverse to any Credit Party, Agent or any Lender.

- b. Unless consented to by Agent and Requisite Lenders in writing, no Credit Party shall change or amend, in any manner which is materially adverse to the interests of the Agents and/or the Lenders, the terms of (i) any Credit Card Agreement or (ii) any agreement with United Security Bank.
- c. Unless consented to by Agent and Requisite Lenders in writing, no Credit Party shall change or amend the terms of the New Subordinated Note; provided, that, the New Subordinated Note may be amended solely to remove any restriction on making any full or partial prepayment of such note, prior to the Commitment Termination Date, to the extent such payment is otherwise permitted under the terms of this Agreement.

6.20 Credit Card Notices.

Borrower shall not deliver to the Credit Card Issuers or the Credit Card Processors any instructions which modify or amend the Credit Card Notices or in any manner attempt to change the delivery of Credit Card Receivables to Agent.

7. TERM

7.1 Termination.

The financing arrangements contemplated hereby shall be in effect until the Commitment Termination Date, and the Loans and all other Obligations shall be automatically due and payable in full on such date.

7.2 Survival of Obligations Upon Termination of Financing Arrangements.

Except as otherwise expressly provided for in the Loan Documents, no termination or cancellation (regardless of cause or procedure) of any financing arrangement under this Agreement shall in any way affect or impair the obligations, duties and liabilities of the Credit Parties or the rights of Agent and Lenders relating to any unpaid portion of the Loans or any other Obligations, due or not due, liquidated, contingent or unliquidated, or any transaction or event occurring prior to such termination, or any transaction or event, the performance of which is required after the Commitment Termination Date. Except as otherwise expressly provided herein or in any other Loan Document, all undertakings, agreements, covenants, warranties and representations of or binding upon the Credit Parties, and all rights of Agent and each Lender, all as contained in the Loan Documents, shall not terminate or expire, but rather shall survive any such termination or cancellation and shall continue in full force and effect until the Termination Date; provided, that the provisions of Section 11, the payment obligations under Sections 1.15 and 1.16, and the indemnities contained in the Loan Documents shall survive the Termination Date.

8. EVENTS OF DEFAULT; RIGHTS AND REMEDIES

8.1 Events of Default.

The occurrence of any one or more of the following events (regardless of the reason therefor) shall constitute an "Event of Default" hereunder:

- a. Borrower (i) fails to make any payment of principal of, or interest on, or Fees owing in respect of, the Loans or any of the other Obligations when due and payable, (ii) fails to pay or reimburse Agent or Lenders for any expense reimbursable hereunder or under any other Loan Document within 10 days following Agent's demand for such reimbursement or payment of expenses, provided, however, that Borrower shall have 2 Business Days to cure any failure under this Section 8.1(a)(i) that arises solely from Agent's failure to charge such payment under Section 1.11(b) at a time when all conditions to a Revolving Credit Advance, including those specified in Sections 1.1 and 2.2, are satisfied.
- b. Any Credit Party fails or neglects to perform, keep or observe any of the provisions of Sections 1.3, 1.4, 1.8, 1.14, 5.1 (with respect to its corporate existence and conduct of business), 5.4, 5.5, 5.14, 5.15 or 6, or any of the provisions set forth in Annexes C or G, or any of the provisions set forth in clause (b) of Annex E, respectively.
- c. Borrower fails or neglects to perform, keep or observe any of the provisions of Section 4 or any provisions set forth in Annexes E or F, (other than the provisions set forth in clause (b) of Annex F) respectively, and the same shall remain unremedied for 3 Business Days or more.
- d. Any Credit Party fails or neglects to perform, keep or observe any other provision of this Agreement or of any of the other Loan Documents (other than any provision embodied in or covered by any other clause of this Section 8.1) and the same shall remain unremedied for 30 days or more.
- e. A default or breach occurs under any other agreement, document or instrument to which any Credit Party is a party that is not cured within any applicable grace period therefor, and such default or breach (i) involves the failure to make any payment when due in respect of any Indebtedness or Guaranteed Indebtedness (other than the Obligations) of any Credit Party in excess of \$250,000 in the aggregate (including (x) undrawn committed or available amounts and (y) amounts owing to all creditors under any combined or syndicated credit arrangements), or (ii) causes, or permits any holder of such Indebtedness or Guaranteed Indebtedness or a trustee to cause, Indebtedness or Guaranteed Indebtedness or a portion thereof in excess of \$250,000 in the aggregate to become due prior to its stated maturity or prior to its regularly scheduled dates of payment, or cash collateral in respect thereof to be demanded, in each case, unless such default is waived within 30 days.
- f. Any information contained in any Borrowing Base Certificate is untrue or incorrect in any respect that is material in the sole discretion of Agent, or any representation or warranty herein or in any Loan Document or in any written statement, report, financial statement or certificate (other than a Borrowing Base Certificate) made or delivered to Agent or any Lender by any Credit Party is untrue or incorrect in any material respect as of the date when made or deemed made.
- g. Assets of any Credit Party with a fair market value of \$250,000 or more are attached, seized, levied upon or subjected to a writ or distress warrant, or come within the possession of any receiver, trustee, custodian or assignee for the benefit of creditors of any Credit Party and such condition continues for 60 days or more.

- h. A case or proceeding is commenced against any Credit Party seeking a decree or order in respect of such Credit Party, (i) under the Bankruptcy Code, or any other applicable federal, state or foreign bankruptcy or other similar law, (ii) appointing a custodian, receiver, liquidator, assignee, trustee or sequestrator (or similar official) for such Credit Party or for any substantial part of any such Credit Party's assets, or (iii) ordering the winding-up or liquidation of the affairs of such Credit Party, and such case or proceeding shall remain undismissed or unstayed for 60 days or more or a decree or order granting the relief sought in such case or proceeding shall be entered by a court of competent jurisdiction.
- i. Any Credit Party (i) files a petition seeking relief under the Bankruptcy Code, or any other applicable federal, state or foreign bankruptcy or other similar law, (ii) consents to or fails to contest in a timely and appropriate manner the institution of proceedings thereunder or the filing of any such petition or the appointment of or taking possession by a custodian, receiver, liquidator, assignee, trustee or sequestrator (or similar official) for such Credit Party or for any substantial part of any such Credit Party's assets, (iii) makes an assignment for the benefit of creditors, (iv) takes any action in furtherance of any of the foregoing, or (v) admits in writing its inability to, or is generally unable to, pay its debts as such debts become due.
- j. A final judgment or judgments for the payment of money in excess of \$250,000 in any one case or in excess of \$500,000 in the aggregate at any time are outstanding against one or more of the Credit Parties and the same are not, within 30 days after the entry thereof, discharged or execution thereof stayed or bonded pending appeal, or such judgments are not discharged prior to the expiration of any such stay.
- k. Any material provision of any Loan Document for any reason ceases to be valid, binding and enforceable in accordance with its terms (or any Credit Party shall challenge the enforceability of any Loan Document or shall assert in writing, or engage in any action or inaction based on any such assertion, that any provision of any of the Loan Documents has ceased to be or otherwise is not valid, binding and enforceable in accordance with its terms), or any Lien created under any Loan Document ceases to be a valid and perfected first priority Lien (except as otherwise permitted herein or therein) in any of the Collateral purported to be covered thereby.
- l. Any Change of Control occurs.
- m. Except to the extent permitted pursuant to Section 6.14, the payment of all or any portion of the principal amount of any Subordinated Debt whether at maturity, upon acceleration or otherwise, so long as the Obligations under this Agreement have not been paid in full and the Commitments have not been terminated.

8.2 Remedies.

- If any Default or Event of Default has occurred and is continuing, Agent may (and at the written request of the Requisite Revolving Lenders shall), without notice, suspend the Revolving Loan facility with respect to additional Advances and/or the incurrence of additional Letter of Credit Obligations, whereupon any additional Advances and additional

Letter of Credit Obligations shall be made or incurred in Agent's sole discretion (or in the sole discretion of the Requisite Revolving Lenders, if such suspension occurred at their direction) so long as such Default or Event of Default is continuing. If any Default or Event of Default has occurred and is continuing, Agent may (and at the written request of Requisite Lenders shall), without notice except as otherwise expressly provided herein, increase the rate of interest applicable to the Loans and the Letter of Credit Fees to the Default Rate.

- b. If any Event of Default has occurred and is continuing, Agent may (and at the written request of the Requisite Lenders shall), without notice: (i) terminate the Revolving Loan facility with respect to further Advances or the incurrence of further Letter of Credit Obligations; (ii) reduce the Revolving Loan Commitment from time to time; (iii) declare all or any portion of the Obligations, including all or any portion of any Loan to be forthwith due and payable, and require that the Letter of Credit Obligations be cash collateralized as provided in Annex B, all without presentment, demand, protest or further notice of any kind, all of which are expressly waived by Borrower and each other Credit Party; or (iv) exercise any rights and remedies provided to Agent under the Loan Documents or at law or equity, including all remedies provided under the Code; provided, that upon the occurrence of an Event of Default specified in Sections 8.1(h) or (i), the Commitments shall be immediately terminated and all of the Obligations, including the aggregate Revolving Loan, shall become immediately due and payable without declaration, notice or demand by any Person.

8.3 Waivers by Credit Parties.

Except as otherwise provided for in this Agreement or by applicable law, each Credit Party waives (including for purposes of Section 12):

(a) presentment, demand and protest and notice of presentment, dishonor, notice of intent to accelerate, notice of acceleration, protest, default, nonpayment, maturity, release, compromise, settlement, extension or renewal of any or all commercial paper, accounts, contract rights, documents, instruments, chattel paper and guaranties at any time held by Agent on which any Credit Party may in any way be liable, and hereby ratifies and confirms whatever Agent may do in this regard, (b) all rights to notice and a hearing prior to Agent's taking possession or control of, or to Agent's replevy, attachment or levy upon, the Collateral or any bond or security that might be required by any court prior to allowing Agent to exercise any of its remedies, and (c) the benefit of all valuation, appraisal, marshaling and exemption laws.

9. ASSIGNMENT AND PARTICIPATIONS; APPOINTMENT OF AGENT

9.1 Assignment and Participations.

- Subject to the terms of this Section 9.1, any Lender may make an assignment to a Qualified Assignee of, or sell participations in, at any time or times, the Loan Documents, Loans, Letter of Credit Obligations and any Commitment or any portion thereof or interest therein, including any Lender's rights, title, interests, remedies, powers or duties thereunder. Any assignment by a Lender shall: (i) require the consent of Agent (which consent shall not be unreasonably withheld or delayed with respect to a Qualified Assignee) and the execution of an assignment agreement (an "Assignment Agreement") substantially in the form attached hereto as Exhibit 9.1(a) and otherwise in form and substance reasonably satisfactory to, and acknowledged by, Agent; (ii) be conditioned on such assignee Lender representing to the assigning Lender and Agent that it is purchasing the applicable Loans to be assigned to it for its

own account, for investment purposes and not with a view to the distribution thereof; (iii) after giving effect to any such partial assignment, the assignee Lender shall have Commitments in an amount at least equal to \$5,000,000 and the assigning Lender shall have retained Commitments in an amount at least equal to \$5,000,000; (iv) include a payment to Agent of an assignment fee of \$3,500; and (v) so long as no Event of Default has occurred and is continuing, require the consent of Borrower, which shall not be unreasonably withheld or delayed; provided that no such consent shall be required for an assignment to a Qualified Assignee. In the case of an assignment by a Lender under this Section 9.1, the assignee shall have, to the extent of such assignment, the same rights, benefits and obligations as all other Lenders hereunder. The assigning Lender shall be relieved of its obligations hereunder with respect to its Commitments or assigned portion thereof from and after the date of such assignment. Borrower hereby acknowledges and agrees that any assignment shall give rise to a direct obligation of Borrower to the assignee and that the assignee shall be considered to be a "Lender." In all instances, each Lender's liability to make Loans hereunder shall be several and not joint and shall be limited to such Lender's Pro Rata Share of the applicable Commitment. In the event Agent or any Lender assigns or otherwise transfers all or any part of the Obligations, Agent or any such Lender shall so notify Borrower and Borrower shall, upon the request of Agent or such Lender, execute new Notes in exchange for the Notes, if any, being assigned. Notwithstanding the foregoing provisions of this Section 9.1(a), any Lender may at any time pledge the Obligations held by it and such Lender's rights under this Agreement and the other Loan Documents to a Federal Reserve Bank, and any Lender that is an investment fund may assign the Obligations held by it and such Lender's rights under this Agreement and the other Loan Documents to another investment fund managed by the same investment advisor; provided, that no such pledge to a Federal Reserve Bank shall release such Lender from such Lender's obligations hereunder or under any other Loan Document.

- b. Any participation by a Lender of all or any part of its Commitments shall be made with the understanding that all amounts payable by Borrower hereunder shall be determined as if that Lender had not sold such participation, and that the holder of any such participation shall not be entitled to require such Lender to take or omit to take any action hereunder except actions directly affecting (i) any reduction in the principal amount of, or interest rate or Fees payable with respect to, any Loan in which such holder participates, (ii) any extension of the scheduled amortization of the principal amount of any Loan in which such holder participates or the final maturity date thereof, and (iii) any release of all or substantially all of the Collateral (other than in accordance with the terms of this Agreement, the Collateral Documents or the other Loan Documents). Solely for purposes of Sections 1.13, 1.15, 1.16 and 9.8, Borrower acknowledges and agrees that a participation shall give rise to a direct obligation of Borrower to the participant effective upon delivery of written notice to Borrower of such participation and the participant shall be considered to be a "Lender." Except as set forth in the preceding sentence neither Borrower nor any other Credit Party shall have any obligation or duty to any participant. Neither Agent nor any Lender (other than the Lender selling a participation) shall have any duty to any participant and may continue to deal solely with the Lender selling a participation as if no such sale had occurred.
- c. Except as expressly provided in this Section 9.1, no Lender shall, as between Borrower and that Lender, or Agent and that Lender, be relieved of any of its

obligations hereunder as a result of any sale, assignment, transfer or negotiation of, or granting of participation in, all or any part of the Loans, the Notes or other Obligations owed to such Lender.

- d. Each Credit Party executing this Agreement shall assist any Lender permitted to sell assignments or participations under this Section 9.1 as reasonably required to enable the assigning or selling Lender to effect any such assignment or participation, including the execution and delivery of any and all agreements, notes and other documents and instruments as shall be requested and, if requested by Agent, the preparation of informational materials for, and the participation of management in meetings with, potential assignees or participants. Each Credit Party executing this Agreement shall certify the correctness, completeness and accuracy of all descriptions of the Credit Parties and their respective affairs contained in any selling materials provided by it and all other information provided by them and included in such materials, except that any Projections delivered by Borrower shall only be certified by Borrower as having been prepared by Borrower in compliance with the representations contained in Section 3.4(c).
- e. Any Lender may furnish any information concerning Credit Parties in the possession of such Lender from time to time to assignees and participants (including prospective assignees and participants); provided that such Lender shall obtain from assignees or participants confidentiality covenants substantially equivalent to those contained in Section 11.8.
- f. So long as no Event of Default has occurred and is continuing, no Lender shall assign or sell participations in any portion of its Loans or Commitments to a potential Lender or participant, if, as of the date of the proposed assignment or sale, the assignee Lender or participant would be subject to capital adequacy or similar requirements under Section 1.16(a), increased costs under Section 1.16(b), an inability to fund LIBOR Loans under Section 1.16(c), withholding taxes in accordance with Section 1.15(a), or has not provided a Certificate of Exemption.
- g. Nothing contained in this Section 9 shall require the consent of any party for Agent or any Lender to assign any of its rights in respect of any Swap Related Reimbursement Obligation.

9.2 Appointment of Agent.

GE Capital is hereby appointed to act on behalf of all Lenders as Agent under this Agreement and the other Loan Documents. The provisions of this Section 9.2 are solely for the benefit of Agent and Lenders and no Credit Party nor any other Person shall have any rights as a third party beneficiary of any of the provisions hereof. In performing its functions and duties under this Agreement and the other Loan Documents, Agent shall act solely as an agent of Lenders and does not assume and shall not be deemed to have assumed any obligation toward or relationship of agency or trust with or for any Credit Party or any other Person. Agent shall have no duties or responsibilities except for those expressly set forth in this Agreement and the other Loan Documents. The duties of Agent shall be mechanical and administrative in nature and Agent shall not have, or be deemed to have, by reason of this Agreement, any other Loan Document or otherwise a fiduciary relationship in respect of any Lender. Except as expressly set forth in this Agreement and the other Loan Documents, Agent shall not have any duty to disclose, and shall not be liable for failure to disclose, any information relating to any Credit Party or any of their respective Subsidiaries or any Account Debtor that is

communicated to or obtained by GE Capital or any of its Affiliates in any capacity. Neither Agent nor any of its Affiliates nor any of their respective officers, directors, employees, agents or representatives shall be liable to any Lender for any action taken or omitted to be taken by it hereunder or under any other Loan Document, or in connection herewith or therewith, except for damages caused by its or their own gross negligence or willful misconduct.

If Agent shall request instructions from Requisite Lenders, Requisite Revolving Lenders, or all affected Lenders with respect to any act or action (including failure to act) in connection with this Agreement or any other Loan Document, then Agent shall be entitled to refrain from such act or taking such action unless and until Agent shall have received instructions from Requisite Lenders, Requisite Revolving Lenders, or all affected Lenders, as the case may be, and Agent shall not incur liability to any Person by reason of so refraining. Agent shall be fully justified in failing or refusing to take any action hereunder or under any other Loan Document (a) if such action would, in the opinion of Agent, be contrary to law or the terms of this Agreement or any other Loan Document, (b) if such action would, in the opinion of Agent, expose Agent to Environmental Liabilities or (c) if Agent shall not first be indemnified to its satisfaction against any and all liability and expense which may be incurred by it by reason of taking or continuing to take any such action. Without limiting the foregoing, no Lender shall have any right of action whatsoever against Agent as a result of Agent acting or refraining from acting hereunder or under any other Loan Document in accordance with the instructions of Requisite Lenders, Requisite Revolving Lenders, or all affected Lenders, as applicable.

9.3 Agent's Reliance, Etc.

Neither Agent nor any of its Affiliates nor any of their respective directors, officers, agents or employees shall be liable for any action taken or omitted to be taken by it or them under or in connection with this Agreement or the other Loan Documents, except for damages caused by its or their own gross negligence or willful misconduct. Without limiting the generality of the foregoing, Agent: (a) may treat the payee of any Note as the holder thereof until Agent receives written notice of the assignment or transfer thereof signed by such payee and in form reasonably satisfactory to Agent; (b) may consult with legal counsel, independent public accountants and other experts selected by it and shall not be liable for any action taken or omitted to be taken by it in good faith in accordance with the advice of such counsel, accountants or experts; (c) makes no warranty or representation to any Lender and shall not be responsible to any Lender for any statements, warranties or representations made in or in connection with this Agreement or the other Loan Documents; (d) shall not have any duty to ascertain or to inquire as to the performance or observance of any of the terms, covenants or conditions of this Agreement or the other Loan Documents on the part of any Credit Party or to inspect the Collateral (including the books and records) of any Credit Party; (e) shall not be responsible to any Lender for the due execution, legality, validity, enforceability, genuineness, sufficiency or value of this Agreement or the other Loan Documents or any other instrument or document furnished pursuant hereto or thereto; and (f) shall incur no liability under or in respect of this Agreement or the other Loan Documents by acting upon any notice, consent, certificate or other instrument or writing (which may be by telecopy, telegram, cable or telex) believed by it to be genuine and signed or sent by the proper party or parties.

9.4 GE Capital and Affiliates.

With respect to its Commitments hereunder, GE Capital shall have the same rights and powers under this Agreement and the other Loan Documents as any other Lender and may exercise the same as though it were not Agent; and the

term "Lender" or "Lenders" shall, unless otherwise expressly indicated, include GE Capital in its individual capacity. GE Capital and its Affiliates may lend money to, invest in, and generally engage in any kind of business with, any Credit Party, any of their Affiliates and any Person who may do business with or own securities of any Credit Party or any such Affiliate, all as if GE Capital were not Agent and without any duty to account therefor to Lenders. GE Capital and its Affiliates may accept fees and other consideration from any Credit Party for services in connection with this Agreement or otherwise without having to account for the same to Lenders. Each Lender acknowledges the potential conflict of interest between GE Capital as a Lender holding disproportionate interests in the Loans and GE Capital as Agent.

9.5 Lender Credit Decision.

Each Lender acknowledges that it has, independently and without reliance upon Agent or any other Lender and based on the Financial Statements referred to in Section 3.4(a) and such other documents and information as it has deemed appropriate, made its own credit and financial analysis of the Credit Parties and its own decision to enter into this Agreement. Each Lender also acknowledges that it will, independently and without reliance upon Agent or any other Lender and based on such documents and information as it shall deem appropriate at the time, continue to make its own credit decisions in taking or not taking action under this Agreement. Each Lender acknowledges the potential conflict of interest of each other Lender as a result of Lenders holding disproportionate interests in the Loans, and expressly consents to, and waives any claim based upon, such conflict of interest.

9.6 Indemnification.

Lenders agree to indemnify Agent (to the extent not reimbursed by Credit Parties and without limiting the obligations of Borrower hereunder), ratably according to their respective Pro Rata Shares, from and against any and all liabilities, obligations, losses, damages, penalties, actions, judgments, suits, costs, expenses or disbursements of any kind or nature whatsoever that may be imposed on, incurred by, or asserted against Agent in any way relating to or arising out of this Agreement or any other Loan Document or any action taken or omitted to be taken by Agent in connection therewith; provided, that no Lender shall be liable for any portion of such liabilities, obligations, losses, damages, penalties, actions, judgments, suits, costs, expenses or disbursements resulting from Agent's gross negligence or willful misconduct. Without limiting the foregoing, each Lender agrees to reimburse Agent promptly upon demand for its ratable share of any out-of-pocket expenses (including reasonable counsel fees) incurred by Agent in connection with the preparation, execution, delivery, administration, modification, amendment or enforcement (whether through negotiations, legal proceedings or otherwise) of, or legal advice in respect of rights or responsibilities under, this Agreement and each other Loan Document, to the extent that Agent is not reimbursed for such expenses by Credit Parties.

9.7 Successor Agent.

Agent may resign at any time by giving not less than 30 days' prior written notice thereof to Lenders and Borrower. Upon any such resignation, the Requisite Lenders shall have the right to appoint a successor Agent. If no successor Agent shall have been so appointed by the Requisite Lenders and shall have accepted such appointment within 30 days after the resigning Agent's giving notice of resignation, then the resigning Agent may, on behalf of Lenders, appoint a successor Agent, which shall be a Lender, if a Lender is willing to accept such appointment, or otherwise shall be a commercial bank or financial institution or a subsidiary of a commercial bank or financial institution if such commercial bank

or financial institution is organized under the laws of the United States of America or of any State thereof and has a combined capital and surplus of at least \$300,000,000. If no successor Agent has been appointed pursuant to the foregoing, within 30 days after the date such notice of resignation was given by the resigning Agent, such resignation shall become effective and the Requisite Lenders shall thereafter perform all the duties of Agent hereunder until such time, if any, as the Requisite Lenders appoint a successor Agent as provided above. Any successor Agent appointed by Requisite Lenders hereunder shall be subject to the approval of Borrower, such approval not to be unreasonably withheld or delayed; provided that such approval shall not be required if a Default or an Event of Default has occurred and is continuing. Upon the acceptance of any appointment as Agent hereunder by a successor Agent, such successor Agent shall succeed to and become vested with all the rights, powers, privileges and duties of the resigning Agent. Upon the earlier of the acceptance of any appointment as Agent hereunder by a successor Agent or the effective date of the resigning Agent's resignation, the resigning Agent shall be discharged from its duties and obligations under this Agreement and the other Loan Documents, except that any indemnity rights or other rights in favor of such resigning Agent shall continue. After any resigning Agent's resignation hereunder, the provisions of this Section 9 shall inure to its benefit as to any actions taken or omitted to be taken by it while it was acting as Agent under this Agreement and the other Loan Documents.

9.8 Setoff and Sharing of Payments.

In addition to any rights now or hereafter granted under applicable law and not by way of limitation of any such rights, upon the occurrence and during the continuance of any Event of Default and subject to Section 9.9(f), each Lender, each participant and each holder is hereby authorized at any time or from time to time, without notice to any Credit Party or to any other Person, any such notice being hereby expressly waived, to offset and to appropriate and to apply any and all balances held by it at any of its offices for the account of Borrower or Guarantor (regardless of whether such balances are then due to Borrower or Guarantor) and any other properties or assets at any time held or owing by that Lender, holder or participant to or for the credit or for the account of Borrower or Guarantor against and on account of any of the Obligations that are not paid when due. Any Lender exercising a right of setoff or otherwise receiving any payment on account of the Obligations in excess of its Pro Rata Share thereof shall purchase for cash (and the other Lenders or holders shall sell) such participations in each such other Lender's or holder's Pro Rata Share of the Obligations as would be necessary to cause such Lender to share the amount so offset or otherwise received with each other Lender or holder in accordance with their respective Pro Rata Shares (other than offset rights exercised by any Lender with respect to Sections 1.13, 1.15 or 1.16). Each Lender's obligation under this Section 9.8 shall be in addition to and not in limitation of its obligations to purchase a participation in an amount equal to its Pro Rata Share of the Swing Line Loans under Section 1.1. Borrower or Guarantor agrees, to the fullest extent permitted by law, that (a) any Lender may exercise its right to offset with respect to amounts in excess of its Pro Rata Share of the Obligations and may sell participations in such amounts so offset to other Lenders, participants and holders and (b) any Lender, participant or holder so purchasing a participation in the Loans made or other Obligations held by other Lenders, participants or holders may exercise all rights of offset, bankers' lien, counterclaim or similar rights with respect to such participation as fully as if such Lender, participant or holder were a direct holder of the Loans and the other Obligations in the amount of such participation. Notwithstanding the foregoing, if all or any portion of the offset amount or payment otherwise received is thereafter recovered from the Lender that has exercised the right of offset, the

purchase of participations by that Lender shall be rescinded and the purchase price restored without interest.

9.9 Advances; Payments; Non-Funding Lenders; Information; Actions in Concert.

- Advances; Payments.
 - i. Revolving Lenders shall refund or participate in the Swing Line Loan in accordance with clauses (iii) and (iv) of Section 1.1(c). If the Swing Line Lender declines to make a Swing Line Loan or if Swing Line Availability is zero, Agent shall notify Revolving Lenders, promptly after receipt of a Notice of Revolving Credit Advance and in any event prior to 12:00 p.m. (Los Angeles time) on the date such Notice of Revolving Credit Advance is received, by telecopy, telephone or other similar form of transmission. Each Revolving Lender shall make the amount of such Lender's Pro Rata Share of such Revolving Credit Advance available to Agent in same day funds by wire transfer to Agent's account as set forth in Annex H not later than 2:00 p.m. (Los Angeles time) on the requested funding date. After receipt of such wire transfers (or, in Agent's sole discretion, before receipt of such wire transfers), subject to the terms hereof, Agent shall make the requested Revolving Credit Advance to Borrower. All payments by each Revolving Lender shall be made without setoff, counterclaim or deduction of any kind.
 - ii. On the 2nd Business Day of each calendar week or more frequently at Agent's election (each, a "Settlement Date"), Agent shall advise each Lender by telephone, or telecopy of the amount of such Lender's Pro Rata Share of principal, interest and Fees paid for the benefit of Lenders with respect to each applicable Loan. Provided that each Lender has funded all payments or Advances required to be made by it and has purchased all participations required to be purchased by it under this Agreement and the other Loan Documents as of such Settlement Date, Agent shall pay to each Lender such Lender's Pro Rata Share of principal, interest and Fees paid by Borrower since the previous Settlement Date for the benefit of such Lender on the Loans held by it. To the extent that any Lender (a "Non-Funding Lender") has failed to fund all such payments and Advances or failed to fund the purchase of all such participations, Agent shall be entitled to set off the funding short-fall against that Non-Funding Lender's Pro Rata Share of all payments received from Borrower. Such payments shall be made by wire transfer to such Lender's account (as specified by such Lender in Annex H or the applicable Assignment Agreement) not later than 1:00 p.m. (Los Angeles time) on the next Business Day following each Settlement Date.
- Availability of Lender's Pro Rata Share. Agent may assume that each Revolving Lender will make its Pro Rata Share of each Revolving Credit Advance available to Agent on each funding date. If such Pro Rata Share is not, in fact, paid to Agent by such Revolving Lender when due, Agent will be entitled to recover such amount on demand from such Revolving Lender without setoff, counterclaim or deduction of any kind. If any Revolving Lender fails to pay the amount of its Pro Rata Share forthwith upon Agent's demand, Agent shall promptly notify Borrower and Borrower shall immediately repay such amount to Agent. Nothing in this Section 9.9(b) or elsewhere in this Agreement or the other Loan Documents shall be deemed to require Agent to advance funds on behalf of any Revolving Lender or to relieve

any Revolving Lender from its obligation to fulfill its Commitments hereunder or to prejudice any rights that Borrower may have against any Revolving Lender as a result of any default by such Revolving Lender hereunder. To the extent that Agent advances funds to Borrower on behalf of any Revolving Lender and is not reimbursed therefor on the same Business Day as such Advance is made, Agent shall be entitled to retain for its account all interest accrued on such Advance until reimbursed by the applicable Revolving Lender.

c. Return of Payments.

- i. If Agent pays an amount to a Lender under this Agreement in the belief or expectation that a related payment has been or will be received by Agent from Borrower and such related payment is not received by Agent, then Agent will be entitled to recover such amount from such Lender on demand without setoff, counterclaim or deduction of any kind.
- ii. If Agent determines at any time that any amount received by Agent under this Agreement must be returned to Borrower or paid to any other Person pursuant to any insolvency law or otherwise, then, notwithstanding any other term or condition of this Agreement or any other Loan Document, Agent will not be required to distribute any portion thereof to any Lender. In addition, each Lender will repay to Agent on demand any portion of such amount that Agent has distributed to such Lender, together with interest at such rate, if any, as Agent is required to pay to Borrower or such other Person, without setoff, counterclaim or deduction of any kind.

- Non-Funding Lenders. The failure of any Non-Funding Lender to make any Revolving Credit Advance or any payment required by it hereunder or to purchase any participation in any Swing Line Loan to be made or purchased by it on the date specified therefor shall not relieve any other Lender (each such other Revolving Lender, an "Other Lender") of its obligations to make such Advance or purchase such participation on such date, but neither any Other Lender nor Agent shall be responsible for the failure of any Non-Funding Lender to make an Advance, purchase a participation or make any other payment required hereunder. Notwithstanding anything set forth herein to the contrary, a Non-Funding Lender shall not have any voting or consent rights under or with respect to any Loan Document or constitute a "Lender" or a "Revolving Lender" (or be included in the calculation of "Requisite Lenders," or "Requisite Revolving Lenders" hereunder) for any voting or consent rights under or with respect to any Loan Document. At Borrower's request, Agent or a Person reasonably acceptable to Agent shall have the right with Agent's consent and in Agent's sole discretion (but shall have no obligation) to purchase from any Non-Funding Lender, and each Non-Funding Lender agrees that it shall, at Agent's request, sell and assign to Agent or such Person, all of the Commitments of that Non-Funding Lender for an amount equal to the principal balance of all Loans held by such Non-Funding Lender and all accrued interest and fees with respect thereto through the date of sale, such purchase and sale to be consummated pursuant to an executed Assignment Agreement.
- Dissemination of Information. Agent shall use reasonable efforts to provide Lenders with any notice of Default or Event of Default received by Agent from, or delivered by Agent to, any Credit Party, with notice of any Event of Default of which Agent has

actually become aware and with notice of any action taken by Agent following any Event of Default; provided, that Agent shall not be liable to any Lender for any failure to do so, except to the extent that such failure is attributable to Agent's gross negligence or willful misconduct. Lenders acknowledge that Borrower is required to provide Financial Statements and Collateral Reports to Lenders in accordance with Annexes E and F hereto and agree that Agent shall have no duty to provide the same to Lenders.

- f. Actions in Concert. Anything in this Agreement to the contrary notwithstanding, each Lender hereby agrees with each other Lender that no Lender shall take any action to protect or enforce its rights arising out of this Agreement or the Notes (including exercising any rights of setoff) without first obtaining the prior written consent of Agent and Requisite Lenders, it being the intent of Lenders that any such action to protect or enforce rights under this Agreement and the Notes shall be taken in concert and at the direction or with the consent of Agent or Requisite Lenders.

9.10 Syndication Agent

. It is expressly acknowledged and agreed by Agent and each Lender, for the benefit of the Syndication Agent that, other than any rights or obligations explicitly reserved to or imposed upon the Syndication Agent hereunder, the Syndication Agent, in such capacity, has no rights or obligations hereunder nor shall the Syndication Agent, in such capacity, be responsible or accountable to any other party hereto for any action or failure to act hereunder other than in connection with such explicitly reserved rights or obligations and then only for damages caused by its own gross negligence or willful misconduct.

10. SUCCESSORS AND ASSIGNS

10.1 Successors and Assigns.

This Agreement and the other Loan Documents shall be binding on and shall inure to the benefit of each Credit Party, Agent, Lenders and their respective successors and assigns (including, in the case of any Credit Party, a debtor-in-possession on behalf of such Credit Party), except as otherwise provided herein or therein. No Credit Party may assign, transfer, hypothecate or otherwise convey its rights, benefits, obligations or duties hereunder or under any of the other Loan Documents without the prior express written consent of Agent and Lenders. Any such purported assignment, transfer, hypothecation or other conveyance by any Credit Party without the prior express written consent of Agent and Lenders shall be void. The terms and provisions of this Agreement are for the purpose of defining the relative rights and obligations of each Credit Party, Agent and Lenders with respect to the transactions contemplated hereby and no Person shall be a third party beneficiary of any of the terms and provisions of this Agreement or any of the other Loan Documents.

11. MISCELLANEOUS

11.1 Complete Agreement; Modification of Agreement.

The Loan Documents constitute the complete agreement between the parties with respect to the subject matter thereof and may not be modified, altered or amended except as set forth in Section 11.2. Any letter of interest, commitment letter, or fee letter (other than the GE Capital Fee Letter) or confidentiality agreement, if any, between any Credit Party and Agent or any Lender or any of

their respective Affiliates, predating this Agreement and relating to a financing of substantially similar form, purpose or effect shall be superseded by this Agreement. Notwithstanding the foregoing, the GE Capital Fee Letter and any market flex provisions contained in the final commitment letter between Agent and Borrower shall survive the execution and delivery of this Agreement and shall continue to be binding obligations of the parties.

11.2 Amendments and Waivers.

- Except for actions expressly permitted to be taken by Agent, no amendment, modification, termination or waiver of any provision of this Agreement or any other Loan Document, or any consent to any departure by any Credit Party therefrom, shall in any event be effective unless the same shall be in writing and signed by Agent and Borrower, and by Requisite Lenders, Requisite Revolving Lenders, or all affected Lenders, as applicable. Except as set forth in clauses (b) and (c) below, all such amendments, modifications, terminations or waivers requiring the consent of any Lenders shall require the written consent of Requisite Lenders.
- No amendment, modification, termination or waiver of or consent with respect to any provision of this Agreement that waives compliance with the conditions precedent set forth in Section 2.2 to the making of any Loan or the incurrence of any Letter of Credit Obligations shall be effective unless the same shall be in writing and signed by Agent, Requisite Revolving Lenders and Borrower. Notwithstanding anything contained in this Agreement to the contrary, no waiver or consent with respect to any Default or any Event of Default shall be effective for purposes of the conditions precedent to the making of Loans or the incurrence of Letter of Credit Obligations set forth in Section 2.2 unless the same shall be in writing and signed by Agent, Requisite Revolving Lenders, and Borrower.
- No amendment, modification, termination or waiver shall, unless in writing and signed by Agent and each Lender directly affected thereby:
 - (i) increase the principal amount of any Lender's Commitment (which action shall be deemed only to affect those Lenders whose Commitments are increased and may be approved by Requisite Lenders, including those Lenders whose Commitments are increased);
 - (ii) reduce the principal of, rate of interest on or Fees payable with respect to any Loan or Letter of Credit Obligations of any affected Lender;
 - (iii) extend any scheduled payment date (other than payment dates of mandatory prepayments under Section 1.3(b)(ii)-(iii)) or final maturity date of the principal amount of any Loan of any affected Lender;
 - (iv) waive, forgive, defer, extend or postpone any payment of interest or Fees as to any affected Lender;
 - (v) increase Borrowing Availability, or otherwise increase the percentage advance rates set forth in the definition of the Borrowing Base, or make less restrictive the nondiscretionary criteria for exclusion from Eligible Inventory or Eligible Credit Card Receivables set forth in Sections 1.6 and 1.7;
 - (vi) reduce the frequency or content of reports required to be delivered to Agent or Lenders by or with respect to any Credit Party;
 - (vii) except as expressly permitted or required in the Loan Documents, release or dispose of any material portion of the Collateral;
 - (viii) change the percentage of the Commitments or of the aggregate unpaid principal amount of the Loans that shall be required for Lenders or any of them to take any action hereunder;
 - (ix) amend or waive this Section 11.2 or the definitions of the terms "Requisite Lenders," or "Requisite Revolving Lenders," insofar as such definitions affect the substance of this Section 11.2;
 - (x) amend Section 1.11(a) or
 - (xi) amend the definition of

"Minimum Excess Availability." Furthermore, no amendment, modification, termination or waiver affecting the rights or duties of Agent or L/C Issuer under this Agreement or any other Loan Document shall be effective unless in writing and signed by Agent or L/C Issuer, as the case may be, in addition to Lenders required hereinabove to take such action. Furthermore, no amendment, modification, termination or waiver affecting the rights or duties of Agent or L/C Issuer, or of any Lender in respect to any Swap Related Reimbursement Obligations, under this Agreement or any other Loan Document, including any release of any Guaranty or Collateral requiring a writing signed by all Lenders, shall be effective unless in writing and signed by Agent or L/C Issuer or the applicable Lenders, as the case may be, in addition to the other Lenders required hereinabove to take such action. No amendment, modification, termination or waiver shall be required for Agent to take additional Collateral pursuant to any Loan Document. No amendment, modification, termination or waiver of any provision of any Note shall be effective without the written concurrence of the holder of that Note. No notice to or demand on any Credit Party in any case shall entitle such Credit Party or any other Credit Party to any other or further notice or demand in similar or other circumstances. Any amendment, modification, termination, waiver or consent effected in accordance with this Section 11.2 shall be binding upon each holder of the Notes at the time outstanding and each future holder of the Notes.

- i. If, in connection with any proposed amendment, modification, waiver or termination (a "Proposed Change") requiring the consent of all affected Lenders, the consent of Agent, but the consent of other Lenders whose consent is required is not obtained (any such Lender whose consent is not obtained being referred to as a "Non-Consenting Lender") then, at Borrower's request, Agent or a Person reasonably acceptable to Agent shall have the right, with Agent's consent and in Agent's sole discretion (but Agent shall have no obligation), to purchase from all, but not less than all, such Non-Consenting Lenders, and such Non-Consenting Lenders agree that they shall, upon Agent's request, sell and assign to Agent or such Person, all of the Commitments of such Non-Consenting Lenders for an amount equal to the principal balance of all Loans held by the Non-Consenting Lenders and all accrued interest and Fees with respect thereto, in each case outstanding as of the date of sale (the "Purchase Price"). Such purchase and sale shall be consummated pursuant to an executed Assignment Agreement, which Assignment Agreement may be executed by the Agent on behalf of each such Non-Consenting Lender so long as the applicable Purchase Price is paid to such Non-Consenting Lender.
- b. Upon payment in full in cash and performance of all of the Obligations (other than indemnification Obligations), termination of the Commitments and a release of all claims against Agent and Lenders, and so long as no suits, actions, proceedings or claims are pending or threatened against any Indemnified Person asserting any damages, losses or liabilities that are Indemnified Liabilities, Agent shall deliver to Borrower termination statements, mortgage releases and other documents necessary or appropriate to evidence the termination of the Liens securing payment of the Obligations.

11.3 Fees and Expenses.

Borrower shall reimburse (i) Agent for all fees, costs and expenses (including the reasonable fees and expenses of all of its counsel, advisors, consultants and auditors) and (ii) Agent (and, with respect to clauses (c) and (d) below, all Lenders) for all fees, costs and expenses, including the reasonable fees, costs and expenses of counsel or other advisors (including environmental and management consultants and appraisers),

incurred in connection with the negotiation and preparation of the Loan Documents and incurred in connection with:

- a. the forwarding to Borrower or any other Person on behalf of Borrower by Agent of the proceeds of any Loan (including a wire transfer fee of \$25 per wire transfer);
- b. any amendment, modification or waiver of, consent with respect to, or termination of, any of the Loan Documents or Related Transactions Documents or advice in connection with the syndication and administration of the Loans made pursuant hereto or its rights hereunder or thereunder;
- c. any litigation, contest, dispute, suit, proceeding or action (whether instituted by Agent, any Lender, Borrower or any other Person and whether as a party, witness or otherwise) in any way relating to the Collateral, any of the Loan Documents or any other agreement to be executed or delivered in connection herewith or therewith, including any litigation, contest, dispute, suit, case, proceeding or action, and any appeal or review thereof, in connection with a case commenced by or against Borrower or any other Person that may be obligated to Agent by virtue of the Loan Documents; including any such litigation, contest, dispute, suit, proceeding or action arising in connection with any work-out or restructuring of the Loans during the pendency of one or more Events of Default; provided that in the case of reimbursement of counsel for Lenders other than Agent, such reimbursement shall be limited to one counsel for all such Lenders; provided, further, that no Person shall be entitled to reimbursement under this clause (c) in respect of any litigation, contest, dispute, suit, proceeding or action to the extent any of the foregoing results from such Person's gross negligence or willful misconduct;
- d. any attempt to enforce any remedies of Agent against any or all of the Credit Parties or any other Person that may be obligated to Agent or any Lender by virtue of any of the Loan Documents, including any such attempt to enforce any such remedies in the course of any work-out or restructuring of the Loans during the pendency of one or more Events of Default; provided, that in the case of reimbursement of counsel for Lenders other than Agent, such reimbursement shall be limited to one counsel for all such Lenders;
- e. any workout or restructuring of the Loans during the pendency of one or more Events of Default; and
- f. efforts to (i) monitor the Loans or any of the other Obligations, (ii) evaluate, observe or assess any of the Credit Parties or their respective affairs, and (iii) verify, protect, evaluate, assess, appraise, collect, sell, liquidate or otherwise dispose of any of the Collateral;

including, as to each of clauses (a) through (f) above, all reasonable attorneys' and other professional and service providers' fees arising from such services and other advice, assistance or other representation, including those in connection with any appellate proceedings, and all expenses, costs, charges and other fees incurred by such counsel and others in connection with or relating to any of the events or actions described in this Section 11.3, all of which shall be

payable, on demand, by Borrower to Agent. Without limiting the generality of the foregoing, such expenses, costs, charges and fees may include: fees, costs and expenses of accountants, environmental advisors, appraisers, investment bankers, management and other consultants and paralegals; court costs and expenses; photocopying and duplication expenses; court reporter fees, costs and expenses; long distance telephone charges; air express charges; telegram or telecopy charges; secretarial overtime charges; and expenses for travel, lodging and food paid or incurred in connection with the performance of such legal or other advisory services.

11.4 No Waiver.

Agent's or any Lender's failure, at any time or times, to require strict performance by the Credit Parties of any provision of this Agreement or any other Loan Document shall not waive, affect or diminish any right of Agent or such Lender thereafter to demand strict compliance and performance herewith or therewith. Any suspension or waiver of an Event of Default shall not suspend, waive or affect any other Event of Default whether the same is prior or subsequent thereto and whether the same or of a different type. Subject to the provisions of Section 11.2, none of the undertakings, agreements, warranties, covenants and representations of any Credit Party contained in this Agreement or any of the other Loan Documents and no Default or Event of Default by any Credit Party shall be deemed to have been suspended or waived by Agent or any Lender, unless such waiver or suspension is by an instrument in writing signed by an officer or other authorized employee of Agent and the applicable required Lenders, and directed to Borrower specifying such suspension or waiver.

11.5 Remedies.

Agent's and Lenders' rights and remedies under this Agreement shall be cumulative and nonexclusive of any other rights and remedies that Agent or any Lender may have under any other agreement, including the other Loan Documents, by operation of law or otherwise. Recourse to the Collateral shall not be required.

11.6 Severability.

Wherever possible, each provision of this Agreement and the other Loan Documents shall be interpreted in such a manner as to be effective and valid under applicable law, but if any provision of this Agreement or any other Loan Document shall be prohibited by or invalid under applicable law, such provision shall be ineffective only to the extent of such prohibition or invalidity without invalidating the remainder of such provision or the remaining provisions of this Agreement or such other Loan Document.

11.7 Conflict of Terms.

Except as otherwise provided in this Agreement or any of the other Loan Documents by specific reference to the applicable provisions of this Agreement, if any provision contained in this Agreement conflicts with any provision in any of the other Loan Documents, the provision contained in this Agreement shall govern and control.

11.8 Confidentiality.

Agent and each Lender agree to use commercially reasonable efforts (equivalent to the efforts Agent or such Lender applies to maintaining confidentiality of its own confidential information) to maintain as confidential all confidential information provided to them by the Credit Parties for a period of 2 years following receipt thereof, except that Agent and any Lender may disclose such information (a) to Persons employed or engaged by Agent or such Lender; (b) to any bona fide assignee or participant or potential assignee or participant that has agreed to comply with the covenant contained in this Section 11.8 (and any such bona fide assignee or participant or potential assignee or participant may disclose such information to Persons employed or engaged by them as described in clause

(a) above); (c) as required or requested by any Governmental Authority or reasonably believed by Agent or such Lender to be compelled by any court decree, subpoena or legal or administrative order or process; (d) as, on the advice of Agent's or such Lender's counsel, is required by law; (e) in connection with the exercise of any right or remedy under the Loan Documents or in connection with any Litigation to which Agent or such Lender is a party; or (f) that ceases to be confidential through no fault of Agent or any Lender. None of the foregoing obligations and restrictions shall apply to any information that (i) was or is generally available to the public other than as a result of a disclosure by Agent or any Lender, or (ii) was or is available to Agent or any Lender on a non-confidential basis prior to its disclosure by the Credit Parties.

11.9 GOVERNING LAW.

EXCEPT AS OTHERWISE EXPRESSLY PROVIDED IN ANY OF THE LOAN DOCUMENTS, IN ALL RESPECTS, INCLUDING ALL MATTERS OF CONSTRUCTION, VALIDITY AND PERFORMANCE, THE LOAN DOCUMENTS AND THE OBLIGATIONS SHALL BE GOVERNED BY, AND CONSTRUED AND ENFORCED IN ACCORDANCE WITH, THE INTERNAL LAWS OF THE STATE OF NEW YORK APPLICABLE TO CONTRACTS MADE AND PERFORMED IN THAT STATE AND ANY APPLICABLE LAWS OF THE UNITED STATES OF AMERICA. EACH CREDIT PARTY HEREBY CONSENTS AND AGREES THAT THE STATE OR FEDERAL COURTS LOCATED IN THE SOUTHERN DISTRICT OF NEW YORK SHALL HAVE EXCLUSIVE JURISDICTION TO HEAR AND DETERMINE ANY CLAIMS OR DISPUTES BETWEEN THE CREDIT PARTIES, AGENT AND LENDERS PERTAINING TO THIS AGREEMENT OR ANY OF THE OTHER LOAN DOCUMENTS OR TO ANY MATTER ARISING OUT OF OR RELATING TO THIS AGREEMENT OR ANY OF THE OTHER LOAN DOCUMENTS; PROVIDED, THAT AGENT, LENDERS AND THE CREDIT PARTIES ACKNOWLEDGE THAT ANY APPEALS FROM THOSE COURTS MAY HAVE TO BE HEARD BY A COURT LOCATED OUTSIDE OF THE SOUTHERN DISTRICT OF NEW YORK; PROVIDED FURTHER, THAT NOTHING IN THIS AGREEMENT SHALL BE DEEMED OR OPERATE TO PRECLUDE AGENT FROM BRINGING SUIT OR TAKING OTHER LEGAL ACTION IN ANY OTHER JURISDICTION TO REALIZE ON THE COLLATERAL OR ANY OTHER SECURITY FOR THE OBLIGATIONS, OR TO ENFORCE A JUDGMENT OR OTHER COURT ORDER IN FAVOR OF AGENT. EACH CREDIT PARTY EXPRESSLY SUBMITS AND CONSENTS IN ADVANCE TO SUCH JURISDICTION IN ANY ACTION OR SUIT COMMENCED IN ANY SUCH COURT, AND EACH CREDIT PARTY HEREBY WAIVES ANY OBJECTION THAT SUCH CREDIT PARTY MAY HAVE BASED UPON LACK OF PERSONAL JURISDICTION, IMPROPER VENUE OR FORUM NON CONVENIENS AND HEREBY CONSENTS TO THE GRANTING OF SUCH LEGAL OR EQUITABLE RELIEF AS IS DEEMED APPROPRIATE BY SUCH COURT. EACH CREDIT PARTY HEREBY WAIVES PERSONAL SERVICE OF THE SUMMONS, COMPLAINT AND OTHER PROCESS ISSUED IN ANY SUCH ACTION OR SUIT AND AGREES THAT SERVICE OF SUCH SUMMONS, COMPLAINTS AND OTHER PROCESS MAY BE MADE BY REGISTERED OR CERTIFIED MAIL ADDRESSED TO SUCH CREDIT PARTY AT THE ADDRESS SET FORTH IN ANNEX I OF THIS AGREEMENT AND THAT SERVICE SO MADE SHALL BE DEEMED COMPLETED UPON THE EARLIER OF SUCH CREDIT PARTY'S ACTUAL RECEIPT THEREOF

11.10 Notices.

Except as otherwise provided herein, whenever it is provided herein that any notice, demand, request, consent, approval, declaration or other communication shall or may be given to or served upon any of the parties by any other parties, or whenever any of the parties desires to give or serve upon any other parties any communication with respect to this Agreement, each such notice, demand, request, consent, approval, declaration or other communication shall be in writing and shall be deemed to have been validly served, given or delivered: (a) upon the earlier of actual receipt and 3 Business Days after deposit in the United States Mail, registered or certified mail, return receipt requested, with proper postage prepaid; (b) upon transmission, when sent by telecopy or other similar facsimile transmission (with such telecopy or facsimile promptly confirmed by delivery of a copy by personal delivery or United States Mail as otherwise provided in this Section 11.10); (c) 1 Business Day after deposit with a reputable overnight courier with all charges prepaid or (d) when delivered, if hand-delivered by messenger, all of which shall be addressed to the party to be notified and sent to the address or facsimile number indicated in Annex I or to such other address (or facsimile number) as may be substituted by notice given as herein provided. The giving of any notice required hereunder may be waived in writing by the party entitled to receive such notice. Failure or delay in delivering copies of any notice, demand, request, consent, approval, declaration or other communication to any Person (other than Borrower or Agent) designated in Annex I to receive copies shall in no way adversely affect the effectiveness of such notice, demand, request, consent, approval, declaration or other communication.

11.11 Section Titles.

The Section titles and Table of Contents contained in this Agreement are and shall be without substantive meaning or content of any kind whatsoever and are not a part of the agreement between the parties hereto.

11.12 Counterparts.

This Agreement may be executed in any number of separate counterparts, each of which shall collectively and separately constitute one agreement.

11.13 WAIVER OF JURY TRIAL. BECAUSE DISPUTES ARISING IN CONNECTION WITH COMPLEX FINANCIAL TRANSACTIONS ARE MOST QUICKLY AND ECONOMICALLY RESOLVED BY AN EXPERIENCED AND EXPERT PERSON AND THE PARTIES WISH APPLICABLE STATE AND FEDERAL LAWS TO APPLY (RATHER THAN ARBITRATION RULES), THE PARTIES DESIRE THAT THEIR DISPUTES BE RESOLVED BY A JUDGE APPLYING SUCH APPLICABLE LAWS. THEREFORE, TO ACHIEVE THE BEST COMBINATION OF THE BENEFITS OF THE JUDICIAL SYSTEM AND OF ARBITRATION, THE PARTIES HERETO WAIVE ALL RIGHT TO TRIAL BY JURY IN ANY ACTION, SUIT, OR PROCEEDING BROUGHT TO RESOLVE ANY DISPUTE, WHETHER SOUNDING IN CONTRACT, TORT OR OTHERWISE, AMONG AGENT, LENDERS AND ANY CREDIT PARTY ARISING OUT OF, CONNECTED WITH, RELATED TO, OR INCIDENTAL TO THE RELATIONSHIP ESTABLISHED AMONG THEM IN CONNECTION WITH, THIS AGREEMENT OR ANY OF THE OTHER LOAN DOCUMENTS OR THE TRANSACTIONS RELATED THERETO.

11.14 Press Releases and Related Matters.

Each Credit Party executing this Agreement agrees that neither it nor its Affiliates will in the future issue any press releases or other public disclosure using the name of GE Capital, or its affiliates or referring to this Agreement, the other Loan Documents or the Related Transactions Documents without at least 2 Business Days' prior notice to GE Capital, and without the prior written consent of GE Capital, unless (and only to the extent that) such Credit Party or Affiliate is required to do so under law and then, in any event, such Credit Party or Affiliate will consult with GE Capital, before issuing such press release or other public disclosure or unless such public disclosure is made in connection with compliance by such Credit Party or Affiliate with its obligations under the federal securities laws. Each Credit Party consents to the publication by Agent or any Lender of a tombstone or similar advertising material relating to the financing transactions contemplated by this Agreement using Borrower's name, product photographs, logo or trademark. Agent or such Lender shall provide a draft of any such tombstone or similar advertising material to each Credit Party for review and comment prior to the publication thereof. Agent reserves the right to provide to industry trade organizations information necessary and customary for inclusion in league table measurements.

11.15 Reinstatement.

This Agreement shall remain in full force and effect and continue to be effective should any petition be filed by or against any Credit Party for liquidation or reorganization, should any Credit Party become insolvent or make an assignment for the benefit of any creditor or creditors or should a receiver or trustee be appointed for all or any significant part of any Credit Party's assets, and shall continue to be effective or to be reinstated, as the case may be, if at any time payment and performance of the Obligations, or any part thereof, is, pursuant to applicable law, rescinded or reduced in amount, or must otherwise be restored or returned by any obligee of the Obligations, whether as a "voidable preference," "fraudulent conveyance," or otherwise, all as though such payment or performance had not been made. In the event that any payment, or any part thereof, is rescinded, reduced, restored or returned, the Obligations shall be reinstated and deemed reduced only by such amount paid and not so rescinded, reduced, restored or returned.

11.16 Advice of Counsel.

Each of the parties represents to each other party hereto that it has discussed this Agreement and, specifically, the provisions of Sections 11.9 and 11.13, with its counsel.

11.17 No Strict Construction.

The parties hereto have participated jointly in the negotiation and drafting of this Agreement. In the event an ambiguity or question of intent or interpretation arises, this Agreement shall be construed as if drafted jointly by the parties hereto and no presumption or burden of proof shall arise favoring or disfavoring any party by virtue of the authorship of any provisions of this Agreement.

[Remainder of Page Intentionally Left Blank]

IN WITNESS WHEREOF, this Agreement has been duly executed as of the date first written above.

GOTTSCHALKS INC.

By: _____

Name: J. Gregory Ambro
Senior Vice President and
Chief Administrative Officer

**GENERAL ELECTRIC CAPITAL
CORPORATION,**

as Agent and as a Lender

By: _____

Name:

Title: Its Duly Authorized Signatory

THE CIT GROUP/BUSINESS CREDIT, INC.,

as a Lender

By: _____

Name:

Title:

WELLS FARGO FOOTHILL, LLC,

as a Lender

By: _____

Name:

Title:

**LASALLE RETAIL FINANCE, a division of
LASALLE BUSINESS CREDIT, LLC, as agent
for STANDARD FEDERAL BANK NATIONAL
ASSOCIATION N.A.,**

as a Lender

By: _____

Name:

Title:

ANNEX A (Recitals)
to
CREDIT AGREEMENT

DEFINITIONS

Capitalized terms used in the Loan Documents shall have (unless otherwise provided elsewhere in the Loan Documents) the following respective meanings, and all references to Sections, Exhibits, Schedules or Annexes in the following definitions shall refer to Sections, Exhibits, Schedules or Annexes of or to the Agreement:

"Account Debtor" means any Person who may become obligated to any Credit Party under, with respect to, or on account of, an Account, Chattel Paper or General Intangibles (including a payment intangible).

"Accounting Changes" has the meaning ascribed thereto in Annex G.

"Accounts" means all "accounts," as such term is defined in the Code, now owned or hereafter acquired by any Credit Party, including (a) all accounts receivable, other receivables, book debts and other forms of obligations (other than forms of obligations evidenced by Chattel Paper, or Instruments), (including any such obligations that may be characterized as an account or contract right under the Code), (b) all of each Credit Party's rights in, to and under all purchase orders or receipts for goods or services, (c) all of each Credit Party's rights to any goods represented by any of the foregoing (including unpaid sellers' rights of rescission, replevin, reclamation and stoppage in transit and rights to returned, reclaimed or repossessed goods), (d) all rights to payment due to any Credit Party for property sold, leased, licensed, assigned or otherwise disposed of, for a policy of insurance issued or to be issued, for a secondary obligation incurred or to be incurred, for energy provided or to be provided, for the use or hire of a vessel under a charter or other contract, arising out of the use of a credit card or charge card, or for services rendered or to be rendered by such Credit Party or in connection with any other transaction (whether or not yet earned by performance on the part of such Credit Party) and, (e) all collateral security of any kind, given by any Account Debtor or any other Person with respect to any of the foregoing.

"Activation Notice" has the meaning ascribed to it in Annex C.

"Advance" means any Revolving Credit Advance or Swing Line Advance, as the context may require.

"Affected Lender" has the meaning ascribed to it in Section 1.16.

"Affiliate" means, with respect to any Person, (a) each Person that, directly or indirectly, owns or controls, whether beneficially, or as a trustee, guardian or other fiduciary, 5% or more of the Stock having ordinary voting power in the election of directors of such Person, (b) each Person that controls, is controlled by or is under common control with such Person,

(c) each of such Person's officers, directors, joint venturers and partners and (d) in the case of Borrower, the immediate family members, spouses and lineal descendants of individuals who are Affiliates of Borrower. For the purposes of this definition, "control" of a Person shall mean the possession, directly or indirectly, of the power to direct or cause the direction of its management or policies, whether through the ownership of voting securities, by contract or otherwise; provided, however, that the term "Affiliate" shall specifically exclude Agent and each Lender.

"Agent" means GE Capital in its capacity as Agent for Lenders or its successor appointed pursuant to Section 9.7.

"Agreement" means the Second Amended and Restated Credit Agreement by and among Borrower, the other Credit Parties party thereto, GE Capital, as Agent and Lender and the other Lenders from time to time party thereto, dated as of September 26, 2007, as the same may be amended, supplemented, restated or otherwise modified from time to time.

"Appendices" has the meaning ascribed to it in the recitals to the Agreement.

"Applicable L/C Margin" means the per annum fee, from time to time in effect, payable with respect to outstanding Letter of Credit Obligations as determined by reference to Section 1.5(a).

"Applicable Margins" means collectively the Applicable L/C Margin, the Applicable Unused Line Fee Margin, the Applicable Revolver Index Margin, and the Applicable Revolver LIBOR Margin.

"Applicable Revolver Index Margin" means the per annum interest rate margin from time to time in effect and payable in addition to the Index Rate applicable to the Revolving Credit Advances, as determined by reference to Section 1.5(a).

"Applicable Revolver LIBOR Margin" means the per annum interest rate from time to time in effect and payable in addition to the LIBOR Rate applicable to the Revolving Credit Advances, as determined by reference to Section 1.5(a).

"Applicable Unused Line Fee Margin" means the per annum fee, from time to time in effect, payable in respect of Borrower's non-use of committed funds pursuant to Section 1.9(b), which fee is determined by reference to Section 1.5(a).

"Assignment Agreement" has the meaning ascribed to it in Section 9.1(a).

"Availability" means as of any date of determination, (a) the lesser of (i) the Maximum Amount less any Reserves and (ii) the Borrowing Base, less (b) the sum of the aggregate Revolving Loan and Swing Line Loan then outstanding, provided that an Overadvance in accordance with Section 1.1(a)(iii) may cause the Revolving Loan and the Swing Line Loan to exceed the Borrowing Base by the amount of such permitted Overadvance.

"Bankruptcy Code" means the provisions of Title 11 of the United States Code, 11 U.S.C. §§101 et seq.

"Blocked Accounts" has the meaning ascribed to it in Annex C.

"Borrower" has the meaning ascribed thereto in the preamble to the Agreement.

"Borrowing Availability" means as of any date of determination, (a) the lesser of (i) the Maximum Amount less any Reserves and (ii) the Borrowing Base, less (b) the sum of the aggregate Revolving Loan and Swing Line Loan then outstanding, and less (c) the Minimum Excess Availability provided that an Overadvance in accordance with Section 1.1(a)(iii) may cause the Revolving Loan and the Swing Line Loan to exceed the Borrowing Base by the amount of such permitted Overadvance.

"Borrowing Base" means, as of any date of determination by Agent, from time to time, an amount equal to the sum of:

- (a) 95% of the net recovery value of Eligible Inventory as determined by a third party appraiser acceptable to Agent in its sole discretion;
- (b) 90% of the Eligible Credit Card Receivables; and
- (c) the lesser of (i) 65% of the Fair Market Value of the Eligible Mortgaged Properties or (ii) \$43,200,000;

in each case, *less* any Reserves established by Agent at such time, including, without limitation (i) in the case of Eligible L/C Inventory and/or Eligible In Transit Inventory, Reserves for duties, custom brokers, freight, taxes, insurance and other charges and expenses pertaining to such Inventory and (ii) in the case of Eligible Mortgaged Properties, Reserves for real property and other applicable taxes, insurance, capital improvements, repairs, operations and maintenance, equipment repair and replacement, remediation, and other charges and expenses pertaining to such Eligible Mortgaged Properties.

"Borrowing Base Certificate" means a certificate to be executed and delivered from time to time by the chief financial officer, vice president of finance or assistant controller of Borrower or any other officer of Borrower previously approved by Agent in writing, in the form attached to the Agreement as Exhibit 4.1(b).

"Business Day" means any day that is not a Saturday, a Sunday or a day on which banks are required or permitted to be closed in the States of California and/or New York and in reference to LIBOR Loans shall mean any such day that is also a LIBOR Business Day.

"Capital Expenditures" means, with respect to any Person, all expenditures (by the expenditure of cash or the incurrence of Indebtedness) by such Person during any measuring period for any fixed assets or improvements or for replacements, substitutions or additions thereto that have a useful life of more than one year and that are required to be capitalized under GAAP.

"Capital Lease" means, with respect to any Person, any lease of any property (whether real, personal or mixed) by such Person as lessee that, in accordance with GAAP,

would be required to be classified and accounted for as a capital lease on a balance sheet of such Person.

"Capital Lease Obligation" means, with respect to any Capital Lease of any Person, the amount of the obligation of the lessee thereunder that, in accordance with GAAP, would appear on a balance sheet of such lessee in respect of such Capital Lease.

"Cash Collateral Account" has the meaning ascribed to it in Annex B.

"Cash Equivalents" has the meaning ascribed to it in Annex B.

"Cash Management Systems" has the meaning ascribed to it in Section 1.8.

"Certificate of Exemption" has the meaning ascribed to it in Section 1.15(c).

"Change of Control" means any of the following: (a) any person or group of persons (within the meaning of the Securities Exchange Act of 1934) other than a Permitted Holder, shall have acquired beneficial ownership (within the meaning of Rule 13d-3 promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934) of 20% or more of the issued and outstanding shares of capital Stock of Borrower having the right to vote for the election of directors of Borrower under ordinary circumstances; (b) any Permitted Holder (or all of the Permitted Holders as a group within the meaning of the Securities Exchange Act of 1934) shall have acquired beneficial ownership (within the meaning of Rule 13d-3 promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934) of 50% or more of the issued and outstanding shares of capital Stock of Borrower having the right to vote for the election of directors of Borrower under ordinary circumstances; (c) during any period of twelve consecutive calendar months, individuals who at the beginning of such period constituted the board of directors of Borrower (together with any new directors whose election by the board of directors of Borrower or whose nomination for election by the Stockholders of Borrower was approved by a vote of at least two-thirds of the directors then still in office who either were directors at the beginning of such period or whose election or nomination for election was previously so approved) cease for any reason other than death or disability to constitute a majority of the directors then in office; or (d) Borrower ceases to own and control all of the economic and voting rights associated with all of the outstanding capital Stock of any of its Subsidiaries.

"Charges" means all federal, state, county, city, municipal, local, foreign or other governmental taxes (including taxes owed to the PBGC at the time due and payable), levies, assessments, charges, liens, claims or encumbrances (a) upon or relating to the Collateral, (b) upon or relating to the Obligations, (c) measured by the employees, payroll, income or gross receipts of any Credit Party owed by or assessable against any Credit Party, (d) upon or relating to any Credit Party's ownership or use of any properties or other assets, or (e) upon or relating to any other aspect of any Credit Party's business.

"Chattel Paper" means any "chattel paper," as such term is defined in the Code, including electronic chattel paper, now owned or hereafter acquired by any Credit Party.

"Closing Date" means September 26, 2007.

"Closing Checklist" means the schedule, including all appendices, exhibits or schedules thereto, listing certain documents and information to be delivered in connection with the Agreement, the other Loan Documents and the transactions contemplated thereunder, substantially in the form attached hereto as Annex D.

"Code" means the Uniform Commercial Code as the same may, from time to time, be enacted and in effect in the State of New York; provided, that to the extent that the Code is used to define any term herein or in any Loan Document and such term is defined differently in different Articles or Divisions of the Code, the definition of such term contained in Article or Division 9 shall govern; provided further, that in the event that, by reason of mandatory provisions of law, any or all of the attachment, perfection or priority of, or remedies with respect to, Agent's or any Lender's Lien on any Collateral is governed by the Uniform Commercial Code as enacted and in effect in a jurisdiction other than the State of New York, the term "Code" shall mean the Uniform Commercial Code as enacted and in effect in such other jurisdiction solely for purposes of the provisions thereof relating to such attachment, perfection, priority or remedies and for purposes of definitions related to such provisions.

"Collateral" means the property covered by the Security Agreement, the Mortgages and the other Collateral Documents and any other property, real or personal, tangible or intangible, now existing or hereafter acquired, that may at any time be or become subject to a security interest or Lien in favor of Agent, on behalf of itself and Lenders, to secure the Obligations.

"Collateral Access Agreement" has the meaning ascribed to it in Section 5.9(a).

"Collateral Documents" means the Security Agreement, the Pledge Agreements, the Guaranties, the Mortgages, the Trademark Security Agreement, the Reaffirmation Agreement and all similar agreements entered into guaranteeing payment of, or granting a Lien upon property as security for payment of, the Obligations.

"Collateral Reports" means the reports with respect to the Collateral referred to in Annex F.

"Collection Account" means that certain account of Agent, account number 502-328-54 in the name of Agent at DeutscheBank Trust Company Americas in New York, New York ABA No. 021 001 033, or such other account as may be specified in writing by Agent as the "Collection Account."

"Commitment Termination Date" means the earliest of (a) September 26, 2012, (b) the date of termination of Lenders' obligations to make Advances and to incur Letter of Credit Obligations or permit existing Loans to remain outstanding pursuant to Section 8.2(b), and (c) the date of indefeasible prepayment in full by Borrower of the Loans and the cancellation and return (or stand-by guarantee) of all Letters of Credit or the cash collateralization of all Letter of Credit Obligations pursuant to Annex B, and the permanent reduction of all Commitments to zero dollars (\$0).

"Commitments" means (a) as to any Lender, such Lender's Revolving Loan Commitment (including without duplication the Swing Line Lender's Swing Line Accommodation as a subset of its Revolving Loan Commitment) as set forth on Annex J to the Agreement or in the most recent Assignment Agreement executed by such Lender and (b) as to all Lenders, the aggregate of all Lenders' Revolving Loan Commitments (including without duplication the Swing Line Lender's Swing Line Accommodation as a subset of its Revolving Loan Commitment), which aggregate commitment shall be Two Hundred Million Dollars (\$200,000,000) on the Closing Date, as to each of clauses (a) and (b), as such Commitments may be reduced, amortized or adjusted from time to time in accordance with the Agreement.

"Compliance Certificate" has the meaning ascribed to it in Annex E.

"Concentration Account Bank" has the meaning ascribed to it in Annex C.

"Concentration Accounts" has the meaning ascribed to it in Annex C.

"Contracts" means all "contracts," as such term is defined in the Code, now owned or hereafter acquired by any Credit Party, in any event, including all contracts, leases, undertakings, or agreements (other than rights evidenced by Chattel Paper, Documents or Instruments) in or under which any Credit Party may now or hereafter have any right, title or interest, including any agreement relating to the terms of payment or the terms of performance of any Account.

"Control Letter" means a letter agreement between Agent and (i) the issuer of uncertificated securities with respect to uncertificated securities in the name of any Credit Party, (ii) a securities intermediary with respect to securities, whether certificated or uncertificated, securities entitlements and other financial assets held in a securities account in the name of any Credit Party, (iii) a futures commission merchant or clearing house, as applicable, with respect to commodity accounts and commodity contracts held by any Credit Party, whereby, among other things, the issuer, securities intermediary or futures commission merchant disclaims any security interest in the applicable financial assets, acknowledges the Lien of Agent, on behalf of itself and Lenders, on such financial assets, and agrees to follow the instructions or entitlement orders of Agent without further consent by the affected Credit Party.

"Copyright License" means any and all rights now owned or hereafter acquired by any Credit Party under any written agreement granting any right to use any Copyright or Copyright registration.

"Copyrights" means all of the following now owned or hereafter adopted or acquired by any Credit Party: (a) all copyrights and General Intangibles of like nature (whether registered or unregistered), all registrations and recordings thereof, and all applications in connection therewith, including all registrations, recordings and applications in the United States Copyright Office or in any similar office or agency of the United States, any state or territory thereof, or any other country or any political subdivision thereof, and (b) all reissues, extensions or renewals thereof.

"Credit Card Agreements" means all agreements now or hereafter entered into by Borrower with any Credit Card Issuer or Credit Card Processor, as the same may now exist or may hereafter be amended, modified, supplemented, extended, renewed, restated or replaced.

"Credit Card Issuer" means any Person who issues or whose members issue credit cards used by customers of Borrower to purchase goods, including, without limitation, Household, Carte Blanche, Diners, Discover, MasterCard or VISA bank credit or debit cards and American Express.

"Credit Card Notices" means those certain notices issued by Borrower in favor of Agent to the Credit Card Issuers and Credit Card Processors pursuant to which such parties acknowledge Agent's first priority security interest in the monies due to Borrower under any Credit Card Agreement and agree to transfer all credit card receipts to the Concentration Account.

"Credit Card Processor" means any servicing or processing agent or any factor or financial intermediary who facilitates, services, processes or manages the credit authorization, billing transfer and/or payment with respect to Credit Card Receivables from a Credit Card Issuer and other procedures with respect to any sales transactions of Borrower involving credit card or debit card purchases by customers using credit cards or debit cards issued by any Credit Card Issuer.

"Credit Card Receivables" means all Accounts consisting of the present and future rights of Borrower to payment by Credit Card Issuers or Credit Card Processors for merchandise sold and delivered to customers of Borrower who have purchased such goods using a credit card or a debit card issued by a Credit Card Issuer.

"Credit Parties" means Borrower, and each of its respective Subsidiaries.

"Default" means any event that, with the passage of time or notice or both, would, unless cured or waived, become an Event of Default.

"Default Rate" has the meaning ascribed to it in Section 1.5(d).

"Deposit Accounts" means all "deposit accounts" as such term is defined in the Code, now or hereafter held in the name of any Credit Party.

"Disbursement Accounts" has the meaning ascribed to it in Annex C.

"Disclosure Schedules" means the Schedules prepared by Borrower and denominated as Disclosure Schedules (3.1) through (6.7) in the Index to the Agreement.

"Documents" means all "documents," as such term is defined in the Code, now owned or hereafter acquired by any Credit Party, wherever located.

"Dollars" or "\$" means lawful currency of the United States of America.

"EBITDA" means, with respect to any Person for any fiscal period, without duplication, an amount equal to (a) consolidated net income of such Person for such period determined in accordance with GAAP, minus (b) the sum of (i) income tax credits, (ii) interest income, (iii) gain from extraordinary and other non-cash, non-recurring items for such period, and (iv) any material aggregate net gain reflected in the Financial Statements during such period arising from the sale, exchange or other disposition of capital assets by such Person (including any fixed assets, whether tangible or intangible, all inventory sold in conjunction with the disposition of fixed assets and all securities), in each case to the extent included in the calculation of consolidated net income of such Person for such period in accordance with GAAP, but without duplication, plus (c) the sum of (i) any provision for income taxes, (ii) Interest Expense, (iii) loss from extraordinary and other non cash, non-recurring items for such period, (iv) the amount of depreciation and amortization for such period, (v) amortized debt discount for such period, and (vi) the amount of any deduction to consolidated net income as the result of any grant to any members of the management of such Person of any Stock, in each case to the extent included in the calculation of consolidated net income of such Person for such period in accordance with GAAP, but without duplication. For purposes of this definition, the following items shall be excluded in determining consolidated net income of a Person: (1) the income (or deficit) of any other Person accrued prior to the date it became a Subsidiary of, or was merged or consolidated into, such Person or any of such Person's Subsidiaries; (2) the income (or deficit) of any other Person (other than a Subsidiary and other than Park 41) in which such Person has an ownership interest, except to the extent any such income has actually been received by such Person in the form of cash dividends or distributions; (3) the undistributed earnings of any Subsidiary of such Person to the extent that the declaration or payment of dividends or similar distributions by such Subsidiary is not at the time permitted by the terms of any contractual obligation or requirement of law applicable to such Subsidiary; (4) any restoration to income of any contingency reserve, except to the extent that provision for such reserve was made out of income accrued during such period; (5) any write-up of any asset; (6) any net gain from the collection of the proceeds of life insurance policies; (7) any net gain arising from the acquisition of any securities, or the extinguishment, under GAAP, of any Indebtedness, of such Person, (8) in the case of a successor to such Person by consolidation or merger or as a transferee of its assets, any earnings of such successor prior to such consolidation, merger or transfer of assets, and (9) any deferred credit representing the excess of equity in any Subsidiary of such Person at the date of acquisition of such Subsidiary over the cost to such Person of the investment in such Subsidiary.

"Eligible Credit Card Receivables" has the meaning ascribed to it in Section 1.6.

"Eligible Inventory" has the meaning ascribed to it in Section 1.7.

"Eligible In-Transit Inventory" means all finished goods inventory owned by Borrower and not covered by Letters of Credit, and which finished goods Inventory is in transit to any of Borrower's locations (other than items in-transit directly from one of Borrower's locations listed on Disclosure Schedule 3.8 to another listed location) and which finished goods Inventory (a) has been paid for and is owned by Borrower, (b) is fully insured other than any applicable deductibles or self-insured retention limits under insurance policies or programs maintained in accordance with Section 5.4(a), (c) is subject to a first priority security interest in

and lien upon such goods in favor of Agent (except for any possessor lien upon such goods in the possession of a freight carrier or shipping company securing only the freight charges for the transportation of such goods to Borrower), (d) is evidenced or deliverable pursuant to documents, notices, instruments, statements and bills of lading that have been delivered to Agent or an agent acting on its behalf, and (e) is otherwise deemed to be "Eligible Inventory" hereunder. It is understood and agreed that any Inventory located at a warehouse or consolidator which has executed and delivered to Agent a bailee letter in form and substance satisfactory to Agent and which Inventory otherwise satisfies the criteria for Eligible Inventory set forth in Section 1.7 shall not be considered in-transit Inventory; provided, however, that Agent retains its discretion to change such criteria, establish reserves or otherwise modify such terms as specified in Section 1.7 or elsewhere in this Agreement.

"Eligible L/C Inventory" means all finished goods Inventory owned by Borrower and covered by documentary Letters of Credit, which finished goods Inventory is in transit to one or more of Borrower's locations and which finished goods Inventory (a) is owned by Borrower, (b) is fully insured other than any applicable deductibles or self-insured retention limits under insurance policies or programs maintained in accordance with Section 5.4(a), (c) is subject to a first priority security interest in and lien upon such goods in favor of Agent (except for any possessor lien upon such goods in the possession of a freight carrier or shipping company securing only the freight charges for the transportation of such goods to Borrower), (d) is evidenced or deliverable pursuant to documents, notices, instruments, statements and bills of lading that have been delivered to Agent or an agent acting on its behalf, and (e) is otherwise deemed to be "Eligible Inventory" hereunder.

"Eligible Mortgaged Property" means each Mortgaged Property set forth on Disclosure Schedule 3.6, as of the date hereof, as one of the "Owned Properties" (other than that property located at 2900 Airport Drive, Madera, CA 93637) which is (a) owned by Borrower, free and clear of all Liens other than Liens set forth in clauses (d) and (g) of the definition of Permitted Encumbrances, (b) is fully insured in accordance with the requirements of Section 5.4 and is in compliance with all other applicable representations, warranties and covenants in the Loan Documents, (c) is subject to a duly filed Mortgage providing a first priority security interest in and lien upon such Mortgaged Property in favor of Agent, on behalf of itself and for the benefit of the Lenders, (d) is the subject of an appraisal having been delivered to Agent which was (at the time of receipt thereof by Agent) and continues to be in form and substance satisfactory to Agent, and (e) is not otherwise unacceptable to Agent in its reasonable credit judgment; provided, however, additional "Owned Properties" of the Borrower set forth on Disclosure Schedule 3.6 (as updated after the date hereof) may be included as Eligible Mortgaged Property so long as (x) each of the conditions set forth in clauses (a) through (e) above are satisfied, (y) such owned property is satisfactory to the Agent and (z) after giving effect to the inclusion of such owned property as an Eligible Mortgaged Property, the amount, as of such date, of the Borrowing Base calculated in accordance with clause (c) of the definition thereof does not exceed the amount, as of the date hereof, of the Borrowing Base calculated in accordance with clause (c) of the definition thereof.

"Environmental Laws" means all applicable federal, state, local and foreign laws, statutes, ordinances, codes, rules, standards and regulations, now or hereafter in effect, and any

applicable judicial or administrative interpretation thereof, including any applicable judicial or administrative order, consent decree, order or judgment, imposing liability or standards of conduct for or relating to the regulation and protection of human health, safety, the environment and natural resources (including ambient air, surface water, groundwater, wetlands, land surface or subsurface strata, wildlife, aquatic species and vegetation). Environmental Laws include the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (42 U.S.C. 9601 et seq.) ("CERCLA"); the Hazardous Materials Transportation Authorization Act of 1994 (49 U.S.C. 5101 et seq.); the Federal Insecticide, Fungicide, and Rodenticide Act (7 U.S.C. 136 et seq.); the Solid Waste Disposal Act (42 U.S.C. 6901 et seq.); the Toxic Substance Control Act (15 U.S.C. 2601 et seq.); the Clean Air Act (42 U.S.C. 7401 et seq.); the Federal Water Pollution Control Act (33 U.S.C. 1251 et seq.); the Occupational Safety and Health Act (29 U.S.C. 651 et seq.); and the Safe Drinking Water Act (42 U.S.C. 300(f) et seq.), and any and all regulations promulgated thereunder, and all analogous state, local and foreign counterparts or equivalents and any transfer of ownership notification or approval statutes.

"Environmental Liabilities" means, with respect to any Person, all liabilities, obligations, responsibilities, response, remedial and removal costs, investigation and feasibility study costs, capital costs, operation and maintenance costs, losses, damages, punitive damages, property damages, natural resource damages, consequential damages, treble damages, costs and expenses (including all reasonable fees, disbursements and expenses of counsel, experts and consultants), fines, penalties, sanctions and interest incurred as a result of or related to any claim, suit, action, investigation, proceeding or demand by any Person, whether based in contract, tort, implied or express warranty, strict liability, criminal or civil statute or common law, including any arising under or related to any Environmental Laws, Environmental Permits, or in connection with any Release or threatened Release or presence of a Hazardous Material whether on, at, in, under, from or about or in the vicinity of any real or personal property.

"Environmental Permits" means all permits, licenses, authorizations, certificates, approvals or registrations required by any Governmental Authority under any Environmental Laws.

"Equipment" means all "equipment," as such term is defined in the Code, now owned or hereafter acquired by any Credit Party, wherever located and, in any event, including all such Credit Party's machinery and equipment, including processing equipment, conveyors, machine tools, data processing and computer equipment, including embedded software and peripheral equipment and all engineering, processing and manufacturing equipment, office machinery, furniture, materials handling equipment, tools, attachments, accessories, automotive equipment, trailers, trucks, forklifts, molds, dies, stamps, motor vehicles, rolling stock and other equipment of every kind and nature, trade fixtures and fixtures not forming a part of real property, together with all additions and accessions thereto, replacements therefor, all parts therefor, all substitutes for any of the foregoing, fuel therefor, and all manuals, drawings, instructions, warranties and rights with respect thereto, and all products and proceeds thereof and condemnation awards and insurance proceeds with respect thereto.

"ERISA" means the Employee Retirement Income Security Act of 1974, as amended from time to time, and any regulations promulgated thereunder.

"ERISA Affiliate" means, with respect to any Credit Party, any trade or business (whether or not incorporated) that, together with such Credit Party, are treated as a single employer within the meaning of Sections 414(b), (c), (m) or (o) of the IRC.

"ERISA Event" means, with respect to any Credit Party or any ERISA Affiliate, (a) any event described in Section 4043(c) of ERISA with respect to a Title IV Plan; (b) the withdrawal of any Credit Party or ERISA Affiliate from a Title IV Plan subject to Section 4063 of ERISA during a plan year in which it was a substantial employer, as defined in Section 4001(a)(2) of ERISA; (c) the complete or partial withdrawal of any Credit Party or any ERISA Affiliate from any Multiemployer Plan; (d) the filing of a notice of intent to terminate a Title IV Plan or the treatment of a plan amendment as a termination under Section 4041 of ERISA; (e) the institution of proceedings to terminate a Title IV Plan or Multiemployer Plan by the PBGC; (f) the failure by any Credit Party or ERISA Affiliate to make when due required contributions to a Multiemployer Plan or Title IV Plan unless such failure is cured within 30 days; (g) any other event or condition that might reasonably be expected to constitute grounds under Section 4042 of ERISA for the termination of, or the appointment of a trustee to administer, any Title IV Plan or Multiemployer Plan or for the imposition of liability under Section 4069 or 4212(c) of ERISA; (h) the termination of a Multiemployer Plan under Section 4041A of ERISA or the reorganization or insolvency of a Multiemployer Plan under Section 4241 or 4245 of ERISA; or (i) the loss of a Qualified Plan's qualification or tax exempt status; or (j) the termination of a Plan described in Section 4064 of ERISA.

"ESOP" means a Plan that is intended to satisfy the requirements of Section 4975(e)(7) of the IRC.

"Event of Default" has the meaning ascribed to it in Section 8.1.

"Extension Request" has the meaning ascribed to it in Section 7.1.

"Fair Labor Standards Act" means the Fair Labor Standards Act, 29 U.S.C. 201 et seq.

"Fair Market Value" means, as of any date of determination with respect to any Mortgaged Property, the fair market value thereof as determined by Agent based on the most recent satisfactory (to Agent) appraisal having been delivered to, or conducted by, Agent pursuant to this Agreement, it being understood that Agent shall have the right to adjust such fair market value downward in its reasonable credit judgment, including as a result of changes to real estate market conditions, or events or circumstances affecting such Mortgaged Property or general real estate values in the geographical area in which such Mortgaged Property is located.

"Federal Funds Rate" means, for any day, a floating rate equal to the weighted average of the rates on overnight Federal funds transactions among members of the Federal Reserve System, as determined by Agent in its sole discretion, which determination shall be final, binding and conclusive (absent manifest error).

"Federal Reserve Board" means the Board of Governors of the Federal Reserve System.

"Fees" means any and all fees payable to Agent or any Lender pursuant to the Agreement or any of the other Loan Documents.

"Financial Covenants" means the financial covenants set forth in Annex G.

"Financial Statements" means the consolidated and consolidating income statements, statements of cash flows and balance sheets of Borrower delivered in accordance with Section 3.4 and Annex E.

"Fiscal Month" means any of the monthly accounting periods of Borrower.

"Fiscal Quarter" means any of the quarterly accounting periods of Borrower, ending on or about April 30, July 31, October 30 and January 31 of each year.

"Fiscal Year" means any of the annual accounting periods of Borrower beginning in any calendar year and ending on the Saturday nearest January 31 of the following year. For further clarification, references to "Fiscal Year 2003" refer to the Fiscal Year ending on the Saturday nearest January 31, 2004.

"Fixed Charges" means, with respect to any Person for any fiscal period, (a) the aggregate of all Interest Expense paid or accrued during such period, *plus* (b) any payments of principal with respect to Indebtedness during such period.

"Fixed Charge Coverage Ratio" means, with respect to any Person for any fiscal period, the ratio of (a) the sum of EBITDA during such period, *less* cash taxes paid during such period, *less* cash Capital Expenditures made during such period to (b) Fixed Charges. With respect to any fiscal period that includes the payment in full of principal and interest to United Security Bank, such payments shall be excluded from Fixed Charges for such fiscal period so long as Borrowing Availability is at least \$15,000,000 for the ninety (90) day period prior to such payment and immediately thereafter. With respect to any fiscal period that includes payments in connection with the prepayment of the New Subordinated Note pursuant to Section 6.14(f), such payments shall be excluded from Fixed Charges for such fiscal period.

"Foreign Person" has the meaning ascribed to it in Section 1.15.

"Fixtures" means all "fixtures" as such term is defined in the Code, now owned or hereafter acquired by any Credit Party.

"Funded Debt" means, with respect to any Person, without duplication, all Indebtedness for borrowed money evidenced by notes, bonds, debentures, or similar evidences of Indebtedness that by its terms matures more than one year from, or is directly or indirectly renewable or extendible at such Person's option under a revolving credit or similar agreement obligating the lender or lenders to extend credit over a period of more than one year from the date of creation thereof, including current maturities of long term debt, revolving credit and

short-term debt extendible beyond one year at the option of the debtor, and also including, in the case of Borrower, the Obligations and, without duplication, Guaranteed Indebtedness consisting of guaranties of Funded Debt of other Persons, but excluding in all instances Subordinated Debt and Capital Lease Obligations.

"GAAP" means generally accepted accounting principles in the United States of America consistently applied, as such term is further defined in Annex G to the Agreement.

"GE Capital" means General Electric Capital Corporation, a Delaware corporation.

"GE Capital Fee Letter" has the meaning ascribed to it in Section 1.9(a).

"General Intangibles" means all "general intangibles," as such term is defined in the Code, now owned or hereafter acquired by any Credit Party, including all right, title and interest that such Credit Party may now or hereafter have in or under any Contract, all payment intangibles, customer lists, Licenses, Copyrights, Trademarks, Patents, and all applications therefor and reissues, extensions or renewals thereof, rights in Intellectual Property, interests in partnerships, joint ventures and other business associations, licenses, permits, copyrights, trade secrets, proprietary or confidential information, inventions (whether or not patented or patentable), technical information, procedures, designs, knowledge, know-how, software, data bases, data, skill, expertise, experience, processes, models, drawings, materials and records, goodwill (including the goodwill associated with any Trademark or Trademark License), all rights and claims in or under insurance policies (including insurance for fire, damage, loss and casualty, whether covering personal property, real property, tangible rights or intangible rights, all liability, life, key man and business interruption insurance, and all unearned premiums), uncertificated securities, choses in action, deposit, checking and other bank accounts, rights to receive tax refunds and other payments, rights to receive dividends, distributions, cash, Instruments and other property in respect of or in exchange for pledged Stock and Investment Property, rights of indemnification, all books and records, correspondence, credit files, invoices and other papers, including without limitation all tapes, cards, computer runs and other papers and documents in the possession or under the control of such Credit Party or any computer bureau or service company from time to time acting for such Credit Party.

"Goods" means all "goods" as defined in the Code, now owned or hereafter acquired by any Credit Party, wherever located, including embedded software to the extent included in "goods" as defined in the Code, manufactured homes, standing timber that is cut and removed for sale and unborn young of animals.

"Governmental Authority" means any nation or government, any state or other political subdivision thereof, and any agency, department or other entity exercising executive, legislative, judicial, regulatory or administrative functions of or pertaining to government.

"Guaranteed Indebtedness" means as to any Person, any obligation of such Person guaranteeing, providing comfort or otherwise supporting any Indebtedness, lease, dividend, or other obligation ("primary obligation") of any other Person (the "primary obligor") in any

manner, including any obligation or arrangement of such Person to (a) purchase or repurchase any such primary obligation, (b) advance or supply funds (i) for the purchase or payment of any such primary obligation or (ii) to maintain working capital or equity capital of the primary obligor or otherwise to maintain the net worth or solvency or any balance sheet condition of the primary obligor, (c) purchase property, securities or services primarily for the purpose of assuring the owner of any such primary obligation of the ability of the primary obligor to make payment of such primary obligation, (d) protect the beneficiary of such arrangement from loss (other than product warranties given in the ordinary course of business) or (e) indemnify the owner of such primary obligation against loss in respect thereof. The amount of any Guaranteed Indebtedness at any time shall be deemed to be an amount equal to the lesser at such time of (x) the stated or determinable amount of the primary obligation in respect of which such Guaranteed Indebtedness is incurred and (y) the maximum amount for which such Person may be liable pursuant to the terms of the instrument embodying such Guaranteed Indebtedness, or, if not stated or determinable, the maximum reasonably anticipated liability (assuming full performance) in respect thereof.

"Guaranties" means, collectively, each Subsidiary Guaranty and any other guaranty executed by any Guarantor in favor of Agent and Lenders in respect of the Obligations.

"Guarantors" means each Subsidiary of Borrower and each other Person, if any, that executes a guaranty or other similar agreement in favor of Agent, for itself and the ratable benefit of Lenders, in connection with the transactions contemplated by the Agreement and the other Loan Documents.

"Harris" means The Harris Company, a California corporation.

"Hazardous Material" means any substance, material or waste that is regulated by, or forms the basis of liability now or hereafter under, any Environmental Laws, including any material or substance that is (a) defined as a "solid waste," "hazardous waste," "hazardous material," "hazardous substance," "extremely hazardous waste," "restricted hazardous waste," "pollutant," "contaminant," "hazardous constituent," "special waste," "toxic substance" or other similar term or phrase under any Environmental Laws, or (b) petroleum or any fraction or by-product thereof, asbestos, polychlorinated biphenyls (PCB's), or any radioactive substance.

"Household" means Household Bank (SB), N.A.

"Indebtedness" means, with respect to any Person, without duplication, (a) all indebtedness of such Person for borrowed money or for the deferred purchase price of property payment for which is deferred 6 months or more, but excluding obligations to trade creditors incurred in the ordinary course of business that are unsecured and not overdue by more than 6 months unless being contested in good faith, (b) all reimbursement and other obligations with respect to letters of credit, bankers' acceptances and surety bonds, whether or not matured, (c) all obligations evidenced by notes, bonds, debentures or similar instruments, (d) all indebtedness created or arising under any conditional sale or other title retention agreement with respect to property acquired by such Person (even though the rights and remedies of the seller or lender under such agreement in the event of default are limited to repossession or sale of such property),

(e) all Capital Lease Obligations and the present value (discounted at the Index Rate as in effect on the Closing Date) of future rental payments under all synthetic leases, (f) all obligations of such Person under commodity purchase or option agreements or other commodity price hedging arrangements, in each case whether contingent or matured, (g) all obligations of such Person under any foreign exchange contract, currency swap agreement, interest rate swap, cap or collar agreement or other similar agreement or arrangement designed to alter the risks of that Person arising from fluctuations in currency values or interest rates, in each case whether contingent or matured, (h) all indebtedness secured by (or for which the holder of such indebtedness has an existing right, contingent or otherwise, to be secured by) any Lien upon or in property or other assets (including accounts and contract rights) owned by such Person, even though such Person has not assumed or become liable for the payment of such indebtedness, and (i) the Obligations.

"Indemnified Liabilities" has the meaning ascribed to it in Section 1.13.

"Indemnified Person" has the meaning ascribed to in Section 1.13.

"Index Rate" means, for any day, a floating rate equal to the higher of (i) the rate publicly quoted from time to time by The Wall Street Journal as the "prime rate" (or, if The Wall Street Journal ceases quoting a prime rate, the highest per annum rate of interest published by the Federal Reserve Board in Federal Reserve statistical release H.15 (519) entitled "Selected Interest Rates" as the Bank prime loan rate or its equivalent), and (ii) the Federal Funds Rate plus 50 basis points per annum. Each change in any interest rate provided for in the Agreement based upon the Index Rate shall take effect at the time of such change in the Index Rate.

"Index Rate Loan" means a Loan or portion thereof bearing interest by reference to the Index Rate.

"Instruments" means all "instruments," as such term is defined in the Code, now owned or hereafter acquired by any Credit Party, wherever located, and, in any event, including all certificated securities, all certificates of deposit, and all promissory notes and other evidences of indebtedness, other than instruments that constitute, or are a part of a group of writings that constitute, Chattel Paper.

"Intellectual Property" means any and all Licenses, Patents, Copyrights, Trademarks, and the goodwill associated with such Trademarks.

"Interest Expense" means, with respect to any Person for any fiscal period, interest expense (whether cash or non-cash) of such Person determined in accordance with GAAP for the relevant period ended on such date, including, interest expense with respect to any Funded Debt of such Person other than interest expense for the relevant period that has been capitalized on the balance sheet of such Person and that is not material to the financial presentation of such Person.

"Interest Payment Date" means (a) as to any Index Rate Loan, the first Business Day of each month to occur while such Loan is outstanding, and (b) as to any LIBOR Loan, the last day of the applicable LIBOR Period; provided, that in the case of any LIBOR Period greater

than three months in duration, interest shall be payable at three-month intervals and on the last day of such LIBOR Period; and provided further that, in addition to the foregoing, each of (x) the date upon which all of the Commitments have been terminated and the Loans have been paid in full and (y) the Commitment Termination Date shall be deemed to be an "Interest Payment Date" with respect to any interest that has then accrued under the Agreement.

"Inventory" means all "inventory," as such term is defined in the Code, now owned or hereafter acquired by any Credit Party, wherever located, and in any event including inventory, merchandise, goods and other personal property that are held by or on behalf of any Credit Party for sale or lease or are furnished or are to be furnished under a contract of service, or that constitute raw materials, work in process, finished goods, returned goods, or materials or supplies of any kind, nature or description used or consumed or to be used or consumed in such Credit Party's business or in the processing, production, packaging, promotion, delivery or shipping of the same, including all supplies and embedded software.

"Investment Property" means all "investment property" as such term is defined in the Code now owned or hereafter acquired by any Credit Party, wherever located, including (i) all securities, whether certificated or uncertificated, including stocks, bonds, interests in limited liability companies, partnership interests, treasuries, certificates of deposit, and mutual fund shares; (ii) all securities entitlements of any Credit Party, including the rights of any Credit Party to any securities account and the financial assets held by a securities intermediary in such securities account and any free credit balance or other money owing by any securities intermediary with respect to that account; (iii) all securities accounts of any Credit Party; (iv) all commodity contracts of any Credit Party; and (v) all commodity accounts held by any Credit Party.

"IRC" means the Internal Revenue Code of 1986 and all regulations promulgated thereunder.

"IRS" means the Internal Revenue Service.

"L/C Issuer" has the meaning ascribed to it in Annex B.

"L/C Sublimit" has the meaning ascribed to it in Annex B.

"Lenders" means GE Capital, the other Lenders named on the signature pages of the Agreement, and, if any such Lender shall decide to assign all or any portion of the Obligations, such term shall include any assignee of such Lender.

"Letter of Credit Fee" has the meaning ascribed to it in Annex B.

"Letter of Credit Obligations" means all outstanding obligations incurred by Agent and Revolving Lenders at the request of Borrower, whether direct or indirect, contingent or otherwise, due or not due, in connection with the issuance of Letters of Credit by Agent or another L/C Issuer or the purchase of a participation as set forth in Annex B with respect to any Letter of Credit. The amount of such Letter of Credit Obligations shall equal the maximum

amount that may be payable at such time or at any time thereafter by Agent or Revolving Lenders thereupon or pursuant thereto.

"Letters of Credit" means documentary or standby letters of credit issued for the account of Borrower by any L/C Issuer, and bankers' acceptances issued by Borrower, for which Agent and Revolving Lenders have incurred Letter of Credit Obligations. The term does not include a Swap Related L/C.

"Letter-of-Credit Rights" means "letter-of-credit rights" as such term is defined in the Code, now owned or hereafter acquired by any Credit Party, including rights to payment or performance under a letter of credit, whether or not such Credit Party, as beneficiary, has demanded or is entitled to demand payment or performance.

"LIBOR Business Day" means a Business Day on which banks in the City of London are generally open for interbank or foreign exchange transactions.

"LIBOR Loan" means a Loan or any portion thereof bearing interest by reference to the LIBOR Rate.

"LIBOR Period" means, with respect to any LIBOR Loan, each period commencing on a LIBOR Business Day selected by Borrower pursuant to the Agreement and ending one, two, three or six months thereafter, as selected by Borrower's irrevocable notice to Agent as set forth in Section 1.5(e); provided, that the foregoing provision relating to LIBOR Periods is subject to the following:

(a) if any LIBOR Period would otherwise end on a day that is not a LIBOR Business Day, such LIBOR Period shall be extended to the next succeeding LIBOR Business Day unless the result of such extension would be to carry such LIBOR Period into another calendar month in which event such LIBOR Period shall end on the immediately preceding LIBOR Business Day;

(b) any LIBOR Period that would otherwise extend beyond the Commitment Termination Date shall end 2 LIBOR Business Days prior to such date;

(c) any LIBOR Period that begins on the last LIBOR Business Day of a calendar month (or on a day for which there is no numerically corresponding day in the calendar month at the end of such LIBOR Period) shall end on the last LIBOR Business Day of a calendar month;

(d) Borrower shall select LIBOR Periods so as not to require a payment or prepayment of any LIBOR Loan during a LIBOR Period for such Loan; and

(e) Borrower shall select LIBOR Periods so that there shall be no more than 5 separate LIBOR Loans in existence at any one time.

"LIBOR Rate" means for each LIBOR Period, a rate of interest determined by Agent equal to:

(a) the offered rate for deposits in United States Dollars for the applicable LIBOR Period that appears on Telerate Page 3750 as of 11:00 a.m. (London time), on the second full LIBOR Business Day next preceding the first day of such LIBOR Period (unless such date is not a Business Day, in which event the next succeeding Business Day will be used); divided by

(b) a number equal to 1.0 minus the aggregate (but without duplication) of the rates (expressed as a decimal fraction) of reserve requirements in effect on the day that is 2 LIBOR Business Days prior to the beginning of such LIBOR Period (including basic, supplemental, marginal and emergency reserves under any regulations of the Federal Reserve Board or other Governmental Authority having jurisdiction with respect thereto, as now and from time to time in effect) for Eurocurrency funding (currently referred to as "Eurocurrency Liabilities" in Regulation D of the Federal Reserve Board that are required to be maintained by a member bank of the Federal Reserve System.

If such interest rates shall cease to be available from Telerate News Service, the LIBOR Rate shall be determined from such financial reporting service or other information as shall be mutually acceptable to Agent and Borrower.

"License" means any Copyright License, Patent License, Trademark License or other license of rights or interests now held or hereafter acquired by any Credit Party.

"Lien" means any mortgage or deed of trust, pledge, hypothecation, assignment, deposit arrangement, lien, charge, claim, security interest, easement or encumbrance, or preference, priority or other security agreement or preferential arrangement of any kind or nature whatsoever (including any lease or title retention agreement, any financing lease having substantially the same economic effect as any of the foregoing, and the filing of, or agreement to give, any financing statement perfecting a security interest under the Code or comparable law of any jurisdiction).

"Litigation" has the meaning ascribed to it in Section 3.13.

"Loan Account" has the meaning ascribed to it in Section 1.12.

"Loan Documents" means the Agreement, the Notes, the Collateral Documents, the Master Standby Agreement, the Master Documentary Agreement, the Collateral Access Agreements, and all other agreements, instruments, documents and certificates identified in the Closing Checklist executed and delivered to, or in favor of, Agent or any Lenders and including all other pledges, powers of attorney, consents, assignments, contracts, notices, letter of credit agreements and all other written matter whether heretofore, now or hereafter executed by or on behalf of any Credit Party or any employee of any Credit Party, and delivered to Agent or any Lender in connection with the Agreement or the transactions contemplated thereby. Any reference in the Agreement or any other Loan Document to a Loan Document shall include all appendices, exhibits or schedules thereto, and all amendments, restatements, supplements or other modifications thereto, and shall refer to the Agreement or such Loan Document as the same may be in effect at any and all times such reference becomes operative.

"Loans" means the Revolving Loan and the Swing Line Loan.

"Margin Stock" has the meaning ascribed to in Section 3.10.

"Master Documentary Agreement" means the Master Agreement for Documentary Letters of Credit dated as of January 31, 2002 among Borrower, as Applicant(s), and GE Capital.

"Master Standby Agreement" means the Master Agreement for Standby Letters of Credit dated as of January 31, 2002 among Borrower, as Applicant(s), and GE Capital, as issuer.

"Material Adverse Effect" means a material adverse effect on (a) the business, assets, operations, prospects or financial or other condition of Borrower or all Credit Parties taken as a whole, (b) Borrower's ability to pay any of the Loans or any of the other Obligations in accordance with the terms of the Agreement, (c) the Collateral or Agent's Liens, on behalf of itself and Lenders, on the Collateral or the priority of such Liens, or (d) Agent's or any Lender's rights and remedies under the Agreement and the other Loan Documents.

"Maximum Amount" means, as of any date of determination, an amount equal to the Revolving Loan Commitment of all Lenders as of that date.

"Minimum Excess Availability" means Fifteen Million Dollars (\$15,000,000).

"Mortgaged Properties" means each of the following properties: (a) 313 Madonna Rd. San Luis Obispo, CA 93405, (b) 1673 W. Lacey Blvd., Hanford, CA 93230, (c) 2300 Watt Avenue, Sacramento, CA 95825, (d) 82225 Highway 111, Indio, CA 92201, (e) 1255 Airport Way & Cowles, Fairbanks, AK 99701, (f) 755 E. Shaw Avenue, Fresno, CA 93710, (g) 3300 S. Broadway, Eureka, CA 95501, (h) 2520 Somersville Rd., Antioch, CA 94509, (i) 905 Colusa Avenue, Yuba City, CA 95991, (j) 1123 W. Avenue "P" Palmdale, CA 93551, (k) E. 802 29th Avenue, Spokane, WA 99203, and (l) and any other Real Estate of any Credit Party which may from time to time become subject to a Mortgage in the favor of Agent securing the Obligations and is otherwise satisfactory to the Agent.

"Mortgages" means each of the mortgages, deeds of trust, leasehold mortgages, leasehold deeds of trust, collateral assignments of leases or other real estate security documents, as amended from time to time, delivered by any Credit Party to Agent on behalf of itself and Lenders with respect to the Real Estate, all in form and substance reasonably satisfactory to Agent.

"Multiemployer Plan" means a "multiemployer plan" as defined in Section 4001(a)(3) of ERISA, and to which any Credit Party or ERISA Affiliate is making, is obligated to make or has made or been obligated to make, contributions on behalf of participants who are or were employed by any of them.

"New Subordinated Note" means the Non-Negotiable Subordinated Unsecured Note Due May 30, 2009 dated December 7, 2004 issued by Borrower in favor of The Harris Company in an aggregate original principal amount of \$22,179,598.00.

"Non-Funding Lender" has the meaning ascribed to it in Section 9.9(a)(ii).

"Notes" means, collectively, the Revolving Notes and the Swing Line Notes.

"Notice of Conversion/Continuation" has the meaning ascribed to it in Section 1.5(e).

"Notice of Revolving Credit Advance" has the meaning ascribed to it in Section 1.1(a).

"Obligations" means all loans, advances, debts, liabilities and obligations for the performance of covenants, tasks or duties or for payment of monetary amounts (whether or not such performance is then required or contingent, or such amounts are liquidated or determinable) owing by any Credit Party to Agent or any Lender, and all covenants and duties regarding such amounts, of any kind or nature, present or future, whether or not evidenced by any note, agreement, letter of credit agreement, or other instrument, arising under the Agreement or any of the other Loan Documents. This term includes all principal, interest (including all interest that accrues after the commencement of any case or proceeding by or against any Credit Party in bankruptcy, whether or not allowed in such case or proceeding), Fees, Swap Related Reimbursement Obligations, expenses, attorneys' fees and any other sum chargeable to any Credit Party under the Agreement or any of the other Loan Documents.

"Original Credit Agreement" has the meaning ascribed to it in the recitals to this Agreement.

"OSHA" means Occupational Safety and Hazard Act.

"Overadvance" has the meaning ascribed to it in Section 1.1(a)(iii).

"Park 41" means Park 41, a California limited partnership.

"Patent License" means rights under any written agreement now owned or hereafter acquired by any Credit Party granting any right with respect to any invention on which a Patent is in existence.

"Patents" means all of the following in which any Credit Party now holds or hereafter acquires any interest: (a) all letters patent of the United States or of any other country, all registrations and recordings thereof, and all applications for letters patent of the United States or of any other country, including registrations, recordings and applications in the United States Patent and Trademark Office or in any similar office or agency of the United States, any State, or any other country, and (b) all reissues, continuations, continuations-in-part or extensions thereof.

"PBGC" means the Pension Benefit Guaranty Corporation.

"Pension Plan" means a Plan described in Section 3(2) of ERISA.

"Permitted Encumbrances" means the following encumbrances: (a) Liens for taxes or assessments or other governmental Charges not yet due and payable or which are being contested in accordance with Section 5.2(b); (b) pledges or deposits of money securing statutory

obligations under workmen's compensation, unemployment insurance, social security or public liability laws or similar legislation (excluding Liens under ERISA); (c) pledges or deposits of money securing bids, tenders, contracts (other than contracts for the payment of money) or leases to which any Credit Party is a party as lessee made in the ordinary course of business; (d) inchoate and unperfected workers', mechanics' or similar liens arising in the ordinary course of business, so long as such Liens attach only to Equipment, Fixtures and/or Real Estate; (e) deposits securing, or in lieu of, surety, appeal or customs bonds in proceedings to which any Credit Party is a party; (f) any attachment or judgment lien not constituting an Event of Default under Section 8.1(j); (g) zoning restrictions, easements, licenses, or other restrictions on the use of any Real Estate or other minor irregularities in title (including leasehold title) thereto, so long as the same do not materially impair the use, value, or marketability of such Real Estate; (h) presently existing or hereafter created Liens in favor of Agent, on behalf of Lenders; (i) Liens expressly permitted under clauses (b) and (c) of Section 6.7 of the Agreement; (j) inchoate Liens arising by operation of law in favor of landlords subject to Reserves established in Agent's reasonable credit judgment; (k) inchoate Liens arising under Division 2 of the Code or similar provisions of applicable law in the ordinary course of Borrower's business, covering only the goods sold and securing only the unpaid purchase price for such goods and related expenses, so long as all Inventory covered by such liens is not Eligible Inventory or that Reserves for such Inventory have been established in Agent's reasonable credit judgment; (l) customary rights of set off and charge back under deposit agreements or under the Code of depository institutions for accounts maintained by Borrower in compliance with the terms of this Agreement; (m) inchoate Liens in favor of banks which arise under Article 4 of the Code or similar provisions of applicable law on items in collection; and (n) Liens not evidenced by a financing statement arising by operation of law in favor of common carriers, covering only the goods carried, securing only charges not yet payable to such carrier so long as all Inventory covered by such Liens is not Eligible Inventory or that Reserves for such charges have been established in Agent's reasonable credit judgment.

"Permitted Holder" means each of (i) Harris, together with all of those Persons who are or become Permitted Transferees of Harris or (ii) Joseph Levy, together with all of those Persons who are or become Permitted Transferees of Joseph Levy.

"Permitted Temporary Lease" means lease of temporary space in malls or shopping centers in which one of Borrower's stores is located and in each case which lease is (i) four months or less in duration; (ii) involves floor space of 5,000 square feet or less; and (iii) the rental amount for such individual location is no more than \$5,000 per month and the rental amount for all such locations is not more than \$100,000 per month in the aggregate.

"Permitted Transferees" means, with respect to any Person, (i) any Subsidiary of such Person, (ii) the heirs, executors, administrators, testamentary trustees, legatees or beneficiaries of any such Person, or (iii) a trust, the beneficiaries of which, or a corporation or partnership, the stockholders of general or limited partners of which, include only such Person or his or her spouse or lineal descendants, in each case to whom such Person has transferred the beneficial ownership of any securities of Borrower.

"Person" means any individual, sole proprietorship, partnership, joint venture, trust, unincorporated organization, association, corporation, limited liability company, institution, public benefit corporation, other entity or government (whether federal, state, county, city, municipal, local, foreign, or otherwise, including any instrumentality, division, agency, body or department thereof).

"Plan" means, at any time, an "employee benefit plan," as defined in Section 3(3) of ERISA, that any Credit Party or ERISA Affiliate maintains, contributes to or has an obligation to contribute to or has maintained, contributed to or had an obligation to contribute to at any time within the past 7 years on behalf of participants who are or were employed by any Credit Party or ERISA Affiliate.

"Pledge Agreement" means the Pledge Agreements, as amended by the Reaffirmation Agreement made in favor of Agent, on behalf of Lenders, by each Credit Party.

"Proceeds" means "proceeds," as such term is defined in the Code, including (a) any and all proceeds of any insurance, indemnity, warranty or guaranty payable to any Credit Party from time to time with respect to any of the Collateral, (b) any and all payments (in any form whatsoever) made or due and payable to any Credit Party from time to time in connection with any requisition, confiscation, condemnation, seizure or forfeiture of all or any part of the Collateral by any Governmental Authority (or any Person acting under color of governmental authority), (c) any claim of any Credit Party against third parties (i) for past, present or future infringement of any Patent or Patent License, or (ii) for past, present or future infringement or dilution of any Copyright, Copyright License, Trademark or Trademark License, or for injury to the goodwill associated with any Trademark or Trademark License, (d) any recoveries by any Credit Party against third parties with respect to any litigation or dispute concerning any of the Collateral including claims arising out of the loss or nonconformity of, interference with the use of, defects in, or infringement of rights in, or damage to, Collateral, (e) all amounts collected on, or distributed on account of, other Collateral, including dividends, interest, distributions and Instruments with respect to Investment Property and pledged Stock, and (f) any and all other amounts, rights to payment or other property acquired upon the sale, lease, license, exchange or other disposition of Collateral and all rights arising out of Collateral.

"Projections" means Borrower's forecasted consolidated: (a) balance sheets; (b) profit and loss statements; and (c) cash flow statements, all prepared on a Subsidiary by Subsidiary basis, if applicable, and otherwise consistent with the historical Financial Statements of Borrower, together with appropriate supporting details and a statement of underlying assumptions.

"Pro Rata Share" means with respect to all matters relating to any Lender (a) with respect to the Revolving Credit Loan, the percentage obtained by dividing (i) the Revolving Loan Commitment of that Lender by (ii) the aggregate Revolving Loan Commitments of all Lenders, (b) with respect to all Loans, the percentage obtained by dividing (i) the aggregate Commitments of that Lender by (ii) the aggregate Commitments of all Lenders, and (c) with respect to all Loans on and after the Commitment Termination Date, the percentage obtained by dividing (i) the aggregate outstanding principal balance of the Loans held by that Lender, by

(ii) the outstanding principal balance of the Loans held by all Lenders, as any such percentages may be adjusted by assignments permitted pursuant to Section 9.1.

"Qualified Plan" means a Pension Plan that is intended to be tax-qualified under Section 401(a) of the IRC.

"Qualified Assignee" means (a) any Lender, any Affiliate of any Lender and, with respect to any Lender that is an investment fund that invests in commercial loans, any other investment fund that invests in commercial loans and that is managed or advised by the same investment advisor as such Lender or by an Affiliate of such investment advisor, and (b) any commercial bank, savings and loan association or savings bank or any other entity which is an "accredited investor" (as defined in Regulation D under the Securities Act of 1933) which extends credit or buys loans as one of its businesses, including insurance companies, mutual funds, lease financing companies and commercial finance companies, in each case, which has a rating of BBB or higher from S&P and a rating of Baa2 or higher from Moody's at the date that it becomes a Lender and which, through its applicable lending office, is capable of lending to Borrower without the imposition of any withholding or similar taxes; provided that no Person determined by Agent to be acting in the capacity of a vulture fund or distressed debt purchaser shall be a Qualified Assignee, and no Person or Affiliate of such Person (other than a Person that is already a Lender) holding Subordinated Debt or Stock issued by any Credit Party shall be a Qualified Assignee.

"Reaffirmation Agreement" means the Reaffirmation and Amendment Agreement dated as of the Closing Date entered into by and among Agent, on behalf of itself and Lenders, and each Credit Party signatory thereto.

"Real Estate" has the meaning ascribed to it in Section 3.6.

"Refunded Swing Line Loan" has the meaning ascribed to it in Section 1.1(c)(iii).

"Related Transactions" means the initial borrowing under the Revolving Loan on the Closing Date, the payment of all fees, costs and expenses associated with all of the foregoing and the execution and delivery of all of the Related Transactions Documents.

"Related Transactions Documents" means the Loan Documents, and all other agreements or instruments executed in connection with the Related Transactions.

"Relationship Bank" has the meaning ascribed to it in Annex C.

"Release" means any release, threatened release, spill, emission, leaking, pumping, pouring, emitting, emptying, escape, injection, deposit, disposal, discharge, dispersal, dumping, leaching or migration of Hazardous Material in the indoor or outdoor environment, including the movement of Hazardous Material through or in the air, soil, surface water, ground water or property.

"Replacement Lender" has the meaning ascribed to it in Section 1.16.

"Requisite Lenders" means Lenders having (a) more than 66 2/3% of the Commitments of all Lenders, or (b) if the Commitments have been terminated, more than 66 2/3% of the aggregate outstanding amount of the Loans.

"Requisite Revolving Lenders" means Lenders having (a) more than 66 2/3% of the Revolving Loan Commitments of all Lenders, or (b) if the Revolving Loan Commitments have been terminated, more than 66 2/3% of the aggregate outstanding amount of the Revolving Credit Advances and Letter of Credit Obligations.

"Reserves" means (a) reserves established by Agent from time to time against Eligible Inventory pursuant to Section 5.9, (b) reserves established pursuant to Section 5.4, (c) such other reserves against Eligible Inventory or Borrowing Availability of Borrower that Agent may, in its reasonable credit judgment, establish from time to time and (d) the Swap Related Reserve. Without limiting the generality of the foregoing, Reserves established to ensure the payment of accrued Interest Expenses or Indebtedness shall be deemed to be a reasonable exercise of Agent's credit judgment.

"Restricted Payment" means, with respect to any Credit Party (a) the declaration or payment of any dividend or the incurrence of any liability to make any other payment or distribution of cash or other property or assets in respect of Stock; (b) any payment on account of the purchase, redemption, defeasance, sinking fund or other retirement of such Credit Party's Stock or any other payment or distribution made in respect thereof, either directly or indirectly; (c) any payment or prepayment of principal of, premium, if any, or interest, fees or other charges on or with respect to, and any redemption, purchase, retirement, defeasance, sinking fund or similar payment and any claim for rescission with respect to, any Subordinated Debt; (d) any payment made to redeem, purchase, repurchase or retire, or to obtain the surrender of, any outstanding warrants, options or other rights to acquire Stock of such Credit Party now or hereafter outstanding; (e) any payment of a claim for the rescission of the purchase or sale of, or for material damages arising from the purchase or sale of, any shares of such Credit Party's Stock or of a claim for reimbursement, indemnification or contribution arising out of or related to any such claim for damages or rescission; (f) any payment, loan, contribution, or other transfer of funds or other property to any Affiliate of such Credit Party other than payment of compensation in the ordinary course of business to Affiliates who are employees or directors of such Person; (g) any payment of management fees (or other fees of a similar nature) by such Credit Party to any Stockholder of such Credit Party or its Affiliates.

"Retiree Welfare Plan" means, at any time, a Welfare Plan that provides for continuing coverage or benefits for any participant or any beneficiary of a participant after such participant's termination of employment, other than continuation coverage provided pursuant to Section 4980B of the IRC and at the sole expense of the participant or the beneficiary of the participant.

"Revolving Credit Advance" has the meaning ascribed to it in Section 1.1(a)(i).

"Revolving Lenders" means, as of any date determination Lenders having a Revolving Loan Commitment.

"Revolving Loan" means, at any time, the sum of (i) the aggregate amount of Revolving Credit Advances outstanding to Borrower plus (ii) the aggregate Letter of Credit Obligations incurred on behalf of Borrower. Unless the context otherwise requires, references to the outstanding principal balance of the Revolving Loan shall include the outstanding balance of Letter of Credit Obligations.

"Revolving Loan Commitments" means, (a) as to any Revolving Lender, the aggregate commitment of such Revolving Lender to make Revolving Credit Advances or incur Letter of Credit Obligations as set forth on Annex J to the Agreement or in the most recent Assignment Agreement executed by such Revolving Lender and (b) as to all Revolving Lenders, the aggregate commitment of all Revolving Lenders to make Revolving Credit Advances or incur Letter of Credit Obligations, which aggregate commitment shall be Two Hundred Million Dollars (\$200,000,000) on the Closing Date, as such amount may be adjusted, if at all, from time to time in accordance with this Agreement.

"Revolving Note" has the meaning ascribed to it in Section 1.1(a)(ii).

"Security Agreement" means the Security Agreement dated as of January 31, 2002 as amended by the Reaffirmation Agreement, entered into by and among Agent, on behalf of itself and Lenders, and each Credit Party that is a signatory thereto.

"Software" means all "software" as such term is defined in the Code, now owned or hereafter acquired by any Credit Party, other than software embedded in any category of Goods, including all computer programs and all supporting information provided in connection with a transaction related to any program.

"Solvent" means, with respect to any Person on a particular date, that on such date (a) the fair value of the property of such Person is greater than the total amount of liabilities, including contingent liabilities, of such Person; (b) the present fair salable value of the assets of such Person is not less than the amount that will be required to pay the probable liability of such Person on its debts as they become absolute and matured; (c) such Person does not intend to, and does not believe that it will, incur debts or liabilities beyond such Person's ability to pay as such debts and liabilities mature; and (d) such Person is not engaged in a business or transaction, and is not about to engage in a business or transaction, for which such Person's property would constitute an unreasonably small capital. The amount of contingent liabilities (such as litigation, guaranties and pension plan liabilities) at any time shall be computed as the amount that, in light of all the facts and circumstances existing at the time, represents the amount that can be reasonably be expected to become an actual or matured liability.

"Space Lease" means any lease that generates annual rent revenue in excess of \$500,000 under which a Credit Party is the lessor or sublessor.

"Specified Location" has the meaning ascribed to it in Section 5.9(a).

"Stock" means all shares, options, warrants, general or limited partnership interests, membership interests or other equivalents (regardless of how designated) of or in a corporation, partnership, limited liability company or equivalent entity whether voting or

nonvoting, including common stock, preferred stock or any other "equity security" (as such term is defined in Rule 3a11-1 of the General Rules and Regulations promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934).

"Stockholder" means, with respect to any Person, each holder of Stock of such Person.

"Store Lease" means each lease identified by its address under the subheading "Store Leases" on Disclosure Schedule 3.6 (as any such lease may be hereinafter amended, modified, restated, extended, supplemented, renewed or consolidated in accordance with the terms hereof), and all other leases which may now or hereinafter be entered into by a Credit Party as lessee, as any such lease may be hereinafter amended, modified, restated, extended, supplemented, renewed or consolidated in accordance with the terms hereof.

"Subordinated Debt" means the Indebtedness of Borrower to Harris evidenced by the New Subordinated Note, and any other Indebtedness of any Credit Party subordinated to the Obligations in a manner and form satisfactory to Agent and Lenders in their sole discretion, as to right and time of payment and as to any other rights and remedies thereunder.

"Subsidiary" means, with respect to any Person, (a) any corporation of which an aggregate of more than 50% of the outstanding Stock having ordinary voting power to elect a majority of the board of directors of such corporation (irrespective of whether, at the time, Stock of any other class or classes of such corporation shall have or might have voting power by reason of the happening of any contingency) is at the time, directly or indirectly, owned legally or beneficially by such Person or one or more Subsidiaries of such Person, or with respect to which any such Person has the right to vote or designate the vote of 50% or more of such Stock whether by proxy, agreement, operation of law or otherwise, and (b) any partnership or limited liability company in which such Person and/or one or more Subsidiaries of such Person shall have an interest (whether in the form of voting or participation in profits or capital contribution) of more than 50% or of which any such Person is a general partner or may exercise the powers of a general partner. Unless the context otherwise requires, each reference to a Subsidiary shall be a reference to a Subsidiary of a Borrower.

"Subsidiary Guaranty" means the Subsidiary Guaranty executed by each Subsidiary of Borrower in favor of Agent, on behalf of itself and Lenders after the Closing Date.

"Supporting Obligations" means all "supporting obligations" as such term is defined in the Code, including letters of credit and guaranties issued in support of Accounts, Chattel Paper, Documents, General Intangibles, Instruments, or Investment Property.

"Swap Related L/C" means a letter of credit or other credit enhancement provided by any Lender to the extent supporting the payment obligations by Borrower under an interest rate protection or hedging agreement or transaction (including, but not limited to, interest rate swaps, caps, collars, floors and similar transactions) designed to protect or manage exposure to the fluctuations in the interest rates applicable to any of the Loans, and which agreement or transaction Borrower entered into as the result of a specific referral pursuant to which GE

Capital, GE Corporate Financial Services, Inc. or any other Affiliate of GE Capital had arranged for Borrower to enter into such agreement or transaction. The term includes a Swap Related L/C as it may be increased from time to time fully to support Borrower's payment obligations under any and all such interest rate protection or hedging agreements or transactions.

"Swap Related Reimbursement Obligation" has the meaning ascribed to it in Section 1.2A.

"Swap Related Reserve" has the meaning ascribed to it in Section 1.2A(g).

"Swing Line Accommodation" means, as to the Swing Line Lender, the accommodation by the Swing Line Lender to make Swing Line Advances as specified in Section 1.1(c) and as set forth on Annex J to the Agreement, which accommodation constitutes a subfacility of the Revolving Loan Commitment of the Swing Line Lender.

"Swing Line Advance" has the meaning ascribed to it in Section 1.1(c)(i).

"Swing Line Availability" has the meaning ascribed to it in Section 1.1(c)(i).

"Swing Line Lender" means GE Capital.

"Swing Line Loan" means, as the context may require, at any time, the aggregate amount of Swing Line Advances outstanding to Borrower.

"Swing Line Note" has the meaning ascribed to it in Section 1.1(c)(ii).

"Syndication Agent" has the meaning ascribed to it in the preamble to this Agreement.

"Taking" means any awards made with respect to Real Estate as the result of the exercise of the power of eminent domain, including, without limitation, any awards of the changes of the grade of streets and/or as the result of any other damage to any Real Estate for which compensation shall be given by any Governmental Authority.

"Taxes" means taxes, levies, imposts, deductions, Charges or withholdings, and all liabilities with respect thereto, excluding (i) taxes (and all liabilities imposed with respect thereto) imposed on or measured by the net income of Agent or a Lender and franchise taxes imposed in lieu thereof (including, without limitation, branch profits taxes, minimum taxes and taxes computed under alternate methods, at least one of which is based on net income) by the jurisdictions under the laws of which Agent or such Lender is organized or conducts or has conducted business or any political subdivision thereof; and (ii) any Taxes (and all liabilities imposed with respect thereto) that would not have been imposed but for (A) the unexcused failure or unreasonable delay by Agent or any Lender, upon or following Borrower's reasonable written request, to complete, provide, file, update or renew properly completed and duly executed Certificates of Exemption (unless such failure or delay results from a change in applicable law after the date of the applicable Assignment Agreement or sale of a participation, which precludes such Agent or Lender from continuing to qualify for a complete exemption from

United States withholding tax), (B) the gross negligence or willful misconduct of Agent or any Lender, or (C) Agent or any Lender being treated as a "conduit entity" within the meaning of Treasury Regulation Section 1.881-3 or any successor provisions thereto.

"Termination Date" means the date on which (a) the Loans have been indefeasibly repaid in full, (b) all other Obligations under the Agreement and the other Loan Documents have been completely discharged (c) all Letter of Credit Obligations have been cash collateralized, canceled or backed by standby letters of credit in accordance with Annex B, and (d) Borrower shall not have any further right to borrow any monies under the Agreement.

"Title IV Plan" means a Pension Plan (other than a Multiemployer Plan), that is covered by Title IV of ERISA, and that any Credit Party or ERISA Affiliate maintains, contributes to or has an obligation to contribute to on behalf of participants who are or were employed by any of them.

"Trademark Security Agreements" means the Trademark Security Agreements, as amended by the Reaffirmation Agreement, made in favor of Agent, on behalf of Lenders, by each applicable Credit Party.

"Trademark License" means rights under any written agreement now owned or hereafter acquired by any Credit Party granting any right to use any Trademark.

"Trademarks" means all of the following now owned or hereafter existing or adopted or acquired by any Credit Party: (a) all trademarks, trade names, corporate names, business names, trade styles, service marks, logos, other source or business identifiers, prints and labels on which any of the foregoing have appeared or appear, designs and general intangibles of like nature (whether registered or unregistered), all registrations and recordings thereof, and all applications in connection therewith, including registrations, recordings and applications in the United States Patent and Trademark Office or in any similar office or agency of the United States, any state or territory thereof, or any other country or any political subdivision thereof; (b) all reissues, extensions or renewals thereof; and (c) all goodwill associated with or symbolized by any of the foregoing.

"Trigger Date" has the meaning ascribed to it in Annex G.

"Unfunded Pension Liability" means, at any time, the aggregate amount, if any, of the sum of (a) the amount by which the present value of all accrued benefits under each Title IV Plan exceeds the fair market value of all assets of such Title IV Plan allocable to such benefits in accordance with Title IV of ERISA, all determined as of the most recent valuation date for each such Title IV Plan using the actuarial assumptions for funding purposes in effect under such Title IV Plan, and (b) for a period of 5 years following a transaction which might reasonably be expected to be covered by Section 4069 of ERISA, the liabilities (whether or not accrued) that could be avoided by any Credit Party or any ERISA Affiliate as a result of such transaction.

"Welfare Plan" means a Plan described in Section 3(i) of ERISA.

Rules of construction with respect to accounting terms used in the Agreement or the other Loan Documents shall be as set forth in Annex G. All other undefined terms contained in any of the Loan Documents shall, unless the context indicates otherwise, have the meanings provided for by the Code to the extent the same are used or defined therein; in the event that any term is defined differently in different Articles or Divisions of the Code, the definition contained in Article or Division 9 shall control. Unless otherwise specified, references in the Agreement or any of the Appendices to a Section, subsection or clause refer to such Section, subsection or clause as contained in the Agreement. The words "herein," "hereof" and "hereunder" and other words of similar import refer to the Agreement as a whole, including all Annexes, Exhibits and Schedules, as the same may from time to time be amended, restated, modified or supplemented, and not to any particular section, subsection or clause contained in the Agreement or any such Annex, Exhibit or Schedule.

Wherever from the context it appears appropriate, each term stated in either the singular or plural shall include the singular and the plural, and pronouns stated in the masculine, feminine or neuter gender shall include the masculine, feminine and neuter genders. The words "including," "includes" and "include" shall be deemed to be followed by the words "without limitation"; the word "or" is not exclusive; references to Persons include their respective successors and assigns (to the extent and only to the extent permitted by the Loan Documents) or, in the case of governmental Persons, Persons succeeding to the relevant functions of such Persons; and all references to statutes and related regulations shall include any amendments of the same and any successor statutes and regulations. Whenever any provision in any Loan Document refers to the knowledge (or an analogous phrase) of any Credit Party, such words are intended to signify that such Credit Party has actual knowledge or awareness of a particular fact or circumstance or that such Credit Party, if it had exercised reasonable diligence, would have known or been aware of such fact or circumstance.

FINANCIAL COVENANTS

Borrower shall not breach or fail to comply with any of the following financial covenants, each of which shall be calculated in accordance with GAAP consistently applied:

(a) Minimum Fixed Charge Coverage Ratio. From and after the first date, if any, on which Availability is less than \$20,000,000 (in each case, the "Trigger Date") Borrower and its Subsidiaries shall have on a consolidated basis on the Trigger Date and as of the last day of each month thereafter, a Fixed Charge Coverage Ratio for the 12-month period most recently then ended of not less than 1.0:1.0.

(b) Minimum Borrowing Availability. Borrower shall at all times maintain Borrowing Availability at least equal to the Minimum Excess Availability. The Minimum Excess Availability shall for all purposes in the Agreement (including conditions to lending and required prepayments), be considered a reserve against Borrowing Availability. No Revolving Loans shall be available to Borrower to the extent that the making of such Revolving Loan would reduce Borrowing Availability below the Minimum Excess Availability, and Borrower shall make any prepayments relating thereto as forth in Section 1.3(b). Notwithstanding the foregoing to the contrary, Agent in its sole discretion may make advances for the account of Lenders to the extent permitted under Section 1.1(a)(iii).

Unless otherwise specifically provided herein, any accounting term used in the Agreement shall have the meaning customarily given such term in accordance with GAAP, and all financial computations hereunder shall be computed in accordance with GAAP consistently applied. That certain items or computations are explicitly modified by the phrase "in accordance with GAAP" shall in no way be construed to limit the foregoing. If any "Accounting Changes" (as defined below) occur and such changes result in a change in the calculation of the financial covenants, standards or terms used in the Agreement or any other Loan Document, then Borrower, Agent and Lenders agree to enter into negotiations in order to amend such provisions of the Agreement so as to equitably reflect such Accounting Changes with the desired result that the criteria for evaluating Borrower's and its Subsidiaries' financial condition shall be the same after such Accounting Changes as if such Accounting Changes had not been made; provided, however, that the agreement of Requisite Lenders to any required amendments of such provisions shall be sufficient to bind all Lenders. "Accounting Changes" means (i) changes in accounting principles required by the promulgation of any rule, regulation, pronouncement or opinion by the Financial Accounting Standards Board of the American Institute of Certified Public Accountants (or successor thereto or any agency with similar functions), (ii) changes in accounting principles concurred in by Borrower's certified public accountants; (iii) purchase accounting adjustments under A.P.B. 16 or 17 and EITF 88-16, and the application of the accounting principles set forth in FASB 109, including the establishment of reserves pursuant

thereto and any subsequent reversal (in whole or in part) of such reserves; and (iv) the reversal of any reserves established as a result of purchase accounting adjustments. If Agent, Borrower and Requisite Lenders agree upon the required amendments, then after appropriate amendments have been executed and the underlying Accounting Change with respect thereto has been implemented, any reference to GAAP contained in the Agreement or in any other Loan Document shall, only to the extent of such Accounting Change, refer to GAAP, consistently applied after giving effect to the implementation of such Accounting Change. If Agent, Borrower and Requisite Lenders cannot agree upon the required amendments within 30 days following the date of implementation of any Accounting Change, then all Financial Statements delivered and all calculations of financial covenants and other standards and terms in accordance with the Agreement and the other Loan Documents shall be prepared, delivered and made without regard to the underlying Accounting Change. For purposes of Section 8.1, a breach of a Financial Covenant contained in this Annex G shall be deemed to have occurred as of any date of determination by Agent or as of the last day of any specified measurement period, regardless of when the Financial Statements reflecting such breach are delivered to Agent.

ANNEX J (from Annex A - Commitments Definition)

to

CREDIT AGREEMENT

Commitments	Lender(s)
Revolving Loan Commitment (including a Swing Line Accommodation of \$15,000,000) of \$111,500,000	General Electric Capital Corporation
Revolving Loan Commitment of \$38,500,000	The CIT Group/Business Credit, Inc.
Revolving Loan Commitment of \$20,000,000	LaSalle Retail Finance
Revolving Loan Commitment of \$30,000,000	Wells Fargo Foothill, LLC

EXHIBIT 1.1(a)(i)
To
CREDIT AGREEMENT

FORM OF NOTICE OF REVOLVING CREDIT ADVANCE

Reference is made to that certain Second Amended and Restated Credit Agreement dated as of September 26, 2007 among Gottschalks Inc., the other Persons named therein as Credit Parties, the Lenders from time to time signatory thereto ("Lenders") and General Electric Capital Corporation, as agent for Lenders ("Agent") (including all annexes, exhibits and schedules thereto, and as from time to time amended, restated, supplemented or otherwise modified, the "Credit Agreement"). Capitalized terms used herein without definition are so used as defined in the Credit Agreement.

Borrower hereby gives irrevocable notice, pursuant to Section 1.1(a)(i) of the Credit Agreement, of its request for a Revolving Credit Advance to be made on [Date] in the aggregate amount of \$[] as [an Index Rate Loan] [a LIBOR Loan having a LIBOR Period of [] month(s)].

Borrower hereby (i) represents and warrants that all of the conditions contained in Section 2.2 of the Credit Agreement have been satisfied on and as of the date hereof, and will continue to be satisfied on and as of the date of the Advance(s) requested hereby, before and after giving effect thereto and to the application of the proceeds therefrom; (ii) represents and warrants that a true and correct copy of the Borrower Base Certificate is attached hereto as Exhibit A; and (iii) reaffirms the granting and continuance of Agent's Liens, on behalf of itself and Lenders, pursuant to the Collateral Documents.

IN WITNESS WHEREOF, Borrower has caused this Notice of Revolving Credit Advance to be executed and delivered by its duly authorized officer as of the date first set forth above.

GOTTSCHALKS INC.

By:
Name:
Title:

EXHIBIT 1.1(a)(ii)
to
CREDIT AGREEMENT

REVOLVING NOTE

\$ __, __, __

_____, 20__

FOR VALUE RECEIVED, the undersigned, GOTTSCHALKS INC., a Delaware corporation ("Borrower"), HEREBY PROMISES TO PAY to the order of _____ ("Lender"), at the offices of GENERAL ELECTRIC CAPITAL CORPORATION, a Delaware corporation, as Agent for Lenders ("Agent"), at its address at 201 Merritt 7, Norwalk, CT 06856-5201, or at such other place as Agent may designate from time to time in writing, in lawful money of the United States of America and in immediately available funds, the amount of _____ DOLLARS AND _____ CENTS (\$ __, __, __) or, if less, the aggregate unpaid amount of all Revolving Credit Advances made to the undersigned under the "Credit Agreement" (as hereinafter defined). All capitalized terms used but not otherwise defined herein have the meanings given to them in the Credit Agreement or in Annex A thereto.

This Revolving Note is one of the Revolving Notes issued pursuant to that certain Second Amended and Restated Credit Agreement dated as of September 26, 2007 by and among Borrower, the other Persons named therein as Credit Parties, Agent, Lender and the other Persons signatory thereto from time to time as Lenders (including annexes, exhibits and schedules thereto, and as from time to time amended, restated, supplemented or otherwise modified, the "Credit Agreement"), and is entitled to the benefit and security of the Credit Agreement, the Security Agreement and all of the other Loan Documents referred to therein. Reference is hereby made to the Credit Agreement for a statement of all of the terms and conditions under which the Loans evidenced hereby are made and are to be repaid. The date and amount of each Revolving Credit Advance made by Lenders to Borrower, the rates of interest applicable thereto and each payment made on account of the principal thereof, shall be recorded by Agent on its books; provided that the failure of Agent to make any such recordation shall not affect the obligations of Borrower to make a payment when due of any amount owing under the Credit Agreement or this Note to in respect of the Revolving Credit Advances made by Lender to Borrower.

The principal amount of the indebtedness evidenced hereby shall be payable in the amounts and on the dates specified in the Credit Agreement, the terms of which are hereby incorporated herein by reference. Interest thereon shall be paid until such principal amount is paid in full at such interest rates and at such times, and pursuant to such calculations, as are specified in the Credit Agreement.

If any payment on this Revolving Note becomes due and payable on a day other than a Business Day, the maturity thereof shall be extended to the next succeeding Business Day and, with respect to payments of principal, interest thereon shall be payable at the then applicable rate during such extension.

Upon and after the occurrence of any Event of Default, this Revolving Note may, as provided in the Credit Agreement, and without demand, notice or legal process of any kind, be declared, and immediately shall become, due and payable.

Time is of the essence of this Revolving Note. Demand, presentment, protest and notice of nonpayment and protest are hereby waived by Borrower.

Except as provided in the Credit Agreement, this Revolving Note may not be assigned by Lender to any Person.

THIS REVOLVING NOTE SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF NEW YORK APPLICABLE TO CONTRACTS MADE AND PERFORMED IN THAT STATE.

GOTTSCHALKS INC.

By: _____

Title: _____

EXHIBIT 1.1(c)(ii)
to
CREDIT AGREEMENT

SWING LINE NOTE

\$15,000,000

September 26, 2007

FOR VALUE RECEIVED, the undersigned, GOTTSCHALKS INC., a Delaware corporation ("Borrower"), HEREBY PROMISES TO PAY to the order of GENERAL ELECTRIC CAPITAL CORPORATION, a Delaware corporation ("Swing Line Lender") at the offices of GENERAL ELECTRIC CAPITAL CORPORATION, a Delaware corporation, as Agent (in such capacity, the "Agent") at the Agent's address at 201 Merritt 7, Norwalk, CT 06856-5201, or at such other place as Agent may designate from time to time in writing, in lawful money of the United States of America and in immediately available funds, the amount of FIFTEEN MILLION DOLLARS AND NO CENTS (\$15,000,000) or, if less, the aggregate unpaid amount of all Swing Line Advances made to the undersigned under the "Credit Agreement" (as hereinafter defined). All capitalized terms used but not otherwise defined herein have the meanings given to them in the Credit Agreement or in Annex A thereto.

This Swing Line Note is issued pursuant to that certain Second Amended and Restated Credit Agreement dated as of September 26, 2007 by and among Borrower, the other Persons named therein as Credit Parties, Agent, Swing Line Lender and the other Persons signatory thereto from time to time as Lenders (including all annexes, exhibits and schedules thereto and as from time to time amended, restated, supplemented or otherwise modified, the "Credit Agreement"), and is entitled to the benefit and security of the Credit Agreement, the Security Agreement and all of the other Loan Documents. Reference is hereby made to the Credit Agreement for a statement of all of the terms and conditions under which the Loans evidenced hereby are made and are to be repaid. The date and amount of each Swing Line Advance made by Swing Line Lender to Borrower, the rate of interest applicable thereto and each payment made on account of the principal thereof, shall be recorded by Agent on its books; provided that the failure of Agent to make any such recordation shall not affect the obligations of Borrower to make a payment when due of any amount owing under the Credit Agreement or this Swing Line Note in respect of the Swing Line Advances made by Swing Line Lender to Borrower.

The principal amount of the indebtedness evidenced hereby shall be payable in the amounts and on the dates specified in the Credit Agreement, the terms of which are hereby incorporated herein by reference. Interest thereon shall be paid until such principal amount is paid in full at such interest rates and at such times, and pursuant to such calculations, as are specified in the Credit Agreement.

If any payment of this Swing Line Note becomes due and payable on a day other than a Business Day, the maturity thereof shall be extended to the next succeeding Business Day

and, with respect to payments of principal, interest thereon shall be payable at the then applicable rate during such extension.

Upon and after the occurrence of any Event of Default, this Swing Line Note may, as provided in the Credit Agreement, and without demand, notice or legal process of any kind, be declared, and immediately shall become, due and payable.

Time is of the essence of this Swing Line Note. Demand, presentment, protest and notice of nonpayment and protest are hereby waived by Borrower.

THIS SWING LINE NOTE SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF NEW YORK APPLICABLE TO CONTRACTS MADE AND PERFORMED IN THAT STATE.

GOTTSCHALKS INC.

By: _____

Name: _____

Title: _____

EXHIBIT 1.5(e)
to
CREDIT AGREEMENT

NOTICE OF CONVERSION/CONTINUATION

Reference is made to that certain Second Amended and Restated Credit Agreement dated as of September 26, 2007 by and among the undersigned ("Borrower"), the other Persons named therein as Credit Parties, General Electric Capital Corporation ("Agent") and the Lenders from time to time signatory thereto (including all annexes, exhibits or schedules thereto, and as from time to time amended, restated, supplemented or otherwise modified, the "Credit Agreement"). Capitalized terms used herein without definition are so used as defined in the Credit Agreement.

Borrower hereby gives irrevocable notice, pursuant to Section 1.5(e) of the Credit Agreement, of its request to:

(a) on [date] convert \$[] of the aggregate outstanding principal amount of the [] Loan, bearing interest at the [] Rate, into a(n) [] Loan [and, in the case of a LIBOR Loan, having a LIBOR Period of [] month(s)];

[(b) on [date] continue \$[] of the aggregate outstanding principal amount of the [] Loan, bearing interest at the LIBOR Rate, as a LIBOR Loan having a LIBOR Period of [] month(s)].

Borrower hereby represents and warrants that all of the conditions contained in Section 2.2 of the Credit Agreement have been satisfied on and as of the date hereof, and will continue to be satisfied on and as of the date of the conversion/continuation requested hereby, before and after giving effect thereto.

IN WITNESS WHEREOF, Borrower has caused this Notice of Conversion/Continuation be executed and delivered by its duly authorized officer as of the date first set forth above.

GOTTSCHALKS INC.

By: _____
Title: _____

ASSIGNMENT AGREEMENT

This Assignment Agreement (this "Agreement") is made as of _____, 200__ by and between _____ ("Assignor Lender") and _____ ("Assignee Lender") and acknowledged and consented to by GENERAL ELECTRIC CAPITAL CORPORATION, as agent ("Agent"). All capitalized terms used in this Agreement and not otherwise defined herein will have the respective meanings set forth in the Credit Agreement as hereinafter defined.

RECITALS

:

WHEREAS, GOTTSCHALKS INC., a Delaware corporation, ("Borrower"), Agent, Assignor Lender and other Persons signatory thereto as Lenders have entered into that certain Second Amended and Restated Credit Agreement dated as of September 26, 2007 (as amended, restated, supplemented or otherwise modified from time to time, the "Credit Agreement") pursuant to which Assignor Lender has agreed to make certain Loans to, and incur certain Letter of Credit Obligations for, Borrowers;

WHEREAS, Assignor Lender desires to assign to Assignee Lender [all/a portion] of its interest in the Loans (as described below), the Letter of Credit Obligations and the Collateral and to delegate to Assignee Lender [all/a portion] of its Commitments and other duties with respect to such Loans, Letter of Credit Obligations and Collateral;

WHEREAS, Assignee Lender desires to become a Lender under the Credit Agreement and to accept such assignment and delegation from Assignor Lender; and

WHEREAS, Assignee Lender desires to appoint Agent to serve as agent for Assignee Lender under the Credit Agreement.

NOW, THEREFORE, in consideration of the premises and the agreements, provisions, and covenants herein contained, Assignor Lender and Assignee Lender agree as follows:

1. ASSIGNMENT, DELEGATION, AND ACCEPTANCE

1.1 Assignment. Assignor Lender hereby transfers and assigns to Assignee Lender, without recourse and without representations or warranties of any kind (except as set forth in Section 3.2), [all/such percentage] of Assignor Lender's right, title, and interest in [the Revolving Loan], [Letter of Credit Obligations], Loan Documents and Collateral as will result in Assignee Lender having as of the Effective Date (as hereinafter defined) a Pro Rata Share thereof, as follows:

3. REPRESENTATIONS, WARRANTIES AND COVENANTS

3.1 Assignee Lender's Representations, Warranties and Covenants. Assignee Lender hereby represents, warrants, and covenants the following to Assignor Lender and Agent:

- (a) This Agreement is a legal, valid, and binding agreement of Assignee Lender, enforceable according to its terms;
- (b) The execution and performance by Assignee Lender of its duties and obligations under this Agreement and the Loan Documents will not require any registration with, notice to, or consent or approval by any Governmental Authority;
- (c) Assignee Lender is familiar with transactions of the kind and scope reflected in the Loan Documents and in this Agreement;
- (d) Assignee Lender has made its own independent investigation and appraisal of the financial condition and affairs of each Credit Party, has conducted its own evaluation of the Loans and Letter of Credit Obligations, the Loan Documents and each Credit Party's creditworthiness, has made its decision to become a Lender to Borrowers under the Credit Agreement independently and without reliance upon Assignor Lender or Agent, and will continue to do so;
- (e) Assignee Lender is entering into this Agreement in the ordinary course of its business, and is acquiring its interest in the Loans and Letter of Credit Obligations for its own account and not with a view to or for sale in connection with any subsequent distribution; provided, however, that at all times the distribution of Assignee Lender's property shall, subject to the terms of the Credit Agreement, be and remain within its control;
- (f) No future assignment or participation granted by Assignee Lender pursuant to Section 9.1 of the Credit Agreement will require Assignor Lender, Agent, or Borrower to file any registration statement with the Securities and Exchange Commission or to apply to qualify under the blue sky laws of any state;
- (g) Assignee Lender has no loans to, written or oral agreements with, or equity or other ownership interest in any Credit Party;
- (h) Assignee Lender will not enter into any written or oral agreement with, or acquire any equity or other ownership interest in, any Credit Party without the prior written consent of Agent; and
- (i) As of the Effective Date, Assignee Lender (i) is entitled to receive payments of principal and interest in respect of the Obligations without deduction for or on account of any taxes imposed by the United States of America or any political subdivision thereof [, (ii) is not subject to capital adequacy or similar requirements under Section 1.16(a) of the Credit Agreement, (iii) does not require the payment of any increased costs under Section 1.16(b) of the Credit Agreement, and (iv) is not unable to fund LIBOR Loans under Section 1.16(c) of the Credit Agreement, and Assignee Lender will indemnify Agent from and against all liabilities, obligations, losses, damages, penalties, actions, judgments, suits, costs, or expenses

that result from Assignee Lender's failure to fulfill its obligations under the terms of Section 1.15(c) of the Credit Agreement or from any other inaccuracy in the foregoing.

3.2 Assignor Lender's Representations, Warranties and Covenants. Assignor Lender hereby represents, warrants and covenants the following to Assignee Lender:

- (a) Assignor Lender is the legal and beneficial owner of the Assigned Amount;
- (b) This Agreement is a legal, valid and binding agreement of Assignor Lender, enforceable according to its terms;
- (c) The execution and performance by Assignor Lender of its duties and obligations under this Agreement and the Loan Documents will not require any registration with, notice to or consent or approval by any Governmental Authority;
- (d) Assignor Lender has full power and authority, and has taken all action necessary to execute and deliver this Agreement and to fulfill the obligations hereunder and to consummate the transactions contemplated hereby;
- (e) Assignor Lender is the legal and beneficial owner of the interests being assigned hereby, free and clear of any adverse claim, lien, encumbrance, security interest, restriction on transfer, purchase option, call or similar right of a third party; and
- (f) This Assignment by Assignor Lender to Assignee Lender complies, in all material respects, with the terms of the Loan Documents.

4. LIMITATIONS OF LIABILITY

Neither Assignor Lender (except as provided in Section 3.2) nor Agent makes any representations or warranties of any kind, nor assumes any responsibility or liability whatsoever, with regard to (a) the Loan Documents or any other document or instrument furnished pursuant thereto or the Loans, Letter of Credit Obligations or other Obligations, (b) the creation, validity, genuineness, enforceability, sufficiency, value or collectibility of any of them, (c) the amount, value or existence of the Collateral, (d) the perfection or priority of any Lien upon the Collateral, or (e) the financial condition of any Credit Party or other obligor or the performance or observance by any Credit Party of its obligations under any of the Loan Documents. Neither Assignor Lender nor Agent has or will have any duty, either initially or on a continuing basis, to make any investigation, evaluation, appraisal of, or any responsibility or liability with respect to the accuracy or completeness of, any information provided to Assignee Lender which has been provided to Assignor Lender or Agent by any Credit Party. Nothing in this Agreement or in the Loan Documents shall impose upon the Assignor Lender or Agent any fiduciary relationship in respect of the Assignee Lender.

5. FAILURE TO ENFORCE

No failure or delay on the part of Agent or Assignor Lender in the exercise of any power, right, or privilege hereunder or under any Loan Document will impair such power, right,

or privilege or be construed to be a waiver of any default or acquiescence therein. No single or partial exercise of any such power, right, or privilege will preclude further exercise thereof or of any other right, power, or privilege. All rights and remedies existing under this Agreement are cumulative with, and not exclusive of, any rights or remedies otherwise available.

6. NOTICES

Unless otherwise specifically provided herein, any notice or other communication required or permitted to be given will be in writing and addressed to the respective party as set forth below its signature hereunder, or to such other address as the party may designate in writing to the other.

7. AMENDMENTS AND WAIVERS

No amendment, modification, termination, or waiver of any provision of this Agreement will be effective without the written concurrence of Assignor Lender, Agent and Assignee Lender.

8. SEVERABILITY

Whenever possible, each provision of this Agreement will be interpreted in such manner as to be effective and valid under applicable law. In the event any provision of this Agreement is or is held to be invalid, illegal, or unenforceable under applicable law, such provision will be ineffective only to the extent of such invalidity, illegality, or unenforceability, without invalidating the remainder of such provision or the remaining provisions of the Agreement. In addition, in the event any provision of or obligation under this Agreement is or is held to be invalid, illegal, or unenforceable in any jurisdiction, the validity, legality, and enforceability of the remaining provisions or obligations in any other jurisdictions will not in any way be affected or impaired thereby.

9. SECTION TITLES

Section and Subsection titles in this Agreement are included for convenience of reference only, do not constitute a part of this Agreement for any other purpose, and have no substantive effect.

10. SUCCESSORS AND ASSIGNS

This Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns.

11. APPLICABLE LAW

THIS AGREEMENT WILL BE CONSTRUED IN ACCORDANCE WITH AND GOVERNED BY THE LAWS OF THE STATE OF NEW YORK APPLICABLE TO CONTRACTS MADE AND PERFORMED IN THAT STATE.

12. COUNTERPARTS

This Agreement and any amendments, waivers, consents, or supplements may be executed in any number of counterparts and by different parties hereto in separate counterparts, each of which, when so executed and delivered, will be deemed an original and all of which shall together constitute one and the same instrument.

[signature page follows]

IN WITNESS WHEREOF, this Agreement has been duly executed as of the date first written above.

ASSIGNEE LENDER:

By: _____

Title: _____

Notice Address:

ASSIGNOR LENDER:

By: _____

Title: _____

Notice Address:

ACKNOWLEDGED AND CONSENTED TO:

GENERAL ELECTRIC CAPITAL
CORPORATION

By: _____

Title: _____

[If required]

GOTTSCHALKS INC.

By: _____

Title: _____

SCHEDULE 2.1

Assignor Lender's Loans

Principal Amount

Revolving Loan \$ _____

Subtotal \$ _____

Accrued Interest \$ _____

Unused Line Fee \$ _____

Other + or -\$ \$ _____

Total \$ _____

All determined as of the Effective Date.

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Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Forms S-8 (Nos. 33-54783, 33-54789, 33-61471, 33-61473, 33-119149 and 33-126616) of our report dated April 7, 2008, relating to the financial statements and schedule of Gottschalks Inc. and our report dated April 7, 2008 on internal control over financial reporting of Gottschalks Inc., which appears in this Form 10-K.

/s/ BDO Seidman, LLP

San Francisco, California

April 7, 2008

Exhibit 23.2

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement Nos. 33-54783, 33-54789, 33-61471, 33-61473, 33-119149 and 33-126616 on Form S-8, of our report dated April 12, 2007, relating to the fiscal 2006 and 2005 financial statements and financial statement schedule of Gottschalks Inc., which report expresses an unqualified opinion and includes an emphasis paragraph regarding the adoption of Financial Accounting Standards Board Statement No. 123(R), *Share-Based Payment*, appearing in the Annual Report on Form 10-K of Gottschalks Inc for the year ended February 3, 2007.

/s/ Deloitte & Touche LLP

San Francisco, California

April 9, 2008

Exhibit 31.1

**SECTION 302 CERTIFICATION OF PRESIDENT AND
CHIEF EXECUTIVE OFFICER**

I, James R. Famalette, certify that:

1. I have reviewed this Annual Report on Form 10-K of Gottschalks Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

April 10, 2008

By: /s/ James R. Famalette

James R. Famalette

Chairman and Chief Executive Officer

Exhibit 31.2

**SECTION 302 CERTIFICATION OF VICE PRESIDENT AND
CHIEF FINANCIAL OFFICER**

I, Daniel T. Warzenski, certify that:

1. I have reviewed this Annual Report on Form 10-K of Gottschalks Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

April 10, 2008

By: /s/ Daniel T. Warzenski

Daniel T. Warzenski

Vice President and Chief Financial Officer

Exhibit 32.1

**CERTIFICATION OF PRESIDENT AND CHIEF EXECUTIVE OFFICER PURSUANT TO 18 U.S.C. §
1350, AS ADOPTED PURSUANT TO
§ 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Gottschalks Inc. (the "Company") on Form 10-K for the period ended February 2, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James R. Famalette, Chairman and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as enacted by § 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ James R. Famalette

James R. Famalette

Chairman and Chief Executive Officer

Date: April 10, 2008

A signed original of this written statement required by Section 906 has been provided to Gottschalks Inc. and will be retained by Gottschalks Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

Exhibit 32.2

**CERTIFICATION OF VICE PRESIDENT AND CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. § 1350, AS ADOPTED PURSUANT TO
§ 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Gottschalks Inc. (the "Company") on Form 10-K for the period ended February 2, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Daniel T. Warzenski, Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as enacted by § 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Daniel T. Warzenski

Daniel T. Warzenski

Vice President and Chief Financial Officer

Date: April 10, 2008

A signed original of this written statement required by Section 906 has been provided to Gottschalks Inc. and will be retained by Gottschalks Inc. and furnished to the Securities and Exchange Commission or its staff upon request.