CHINA PHARMA HOLDINGS, INC.
Form 10-Q
August 14, 2013

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

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the quarterly period ended June 30, 2013

o 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 001-34471

CHINA PHARMA HOLDINGS, INC.
(Exact name of registrant as specified in its charter)

| Nevada | 73-1564807 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification No.) |

Second Floor, No. 17, Jinpan Road
Haikou, Hainan Province, China 570216
(Address of principal executive offices) (Zip Code)

+86- 898-6681-1730 (China)
(Issuer's telephone number, including area code)

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 such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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 the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check One):

| | |
|---|---|
| Large accelerated filer o | Accelerated filer o |
| Non-accelerated filer o | Smaller reporting company x |
| (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 o No x

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 43,579,557 shares of Common Stock, $.001 par value, were outstanding as of August 9, 2013.

CHINA PHARMA HOLDINGS, INC. AND SUBSIDIARIES

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PART I FINANCIAL INFORMATION

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

The accompanying unaudited condensed consolidated balance sheets, statements of operations and comprehensive income, and statements of cash flows and the related notes thereto, have been prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP") for interim financial information and in conjunction with the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the disclosures required by U.S. GAAP for complete financial statements. The financial statements reflect all adjustments, consisting only of normal, recurring adjustments, which are, in the opinion of management, necessary for a fair presentation for the interim periods.

The accompanying financial statements should be read in conjunction with the financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2012.

The results of operations for the six-month period ended June 30, 2013 are not necessarily indicative of the results to be expected for the entire fiscal year or any other period.

CHINA PHARMA HOLDINGS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

| | June 30, 2013 | December 31, 2012 |
|---|---|---|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | $2,524,523 | $4,029,708 |
| Banker's acceptances | 1,714,011 | 101,570 |
| Trade accounts receivable, less allowance for doubtful accounts of $9,196,993 and $4,429,945, respectively | 55,355,747 | 66,175,570 |
| Other receivables, less allowance for doubtful accounts of $58,209 and $49,881, respectively | 556,014 | 80,799 |
| Advances to suppliers | 5,571,542 | 4,816,354 |
| Inventory, less allowance for obsolescence of $5,566,682 and $1,769,984, respectively | 33,710,598 | 36,359,516 |
| Deferred tax assets | 1,690,104 | 967,671 |
| Total Current Assets | 101,122,539 | 112,531,188 |
| | | |
| Advances for purchases of intangible assets | 40,213,220 | 39,263,977 |
| Property and equipment, net of accumulated depreciation of $4,796,901 and $4,273,373, respectively | 15,404,689 | 9,031,894 |
| Intangible assets, net of accumulated amortization of $3,275,787 and $2,944,726, respectively | 2,192,794 | 2,412,854 |
| TOTAL ASSETS | $158,933,242 | $163,239,913 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Trade accounts payable | $4,318,202 | $2,841,862 |
| Accrued expenses | 258,618 | 202,185 |
| Accrued taxes payable | 690,781 | 2,426,826 |
| Other payables | 1,030,466 | 1,094,886 |
| Advances from customers | 2,005,509 | 1,945,984 |
| Other payables - related parties | 1,354,567 | 1,354,567 |
| Short-term notes payable | 4,859,716 | 4,761,073 |
| Total Current Liabilities | 14,517,859 | 14,627,383 |
| Long-term deferred tax liability | 136,285 | 95,963 |
| Total Liabilities | 14,654,144 | 14,723,346 |
| Stockholders' Equity: | | |
| Preferred stock, $0.001 par value; 5,000,000 shares authorized; no shares issued or outstanding | - | - |
| Common stock, $0.001 par value; 95,000,000 shares authorized; 43,579,557 shares and 43,579,557 shares outstanding, respectively | 43,580 | 43,580 |
| Additional paid-in capital | 23,590,204 | 23,590,204 |
| Retained earnings | 101,628,193 | 108,904,325 |
| Accumulated other comprehensive income | 19,017,121 | 15,978,458 |
| Total Stockholders' Equity | 144,279,098 | 148,516,567 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $158,933,242 | $163,239,913 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

CHINA PHARMA HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE INCOME
(Unaudited)

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Revenue | $8,026,325 | $14,598,403 | $16,275,712 | $30,685,134 |
| Cost of revenue | 5,849,002 | 10,460,047 | 11,974,402 | 21,242,431 |
| Inventory obsolescence | 27,178 | - | 3,720,073 | - |
| Gross profit | 2,150,145 | 4,138,356 | 581,237 | 9,442,703 |
| Operating expenses: | | | | |
| Selling expenses | 701,687 | 881,945 | 1,513,741 | 1,776,005 |
| General and administrative expenses | 1,456,500 | 812,741 | 2,195,927 | 1,489,143 |
| Bad debt expense | 4,752,733 | 233,139 | 4,632,803 | 553,237 |
| Total operating expenses | 6,910,920 | 1,927,825 | 8,342,471 | 3,818,385 |
| (Loss) income from operations | (4,760,775) | 2,210,531 | (7,761,234) | 5,624,318 |
| Other income (expense): | | | | |
| Interest income | 1,016 | 791 | 2,602 | 1,481 |
| Interest expense | (92,049) | (78,472) | (174,494) | (156,009) |
| Net other income (expense) | (91,033) | (77,681) | (171,892) | (154,528) |
| (Loss) income before income taxes | (4,851,808) | 2,132,850 | (7,933,126) | 5,469,790 |
| Income tax benefit (expense) | 387,983 | (372,932) | 656,994 | (903,513) |
| Net (loss) income | (4,463,825) | 1,759,918 | (7,276,132) | 4,566,277 |
| Other comprehensive income - foreign currency translation adjustment | 2,218,896 | 106,311 | 3,038,663 | 972,885 |
| Comprehensive (loss) income | $(2,244,929) | $1,866,229 | $(4,237,469) | $5,539,162 |
| (Loss) earnings per share: | | | | |
| Basic | $(0.10) | $0.04 | $(0.17) | $0.10 |
| Diluted | $(0.10) | $0.04 | $(0.17) | $0.10 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

CHINA PHARMA HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | For the Six Months Ended June 30, | |
|---|---|---|
| | 2013 | 2012 |
| Cash Flows from Operating Activities: | | |
| Net (loss) income | $(7,276,132) | $4,566,277 |
| Depreciation and amortization | 697,549 | 729,167 |
| Stock based compensation | - | 141,721 |
| Bad debt expense | 4,632,803 | 553,237 |
| Deferred income taxes | (656,994) | (55,634) |
| Inventory obsolescence reserve | 3,720,073 | - |
| Changes in assets and liabilities: | | |
| Trade accounts receivable | 1,672,236 | (3,756,396) |
| Other receivables | (468,509) | (26,505) |
| Advances to suppliers | (648,436) | 1,873,778 |
| Inventory | 1,745,256 | (4,552,918) |
| Trade accounts payable | 1,403,638 | 1,768,420 |
| Accrued expenses | (6,086) | 46,311 |
| Accrued taxes payable | (1,767,344) | 161,533 |
| Other payables | (9,017) | 46,552 |
| Advances from customers | 19,003 | 398,842 |
| Net Cash Provided by Operating Activities | 3,058,040 | 1,894,385 |
| | | |
| Cash Flows from Investing Activities: | | |
| Advances for purchases of intangible assets | (4,572,982) | (1,270,399) |
| Purchase of property and equipment | (49,030) | (67,722) |
| Net Cash Used in Investing Activities | (4,622,012) | (1,338,121) |
| | | |
| Cash Flows from Financing Activities: | | |
| Proceeds from related party loan | - | 293,004 |
| Net Cash Provided by Financing Activity | - | 293,004 |
| | | |
| Effect of Exchange Rate Changes on Cash | 58,787 | (28,571) |
| Net (Decrease ) Increase in Cash and Cash Equivalents | (1,505,185) | 820,697 |
| Cash and Cash Equivalents at Beginning of Period | 4,029,708 | 4,050,854 |
| Cash and Cash Equivalents at End of Period | $2,524,523 | $4,871,551 |
| | | |
| Supplemental Cash Flow Information: | | |
| Cash paid for interest | $167,819 | $151,667 |
| Cash paid for income taxes | 1,716,064 | 588,661 |
| | | |
| Supplemental Noncash Investing and Financing Activities: | | |
| Accounts payable for purchases of property and equipment | $153,621 | $144,153 |
| Accounts receivable collected with banker's acceptances | 5,756,309 | 2,026,928 |
| Advances for purchases of equipment paid with banker's acceptances | 2,063,840 | - |
| Advances to suppliers paid with banker's acceptances | - | 402,338 |

| | | |
|---|---|---|
| Inventory purchased with banker's acceptances | 2,099,243 | 1,248,820 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

CHINA PHARMA HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 - BASIS OF PRESENTATION

Organization and Nature of Operations – China Pharma Holdings, Inc., a Nevada corporation, owns 100% of Onny Investment Limited ("Onny"), a British Virgin Islands corporation, that in turn owns 100% of Hainan Helpson Medical & Biotechnology Co., Ltd ("Helpson"), a corporation organized under the laws of the People's Republic of China (the "PRC"). China Pharma Holdings, Inc. and its subsidiaries are referred to herein as the Company.

The Foreign Investment Industrial Catalogue (the "Catalogue") jointly issued by the China's Ministry of Commerce and the National Development and Reform Commission (as the latest version is the year 2012 version, effective January 30, 2012) classified various industries/businesses into three different categories: (i) encouraged for foreign investment; (ii) restricted to foreign investment; and (iii) prohibited from foreign investment. For any industry/business not covered by any of these three categories, they will be deemed industries/businesses permitted for foreign investment. A typical foreign investment ownership restriction in the pharmaceutical industry is that a foreign investment enterprise (the "FIE") shall not have the whole or majority of its equity interests owned by a foreign owner if the FIE establishes more than 30 branch stores and distributes a variety of brands in those franchise stores, which is not the case of the Company's business.

Helpson manufactures and markets generic and branded pharmaceutical products as well as biochemical products primarily to hospitals and private retailers located throughout the PRC. The Company believes Helpson's business is not subject to any ownership restrictions prescribed under the Catalogue. Onny acquired 100% of the ownership in Helpson from Helpson's three former shareholders on May 25, 2005 by entry into an Equity Transfer Agreement with such three parties on May 25, 2005. The transaction was approved by the Commercial Bureau of Hainan Province on June 12, 2005 and Helpson received the Certificate of Approval for Establishing of Enterprises with Foreign Investment in the PRC on the same day and its business license evidencing its WFOE (Wholly Foreign Owned Enterprise) status on June 21, 2005.

The Company has and continues to acquire well-accepted medical formulas to a diverse portfolio of Western and Chinese medicines.

Consolidation and Basis of Presentation – The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") and are expressed in United States dollars. The accompanying consolidated financial statements include the accounts and operations of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Helpson's functional currency is the Chinese Renminbi. Helpson's revenue and expenses are translated into United States dollars at the average exchange rate for the period. Assets and liabilities are translated at the exchange rate as of the end of the reporting period. Gains or losses from translating Helpson's financial statements are included in accumulated other comprehensive income, which is a component of stockholders' equity. Gains and losses arising from transactions denominated in a currency other than the functional currency of the entity that is a party to the transaction are included in the results of operations.

Condensed Financial Statements – The accompanying unaudited condensed consolidated financial statements were prepared pursuant to the rules and regulations of the United States Securities and Exchange Commission (the

"Commission"). Certain information and note disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such rules and regulations. Management of the Company ("Management") believes the following disclosures are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 filed with the Commission on March 14, 2013.

These unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) that, in the opinion of Management, are necessary to present fairly the consolidated financial position and results of operations of the Company for the periods presented. Operating results for the six months ended June 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013.

CHINA PHARMA HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Accounting Estimates - The preparation of financial statements in conformity with U.S. GAAP requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Basic and Diluted (Loss) Earnings per Common Share - Basic (loss) earnings per common share is computed by dividing net (loss) income by the weighted-average number of common shares outstanding during the period. Diluted (loss) earnings per share is calculated to give effect to potentially issuable dilutive common shares.

The following table is a presentation of the numerators and denominators used in the calculation of basic and diluted (loss) earnings per share:

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Net (loss) income | $(4,463,825) | $1,759,918 | $(7,276,132) | $4,566,277 |
| Basic weighted-average common shares outstanding | 43,579,557 | 43,571,590 | 43,579,557 | 43,550,573 |
| Effect of dilutive securities: | | | | |
| Warrants | - | - | - | - |
| Options | - | - | - | - |
| Diluted weighted-average common shares outstanding | 43,579,557 | 43,571,590 | 43,579,557 | 43,550,573 |
| Basic (loss) earnings per share | $(0.10) | $0.04 | $(0.17) | $0.10 |
| Diluted (loss) earnings per share | $(0.10) | $0.04 | $(0.17) | $0.10 |

The following potential common shares were not included in the computation of diluted earnings per share as their effect would have been anti-dilutive:

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Warrants with exercise prices of $3.00 to $3.80 per share | - | 150,000 | - | 150,000 |
| Options with an exercise price of $2.54 to $3.47 per share | - | 50,000 | - | 50,000 |
| Total | - | 200,000 | - | 200,000 |

NOTE 2 – PRODUCT RECALL

In March 2013, the China Food and Drug Administration (“CFDA”) issued a nationwide notice (the “CFDA Notice”) for the cessation of the production, sale and use of Buflomedil effective immediately. The CFDA Notice was a result of the reevaluation done by the CFDA based on the indications from the recent China and international research materials, which found that the side effect risks of Buflomedil to the nerve system and the cardiovascular system have surpassed its clinical treatment effect risks. The CFDA Notice was applicable to all the manufacturers and distributors in China who are in the business of the production and sale of Buflomedil-related products.

Pursuant to the CFDA Notice, the Company ceased the production and sale of Buflomedil-based products and ceased all promotional and marketing activities for Buflomedil-based products. Furthermore, the Company recognized an inventory obsolescence allowance of approximately $3.7 million for Buflomedil-related raw materials and finished goods inventory. This was recorded as inventory obsolescence on the accompanying statement of operations for the six months ended June 30, 2013.

In addition, the Company recalled Buflomedil-based products from the market. It authorized the return of its previously sold Buflomedil-related products through April 30, 2013. The loss from the refunds to customers was $27,507 and was recognized as a reduction of revenues for the six months ended June 30, 2013. Under CFDA regulatory provisions, the CFDA notice does not impose legal liability to the manufacturers of Buflomedil as long as they act pursuant to the CFDA Notice to cease the production, sale and use of Buflomedil and destroy such finished goods immediately.

Pursuant to the CFDA Notice, the CFDA revoked the production licenses for Buflomedil-based products. The carrying value of the Company’s Buflomedil-related intangible assets was zero; therefore, no impairment of the Company’s intangible assets was necessary.

CHINA PHARMA HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 3 - INVENTORY

Inventory consisted of the following:

| | June 30, 2013 | December 31, 2012 |
|---|---|---|
| Raw materials | $32,733,860 | $30,198,816 |
| Finished goods | 6,543,420 | 7,930,684 |
| | 39,277,280 | 38,129,500 |
| Obsolescence reserve | (5,566,682 ) | (1,769,984 ) |
| Total Inventory | $33,710,598 | $36,359,516 |

NOTE 4 - PROPERTY AND EQUIPMENT

Property and equipment consisted of the following:

| | June 30, 2013 | December 31, 2012 |
|---|---|---|
| Permit of land use | $456,275 | $447,013 |
| Building | 2,469,245 | 2,419,125 |
| Plant, machinery and equipment | 6,559,635 | 6,381,209 |
| Motor vehicle | 150,127 | 147,080 |
| Office equipment | 228,966 | 222,273 |
| Construction in progress | 10,337,342 | 3,688,567 |
| Total | 20,201,590 | 13,305,267 |
| Less: accumulated depreciation | (4,796,901 ) | (4,273,373 ) |
| Property and Equipment, net | $15,404,689 | $9,031,894 |

Construction in progress consists primarily of the construction of a new production facility and the acquisition of related equipment. Depreciation is computed on a straight-line basis over the estimated useful lives of the assets as follows:

| Asset | Life - years |
|---|---|
| Permit of land use | 40 - 70 |
| Building | 20 - 35 |
| Plant, machinery and equipment | 10 |
| Motor vehicle | 5 - 10 |
| Office equipment | 3-5 |

For the six months ended June 30, 2013 and 2012, depreciation expense was $430,368 and $424,167, respectively.

NOTE 5 - INTANGIBLE ASSETS

Intangible assets represent the cost of medical formulas approved for production by the CFDA in China. During the six months ended June 30, 2013 or 2012, the Company did not obtain CFDA production approval for any medical formula and therefore there were no costs reclassified from advances to medical formulas.

Approved medical formulas are amortized from the date CFDA approval is obtained over their individually identifiable estimated useful life, which are from ten to thirteen years. It is at least reasonably possible that a change in the estimated useful lives of the medical formulas could occur in the near term due to changes in the demand for the drugs and medicines produced from these medical formulas. For the six months ended June 30, 2013 and 2012, amortization expense relating to intangible assets was $267,181 and $305,000, respectively. Medical formulas typically do not have a residual value at the end of their amortization period.

The Company evaluates each approved medical formula for impairment at the date of CFDA approval, when indications of impairment are present and at the date of each financial statement. The Company’s evaluation is based on an estimated undiscounted net cash flow model, considering currently available market data for the related drug and the Company’s estimated market share. If the carrying value of the medical formula exceeds the estimated future net cash flows, an impairment loss is recognized for the excess of the carrying value over the discounted estimated future net cash flows. As a result of the evaluation, the Company has determined that each medical formula continues to provide benefits to the Company and no impairment was recognized during the six months ended June 30, 2013 or 2012.

CHINA PHARMA HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

At June 30, 2013 and December 31, 2012, intangible assets consisted solely of CFDA approved medical formulas as follows:

| | June 30, 2013 | December 31, 2012 |
|---|---|---|
| Gross carrying amount | $ 5,468,581 | $ 5,357,580 |
| Accumulated amortization | (3,275,787) | (2,944,726) |
| Net carrying amount | $ 2,192,794 | $ 2,412,854 |

NOTE 6 – ADVANCES FOR PURCHASES OF INTANGIBLE ASSETS

In order to expand the number of medicines manufactured and marketed by the Company, the Company has entered into contracts with independent laboratories for the purchase of medical formulas. Although CFDA approval has not been obtained for these medical formulas as of the dates of the contracts, the object of the contracts is for the purchase of CFDA-approved medical formulas once the CFDA approval process is completed. Some of the medical formulas currently in the CFDA approval process also come with patents. The Company has received the title for two patents. The related patents have not expired.

Prior to entering into the contracts, the laboratories typically have completed all required research and development to determine the medical formula for and the method of production of the generic medicine. Since the laboratories are not eligible to apply for CFDA production approval, they usually collaborate with a production facility (such as the Company) and apply for the production approval in the name of the manufacturer. The Company buys the final products with the production approval from the CFDA and the laboratories have to complete the CFDA approval process from the point of the contract.

A typical CFDA approval process for the production of a generic medical product involves a number of steps that generally requires three to five years. If the medical formula is purchased at the point when the generic medical product receives the CFDA's approval for clinical study, which is very typical for the Company, the clinical study that follows will usually take from one and a half to three years to complete. After the clinical study is completed, the results are submitted to the CFDA and a production approval application is filed with the CFDA. In most cases, it will take between eight to eighteen months to prepare and submit the production approval application and obtain CFDA approval. Upon approving the generic medical product, the CFDA issues a production certificate and the Company can produce and sell the generic medical product. As a result of this process, CFDA approval is expected to be received in approximately two to five years from the dates of the medical formula contracts. However, this process can, and in some cases has, taken longer than five years to obtain CFDA approval.

Under the terms of the contracts, the laboratories are required to obtain production approval (on behalf of the Company) for the medical formulas from the CFDA. Management monitors the status of each medical formula on a regular basis in order to assess whether the laboratories are performing adequately under the contracts. If a medical product is not approved by the CFDA, as evidenced by their issuance of a denial letter, or if the laboratory breaches the contract, the laboratory is required under the contract to provide a refund to the Company of the full amount of the payments made to the laboratory for that formula, or the Company can require the application of those payments to another medical formula with the same laboratory. As a result of the refund right, the Company is purchasing an approved medical product. Accordingly, payments made prior to the issuance of production approval by the CFDA

are recorded as advances for purchases of intangible assets.

To date, no formula has failed to receive CFDA production approval nor has the Company been informed or become aware of any formula that may fail to receive such approval. However, there is no assurance that the medical products will receive production approval and if the Company does not receive such approval, it will enforce its contractual rights to receive the refund from the laboratory or have the payments applied to another medical formula with the same laboratory.

CHINA PHARMA HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

At June 30, 2013, the Company was obligated to pay laboratories and others approximately $7,057,338 upon completion of the various phases of contracts to provide CFDA production approval of medical formulas.

NOTE 7 – RELATED PARTY TRANSACTIONS

Total advances owing to a board member were $1,354,567 and $1,354,567 as of June 30, 2013 and December 31, 2012, respectively, and are recorded as other payables – related parties on the accompanying condensed consolidated balance sheets. The advances bear interest at a rate of 1.0% per year. Total interest expense relating to these advances of $3,386, $2,372, $6,772 and $4,342 was recognized for the three and six months ended June 30, 2013 and 2012, respectively.

NOTE 8 – NOTES PAYABLE

On October 30, 2012, the Company entered into a revolving line of credit with a bank in the amount of RMB 30,000,000. The related note payable bears interest at an annual rate of 6.90% (based upon 115% of the PRC government's current short term rate of 6.00%). Advances on the line of credit are due one year from the date of the advance and are collateralized by certain land use rights, buildings and accounts receivable. The outstanding balance due under the revolving line of credit was RMB 30,000,000 ($4,859,716) as of June 30, 2013. The Company has no additional amounts available to it under the line of credit. This amount has been classified as short-term notes payable in the accompanying consolidated balance sheet at June 30, 2013.

Fair Value of Notes Payable – Based on the borrowing rates currently available to the Company for bank loans with similar terms and maturities, the carrying amounts of notes payable outstanding as of June 30, 2013 and December 31, 2012 approximated their fair value because of either the immediate or short-term maturity of these financial instruments or because the underlying instruments bear interest rates that approximated current market rates.

NOTE 9 - INCOME TAXES

Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax laws or rates is recognized in operations in the period that includes the enactment date.

Undistributed earnings of Helpson, the Company's foreign subsidiary, since its acquisition, amounted to approximately $113.4 million at June 30, 2013. Those earnings, as well as the investment in Helpson of approximately $23.3 million, are considered to be indefinitely reinvested and, accordingly, no U.S. federal or state income taxes have been provided thereon. Upon distribution of those earnings in the form of dividends or otherwise, the Company would be subject to U.S. federal and state income taxes (net of an adjustment for foreign tax credits) and withholding taxes payable to the PRC. Determination of the amount of unrecognized deferred U.S. income tax liability is not practicable because of the complexities associated with its hypothetical calculation; however, unrecognized foreign tax credits may be available to reduce a portion of the U.S. tax liability.

Under current tax law in the PRC, the Company is and will be subject to the following enterprise income tax rates:

| Year | Enterprise Income Tax Rate |
|---|---|
| 2013 | 15% |
| 2014 and after | 25% |

The provision for income taxes consisted of the following:

CHINA PHARMA HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

| | Three months ended March 31, | | Three months ended March 31, | |
|---|---|---|---|---|
| | 2013 | 2012 | 2013 | 2012 |
| Current | $- | $394,254 | $- | $959,147 |
| Deferred | (387,983) | (21,322) | (656,994) | (55,634) |
| Total income tax (benefit) expense | $(387,983) | $372,932 | $(656,994) | $903,513 |

The Company has net operating loss carryforwards for PRC tax purposes of approximately $3,350,000. The related deferred tax asset of $502,750 does not meet the more-likely-than-not criteria of realization and the Company has provided a valuation allowance in this same amount against the full amount of the deferred tax asset.

The Company has also incurred various other taxes, comprised primarily of business taxes, value-added taxes, urban construction taxes, education surcharges and others. Any unpaid amounts are reflected on the balance sheets as accrued taxes payable.

NOTE 10 – FAIR VALUE MEASUREMENTS

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. To measure fair value, a hierarchy has been established which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs. This hierarchy uses three levels of inputs to measure the fair value of assets and liabilities as follows: Level 1 – Quoted prices in active markets for identical assets or liabilities. Level 2 – Observable inputs other than Level 1 including quoted prices for similar assets or liabilities, quoted prices in less active markets, or other observable inputs that can be corroborated by observable market data. Level 3 – Unobservable inputs supported by little or no market activity for financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The Company uses fair value to measure the value of the banker’s acceptance notes it holds. The banker’s acceptance notes are recorded at cost which approximates fair value. The Company held the following assets recorded at fair value as of June 30, 2013 and December 31, 2012:

| | | Fair Value Measurements at Reporting Date Using | | |
|---|---|---|---|---|
| Description | June 30, 2013 | Level 1 | Level 2 | Level 3 |
| Banker's acceptance notes | $ 1,714,011 | $ - | $ 1,714,011 | $ - |
| Total | $ 1,714,011 | $ - | $ 1,714,011 | $ - |

| | Fair Value Measurements at Reporting Date Using | | |
|---|---|---|---|
| Description | Level 1 | Level 2 | Level 3 |

| | | | | |
|---|---|---|---|---|
| | December 31, 2012 | | | |
| Banker's acceptance notes | $ 101,570 | $ - | $ 101,570 | $ - |
| Total | $ 101,570 | $ - | $ 101,570 | $ - |

NOTE 11 - STOCKHOLDERS' EQUITY

Preferred and Common Stock – The total number of authorized shares is 95,000,000 shares of common stock and 5,000,000 shares of preferred stock. The preferred stock may be issued in series with such designations, preferences, stated values, rights, qualifications or limitations as determined solely by the Company’s board of directors.

Warrants – During the six months ended June 30, 2013, warrants to purchase an aggregate of 150,000 shares of the Company's common stock at exercise prices ranging from $3.00 to $3.80 per share expired unexercised. At June 30, 2013 there are no warrants outstanding.

CHINA PHARMA HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Stock and Stock Options – On November 12, 2010, the Company's Board of Directors adopted, and on December 22, 2010 its stockholders approved, the 2010 Long-Term Incentive Plan (the "2010 Incentive Plan"), which gave the Company the ability to grant stock options, restricted stock, stock appreciation rights and performance units to its employees, directors and consultants, or those who will become employees, directors and consultants of the Company and/or its subsidiaries. The 2010 Incentive Plan currently allows for equity awards of up to 4,000,000 shares of common stock. Through June 30, 2013, 75,000 shares of common stock had been granted under the 2010 Incentive Plan. During the six months ended June 30, 2013, options to purchase an aggregate of 25,000 shares of stock at an exercise price of $2.54 per share expired unexercised.

There were no securities issued from the 2010 Incentive Plan during the six months ended June 30, 2013.

At June 30, 2013, there was no remaining unrecognized compensation expense related to stock options or restricted stock grants.

NOTE 12 – CONTINGENCIES

Economic environment - Substantially all of the Company's operations are conducted in the PRC, and therefore the Company is subject to special considerations and significant risks not typically associated with companies operating in the United States of America. These risks include, among others, the political, economic and legal environments and fluctuations in the foreign currency exchange rate. The Company's results from operations may be adversely affected by changes in the political and social conditions in the PRC, and by changes in governmental policies with respect to laws and regulations, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation, among other things. The unfavorable changes in global macroeconomic factors may also adversely affect the Company's operations.

In addition, all of the Company's revenue is denominated in the PRC's currency of Renminbi (RMB), which must be converted into other currencies before remittance out of the PRC. Both the conversion of RMB into foreign currencies and the remittance of foreign currencies abroad require approval of the PRC government.

NOTE 13 – CONCENTRATIONS

At June 30, 2013, one customer accounted for 11.7% of accounts receivable. At December 31, 2012, no customer accounted for more than 10.0% of accounts receivable.

For the six months ended June 30, 2013, two customers accounted for 10.3% and 10.2% of sales, respectively. For the six months ended June 30, 2012, no customer accounted for more than 10% of sales.

For the six months ended June 30, 2013, purchases from one supplier accounted for 26.9% of raw material purchases. For the six months ended June 30, 2012, purchases from two suppliers accounted for 14.6% and 11.0% of raw material purchases, respectively.

NOTE 14 – SUBSEQUENT EVENTS

On July 11, 2013 the Company drew RMB 30,000,000 (approximately $4.86 million) down from a construction loan facility dated June 21, 2013. The loan facility is for an eight-year term, commencing from July 11, 2013, the actual draw-down date. The total loan amount is RMB 80,000,000 (approximately $13 million) from the same bank that provides the line of credit as discussed in Note 8. The proceeds of the loan are to be used for and are collateralized by the construction of the Company's new production facility and equipment. The loan currently bears interest at 7.205%, based upon 110% of the PRC government's eight-year term rate effective on the actual draw-down date, subject to annual adjustments based on 110% of the floating rate for the same type of loan on the anniversary from the draw-down date and its subsequent anniversary dates. The loan requires interest only payments for the first two years. Beginning July 11, 2015 the balance of the principal is due in installments over the next six years through July 11, 2021. The Company is required to draw down the entire loan amount by December 31, 2014.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The statements contained in this report with respect to our financial condition, results of operations and business that are not historical facts are forward-looking statements. Forward-looking statements can be identified by the use of forward-looking terminology, such as "anticipate", "believe", "expect", "plan", "intend", "seek", "estimate", "project", "could", "may" or the negative thereof or other variations thereon, or by discussions of strategy that involve risks and uncertainties. Management wishes to caution the reader of the forward-looking statements that any such statements that are contained in this report reflect our current beliefs with respect to future events and involve known and unknown risks, uncertainties and other factors, including, but not limited to, economic, competitive, regulatory, technological, key employees, and general business factors affecting our operations, markets, growth, services, products, licenses and other factors, some of which are described in this report and some of which are discussed in our other filings with the Securities and Exchange Commission. These forward-looking statements are only estimates or predictions. No assurances can be given regarding the achievement of future results, as actual results may differ materially as a result of risks facing our company, and actual events may differ from the assumptions underlying the statements that have been made regarding anticipated events.

These risk factors should be considered in connection with any subsequent written or oral forward-looking statements that we or persons acting on our behalf may issue. All written and oral forward looking statements made in connection with this report that are attributable to our company or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. Given these uncertainties, we caution investors not to unduly rely on our forward-looking statements. We do not undertake any obligation to review or confirm analysts' expectations or estimates or to release publicly any revisions to any forward-looking statements to reflect events or circumstances after the date of this report or to reflect the occurrence of unanticipated events, except as required by applicable law or regulation.

Business Overview & Recent Developments

China Pharma Holdings, Inc. is a specialty pharmaceutical company that develops, manufactures, and markets pharmaceutical products for human use for a wide range of high incidence and high mortality conditions in China, including cardiovascular, central nervous system ("CNS"), infectious and digestive diseases. The Company has a broad and expanding distribution network across 30 provinces, municipalities and autonomous regions. The Company is currently organized under the laws of the State of Nevada in the United States. Hainan Helpson Medical & Biotechnology Co., Ltd. (Helpson), located in Haikou City, Hainan Province, China, is a wholly-owned subsidiary of China Pharma Holdings, Inc.

In the second quarter of 2013, we continued to execute our prudent marketing strategy to a more stringent screening of existing and potential distributors and hospital customers in terms of speed of payment in order to gradually improve our trade pattern, especially in terms of the collection of our accounts receivable. This strategy temporarily impacts our sales in the current period.

The CFDA promulgated Good Manufacturing Practices for Pharmaceutical Products (2010 revised version) (the "new GMP") on February 12, 2011, which became effective on March 1, 2011. The new GMP standards outline the basic principles and standards for the manufacturing of pharmaceutical products and the management of quality controls in the manufacturing process in the PRC. Pursuant to those mandatory requirements, the upgrading of our two injectable product lines must be accomplished by the end of 2013. While management expects to see the completion of such product lines within the required time line, we cannot assure you it will in fact occur. To the extent delay is caused by factors beyond our control, it may have a material adverse effect on our business, financial condition and results of operations. We already completed the overall architectural structure of our new five-floor facility. We are progressing according to our plan to continue to construct the new GMP facility and ancillary projects. We have also made down payments for the major equipment and facilities for the new production lines in the new building. We are confident that the new-GMP upgrading will be accomplished in good quality and our existing production capacity will also be expanded significantly.

The products in our pipe-line progressed slowly but steadily along the development process, and are getting closer to product launch. The CFDA is also revising its production approval criteria and processes, resulting in longer approval time for new production applications across all types of products. In some cases they are adding additional requirements for products already under review.

The following is a list of the current status of some of our pipeline products:

Ÿ Cadesartan. We received production approval from the CFDA for Candesartan, a front-line drug therapy for the treatment of hypertension in November 2012. We plan to launch this product during 2013.

Ÿ Antibiotic Combination. We completed the Phase I clinical trials of our novel cephalosporin-based combination antibiotic in the third quarter of 2010. We are currently in Phase II of the clinical trial.

Ÿ Rosuvastatin. Rosuvastatin is a generic form of Crestor, a drug for indication of high blood cholesterol level. Clinical trials for this generic drug were completed in the fourth quarter of 2010 and we have submitted an application for production approval.

Ÿ Heart Disease Drug. We have a liquid oral medicine for the treatment of coronary heart disease in our new product pipeline. This product comes with a patented Traditional Chinese Medicine (TCM) formula and is currently in Phase III clinical trials. Due to the improved regulatory requests for clinical works, we adjusted our anticipated completion time frame for the clinical trials work for this product to late 2013.

Market Trends

The Chinese pharmaceutical industry has been a key contributor to the PRC's economic growth. Chinese pharmaceutical market reached CNY 926.1 billion in 2012 according to "Medicine Blue Book: China Pharmaceutical Market Report (2012)" ("Blue Book") published by Chinese Academy of Social Sciences (CASS) on December 28, 2012. The Blue Book noted that the compound growth rate of China's pharmaceutical market was over 20% from 2005 to 2010; and forecasted that it would continue its rapid expansion at an average rate of 12% from 2013 to 2020. The Blue Book pointed out that Chinese pharmaceutical market showing features of rapid expansion, fierce competition, low concentration, and greatly influenced by government policies; and the pharmaceutical market expansion is supported by increased demands for medicine associated with population aging, and improved social welfare and enhanced residents' purchasing power along with economic development.

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The Healthcare Reform program announced by the Chinese government in late 2009 is having a significant impact on all healthcare related industries in China, including the pharmaceutical industry. Overall, the government plans to provide a basic, universal healthcare system to all citizens of China. We believe volume expansion will continue as government subsidies to rural communities expand further. While pricing is generally set at the central government level, provincial government intervention has added complexity to the pricing-volume interaction. In addition to EDL products, we have also seen pricing pressure on most of the drugs we sell. While these changes have more impact on pharmaceutical distribution companies, manufacturers of pharmaceutical products are also affected. We believe the general implication is that gross margins for pharmaceutical products will continue to be under pressure for some time. That being said, a pharmaceutical manufacturer with experienced management and the ability to react quickly to changes will not only survive but thrive in this environment.

Results of Operations

Three Months Ended June 30, 2013 and 2012

Revenue

For the three months ended June 30, 2013, our sales revenue was $8.0 million, a decrease of 45%, compared to $14.6 million in the previous year period.

Set forth below are our revenues by product category in millions USD for the three months ended June 30, 2013 and 2012.

| Product Category | Three Months Ended June 30 | | Net Change | % Change |
|---|---|---|---|---|
| | 2013 | 2012 | | |
| CNS Cerebral & Cardio Vascular | $ 2.0 | $ 4.1 | -$ 2.1 | -52% |
| Anti-Viro/ Infection & Respiratory | $ 4.1 | $ 6.7 | -$ 2.6 | -39% |
| Digestive Diseases | $ 1.0 | $ 1.7 | -$ 0.7 | -42% |
| Other | $ 1.0 | $ 2.1 | -$ 1.1 | -54% |

Given the capital expenditure pressure from 2013 new GMP upgrade project, we have to control credit expansion in the market, this tightening marketing strategy has negatively impacted our revenue. Sales decreased throughout our major product categories. The most significant revenue decrease in terms of dollar amount was in our “Anti-Viro/Infection & Respiratory” product category, which generated $4.1 million in sales revenue in the three months ended June 30, 2013 compared to $6.7 million a year ago, a decrease of $2.6 million. This decrease was mainly due to the decrease in the sales of our two antibiotic products, Roxithromycin and Clarithromycin. Sales of the “CNS Cerebral & Cardio Vascular” category decreased by $2.1 million to $2.0 million in the three months ended June 30, 2013 compared to $4.1 million in the previous year period. This was mainly due to decrease in sales of Gastrodin and the CFDA notice on Bufomedil. The CFDA issued a nationwide notice for the cessation of the production, sale and use of Buflomedil effective immediately in March 2013. The Company ceased the production and sale of this product. Our “Digestive Diseases” category generated $1.0 million of sales in the three months ended June 30, 2013, compared to $1.7 million in the previous year period, or a decrease of $0.7 million. Our “Other” product category sales fell to $1.0 million from $2.1 million, a decrease of $1.1 million.

In the three months ended June 30, 2013, revenue breakdown by product category showed some changes mainly due to the CFDA notice and sales decrease of our main antibiotics. Sales of the "CNS, Cerebral & Cardio Vascular" category represented 25% and 28% of total sales in the three months ended June 30, 2013 and 2012 respectively. Sales of the "Anti-Viro & Respiratory" products category represented 51% and 46% of total sales in the three months ended June 30, 2013 and 2012. The "Digestive Diseases" category represented 12% and 12% of total revenue in the three months ended June 30, 2013 and 2012 respectively. The "Other" category represented 12% and 14% of total revenue in the three months ended June 30, 2013 and 2012 respectively.

Cost of Revenue

For the three months ended June 30, 2013, our cost of revenue was $5.8 million, or 73% of total revenue, which represented a decrease of $4.7 million from $10.5 million, or 72% of total revenue, in the three months ended June 30, 2012, a decrease of 44%. The decrease in cost of revenue during the second quarter of 2013 was almost proportionate to the decrease in revenue.

Inventory Obsolescence

The Company recognized an inventory obsolescence expense in the amount of $27,178 for the three months ended June 30, 2013. There was no comparable expense for the three months ended June 30, 2012.

Gross Profit and Gross Margin

Gross profit for the three months ended June 30, 2013 was $2.2 million, while gross profit for the three months ended June 30, 2012 was $4.1 million. Our gross profit margin in the second quarter of 2013 was 27%, compared to 28% in the second quarter of 2012. The Healthcare Reform instituted by the Chinese government since 2009 has resulted in margin compression in most pharmaceutical products on the markets today, especially in the generic space that many of our products are in. The decrease of sales and continued increases of the purchase price of raw materials attributed to the decrease of gross profit. Going forward, we expect to see continued pricing pressure on most products, but new products such as Candesartan could help to support overall gross margin once it is launched.

Selling Expenses

Our selling expenses for the three months ended June 30, 2013 were $0.7 million, a decrease of approximately $0.2 million, compared to $0.9 million in the same period last year. Selling expenses accounted for 9% of the total revenue in the three months ended June 30, 2013 compared to 6% in the three months ended June 30, 2012. Due to many adjustments in our selling processes from healthcare reform policies, despite the decrease in sales, we still needed to maintain necessary personnel and expenses to support the sales and collection of accounts receivable.

General and Administrative Expenses

Our general and administrative expenses for the three months ended June 30, 2013 were $1.5 million, an increase of $0.7 million from $0.8 million for the same period of 2012. General and administrative expenses accounted for 18% and 6% of our total revenues for the three months ended June 30, 2013 and 2012, respectively. This increase was mainly due to the expenses incurred related to technology upgrades and production process improvements of some of our existing marketed products in this period.

Bad Debt Expense and Account Receivables

In general, our normal credit or payment terms extended to customers are 90 days. This has not changed in recent years. Due to the peculiarity of the Chinese pharmaceutical market environment, deferred payments to pharmaceutical companies by state-owned hospitals and local medicine distributors are a normal phenomenon. Our customers are primarily pharmaceutical distributors who sell to mostly government-backed hospitals. Therefore the age of our receivables from our customers tends to be long. Although these customers typically pay after the due date of the receivables, since the majority of hospitals in China are backed by the government, management believes that the deferred payments from state-owned hospitals are secure and will eventually be collected. So far, we have always been able to collect our receivables and have not written-off any receivables in our 19-year history of doing business with hospitals.

The amount of accounts receivable that were past due (or the amount of accounts receivable that were more than 90 days old) was $50.3 million and $62.1 million as of June 30, 2013 and December 31, 2012, respectively. The following table illustrates our accounts receivable aging distribution in terms of percentage of total accounts receivable as of June 30, 2013 and December 31, 2012:

| | June 30, 2013 | | December 31, 2012 | |
|---|---|---|---|---|
| 1 - 90 Days | 9.1 | % | 12.1 | % |
| 90 - 180 Days | 15.4 | % | 12.8 | % |
| 180 - 360 Days | 22.9 | % | 32.4 | % |
| 360 - 720 Days | 44.4 | % | 42.7 | % |
| > 720 Days | 8.1 | % | 0 | % |
| Total | 100 | % | 100 | % |

In order to support the capital expenditure need from new-GMP ded in the previous sentence. The Company will give Parent (i) notice of any demands received by the Company for appraisals of shares of Common Stock and (ii) the opportunity to participate in and direct all negotiations and proceedings with respect to such notices and demands. The Company shall not, except with the prior written consent of Parent, make any payment with respect to any demands for appraisal or settle any such demands.

(e) If between the date of this Agreement and the Effective Time the number of outstanding Common Shares is changed into a different number of shares or a different class, by reason of any stock dividend, subdivision, reclassification, recapitalization, split-up, combination, exchange of shares or the like, other than pursuant to the Merger, the amount of Merger Consideration payable per Common Share shall be correspondingly adjusted.

(f) All vested or unvested restricted shares of Common Stock outstanding immediately prior to the Effective Time and all vested and unvested restricted share units outstanding immediately prior to the Effective Time (collectively, the "**Company Restricted Shares**") shall, by virtue of this Agreement and, without further action of the Company, Parent, Merger Sub or the holder of such Company Restricted Shares, vest and become free of all restrictions immediately prior to the Effective Time and shall be canceled, retired and shall cease to exist and shall be

converted into the right to receive the Merger Consideration.

(g) The Company Options shall be treated as provided in *Section 2.4*.

(h) For the avoidance of doubt, the parties acknowledge and agree that the contribution of Common Shares by the Contributing Holders to Parent pursuant to the Contribution and Exchange Agreements shall be deemed to occur immediately prior to the Effective Time and prior to any other above-described event.

Section 2.3 *Payment of Cash for Merger Shares.*

(a) Prior to the Closing Date, Parent shall designate a bank or trust company that is reasonably satisfactory to the Company, that is organized and doing business under the laws of the United States or any state thereof and that has a combined capital and surplus of at least $500,000,000 to serve as the disbursing agent for the Merger Consideration and payments in respect of the Company Options, unless another agent is designated as provided in *Section 2.4(a)* (the "**Disbursing Agent**"). At or prior to the Closing, Parent will cause to be deposited with the Disbursing Agent cash in the aggregate amount sufficient to pay the Merger Consideration in respect of all Merger Shares outstanding immediately prior to the Effective Time plus any cash necessary to pay for Company Options pursuant to *Section 2.4*. Pending distribution of the cash deposited with the Disbursing Agent, such cash shall be held in trust for the benefit of the holders of Merger Shares and such Company Options and shall not be used for any other purposes; *provided, however*, that Parent may direct the Disbursing Agent to invest such cash in obligations of or guaranteed by the United States of America, as long as no such investments have maturities that could prevent or delay payments to be made pursuant to *Section 2.3(b)* .

(b) As promptly as practicable after the Effective Time (but no later than five Business Days after the Effective Time), the Surviving Corporation shall send, or cause the Disbursing Agent to send, to each record holder of Merger Shares as of immediately prior to the Effective Time (other than Common Shares to be canceled pursuant to *Section 2.2(a)*) a letter of transmittal and instructions for exchanging their Merger Shares for the Merger Consideration payable therefor. The letter of transmittal will be in customary form and will specify that delivery of Merger Shares will be effected, and risk of loss and title will pass, only upon delivery of the stock certificates representing the Merger Shares to the Disbursing Agent. Upon surrender of such stock certificate or certificates to the Disbursing Agent together with a properly completed and duly executed letter of transmittal and any other documentation that the Disbursing Agent may reasonably require, the record holder thereof shall be entitled to receive the Merger Consideration payable in exchange therefor, less any amounts required to be withheld for Tax. Until so surrendered and exchanged, each such certificate shall, after the Effective Time, be deemed to represent only the right to receive the Merger Consideration, and until such surrender and exchange, no cash shall be paid to the holder of such outstanding certificate in respect thereof.

(c) If payment is to be made to a Person other than the registered holder of the Merger Shares represented by the certificate or certificates surrendered in exchange therefor, it shall be a condition to such payment that the certificate or certificates so surrendered shall be properly endorsed or otherwise be in proper form for transfer and that the Person requesting such payment shall pay to the Disbursing Agent any applicable stock transfer taxes required as a result of such payment to a Person other than the registered holder of such Merger Shares or establish to the satisfaction of the Disbursing Agent that such stock transfer taxes have been paid or are not payable.

(d) After the Effective Time, there shall be no further transfers on the stock transfer books of the Surviving Corporation of the Common Shares that were outstanding immediately prior to the Effective Time. If, after the Effective Time, certificates representing Merger Shares are presented to the Surviving Corporation, such shares shall be canceled and exchanged for the consideration provided for, and in accordance with the procedures set forth, in this *Article II*.

(e) If any cash deposited with the Disbursing Agent remains unclaimed twelve months after the Effective Time, such cash shall be returned to the Surviving Corporation upon demand, and any holder who has not surrendered his Merger Shares certificates for the Merger Consideration prior to that time shall thereafter look only to the Surviving Corporation for payment of the Merger Consideration. Notwithstanding the foregoing, the Surviving Corporation shall not be liable to any holder of Merger Shares for an amount paid to a public official pursuant to any applicable unclaimed property laws. Any

amounts remaining unclaimed by holders of Merger Shares as of a date immediately prior to such time that such amounts would otherwise escheat to or become property of any Governmental Authority shall, to the extent permitted by applicable Law, become the property of the Surviving Corporation on such date, free and clear of any claims or interest of any Person previously entitled thereto.

(f) No dividends or other distributions with respect to capital stock of the Surviving Corporation with a record date after the Effective Time shall be paid to the holder of any unsurrendered certificate for Common Shares.

(g) From and after the Effective Time, the holders of Common Shares (other than Dissenting Common Shares) outstanding immediately prior to the Effective Time shall cease to have any rights with respect to such Common Shares, other than the right to receive the Merger Consideration as provided in this Agreement.

(h) In the event that any Merger Share certificate has been lost, stolen or destroyed, upon the making of an affidavit of that fact by the Person claiming such Merger Share certificate to be lost, stolen or destroyed, in addition to the posting by such holder of any bond in such reasonable amount as the Surviving Corporation may direct as indemnity against any claim that may be made against the Surviving Corporation with respect to such Merger Share certificate, the Disbursing Agent will issue in exchange for such lost, stolen or destroyed Merger Share certificate the proper amount of the Merger Consideration.

(i) Parent, Surviving Corporation and the Disbursing Agent shall be entitled to deduct and withhold from the Merger Consideration otherwise payable hereunder any amounts required to be deducted and withheld under any applicable Tax Law. To the extent any amounts are so withheld, such withheld amounts shall be treated for all purposes as having been paid to the holder from whose Merger Consideration the amounts were so deducted and withheld.

Section 2.4 *Treatment of Options.*

(a) As of the Effective Time, each Company Option (other than Amended Options) will be cancelled and extinguished, and the holder thereof will be entitled to receive an amount in cash equal to the excess (if any) of (A) the product of (i) the number of Common Shares subject to such Company Option and (ii) the Merger Consideration over (B) the aggregate exercise price of such Company Option, without interest and less any amounts required to be deducted and withheld under any applicable Law. All payments with respect to canceled Company Options shall be made by the Disbursing Agent (or such other agent reasonably acceptable to the Company as Parent shall designate prior to the Effective Time) as promptly as reasonably practicable after the Effective Time from funds deposited by or at the direction of Parent to pay such amounts in accordance with *Section 2.3(a)*. Notwithstanding the foregoing, with respect to Company Options that are identified in a Contribution and Exchange Agreement between a Contributing Holder and Parent, such Company Options will be assumed by Parent and amended concurrently with the consummation of the Merger pursuant to the terms of such Contribution and Exchange Agreement (any Company Option so to be amended, an "**Amended Option**").

(b) Prior to the Effective Time, the Company and Parent will adopt such resolutions as may be reasonably required to effectuate the actions contemplated by this *Section 2.4*, without paying any consideration or incurring any debts or obligations on behalf of the Company or the Surviving Corporation.

(c) Parent and the Surviving Corporation shall be entitled to deduct and withhold from any amounts to be paid hereunder in respect of Company Options or Company Restricted Shares any amounts required to be deducted and withheld under any applicable Tax Law. To the extent any amounts are so withheld, such withheld amounts shall be treated for all purposes as having been paid

to the Company Option or Company Restricted Share holder from whose payments in respect of Company Options or Company Restricted Shares the amounts were so deducted and withheld.

**ARTICLE III**
**THE SURVIVING CORPORATION**

Section 3.1 *Articles of Incorporation.* The certificate of incorporation of the Company as in effect immediately prior to the Effective Time shall be amended as set forth on Exhibit B, and, as so amended, shall be the certificate of incorporation of the Surviving Corporation until thereafter amended in accordance with the terms thereof and as provided by applicable Law.

Section 3.2 *Bylaws.* The bylaws of the Company in effect at the Effective Time shall be amended to read the same as the bylaws of the Merger Sub in effect immediately prior to the Effective Time, and shall be the bylaws of the Surviving Corporation until thereafter amended in accordance with the terms thereof and as provided by applicable Law.

Section 3.3 *Directors and Officers.* From and after the Effective Time, (i) the directors of Merger Sub at the Effective Time shall be the directors of the Surviving Corporation and (ii) the officers of the Company at the Effective Time shall be the officers of the Surviving Corporation, in each case until their respective successors are duly elected or appointed and qualified in accordance with applicable Law.

**ARTICLE IV**
**REPRESENTATIONS AND WARRANTIES OF THE COMPANY**

Except as set forth in the corresponding sections or subsections of the Disclosure Letter delivered to Parent and Merger Sub by the Company concurrently with entering into this Agreement (the "**Disclosure Letter**") or as may be disclosed in reasonable detail in any Current Company SEC Report filed prior to the date hereof (it being understood that any information set forth in a particular section or subsection of the Disclosure Letter shall be deemed to be disclosed in each other section or subsection thereof to which the relevance of such information is reasonably apparent), the Company hereby represents and warrants to Parent and Merger Sub that:

Section 4.1 *Corporate Existence and Power.*

(a) Each of the Company and its Subsidiaries is a corporation duly incorporated, validly existing and in good standing under the laws of its jurisdiction of incorporation. Each of the Company and its Subsidiaries has all corporate powers and authority required to own, lease and operate its respective properties and to carry on its business as now conducted. The Company has all corporate powers and authority to execute and deliver this Agreement, and to consummate the Merger and the other transactions contemplated hereby and to perform each of its obligations hereunder. Each of the Company Joint Ventures has all powers and authority required to own, lease and operate its respective properties and to carry on its business as now conducted, except where the failure to have such power and authority would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect on the Company.

(b) Each of the Company and its Subsidiaries listed on Exhibit 21.1 to the Company's Annual Report on Form 10-K for the fiscal year ended January 29, 2005 (the "**Significant Subsidiaries**") is duly qualified to do business as a foreign corporation and is in good standing in each jurisdiction where the character of the property owned or leased by it or the nature of its activities makes such qualification necessary, except where the failure to be so qualified or be in good standing would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect on the Company. None of the Company Subsidiaries (other than the Significant Subsidiaries) has any material assets or liabilities, conducts any operations or has any employees.

(c) The Company has made available to Parent and Merger Sub true and complete copies of the currently effective articles of incorporation and bylaws or similar organizational and governing documents of the Company and its Subsidiaries and the Company Joint Ventures. Neither the Company nor any Subsidiary nor, to the Company's knowledge, any Company Joint Venture, is in violation of its organizational or governing documents.

Section 4.2 *Corporate Authorization; Company Fairness Opinion.*

(a) The execution, delivery and performance by the Company of this Agreement and the consummation by the Company of the Merger and the other transactions contemplated hereby have been duly and validly authorized by the Board of Directors of the Company. The only Company shareholder approval or authorization required to approve this Agreement and effect the Merger is the affirmative vote of the holders of Common Shares as required by the Delaware Corporate Law (the "**Requisite Shareholder Vote**").

(b) This Agreement has been duly and validly executed and delivered by the Company and, assuming the due and valid execution and delivery by Parent and Merger Sub, constitutes a legal, valid and binding agreement of the Company enforceable against the Company in accordance with its terms, except (i) as rights to indemnity hereunder may be limited by federal or state securities laws or the public policies embodied therein, (ii) as such enforceability may be limited by bankruptcy, insolvency, moratorium, reorganization or similar laws affecting the enforcement of creditors' rights generally, and (iii) as the remedy of specific performance and other forms of injunctive relief may be subject to equitable defenses and to the discretion of the court before which any proceeding therefor may be brought.

(c) On or prior to the date hereof, the Board of Directors of the Company, based on the unanimous recommendation of the Special Committee, has (except for directors who are affiliated with Parent or Merger Sub and members of Company management who have recused themselves) unanimously adopted resolutions (i) adopting this Agreement and declaring the Merger and the other transactions contemplated by this Agreement advisable and (ii) resolving to recommend that the Company shareholders approve this Agreement. As of the date hereof, all such resolutions are in full force and effect and none have been amended or superseded.

(d) Merrill Lynch & Co. (the "**Company Financial Advisor**") has delivered to the Board of the Directors of the Company its opinion to the effect that, as of the date such opinion was delivered, the consideration to be received in the Merger is fair, from a financial point of view, to the holders of Common Shares other than Merger Sub and its Affiliates (the "**Company Fairness Opinion**"). The Company has been authorized by the Company Financial Advisor to permit the inclusion in full of the Company Fairness Opinion in the Company Proxy Statement. As of the date hereof, the Company Fairness Opinion has not been withdrawn, revoked or modified.

Section 4.3 *Governmental Authorization.* The execution, delivery and performance by the Company of this Agreement and the consummation of the Merger by the Company require no action by, or by the Company or any Subsidiary in respect of, or filing by the Company or any Subsidiary with, any Governmental Authority other than (i) the filing of the Certificate of Merger; (ii) compliance with any applicable requirements of the HSR Act or any other applicable Other Antitrust Laws or any other Laws specified in Section 4.3 of the Disclosure Letter (the "**Required Governmental Approvals**"); (iii) compliance with the applicable requirements of the Exchange Act; (iv) compliance with the applicable requirements of the Securities Act; (v) compliance with any applicable foreign or state securities or Blue Sky laws; and (vi) such other items or filings, which if not taken or made, (A) would not, individually or in the aggregate, be reasonably expected to be material to the Company or the applicable Subsidiary and (B) would not reasonably be expected to adversely effect in any material respect, or materially hinder or delay, the consummation of the Merger or the Company's ability to observe and perform its obligations hereunder.

Section 4.4 *Non-Contravention.* The execution, delivery and performance by the Company of this Agreement and the consummation by the Company of the transactions contemplated hereby do not and will not (i) contravene or conflict with the organizational or governing documents of the Company or any of its Significant Subsidiaries or Company Joint Ventures; (ii) assuming compliance with the matters referenced in *Section 4.3* and the receipt of the Requisite Shareholder Vote, contravene or conflict with or constitute a violation of any provision of any Law binding upon or applicable to the Company or any of its Significant Subsidiaries or Company Joint Ventures or any of their respective properties or assets; (iii) constitute a default under or give rise to a right of termination, cancellation or acceleration of any right or obligation that is material to the Company and its Significant Subsidiaries taken as a whole or to a loss of any benefit that is material to the Company and its Significant Subsidiaries taken as a whole to which any such Person is entitled under any agreement, contract or other instrument applicable to or binding upon the Company or any of its Subsidiaries or Company Joint Ventures, except those consents set forth in Section 4.4 of the Disclosure Letter (the "**Required Contractual Consents**"); or (iv) result in the creation or imposition of any Lien on any assets that are material to the Company and its Subsidiaries taken as a whole (other than any such Lien as may be created or imposed in connection with the Financing or as otherwise may arise from any actions taken by Parent or Merger Sub), except in the case of (ii) (iv) above, which would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect on the Company or materially hinder or delay the consummation of the Merger or the Company's ability to observe and perform its obligations hereunder.

Section 4.5 *Capitalization.*

(a) The authorized capital stock of the Company consists of (i) 75,000,000 Common Shares, of which as of January 18, 2006 there were 26,436,542 Common Shares issued and outstanding (excluding 1,572,738 Common Shares held in treasury) and (ii) 10,000,000 shares of Preferred Stock, par value $0.01 per share, of which no shares are issued and outstanding. As of January 18, 2006 there were outstanding (A) Company Options to purchase an aggregate of 1,635,862 Common Shares and (B) 855,084 unvested restricted stock units. All outstanding shares of capital stock of the Company have been duly authorized and validly issued and are fully paid and non-assessable. Section 4.5(a) of the Disclosure Letter sets forth a complete and accurate list of all outstanding Company Options and other stock-related awards, including grants of Company Restricted Shares, which list sets forth the name of the holders thereof and, to the extent applicable thereto, the exercise price or purchase price thereof, the governing stock option plan with respect thereto and the expiration date thereof.

(b) Except as set forth in *Section 4.5(a)*, and except for changes since January 18, 2006 resulting from the exercise of Company Options outstanding on such date, there are no outstanding, and there have not been reserved for issuance, any (i) shares of capital stock or other voting securities of the Company; (ii) securities of the Company or any Subsidiary convertible into or exchangeable for shares of capital stock or voting securities of the Company or its Subsidiaries; (iii) Company Options or other rights or options to acquire from the Company or its Subsidiaries, or obligations of the Company or its Subsidiaries to issue, any shares of capital stock, voting securities or securities convertible into or exchangeable for shares of capital stock or voting securities of the Company or such Subsidiary, as the case may be; or (iv) equity equivalent interests in the ownership or earnings of the Company of its Subsidiaries or other similar rights (the items in *clauses (i)* through *(iv)* collectively, "**Company Securities**"). There are no outstanding obligations of the Company or any Subsidiary to repurchase, redeem or otherwise acquire any Company Securities. There are no shareholder agreements, voting trusts or other agreements or understandings to which the Company or any of its Subsidiaries is a party or by which it is bound relating to the voting or registration of any shares of capital stock of the Company or any of its Subsidiaries or preemptive rights with respect thereto.

(c) Other than the issuance of Common Shares upon exercise of Company Options, since the Balance Sheet Date, the Company has not declared or paid any dividend or distribution in respect of

any Company Securities, and neither the Company nor any Subsidiary has issued, sold, repurchased, redeemed or otherwise acquired any Company Securities, and their respective Boards of Directors have not authorized any of the foregoing.

(d) Neither the Company nor any of its Subsidiaries has entered into any commitment or agreement, or are otherwise obligated, to contribute capital, loan money or otherwise provide funds or make additional investments in any Company Joint Venture or any other Person.

Section 4.6 *Company Subsidiaries and Joint Ventures.*

(a) Section 4.6(a) of the Disclosure Letter sets forth all Subsidiaries of the Company and Company Joint Ventures, as well as the respective jurisdictions of incorporation and all jurisdictions in which the Company and such Subsidiaries and Company Joint Ventures are qualified to do business. Each of the Company Subsidiaries is wholly owned (directly or indirectly) by the Company and, except for such Company Subsidiaries and Company Joint Ventures, the Company does not directly or indirectly own any equity interest in any other Person.

(b) All equity interests of the Company Subsidiaries and the Company Joint Ventures held by the Company or any other Company Subsidiary are fully paid and non-assessable and were not issued in violation of any preemptive or similar rights. All such equity interests are free and clear of any Liens or any other limitations or restrictions on such equity interests (including any limitation or restriction on the right to vote, pledge or sell or otherwise dispose of such equity interests).

Section 4.7 *Reports and Financial Statements.*

(a) The Company has timely filed with or otherwise furnished to the SEC all forms, reports, schedules, statements and other documents required to be filed or furnished by it under the Securities Act or the Exchange Act since August 4, 2003 (such documents, as supplemented or amended since the time of filing, the "**Company SEC Reports**"). No Subsidiary of the Company is or at any time since August 4, 2003 has been required to file with or furnish to the SEC any such forms, reports, schedules or other documents. As of their respective dates, the Company SEC Reports, including any financial statements or schedules included or incorporated by reference therein, at the time filed (and, in the case of registration statements and proxy statements, on the dates of effectiveness and the dates of mailing, respectively) (i) complied as to form in all material respects with the applicable requirements of the Securities Act and the Exchange Act, as applicable, and (ii) did not contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading.

(b) The audited consolidated financial statements and unaudited consolidated interim financial statements included or incorporated by reference in the Company SEC Reports (including any related notes and schedules) fairly present, in all material respects, the consolidated financial position of the Company and its consolidated Subsidiaries as of the dates thereof, and the results of their operations and their cash flows for the periods set forth therein, and in each case were prepared in accordance with GAAP consistently applied during the periods involved (except as otherwise disclosed in the notes thereto and subject, where appropriate, to normal year-end adjustments that would not be material in amount or effect).

(c) There are no liabilities or obligations of the Company or any Company Subsidiary (whether accrued, contingent, absolute, determined, determinable or otherwise) which, individually or in the aggregate, would be material to the Company and its Subsidiaries taken as a whole other than (i) liabilities or obligations disclosed or provided for in the Balance Sheet or disclosed in the notes thereto; (ii) liabilities or obligations incurred after the Balance Sheet Date in the ordinary course of business; (iii) liabilities under this Agreement or incurred in connection with the transactions contemplated hereby; and (iv) liabilities disclosed on Section 4.15 of the Disclosure Letter.

(d) The Company has heretofore made available or promptly will make available to Parent and Merger Sub a complete and correct copy of any amendments or modifications to any Company SEC Reports filed prior to the date hereof which are required to be filed with the SEC but have not yet been filed with the SEC, and any Company SEC Reports required to be filed by the Company on or after the date hereof and prior to the Effective Time.

Section 4.8 *Disclosure Documents.* The proxy statement (the "**Company Proxy Statement**") and the Rule 13e-3 Transaction Statement on Schedule 13E-3 (the "**Schedule 13E-3**") relating to the Merger and the other transactions contemplated hereby, to be filed by the Company with the SEC in connection with seeking the adoption and approval of this Agreement by the Company shareholders will not, at the date it is first mailed to shareholders of the Company (in the case of the Proxy Statement) or at the time of the Company Shareholder Meeting (other than as to information supplied by Parent and Merger Sub for inclusion therein), contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they are made, not misleading. The Company will cause the Company Proxy Statement, the Schedule 13E-3 and all related SEC filings to comply as to form in all material respects with the requirements of the Exchange Act applicable thereto as of the date of such filing. No representation is made by the Company with respect to statements made in the Company Proxy Statement or the Schedule 13E-3 based on information supplied, or required to be supplied, by Parent and Merger Sub or their Affiliates specifically for inclusion therein.

Section 4.9 *Absence of Certain Changes or Events.*

(a) Since the Balance Sheet Date through the date hereof, the businesses of the Company and its Subsidiaries and, to the Company's knowledge, the businesses of the Company Joint Ventures, have been conducted in all material respects in the ordinary course and neither the Company nor any of its Subsidiaries, nor to the Company's knowledge any Company Joint Venture, has engaged in any transaction or series of related transactions outside the ordinary course material to the Company and its Subsidiaries taken as a whole. Since the Balance Sheet Date, there has not been a Material Adverse Effect on the Company. For purposes of this Agreement, "**Material Adverse Effect on the Company**" means any change, circumstance, event or effect that would be materially adverse to the assets and liabilities, business, financial condition or results of operations of the Company and its Subsidiaries, taken as a whole, other than any change, circumstance, event or effect resulting from (i) changes in general economic conditions, (ii) the announcement or pendency of this Agreement and the transactions contemplated hereby, (iii) general changes or developments in the industries in which the Company and its Subsidiaries operate, (iv) any actions required under this Agreement to obtain any approval or authorization under the HSR Act or any applicable Other Antitrust Laws for the consummation of the transactions contemplated by this Agreement or (v) changes in any Laws or applicable accounting regulations or principles, except, in the case of the foregoing clauses (i) and (iii), to the extent such changes or developments referred to therein would reasonably be expected to have a materially disproportionate impact on the business, financial condition or results of operations of the Company and its Subsidiaries, taken as a whole, relative to other industry participants, it being understood that in the event the Company should fail to meet any expected financial or operating performance targets, the fact of such failure, alone, would not constitute a Material Adverse Effect on the Company (although any party can assert the facts underlying any such failure in any dispute as to whether there has been a Material Adverse Effect on the Company).

(b) Without limiting the generality of the foregoing Section 4.9(a), since the Balance Sheet Date, there has not been (except, in each case, for transactions solely among the Company and its wholly-owned Subsidiaries or among the Company's wholly-owned Subsidiaries):

(i) any declaration, setting aside or payment of any dividend or distribution or capital return in respect of any shares of the Company's capital stock or any redemption, purchase or other acquisition by the Company or any of its Subsidiaries of any shares of the Company's capital stock or any amendment of any material term of any outstanding capital stock of the Company or any of its Subsidiaries;

(ii) any (A) incurrence of, or guarantee with respect to, or provision of credit support for, any indebtedness for borrowed money by the Company or any of its Subsidiaries, other than pursuant to the Company's or any Company Subsidiary's existing credit facilities in the ordinary course of business; (B) event of default or default under the Company's or any Subsidiary's existing credit facilities or outstanding loans; or (C) creation or assumption by the Company or any of its Subsidiaries of any material Lien on any material asset, other than Permitted Liens;

(iii) any material change in any method of financial accounting or financial accounting principle or practice used by the Company or any of its Subsidiaries, other than such changes required by Law or a change in GAAP;

(iv) (A) any deferred compensation, severance or similar agreement entered into or amended by the Company or any of its Subsidiaries and any employee; (B) any material increase in or acceleration of the compensation or benefits payable or to become payable by the Company or any of its Subsidiaries to its directors or officers or generally applicable to all or any category of the Company's or any such Subsidiary's employees; (C) any material increase in the coverage or benefits available under any vacation pay, company awards, salary continuation or disability, sick leave, deferred compensation, bonus or other incentive compensation, insurance, pension or other employee benefit plan, payment or arrangement made to, for or with any of the directors or officers of the Company or any Subsidiary or generally applicable to all or any category of the Company's or any Subsidiary's employees; or (D) any Material Employment Agreement or any amendment to the same, other than increases in compensation in the ordinary course of business and that in the aggregate have not resulted in a material increase in the benefits or compensation expense of the Company or any of its Subsidiaries;

(v) any loan, advance or capital contribution made by the Company or any of its Subsidiaries to, or investment in, any Person other than loans, advances or capital contributions made to a Subsidiary;

(vi) any amendment, alteration or modification in any material term of any currently outstanding Company Options, warrants or other rights to purchase any capital stock or other equity interests in the Company or any securities exchangeable or exercisable for or convertible into the same; or

(vii) any agreement to take or permit any actions specified in this *Section 4.9(b)*, except for this Agreement.

Section 4.10 *Litigation.* As of the date hereof, there is no material action, suit, claim, investigation, arbitration or proceeding pending or, to the knowledge of the Company, threatened against or affecting the Company or any of its Subsidiaries or their respective assets or properties before any arbitrator, arbitration provider or Governmental Authority (a "**Proceeding**"). As of the date hereof, neither the Company, nor any Subsidiary of the Company, nor any officer, director or employee of the Company or any such Subsidiary has been permanently or temporarily enjoined by any Law from engaging in or continuing any conduct or practice in connection with the business or assets of the Company or any Subsidiary of the Company. To the knowledge of the Company as of the date hereof,

none of the Company, nor any Subsidiary of the Company, nor any officer, director or employee of the Company or any such Subsidiary is under investigation by any Governmental Authority related to the conduct of the Company's or any such Subsidiary's business, the results of which investigation reasonably could be materially adverse to the business or assets of the Company and its Subsidiaries taken as a whole.

Section 4.11 *Taxes.*

(a) Except as would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect on the Company:

(i) Within the times and in the manner prescribed by Law, the Company and its Subsidiaries (and their predecessors) have properly prepared and timely filed all Tax Returns required by Law, have timely paid all Taxes due and payable (whether or not shown on any Tax Return) and have timely withheld and deposited all Taxes required to be withheld and deposited. Tax Returns filed by the Company and its Subsidiaries (and their predecessors) are true, correct and complete, and include all statements and other information required to avoid penalties or additions to Tax. The Company and its Subsidiaries (and their predecessors) have complied with all Law relating to Taxes. The Company has made available to Parent and Merger Sub all federal and material state, local and foreign Tax Returns containing material elections of the Company or any of its Subsidiaries with respect to periods commencing on or after January 31, 2002. Neither the Company nor any of its Subsidiaries (nor any of their predecessors) has either (A) been a party to a "reportable transaction" (as such term is defined in Treasury Regulations issued under the Code) that has not been properly reported on its Tax Returns, or (B) been a party to a "listed transaction" (as such term is defined in Treasury Regulations issued under the Code).

(ii) Neither the Company nor any of its Subsidiaries (nor any predecessor thereof) (A) is a party to or bound by any closing agreement, offer in compromise or any other agreement with any Tax authority or any Tax indemnity agreement, Tax sharing agreement or other agreement whereby amounts due thereunder are determined with reference to Taxes or items used to determine the amount of any Taxes, in each case, that is currently in effect; (B) has requested in writing a ruling or other advice or guidance from any Governmental Authority with respect to Taxes; (C) has present or contingent liabilities for Taxes, other than Taxes that either have been (1) incurred in the ordinary course of business thereof and reflected as a liability on the most recent balance sheet included in the Financial Statements or (2) incurred in the ordinary course of business with respect to taxable periods or portions of taxable periods following the date of the most recent balance sheet included in the Financial Statements in amounts consistent with prior years (adjusted for changes in ordinary course operating results and ordinary course changes in assets) and for which adequate reserves have been established and separately reflected in the financial records of the Company; or (D) that is subject to United States federal income taxation, has engaged in a trade or business, or had a permanent establishment (within the meaning of an applicable tax treaty), within a country other than the United States.

(iii) There are no proposed, threatened or actual pending assessments, audits, examinations, disputes or requests from a Governmental Authority for filings or information pertaining to Taxes relating to the Company or any of its Subsidiaries (or their predecessors). There are no (A) adjustments under Section 481 of the Code or any similar adjustments with respect to the Company or any Subsidiary (or their predecessors) applicable to the current or any future taxable year of the Company or such Subsidiary, (B) waivers or extensions of the statute of limitations with respect to Taxes for which the Company or any Subsidiary could be held liable, or (C) grants by the Company or any Subsidiary of power of attorney to any Person with respect to Taxes for which the Company or any Subsidiary would be liable.

(iv) During any taxable year for which the applicable statute of limitations on the assessment of Tax against the Company or any of its Subsidiaries remains open, neither the Company nor any of its Subsidiaries (nor any predecessor thereof) has been (A) a "distributing corporation," or a "controlled corporation" in connection with a distribution intended or purported to be governed by Section 355 of the Code, or (B) a member of an affiliated group of corporations, within the meaning of Section 1504 of the Code, or a member of a combined, consolidated or unitary group for state, local or foreign Tax purposes, other than such a group the common parent of which is and at all times has been the Company (or TSA Stores, Inc.) or a group that did not include as members entities other than the Company and its Subsidiaries (or TSA Stores, Inc. and its Subsidiaries).

(v) No Subsidiary of the Company (or predecessor thereof) that is not a United States person, as defined in the Code, is a passive foreign investment company within the meaning of Section 1297 of the Code, and neither the Company nor any Subsidiary is a shareholder, directly or indirectly, in a passive foreign investment company, except, in each case, as is properly reflected in Tax Returns with respect to periods commencing on or after January 31, 2002. No Subsidiary of the Company (or any predecessor thereof) that is not a United States person as defined in the Code (x) is, or at any time has been, engaged in the conduct of a trade or business within the United States or treated as or considered to be so engaged and (y) has, or at any time has had, an investment in "United States property" within the meaning of Section 956(c) of the Code other than investments in United states property that are properly reflected in Tax Returns filed by the Company or its Subsidiaries. Neither the Company nor any Subsidiary is, or at any time has been, impacted by (A) the dual consolidated loss provisions of the Section 1503(d) of the Code, (B) the overall foreign loss provisions of Section 904(f) of the Code, or (C) the recharacterization provisions of Section 952(c)(2) of the Code, except for any such impacts that are properly reflected in Tax Returns filed by the Company or its Subsidiaries.

(b) (i) To the knowledge of the Company, the Company is not and has not been a United States real property holding corporation at any time during the applicable period specified in Code Section 897(c)(1)(A)(ii), (ii) to the knowledge of the Company, no interest in the stock in the Company constitutes a United States real property interest pursuant to Section 897(c) of the Code, and (iii) prior to Closing the Company will use commercially reasonable efforts to provide to Parent an affidavit satisfying the requirements of Treasury Regulation Section 1.1445-2(c)(3) in form and substance reasonably satisfactory to Parent.

(c) It is understood and agreed that the Company does not provide any representations or warranties under this Agreement regarding Taxes, except for those set forth in this *Section 4.11* or *Section 4.12*.

Section 4.12 *ERISA.*

(a) Section 4.12(a) of the Disclosure Letter sets forth a list identifying as of the date hereof (i) all Employee Benefit Plans and all bonus, stock option, stock purchase, incentive, deferred compensation, supplemental retirement, health, life, or disability insurance, dependent care, severance and other similar fringe or employee benefit plans or programs maintained or contributed to by the Company or any of its Subsidiaries for the benefit of or relating to any employee or former employee (each such plan or program, an "**Employee Plan**") and (ii) each Material Employment Agreement; provided, however, that there shall be no obligation to disclose on Section 4.12(a) of the Disclosure Letter any Employee Plan that is not material. The most recent copies of each material Employee Plan and Material Employment Agreement (and, if applicable, related trust agreements) and all amendments thereto have been made available to Parent and Merger Sub together with, to the extent applicable, (A) the two most recent annual reports (Form 5500 including applicable schedules and financial reports) or ERISA alternative compliance statements prepared in connection with any such Employee

Plan; (B) the most recent actuarial valuation report prepared in connection with any such Employee Plan; (C) the most recent summary plan description and any summaries of material modifications for each such Employee Plan and (D) the most recent favorable IRS determination letter for each Employee Plan that is intended to be qualified pursuant to Section 401(a) of the Code.

(b) Neither the Company nor any ERISA Affiliate sponsors, maintains, contributes to or has an obligation to contribute to, has sponsored, maintained, contributed to or been required to contribute to within the last five years, or has any liability (contingent or otherwise) with respect to a pension plan subject to Section 302 of ERISA, Title IV of ERISA or Section 412 of the Code. Neither the Company nor any ERISA Affiliate sponsors, maintains, contributes to or has an obligation to contribute to, has in the last five years sponsored, maintained, contributed to, or incurred an obligation to contribute to, or has any liability (contingent or otherwise) with respect to any multiemployer plan (as defined in Section 3(37) of ERISA) or any plan sponsored by more than one employer within the meaning of Sections 4063 or 4064 of ERISA or Section 413(c) of the Code. There does not now exist, nor do any circumstances exist that could reasonably be expected to result in, any Controlled Group Liability that would be a material liability of the Company or any of its Subsidiaries following the Closing.

(c) Each Employee Plan that is intended to be qualified under Section 401(a) of the Code has received a determination letter from the Internal Revenue Service to the effect that such Employee Plan is so qualified, and, to the knowledge of the Company, nothing has occurred since the date of the most recent Internal Revenue Service determination letters that could be reasonably expected to adversely affect the tax-qualified status of any Plan. Each Employee Plan has been maintained in material compliance with its terms and with the requirements prescribed by any and all statutes, orders, rules and regulations, including but not limited to ERISA and the Code, which are applicable to such Employee Plan. No prohibited transaction (as defined in Section 406 of ERISA and Section 4975 of the Code) has occurred in respect of any Employee Plan.

(d) There is no contract, agreement, plan or arrangement covering any employee or former employee of the Company or any of its Affiliates that, individually or collectively, could give rise to the payment of any amount that would not be deductible pursuant to the terms of Section 280G of the Code.

(e) No payment, accrual of additional benefits, acceleration of payments or vesting in any benefit under any Employee Plan or Material Employment Agreement will be caused by the Company's entering into this Agreement or by the consummation of the transactions contemplated by this Agreement (either alone or in combination with any other event).

(f) No Employee Plan that is a welfare benefit plan (within the meaning of Section 3(1) of ERISA) provides benefits to former employees of the Company, other than pursuant to Section 4980B of the Code or any similar state or local law.

Section 4.13 *Labor Matters.*

(a) There is no labor strike, dispute, slowdown, stoppage or lockout actually pending or, to the knowledge of the Company, threatened against or affecting the Company or any Subsidiary and since August 4, 2003 there has not been any such action.

(b) To the knowledge of the Company, no union claims to represent the employees of the Company or any Subsidiary. Neither the Company nor any Subsidiary is a party to or bound by any collective bargaining or similar agreement with any labor organization, or work rules or practices agreed to with any labor organization or employee association applicable to employees of the Company or any Subsidiary.

(c) None of the employees of the Company or any Subsidiary are represented by any labor organization and, to the Company's knowledge, there are no current union organizing activities among the employees of the Company or any Subsidiary.

(d) From the Balance Sheet Date, except as has not had, and would not reasonably be expected to have, a Material Adverse Effect on the Company, there is no unfair labor practice charge or complaint against the Company or any Subsidiary pending or, to the knowledge of the Company, threatened before the National Labor Relations Board or any similar state or foreign agency.

Section 4.14 *Compliance with Laws.*

(a) The Company and each of its Subsidiaries is, and at all times since the Balance Sheet Date has been, in compliance in all material respects with all material Laws applicable to the Company, its Subsidiaries and their respective businesses and activities.

(b) The Company and each Company Subsidiary has and maintains in full force and effect, and is in compliance with, all Permits necessary for the Company and each Subsidiary to carry on their respective businesses as currently conducted and currently proposed to be conducted, except as would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect on the Company.

Section 4.15 *Finders' Fees.* There is no investment banker, broker, finder or other intermediary that has been retained by or is authorized to act on behalf of the Company or any of its Subsidiaries or Affiliates and that might be entitled to any fee or commission from the Company or any of its Affiliates in connection with the transactions contemplated by this Agreement (other than based on arrangements made by Parent or Merger Sub or any of their respective Affiliates). The Company has provided true and complete copies of all engagement letters or other agreements providing for the payment of the fees and commissions described in Section 4.15 of the Disclosure Letter, and no such letters or agreements have been amended or superseded.

Section 4.16 *Environmental Matters.* Except as would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect on the Company:

(a) the Company is and has at all times been in compliance in all material respects with all Environmental Laws;

(b) there has been no Release of Hazardous Substances at any real property that is or was owned or operated by the Company during the period of such ownership or operation;

(c) no notice, demand, request for information, citation, summons, complaint, order, consent decree, or settlement has been received or entered into by, or to the knowledge of the Company is pending or threatened by any Person against, the Company or any of its Subsidiaries nor has any penalty been assessed against the Company or any such Subsidiary with respect to any alleged violation of any Environmental Law;

(d) neither the Company nor any of its Subsidiaries has disposed or arranged for the disposal of any Hazardous Substances that has resulted in or reasonably may be expected to result in the Company or any Subsidiary having or incurring any liability under any Environmental Law;

(e) to the Company's knowledge, no underground tanks or Hazardous Substances are or have been located on real property that is owned or operated by the Company or any of its Subsidiaries nor has the Company or any of its Subsidiaries ever operated an underground tank or used, handled or stored Hazardous Substances except for products and materials held as inventory (and of a nature customarily held by sporting goods stores) and for generally accepted cleaning agents in typical quantities;

(f) there has been no material written report of any environmental investigation, study, audit, test, review or other analysis conducted of which the Company or any of its Subsidiaries has knowledge and has in its possession or control relating to the business of the Company or such Subsidiary or any real property that is owned or operated by the Company or such Subsidiary that has not been disclosed and made available to Parent and Merger Sub; and

(g) to the Company's knowledge, neither the Company nor any of its Subsidiaries has agreed to assume, undertake or provide indemnification for any liability of any other Person under any Environmental Law, including any obligation for corrective or remedial action.

Section 4.17 *Suppliers and Relationships.* Set forth in Section 4.17 of the Disclosure Letter is a list of the twenty largest merchandise vendors of the Company and its Subsidiaries based on the dollar value of materials or products purchased by the Company and its Subsidiaries for the fiscal year ended January 29, 2005. Since the Balance Sheet Date, there has not been, and the Company has not received any notice of or threatening, any material change in relations with any of the major suppliers of the Company or its Subsidiaries, the result of which would be material to the Company and its Subsidiaries taken as a whole.

Section 4.18 *Contracts.*

(a) Section 4.18 of the Disclosure Letter contains a complete and accurate list, as of the date hereof, of all Contracts (as hereinafter defined) that are material Contracts within the meaning of Item 601 of Regulation S-K promulgated under the Securities Act or Contracts that the Company's management considers material to the Company and its Subsidiaries, taken as a whole ("**Material Contracts**"). All of the Material Contracts are in full force and effect, except as would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect on the Company. As used herein, "**Contracts**" means contracts, undertakings, commitments or agreements (other than contracts, undertakings, commitments or agreements for employee benefit matters set forth in Section 4.12(a) of the Disclosure Letter and real property leases set forth in Section 4.20(c) of the Disclosure Letter and any vendor contracts entered into in the ordinary course of business).

(b) True and complete copies of all written Material Contracts have been either (i) filed as exhibits to the Company's annual report on Form 10-K for the fiscal year ended January 29, 2005 or (ii) delivered or made available to Parent and Merger Sub. Each such Material Contract is a valid and binding obligation of the Company (or the Subsidiaries party thereto) and enforceable against the Company and its Subsidiaries and, to the Company's knowledge, the other parties thereto in accordance with its terms, except as enforcement may be limited by bankruptcy, insolvency, moratorium, reorganization, arrangement or similar laws affecting creditors' rights generally and by general principles of equity, except as would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect on the Company.

(c) As of the date hereof, neither the Company nor any of its Subsidiaries is, nor to the knowledge of the Company is any other party, in material breach, default or violation (and no event has occurred or not occurred through the Company's action or inaction or, to the knowledge of the Company, through the action or inaction of any third parties, which with notice or the lapse of time or both could constitute a breach, default or violation) of any term, condition or provision of any Material Contract to which the Company or any of its Subsidiaries is now a party or by which any of them or any of their respective properties or assets may be bound, except as would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect on the Company.

(d) With respect to each of the Company Joint Ventures, all agreements to which the Company or any of its Subsidiaries is a party that contain (i) any change of control provisions, put options or call options related to the interests in such Company Joint Venture, (ii) any rights of first refusal or other similar provisions or (iii) any provisions that are reasonably likely to alter the Company's rights with

respect to such Company Joint Venture following consummation of the Merger and other transactions contemplated hereby, in each case, have been disclosed in Section 4.6(a) of the Disclosure Letter and true, correct and complete copies (or descriptions of oral agreements, if any) of such agreements have been made available to Parent and Merger Sub. No Company Joint Venture has any material liability for which the Company or any of its Subsidiaries may be held liable.

Section 4.19 *Intellectual Property.* Section 4.19 of the Disclosure Letter sets forth the material Intellectual Property of the Company and its Subsidiaries that have been registered with any Governmental Authority (or as to which there are pending applications for registration). With respect to Intellectual Property that is used in the conduct of the business of the Company or any of its Significant Subsidiaries, except as would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect on the Company:

(a) the Company and its Subsidiaries own or have a valid right to use all of their material Intellectual Property free and clear of all material Liens (other than Permitted Liens), and there are no agreements or arrangements by which any such Intellectual Property has been licensed to any third parties;

(b) to the Company's knowledge, no third party is materially infringing the Company's Intellectual Property, the Company and its Subsidiaries are not materially infringing any Intellectual Property of a third party, and the Company and its Subsidiaries are not in default (or with the giving of time or lapse of notice would be in default) on any material license to use their Intellectual Property; and

(c) no material claim has been asserted against the Company or any of its Subsidiaries and is pending by any Person challenging the ownership or use by the Company or any of its Subsidiaries of their Intellectual Property, and the Company and its Subsidiaries have not asserted any material claims against any third parties challenging the use by third parties of their Intellectual Property.

Section 4.20 *Assets and Property.*

(a) The Company and its Subsidiaries have good and valid title to or a valid leasehold estate, free and clear of any Liens (other than Permitted Liens), in all real property and personal properties and assets reflected on the Balance Sheet at the Balance Sheet Date or acquired after the Balance Sheet Date (except for properties or assets subsequently sold, including real property leases that are subsequently terminated, in the ordinary course of business).

(b) Section 4.20(b) of the Disclosure Letter sets forth a true, correct and complete list of all real property owned in fee simple by the Company or any of its Subsidiaries (collectively, the "**Owned Real Property**"). With respect to each such parcel of Owned Real Property: (i) there are no leases, subleases, licenses, concessions or other agreements, written or oral, granting to any person the right of use or occupancy of any portion of such parcel other than the Leases (as defined below); and (ii) there are no outstanding rights of first refusal or options to purchase such parcel.

(c) Section 4.20(c) of the Disclosure Letter sets forth a true, correct and complete list of all of the leases and subleases (the "**Leases**") and each leased and subleased parcel of real property in which the Company or any of its Subsidiaries is a tenant, subtenant, landlord or sublandlord (collectively, the "**Leased Real Property**") and for each Lease indicates: (i) its term and any options to extend the term; and (ii) other than in respect of subleases, closed stores and non-store properties, the current rent payable (including all occupancy costs other than utilities). The Company (either directly or through a Subsidiary) holds a valid and existing leasehold or subleasehold interest or landlord or sublandlord interest as applicable in the Leased Real Property, under each of the Leases listed in Section 4.20(c) of the Disclosure Letter. The Company has delivered or made available to Parent and Merger Sub true, correct and complete copies of each of the Leases, including, without limitation, all material amendments, modifications, side agreements, consents, subordination agreements and guarantees. Except as would not, individually or in the aggregate, reasonably be expected to have a Material

Adverse Effect on the Company: (A) each Lease is legal, valid, binding, enforceable and in full force and effect; (B) each Lease will continue to be legal, valid, binding, enforceable and in full force and effect on the same terms and conditions following the Effective Time; (C) neither the Company (or its applicable Subsidiary), nor, to the Company's knowledge, any other party to any Lease, has received written notice of a material breach or default under any Lease, and to the Company's knowledge, no event has occurred that, with notice or lapse of time, would constitute a breach or material default by the Company (or such Subsidiary) or permit termination, modification or acceleration under any Lease by any other party thereto; (D) there are no material disputes, oral agreements or rent forbearance programs in effect as to any Lease; (E) the Company has not assigned, transferred, conveyed, mortgaged, deeded in trust or encumbered any interest in any Lease; (F) no Lease has been modified in any material respect, except to the extent that such modifications are set forth in the documents previously delivered or made available to Parent and Merger Sub; and (G) each guaranty by the Company or any of its Subsidiaries is in full force and effect and no default has occurred thereunder.

(d) The Owned Real Property and the Leased Real Property are referred to collectively herein as the "**Real Property**." To the knowledge of the Company, each parcel of Real Property is in material compliance with all existing material Laws applicable to such Real Property. Except as would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect on the Company, (i) the Company has not received written notice of any proceedings in eminent domain, condemnation or other similar proceedings that are pending, and, to the Company's knowledge, there are no such proceedings threatened, affecting any portion of the Real Property and (ii) the Company has not received written notice of the existence of any outstanding writ, injunction, decree, order or judgment or of any pending proceeding, and, to the Company's knowledge, there is no such writ, injunction, decree, order, judgment or proceeding threatened, relating to the ownership, lease, use, occupancy or operation by any person of the Real Property.

(e) To the knowledge of the Company, there are no violations of any covenants, conditions, restrictions, easements, agreements or orders of any Governmental Authority having jurisdiction over any of the Real Property that affect such Real Property or the use or occupancy thereof other than those that do not, individually or in the aggregate, constitute a Material Adverse Effect on the Company.

Section 4.21 *Insurance.* Each of the Company and its Subsidiaries maintains insurance policies (the "**Insurance Policies**") against all risks of a character and in such amounts as are usually insured against by similarly situated companies in the same or similar businesses. Except as would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect on the Company, (i) each Insurance Policy is in full force and effect and all premiums due thereon have been paid in full; (ii) none of the Insurance Policies will terminate or lapse (or be affected in any other materially adverse manner) by reason of the transactions contemplated by this Agreement; (iii) each of the Company and its Subsidiaries has complied in all material respects with the provisions of each Insurance Policy under which it is the insured party; and (iv) no insurer under any Insurance Policy has canceled or generally disclaimed liability under any such policy and all material claims for which coverage is provided under the Insurance Policies have been filed in a timely fashion.

**ARTICLE V**
**REPRESENTATIONS AND WARRANTIES**
**OF PARENT AND MERGER SUB**

Parent and Merger Sub hereby jointly and severally represent and warrant to the Company that:

Section 5.1. *Corporate Existence and Power.* Each of Parent and Merger Sub is a corporation duly organized, validly existing and in good standing under the laws of the State of Delaware and has all corporate powers and authority required to execute and deliver this Agreement and to consummate

the Merger and the other transactions contemplated hereby and to perform each of its obligations hereunder. Since their respective dates of organization, neither Parent or Merger Sub has engaged in any activities other than in connection with or as contemplated by this Agreement or in connection with arranging the Financing.

Section 5.2 *Corporate Authorization.* The execution, delivery and performance by Parent and Merger Sub of this Agreement and the consummation by Parent and Merger Sub of the transactions contemplated hereby have been duly authorized by all necessary Parent and Merger Sub corporate and shareholder action. This Agreement has been duly and validly executed and delivered by Parent and Merger Sub and, assuming the due and valid execution and delivery of the Agreement by the Company, constitutes a valid and binding agreement of Parent and Merger Sub, respectively, enforceable against Parent and Merger Sub except (i) as rights to indemnity hereunder may be limited by federal or state securities laws or the public policies embodied therein, (ii) as such enforceability may be limited by bankruptcy, insolvency, moratorium, reorganization or similar laws affecting the enforcement of creditors' rights generally, and (iii) as the remedy of specific performance and other forms of injunctive relief may be subject to equitable defenses and to the discretion of the court before which any proceeding therefor may be brought.

Section 5.3 *Governmental Authorization.* The execution, delivery and performance by Parent and Merger Sub of this Agreement and the consummation by Parent and Merger Sub of the transactions contemplated by this Agreement will not require any action by Parent or Merger Sub in respect of, or filing by Parent or Merger Sub with, any Governmental Authority other than (a) the filing of the Certificate of Merger as provided in *Section 2.1(b)*, (b) compliance with any applicable requirements of the HSR Act and any applicable Other Antitrust Law and any other Law specified in Section 4.3 of the Disclosure Letter; (c) compliance with the applicable requirements of the Exchange Act; (d) compliance with the applicable requirements of the Securities Act; (e) compliance with any applicable foreign or state securities or Blue Sky laws; and (f) such other items the failure of which to do or be obtained would not reasonably be expected to adversely effect in any material respect, or materially delay, Parent's and Merger Sub's ability to observe and perform their respective obligations hereunder.

Section 5.4 *Non-Contravention.* The execution, delivery and performance by Parent and Merger Sub of this Agreement and the consummation by Parent and Merger Sub of the transactions contemplated hereby do not and will not (a) contravene or conflict with the organizational or governing documents of Parent or Merger Sub, (b) assuming compliance with the items specified in *Section 5.3*, contravene, conflict with or constitute a violation of any provision of Law binding upon Parent or Merger Sub, or (c) constitute a default under or give rise to any right of termination, cancellation or acceleration of any right or obligation of Parent or Merger Sub or to a loss of any material benefit to which Parent or Merger Sub is entitled under any agreement, contract or other instrument.

Section 5.5 *Disclosure Documents.* None of the information supplied or to be supplied by Parent or Merger Sub specifically for inclusion in the Company Proxy Statement or Schedule 13E-3 will, (a) at the date it is first mailed to shareholders of the Company (in the case of the Company Proxy Statement) or (b) at the time of the Company Shareholder Meeting, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they are made, not misleading; *provided, however*, that this representation and warranty shall not apply to any information so provided by Parent or Merger Sub that subsequently changes or becomes incomplete or incorrect to the extent such changes or failure to be complete or correct are promptly disclosed to the Company and to the further extent that Parent and Merger Sub reasonably cooperate with the Company in preparing, filing or disseminating updated information to the extent required by Law.

Section 5.6 *Finders' Fees.* There is no investment banker, broker, finder or other intermediary who is entitled to any fee or commission from the Company in connection with the transactions contemplated by this Agreement based on any arrangements made by Parent or Merger Sub or any of their respective Affiliates.

Section 5.7 *Financing.* Parent and Merger Sub have delivered to the Company financing letters from the following Persons: Green Equity Investors IV, L.P. (the "**GEI IV Letter**"), Banc of America Securities LLC and Bank of America, N.A. and TCW/Crescent Mezzanine Management III, LLC and TCW/Crescent Mezzanine Management IV, LLC (collectively, the "**Financing Letters**"), which together reflect commitments from such equity investors and financial institutions, in each case subject to the conditions set forth in the respective Financing Letters, sufficient to pay the full Merger Consideration (and all other cash amounts payable pursuant hereto), and all of the related fees and expenses payable by Parent or Merger Sub (or, after the Closing, the Surviving Corporation) in connection with the Merger (the funds necessary to pay the foregoing amounts, the "**Financing**"). Such Financing Letters are in full force and effect and the parties thereto have not withdrawn or indicated an intent to withdraw the commitments made therein. Notwithstanding anything in this Agreement to the contrary, one or more Financing Letters may be superseded at the option of Parent and Merger Sub after the date hereof but prior to the Effective Time by instruments (the "**New Financing Letters**") which replace existing Financing Letters and/or contemplate co-investment by or financing from one or more other or additional parties; *provided*, that the terms of the New Financing Letters shall not (a) expand upon the conditions precedent to the Financing as set forth in the Financing Letters in any respect that would make such conditions less likely to be satisfied, (b) reasonably be expected to delay the Closing or (c) otherwise have an adverse impact on the Company at any time that is prior to the Closing. In such event, the term "**Financing Letters**" as used herein shall be deemed to include the Financing Letters that are not so superseded at the time in question and the New Financing Letters to the extent then in effect. There are no conditions precedent or other contingencies related to the funding of the Financing other than as set forth or referred to in the Financing Letters.

Section 5.8 *No Other Information.* Parent and Merger Sub acknowledge that the Company makes no representations or warranties as to any matter whatsoever except as expressly set forth in this Agreement, and specifically (but without limitation) that the Company makes no representation or warranty with respect to any projections, estimates or budgets delivered to or made available to Parent and Merger Sub or to any of their respective Affiliates or any representatives of future revenues, future results of operations (or any component thereof), future cash flows or future financial condition (or any component thereof) of the Company and its Subsidiaries or of the future business and operations of the Company and its Subsidiaries.

Section 5.9 *Interest in Competitors.* Neither Parent nor Merger Sub owns any interest(s) (nor do any of their respective Affiliates insofar as such Affiliate-owned interests would be attributed to Parent or Merger Sub under the HSR Act) in any entity or Person that derives a substantial portion of its revenues from a line of business within the Company's principal lines of business.

Section 5.10. *Ownership of Common Shares.* On the date hereof, neither Parent nor Merger Sub owns any shares of Common Stock of the Company.

Section 5.11. *Solvency of the Company Following Completion of the Merger.* As of the date hereof, to the knowledge of Parent and Merger Sub, immediately following the Effective Time and after giving effect to the Merger and the other transactions contemplated hereby, the Company and each of its Subsidiaries will not (i) be insolvent (either because of its financial condition is such that the sum of its debts is greater than the fair market value of its assets or because the fair saleable value of its assets is less than the amount required to pay its probable liability on its existing debts as they mature), (ii) have unreasonably small capital with which to engage in its business or (iii) have incurred debts beyond its ability to pay as they become due.

Section 5.12. *Management Agreements.* Other than (i) the Contribution and Exchange Agreements, (ii) the stockholders agreement among Parent and the Contributing Holders and (iii) those certain amendments to the Contributing Holders' respective Employment Agreements entered into by the Contributing Holders and Merger Sub in connection with the Contribution and Exchange Agreements, there are no Contracts between Parent and/or Merger Sub, on the one hand, and members of the Company's management on the other hand. None of the foregoing agreements requires any material performance or forbearance by the Contributing Holders prior to the Effective Time.

**ARTICLE VI**
**COVENANTS OF THE COMPANY**

Section 6.1 *Conduct of the Company and Subsidiaries.* Except for matters set forth in Section 6.1 of the Disclosure Letter or as otherwise contemplated by or specifically provided in this Agreement, without the prior written consent of Parent and Merger Sub (which consent shall not be unreasonably withheld, conditioned or delayed), from the date hereof to the Effective Time, the Company shall, and shall cause its Subsidiaries to, conduct their respective businesses in the ordinary and usual course consistent with past practice, and shall use its reasonable best efforts (with the reasonable cooperation of Parent and Merger Sub and their Affiliates) to (i) preserve intact its and its Subsidiaries' present business organization and capital structure; (ii) maintain in effect all material Permits that are required for the Company or its Subsidiaries to carry on their respective businesses; (iii) keep available the services of present officers and key employees (as a group); and (iv) maintain the current relationships with its lenders, suppliers and other Persons with which the Company or its Subsidiaries have significant business relationships. Without limiting the generality of the foregoing, and except for matters set forth in Section 6.1 of the Disclosure Letter or as expressly contemplated or permitted by this Agreement, without the prior written consent of Parent and Merger Sub (which consent shall not be unreasonably withheld, conditioned or delayed), the Company shall not, and shall not permit its Subsidiaries to (except, in each case, for transactions solely among the Company and its wholly-owned Subsidiaries or among the Company's wholly-owned Subsidiaries):

(a) (i) enter into any new line of business or discontinue any line of business or (ii) propose or adopt any change in its organizational or governing documents (other than with respect to Company Subsidiaries that are not Significant Subsidiaries);

(b) merge or consolidate the Company or any of its Subsidiaries with any Person;

(c) sell, lease or otherwise dispose of a material amount of assets (other than the sale of inventory or the closing of stores in the ordinary course of business) or securities;

(d) (i) other than in connection with intercompany transactions, incur any third-party indebtedness for borrowed money or guarantee such indebtedness of another Person, except for borrowings under the Company's and its Subsidiaries' existing revolving lines of credit incurred in the ordinary course of business repayable within 180 days without penalty; (ii) make any loans, advances or capital contributions to, or investments in, any other Person, except in the ordinary course of business consistent with past practice or as required by existing contracts set forth in Section 6.1(d) of the Disclosure Letter; (iii) authorize any capital expenditures in excess of $5,000,000 in the aggregate in excess of the capital expenditures set forth in the Company's 2005 and 2006 budget forecasts;

(e) pledge or otherwise encumber shares of capital stock or other voting securities of the Company or any of its Subsidiaries;

(f) mortgage or pledge any of its material assets, tangible or intangible, or create any material Lien thereupon (other than Permitted Liens);

(g) enter into any Contract other than in the ordinary course of business that would be material to the Company and its Subsidiaries, taken as a whole;

(h) amend, modify or waive in any material respect any material right under any existing Material Contract, except in the ordinary course of business;

(i) (i) split, combine or reclassify any Company Securities or amend the terms of any Company Securities, (ii) declare, set aside or pay any dividend or other distribution (whether in cash, stock or property or any combination thereof) in respect of Company Securities other than a dividend or distribution by a wholly owned Subsidiary of the Company to its parent corporation in the ordinary course of business, or (iii) issue or offer to issue any Company Securities, or redeem, repurchase or otherwise acquire or offer to redeem, repurchase, or otherwise acquire, any Company Securities, other than in connection with (x) the exercise of Company Options outstanding on the date hereof in accordance with their original terms or as set forth on Section 6.1(i)(iii) of the Disclosure Letter or (y) the withholding of Company Securities to satisfy tax obligations with respect to Company Options or Company Restricted Shares;

(j) except (x) as required pursuant to existing written agreements or Employee Plans in effect on the date hereof, in each case, that are set forth in Section 4.12(a) of the Disclosure Letter, (y) as specifically permitted by the terms of this Agreement or (z) as otherwise required by Law, (i) enter into any Material Employment Agreement (except for entry into a Material Employment Agreement with respect to promotions of current employees or to the extent necessary to replace a departing employee or to fill an existing vacancy), (ii) adopt or amend any bonus, profit sharing, compensation, severance, termination, stock option, pension, retirement, deferred compensation, employment or employee benefit plan in a manner that materially increases the cost to the Company or (iii) materially increase in any manner the compensation or fringe benefits of any director, officer or any class of employee, except in the ordinary course of business consistent with past practice (it being understood that (1) the normal salary and bonus review process conducted each year and any resulting increases and (2) bonus payments for fiscal year 2005 shall, in each case, be permitted hereunder);

(k) except as required by applicable Law or GAAP or in the ordinary course of business, revalue in any material respect any of its assets, including writing down the value of inventory in any material manner or writing-off notes or accounts receivable in any material manner;

(l) pay, discharge or satisfy any material claims, liabilities or obligations (whether absolute, accrued, asserted or unasserted, contingent or otherwise), except (i) as required by Law or existing Contract or (ii) in the ordinary course for an amount less than $1,000,000 individually excluding any amounts which may be paid under existing Insurance Policies;

(m) (i) make, change or rescind any express or deemed material election relating to Taxes (other than in the ordinary course of business, as required by applicable Law, or as is consistent with past practice), (ii) take any position or adopt any tax accounting method that is inconsistent with methods used in preparing or filing Tax Returns for similar Taxes in prior periods, other than with respect to such items that, in the aggregate, are not material or such actions that are required by Law, (iii) settle or compromise any material Tax liability for an amount in excess of the amount currently reserved in the books and records of the Company for such Tax liability, (iv) enter into any closing or other agreement with respect to any material Tax liability with any Tax authority for an amount in excess of the amount currently reserved in the books and records of the Company for such Tax liability, (v) file or cause to be filed any material amended Tax Return (except as required by applicable Law or as is consistent with past practice), (vi) file or cause to be filed a material claim for refund of Taxes previously paid (except as required by applicable Law or as is consistent with past practice), (vii) agree to an extension of a statute of limitations with respect to the assessment or determination of material Taxes, or (viii) grant any power of attorney with respect to material Taxes;

(n) make any change in financial accounting methods, principles or practices materially affecting the reported consolidated assets, liabilities or results of operations of the Company and its Subsidiaries, except insofar as may have been required by a change in GAAP or Law (including, without limitation, Regulation S-X of the Exchange Act) and after consulting with the Company's outside accountants;

(o) adopt a plan of complete or partial liquidation, dissolution, merger, consolidation, restructuring, recapitalization or other reorganization of the Company or any of its Subsidiaries (other than the Merger and other than in respect of Company Subsidiaries that are not Significant Subsidiaries);

(p) alter the corporate structure of ownership of any Significant Subsidiary, through merger, liquidation, reorganization, restructuring or any other fashion;

(q) settle, pay or discharge, any litigation, investigation, arbitration, proceeding or other claim, liability or obligation except in the ordinary course for an amount less than $1,000,000 individually excluding any amounts which may be paid under existing Insurance Policies; or

(r) authorize, agree or commit to do any of the foregoing.

Section 6.2 *Stockholder Meeting; Proxy Material.*

(a) The Company shall duly call and hold a meeting of its shareholders (the "**Company Shareholder Meeting**") for the purpose of obtaining the approval of this Agreement and the Merger by the Company shareholders in accordance with applicable Law as promptly as reasonably practicable after the SEC clears the Company Proxy Statement and the Schedule 13E-3. In connection with the Company Shareholder Meeting, the Company will (i) as promptly as reasonably practicable prepare and file with the SEC the Company Proxy Statement relating to the Merger and the other transactions contemplated hereby, (ii) respond as promptly as reasonably practicable to any comments received from the SEC with respect to such filings and will provide copies of such comments to Parent and Merger Sub promptly upon receipt, (iii) as promptly as reasonably practicable prepare and file (after Parent and Merger Sub have had a reasonable opportunity to review and comment on) any amendments or supplements necessary to be filed in response to any SEC comments or as required by Law, (iv) use its reasonable best efforts to have cleared by the SEC and will thereafter mail to its shareholders as promptly as reasonably practicable, the Company Proxy Statement and all other customary proxy or other materials for meetings such as the Company Shareholder Meeting, (v) to the extent required by applicable Law, as promptly as reasonably practicable prepare, file and distribute to the Company shareholders (in the case of the Company Proxy Statement) any supplement or amendment to the Company Proxy Statement if any event shall occur which requires such action at any time prior to the Company Shareholder Meeting, and (vi) otherwise use commercially reasonable efforts to comply with all requirements of Law applicable to the Company Shareholder Meeting and the Merger. Parent and Merger Sub shall cooperate with the Company in connection with the preparation and filing of the Company Proxy Statement, including furnishing the Company upon request with any and all information as may be required to be set forth in the Company Proxy Statement under the Exchange Act. The Company will provide Parent and Merger Sub a reasonable opportunity to review and comment upon the Company Proxy Statement, or any amendments or supplements thereto, prior to filing the same with the SEC. In connection with the filing of the Company Proxy Statement, the Company and Parent and Merger Sub will cooperate to (i) concurrently with the preparation and filing of the Company Proxy Statement, jointly prepare and file with the SEC the Schedule 13E-3 relating to the Merger and the other transactions contemplated hereby and furnish to each other all information concerning such party as may be reasonably requested in connection with the preparation of the Schedule 13E-3, (ii) respond as promptly as reasonably practicable to any comments received from the SEC with respect to such filings and will consult with each other prior to providing such response, (iii) as promptly as reasonable practicable after consulting with each other, prepare and file any amendments or supplements necessary to be filed in response to any SEC

comments or as required by Law, (iv) to have cleared by the SEC the Schedule 13E-3 and (v) to the extent required by applicable Law, as promptly as reasonably practicable prepare, file and distribute to the Company stockholders any supplement or amendment to the Schedule 13E-3 if any event shall occur which requires such action at any time prior to the Stockholders Meeting.

(b) Subject to *Section 6.4*, the Company Proxy Statement will contain the recommendation of the Board of Directors of the Company that the shareholders of the Company adopt this Agreement and the Merger (the "**Recommendation**") and the Company shall use reasonable best efforts to solicit the adoption and approval of this Agreement by the Company stockholders.

Section 6.3 *Access to Information; Cooperation in Financing.*

(a) Subject to applicable Law, the Company will provide and will cause its Subsidiaries and its and their respective Representatives to provide Parent and Merger Sub and their respective authorized representatives, during normal business hours and upon reasonable advance notice (i) such access to the offices, properties, books and records of the Company and such Subsidiaries (so long as such access does not unreasonably interfere with the operations of the Company) as Parent or Merger Sub reasonably may request and (ii) all documents that Parent or Merger Sub reasonably may request. Notwithstanding the foregoing, Parent, Merger Sub and their representatives shall not have access to any books, records and other information the disclosure of which would, in the Company's good faith opinion after consultation with legal counsel, result in the loss of attorney-client privilege with respect to such books, records and other information.

(b) The Company will and will cause its Subsidiaries to and will request their respective representatives to reasonably cooperate with Parent, Merger Sub and their authorized representatives in connection with the arrangement of the Financing, including (i) participation in meetings, (ii) furnishing information (including any financial statements) required to be included in the preparation of offering memoranda, private placement memoranda, prospectuses and similar documents and (iii) cooperation in respect of the preparation of any underwriting or placement agreements, pledge and security documents, other definitive financing documents, including a certificate of the chief financial officer of the Company with respect to solvency matters, comfort letters of accountants and legal opinions as reasonably may be requested by Parent or Merger Sub; *provided*, that any information provided to Parent or Merger Sub pursuant to this *Section 6.3* shall be subject to the Confidentiality Agreement; and *provided, further*, that the Company shall not be required to incur any significant expenses or become subject to any significant obligations relating to such activities prior to the Closing.

Section 6.4 *Solicitation.*

(a) During the period beginning on the date of this Agreement and continuing until 12:01 a.m. (EST) on the 21st day after the date of this Agreement (the "**Exclusivity Period Start Date**"), the Company and its Subsidiaries and their respective officers, directors, employees, agents, advisors, affiliates and other representatives (such Persons, together with the Subsidiaries of the Company, collectively, the "**Company Representatives**") shall have the right (acting under the direction of the Special Committee) to: (i) initiate, solicit and encourage Company Acquisition Proposals (as hereinafter defined), including by way of providing access to non-public information pursuant to (but only pursuant to) one or more Acceptable Confidentiality Agreements (as hereinafter defined); *provided* that the Company shall promptly provide to Parent and Merger Sub any material non-public information concerning the Company or its Subsidiaries that is provided to any Person given such access which was not previously provided to Parent and Merger Sub; and (ii) enter into and maintain or continue discussions or negotiations with respect to Company Acquisition Proposals or otherwise cooperate with or assist or participate in, or facilitate any such inquiries, proposals, discussions or negotiations.

(b) Subject to *Section 6.4(c)*, and except as may relate to any Person or group of related Persons from whom the Company has received, after the date hereof and prior to the Exclusivity Period Start

Date, a written indication of interest that the Board of Directors of the Company (acting through the Special Committee if such committee still exists) believes in good faith is bona fide and could reasonably be expected to result in a Superior Proposal (as hereinafter defined) (each such Person or group, an "**Excluded Party**"), from the Exclusivity Period Start Date until the Effective Time or, if earlier, the termination of this Agreement in accordance with Article X, the Company shall not, and shall not direct, authorize or permit any of the Company Representatives, and shall be responsible for noncompliance with the following provisions by any of the foregoing, to, directly or indirectly, (A) initiate, solicit or encourage (including by way of providing information) the submission of any inquiries, proposals or offers or any other efforts or attempts that constitute or may reasonably be expected to lead to, any Company Acquisition Proposal or engage in any discussions or negotiations with respect thereto or otherwise cooperate with or assist or participate in, or facilitate any such inquiries, proposals, discussions or negotiations or (B) accept a Company Acquisition Proposal or enter into any agreement or agreement in principle (other than an Acceptable Confidentiality Agreement) providing for or relating to a Company Acquisition Proposal or enter into any agreement or agreement in principle requiring the Company to abandon, terminate or fail to consummate the transactions contemplated hereby or breach its obligations hereunder. Subject to *Section 6.4(c)* and except as may relate to an Excluded Party, on the Exclusivity Period Start Date the Company shall immediately cease and cause to be terminated any existing solicitation, encouragement, discussion or negotiation with any Persons conducted theretofore by the Company or any Company Representatives with respect to any Company Acquisition Proposal. Notwithstanding anything to the contrary contained herein, the Company (A) shall not, and shall not permit any of the Company Representatives to, provide any non-public information to any Excluded Party without first entering into an Acceptable Confidentiality Agreement and (B) will promptly provide to Parent and Merger Sub any material non-public information concerning the Company or its Subsidiaries provided to any Excluded Party which was not previously provided to Parent and Merger Sub.

(c) Notwithstanding anything to the contrary contained in *Section 6.4(b)*, if at any time prior to obtaining Company Stockholder Approval, (i) the Company has otherwise complied with its obligations under this *Section 6.4* and the Company has received a written Company Acquisition Proposal from a third party that the Board of Directors of the Company (acting through the Special Committee if such committee still exists) believes in good faith to be bona fide, (ii) the Board of Directors of the Company (acting through the Special Committee if such committee still exists) determines in good faith, after consultation with its independent financial advisors and outside counsel, that such Company Acquisition Proposal constitutes or could reasonably be expected to result in a Superior Proposal and (iii) after consultation with its outside counsel, the Board of Directors of the Company (acting through the Special Committee if such committee still exists) determines in good faith that the failure to take such action would be inconsistent with its fiduciary duties under applicable Law, then the Company may (x) furnish information with respect to the Company and its Subsidiaries to the Person making such Company Acquisition Proposal and (y) participate in discussions or negotiations with the Person making such Company Acquisition Proposal regarding such Company Acquisition Proposal; *provided*, that the Company (A) will not, and will not allow Company Representatives to, disclose any non-public information to such Person without entering into an Acceptable Confidentiality Agreement, (B) will promptly provide to Parent and Merger Sub any material non-public information concerning the Company or its Subsidiaries provided to such other Person which was not previously provided to Parent and Merger Sub and (C) will promptly notify Parent and Merger Sub in the event it receives such Company Acquisition Proposal, including the material terms and conditions thereof and the identity of the party making such proposal or inquiry, and shall keep Parent and Merger Sub reasonably informed as to the status and any material developments concerning the same, including furnishing copies of any such written inquiries, correspondence, draft documentation and written summaries of any material oral inquiries or discussions. Nothing contained in this *Section 6.4(c)* shall prohibit the Company or the Board of Directors of the Company (in each case, acting through the Special Committee if such

committee still exists) from taking and disclosing to the Company's stockholders a position with respect to a tender or exchange offer by a third party pursuant to Rules 14d-9 and 14e-2(a) promulgated under the Exchange Act or from making any other disclosure required by applicable Law.

(d) Neither the Board of Directors of the Company nor any committee thereof shall directly or indirectly (i) (A) withdraw (or modify in a manner adverse to Parent or Merger Sub), or publicly propose to withdraw (or modify in a manner adverse to Parent or Merger Sub), the approval, recommendation or declaration of advisability by such Board of Directors or any such committee thereof of this Agreement, or the Merger or the other transactions contemplated by this Agreement or (B) recommend, adopt or approve, or propose publicly to recommend, adopt or approve, any alternative Company Acquisition Proposal, including any Permitted Alternative Agreement (as hereinafter defined) (any action described in this *clause (i)* being referred to as an "**Adverse Recommendation Change**") or (ii) approve or recommend, or publicly propose to approve or recommend, or allow the Company or any of its Subsidiaries to execute or enter into, any letter of intent, memorandum of understanding, agreement in principle, merger agreement, acquisition agreement, option agreement, joint venture agreement, partnership agreement or other similar agreement constituting or related to, or that is intended to or could reasonably be expected to lead to, any Company Acquisition Proposal (other than an Acceptable Confidentiality Agreement and, to the extent a Company Acquisition Proposal involves the issuance of securities to stockholders of the Company, other than an appropriate confidentiality agreement that allows the Company to receive and review confidential information with respect to a proposed issuer of any such securities) (a "**Company Acquisition Agreement**"); *provided*, that the Company shall not be prohibited from terminating this Agreement and entering into a Permitted Alternative Agreement in accordance with *Section 10.1(e)*. Notwithstanding the foregoing, at any time prior to obtaining Company Stockholder Approval, the Board of Directors of the Company (acting through the Special Committee if such committee still exists) may make an Adverse Recommendation Change if such Board of Directors determines in good faith (after consultation with its independent financial advisors and outside counsel) that failure to take such action would be inconsistent with its fiduciary duties to the stockholders of the Company under applicable Law.

(e) From and after the date hereof, the Company shall provide notice promptly to Parent and Merger Sub of any resolution to take any of the actions described in this *Section 6.4* or to terminate this Agreement pursuant to *Section 10.1(e)*.

(f) As used in this Agreement, the term:

(i) "**Acceptable Confidentiality Agreement**" means a confidentiality and standstill agreement that contains provisions that are no less favorable in the aggregate to the Company than those contained in the Confidentiality Agreement; *provided, however*, that an Acceptable Confidentiality Agreement may include provisions that are less favorable to the Company than those contained in the Confidentiality Agreement so long as the Company offers to amend the Confidentiality Agreement, concurrently with execution of such Acceptable Confidentiality Agreement, to include substantially similar provisions for the benefit of LGP;

(ii) "**Company Acquisition Proposal**" means any inquiry, proposal or offer from any Person or group of Persons other than Parent, Merger Sub or their respective Affiliates relating to any direct or indirect acquisition or purchase of a business that constitutes 25% or more of the net revenues, net income or assets of the Company and its Subsidiaries, taken as a whole, or 25% or more of the outstanding Company Securities, any tender offer or exchange offer that if consummated would result in any Person or group of Persons beneficially owning 25% or more of the outstanding Company Securities, or any merger, reorganization, consolidation, share exchange, business combination, recapitalization, liquidation, dissolution or similar transaction involving the Company (or any Subsidiary or Subsidiaries of the Company whose business constitutes 25% or

more of the net revenues, net income or assets of the Company and its Subsidiaries, taken as a whole);

(iii) "**Superior Proposal**" means a Company Acquisition Proposal (but changing the references to "25% or more" in the definition of "Company Acquisition Proposal" to "50% or more") which the Board of Directors of the Company (acting through the Special Committee if it still exists) in good faith determines (based on such matters as it deems relevant, including the advice of its independent financial advisor and outside counsel), would, if consummated, result in a transaction that is more favorable from a financial point of view to the stockholders of the Company, (in their capacities as stockholders) than the transactions contemplated hereby.

**ARTICLE VII**
**COVENANTS OF PARENT AND MERGER SUB**

Section 7.1 *Voting of Shares.* Each of Parent and Merger Sub agree to vote all Common Shares beneficially owned by it, and to cause all Common Shares beneficially owned by any of their respective Affiliates that are (i) controlled by Parent or Merger Sub or (ii) members of the Company's Board of Directors to be voted, in favor of adoption of this Agreement at the Company Shareholder Meeting.

Section 7.2 *Director and Officer Liability.*

(a) The Surviving Corporation shall comply with all of the Company's and its respective Subsidiaries' obligations to indemnify and hold harmless (including any obligations to advance funds for expenses) (i) the present and former officers and directors thereof against any and all costs or expenses (including reasonable attorneys' fees and expenses), judgments, fines, losses, claims, damages, liabilities and amounts paid in settlement in connection with any actual or threatened claim, action, suit, proceeding or investigation, whether civil, criminal, administrative or investigative ("**Damages**"), arising out of, relating to or in connection with any acts or omissions occurring or alleged to occur prior to or at the Effective Time to the extent provided under the Company's or such Subsidiaries' respective organizational and governing documents or agreements in effect on the date hereof, including, without limitation, the adoption and approval of this Agreement, the Merger or the other transactions contemplated by this Agreement or arising out of or pertaining to the transactions contemplated by this Agreement; and (ii) such persons and any other present or former employee of the Company against any and all Damages arising out of acts or omissions in connection with such persons serving as an officer, director or other fiduciary in any entity if such service was at the request or for the benefit of the Company or any of its Subsidiaries. Such obligations shall survive the Merger and shall continue in full force and effect in accordance with the terms of the Surviving Corporation's articles of incorporation and bylaws from the Effective Time until the expiration of the applicable statue of limitations with respect to any claims against such directors or officers arising out of such acts or omissions. Any determination required to be made with respect to whether the conduct of an individual seeking indemnification has complied with the standards set forth under applicable Law shall be made by independent counsel mutually acceptable to the Surviving Corporation and such individual. For a period of six years after the Effective Time, the Surviving Corporation shall cause to be maintained in effect the current policies of officers' and directors' liability insurance maintained on the date hereof by the Company and its respective Subsidiaries (the "**Current Policies**"); *provided, however*, that the Surviving Corporation may, and in the event of the cancellation or termination of such policies shall, substitute therefor policies with reputable and financially sound carriers providing at least the same coverage and amount and containing terms and conditions that are no less favorable to the covered persons (the "**Replacement Policies**") in respect of claims arising from facts or events that existed or occurred prior to or at the Effective Time under the Current Policies; *provided, further, however*, that in no event will the Surviving Corporation be required to expend annually in excess of 300% of the annual premium currently paid by the Company under the Current Policies; *provided, further, however*,

that in lieu of the foregoing insurance coverage, Parent may direct the Company to purchase "tail" insurance coverage that provides coverage no less favorable than the coverage described above, *provided* that the Company shall not be required to pay any amounts in respect of such coverage prior to the Closing.

(b) This *Section 7.2* shall survive the consummation of the Merger and is intended to be for the benefit of, and shall be enforceable by, present or former directors or officers of the Company or its Subsidiaries, their respective heirs and personal representatives and shall be binding on the Surviving Corporation and its successors and assigns, and the agreements and covenants contained herein shall not be deemed to be exclusive of any other rights to which any such present or former director or officer is entitled, whether pursuant to Law, contract or otherwise. Nothing in this Agreement is intended to, shall be construed to or shall release, waive or impair any rights to directors' and officers' insurance claims under any policy that is or has been in existence with respect to the Company or any of its Subsidiaries or their respective officers, directors and employees, it being understood and agreed that the indemnification provided for in this *Section 7.2* is not prior to or in substitution for any such claims under any such policies.

(c) If the Surviving Corporation or any of its successors or assigns (i) consolidates with or merges into any other Person and shall not be the continuing or surviving corporation or entity or (ii) transfers or conveys substantially all of its properties and assets to any person, then and in each case to the extent reasonably necessary, proper provision shall be made so that the successors and assigns of the Surviving Corporation shall assume the obligations set forth in this *Section 7.2*.

Section 7.3 *Financing Efforts.* Parent and Merger Sub shall use all reasonable best efforts to obtain the Financing contemplated by the Financing Letters. Parent and Merger Sub shall not, without the prior written consent of the Company (approved by the Special Committee), amend, modify or supplement (including in the definitive documents) (i) any of the conditions or contingencies to funding contained in the Financing Letters or (ii) any other provision of the Financing Letters, in either case to the extent such amendment, modification or supplement would have the effect of amending, modifying or supplementing the conditions or contingencies to funding in a manner adverse to the Company or the holders of Common Shares. In the event that any portion of the Financing contemplated by the Financing Letters becomes unavailable otherwise than due to the material breach of representations and warranties or covenants of the Company or a failure of a condition to be satisfied by the Company, Parent and Merger Sub will use all reasonable best efforts to arrange alternative Financing from the same or other sources on terms and conditions not materially less favorable to Parent and Merger Sub than those contained in the Financing Letters as of the date hereof. Parent and Merger Sub shall use all reasonable best efforts to satisfy on or before the Closing all requirements of the definitive agreements pursuant to which the Financing will be obtained. Parent and Merger Sub shall keep the Company reasonably apprised of material developments relating to the Financing.

Section 7.4 *Solvency Opinion.* The parties shall, at the expense of the Surviving Corporation, retain a nationally recognized investment banking or valuation firm to render a solvency opinion of customary scope and substance as of the Closing to the Boards of Directors of the Company, Parent and Merger Sub.

## ARTICLE VIII
## COVENANTS OF THE PARTIES

The parties hereto agree that:

Section 8.1 *Reasonable Best Efforts.* Subject to the terms and conditions of this Agreement (including *Section 6.4*), each party will use its reasonable best efforts to take, or cause to be taken, all actions, to file, or cause to be filed, all documents and to do, or cause to be done, all things necessary, proper or advisable to consummate the transactions contemplated by this Agreement, including

obtaining all necessary consents, waivers, approvals, authorizations, Permits or orders from all Governmental Authorities or other Persons; *provided, however*, that in no event shall the Company or any of its Subsidiaries be required to pay prior to the Effective Time any fee, penalties or other consideration to any landlord or other third party to obtain any consent or approval required for the consummation of the Merger under any real estate leases or other material contracts (other than *de minimis* amounts or if Parent and Merger Sub have provided adequate assurance of repayment). Each party shall also refrain from taking, directly or indirectly, any action that would be reasonably likely to result in a failure of any of the conditions to the Merger in this Agreement being satisfied or restrict such party's ability to consummate the Merger and the other transactions contemplated hereby. Without limiting the foregoing, the parties shall use their respective reasonable best efforts to (i) to take all action necessary so that no takeover, anti-takeover, moratorium, "fair price," "control share" or other similar Law is or becomes applicable to the Merger or any of the other transactions contemplated by this Agreement and (ii) if any such Law is or becomes applicable to any of the foregoing, to take all action necessary so that the Merger and the other transactions contemplated by this Agreement may be consummated as promptly as practicable on the terms contemplated by this Agreement and otherwise to minimize the effect of such statute or regulation on the Merger and the other transactions contemplated by this Agreement.

Section 8.2 *Certain Filings.*

(a) The parties shall cooperate with one another (i) in determining whether any action by or in respect of, or filing with, any Governmental Authority is required, or any actions, consents, approvals or waivers are required to be obtained from any parties to any Contracts, in connection with the consummation of the transactions contemplated by this Agreement and (ii) in seeking and obtaining any such actions, consents, approvals or waivers or making any such filings, furnishing information required in connection therewith or with the Company Proxy Statement or the Schedule 13E-3; *provided, however*, that the conditions to the parties' respective obligations to consummate the transactions contemplated hereby shall be limited to those conditions specified in Article IX. The parties shall have the right to review in advance, and to the extent reasonably practicable each will consult the other on, all the information relating to the other and each of their respective Subsidiaries that appears in any filing made with, or written materials submitted to, any Governmental Authority in connection with the Merger and the other transactions contemplated by this Agreement. Each of the Company and Parent shall promptly notify and provide a copy to the other party of any substantive written communication received from any Governmental Authority with respect to any filing or submission or with respect to the Merger and the other transactions contemplated by this Agreement. Each of the Company and Parent shall give the other reasonable prior notice of any substantive communication with, and any proposed understanding, undertaking or agreement with, any Governmental Authority regarding any such filing or any such transaction. Neither the Company nor Parent shall, nor shall they permit their respective representatives to, participate independently in any meeting or engage in any substantive conversation with any Governmental Authority in respect of any such filing, investigation or other inquiry without giving the other party prior notice of such meeting or conversation and without giving, unless prohibited by such Governmental Authority, the opportunity of the other party to attend or participate. The parties to this Agreement will consult and cooperate with one another in connection with any analyses, appearance, presentations, memoranda, briefs, arguments, opinions, and proposals made or submitted by or on behalf of any party to this Agreement in connection with proceedings under or related to the HSR Act or Other Antitrust Laws.

(b) The parties (i) shall use their respective reasonable best efforts to take or cause to be taken (A) all actions necessary, proper or advisable by such party with respect to the prompt preparation and filing with the SEC of the Company Proxy Statement and the Schedule 13E-3, (B) such actions as may be required to have the Company Proxy Statement and any related materials cleared by the SEC as promptly as reasonably practicable, and (C) such actions as may be required to be taken under the

Exchange Act and state securities or applicable Blue Sky Laws in connection with the Merger; and (ii) shall promptly prepare and file all necessary documentation, effect all necessary applications, notices, petitions and filings, and use all reasonable efforts to obtain all material Permits from any Governmental Authorities necessary to consummate the Merger (including, without limitation, any filing under the HSR Act or any applicable Other Antitrust Law), including (1) responding as promptly as practicable to any inquiries from the Federal Trade Commission and the Antitrust Division of the Department of Justice for additional information or documentation; and (2) complying with the requirements of, and responding as promptly as reasonably practicable to all inquiries and requests received from any Governmental Authority in connection with, the HSR Act or Other Antitrust Laws related to the Merger or the other transactions contemplated by this Agreement.

Section 8.3 *Public Announcements.* So long as this Agreement is in effect, the parties will consult with each other before issuing any press release or making any public statement with respect to this Agreement or the transactions contemplated hereby and, except for any press release or public statement as may be required by applicable Law or any listing agreement with the New York Stock Exchange, will not issue any such press release or make any such public statement without the consent of the other parties (not to be unreasonably delayed, conditioned or withheld).

Section 8.4 *Further Assurances.* At and after the Effective Time, the officers and directors of the Surviving Corporation will be authorized to execute and deliver, in the name and on behalf of the Company or Merger Sub, any deeds, bills of sale, assignments or assurances and to take and do, in the name and on behalf of the Company or Merger Sub, any other actions and things to vest, perfect or confirm of record or otherwise in the Surviving Corporation any and all right, title and interest in, to and under any of the rights, properties or assets of the Company.

Section 8.5 *Notices of Certain Events.* Each of the parties hereto shall use reasonable best efforts to promptly notify the other party of:

(a) the occurrence or nonoccurrence of any event the occurrence or nonoccurrence of which would reasonably be expected to cause any representation or warranty of such party contained in this Agreement to be untrue or inaccurate in any material respect;

(b) any failure of the Company, Parent or Merger Sub, as the case may be, to comply with or satisfy, or the occurrence or nonoccurrence of any event, the occurrence or nonoccurrence of which would reasonably be expected to cause the failure by such party to comply with or satisfy, any covenant, condition or agreement to be complied with or satisfied by it hereunder;

(c) the receipt by such party of any notice or other communication from any Person alleging that the consent of such Person, which consent is or could reasonably be expected to be material to the Company and its Subsidiaries or the operation of their businesses, is or may be required in connection with the transactions contemplated by this Agreement;

(d) the receipt by such party of any notice or other communication from any Governmental Authority in connection with the transactions contemplated by this Agreement; and

(e) its learning of any actions, suits, claims, investigations or proceedings commenced against, or affecting such party that, if they were pending on the date of this Agreement, would have been required to be disclosed pursuant to this Agreement or which relate to the consummation of the transactions contemplated by this Agreement.

Section 8.6 *Disposition of Litigation.* The Company will keep Parent and Merger Sub reasonably apprised of all important developments relating to, and consult with Parent and Merger Sub with respect to, any action by any third party to restrain or prohibit or otherwise oppose the Merger or the other transactions contemplated by this Agreement and, subject to *Section 6.4*, will use reasonable best efforts to resist any such effort to restrain or prohibit or otherwise oppose the Merger or the other

transactions contemplated by this Agreement. Parent and Merger Sub may participate in (but not control) the defense of any stockholder litigation against the Company and its Directors relating to the transactions contemplated by this Agreement at Parent and Merger Sub's sole cost and expense (subject to *Section 10.2*). In addition, subject to *Section 6.4*, the Company will reasonably cooperate with Parent and Merger Sub to resist any such effort to restrain or prohibit or otherwise oppose the Merger or the other transactions contemplated by this Agreement.

Section 8.7 *Employee Matters.*

(a) For all purposes (other than benefit accrual under final average pay defined benefit pension plans) under the employee benefit plans of the Parent and its Subsidiaries providing benefits to each current and former employee of the Company and its Subsidiaries ("**Company Employees**") after the Effective Time (the "**New Plans**"), except as would result in a duplication of benefits, each Company Employee shall be credited with all years of service for which such Company Employee was credited before the Effective Time under any similar Employee Plans. In addition and without limiting the generality of the foregoing: (i) each Company Employee shall be immediately eligible to participate, without any waiting time, in any and all New Plans to the extent coverage under such New Plan replaces coverage under a comparable Employee Plan in which such Company Employee participated immediately before the Effective Time (such plans, collectively, the "**Old Plans**"); and (ii) for purposes of each New Plan providing medical, dental, disability, pharmaceutical and/or vision benefits to any Company Employee, Parent shall cause all pre-existing condition exclusions and actively-at-work requirements of such New Plan to be waived for such employee and his or her covered dependents during the portion of the plan year of the Old Plan ending on the date such employee's participation in the corresponding New Plan begins to be taken into account under such New Plan for purposes of satisfying all deductible, coinsurance and maximum out-of-pocket requirements applicable to such employee and his or her covered dependents for the applicable plan year as if such amounts had been paid in accordance with such New Plan.

(b) For a period of one year from the Effective Time, Parent shall honor, fulfill and discharge the Company's and its Subsidiaries' obligations under the severance plans listed on Section 8.7(b) of the Disclosure Letter without any amendment or change that is adverse to the Company Employees. During the period specified above, severance benefits offered to Company Employees shall be determined without taking into account any reduction after the Effective Time in the compensation paid to Company Employees and used to determine severance benefits.

Section 8.8 *Confidentiality Agreement.* The parties acknowledge that the Company, and LGP entered into the Confidentiality Agreement, which agreement shall be deemed incorporated herein as if it were set forth in its entirety, and the Confidentiality Agreement shall continue in full force and effect in accordance with its terms until the earlier of (a) the Effective Time or (b) the expiration of the Confidentiality Agreement according to its terms.

## ARTICLE IX
## CONDITIONS TO THE MERGER

Section 9.1 *Conditions to the Obligations of Each Party.* The obligations of the Company, Parent and Merger Sub to consummate the Merger are subject to the satisfaction of the following conditions:

(a) This Agreement shall have been approved by the Requisite Shareholder Vote;

(b) Any applicable waiting period under the HSR Act (and any extension thereof) relating to the Merger shall have expired or been terminated; and

(c) No Law shall be in effect which prohibits, restrains or renders illegal the consummation of the Merger.

Section 9.2 *Conditions to the Obligations of Parent and Merger Sub.* The obligations of Parent and Merger Sub to consummate the Merger are subject to the satisfaction or valid waiver of the following further conditions:

(a) (i) the Company shall have performed in all material respects all of its obligations hereunder required to be performed by it at or prior to the Effective Time; (ii) the representations and warranties (A) set forth in *Section 4.5* shall be true and correct in all respects (except for inaccuracies that are *de minimis* in the aggregate) as of the Effective Time as if made at and as of such time and (B) set forth in *Article IV*, other than those described in clause (A) above, shall be true and correct as of the date of the Effective Time as if made at and as of such time (without giving effect to any qualification as to "materiality" or "Material Adverse Effect" set forth therein), except in the case of this *clause (B)* where the failure to be so true and correct does not constitute a Material Adverse Effect on the Company, *provided* that representations made as of a specific date shall be required to be so true and correct (subject to such qualifications) as of such date only; and (iii) Parent and Merger Sub shall have received a certificate signed by a senior officer of the Company attesting to (i) and (ii) above;

(b) Parent and Merger Sub have obtained the Financing (other than the equity financing described in the GEI IV Letter); *provided*, that the condition set forth in this *Section 9.2(b)* shall be deemed waived if the failure to satisfy such condition arises out of or results from a willful breach by Parent or Merger Sub of their respective obligations under *Section 7.3*; and

(c) the aggregate number of shares of Common Stock at the Effective Time, the holders of which have demanded appraisal of their shares from the Company in accordance with the provisions of Section 262 of the Delaware Corporate Law, shall not equal 15% or more of the Common Stock outstanding as of the record date for the Stockholder Meeting.

Section 9.3 *Conditions to the Obligations of the Company.* The obligation of the Company to consummate the Merger is subject to the satisfaction or valid waiver of the following further conditions:

(a) Parent and Merger Sub shall have performed in all material respects all of their respective obligations hereunder required to be performed by them at or prior to the Effective Time;

(b) the representations and warranties of Parent and Merger Sub contained in this Agreement and in any certificate or other writing delivered by them pursuant hereto that are qualified as to materiality shall be true and correct in accordance with their terms as of date of this Agreement and as of the Effective Time as if made at and as of such time and those which are not so qualified will be true and correct in all material respects as of date of this Agreement and as of the Effective Time as if made at and as of such time (provided that representations made as of a specific date shall be required to be true as of such date only); and

(c) the Company shall have received a certificate signed by a senior officer of Parent and Merger Sub attesting to (a) and (b) above.

## ARTICLE X
## TERMINATION

Section 10.1 *Termination.* This Agreement may be terminated and the Merger may be abandoned at any time prior to the Effective Time (notwithstanding any prior approval of this Agreement by the shareholders of the Company):

(a) by mutual written consent of the Company, on the one hand, and Parent and Merger Sub, on the other hand;

(b) by either the Company or Merger Sub, if:

(i) the Merger has not been consummated by the End Date, provided that the failure of the Merger to be consummated by such date is not the result of, or caused by, the failure of the party seeking to exercise such termination right to fulfill any of its obligations under this Agreement;

(ii) there shall be any final and nonappealable Law that makes consummation of the Merger illegal or otherwise prohibited; *provided, however*, that the right to terminate this Agreement pursuant to this *Section 10.1(b)(ii)* shall not be available to any party whose breach of any provision of this Agreement results in the application or imposition of such Law; or

(iii) at the Company Shareholder Meeting or any adjournment thereof at which this Agreement has been voted upon, the Company shareholders fail to approve this Agreement by the Requisite Shareholder Vote;

(c) by the Company, if a breach of or failure to perform any representation, warranty, covenant or agreement on the part of Parent or Merger Sub set forth in this Agreement shall have occurred which would cause any of the conditions set forth in *Sections 9.3(a)* or *(b)* not to be satisfied, and such condition is incapable of being satisfied by the End Date; *provided, however*, that the Company is not then in material breach of this Agreement;

(d) by Parent or Merger Sub, if:

(i) a breach of or failure to perform any representation, warranty, covenant or agreement on the part of the Company set forth in this Agreement shall have occurred which would cause any of the conditions set forth in *Section 9.2(a)* not to be satisfied, and such condition is incapable of being satisfied by the End Date; *provided, however*, that neither Parent nor Merger Sub is then in material breach of this Agreement;

(ii) the Board of Directors of the Company shall make an Adverse Recommendation Change or approve a resolution or authorize or agree to do so; or

(iii) the Company shall have entered into a Company Acquisition Agreement;

(e) by the Company, at any time prior to obtaining the Requisite Shareholder Vote, upon the Board of Directors of the Company (acting through the Special Committee but only if such committee still exists) resolving to enter into, subject to the terms of this Agreement, including *Section 6.4*, a definitive agreement containing a Company Acquisition Proposal; *provided*, that (i) the Board of Directors of the Company (acting through the Special Committee but only if such committee still exists) shall not so resolve unless (A) the Company shall have complied with its obligations under *Section 6.4*, (B) the Board of Directors of the Company shall have determined in good faith (after consultation with its independent financial advisors and outside counsel) that such Company Acquisition Proposal constitutes a Superior Proposal and the failure to take such action is inconsistent with the fiduciary duties of the Board of Directors of the Company to the shareholders of the Company under applicable Law, and (C) the Company shall have substantially negotiated and documented the terms of such Company Acquisition Proposal; (ii) immediately following the Board of Directors of the Company (acting through the Special Committee) so resolving, the Company shall have so notified Parent and provided to Parent in writing the identity of the Person making, and the final terms and conditions of, such Company Acquisition Proposal; and (iii) the Company shall have the right to enter into such a definitive agreement (a "**Permitted Alternative Agreement**") so long as (A) the effectiveness of such agreement is conditioned upon the Company complying with its obligations under *Section 10.2*, (B) the effectiveness of such agreement is conditioned upon the termination of this Agreement pursuant to this *Section 10.1(e)* and (C) immediately following the execution of such agreement, a copy of such agreement and all related agreements, exhibits, schedules and other documents are delivered to Parent and Merger Sub.

The party desiring to terminate this Agreement pursuant to Sections *10.1(b)* through *(e)* shall give written notice of such termination to the other party in accordance with *Section 11.1* of this Agreement; *provided, however*, that no termination by the Company shall be effective unless and until the Company shall have paid any amounts required to be paid by the Company pursuant to *Section 10.2*.

Section 10.2 *Termination Fee.* Notwithstanding any other provision of this Agreement, if this Agreement is terminated pursuant to either *Section 10.1(d)(iii)* or *Section 10.1(e)*, then the Company shall immediately pay to Parent and Merger Sub, collectively, a break-up fee of $30,000,000 (the "**Termination Fee**"). In addition, if this Agreement is terminated pursuant to *Section 10.1(b)(iii)*, then the Company shall immediately pay to Parent and Merger Sub, collectively, all of Parent's and Merger Sub's actual and reasonably documented out-of-pocket expenses and fees (including reasonable attorneys' fees) actually incurred by Parent, Merger Sub and their respective Affiliates on or prior to the termination of this Agreement in connection with the transactions contemplated by this Agreement, which amount shall not be greater than $5,000,000 (the "**Parent Expenses**"); *provided* that, if Parent's and Merger Sub's actual and reasonably incurred and documented out-of-pocket expenses exceed $5,000,000 as a result of their good faith efforts to satisfy the conditions set forth in *Article IX* and their compliance with the covenants and agreements set forth in this Agreement, then the Company shall negotiate in good faith with Parent with respect to increasing the amount of such expenses that are reimbursed by the Company. Notwithstanding the foregoing, if this Agreement is terminated pursuant to *Section 10.1(b)(iii)* and at the time of the Company Stockholder Meeting a Company Acquisition Proposal has been made public and not withdrawn, then in the event that, within twelve months after such termination, either (A) the acquisition of more than 50% of the voting securities of the Company occurs or (B) the Company enters into a definitive agreement in respect of such a transaction, which transaction is subsequently consummated (whether within the twelve month period described above or thereafter), then in either case the Company shall immediately pay to Parent and Merger Sub, collectively, the Termination Fee (less the amount of any Parent Expenses previously paid by the Company to Parent and Merger Sub). The parties hereto agree that the Termination Fee is not a penalty, but rather is liquidated Damages in a reasonable amount that will compensate Parent and Merger Sub for the efforts and resources expended and opportunities foregone while negotiating this Agreement and in reliance on this Agreement and on the expectation of the consummation of the transactions contemplated hereby, which amount would otherwise be impossible to calculate with precision. The parties further agree that in the event any payment of the Termination Fee is made by the Company to Parent and Merger Sub pursuant to this *Section 10.2*, the Termination Fee paid shall be the exclusive remedy available to Parent and Merger Sub and, upon payment of such amounts by the Company, the Company shall have no further liability to Parent or Merger Sub hereunder.

Section 10.3 *Effect of Termination.* If this Agreement is terminated pursuant to *Section 10.1*, this Agreement shall forthwith become null and void and there shall be no liability or obligation on the part of the Company, Parent, Merger Sub or their respective Subsidiaries or Affiliates, except (i) *Sections 10.2, 10.3, 11.1, 11.4, 11.6* and *11.11* will survive the termination hereof and (ii) with respect to any liabilities for Damages incurred or suffered by a party as a result of the willful and material breach by any other party of any of its representations, warranties, covenants or other agreements set forth in this Agreement.

**ARTICLE XI**
**MISCELLANEOUS**

Section 11.1 *Notices.* All notices, requests and other communications to any part hereunder shall be in writing (including facsimile or similar writing) and shall be given:

if to Parent or Merger Sub, to:

Slap Shot Holdings Corp.
11111 Santa Monica Blvd.
Suite 2000
Los Angeles, California 90025
Attention: Jonathan A. Seiffer
Fax: (310) 954-0404

and

SAS Acquisition Corp.
11111 Santa Monica Blvd.
Suite 2000
Los Angeles, California 90025
Attention: Jonathan A. Seiffer
Fax: (310) 954-0404

with copies (which shall not constitute notice) to:

Gibson, Dunn & Crutcher LLP
333 South Grand Avenue
Los Angeles, California 90071
Attention: Jennifer Bellah Maguire, Esq.
Fax: (213) 229-7520

if to the Company, to:

The Sports Authority, Inc.
1050 W. Hampden Avenue
Englewood, Colorado 80110
Attention: General Counsel
Fax: (720) 475-2188

with a copy (which shall not constitute notice) to:

Wachtell, Lipton, Rosen & Katz
51 West 52nd Street
New York, New York 10019

Attention: Richard D. Katcher, Esq.
Trevor S. Norwitz, Esq.
Fax: (212) 403-2000

or such other address or facsimile number as such party may hereafter specify for by notice to the other parties hereto. Each such notice, request or other communication shall be effective (i) if given by telecopier, when such telecopy is transmitted to the facsimile number specified above and electronic confirmation of transmission is received or (ii) if given by any other means, when delivered at the address specified in this *Section 11.1*.

Section 11.2 *Survival of Representations and Warranties.* The representations and warranties contained herein and in any certificate or other writing delivered pursuant hereto shall survive until

(but not beyond) the Effective Time. None of the representations and warranties herein shall be considered modified, vitiated or waived in regard to any matter by any due diligence review or research conducted by or on behalf of Parent or Merger Sub, unless such matter is contained in the Disclosure Letter or an amendment to such representation and warranty adopted pursuant to *Section 11.3(a)*. This *Section 11.2* shall not limit any covenant or agreement of the parties that by its terms contemplates performance in whole or in part after the Effective Time.

Section 11.3 *Amendments No Waivers.*

(a) Any provision of this Agreement may be amended or waived prior to the Effective Time only by amendment or waiver in writing and signed, (i) in the case of an amendment to this Agreement, by the Company (approved by the Special Committee), Parent and Merger Sub, or (ii) in the case of a waiver, by the party against whom the waiver is to be effective; *provided, however*, that after the approval of this Agreement by the shareholders of the Company, any proposed amendment that by Law requires further approval by the shareholders of the Company shall not be effective without such further shareholder approval.

(b) At any time prior to the Effective Time, the Company, on the one hand, and Parent and Merger Sub, on the other hand, may but will have no obligation to, or to consider, with respect to the other parties hereto (i) extend the time for the performance of any of the obligations or other acts of such party and (ii) waive any inaccuracies in the representations and warranties of such party contained herein or in any document delivered pursuant hereto.

(c) No failure or delay by any party in exercising any right, power or privilege hereunder shall operate as a waiver thereof, nor shall any single or partial exercise thereof preclude any other or further exercise thereof or the exercise of any other right, power or privilege. Except as expressly set forth in *Section 10.2*, the rights and remedies herein provided shall be cumulative and not exclusive of any other rights or remedies herein provided or available at Law or in equity.

Section 11.4 *Expenses.* Except as otherwise expressly provided in *Sections 6.4* and *10.2*, all costs and expenses incurred in connection with this Agreement shall be paid by the party incurring such cost or expense.

Section 11.5 *Successors and Assigns.* The provisions of this Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns, provided that no party may assign, delegate or otherwise transfer any of its rights or obligations under this Agreement without the consent of the other parties hereto. Any purported assignment in violation of these provisions shall be null and void *ab initio*.

Section 11.6 *Governing Law.* This Agreement shall be governed by and construed in accordance with the law of the State of Delaware, without giving effect to the conflicts or choice of law principles of such states.

Section 11.7 *Counterparts; Effectiveness; Third Party Beneficiaries.* This Agreement may be executed by facsimile signatures and in any number of counterparts, each of which shall be an original, with the same effect as if the signatures thereto and hereto were upon the same instrument. This Agreement shall become effective only when actually signed by each party hereto and each such party has received counterparts hereof signed by all of the other parties hereto. No provision of this Agreement is intended to or shall confer upon any Person other than the parties hereto any rights or remedies hereunder or with respect hereto, except with respect to the matters provided in *Sections 2.3, 2.4* and *7.2*.

Section 11.8 *Severability.* If any term or other provision of this Agreement is invalid, illegal or incapable of being enforced by virtue of any Law, or due to any public policy, all other conditions and provisions of this Agreement shall nevertheless remain in full force and effect so long as the economic or legal substance of the transactions contemplated hereby is not affected in any manner materially

adverse to any party. Upon such determination that any term or other provision is invalid, illegal or incapable of being enforced, the parties hereto shall negotiate in good faith to modify this Agreement so as to effect the original intent of the parties as closely as possible in an acceptable manner so that the transactions contemplated hereby are fulfilled to the extent possible.

Section 11.9 *Specific Performance.* The parties hereby acknowledge and agree that the failure of any party to perform its agreements and covenants hereunder, including its failure to take all actions as are necessary on its part to consummate the Merger, will cause irreparable injury to the other parties, for which damages, even if available, will not be an adequate remedy. Accordingly, each party hereby consents to the issuance of injunctive relief by any court of competent jurisdiction to compel performance of such party's obligations and to the granting by any court of the remedy of specific performance of its obligations hereunder, in addition to any other rights or remedies available hereunder or at law or in equity.

Section 11.10 *Entire Agreement.* This Agreement constitutes the entire agreement of the parties hereto with respect to its subject matter and supersedes all oral or written prior or contemporaneous agreements and understandings among the parties with respect to such subject matter.

Section 11.11 *Jurisdiction.*

(a) Except as otherwise expressly provided in this Agreement, the parties hereto agree that any suit, action or proceeding seeking to enforce any provision of, or based on any matter arising out of or in connection with, this Agreement or the transactions contemplated hereby shall be brought exclusively in the Court of Chancery of the State of Delaware, County of New Castle or, if such court does not have jurisdiction over the subject matter of such proceeding or if such jurisdiction is not available, in the United State District Court for the District of Delaware, and each of the parties hereby irrevocably consents to the exclusive jurisdiction of those courts (and of the appropriate appellate courts therefrom) in any suit, action or proceeding and irrevocably waives, to the fullest extent permitted by Law, any objection which it may now or hereafter have to the laying of the venue of any suit, action or proceeding in any of those courts or that any suit, action or proceeding which is brought in any of those courts has been brought in an inconvenient forum. Process in any suit, action or proceeding may be served on any party anywhere in the world, whether within or without the jurisdiction of any of the named courts.

(b) EACH PARTY HERETO ACKNOWLEDGES AND AGREES THAT ANY CONTROVERSY WHICH MAY ARISE UNDER THIS AGREEMENT IS LIKELY TO INVOLVE COMPLICATED AND DIFFICULT ISSUES, AND THEREFORE EACH SUCH PARTY HEREBY IRREVOCABLY AND UNCONDITIONALLY WAIVES ANY RIGHT SUCH PARTY MAY HAVE TO A TRIAL BY JURY IN RESPECT OF ANY LITIGATION DIRECTLY OR INDIRECTLY ARISING OUT OF OR RELATING TO THIS AGREEMENT, OR THE TRANSACTIONS CONTEMPLATED BY THIS AGREEMENT. EACH PARTY CERTIFIES AND ACKNOWLEDGES THAT (I) NO REPRESENTATIVE, AGENT OR ATTORNEY OF ANY OTHER PARTY HAS REPRESENTED, EXPRESSLY OR OTHERWISE, THAT SUCH OTHER PARTY WOULD NOT, IN THE EVENT OF LITIGATION, SEEK TO ENFORCE THE FOREGOING WAIVER, (II) EACH PARTY UNDERSTANDS AND HAS CONSIDERED THE IMPLICATIONS OF THIS WAIVER, (III) EACH PARTY MAKES THIS WAIVER VOLUNTARILY AND (IV) EACH PARTY HAS BEEN INDUCED TO ENTER INTO THIS AGREEMENT BY, AMONG OTHER THINGS, THE MUTUAL WAIVERS AND CERTIFICATIONS IN THIS SECTION 11.11.

Section 11.12 *Authorship.* The parties agree that the terms and language of this Agreement were the result of negotiations between the parties and their respective advisors and, as a result, there shall be no presumption that any ambiguities in this Agreement shall be resolved against any party. Any controversy over construction of this Agreement shall be decided without regard to events of authorship or negotiation.

[signature page follows]

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed by their respective authorized officers as of the day and year first above written.

**THE COMPANY**

**THE SPORTS AUTHORITY, INC.**

By: /s/ GORDON D. BARKER

Name: Gordon D. Barker
Title: Director

**PARENT**

**SLAP SHOT HOLDINGS CORP.**

By: /s/ JONATHAN A. SEIFFER

Name: Jonathan A. Seiffer
Title: President

**MERGER SUB**

**SAS ACQUISITION CORP.**

By: /s/ JONATHAN A. SEIFFER

Name: Jonathan A. Seiffer
Title: President

**Annex B**

January 22, 2006

Special Committee of the Board of Directors
The Sports Authority, Inc.
1050 West Hampden Avenue
Englewood, Colorado 80110

Members of the Special Committee of the Board of Directors.

The Sports Authority, Inc. (the "Company") and SAS Acquisition Corp. (the "Acquisition Sub"), a newly-formed subsidiary of Leonard Green & Partners, L.P. (the "Acquiror"), propose to enter into the Agreement and Plan of Merger by and between the Company and Acquisition Sub (the "Agreement") pursuant to which Acquisition Sub would be merged with and into the Company in a merger (the "Merger") in which each share of common stock of the Company, par value $0.01 per share (each, a "Company Share"), would be converted into the right to receive $37.25 per share in cash (the "Consideration") other than Company Shares held in treasury, or held by Acquisition Sub or any subsidiary of the Company, or as to which dissenter's rights have been perfected.

You have asked us whether, in our opinion, the Consideration to be received by the holders of the Company Shares pursuant to the Merger is fair from a financial point of view to such holders, other than the Acquiror and its affiliates.

In arriving at the opinion set forth below, we have, among other things:

(1) Reviewed certain publicly available business and financial information relating to the Company that we deemed to be relevant;

(2) Reviewed certain information, including financial forecasts, relating to the business, earnings, cash flow, assets, liabilities and prospects of the Company furnished to us by the Company;

(3) Conducted discussions with members of senior management of the Company concerning the matters described in clauses 1 and 2 above;

(4) Reviewed the market prices and valuation multiples for the Company Shares and compared them with those of certain publicly traded companies that we deemed to be relevant;

(5) Reviewed the results of operations of the Company and compared them with those of certain publicly traded companies that we deemed to be relevant;

(6) Compared the proposed financial terms of the Merger with the financial terms of certain other Mergers that we deemed to be relevant;

(7) Participated in certain discussions and negotiations among representatives of the Company and the Acquiror and their financial and legal advisors;

(8) Reviewed a draft dated January 21, 2006 of the Agreement, including all schedules and exhibits thereto; and

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(9) Reviewed such other financial studies and analyses and took into account such other matters as we deemed necessary, including our assessment of general economic, market and monetary conditions.

In preparing our opinion, we have assumed and relied on the accuracy and completeness of all information supplied or otherwise made available to us, discussed with or reviewed by or for us, or publicly available, and we have not assumed any responsibility for independently verifying such information or undertaken an independent evaluation or appraisal of any of the assets or liabilities of the Company or been furnished with any such evaluation or appraisal, nor have we evaluated the solvency or fair value of the Company under any state or federal laws relating to bankruptcy, insolvency or similar matters. In addition, we have not assumed any obligation to conduct any physical inspection of the properties or facilities of the Company. With respect to the financial forecast information furnished to or discussed with us by the Company, we have assumed that they have been reasonably prepared and reflect the best currently available estimates and judgment of the Company's management as to the expected future financial performance of the Company. We have also assumed that the final form of the Agreement will be substantially similar to the last draft reviewed by us.

Our opinion is necessarily based upon market, economic and other conditions as they exist and can be evaluated on, and on the information made available to us as of, the date hereof.

We are acting as financial advisor to the Special Committee of the Board of Directors in connection with the Merger and will receive a fee from the Company for our services, a significant portion of which is contingent upon the consummation of the Merger. In addition, the Company has agreed to indemnify us for certain liabilities arising out of our engagement. We have, in the past, provided financial advisory and financing services to the Company and the Acquiror and/or its affiliates and may continue to do so and have received, and may receive, fees for the rendering of such services. In addition, in the ordinary course of our business, we may actively trade the Company Shares for our own account and for the accounts of customers and, accordingly, may at any time hold a long or short position in such securities.

This opinion is for the use and benefit of the Special Committee of the Board of Directors of the Company. Our opinion does not address the merits of the underlying decision by the Company to engage in the Merger and does not constitute a recommendation to any shareholder as to whether such shareholder should vote on the proposed Merger or any matter related thereto. In addition, you have not asked us to address, and this opinion does not address, the fairness to, or any other consideration of, the holders of any class of securities, creditors or other constituencies of the Company, other than the holders of the Company Shares.

On the basis of and subject to the foregoing, we are of the opinion that, as of the date hereof, the Consideration to be received by the holders of the Company Shares pursuant to the Merger is fair from a financial point of view to the holders of such shares, other than the Acquiror and its affiliates.

Very truly yours,

/s/ MERRILL LYNCH, PIERCE, FENNER &
SMITH INCORPORATED

MERRILL LYNCH, PIERCE, FENNER &
SMITH INCORPORATED

**Annex C**

GENERAL CORPORATION LAW OF THE STATE OF DELAWARE

**§ 262 APPRAISAL RIGHTS.**

(a) Any stockholder of a corporation of this State who holds shares of stock on the date of the making of a demand pursuant to subsection (d) of this section with respect to such shares, who continuously holds such shares through the effective date of the merger or consolidation, who has otherwise complied with subsection (d) of this section and who has neither voted in favor of the merger or consolidation nor consented thereto in writing pursuant to § 228 of this title shall be entitled to an appraisal by the Court of Chancery of the fair value of the stockholder's shares of stock under the circumstances described in subsections (b) and (c) of this section. As used in this section, the word "stockholder" means a holder of record of stock in a stock corporation and also a member of record of a nonstock corporation; the words "stock" and "share" mean and include what is ordinarily meant by those words and also membership or membership interest of a member of a nonstock corporation; and the words "depository receipt" mean a receipt or other instrument issued by a depository representing an interest in one or more shares, or fractions thereof, solely of stock of a corporation, which stock is deposited with the depository.

(b) Appraisal rights shall be available for the shares of any class or series of stock of a constituent corporation in a merger or consolidation to be effected pursuant to §251 (other than a merger effected pursuant to § 251(g) of this title), § 252, § 254, § 257, § 258, § 263 or § 264 of this title:

(1)

Provided, however, that no appraisal rights under this section shall be available for the shares of any class or series of stock, which stock, or depository receipts in respect thereof, at the record date fixed to determine the stockholders entitled to receive notice of and to vote at the meeting of stockholders to act upon the agreement of merger or consolidation, were either (i) listed on a national securities exchange or designated as a national market system security on an interdealer quotation system by the National Association of Securities Dealers, Inc. or (ii) held of record by more than 2,000 holders; and further provided that no appraisal rights shall be available for any shares of stock of the constituent corporation surviving a merger if the merger did not require for its approval the vote of the stockholders of the surviving corporation as provided in subsection (f) of § 251 of this title.

(2)

Notwithstanding paragraph (1) of this subsection, appraisal rights under this section shall be available for the shares of any class or series of stock of a constituent corporation if the holders thereof are required by the terms of an agreement of merger or consolidation pursuant to §§ 251, 252, 254, 257, 258, 263 and 264 of this title to accept for such stock anything except:

a.

Shares of stock of the corporation surviving or resulting from such merger or consolidation, or depository receipts in respect thereof;

b.

Shares of stock of any other corporation, or depository receipts in respect thereof, which shares of stock (or depository receipts in respect thereof) or depository receipts at the effective date of the merger or consolidation will be either listed on a national securities exchange or designated as a national market system security on an interdealer quotation system by the National Association of Securities Dealers, Inc. or held of record by more than 2,000 holders;

c.

Cash in lieu of fractional shares or fractional depository receipts described in the foregoing subparagraphs a. and b. of this paragraph; or

d.

Any combination of the shares of stock, depository receipts and cash in lieu of fractional shares or fractional depository receipts described in the foregoing subparagraphs a., b. and c. of this paragraph.

(3)

In the event all of the stock of a subsidiary Delaware corporation party to a merger effected under § 253 of this title is not owned by the parent corporation immediately prior to the merger, appraisal rights shall be available for the shares of the subsidiary Delaware corporation.

(c) Any corporation may provide in its certificate of incorporation that appraisal rights under this section shall be available for the shares of any class or series of its stock as a result of an amendment to its certificate of incorporation, any merger or consolidation in which the corporation is a constituent corporation or the sale of all or substantially all of the assets of the corporation. If the certificate of incorporation contains such a provision, the procedures of this section, including those set forth in subsections (d) and (e) of this section, shall apply as nearly as is practicable.

(d) Appraisal rights shall be perfected as follows:

(1)

If a proposed merger or consolidation for which appraisal rights are provided under this section is to be submitted for approval at a meeting of stockholders, the corporation, not less than 20 days prior to the meeting, shall notify each of its stockholders who was such on the record date for such meeting with respect to shares for which appraisal rights are available pursuant to subsection (b) or (c) hereof that appraisal rights are available for any or all of the shares of the constituent corporations, and shall include in such notice a copy of this section. Each stockholder electing to demand the appraisal of such stockholder's shares shall deliver to the corporation, before the taking of the vote on the merger or consolidation, a written demand for appraisal of such stockholder's shares. Such demand will be sufficient if it reasonably informs the corporation of the identity of the stockholder and that the stockholder intends thereby to demand the appraisal of such stockholder's shares. A proxy or vote against the merger or consolidation shall not constitute such a demand. A stockholder electing to take such action must do so by a separate written demand as herein provided. Within 10 days after the effective date of such merger or consolidation, the surviving or resulting corporation shall notify each stockholder of each constituent corporation who has complied with this subsection and has not voted in favor of or consented to the merger or consolidation of the date that the merger or consolidation has become effective; or

(2)

If the merger or consolidation was approved pursuant to § 228 or § 253 of this title, then, either a constituent corporation before the effective date of the merger or consolidation, or the surviving or resulting corporation within ten days thereafter, shall notify each of the holders of any class or series of stock of such constituent corporation who are entitled to appraisal rights of the approval of the merger or consolidation and that appraisal rights are available for any or all shares of such class or series of stock of such constituent corporation, and shall include in such notice a copy of this section. Such notice may, and, if given on or after the effective date of the merger or consolidation, shall, also notify such stockholders of the effective date of the merger or consolidation. Any stockholder entitled to appraisal rights may, within 20 days after the date of mailing of such notice, demand in writing from the surviving or resulting corporation the appraisal of such holder's shares. Such demand will be sufficient if it reasonably informs the corporation of the identity of the stockholder and that the stockholder intends thereby to demand the appraisal of such holder's shares. If such notice did not notify stockholders of the effective date of the

merger or consolidation, either (i) each such constituent corporation shall send a second notice before the effective date of the merger or consolidation notifying each of the holders of any class or series of stock of such constituent corporation that are entitled to appraisal rights of the effective date of the merger or consolidation or (ii) the surviving or resulting corporation shall send such a second notice to all such holders on or within 10 days after such effective date; provided, however, that if such second notice is sent more than 20 days following the sending of the first notice, such second notice need only be sent to each stockholder who is entitled to appraisal rights and who has demanded appraisal of such holder's shares in accordance with this subsection. An affidavit of the secretary or assistant secretary or of the transfer agent of the corporation that is required to give either notice that such notice has been given shall, in the absence of fraud, be prima facie evidence of the facts stated therein. For purposes of determining the stockholders entitled to receive either notice, each constituent corporation may fix, in advance, a record date that shall be not more than 10 days prior to the date the notice is given, provided, that if the notice is given on or after the effective date of the merger or consolidation, the record date shall be such effective date. If no record date is fixed and the notice is given prior to the effective date, the record date shall be the close of business on the day next preceding the day on which the notice is given.

(e) Within 120 days after the effective date of the merger or consolidation, the surviving or resulting corporation or any stockholder who has complied with subsections (a) and (d) hereof and who is otherwise entitled to appraisal rights, may file a petition in the Court of Chancery demanding a determination of the value of the stock of all such stockholders. Notwithstanding the foregoing, at any time within 60 days after the effective date of the merger or consolidation, any stockholder shall have the right to withdraw such stockholder's demand for appraisal and to accept the terms offered upon the merger or consolidation. Within 120 days after the effective date of the merger or consolidation, any stockholder who has complied with the requirements of subsections (a) and (d) hereof, upon written request, shall be entitled to receive from the corporation surviving the merger or resulting from the consolidation a statement setting forth the aggregate number of shares not voted in favor of the merger or consolidation and with respect to which demands for appraisal have been received and the aggregate number of holders of such shares. Such written statement shall be mailed to the stockholder within 10 days after such stockholder's written request for such a statement is received by the surviving or resulting corporation or within 10 days after expiration of the period for delivery of demands for appraisal under subsection (d) hereof, whichever is later.

(f) Upon the filing of any such petition by a stockholder, service of a copy thereof shall be made upon the surviving or resulting corporation, which shall within 20 days after such service file in the office of the Register in Chancery in which the petition was filed a duly verified list containing the names and addresses of all stockholders who have demanded payment for their shares and with whom agreements as to the value of their shares have not been reached by the surviving or resulting corporation. If the petition shall be filed by the surviving or resulting corporation, the petition shall be accompanied by such a duly verified list. The Register in Chancery, if so ordered by the Court, shall give notice of the time and place fixed for the hearing of such petition by registered or certified mail to the surviving or resulting corporation and to the stockholders shown on the list at the addresses therein stated. Such notice shall also be given by 1 or more publications at least 1 week before the day of the hearing, in a newspaper of general circulation published in the City of Wilmington, Delaware or such publication as the Court deems advisable. The forms of the notices by mail and by publication shall be approved by the Court, and the costs thereof shall be borne by the surviving or resulting corporation.

(g) At the hearing on such petition, the Court shall determine the stockholders who have complied with this section and who have become entitled to appraisal rights. The Court may require

the stockholders who have demanded an appraisal for their shares and who hold stock represented by certificates to submit their certificates of stock to the Register in Chancery for notation thereon of the pendency of the appraisal proceedings; and if any stockholder fails to comply with such direction, the Court may dismiss the proceedings as to such stockholder.

(h) After determining the stockholders entitled to an appraisal, the Court shall appraise the shares, determining their fair value exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation, together with a fair rate of interest, if any, to be paid upon the amount determined to be the fair value. In determining such fair value, the Court shall take into account all relevant factors. In determining the fair rate of interest, the Court may consider all relevant factors, including the rate of interest which the surviving or resulting corporation would have had to pay to borrow money during the pendency of the proceeding. Upon application by the surviving or resulting corporation or by any stockholder entitled to participate in the appraisal proceeding, the Court may, in its discretion, permit discovery or other pretrial proceedings and may proceed to trial upon the appraisal prior to the final determination of the stockholder entitled to an appraisal. Any stockholder whose name appears on the list filed by the surviving or resulting corporation pursuant to subsection (f) of this section and who has submitted such stockholder's certificates of stock to the Register in Chancery, if such is required, may participate fully in all proceedings until it is finally determined that such stockholder is not entitled to appraisal rights under this section.

(i) The Court shall direct the payment of the fair value of the shares, together with interest, if any, by the surviving or resulting corporation to the stockholders entitled thereto. Interest may be simple or compound, as the Court may direct. Payment shall be so made to each such stockholder, in the case of holders of uncertificated stock forthwith, and the case of holders of shares represented by certificates upon the surrender to the corporation of the certificates representing such stock. The Court's decree may be enforced as other decrees in the Court of Chancery may be enforced, whether such surviving or resulting corporation be a corporation of this State or of any state.

(j) The costs of the proceeding may be determined by the Court and taxed upon the parties as the Court deems equitable in the circumstances. Upon application of a stockholder, the Court may order all or a portion of the expenses incurred by any stockholder in connection with the appraisal proceeding, including, without limitation, reasonable attorney's fees and the fees and expenses of experts, to be charged pro rata against the value of all the shares entitled to an appraisal.

(k) From and after the effective date of the merger or consolidation, no stockholder who has demanded appraisal rights as provided in subsection (d) of this section shall be entitled to vote such stock for any purpose or to receive payment of dividends or other distributions on the stock (except dividends or other distributions payable to stockholders of record at a date which is prior to the effective date of the merger or consolidation); provided, however, that if no petition for an appraisal shall be filed within the time provided in subsection (e) of this section, or if such stockholder shall deliver to the surviving or resulting corporation a written withdrawal of such stockholder's demand for an appraisal and an acceptance of the merger or consolidation, either within 60 days after the effective date of the merger or consolidation as provided in subsection (e) of this section or thereafter with the written approval of the corporation, then the right of such stockholder to an appraisal shall cease. Notwithstanding the foregoing, no appraisal proceeding in the Court of Chancery shall be dismissed as to any stockholder without the approval of the Court, and such approval may be conditioned upon such terms as the Court deems just.

(l) The shares of the surviving or resulting corporation to which the shares of such objecting stockholders would have been converted had they assented to the merger or consolidation shall have the status of authorized and unissued shares of the surviving or resulting corporation.

**THE SPORTS AUTHORITY, INC.**

**SPECIAL MEETING OF STOCKHOLDERS**

**May 2, 2006**

**1050 West Hampden Ave.**
**Englewood, CO 80110**

**at**

**9:00 a.m. Mountain Daylight Time**

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**The Sports Authority, Inc.**
**1050 West Hampden Ave.**
**Englewood, CO 80110**

**proxy**

**This proxy is solicited by the Board of Directors for use at the Special Meeting on May 2, 2006.**

The undersigned hereby appoints GORDON D. BARKER, MARY ELIZABETH BURTON and PETER R. FORMANEK, and each of them, as lawful proxies, separately and with full power of substitution, for and in the name of the undersigned, to vote on behalf of the undersigned all shares of the common stock, $0.01 par value, of The Sports Authority, Inc. that the undersigned is entitled to vote at the Special Meeting of Stockholders of The Sports Authority, Inc. on May 2, 2006, and any adjournment, continuation or postponement thereof. The above named proxies are instructed to vote as specified all of the undersigned's shares of stock on the proposal set forth in the accompanying Notice of Special Meeting and Proxy Statement, the receipt of which such shareholder acknowledges, and are authorized in their discretion to vote upon such other business as may properly come before the meeting or any adjournment thereof.

**This Proxy relates to shares owned by the undersigned. Each share of common stock is entitled to one vote.**

**This proxy when properly executed will be voted in the manner directed herein by the undersigned shareholder. A proxy that is returned properly signed but without direction as to voting will be voted "FOR" the approval.**

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE "FOR" EACH OF THE PROPOSALS**
**(Important To be signed and dated on reverse side)**

**RETURN PROXY CARD PROMPTLY USING THE ENCLOSED ENVELOPE OR VOTE VIA THE INTERNET OR BY TELEPHONE; NO POSTAGE IS NECESSARY IF MAILED FROM THE UNITED STATES**

*See reverse for voting instructions.*

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COMPANY #

## There are three ways to vote your Proxy

**VOTE BY PHONE TOLL FREE 1-800-560-1965 QUICK *** EASY *** IMMEDIATE**

Use any touch-tone telephone to vote your proxy 24 hours a day, 7 days a week, until 12:00 p.m. (CT) on May 1, 2006.

Please have your proxy card and the last four digits of your Social Security Number or Tax Identification Number available. Follow the simple instructions the voice provides you.

**VOTE BY INTERNET http://www.eproxy.com/tsa/ QUICK *** EASY *** IMMEDIATE**

Use the Internet to vote your proxy 24 hours a day, 7 days a week, until 12:00 p.m. (CT) on May 1, 2006.

Please have your proxy card and the last four digits of your Social Security Number or Tax Identification Number available. Follow the simple instructions to obtain your records and create an electronic ballot.

**VOTE BY MAIL**

Mark, sign and date your proxy card and return it in the postage-paid envelope we've provided or return it to The Sports Authority, Inc., c/o Shareowner Services[SM], P.O. Box 64873, St. Paul, MN 55164-0873.

**Your telephone or Internet vote authorizes the Named Proxies to vote your shares in the same manner as if you marked, signed and returned your proxy card.**

**If you vote by Phone or Internet, please do not mail your Proxy Card**

*Please detach here*

**The Sports Authority, Inc.'s Board of Directors Recommends a Vote "FOR" Items 1, 2 and 3.**

**MARK THE APPROPRIATE BOXES BUT YOU NEED NOT MARK ANY BOXES IF YOU WISH TO VOTE IN ACCORDANCE WITH THE BOARD OF DIRECTORS' RECOMMENDATION**

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **1.** | Proposal to adopt the Agreement and Plan of Merger, dated as of January 22, 2006, by and among The Sports Authority, Inc., Slap Shot Holdings Corp., a Delaware corporation, and SAS Acquisition Corp., a Delaware corporation and a wholly owned subsidiary of Slap Shot Holdings Corp., pursuant to which SAS Acquisition Corp. will be merged with and into The Sports Authority, Inc. and each share of common stock of The Sports Authority, Inc. outstanding immediately prior to the merger (other than shares held by Slap Shot Holdings Corp., SAS Acquisition Corp., The Sports Authority, Inc. (or any of its subsidiaries) and other than shares held by stockholders properly exercising appraisal rights in accordance with Section 262 of the Delaware General Corporation Law) will be converted into the right to receive $37.25 in cash, without interest. | o | For | o | Against | o | Abstain |
| **2.** | To approve postponements or adjournments of the special meeting, if necessary, to solicit additional proxies. | o | For | o | Against | o | Abstain |
| **3.** | In their discretion, the Proxies are authorized to vote upon any other business that may properly come before the meeting, including any adjournments or postponements of the meeting. | o | For | o | Against | o | Abstain |

**PLEASE SIGN EXACTLY AS YOUR NAME APPEARS. JOINT OWNERS SHOULD EACH SIGN PERSONALLY WHERE APPLICABLE, INDICATE YOUR OFFICIAL POSITION OR REPRESENTATION CAPACITY. IF NO INSTRUCTIONS ARE INDICATED, ALL OF YOUR SHARES WILL BE VOTED FOR APPROVAL.**

Address Change? Mark Box **O** Indicate changes below: Date

Signature(s) in Box
IMPORTANT: Please sign exactly as your name(s) appear(s). When shares are held by joint tenants, both should sign. When signing as attorney, executor, administrator, trustee or guardian, please give full title as such. If a corporation, please sign in full corporate name by President or other authorized officer. If a partnership, please sign in partnership name by authorized person.