

Specialty Retail

Investors Back Select Consumer Growth Trends

EXECUTIVE SUMMARY

Amid multiple data points indicating that a consumer recovery is slowly underway, more than a dozen retailers successfully raised capital through private placements and public offerings. Retailers receiving funding generally operated in one of three segments: 1) discount/value/off price; 2) health & wellness; or 3) internet retailing, all believed to have superior growth prospects. Meanwhile, a still tepid M&A market saw multiple retailers, primarily in the multi-channel and internet segments, acquired by strategic buyers. Retail valuations settled into a trading range with brick and mortar EBITDA multiples firmly returning to historical norms. Select high growth internet retailers were valued on a different scale.

RETAIL ECONOMIC INDICATORS

- The consumer confidence index from The Conference Board increased again in January to 55.9, hitting its highest point since the fall of 2008. This represents the third consecutive monthly increase in the index and suggests that consumer spending is on the mend.
- After having been on a run from March 2009 through November, retail stock prices leveled in November and settled into a trading range. Nonetheless, we note that the S&P Retail Index is now up 78% from its March 2009 low.
- Off-price retailers, discounters, and warehouse club stores continue to benefit from the structural shift in consumer buying habits toward value. Among those retailers posting consistently positive comparable store sales growth were BJ's, Costco, Dollar General, Dollar Tree, Old Navy, Ross Stores, and TJX.
- Most retailers posted comparable store sales growth in December 2009. This was a welcome change for many mall-based specialty apparel retailers, mid-tier department stores, and luxury retailers who have been suffering from negative same store sales since August of 2008.
- Bankruptcies in the specialty retail sector fell off dramatically in both the 3rd and 4th quarters of 2009. Only seventeen specialty retail bankruptcies occurred in the 4th quarter, as compared to 92 in the 1st quarter of 2009 and 70 in the 4th quarter of 2008.

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Christopher Kampe
Managing Director
781.239.2900 x19
ckampe@tullyandholland.com

60 William St.
Suite 100
Wellesley, MA 02481
tullyandholland.com

M&A TRANSACTIONS

Caught between improving economic conditions, which all but eliminated distressed sales, and continued tightness in credit markets, which held off private equity backed LBOs, M&A activity in the specialty retail sector temporarily contracted in the 2nd half of 2009. Nineteen transactions were announced in the specialty retail sector during the 2nd half of 2009, as compared to 29 in the second half of 2008. Instead most transactions involved strategic buyers acquiring privately held retailers. These strategic transactions were motivated by a variety of rationales including: expanding direct eCommerce sales, brand acquisition, access to new channels, and acquisition of complementary new growth vehicles. Perhaps most interesting were Billabong's and Beverly Hills Teddy Bear's acquisitions of pure play internet retailers in their respective product categories. As growth in internet retailing continues to outpace other retail channels, we expect both consumer product companies and brick and mortar retailers to make acquisitions in eCommerce. Also of interest was the GSI Commerce acquisition of Retail Convergence, which operates Rue La La (in the fast growing private-sale shopping market) and SmartBargains (a leading off-price e-tailer), due to its lofty valuation.

| Announced Date | Target | Buyer | Segment |
|-----------------------|--|-------------------------------------|-----------------|
| 1/22/2010 | Kailani LLC | Sanyo Shokai Ltd. | Apparel Retail |
| 1/8/2010 | Smith & Hawken, Ltd. (brand) | Target Corp. | n/a |
| 12/11/2009 | StuffedAnimals.com | Beverly Hills Teddy Bear Company | Internet Retail |
| 12/7/2009 | Plow and Hearth, Problem Solvers, Wind and Weather, HearthSong, and Magic Cabin catalogs | PH International, LLC | Catalog |
| 11/23/2009 | Swell, Inc. | Billabong International Ltd. | Internet Retail |
| 11/10/2009 | The Wilkes Bashford Company | Mitchells Richards | Apparel Retail |
| 11/3/2009 | Sports Fan-Attic, Inc. | Hat World (Genesco) | Multi-Channel |
| 10/27/2009 | Retail Convergence, Inc. (dba RueLaLa.com and SmartBargains.com) | GSI Commerce Inc. | Internet Retail |
| 10/22/2009 | Socks4Life.com LLC | One Click Ventures LLC | Internet Retail |
| 10/19/2009 | Golf & Tennis Pro Shop, Inc. | AMB Group, LLC | Sporting Goods |
| 10/4/2009 | The Tall Girl Shop, certain assets | Long Tall Sally Ltd. | Apparel Retail |
| 10/2/2009 | X-Treme Geek Inc. | VWR Education, LLC | Multi-Channel |
| 9/28/2009 | Great Plains Sports LLC | Hat World (Genesco) | Sporting Goods |
| 9/23/2009 | Belleza Concept International, Inc. | Beauty Systems Group LLC | Beauty Care |
| 9/23/2009 | Finlay Enterprises Inc., Substantially All Assets | Gordon Brothers Retail Partners LLC | Jewelry Stores |
| 8/26/2009 | Anchor Blue, Inc. | Sun Capital Partners, Inc. | Apparel Retail |
| 8/24/2009 | Charlotte Russe Holding, Inc. | Advent International Corporation | Apparel Retail |
| 8/7/2009 | Barnes & Noble College Booksellers, Inc. | Barnes & Noble, Inc. | Book Stores |

Source: Capital IQ, Tully & Holland Analysis

PUBLIC OFFERINGS

The IPO market opened up for select retailers in 2009 after having been latent for nearly two years. No fewer than four brick and mortar retailers went public in the 3rd quarter of 2009. Common to all were strong financial performance, superior growth prospects, and a tie in to a current consumer trend, either value or healthy lifestyle. Three of the four, Dollarama, Dollar General, and Rue 21, are value-orientated retailers. Vitamin Shoppe is a play on the growing consumer trend toward healthy lifestyle.

| <u>Registration Filed Date</u> | <u>Issuer</u> | <u>Gross Offering Amount (\$mm)</u> | <u>Offer Date</u> | <u>Trend</u> |
|--------------------------------|----------------------|-------------------------------------|-------------------|-------------------|
| 09/10/2009 | Dollarama Inc. | \$ 300.0 | 10/08/2009 | Value |
| 09/10/2009 | rue21, Inc. | \$ 128.5 | 11/12/2009 | Value |
| 08/20/2009 | Dollar General Corp. | \$ 716.1 | 11/12/2009 | Value |
| 07/23/2009 | Vitamin Shoppe, Inc. | \$ 154.6 | 10/27/2009 | Healthy Lifestyle |

Source: Capital IQ, Tully & Holland Analysis

PRIVATE PLACEMENTS

More than a dozen retailers successfully raised equity capital through private placements in the last six months. Most issuers were retailers riding one of three specific consumer trends: 1) discount/value/off price; 2) health & wellness; or 3) internet retailing, all believed to have superior growth prospects. Among those receiving growth capital was Second Time Around, a chain of luxury brand consignment shops.

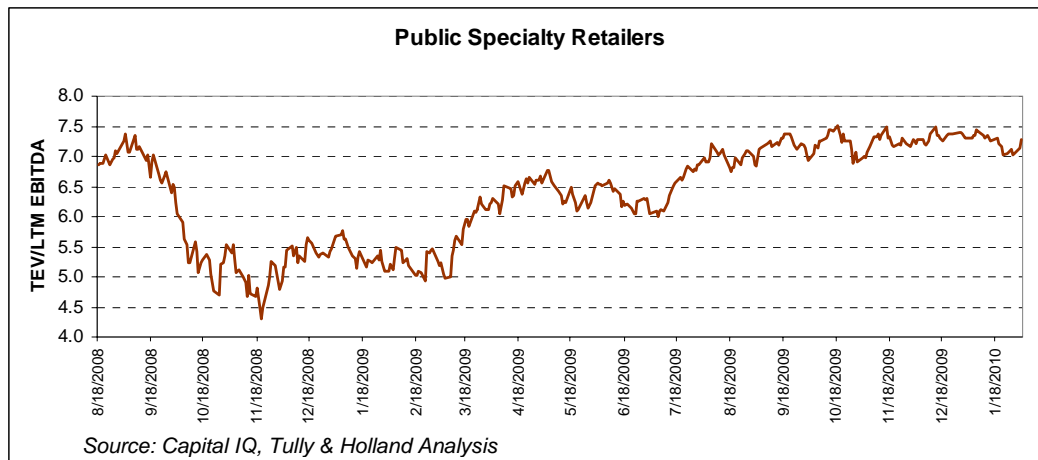
| <u>Announced Date</u> | <u>Issuer</u> | <u>Gross Offering Amount (\$mm)</u> | <u>Investors</u> | <u>Trend</u> |
|-----------------------|--|-------------------------------------|---|-------------------|
| 12/21/2009 | Bluefly Inc. | \$ 15.0 | Rho Ventures VI, L.P. | Internet Retail |
| 12/17/2009 | Zulily, Inc. | \$ 4.6 | Maveron LLC | Internet Retail |
| 12/14/2009 | Moosejaw Mountaineering and Backcountry Travel, Inc. | na | Glencoe Capital, LLC, Michigan Opportunities Fund, L.P. | Healthy Lifestyle |
| 12/6/2009 | One Kings Lane, Inc. | na | First Round Capital, Kleiner, Perkins, Caufield & Byers | Internet Retail |
| 11/9/2009 | ShoeDazzle.com, Inc. | \$ 7.0 | Undisclosed | Internet Retail |
| 11/4/2009 | Lighter Living, Inc. | \$ 3.1 | Flybridge Capital Partners | Internet Retail |
| 10/29/2009 | Journelle, Inc. | \$ 0.9 | Undisclosed | Apparel Retail |
| 10/16/2009 | 1800Diapers, Inc. | \$ 30.0 | Accel Partners, Bessemer Venture Partners, MentorTech Ventures, New Enterprise Associates | Internet Retail |
| 9/30/2009 | Affordit.com, LLC | na | Crosscut Ventures Management | Internet Retail |
| 9/9/2009 | Alice.com, Inc. | \$ 6.0 | Undisclosed | Internet Retail |
| 9/8/2009 | USA Discounters, Ltd. | \$ 3.0 | Undisclosed | Discount |
| 8/14/2009 | myShape, Inc. | \$ 12.1 | Draper Fisher Jurvetson, Tenaya Capital and Tech Coast Angels | Internet Retail |
| 8/7/2009 | Max-Wellness, LLC | \$ 2.5 | Undisclosed | H&BA Stores |
| 7/21/2009 | Second Time Around | na | GEI, LP (Generation Equity Investors, LLC) | Value |

Source: Capital IQ, Tully & Holland Analysis

VALUATION

While most recent specialty retail deals have been private transactions or below public materiality disclosure and thus have not publicized valuation metrics – we note a number of recent transactions. In the brick and mortar category, Barnes & Noble College Booksellers and Charlotte Russe traded at 4.9x and 6.6x EBITDA, respectively. In stark contrast, high growth internet retailers with scale were valued much higher. Amazon acquired Zappos for 1.25x revenues (and 20.6x EBITDA) and GSI Commerce bought Retail Convergence for 1.3x revenues, with a potential to nearly double the price through earnout.

Beyond precedent transactions, we look to the equity markets to provide additional guidance. As of 2/2/2010, fifty public specialty retailers traded at median Enterprise Value multiple of 7.3x EBITDA, up from only 4.3x during the November panic.



CONCLUSION

As positive data continues to filter through supporting a slow recovery in consumer spending, a host of retailers operating in value, wellness, or eCommerce successfully raised growth capital. M&A activity, while temporarily slow, indicates increased interest in internet retailing from strategic buyers. Valuations of brick and mortar retailers have returned to historical norms, while those of high growth internet retailers traded at significant premiums.

ABOUT TULLY & HOLLAND

INVESTMENT BANKING SOLUTIONS FOR CONSUMER PRODUCT COMPANIES

Founded in 1992, Tully & Holland, Inc. is a leading US investment bank that provides merger & acquisition advisory services and private placements to consumer companies with special emphasis on food companies, multi-channel marketers, consumer product manufacturers/distributors, and retailers.

Christopher Kampe
Managing Director
781.239.2900 x19
ckampe@tullyandholland.com

60 William St.
Suite 100
Wellesley, MA 02481
tullyandholland.com