

Specialty Retail

Brick and Mortar M&A Comes Back in Vogue

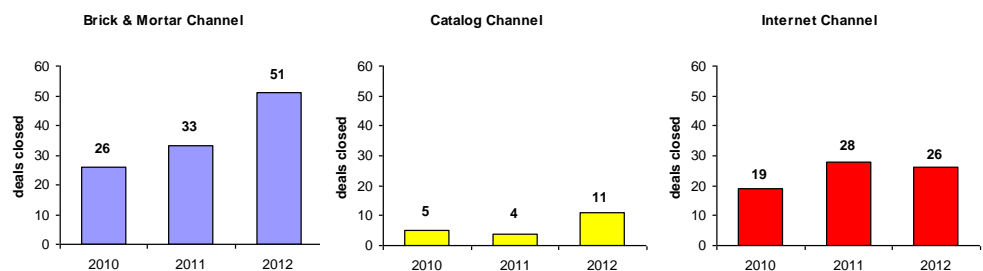
EXECUTIVE SUMMARY

M&A activity in the specialty retail sector soared in 2012, driven by heightened interest from both strategic and financial buyers, as well as urgency on the part of sellers to transact before changes in capital gains tax rates transpired. Sales of specialty retailers operating brick and mortar models dominated deal volume, as private equity groups again became active acquirers of traditional retailers. While internet retail transaction volume fell, several large brick and mortar retailers made acquisitions of pure play internet retail companies to grow their online business.

M&A ACTIVITY

Eighty-eight U.S.-based specialty retail companies sold in 2012, marking a 35% increase in M&A volume from the prior year. Most of the growth was attributable directly from the brick & mortar channel. M&A closings in the brick & mortar channel increased 55% in 2012, impressive on such a large base. Brick and mortar deals represented nearly 60% of all specialty retail transactions closed in 2012.

Specialty Retail Transactions



Source: Capital IQ, Tully & Holland Analysis

Internet retail comprised roughly 30% of specialty retail transactions in 2012, but the number of internet retail deals actually fell 7% from the prior year. While not reflected in the data, internet retailers, benefitting from the steady shift in consumer buying behavior toward online purchases, are attracting significant interest from both financial and strategic acquirers. Transaction volume, however, has not followed suit, we believe due to lofty valuation expectations from often venture backed sellers which has hampered private equity investment. As a result 90% of all internet retail transactions are being sold to strategic buyers.

SPECIALTY RETAIL

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M&A ACTIVITY

The following table highlights significant specialty retail transactions closed/announced in the fourth quarter of 2012.

<u>Closed Date</u>	<u>Target</u>	<u>Buyer</u>	<u>Segment</u>
pending	OneStopPlus Group	Charlesbank Capital Partners, LLC; Webster Capital	Internet Retail
pending	Blue Ribbon Motoring, LLC	AutoZone, Inc. (NYSE:AZO)	Internet Retail
pending	Factory Mattress & Water Bed Outlet Of Charlotte, Inc.	Mattress Firm Holding Corp.	Specialty Stores
pending	Oriental Trading Company	Berkshire Hathaway	Catalog Retail
12/31/2012	Cuddledown, Inc.	Potpourri Group Inc.	Textiles
12/31/2012	Intermix, Inc.	Gap Inc. (NYSE:GPS)	Apparel Retail
12/31/2012	Villa, Inc.	Goode Partners LLC	Apparel Retail
12/28/2012	Paul Stuart, Inc	Mitsui & Co. Ltd	Apparel Retail
12/21/2012	Sierra Trading Post, Inc.	The TJX Companies, Inc. (NYSE:TJX)	Internet Retail
12/17/2012	The Sportsman's Guide Inc.	Northern Tool + Equipment Company, Inc.	Catalog Retail
12/17/2012	Westlake Hardware, Inc.	Ace Hardware Corporation	Home Improvement
12/13/2012	It'sugar LLC	Star Avenue Capital	Food Retail
12/3/2012	Journelle, Inc.	Triumph International LTD	Apparel Retail
11/30/2012	Bike Gallery, Inc.	Mike Olson, Trek Bicycle Superstore	Specialty Stores
11/29/2012	Cohn-Turner And Co., Inc.	Perlis, Inc.	Apparel Retail
11/26/2012	BIDZ.com, Inc.	Kia Jamm	Internet Retail
11/26/2012	Eastern Mountain Sports, Inc.	Versa Capital Management, Inc.	Specialty Stores
11/16/2012	Woodline Tool & Supply	Woodcraft Supply LLC	Catalog Retail
11/15/2012	Gamblers Gifts, Inc.	Poplyn eCommerce Inc.	Internet Retail
11/14/2012	One Jackson, Inc.	TaskRabbit, Inc	Internet Retail
11/13/2012	GoJane.com, Inc.	Aéropostale, Inc. (NYSE:ARO)	Internet Retail
11/12/2012	Messner Incorporated	Nassco Inc.	Internet Retail
11/7/2012	Mattress Discounters Group LLC	Sleepy's, LLC	Home Furnishing
11/6/2012	Vann's Acquisition LLC	McMagic Partners LP	Computer and Electronics Retail
11/2/2012	EBL, Inc.	KarpReilly LLC	Apparel Retail
11/2/2012	Ultra Stores, Inc.	Signet Jewelers Limited	Apparel Retail
10/31/2012	Fanatics, Inc., 12 Retail Stores	Genesco Inc. (NYSE:GCO)	Specialty Stores
10/25/2012	Mac's Antique Auto Parts	Eckler Industries	Catalog Retail
10/12/2012	Blue Wave Products, Inc.	River Capital, Inc.	Internet Retail
10/11/2012	David's Bridal, Inc.	Clayton, Dubilier & Rice, Inc., Leonard Green & Partners, L.P.	Apparel Retail

Source: Capital IQ, Tully & Holland Analysis

EMERGING TRENDS

Tully & Holland has observed several emerging trends in the specialty retail M&A market, including:

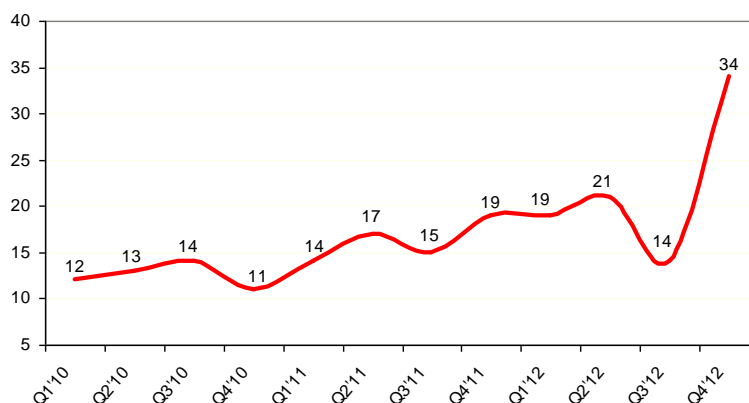
PRIVATE EQUITY ACTIVELY CHASING BRICK & MORTAR AGAIN

Throughout 2012, private equity groups, which had been very cautious and selective toward the specialty retail sector since the downturn, became active buyers of both brick & mortar and catalog retailers. Many of the old-standby consumer-focused funds made one or more investments in specialty retail during the year. These included private equity investors Goode Partners, KarpReilly, Leonard Green, Star Avenue Capital (the successor to Bear Stearns Growth), and Versa Capital Management. Four key factors positively impact interest and valuations from private equity buyers: 1) a clearly differentiated concept and/or merchandise offering; 2) a capable, continuing management team enthusiastic on growing the business, 3) strong store level economics, and 4) an ability to scale to a larger business.

TAX CHANGES INFLUENCED ACTIVITY

Tax policy, specifically the proposed and eventual increase in the tax rates for long term capital gains for 2013, drove the market in 2012. As a result deal activity in the specialty retail sector spiked in the fourth quarter of 2012, driven by urgency on the part of sellers to transact before the change in capital gains tax rates became effective. No fewer than 34 specialty retail transactions were closed in Q4, more than double the average rate of roughly 15 closings per quarter.

Specialty Retail Sector
M&A Transactions Closed per Quarter



Source: Capital IQ, Tully & Holland Analysis

HOUSING RELATED BUSINESSES PERCULATE INTEREST

In another trend, brick and mortar transaction activity in the home furnishing and home improvement subsectors was brisk in 2012, on the back of improving housing economic data. Several home retailers made strategic acquisitions during the year including: Mattress Firm, Mattress USA, Sleepy's, La-Z-Boy, Ace Hardware, and Bed Bath Beyond.

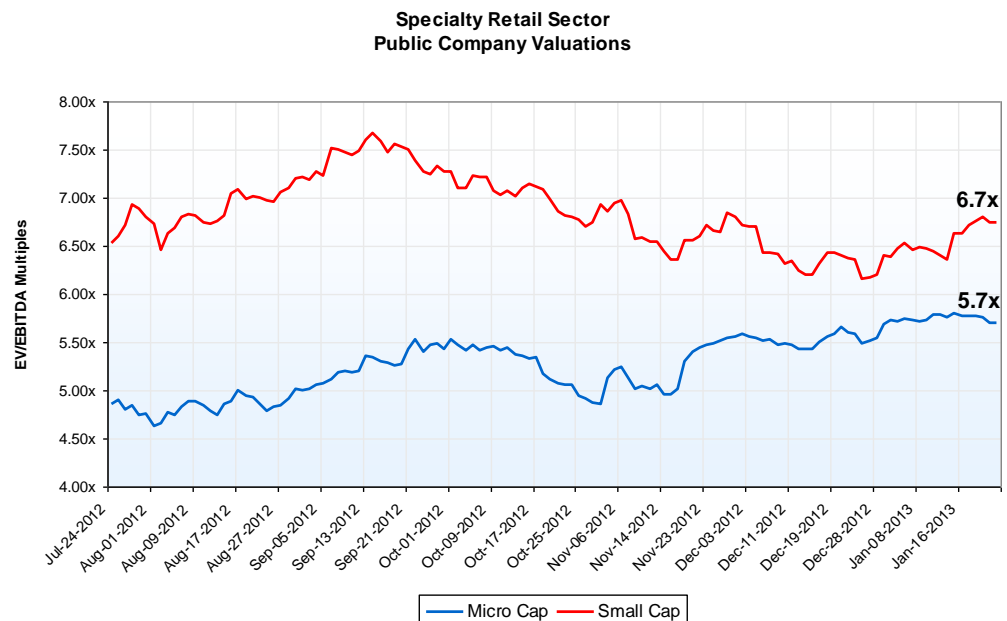
BRICKS ACQUIRE CLICKS

For the last year, we have been tracking the emerging trend of brick & mortar retailers (and to a lesser extent consumer product manufacturers) acquiring pure play internet retailers in their respective merchandise categories. In just the last 90 days, several such examples have sprung up. Autozone announced its acquisition of Blue Ribbon Motoring d/b/a AutoAnything.com, an internet retailer of automotive accessories, to facilitate growth in its online business. TJX, which had not previously had an online presence, acquired Sierra Trading Post, an internet retailer of close-out merchandise. In Sierra, TJX acquired a large and highly scalable internet platform boasting 700 employees. Last but not least, Aeropostale acquired GoJane.com, an internet retailer of fashion footwear and apparel, to extend its product offering and grow its existing online business.

VALUATION

The majority of recent specialty retail deals did not disclose terms, and thus provide limited guidance on valuation. However, based on transaction data over the last four years, the median enterprise value to EBITDA multiple was 6.1x for specialty retailers under \$500 million in deal size. For larger deals, those over \$500 million in transaction size, the median enterprise value to EBITDA multiple was 8.8x.

While precedent transaction data is somewhat limited, fortunately there are a multitude of publicly traded companies in the specialty retail sector which are useful for valuation guidance. As of the date of this publication, specialty retailers in the micro cap bracket (defined as those with less than \$250 million in market capitalization) traded at an average enterprise value to EBITDA multiple of 5.7x. Specialty retailers in the small cap bracket (defined as those with market capitalizations between \$250 million and \$2 billion) traded at an average enterprise value to EBITDA multiple of 6.7x. While size is a factor in valuation, the valuation gap between smaller companies and larger ones narrowed in 2012.



Source: Capital IQ, Tully & Holland Analysis

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 retailers, multi-channel marketers, food companies, and consumer product manufacturers/distributors.

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