

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.

CONTENTS

Executive Summary

Retail Economic Indicators

M&A Transactions

Public Offerings

Private Placements

Valuation Analysis

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.

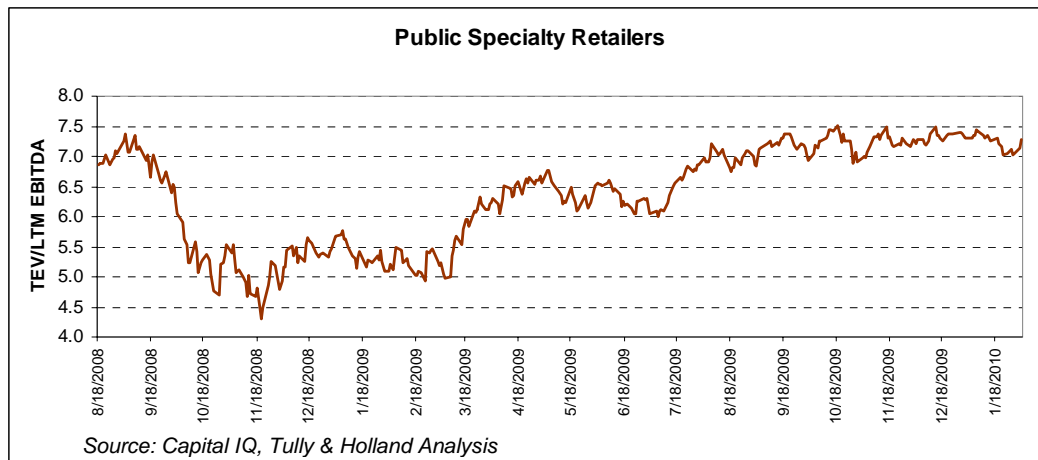
<u>Announced Date</u>	<u>Issuer</u>	<u>Gross Offering Amount (\$mm)</u>	<u>Investors</u>	<u>Trend</u>
12/21/2009	Bluefly Inc.	\$ 15.0	Rho Ventures VI, L.P.	Internet Retail
12/17/2009	Zulily, Inc.	\$ 4.6	Maveron LLC	Internet Retail
12/14/2009	Moosejaw Mountaineering and Backcountry Travel, Inc.	na	Glencoe 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