
Retail and Consumer 2012 in Review

Omnichannel marketing, niche reach and growth plays characterized a dynamic year

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Situation Room:

The domestic retail and consumer sector outperformed the broad economy this past year, albeit on shaky ground. Even with the backdrop of a languishing macroeconomic environment and a political landscape wrought with uncertainty, the American consumer continued to remain positive. Consumer confidence improved between January and November, even while underlying economic fundamentals continued to send mixed signals to the marketplace. The American consumer's stubborn refusal to yield to macroeconomic pressures and curtail spending habits helped push retail and consumer company equity valuations higher throughout the year.

The retail and consumer sector outperformed the broad market in spite of a weak macro environment

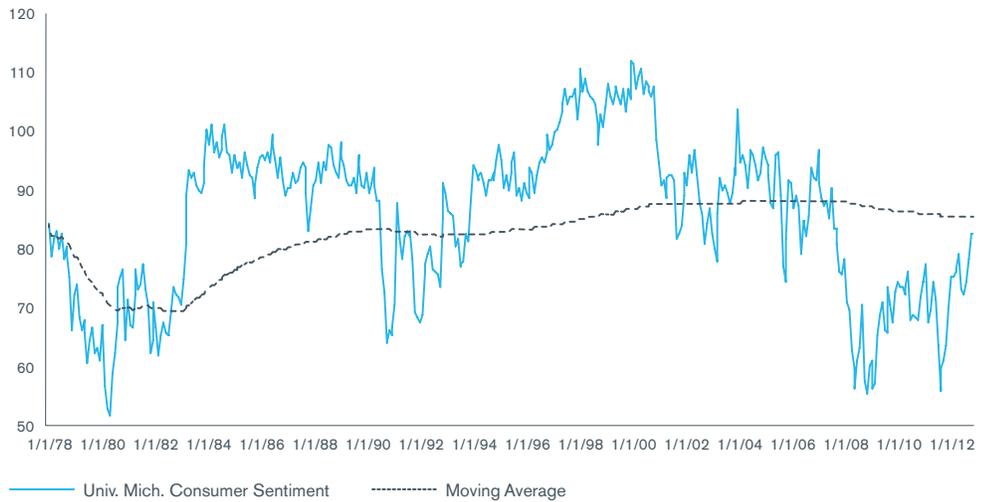
Investment trends focused on growth, niche-market expansion and omnichannel integration

M&A Trends:

Duff & Phelps has isolated three trends driving volume this year in the M&A marketplace:

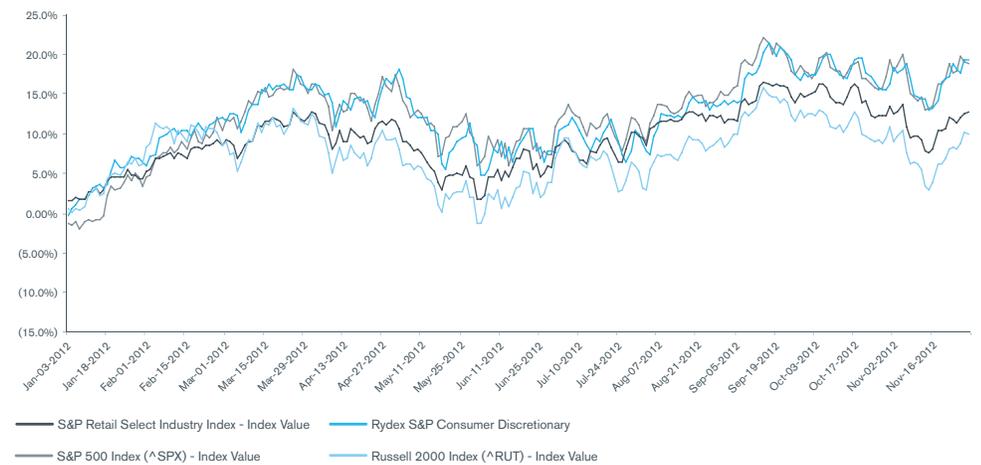
- **Omnichannel Integration** – Investment into omnichannel distribution and marketing, including mobile commerce, was a core M&A driver among strategic consumer and retail players
- **Niche-Market Expansion** – The era of personalization and specialization continues. Consumer and retail companies took note by purchasing into fast-growing niche markets, as opposed to all-encompassing brands
- **Sponsor Growth Plays** – Sponsors are seeking growth opportunities in a continued low-growth marketplace. With consumer sentiment in an aggregate upward trajectory, the retail and consumer sector is driving increasing investor interest

University of Michigan Consumer Confidence Index



Source: University of Michigan

Consumer & Retail – 2012 Relative Equity Performance



Source: Capital IQ

Improved consumer sentiment in a continued slow-growth economy

Macroeconomics and Geopolitics

Political Economy Overview:

An outside observer would not be faulted for thinking that the headlines of the last several years were simply cycled through again in 2012. The American economy continues to stumble forward and European politicians continue their banal fiscal arguments while their constituents protest austerity. But 2012 was, beneath the seeming predictability of newspaper headings, a dynamic year that brought with it increased geopolitical challenges and new economic opportunities.

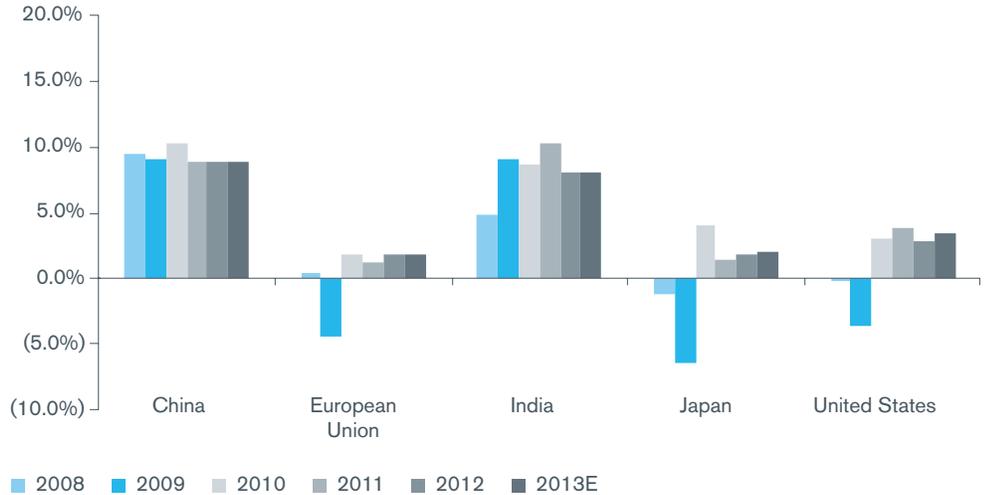
2012 brought continued macro-economic challenges, with a focus on U.S. government spending and fiscal austerity in Europe

The geopolitical uncertainties we face are easy to delineate but difficult to solve. In the United States, we have faced a potential Fiscal Cliff in 2013, a consumer savings rate of less than 8%, a Congress unwilling to compromise, and an uncertain future tax environment. Rolled into this environment is an extraordinary lack of clarity when it comes to the future of healthcare costs and financial regulations. All of these contribute to both a sour sentiment about short-term growth prospects and a general unwillingness to pursue capital initiatives among business leaders. Looking globally, the economic future becomes even more uncertain as stochastic variables make regional growth predictions increasingly difficult.

In spite of the economic lethargy and political uncertainty, 2012 saw renewed glimmers of a sustainable recovery. At the time of this publication, U.S. GDP is on track to increase by 2.8% in 2012 with a 3.4% increase expected during 2013.¹ U.S. housing starts continue to improve and PMI expectations remain positive. Notwithstanding a prolonged budgetary debate in Washington, the U.S. economy is poised for slow, but steady, growth in 2013.

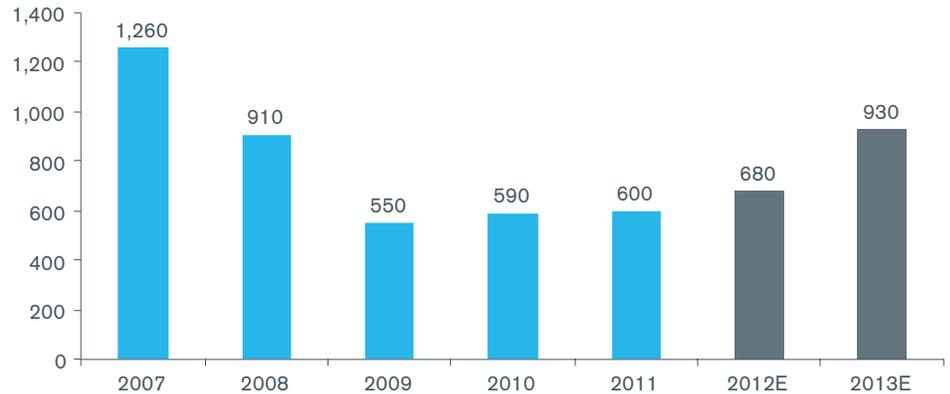
1. The Guardian, 2012

Global GDP Growth



Source: World Bank

U.S. Housing Starts



Source: FreddieMac

Macroeconomics and Geopolitics continued

Retail & Consumer in Focus:

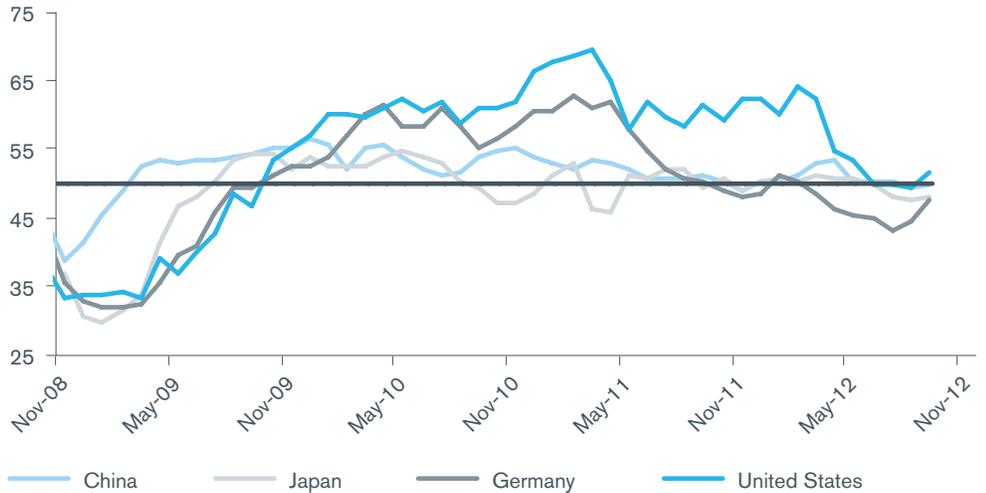
In late 2012, business leaders reported one of the most negative outlooks since the depths of the financial crisis.¹ On the other hand, measures of consumer confidence indicate that consumers are more confident than they have been since the start of the recession. Consumers appear to be looking past the high unemployment rates that have become the new norm and the impact of widespread tax increases. Instead they are focused on the improving housing market and a stock market that has performed relatively well. Seeing their net worth increasing from the financial crisis nadir, the American consumer is optimistic about 2013.

Such optimism has led to increased retail sales during the first three quarters of 2012 with expected increases in Q4 as well. However, increased retail sales will not necessarily lead to a rising tide across the sector. Consumers are still increasingly searching online for their purchasing needs as well as turning from the mass channels towards specialty retailers catering to a specific niche. Consumers are looking not only at price, but also at the ease of purchase and the overall service experience.

Duff & Phelps 2013 Outlook:

Duff & Phelps' retail and consumer practice remains marginally bullish going into 2013. As reported by The Guardian, many analysts expect FY 2013 retail sales growth of 3.0% on a GDP growth rate of roughly 2.0%. Retail and consumer sales are expected to be buoyed by strong consumer sentiment, which therefore represents a risk should the drivers of this index fall. U.S. retail and consumer lines may also increasingly engage the emerging markets, due in part to continued market liberalization initiatives such as the recent Indian allowance of multi-national retailers. The possible upside of such liberalization may provide opportunities to U.S. retail firms with an international global footprint and global brand recognition.

Purchase Manufacturing Indexes



Source: Bloomberg

Duff & Phelps and consensus estimates point to continued growth in 2013

U.S. Retail Sales



Source: Bureau of Economic Statistics

1. National Federation of Independent Business

Mergers and Acquisitions – Retail and Consumer

M&A Transaction Volumes

M&A activity in the retail and consumer sectors remained strong throughout the year, with 128 deals closing in the first three quarters of the year. Most transactions occurred in the Retail and Food & Beverage spaces, with these two sub verticals accounting for nearly 59% of all deal activity. Final FY 2012 aggregates are likely higher than 2011 numbers, due in part to the recovery of bank lending and debt capital markets, the prevalence of cash among both private equity and strategic buyers and the fear of non-trivial increases in capital gains taxes by private business sellers. That said, the valuation spread between buyers and sellers has yielded a large number of hung deals. As M&A spreads contract and consumer-facing businesses continue to show positive performance through the holiday season, the M&A market could maintain an upward trajectory into 2013.

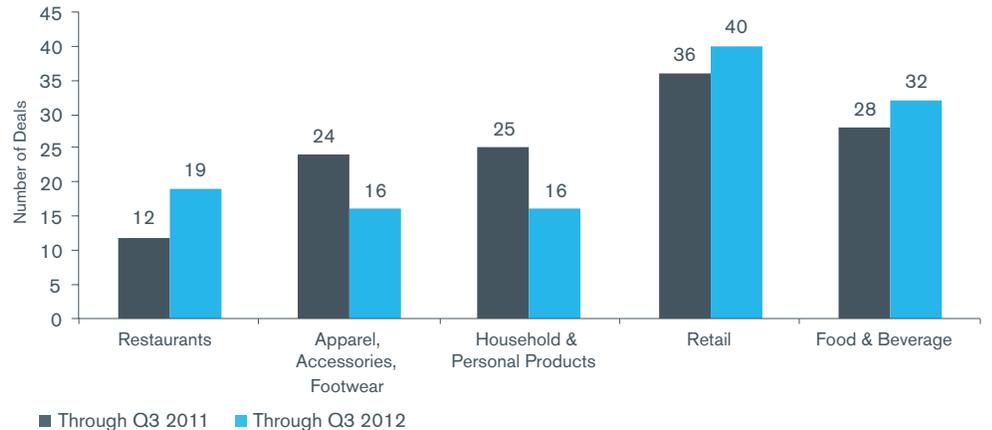
Deal flow remained in line with expectations as Q4 is expected to be robust given an uncertain tax environment in 2013

Total 2012 Retail / Consumer M&A Value and Volume



Source: Capital IQ as of September 30, 2012

Retail / Consumer M&A By Segment (2011 – 2012)



Source: Capital IQ as of September 30, 2012

2011 - 2012 M&A Activity Comparison

(value in \$billions)	Q3 2012		Q3 2011		% Change	
	Volume	Value	Volume	Value	Volume	Value
Less than \$100	21	\$0.8	26	\$1.1	(19%)	(27%)
\$100 - \$499	18	4.1	11	2.6	64%	58%
\$500 - \$999	2	1.5	1	1	100%	50%
Total Middle Market	41	\$6.4	38	\$4.7	8%	36%
Greater Than \$1bn	4	7.1	3	6	33%	18%
Total Market	45	\$13.5	41	\$10.7	10%	26%
% Total Market						
Less than \$100	47%	6%	63%	10%		
\$100 - \$499	40%	30%	27%	24%		
\$500 - \$999	4%	11%	2%	9%		
Total Middle Market	91%	47%	93%	44%		
Greater Than \$1bn	9%	53%	7%	56%		
Total Market	100%	100%	100%	100%		

Source: Capital IQ and publicly available data

Source: Capital IQ

Mergers and Acquisitions – Retail and Consumer continued

M&A Transaction Valuations

M&A multiples YTD increased Y-o-Y to 10.4x EV/EBITDA from 10.2x in 2011. Valuation multiples for retail and consumer transactions are above the 10-year average multiple, reflecting the availability of debt capital to bolster purchase prices and signaling that the market is pricing in continued future growth, and that sponsors and strategics alike are willing to pay up for quality assets.

Overall deal activity was partially driven by large retail and consumer firms divesting non-core brands and businesses. Examples include the Nike sale of Umbro and Cole Haan brands to Iconix Brand Group and Apax Partners respectively, the sale of Dole's packaged foods business to Itochu and the Dean Foods sale of Morningstar to Saputo. These divestitures support a continuing corporate trend of streamlining operations in an uncertain macroeconomic climate and the shedding of low-margin, underperforming, or non-core business lines. At the same time, both pure play strategics and sponsor-backed portfolio companies are seeking opportunities to take market share and enter new market segments, while at the same time eliminating duplicative corporate expenses. For example, Darden Restaurants, the parent company of Olive Garden, Red Lobster and LongHorn Steakhouse, acquired the fast-growing Yard House restaurant chain from TSG Consumer Partners. In addition, Starbucks' announced acquisition of Teavana at a reported 17.5x EBITDA is indicative of the premium corporations will pay to enter new markets.

Yearly EV/EBITDA M&A Multiples



Source: Capital IQ as of September 30, 2012

Retail and Consumer Deal Trends

Omnichannel Capabilities

In the retail space, strategic players bought heavily into omnichannel distribution and marketing lines this year. Retailers are increasingly looking at acquisition opportunities to increase their exposure in e-commerce and mobile sales platforms. Traditional brick and mortar retailers have been under mounting pressure from established online players, such as Amazon and Zappos, as well as fast-growing upstarts, such as Gilt Group and ModCloth. In order to combat this trend, retail and consumer businesses have been diversifying their revenue base through investments into established omnichannel lines. For example, in April Nordstrom invested in the online retailer Bonobos to gain access to their ecommerce platform¹ and Liberty Media's QVC announced the acquisitions of the members-only ecommerce site Send the Trend and social market place Oodle. Earlier this year, Zumiez acquired Blue Tomato to take advantage of the company's strong brand and omnichannel marketing capabilities.

Retail and consumer companies are acquiring into omnichannel platforms to increase their web and mobile presence

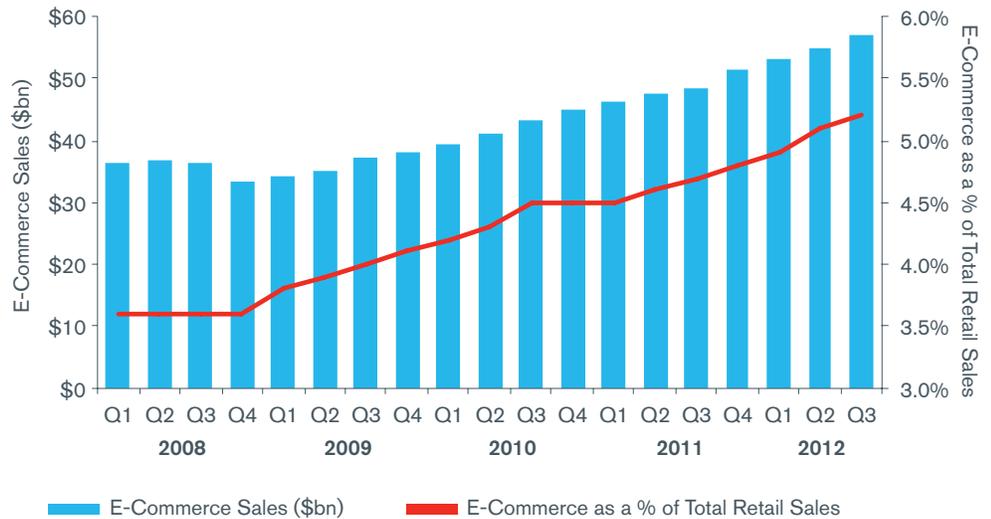
Recent studies, including the 2012 Retrevo and Cortex Study, indicate increasing instances of 'showrooming'; this trend describes the phenomenon in which consumers browse in stores but purchase items online, often using mobile devices, in the hopes of a discount.

Studies indicate that nearly 25% of online sales started by customers viewing the item in a brick-and mortar location first.² Meanwhile, e-commerce has continued growing both in absolute terms and as a percentage of retail sales.

1. Forbes.com, April 2012

2. 2012 Retrevo and Cortex Study

U.S. E-Commerce Sales Trends



Source: U.S. Census

Niche Market Expansion

Duff & Phelps also witnessed increased investment in niche retail and consumer markets by strategic players. Retail and consumer M&A activity in 2012 was characterized by a number of specialized strategic transactions geared towards increased niche market exposure. Zumiez's acquisition of Blue Tomato, for example, showcases cross-border entry from the U.S. to the European youth snowboard and ski apparel market while Signet Jewelers' purchase of Ultra Diamonds represents expansion of a mall-based retailer into the burgeoning outlet channel. The acquisition of Skagen Designs by Fossil further suggests that U.S. companies are seeking growth in new markets overseas. Such transactions indicate that companies are looking for micro-growth opportunities in a slow growth environment.

The 21st century is already shaping into the century of personalization, in much the same way that the prior century brought the advent of mass production. Consumers are increasingly purchasing niche products specially designed for their distinct lifestyle. Niche markets offer attractive additional cash flows to retailers looking to use new and untapped resources. By targeting a specific cluster of customers, retail and consumer firms can execute more targeted marketing while engaging a less elastic pool of demand.

Certain niche markets see above-market growth rates, causing retail and consumer firms to take note

Retail and Consumer Deal Trends continued

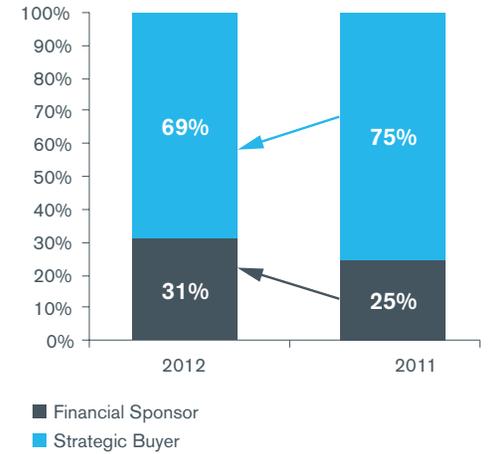
Financial Sponsors Buying Into Growth

Financial sponsors have been more active in 2012 than in prior years, due in part to increased credit availability. One continued trend was the continued search for growth plays by private equity firms. TH Lee Partners acquired Party City for \$2.7 billion, delivering over a 3 times return to the selling private equity owners. Leonard Green & Partners and TPG Capital acquired Savers for a reported \$1.7 billion or 12x EBITDA. The consortium buyout of Collective Brands also indicates a focus on growth potential among

sponsors searching for company-specific opportunities. Finally in the food retail segment, Oak Hill's acquisition of Earth Fare and Ares Management's acquisition of Smart & Final underscore renewed interest in higher growth, non-traditional grocery retail formats.

Financial sponsors have been searching for high-growth opportunities in a slow macro environment

Strategic vs. Sponsor Deal Volume



Source: Capital IQ

Retail and Consumer Capital Markets

2012 Equity Index Gains

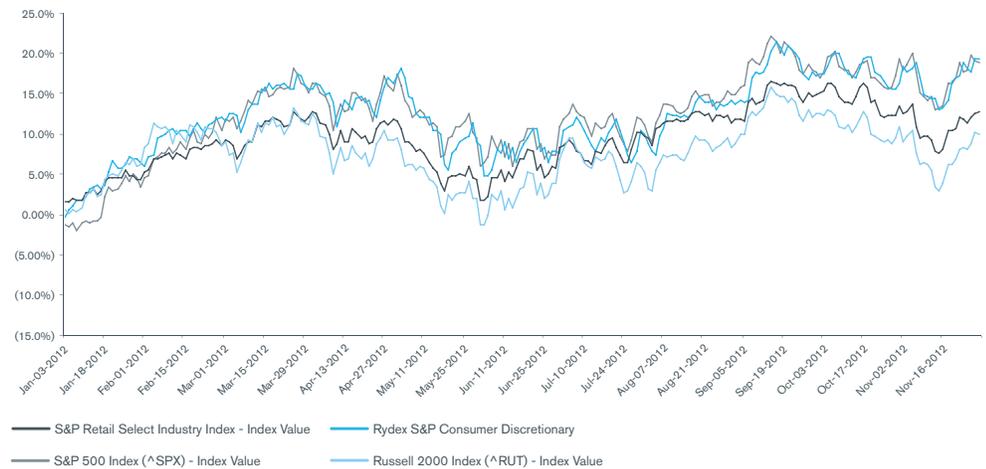
S&P Retail Select Industry Index:	21.9%
S&P Consumer Discretionary:	19.35%
S&P 500:	10.35%
Russell 2000:	9.28%

The consumer and retail equity markets displayed strength in spite of continued macro instability and political uncertainty regarding both the domestic Fiscal Cliff and continued European bailouts.

Equity markets were in line with the industry's M&A trends as Specialty Retail outperformed, gaining over 45% since January 1st, 2012. Specific sub-sectors with room for niche growth, including Apparel, Accessories and Footwear Retail, also saw substantial gains in the equity markets over the first three quarters of 2012.

Source: Capital IQ and publicly available data unless otherwise noted

2012 Retail and Consumer Equity Index Performance



Source: Capital IQ

Retail and Consumer Capital Markets continued

Equity values rose as consumer confidence improved over the year. Going forward, both consumers and retail industry investors may continue to see opportunities in 2013.

Despite the large increases in equity stock prices, the valuation multiples for consumer and retail companies did not increase at an unreasonable rate. Instead, the market is beginning to price growth back into the sector to account for the underlying rise in consumer confidence throughout 2012. This increase in consumer confidence came in tandem with only moderately increased industrial output, often weak employment numbers, and a volatile political environment. Yet despite these, the American consumer was willing to spend, increasing their retail spending 4.1% Y-o-Y on average during the first three quarters of the year. After nearly four years of recession, the savings-poor, often leveraged American consumer was willing to buy again, pulling the industry ahead of the broad economy.

It is currently uncertain if such spending can be sustained in 2013. Pending tax increases may cause the average consumer to cut back on discretionary spending. However, a short term decline in the equity markets may not materially impact the long-term omnichannel integration, niche product expansion, and growth-focused investing trends that are expected to drive the market for years to come.

Retail & Consumer Public Equity Offerings Q3 2012

(value in millions)

Offer Date	Issuer	Industry Sector	IPO/Secondary
November 1, 2012	Restoration Hardware Holdings, Inc.	Home Furnishings	IPO
September 27, 2012	Dollar General Corp.	Discount Stores	Secondary
August 9, 2012	Dunkin' Brands Group, Inc.	Restaurants	Secondary
August 9, 2012	GNC Holdings	Specialty Retail	Secondary
August 7, 2012	Bloomin' Brands	Restaurants	IPO
July 31, 2012	Annie's, Inc.	Packaged Foods	Secondary
July 26, 2012	Del Frisco's Restaurant Group	Restaurants	IPO
July 24, 2012	Natural Grocers by Bitamin Cottage, Inc.	Food Retail	IPO
July 23, 2012	Chuy's Holdings, Inc.	Restaurants	IPO
July 18, 2012	Sally Beauty Holdings, Inc.	Specialty Retail	Secondary
July 18, 2012	Five Below, Inc.	Specialty Retail	IPO
July 17, 2012	Susser Holdings Corp.	Food Retail	Secondary

Source: Captial IQ

Retail & Consumer Sub-Sector Equity Performance

Industry Sector	Change in Stock Price		Median Enterprise Value / LTM	
	3 Months	12 Months	Revenue	EBITDA
Specialty Retail	8.0%	45.6%	0.6x	9.8x
Department Store Retail	8.0%	17.4%	0.7x	6.6x
Discount Stores & Mass Merchants	5.2%	36.6%	0.7x	8.8x
Apparel, Accessories, & Footwear Retail	10.7%	47.5%	0.6x	6.9x
Apparel, Accessories, & Footwear	10.3%	21.1%	1.0x	9.5x
Furniture & Furnishings Retail	9.7%	45.2%	1.0x	8.5x
Furniture & Furnishings Manufacturers	9.7%	27.3%	0.8x	7.4x
Personal Care Products	10.2%	13.2%	1.4x	9.8x
Household Products	13.2%	43.9%	1.4x	8.9x
Recreational & Leisure Products	6.9%	35.7%	1.4x	8.8x
Restaurants	1.8%	18.0%	1.2x	9.2x
Packaged Foods	3.6%	10.3%	1.7x	10.4x
Beverages	1.2%	25.8%	3.7x	14.5x
Food Retail	3.4%	18.7%	0.3x	5.8x

Source: Captial IQ

Select Retail and Consumer Transactions

Sell Side Advisor



has been acquired by



Exclusive financial advisor to Eastern Mountain Sports, Inc.

Buy Side Advisor



has acquired



Exclusive financial advisor to Zumiez Inc.

Sell Side Advisor



has been acquired by



Exclusive financial advisor to Ultra Stores, Inc.

Placement Agent



\$38,000,000 Senior Credit Facility

Exclusive financial advisor to Black Angus Steakhouse

Sell Side Advisor



has been acquired by

SUN CAPITAL PARTNERS, INC.

Exclusive financial advisor to Friendly's Holding Company, Inc.

Restructuring Advisor



has emerged from Chapter 11 bankruptcy

Exclusive financial advisor to the Unsecured Creditors Committee

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