

Grant Thornton Corporate Finance mergers & acquisitions

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Grant Thornton Corporate Finance Mergers & Acquisitions

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Urban Fashion Retailing

Investors get hip (hop) and discover urban retailing

Executive Summary

Despite the buzz from the Initiative for a Competitive Inner City (ICIC) study years ago, the investment community had largely ignored the tremendous opportunity in urban retailing — that is until 2005, when no less than four privately-held urban retailers completed transactions. Interest in the urban sector further sky rocketed following the highly successful initial public offering (IPO) of urban off-price retailer Citi Trends in mid-2005. While no private equity backed transactions have occurred in recent months, investor interest remains strong with several retail-focused private equity groups anxious to either acquire a majority or minority stake in successful retail chains, or to provide the capital needed to fuel their growth.

Industry Overview

- The urban retail segment is a sizable niche market. One estimate of the urban apparel market from NPD Fashion World, pegs U.S. sales at \$58 billion. Still another places aggregate annual expenditures by 15 to 24-year-olds in the 15 urban areas with the highest concentration of multicultural youth at \$160 billion.¹
- Due to its heavily congested population density, the urban market boasts some of the highest rates of retail spending per

square mile in the country.² Densely populated inner-city markets can support exceptionally high store productivity for strong operators with the right product.

- Urban retail sales are expected to grow at a rate significantly faster than the overall economy — due to stronger than average population growth. The African-American population is growing faster than the overall population and will grow to 40.5 million persons by 2010, according to the U.S. Census. >

¹The U.S. Youth Market, Packaged Facts, July 2003

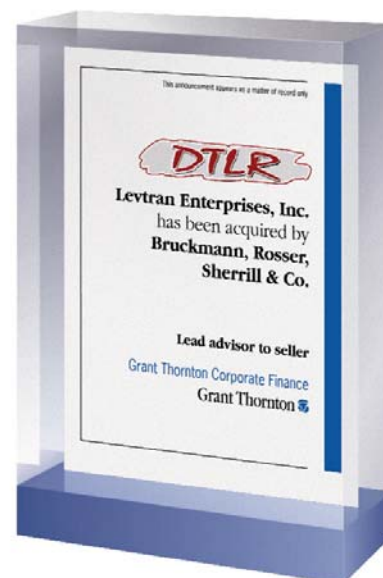
²The Business Case for Pursuing Retail Opportunities in the Inner City, ICIC/Boston Consulting Group, June 1998, restated in June 2002 report.

- Despite its large size and attractive investment characteristics, the niche urban fashion retail market remains highly fragmented and today is primarily served by smaller regional specialty chains and single store operators. Outside of footwear chain Foot Locker and apparel chains like Dots and Rainbow, the urban market has been largely avoided by large national retailers. Most large retail corporations remain hesitant to enter the urban market primarily due to a lack of understanding and information about inner-city consumers and real estate.
- Of those truly authentic chains catering predominately to the African-American shopper, fewer than 10 retailers operate chains with more than 50 doors and none of these are national players. We believe the largest chains focused on the urban consumer to include: Citi Trends, Simply Fashions, Ashley Stuart, Forman Mills, Shiekh Shoes, Jimmy Jazz, DTLR, Man Alive, Epic and Against All Odds. Other than Citi Trends and Man Alive (now owned by Finish Line), all of these key industry players are privately held.
- The highly fragmented structure of the market may present a significant opportunity for consolidation. The marketplace is already observing five regional urban fashion retailers expand outside their core regions in a bid to become larger, national players. Jimmy Jazz has expanded beyond the Northeast into the mid-Atlantic and Detroit, DTLR is looking outside of its core Southeast market to Chicago and Man Alive has expanded outside of its core Midwest presence into the Southeast, to name a few. While we believe there is room for multiple participants in the same markets, particularly because of product differences, certain regions in the Southeast and parts of the Midwest are becoming increasingly competitive.

M&A ACTIVITY

Not so long ago, private equity groups steered clear of the retail sector, preferring to invest in lower risk sectors like branded consumer goods or industrial manufacturing. Recently, this investment climate changed for retailers when a host of private equity groups entered the sector through well-publicized M&A deals, including Neiman Marcus, Linens N Things, Burlington Coat Factory, Sports Authority, Shopko, Sally Beauty, and Michaels. While many are probably aware of these and other retail mega-deals, fewer perhaps have observed the heightened interest in smaller specialty retail chains, but that is just what has happened.

2005 saw a number of interesting developments in urban retailing, notably the IPO of private equity backed Citi Trends (owned by Hampshire Equity Partners), the sale of DTLR to private equity group Bruckmann, Rosser, Sherrill, and the acquisition of a majority stake in Sneaker Villa, made by venture capital group Catalytic Capital LLC and a group of private investors organized as Haystack LLC. While no private equity backed urban retail deals have been reported thus far in 2006, we believe that this is a result of a lack of willing sellers, as there is no shortage of private equity buyers.



Transaction List Summary

Date	Transaction Type	Target Company	Trade Name	Buyer/Investor
Jun-06	Merger/Acquisition	Long Rap, Inc.	Up Against the Wall	Blue Holdings, Inc. (NASDAQ: BLUE)
Nov-05	Merger/Acquisition	Lutz Enterprises, Inc.	Sneaker Villa	Catalytic Capital LLC, Haystack LLC
Oct-05	Merger/Acquisition	Levtran Enterprises, Inc.	DTLR, Down Town Locker Room	Bruckmann Rosser, Sherrill & Co. L.L.C.
May-05	IPO	Citi Trends, Inc.	Citi Trends	Hampshire Equity Partners
May-05	Merger/Acquisition	Norstan Apparel Shops, Inc.	Fashion Cents	DJM Asset Management, LLC, Gordon Brothers Group, LLC, Hilco Merchant resources LLC, Hilco Real Estate LLC, Rainbow Northeast Leasing, Inc., Retail Partners, LLC, Simply Fashions Stores, Ltd.
Jan-05	Merger/Acquisition	The Hang Up Shoppes, Inc.	Man Alive	Finish Line Inc., NASDAQ NM:FINL
Apr-04	Merger/Acquisition	Urban Brands, Inc.	Ashley Stuart	Trimaran Capital Partners
Apr-04	Merger/Acquisition	Footaction USA	Footaction	Foot Locker Inc. (NYSE: FL)
Feb-04	Merger/Acquisition	Hat World Corp.	Hat World, Lids	Genesco Inc. (NYSE: GCO)
Jun-03	Merger/Acquisition	DOTS, Inc.	DOTS	William Blair Capital Partners

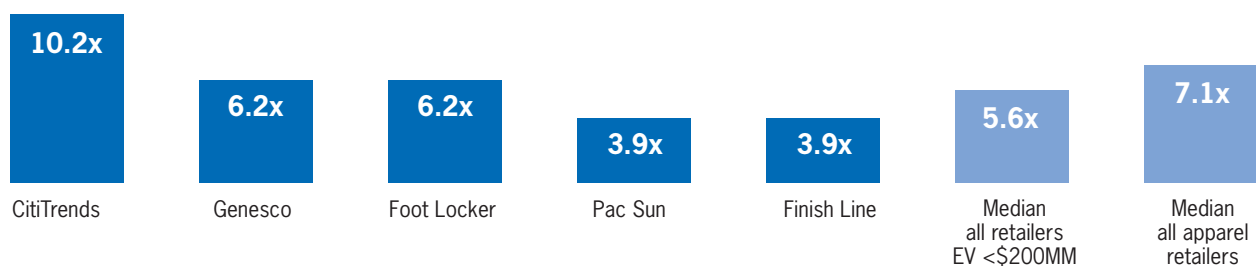
Notably large fashion retail chains tend to shy away from acquisitions, choosing to launch (and roll out) their own concept. Of those strategic deals that do occur, many involve the acquisition of an underperforming player at a relatively low price. The intention of such deals is to bring about a turnaround or to take control of the lease portfolio and convert the doors to another concept. We believe that the Man Alive and Fashion Cents transactions during 2005 fall under these categories.

VALUATION

Precedent Transactions

While most urban retail transactions have not been available for public display, a number of privately held fashion retailers have recently sold in the 5.5x to 7.5x Adjusted EBITDA range. However, critical mass (EBITDA >\$10 million), experienced management, superior store economics, strong growth rates and a clearly differentiated store concept are a few identifiable characteristics that can push valuation multiples to the upper end of the range and beyond. >

Urban fashion retail public comparables TEV/EBITDA multiples



Public Company Comparables

Except Citi Trends and Finish Line (which operates Man Alive), all of the authentic urban retailers today remain privately held. We believe it is difficult to look to Citi Trends as a valuation comparable, because its high flying valuation is clearly outside of normal retail valuation parameters. Rather, for valuation guidance, we point to certain specific retailers selling similar products and keep in mind the overall valuation statistics for small capitalization public retailers and the median valuation statistics for the apparel retail segment. Examining this data, it is clear that public enterprise valuations, with the exception of high growth retailer Citi Trends, are currently in the 4.0x to 8.0x EBITDA range.

Conclusion

The urban market appears to provide one of the last, large untapped opportunities for retail consolidation in the United States, offering industry players an opportunity to achieve superior store economics on a fragmented playing field still ignored by most national retailers. Flush with cash for investment, several private equity investors have acquired regional urban retail chains to exploit the market opportunity. Investor interest in the sector continues today, with a host of private equity groups looking to acquire or invest in urban retail.

About Grant Thornton Corporate Finance LLC

Grant Thornton Corporate Finance provides boutique investment banking services to privately held middle-market businesses in the United States and around the world. As a recognized advisor on middle-market mergers and acquisitions, we offer a range of investment banking services including sell side advisory, buy side advisory, management buyouts, restructurings and capital raising. Grant Thornton LLP provides investment banking services through its wholly owned broker-dealer subsidiary Grant Thornton Corporate Finance LLC.

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