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**STORE DESIGN
DEPARTMENTS:
THE PENDULUM
SWINGS... AGAIN...**

CHICAGO | FRANKFURT | LOS ANGELES | NEW YORK | PARIS



Results you can rely on

STORE DESIGN
DEPARTMENTS:
THE PENDULUM
SWINGS... AGAIN...



Results you can rely on

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Retail Store Design Departments: The Pendulum Swings...Again...

Introduction

“Fixtures are a huge capital investment – we must understand both our product and customer to make wise choices...”

It is our view that the increasing clout of the store design function is being driven by more than a robust economy...

The ascent of Terry Lundgren to the helm of Federated and, more recently, Scott Olivet to the CEO position at Oakley, reflects an emerging trend in the retail industry. Both executives cut their teeth in the store design departments at large retailers before moving into the corner office. We all know that retail can be a harshly cyclical industry and that store design departments are often at the leading edge of growth and cutbacks. However, many are beginning to speculate about what may be a more lasting change in the role of the store planning groups at the nation’s largest retailers. Store executives who have tired of trying to ‘out-Wal-Mart Wal-Mart’ have begun to realize that they have other competitive weapons in their arsenal despite their smaller scale. While it may not be possible to consistently beat Wal-Mart on price, you can compete effectively against them by creating a more appealing overall shopping experience. To create this more appealing shopping experience, retailers need to invest in design capabilities and empower the store design departments with greater influence and decision-making authority. The rising profile of these groups is not only being driven by a strong economy, but by an emerging operating philosophy that is being adopted at the highest levels of the retail executive ranks.

A broader philosophical shift may be driving this trend.

This report will outline the impact that the recession had upon store design departments at the nation’s leading retailers; trace the rebound of these groups since the beginning of the consumer boom in 2003; discuss the reasons for increasing corporate focus on a group that was once viewed by many as a cost-center; and comment on the impact that this increasing clout is likely to have on store fixtures manufacturers.

The Dark Days of Store Design

“It takes the same number of people to design 50 new stores as it does five – you just work harder and have less customization...”

The first recession of the new Millennium may not have been a long one by historical standards. In fact, its duration of eight months was statistically shorter than the average of the nine other U.S. recessions that have occurred since World War II. Frankly, in many respects the recession was not as severe as many had expected it to be following the bursting of the dot.com bubble

in 2001. Unemployment spiked, but remained relatively benign by historical standards. Wages slipped, but many were spared the pain that many deeper recessions have inflicted on workers. Now, that being said, retailers certainly felt pain during the period. Overall revenue growth rates declined or, in many cases, fell into the red. Comp store sales levels declined or dipped below zero. Perhaps most importantly, operating cash flow margins – adjusted for capital expenditures – deteriorated meaningfully from 2001 through 2003. As is always the case, tough economic times led senior managers to seek cost cutting opportunities throughout their organizations and store design departments suffered as a result. Compounding the broad economic difficulties during these years, it is our view that many retailers were still in the midst of a ‘strategic shift’ that had started in the prior decade.

We would argue that the late 1990s and early 2000s saw a meaningful shift take place in terms of retail strategy. The lessons of Wal-Mart, which consumer packaged goods manufacturers had been learning for many years, were becoming increasingly apparent to retailers of all shapes and sizes. Best practices from the nation’s largest retailer were analyzed and applied throughout the industry. An unprecedented focus on profitability and capital efficiency led to greater scrutiny of every dollar invested and each line item on the income statement. In many ways, this new operating philosophy was epitomized by the arrival of Bob Nardelli at Home Depot in 2000 and his subsequent efforts to revamp the then-stumbling retailer’s modus operandi. The very nature of the shopping experience was changing. The emphasis became the delivery of inexpensive goods as efficiently as possible to an increasingly standardized store base. There was very little emphasis on building customer loyalty through a differentiated shopping experience – it was all about price. When combined with a weak economic environment and, arguably, a myopic focus on the bottom-line, this emerging philosophy endangered store design teams and others who were viewed as ‘cost-centers’ in this new retail model.

The impact on store design departments was immediate and severe. Many retailers pared back their store openings and refurbishment plans significantly, and the professionals who were supposed to design those stores were viewed as expendable. While a limited number of retailers made efforts to maintain their staffing levels, many groups experienced cut-backs of more than 50%. It is our sense that industry-wide head count reductions in store design departments may have exceeded 25% – perhaps by a significant margin. Overall budget levels experienced similar cutbacks and

Pressure from Wal-Mart forced retail executives to focus on margin enhancement and capital efficiency...

And store design teams paid a stiff price.

Strategic M&A deals slow the pace of CapEx and led to layoffs.

outsourcing became much more prevalent. The dollars that were allocated to the store design function were scrutinized rigorously and the remaining staff was stretched to maximize group efficiency.

“...We were under pressure to reduce square foot costs of stores and to acquire all new store fixtures at as low a price as possible...”

There was another important strategic development during these years that added to the difficulties of store design teams. Retail mergers and acquisitions resulted in staff redundancy throughout many functional areas – including store design and development. As retailers merged in an effort to increase scale to compete with the category leader, the pursuit of synergies drove further cost-reduction initiatives. While the argument can be made that these transactions enhanced the need for these teams in many ways (particularly with regard to remodelling the existing stores of the target to conform to the identity of the acquirer), in many cases the result was additional layoffs.

Furthermore, as discussed in our December 2005 report entitled “Retail M&A – The Impact on Capital Expenditures,” these strategic transactions typically put a damper on new capital expenditures for the two years following the completion of a deal. The following data, excerpted from that report, illustrates the median growth in capital expenditures of retailers in the years immediately prior to and following a strategic M&A transaction.

Strategic Buyer Transactions

Sample Size: Sixteen Transactions Median Transaction Value: \$1.5 billion	
Median CapEx Growth — YoD - 1	16%
Median CapEx Growth — YoD	0%
Median CapEx Growth — YoD + 1	1%
Median CapEx Growth — YoD + 2	3%

* YoD = Year of Deal

A ‘Perfect Storm’ dealt a difficult blow to the store design function.

Given the rationale for most of these transactions, the reason for this deceleration is quite simple. Managers are more focused on rationalizing the combined store base to weed out underperforming locations than they are on expanding the store count. As a result, the pace of new store openings typically slows and the need for design staff declines accordingly.

In many ways, these years represented the perfect storm for store design departments: a weak economy; a new operating philosophy that was premised on standardization of the shopping experience; and a boomlet of M&A deals. Those who managed to keep their jobs 'operated in the background' and worked hard to maintain their influence with the key decision-makers.

Thank You Mr. Greenspan

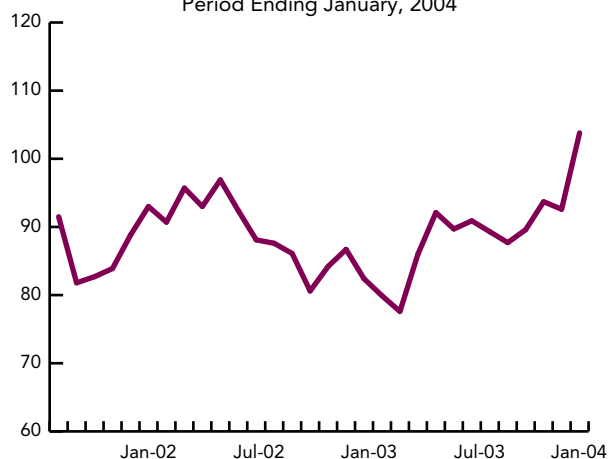
"...Forget the costs – design great stores and define our brand..."

It is difficult to identify a specific turning point, but most agree that the retail environment had started to swing in a positive direction by the beginning of 2003. Consumer confidence levels, which had declined to a post-9/11 low in early 2003, turned dramatically in the following months before reaching another peak in 2004. Given the strong correlation that exists between consumer confidence levels and retail spending, it is our view that this did indeed represent a turning point in terms of retail sales.

An unwritten law of physics states that consumer confidence tends to chase asset bubbles – both up and down. The aggressive reductions in interest rates pursued by the Federal Reserve injected an abundance of liquidity into the system, and one of the consequences was an unprecedented rise in housing prices. This trend buoyed consumer confidence and spending in two ways. First, the much-maligned wealth effect that evaporated after the stock market correction came back to life as consumers watched the value of their homes reach new highs. Second, lenders aggressively targeted these consumers with offers for cash-out refinancings, allowing them to monetize this newfound equity. As a result, rising consumer confidence was married to an abundance of cash-in-hand (and credit card debt), and retailers were quick to capitalize. Foot traffic and sales volumes rose substantially as the crowds grew at the local malls.

The rebound in consumer confidence in early 2003 turned the tide.

HISTORICAL MONTHLY CONSUMER CONFIDENCE
Period Ending January, 2004



Source: University of Michigan

Strength in housing and a boom in cash-out refinancings filled the shopping malls.

Being successful
in the new retail
environment is a
three-step process...

Step One: Houston,
we have a problem...

Step Two: Stop
the bleeding...

Step Three: Pivot
and redefine the rules
of the game...

This spending boom also translated into stronger operating cash flows and higher levels of capital expenditures as retailers sought to expand their store base. This renewed commitment to store growth set the stage for a rebound in the fortunes of store planning departments. However, it would take another philosophical shift in the corner office for them to gain the momentum that they now have.

Learning to Pivot

“...Management understands that newer, nicer fixtures will lead to nicer stores and higher sales...”

As discussed, we would argue that most of the nation’s retailers reconfigured their operating strategies in response to the competitive threat posed by Wal-Mart. Decrease costs, increase standardization and maximize operating efficiency – even if the overall quality of the shopping experience declines as a result.

In our view, there are three distinct stages that retailers have passed through in response to the pressures created by Wal-Mart:

- 1. Recognize the nature of the threat.** In many cases, it took a surprisingly long period of time for retailers to recognize the threat that Wal-Mart represented to their business model. Small local retailers were the first to close their doors as new Wal-Mart stores deprived them of their customers. As Wal-Mart expanded its geographic reach and product mix, the company’s impact became more direct on larger retailers as well. We would argue that the grocers were among the last to grasp the true extent of the threat and, before many could respond in a meaningful way, Wal-Mart became the largest marketer of food in the nation. The result was a wave of bankruptcies and depressed margins throughout the industry. By the early 2000s, retailers of all sizes had been battered by Wal-Mart’s growing clout and clearly recognized the nature of the threat.
- 2. Shoring up the Defenses – Stabilization.** The second step was to identify the key reasons for market share atrophy and to formulate a tactical response to the Wal-Mart threat. The stabilization phase was characterized by retailers attempting to beat Wal-Mart at its own game. Lower prices; pressure suppliers to offer more attractive pricing and terms; enhance capital efficiency; invest aggressively in technology to improve merchandising and inventory management; standardize store design and layout. Many companies are now reaching the end of this phase. Even companies that are not directly threatened by Wal-Mart have implemented many of these tactics in an effort to bolster margins and cash flow. However, many of the retailers that have successfully done so have come to realize that efficiency is not enough to keep consumers coming through the doors on a consistent basis and are entering the third responsive phase.
- 3. Moving to the Offensive – Differentiation.** *It isn’t always about price!* We are of the view that many retailers have now moved to the third stage of this process. After years of attempting to confront Wal-Mart at its strongest point

– pricing – retailers have come to realize that they have other weapons in their arsenal. Target has taught the industry that you can challenge Wal-Mart by offering a differentiated shopping experience *and* value – **Expect More, Pay Less**. In crafting this strategy, Target has been able to appeal to a more affluent constituency of consumers than Wal-Mart and has successfully removed the stigma that once applied to value shopping. Part of this success has clearly been driven by competitive pricing and creative merchandising, but it can also be attributed to well-designed stores and a higher-end ‘look and feel’.

There seems to be a rebellion brewing against the cookie-cutter standardization of the past decade.

In our view, this final point is having the greatest impact on the revival of store planning departments. On many fronts, there is an incipient rebellion taking shape against the cookie-cutter standardization that has driven the retail industry over the past decade. Whole Foods has arguably been at the forefront of this transition. While the emergence of the organic foods category has been a primary driver of their growth, their ability to redefine the shopping experience through design and layout has also played a very important role. Their stores are creative, bright and well-designed to convey the wholesome image that their brand represents to consumers. Retailers in all categories have watched with interest as consumers have made clear that they are actually willing to pay more for a higher-quality shopping experience at Whole Foods than they are at traditional grocery retailers who now offer many of the same products.

“A nice store environment drives my perception of product quality and I’m always willing to pay more for high quality products...”

As more retailers enter into this third phase, there appears to be increasing recognition that store design can be viewed as an investment as opposed to a line item on an income statement. If differentiation is going to drive performance in an increasingly difficult retail environment (and recent consumer confidence data is not encouraging in that regard), retailers are realizing that they need to invest in teams that are able to effectively marry brand identity to the overall store environment. As a result, most of the retailers with whom we spoke now have larger store design staffs than they did prior to the last round of cutbacks during the recession.

Retailers are also doing a better job of tracking and quantifying the correlation between store refurbishments and increases in foot traffic, comps and profitability. Many retailers are also making greater efforts to calculate and track return-on-investment statistics for store fixtures and related products to truly understand the positive impact that these investments can have on operating performance. As key decision-makers have gained a greater understanding of the tangible economic benefits of effective store

Retailers are beginning to quantify the positive impact that fixtures can have on operating results.

design, many have made the strategic decision to delegate increasing levels of authority to their creative teams and to increase their own involvement in the development process.

Increasing 'C-Level' Focus on Store Design

"Not every group meets with the CEO on a daily basis. We do, and that really means something..."

CEO involvement in the design process is ramping up.

In order to gauge the extent of this increasing influence, we surveyed store design groups to better understand their level of interaction with the executives in the corner office. While several people interviewed for this report stated that their company's most senior executives remain fairly 'hands-off' in terms of store design, a significant majority of respondents expressed the opposite view. In most cases, CEOs had increased their focus on, and interaction with, the store design departments in a meaningful way in recent years. Whereas many CEOs have historically limited their involvement to walk-throughs of new openings and major refurbishments, in a number of cases they are now interacting with their design teams on a daily basis. This represents a meaningful shift in focus and, in our view, is a strong indicator that store design teams are gaining influence within the nation's largest retailers.

There is an additional indicator that senior executives are attaching a greater degree of importance to the store design function. In our interviews we learned that an increasing number of retailers are including store design and planning as a component of their management training program rotations. While this is far from universal at this point, it certainly seems to be a concept that is gaining momentum in the industry.

Increasing Influence on Budgeting & Procurement

"The only time we are changing our budget is to increase it..."

Budgets have rebounded alongside staffing levels.

Based on our conversations, it also seems as if the store planning groups are having more of an impact on the budgeting process than they have historically. Without exception, our respondents indicated that budgets had suffered meaningfully during the recession as staff levels declined. Those dollars that were allocated to store design were scrutinized much more rigorously and designers were pressured to accomplish more with fewer

resources. This trend has reversed and more dollars are flowing towards design teams who are being tasked with additional responsibility. Perhaps more importantly, most respondents commented that they are playing a more substantial role in the budgeting process. Whereas budgets were often drawn up by the finance team and passed along to store design, in many cases the design staff is now driving the budget process or, at the very least, having much more of an impact on the outcome.

The same can be said for procurement. While store design departments have always played a key role in the procurement of fixtures and related products or services, the finance and/or purchasing teams have also been a driving force in the process. Based on our conversations with people throughout the industry, it appears as if the balance of power between the two has shifted somewhat and that store design staffs have been gaining increasing influence in the procurement process.

Impact on Store Fixtures Manufacturers

“We need to receive \$1.05 of benefit for every dollar we spend on fixtures...”

Be it through a higher level of interaction with senior executives, increased influence over the budgeting process or other less tangible factors, store design departments have clearly been on a roll. While we believe that this trend may be more than a simple function of a strong economy, this assertion cannot be confirmed until the tide of consumer spending turns in the opposite direction once again (which may already be starting to take place).

In the meantime, store fixtures manufacturers must work under the assumption that the growing influence of the store design teams will continue for the foreseeable future. If senior retail executives are sincere in their view that value must be coupled with a differentiated shopping experience for their companies to prosper over the long term, an ongoing investment in (and the empowerment of) the design function will be required. Assuming that to be true, what are the ramifications for store fixtures manufacturers?

“We demand lower prices, better design and an ability to deliver...”

The first, and perhaps most important, implication for store fixture manufacturers will be the need to effectively manage the conflicting

Fixtures suppliers should assume that Store Design will continue to be a player in decision-making.

Mangaging conflicting priorities will continue to be a challenge.

priorities of those involved in the purchase decision. Given the environment of the past several years, fixtures manufacturers have grown increasingly adept at dealing with the finance teams and purchasing departments of their retail customers. This has always been a demanding customer base and it has become even more so in recent years. Delivery and installation windows have compressed, purchase terms have worsened in many respects and there is an ever-present pressure to keep pricing as low as possible. That being said, fixtures manufacturers have grown accustomed to that dynamic over the years and, while these pressures are certainly not easy to deal with, have learned to structure their marketing and manufacturing initiatives accordingly. The increasing influence of the store design teams, on the other hand, has presented a variety of challenges to many fixtures suppliers. First and foremost, fixtures manufacturers are now facing increasing pressure from store design teams to provide an abundance of 'bells & whistles' and, at the same time, are continuing to be pressured by purchasing to keep prices as low as possible. Even some of the largest retailers (including Wal-Mart), who have historically been focused on price, are now demanding much more from a design perspective than has previously been the case. The combination of pressures from purchasing and design is exacerbating an increasingly difficult operating environment for many suppliers and is negatively impacting overall profitability levels.

Value-Added services are a top priority for design teams.

A related point relates to a topic addressed in previous reports. While small and mid-sized retailers were less focused on the provision of value-added services than we initially expected, the exact opposite is true of the large retailers that we interviewed for this report. Within these large retail organizations, no one appears to be more demanding of these services than the store design teams. Many designers explicitly stated that they are unwilling to work with fixtures manufacturers who are unable to provide a suite of service offerings in addition to broad product lines. A number of respondents expressed their willingness to pay more for their fixtures if value-added services were part of the package. However, there were others who stated that the provision of value-added services was viewed as a marketing necessity and that they would not pay a premium for them. While it remains unclear if value-added services represent a meaningful incremental revenue opportunity for fixtures manufacturers, clearly store design professionals are expecting their suppliers to provide them regardless. Accordingly, this supports our previous assertions that fixtures manufacturers must become service companies that can manufacture as opposed to manufacturers who can provide some services.

Part of the challenge that many fixtures manufacturers are facing in dealing with store design teams is cultural. To be blunt, the manufacturing mindset of many fixtures suppliers often conflicts with the creative instincts that drive successful store design professionals. Manufacturers often look at the creative side of the business with a jaundiced eye and feel that design teams do not adequately appreciate the complexities involved in producing and delivering high quality fixtures. Conversely, store design professionals often view their fixtures suppliers as providers of what are effectively commodity products and feel that they do not make enough effort to 'think outside the box' on design-related issues. It is not our place to take one side or the other in this argument, but we do believe that both constituencies need to work hard to understand and harness the strengths of the other if effective and lasting partnerships are to be formed. Doing so is in everyone's best interest.

While the increasing clout of store design teams may be viewed as a negative by many fixtures manufacturers, we believe that it may also represent a significant opportunity. In many industries with a complex product requirement, sales and marketing executives will typically say that if they are dealing with purchasing they have not been effective in their sales efforts. Their goal is to sell to a higher level within the organization and to integrate themselves as deeply as possible into the product design process. In doing so, the goal is to differentiate their products in terms of quality and functionality and to attempt to reduce the importance of price in the overall purchase decision. Playing a greater role in the 'creative' side of the design process and strengthening those relationships may not guarantee future business, but it will certainly enhance the probability of future wins and should increase the overall stickiness of the account.

Many fixtures executives have lamented the demise of the 'relationship' component of the sale over the past decade. As purchasing departments assumed increasing control over the process and as retailers made price the primary factor in their purchase decisions, the length and strength of a relationship became an afterthought. The emergence of the Internet auction is a striking example of this trend. In many respects, we view the growing clout of the store design teams as an opportunity to turn back the clock somewhat. Let us be clear – price will always be a top priority for retailers as they evaluate a fixtures purchase, regardless of whether it is someone in the purchasing department of the store design group making the ultimate decision. Based on our conversations, we have absolutely no reason to believe that the creative professionals in the store design departments cannot be just as demanding and effective as negotiators as the 'numbers

**Differing cultures
and mindsets
can cause tensions.**

Designers have a more complex portfolio of requirements that must be addressed.

guys' of the organization. However, the portfolio of requirements of the design staff is fundamentally different than that of the purchasing teams – and much more complicated. Complexity, if addressed correctly, often translates into opportunity. By addressing each of the design team's requirements in a proactive manner, all the while being sensitive to the price pressures that they are facing internally, fixtures suppliers may once again have the opportunity to sell at a higher level. To do so, they need to work closely with the design staff at each stage of the process and to serve as a turnkey solutions provider. By bridging the cultural gap and by solving their problems, fixtures suppliers can gain valuable allies who now possess growing clout. In our view, those suppliers who successfully do so will gain a meaningful advantage over the competition during increasingly difficult times in the retail industry.

Conclusions

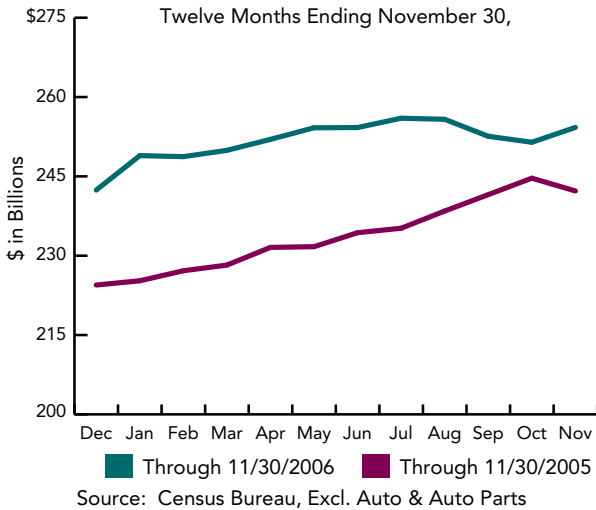
“Our constant struggle is to balance desire and cost...”

In many respects, we believe that this quote captures the essence of the conflict that many store fixtures manufacturers are now facing. On one hand, the rising influence of store design teams is driving a more demanding approach to products and services. These design professionals are being empowered with greater responsibilities and exposure within their organizations and are tasked with one of their company's primary strategic objectives – differentiation. To accomplish this goal, store designers are looking to their fixtures suppliers to provide creatively designed products that are functional, enhance the retail environment and the overall shopping experience. On the other, store design teams and purchasing departments are relentless in their pursuit of low costs. While there is clearly a growing recognition that “you get what you pay for...” and “cheap isn't always the best,” pricing will always be a key component to any purchase decision.

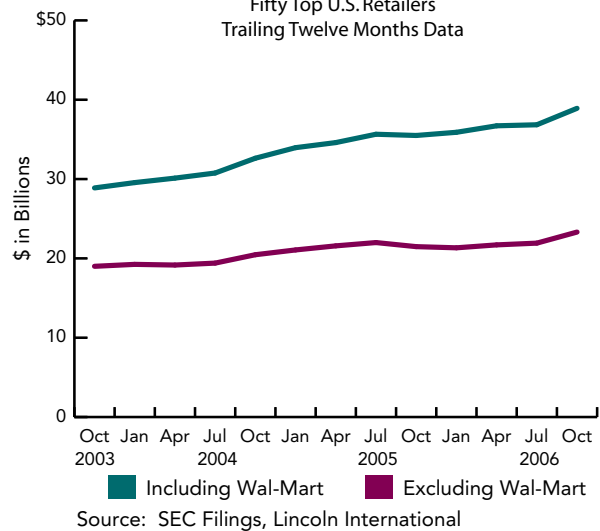
In addition to reconfiguring their product offerings and marketing strategies to better reflect the priorities of the store design teams, fixtures manufactures must continue to be creative in terms of new service offerings. Value-added services will always be an important competitive differentiator, but they should also be viewed as a key to better pricing and profit enhancement over the longer term. Store design teams are looking to leverage their fixtures suppliers and are more willing to view them as design partners than ever before. This provides fixtures manufacturers with a great opportunity to deepen their customer relationships and, in doing so, enhance profitability and increase the probability of repeat business in the future.

Statistical Snapshot

HISTORICAL MONTHLY RETAIL SALES
Twelve Months Ending November 30,

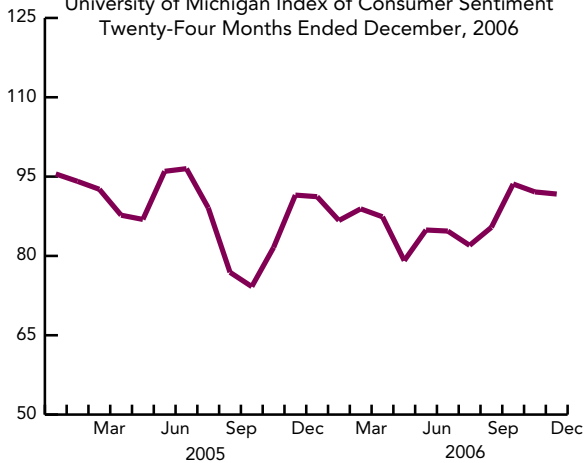


RETAIL CAPITAL EXPENDITURES
Fifty Top U.S. Retailers
Trailing Twelve Months Data



CONSUMER CONFIDENCE

University of Michigan Index of Consumer Sentiment
Twenty-Four Months Ended December, 2006



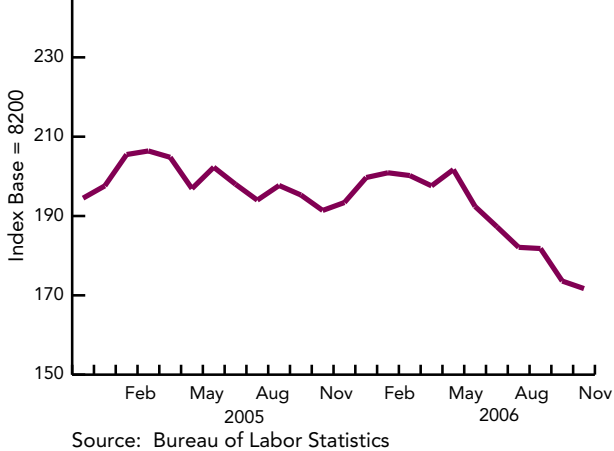
HISTORICAL STEEL PRICES

Producer Price Index - Steel Mill Products
Twenty-Four Months Ended November, 2006



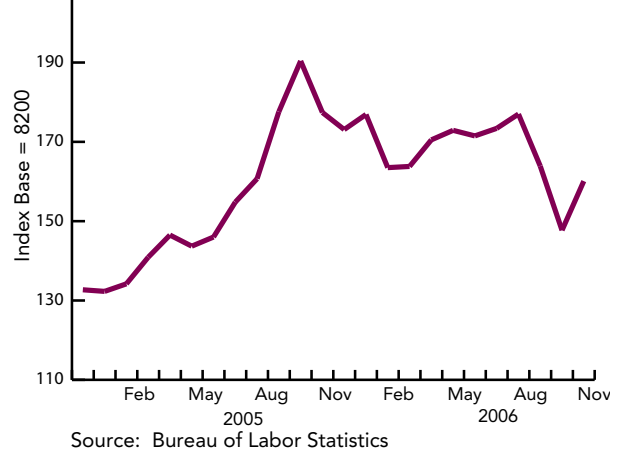
HISTORICAL LUMBER PRICES

Producer Price Index - Lumber & Wood Products
Twenty-Four Months Ended November, 2006



HISTORICAL ENERGY PRICES

Producer Price Index - Fuel & Related Products & Power
Twenty-Four Months Ended November, 2006



Retail CapEx Monitor

Fifty Large U.S. Retailers (Dollars in Millions)

Company Name	9 Mos 31-Oct	6 Mos 31-Jul	3 Mos 30-Apr	2006	9 Mos 31-Oct	6 Mos 31-Jul	3 Mos 30-Apr	2005	9 Mos 31-Oct
Abercrombie & Fitch	\$303	\$184	\$77	\$256	\$186	\$117	\$50	\$185	\$141
% YoY Change	63%	57%	53%	39%	32%	41%	22%	16%	18%
American Eagle Outfitters	\$162	\$103	\$32	\$82	\$68	\$39	\$17	\$97	\$78
% YoY Change	170%	167%	89%	-16%	-13%	-33%	2%	25%	43%
AnnTaylor Stores	\$116	\$59	\$23	\$188	\$164	\$99	\$44	\$152	\$102
% YoY Change	-25%	-48%	-48%	23%	60%	79%	64%	57%	44%
Barnes & Noble (E)	\$109	\$73	\$31	\$187	\$136	\$92	\$39	\$185	\$118
% YoY Change	-20%	-21%	-20%	1%	15%	23%	82%	42%	3%
Big Lots	\$26	\$15	\$6	\$69	\$58	\$44	\$15	\$135	\$108
% YoY Change	-55%	-66%	-61%	-49%	-46%	-39%	-38%	-20%	-15%
BJ's Wholesale Club, Inc.	\$141	\$93	\$51	\$123	\$78	\$52	\$31	\$133	\$89
% YoY Change	81%	80%	63%	-8%	-12%	5%	3%	-25%	-34%
Borders Group	\$149	\$87	\$40	\$196	\$143	\$85	\$41	\$116	\$80
% YoY Change	5%	2%	-1%	70%	79%	112%	232%	4%	3%
Bon-Ton Stores	\$73	\$48	\$15	\$29	\$19	\$10	\$3	\$32	\$24
% YoY Change	282%	366%	465%	-7%	-21%	-22%	-36%	56%	155%
Casual Male Retail Group	\$16	\$8	\$3	\$16	\$11	\$7	\$2	\$21	\$15
% YoY Change	48%	18%	39%	-24%	-29%	-30%	-58%	67%	70%
Charming Shoppes	\$93	\$55	\$24	\$104	\$69	\$37	\$18	\$61	\$42
% YoY Change	36%	47%	35%	71%	64%	57%	49%	12%	7%
Chico's FAS, Inc.	\$165	\$91	\$54	\$148	\$87	\$45	\$25	\$93	\$64
% YoY Change	90%	101%	112%	59%	36%	34%	54%	78%	68%
Claire's Stores, Inc.	\$77	\$47	\$23	\$73	\$56	\$34	\$17	\$64	\$50
% YoY Change	39%	35%	36%	15%	11%	0%	-1%	30%	35%
Dick's Sporting Goods	\$136	\$47	\$23	\$73	\$56	\$34	\$17	\$64	\$50
% YoY Change	45%	35%	36%	15%	11%	0%	-1%	30%	35%
Dillard's, Inc.	\$259	\$171	\$77	\$456	\$328	\$198	\$101	\$285	\$189
% YoY Change	-21%	-14%	-24%	60%	74%	94%	137%	25%	10%
Dollar General Corp.	\$221	\$156	\$77	\$284	\$217	\$140	\$65	\$292	\$219
% YoY Change	2%	12%	19%	-3%	-1%	4%	7%	108%	136%
Dollar Tree Stores	\$140	\$89	\$43	\$139	\$114	\$74	\$34	\$182	\$148
% YoY Change	22%	19%	26%	-23%	-23%	-20%	-39%	-23%	-17%
Federated	\$804	\$353	\$86	\$568	\$321	\$384	\$165	\$1,110	\$705
% YoY Change	150%	-8%	-48%	-49%	-54%	-4%	-1%	0%	-7%
Foot Locker	\$129	\$80	\$34	\$155	\$113	\$77	\$38	\$156	\$127
% YoY Change	14%	4%	-11%	-1%	-11%	-7%	0%	8%	38%
Fred's, Inc.	\$19	\$11	\$5	\$31	\$23	\$15	\$6	\$35	\$27
% YoY Change	0%	-27%	-17%	-11%	-15%	-18%	-25%	-28%	-21%
Gap Inc.	\$406	\$233	\$91	\$600	\$448	\$275	\$122	\$419	\$294
% YoY Change	-9%	-15%	-25%	43%	52%	87%	249%	61%	62%
Home Depot, Inc.	\$2,510	\$1,503	\$705	\$3,881	\$2,889	\$1,835	\$821	\$3,948	\$2,778
% YoY Change	-12%	-18%	-14%	-2%	4%	19%	21%	13%	11%
Hot Topic	\$32	\$22	\$11	\$69	\$61	\$49	\$17	\$58	\$46
% YoY Change	-48%	-56%	-34%	20%	33%	64%	14%	38%	71%
J.C. Penney Company	\$560	\$323	\$126	\$535	\$395	\$233	\$97	\$412	\$308
% YoY Change	42%	39%	30%	30%	28%	30%	52%	10%	27%
Jo-Ann Stores, Inc.	\$43	\$33	\$14	\$143	\$91	\$36	\$12	\$67	\$43
% YoY Change	-53%	-7%	22%	113%	113%	34%	-11%	31%	37%
Kohl's Corporation	\$965	\$706	\$281	\$799	\$668	\$417	\$176	\$890	\$669
% YoY Change	40%	70%	59%	-10%	0%	-6%	5%	7%	26%
Kroger Co.	\$1,178	\$763	\$420	\$1,307	\$1,011	\$673	\$401	\$1,615	\$1,280
% YoY Change	17%	14%	5%	-19%	-21%	-21%	-11%	-19%	-22%
Limited Brands, Inc.	\$418	\$249	\$123	\$480	\$391	\$250	\$134	\$431	\$365
% YoY Change	7%	0%	-8%	11%	7%	5%	33%	47%	57%

Retail CapEx Monitor

Fifty Large U.S. Retailers (Dollars in Millions)

Company Name	9 Mos 31-Oct	6 Mos 31-Jul	3 Mos 30-Apr	2006	9 Mos 31-Oct	6 Mos 31-Jul	3 Mos 30-Apr	2005	9 Mos 31-Oct
Longs Drug Stores	\$111	\$71	\$44	\$106	\$77	\$45	\$20	\$91	\$75
% YoY Change	43%	58%	123%	17%	3%	-14%	-17%	-20%	-10%
Lowe's Companies	\$2,724	\$1,556	\$732	\$3,379	\$2,277	\$1,365	\$624	\$2,927	\$2,116
% YoY Change	20%	14%	17%	15%	8%	3%	10%	25%	27%
Men's Wearhouse	\$48	\$25	\$12	\$66	\$52	\$35	\$18	\$85	\$56
% YoY Change	-9%	-30%	-32%	-22%	-7%	47%	95%	72%	72%
Michaels Stores	\$108	\$70	\$39	\$118	\$86	\$61	\$27	\$91	\$72
% YoY Change	26%	15%	42%	30%	20%	17%	6%	-12%	3%
New York & Company	\$66	\$38	\$17	\$81	\$69	\$43	\$15	\$54	\$43
% YoY Change	-4%	-11%	13%	49%	60%	91%	54%	79%	149%
Nordstrom, Inc.	\$188	\$116	\$48	\$272	\$205	\$131	\$53	\$247	\$165
% YoY Change	-8%	-12%	-10%	10%	24%	29%	10%	-4%	-19%
Pacific Sunwear	\$107	\$63	\$29	\$109	\$78	\$48	\$22	\$82	\$63
% YoY Change	38%	30%	34%	33%	24%	21%	26%	65%	72%
Pathmark Stores	\$55	\$26	\$12	\$64	\$44	\$15	\$7	\$99	\$82
% YoY Change	38%	67%	81%	-35%	-46%	-66%	-70%	44%	89%
Payless ShoeSource	\$90	\$53	\$23	\$64	\$50	\$35	\$22	\$103	\$82
% YoY Change	81%	50%	6%	-37%	-39%	-37%	-17%	-11%	-2%
Pep Boys	\$25	\$14	\$6	\$86	\$65	\$42	\$19	\$88	\$53
% YoY Change	-62%	-66%	-71%	-2%	24%	47%	153%	110%	61%
PetSmart	\$158	\$91	\$45	\$166	\$125	\$70	\$28	\$143	\$104
% YoY Change	26%	31%	62%	16%	20%	64%	163%	-17%	-22%
Ross Stores	\$181	\$59	\$18	\$176	\$139	\$96	\$16	\$150	\$112
% YoY Change	30%	-39%	12%	18%	24%	60%	-37%	-2%	3%
Saks Incorporated	\$79	\$67	\$26	\$237	\$174	\$93	\$41	\$198	\$144
% YoY Change	-13%	-28%	-36%	19%	21%	10%	6%	6%	6%
Sears (Pro Forma)	\$325	\$173	\$80	\$546	\$333	\$180	\$66	\$1,112	\$784
% YoY Change	-2%	-4%	21%	-51%	-58%	-58%	-54%	7%	24%
Stage Stores, Inc. (E)	\$51	\$34	\$14	\$75	\$58	\$38	\$16	\$48	\$32
% YoY Change	-12%	-10%	-10%	57%	81%	151%	149%	3%	7%
Staples, Inc.	\$352	\$254	\$115	\$456	\$289	\$174	\$63	\$335	\$201
% YoY Change	22%	46%	81%	36%	44%	28%	15%	21%	5%
Stein Mart, Inc.	\$39	\$28	\$13	\$35	\$25	\$16	\$9	\$19	\$16
% YoY Change	58%	77%	46%	83%	59%	63%	139%	38%	32%
Talbots, Inc.	\$66	\$32	\$14	\$73	\$55	\$32	\$14	\$93	\$69
% YoY Change	20%	0%	5%	-22%	-20%	-29%	-35%	-15%	5%
Target Corporation	\$3,004	\$1,899	\$884	\$3,388	\$2,657	\$1,774	\$717	\$3,068	\$2,206
% YoY Change	13%	7%	23%	10%	20%	27%	13%	12%	5%
Tiffany & Co.	\$143	\$88	\$44	\$157	\$122	\$76	\$32	\$142	\$111
% YoY Change	18%	16%	38%	10%	9%	8%	10%	-48%	-55%
TJX Companies, Inc.	\$292	\$179	\$96	\$496	\$402	\$219	\$101	\$429	\$286
% YoY Change	-27%	-18%	-5%	16%	40%	59%	60%	5%	-8%
Wal-Mart Stores, Inc.	\$11,417	\$6,812	\$3,220	\$14,563	\$10,405	\$6,455	\$2,772	\$12,893	\$9,260
% YoY Change	10%	6%	16%	13%	12%	13%	5%	25%	25%
Williams-Sonoma	\$144	\$84	\$39	\$152	\$119	\$77	\$34	\$181	\$145
% YoY Change	21%	10%	14%	-16%	-18%	-6%	-8%	-14%	10%
TRAILING 12 MOS CAPEX	\$38,918	\$36,842	\$36,713	\$35,895	\$35,494	\$35,649	\$34,598	\$33,957	\$32,626
% YoY Change	10%	3%	6%	6%	9%	16%	15%	15%	13%
TTM CAPEX (EX-WMT)	\$23,318	\$21,922	\$21,702	\$21,332	\$21,481	\$21,995	\$21,578	\$21,064	\$20,461
% YoY Change	9%	0%	1%	1%	5%	13%	13%	9%	8%

Private Capital Markets Update

The private equity party continues...

Lenders are continuing to fund aggressive acquisition capital structures...

Recent Market Activity

At the risk of being too colloquial – same old, same old... It is surprising to us how little conditions in the M&A market have changed since we compiled our first report a year ago. The clouds that sat on the horizon last summer are still hovering there. While we would argue that they have grown more ominous over the past twelve months, no one at the party has gotten wet – yet.

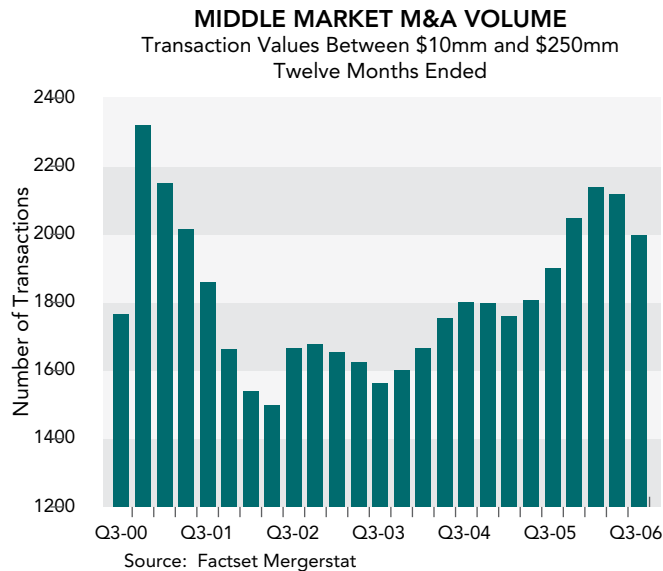
Private equity buyers are concerned about an overheated deal market and speak of how they have grown increasingly cautious this year. Frankly, we haven't really seen it. The transactions that Lincoln International has been managing continue to be very well-attended and private equity firms are among the most aggressive bidders. As was the case last year, private equity firms are still outbidding strategic buyers in many circumstances, although we would argue that strategic buyers have a hearty deal appetite as well. Private equity firms continue to raise record amounts of capital and their limited partners are pressuring them to deploy the money in spite of rising valuations (and, presumably, the outlook for falling future returns).

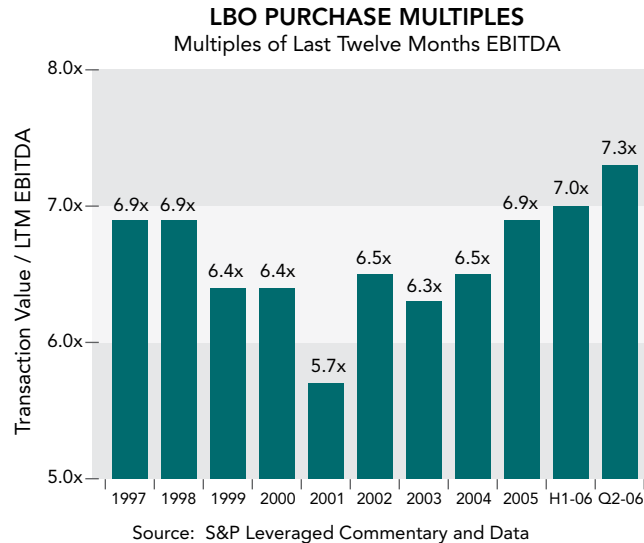
The strategic buyers, having streamlined their P&L's over the past five

years, are looking to deploy their accumulating cash by pursuing value-enhancing acquisition opportunities. The result has been a level of transaction activity that has not been seen since the end of the Internet bubble. The following graph illustrates the robust pace of deal activity.

As is the case in any free and efficient market, supply and demand dynamics in the deal market drive valuations. The community of cash-rich buyers in search of deal opportunities has grown so dramatically that the

supply of available companies cannot satisfy demand. As a result, valuations have continued to move upwards. The following graph illustrates that LBO purchase multiples have surpassed the levels seen during the deal boom of the late 1990s.



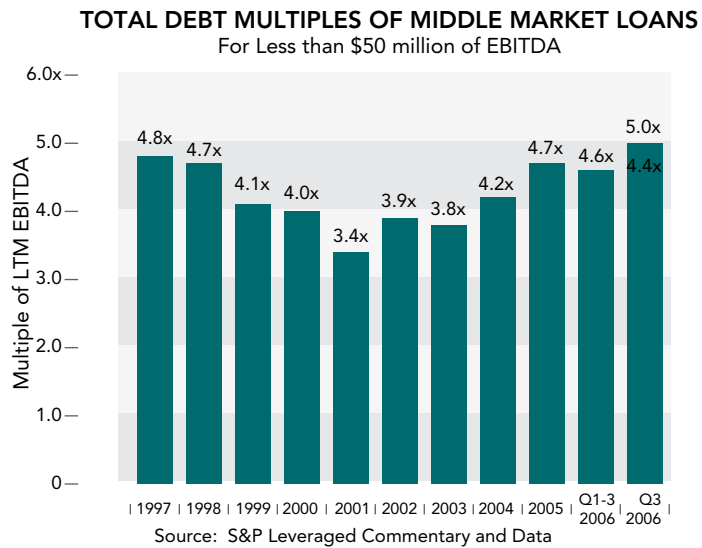


And purchase multiples have continued to climb as a result...

Despite the froth, we have seen valuations level off recently...

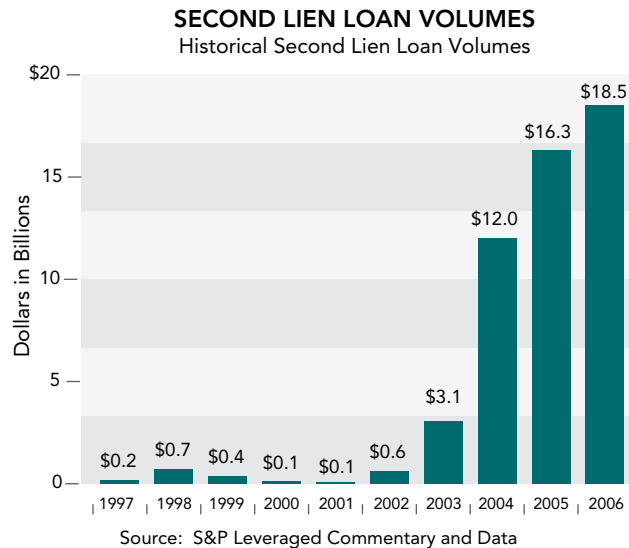
Now, despite these factors, we would argue that valuations may be leveling off somewhat despite the pace of activity. It is important for business owners to note that the availability of equity capital, while vitally important to deal market conditions, is not the primary driver of valuations. Similar to today, when the deal market collapsed in 2001 there was an abundance of private equity capital available to fund transactions. However, as the economy fell into the post-9/11 recession the debt markets ground to a halt – ending a retrenchment that began in late 1998. Banks stopped making new commitments and tightened conditions on existing credits as they dealt with trouble in their portfolios. Subordinated debt investors grew increasingly cautious as well. Traditional cash flow lending was effectively unavailable to most middle market companies. Accordingly, private equity groups found themselves unable to secure the leverage required to complete transactions with attractive return characteristics. Valuations for deals that did get done declined materially. While we are not seeing a decline in the appetite of senior and subordinated lenders to pursue transactions at this point, we do believe that their willingness to push lending multiples higher has plateaued. Rising rates, growing economic uncertainty and concerns about excessive corporate debt levels have started to have an impact. Accordingly, leverage multiples have flattened and, in our view, valuations have done so as well. The graph on the following page reflects the trend in leverage multiples for middle market credits since 1997.

As have total debt multiples...



Banks and traditional lenders continue to be challenged by a new breed of debt providers: hedge funds, business development companies and other non-regulated players. The emergence of second lien loans – which serve as a bridge between traditional senior and subordinated debt in the capital structure – reflects that these new investors are having more of an impact on the debt markets than ever. The following graph illustrates the boom in second lien demand.

And booming demand for second lien loans continues to be the wildcard...



In conclusion, it is our view that this robust deal environment will continue in coming months. While valuations may not be increasing, they have stabilized at historically high levels. At some point interest rates, rising defaults or a 'shock' will cause a significant retrenchment in the availability of credit. That being said, until that time this will remain a seller's market.



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