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# It's Been an Active M&A Market for Retail – What's in Store for the Future?

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The U.S. retail industry saw resurgence in merger and acquisition activity in 2005. There were about 50 more transactions announced in 2005 than in 2004 and the value of the 2005 transactions was more than double that of the previous year. This resurgence was due in large part to three driving factors: 1) margin pressures resulting from little, if any, meaningful comparable store sales growth for most retailers serving lower and middle income customers, 2) an abundance of private equity and senior and subordinated debt, and 3) the continuing improvement in the valuation of real estate and credit card businesses owned by some retailers.

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Two major mergers (Sears/Kmart and Federated/May) alone are predicted by many analysts to change the face of the retail department store sector and the fact that 40% of sector M&A activity involved transactions sponsored by private equity funds is predictive of additional consolidation to come over the next three to five years. Transformational activity was not confined to M&A as several publicly traded retailers went private in leveraged transactions during the year and some non-public retailers effected dividend and/or redemption recapitalizations.

## A Glimpse Behind Retail

According to the National Retail Federation, 2005 U.S. retail sales grew by 6.1% to over $3.8 trillion annually. The highest sales growth occurred in the building material, warehouse clubs and electronics store sectors and the lowest occurred in the department store sector. Consolidation continued to shape the retail industry. The number of public retailers went from 500 in 1995 to less than 300 by the end of 2005.

Historically, retailers engaged in three distinct but complementary business lines: retail operations, lending (through private label credit cards), and real estate. The clear trend developing over the last few years has been for retailers to exit ancillary businesses and focus solely on their core competency – operating a retail business in an increasingly competitive and challenging environment. Most major retailers have "sold" their private label credit card business to third parties and most have sold their real estate to REITS or other institutional owners and leased them back, thereby removing the asset from the balance sheet and conserving borrowing capacity.

## A Flurry of M&A Activity

There has been more M&A activity in the retail sector over the past 18 months than over the prior five years combined. Values of completed transactions more than doubled from about $75 billion in 2004 to over $150 billion in 2005.

Although the Sears/Kmart and Federated/May mergers were the largest department store transactions of 2005 and among the largest in history, there was substantial additional activity in the industry. Saks sold its southern stores to Belk and announced the sale of its northern stores to Bon-Ton. Neiman Marcus was acquired by Texas Pacific Group and Warburg Pincus and Co. in a leveraged transaction.

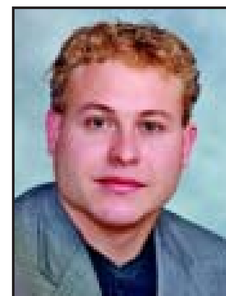
Also, Boscov's Inc., announced a refinancing and recapitalization where, after an intensive strategic alternatives study, shareholders and management participated in a generational transfer of ownership and management from retiring controlling shareholders to other members of their families. Boscov's continues to be owned 100% by the founder's family and management. Boscov's, headquartered near Philadelphia, operates 40 department stores in six Mid-Atlantic States, 10 of which are located within the greater Philadelphia market. Boscov's also recently announced its intent to purchase 10 former May stores from Federated, four of which are located in the greater Philadelphia market. These stores will allow Boscov's to fill in its current footprint and expand its penetration into the greater Pittsburgh and Baltimore markets.

Outside of the department store sector, M&A activity included KKR, Bain Capital and Vornado Realty's acquisition of Toys "R" Us, Inc.; Sun Capital's group acquisition of ShopKo Stores, Inc.; and Weston Presidio and Berkshire Partners' acquisition of Party City Corp., among other private equity sponsored transactions. To date in 2006, Bain Capital announced the acquisition of Burlington Coat Factory Warehouse Corp.; Leonard Green announced the acquisition of The Sports Authority, Inc.; and Cerberus Capital, Supervalu, Inc., and CVS Corp. announced the acquisition of Albertson's, Inc. Some of the transactions are designed to give management the financial and additional managerial resources and other benefits of ownership by private equity necessary in order to grow earnings and valuation. Others are focused more on the value of real estate assets. Major real estate players such as Kimco, Klaff Realty and Lubert-Adler Partners were involved in the Albertson's transaction.

Mark B. Russell

## Outlook for 2006

The National Retail Federation estimates that overall retail sales growth is expected to slow to 4.7% in 2006 (compared to 6.1% in 2005) due to higher interest rates, tightening consumer credit standards, higher energy prices and lower real wage growth. The availability of private equity, real estate valuation and the ability to increase leverage should continue to provide value for buyers and sellers in the retail industry. 2006 should be a solid year for M&A activity in the United States.



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*David M. McCanney, Managing Director, Mark B. Russell, Managing Director and Jeffrey A. Harenza, Vice President are with Griffin Financial Group and can be reached at dmm@go2griffin.com, mbr@go2griffin.com or jaha@go2griffin.com. These professionals provided strategic guidance in all aspects of the Boscov's management buyout transaction including restructuring the company's balance sheet, attracting capital and effecting an intra-family transfer of equity ownership. Griffin is a regional investment banking firm and a member of ACG Philadelphia.*

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