2012 UNC Alpha Challenge

Staples, Inc. (Nasdaq: SPLS)

Taylor Davis, Richard Hunt, Stephen Lieu

Do not think

“*brick and mortar*” or “*back to school*”…

think

“*B2B contract and direct relationship selling*”

Investment Recommendation

- Recommendation: Buy common shares of SPLS with a target share price of $18.00, which represents 57% upside to the current share price
- We believe SPLS presents an attractive investment opportunity for the following reasons:
  - North American Delivery segment alone is worth the current share price;
  - Threat from Amazon is misunderstood;
  - Shift to smaller stores will reduce costs without sacrificing sales;
  - Push into high-growth, high-margin categories offsets slow declines in paper, ink, and toner

As of 11/5/12; in USD m except per share data

Current Capitalization	
Stock Price	$11.57
52-Week Range	$10.57-$16.93
Shares Outstanding (M)	682.4
Market Cap	**$7,895**
Cash	$985
Debt	$2,044
Enterprise Value	**$8,954**

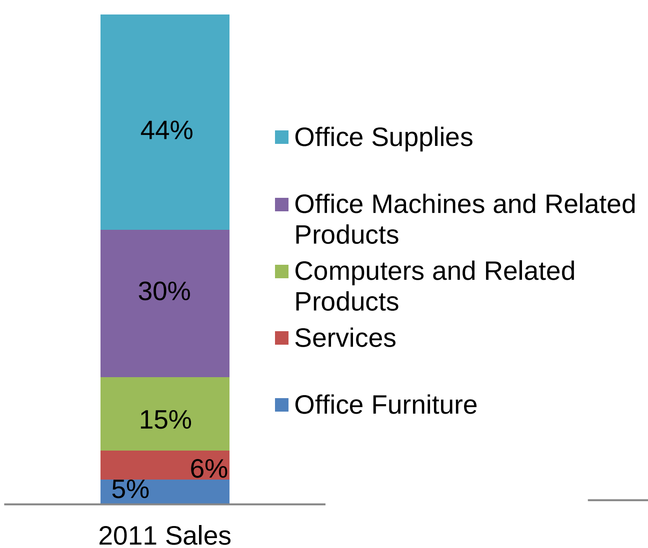
Trading Statistics	
Short Interest as % of Float	12.1%
Avg. Daily Volume ('000s)	14,872

Company Overview

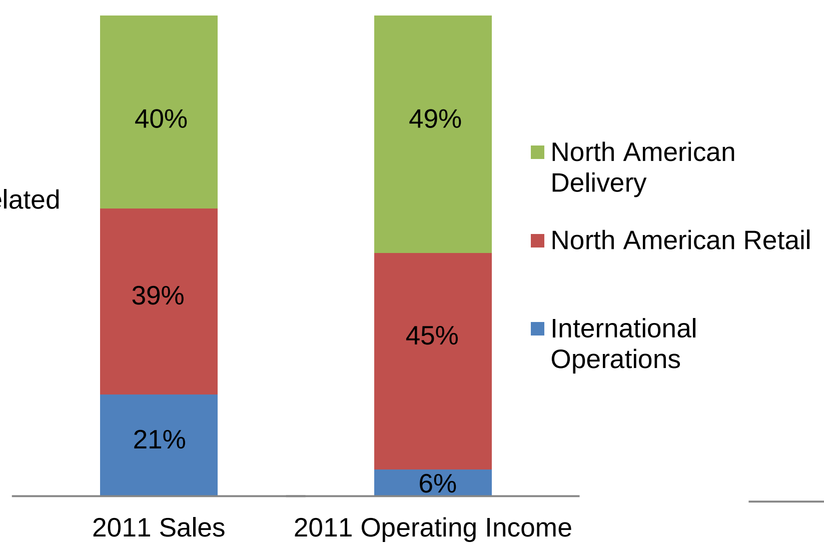
Revenue By Category and Segment

- World’s largest office supplies company
- Industry leader in sales (more than 2x closest competitor) and profitability (more than 5x closest competitor)
- Second-largest internet retailer: Staples.com is the Amazon.com of office supplies
- 80% of sales are B2B

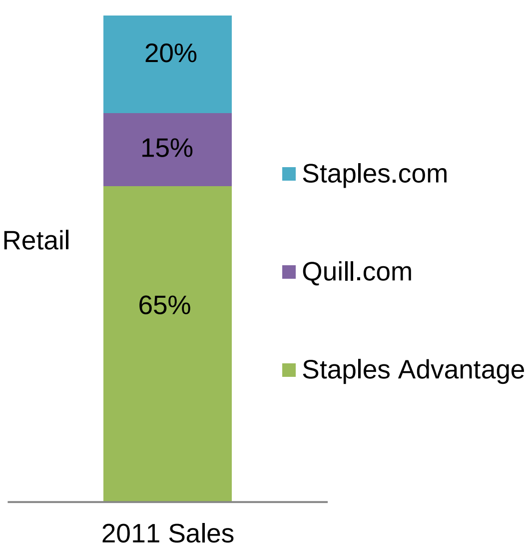
Categories



Segments



North American Delivery



Share Price Performance

SPLS vs. Peers

- SPLS has underperformed its peers over the past twelve months

Comparable Companies

Office Depot & OfficeMax

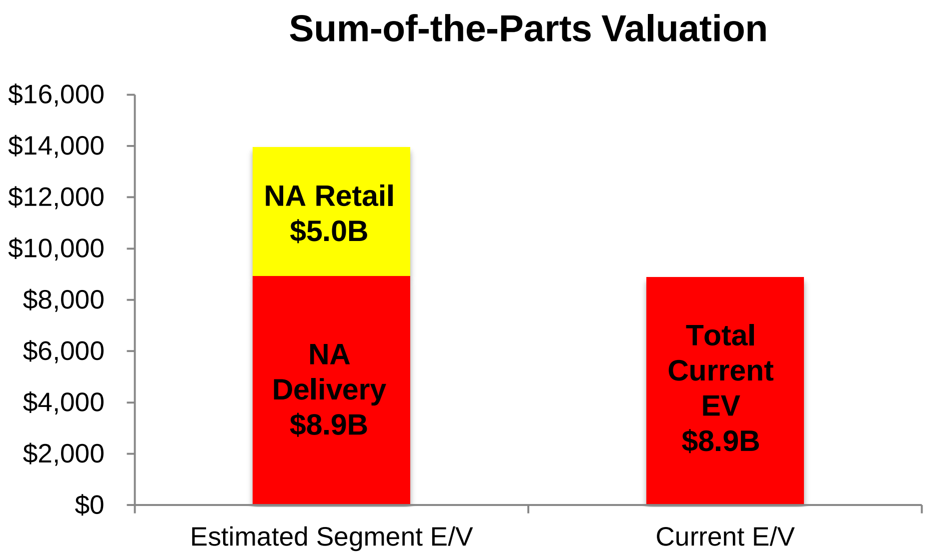
- Office Depot (NYSE: ODP) and OfficeMax (NYSE: OMX) are Staples' closest competitors

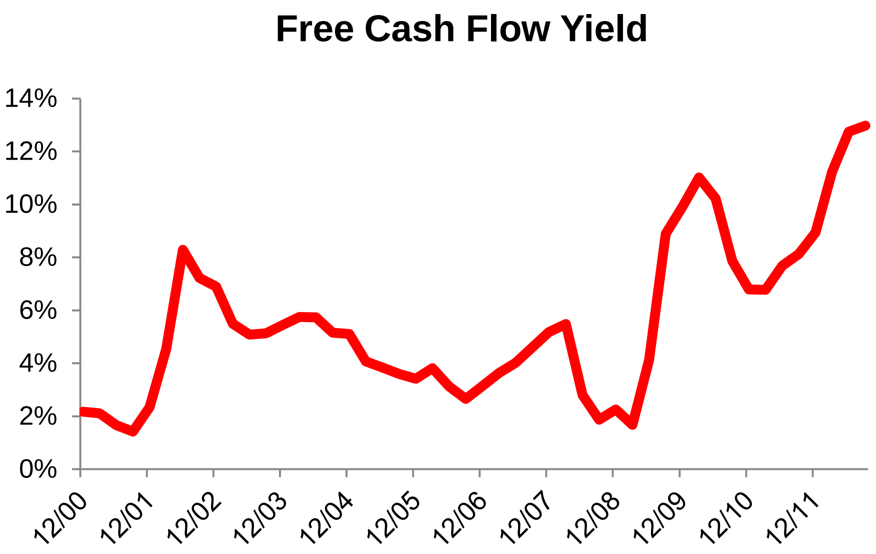
	Price ($)	Shares Oustanding (mm)	Market Capitalization ($mm)	Net Debt ($mm)	Enterprise Value ($mm)	EV/EBITDA		P/E	
						LTM	NTM	LTM	NTM
Office Depot, Inc.	2.51	285.2	715.9	251.9	1,349.3	3.8	4.1	8.7	41.8
OfficeMax Inc.	7.44	86.6	644.3	1,262.9	1,907.2	10.0	8.6	16.2	9.7
Staples, Inc.	11.57	682.4	7,895.4	1,058.9	8,954.3	4.4	4.6	8.6	8.1

	Gross Margin	Operating Margin	Net Income Margin	North American Distribution Centers (a)	Estimated Sales/sf ($)	3-Year CAGR Sales
	LTM	LTM	LTM			
Office Depot, Inc.	30.3%	0.3%	1.0%	13	466.5	-7.5%
OfficeMax Inc.	25.4%	1.2%	0.6%	27	391.6	-4.9%
Staples, Inc.	26.8%	6.5%	3.7%	70	596.3	2.7%
(a) As of FY 2011						

Valuation

- Based on a sum-of-the-parts analysis, the North American Delivery segment alone is worth the current share price
- The current free cash flow yield of 13% is at an all-time high





Principal Reason Why SPLS Is Cheap…

Investors hate SPLS because of the

Amazon Threat

But, they misunderstand…

1 B2B Selling (Contract/Direct Relationship)

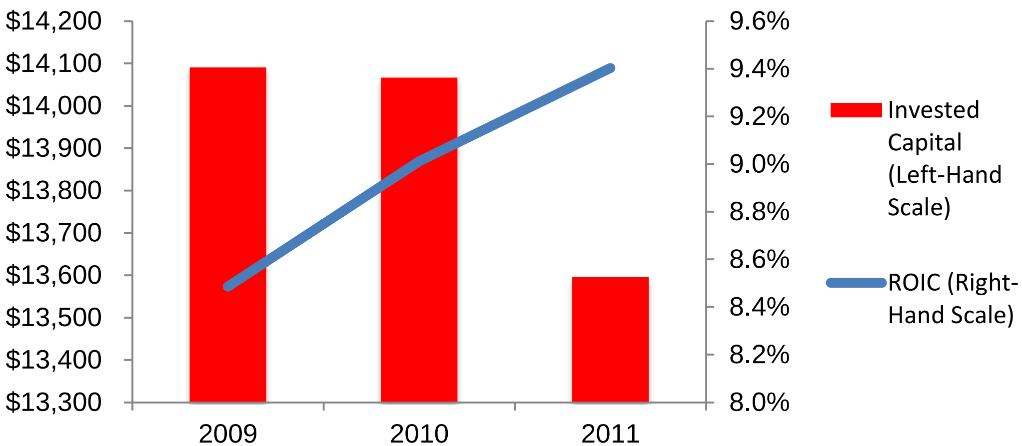
- **Thesis:** The market completely misunderstands Amazon's threat to B2B. B2B requires complex sales relationships with custom service levels. Amazon does not have this sales base

STAPLES	amazon.com
B2B	B2C
High-Touch Sales	Low-Touch Sales
Free next/same-day delivery	Free 2-day delivery

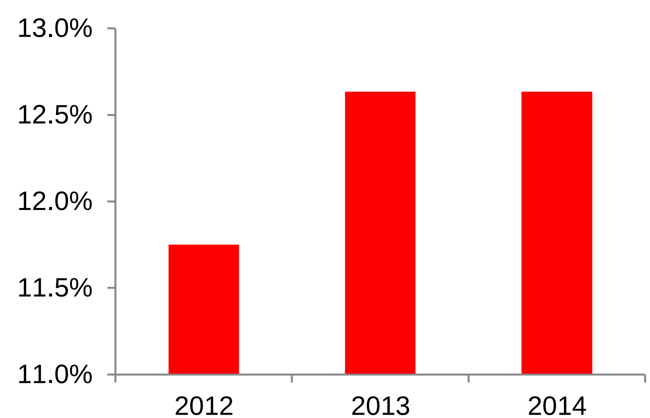
② Good Game Plan for Retail

- **Thesis:** While Amazon is a threat to this segment, stores are profitable and will continue to be as Staples shrinks its store size without sacrificing sales

By 2015, Staples will be saving $250mm/year relative to today



Percentage of U.S. Store Lease Renewals: ~40% over next 3 years



3 Significant Growth Opportunities in New Categories

- **Thesis:** New categories– Facilities & Breakroom in particular– are plug-and-play, have material growth opportunities, and have higher margins than Office Supplies

Services	• EasyTech
Copy & Print	• 5%-7% growth
Facilities & Breakroom	• $0 in 2005, $1.5B today • 20% growth in FY 2012

2x or better margins relative to Office Supplies

Investment Risks and Mitigating Factors

- International business is not as strong as the North American business, and continued macro and company-specific problems could significantly drag down the stock
  - Management is being proactive:
    - Staples has announced plans to close 45 unprofitable stores and sell off its unprofitable printing systems business
    - John Wilson, Staples' respected former CFO and Gap's former COO, has been brought on to lead this turnaround
- Ink/Paper/Toner declines more than expected
  - 1%-2% decline in paper sales offset by price increases resulting from decreased mill capacity
  - Paper is a "basket-starter" with low margins—decreases in sales will not materially affect profitability
- Amazon makes a U-turn and decides to invest heavily in the office supply/B2B space
  - Staples' world-class logistics and massive scale in office supplies give it an advantage

Appendix

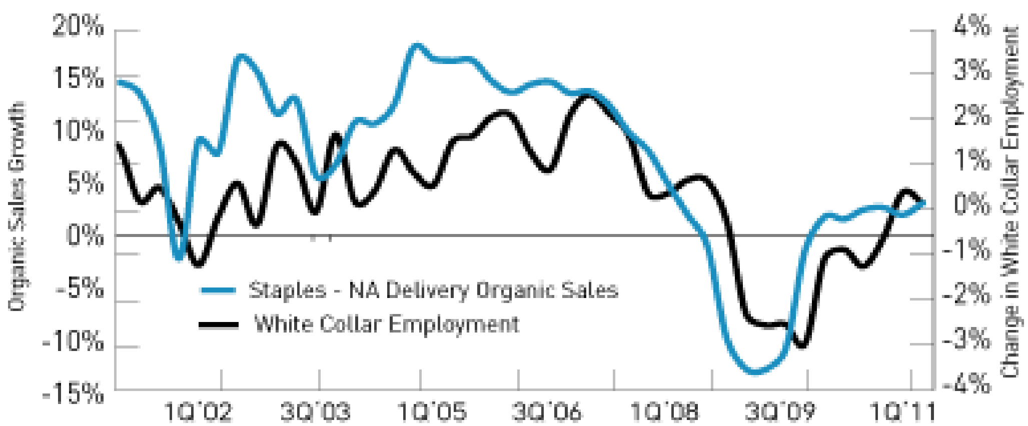
Table of Contents

Ⓐ Additional Upside

Participation in Employment Rebound

- Staples' North America Delivery sales are highly correlated with white-collar employment. More office workers means more office supply sales
- As white-collar employment bounces back, we expect Staples' North American Delivery sales to increase
- We expect operating margins to increase up to 75bps as the company leverages its fixed costs

Staples North America Delivery Sales
Correlated with White Collar Employment



Source: Bureau of Labor Statistics, Company Reports

Source: Pzena Investment Management

B Near-Term Value Realization

Possibility of Buyout

- The possibility of a buyout increases the probability of near-term value realization
- Staples is an attractive buyout candidate:
  - Strong and stable free cash flow
  - Low valuation – 13% free cash flow yield at all-time high
  - Under-leveraged balance sheet – lowest leverage since 2008
  - Strong brand and market leadership
  - High-quality management
- There have been rumors of a Bain-led buyout
  - "Could Staples go private?", Dan Primack, *CNNMoney*, 9/13/12

C Summary Financials

Staples Summary Financials

($mm)	2008	2009	2010	2011
Revenue	**$23,084**	**$24,276**	**$24,545**	**$25,022**
% Growth	**-**	***5.2%***	***1.1%***	***1.9%***
Gross Profit	$6,247	$6,474	$6,606	$6,742
% Margin	*27.1%*	*26.7%*	*26.9%*	*26.9%*
SG&A	$4,631	$4,907	$4,913	$5,048
% of Revenue	*20.1%*	*20.2%*	*20.0%*	*20.2%*
% Growth	-	*6.0%*	*0.1%*	*2.8%*
EBIT	$1,616	$1,567	$1,693	$1,693
% Margin	*7.0%*	*6.5%*	*6.9%*	*6.8%*
D&A	$549	$552	$499	$482
% of Revenue	*2.4%*	*2.3%*	*2.0%*	*1.9%*
EBITDA	**$2,165**	**$2,119**	**$2,192**	**$2,175**
% Margin	***9.4%***	***8.7%***	***8.9%***	***8.7%***
% Growth	**-**	***(2.1%)***	***3.4%***	***(0.7%)***
CapEx	$378	$313	$409	$384
% of Revenue	*1.6%*	*1.3%*	*1.7%*	*1.5%*

Segment Margins	**2008**	**2009**	**2010**	**2011**
North American Delivery	9.0%	8.2%	8.5%	8.7%
North American Retail	8.1%	8.3%	8.1%	8.3%
International Operations	3.3%	2.3%	3.2%	1.8%

D Discounted Cash Flow Analysis

	2012	2013	2014	2015	2016
Total Operating Revenue	25,022	25,022	25,773	26,546	27,342
Total NOPAT	1,272	1,288	1,361	1,419	1,480
Change in Net Working Capital	0	0	(38)	(39)	(40)
Change in Fixed Assets	0	0	(150)	(155)	(159)
Free Cash Flow	**1,272**	**1,288**	**1,173**	**1,226**	**1,281**

PV of FCF and Terminal Value	**18,110**
Less: Debt and Operating Leases	6,054
Plus: Pension & OPEB Funded Status	103
Less: Minority Interests	7
Less: Value of ESOs	30
Plus: Excess Cash	13
Implied Equity Value	**12,135**
Shares Outstanding	682.4
Implied Share Price	**$18.00**
Current Share Price	**$11.57**
Discount to Current Share Price	*36%*

E Research Process

Resources Used

- 10-Ks, 10-Qs
- Last 10 quarters earnings transcripts
- Sell-side research reports
- Investor presentations
- Primary research

People Contacted

- Staples investor relations
- Staples salespeople
- Competitors
  - OfficeMax investor relations
  - Amazon customer support
- Sell-side Analysts
  - Caris & Company
  - Credit Suisse
- Customers
  - Columbia University purchasing manager
  - Small financial services firm
- Suppliers
  - United Stationers, Inc.
  - Publicly-traded supplier with $80mm in sales to Staples
- Buy-side Analysts
  - Lead analyst of major Staples shareholder

2012 UNC Alpha Challenge

Conn's, Inc. (Nasdaq: CONN)

Taylor Davis, Richard Hunt, Stephen Lieu

Investment Recommendation

- Recommendation: Short common shares of CONN with a target share price range of $9.00 to $13.00, which represents a 50% to 65% discount to the current share price

- We believe CONN presents an attractive short opportunity because the company:

1. Operates in an industry in secular decline;
2. Has deteriorating underwriting standards that have led to a high risk credit portfolio that will eventually result in substantial write-offs;
3. Has aggressive accounting practices;
4. Has misleading same-store sales growth; and
5. Is trading at an extraordinarily high valuation on all metrics

As of 11/5/12; in USD m except per share data

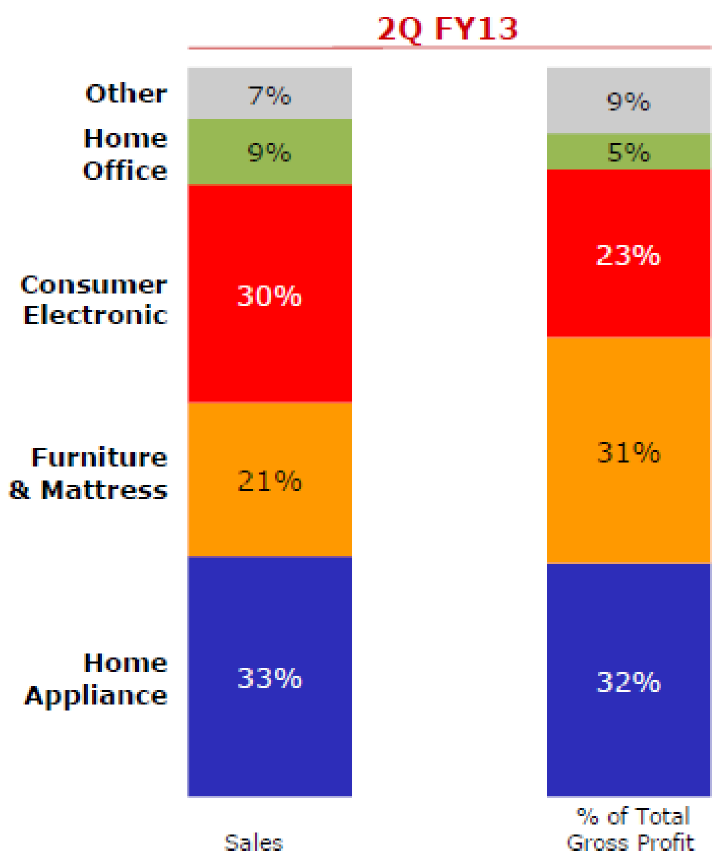
Current Capitalization	
Stock Price	$25.71
52-Week Range	$8.54-$26.98
Shares Outstanding (M)	32.6
Market Cap	**$838**
Cash	$5
Debt	$315
Enterprise Value	**$1,148**

Trading Statistics	
Short Interest as % of Float	35.5%
Avg. Daily Volume ('000s)	218.0

Company Overview

Revenue By Segment / Geographic Locations

- Brick-and-mortar retailer of home appliances, furniture, mattresses, and consumer electronics



- 65 brick-and-mortar locations in three states
  - 57 in Texas
  - 6 In Louisiana
  - 2 in Oklahoma

Company Overview

Credit Offering

- Offers consumers a credit product not available at traditional retailers
  - <u>88% of sales</u> were financed in FY Q2 2013
- Financing is offered through three different means:
  - **In-House Credit (<u>69% of sales</u>)**
    - **For customers with credit scores that are generally between 550 and 650**
    - **Receivables carried on balance sheet**
  - GE Capital's Promotional Credit (<u>16% of sales</u>)
    - For customers with credit scores that are typically above 650
    - Cash received upfront, no risk to CONN
  - Rent-A-Center's Acceptance (<u>3% of sales</u>)
    - For customers denied financing by CONN
    - Cash received upfront, no risk to CONN

Delinquency Rates by Credit Score Range

Percentile	% of People	Credit Score	Delinquency Rate
2nd	2%	300-499	87%
7th	5%	500-549	71%
15th	**8%**	**550-599**	**51%**
27th	**12%**	**600-649**	**31%**
42nd	15%	650-699	15%
60th	18%	700-749	5%
87th	27%	750-799	2%
100th	13%	800-850	1%

Source: www.creditscoring.com

Investment Thesis

We believe CONN is a highly attractive short candidate for several reasons:

1. Secular Decline in Brick-and-Mortar Specialty Retail Industry
2. Deteriorating Underwriting Standards → High Risk Credit Portfolio
3. Aggressive Accounting Practices
4. Misleading Same-Store Sales Growth
5. Extraordinarily High Valuation

1 Secular Decline in Brick-and-Mortar Specialty Retail Industry

- Amazon → brick-and-mortar specialty retailers sales decline
  - Amazon = lower SG&A = lower prices

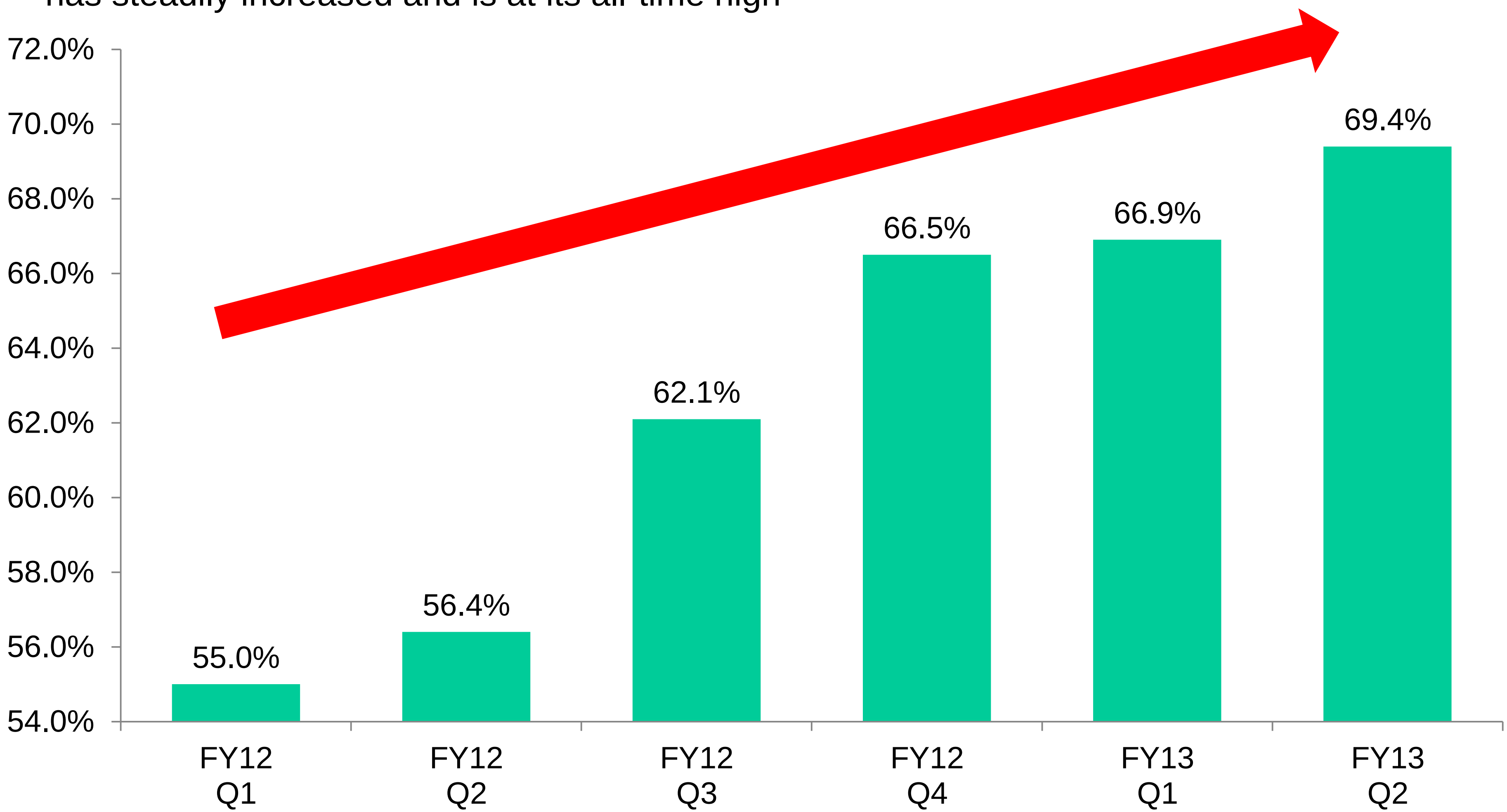
- Brick-and-mortar sales decrease → high operating leverage = difficult to cover fixed costs
  - Circuit City bankruptcy
  - Best Buy struggling

- **Many believe that it is only a matter of time before the entire industry moves online and brick-and-mortar specialty retailers cease operations**

2 Deteriorating Underwriting Standards → High Risk Credit Portfolio

Percentage of Sales Financed by In-House Credit Offering

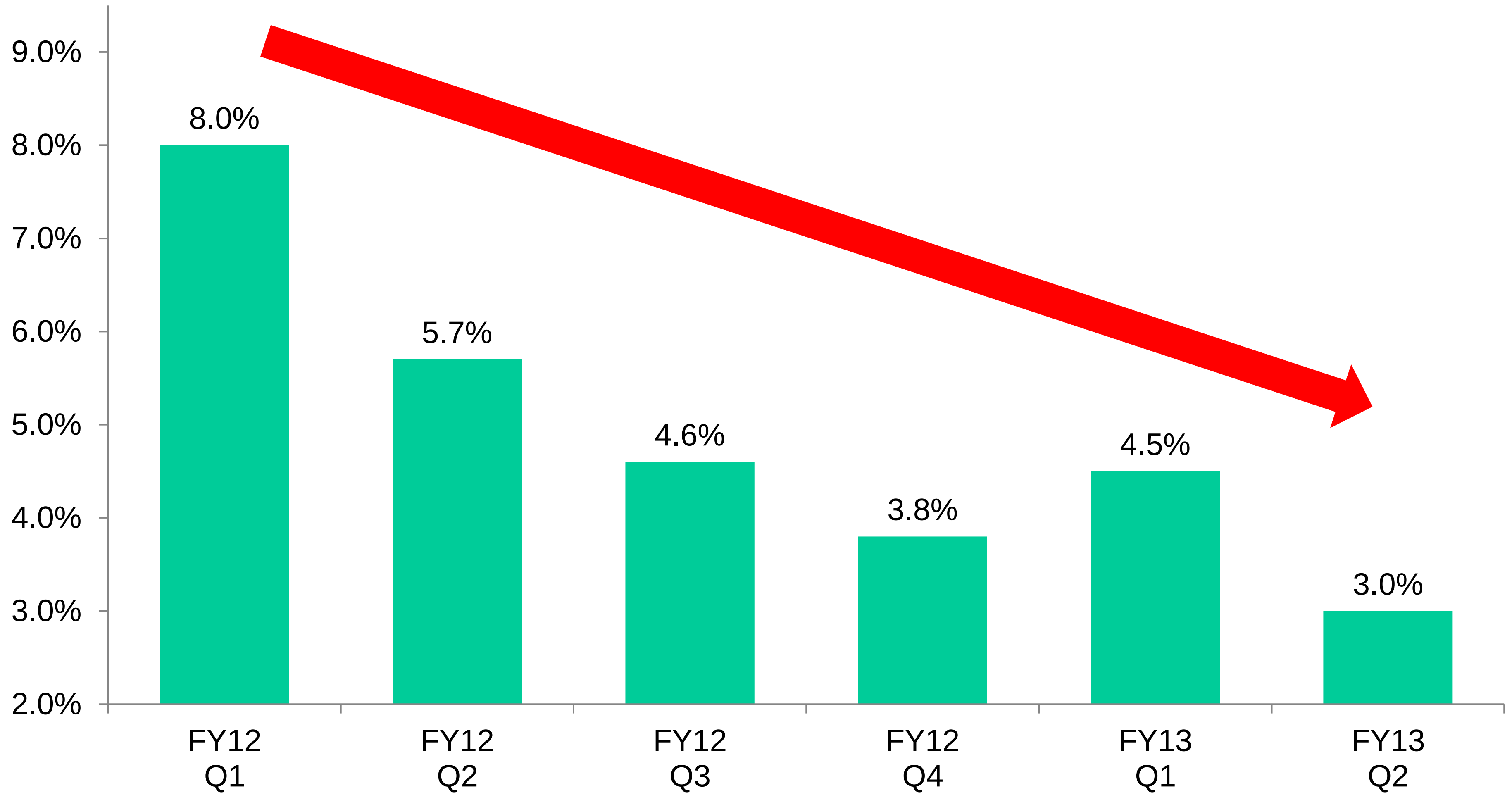
- Over the past six quarters, the percentage of sales financed by CONN's in-house credit offering has steadily increased and is at its all-time high



2 Deteriorating Underwriting Standards → High Risk Credit Portfolio

Average Down Payment

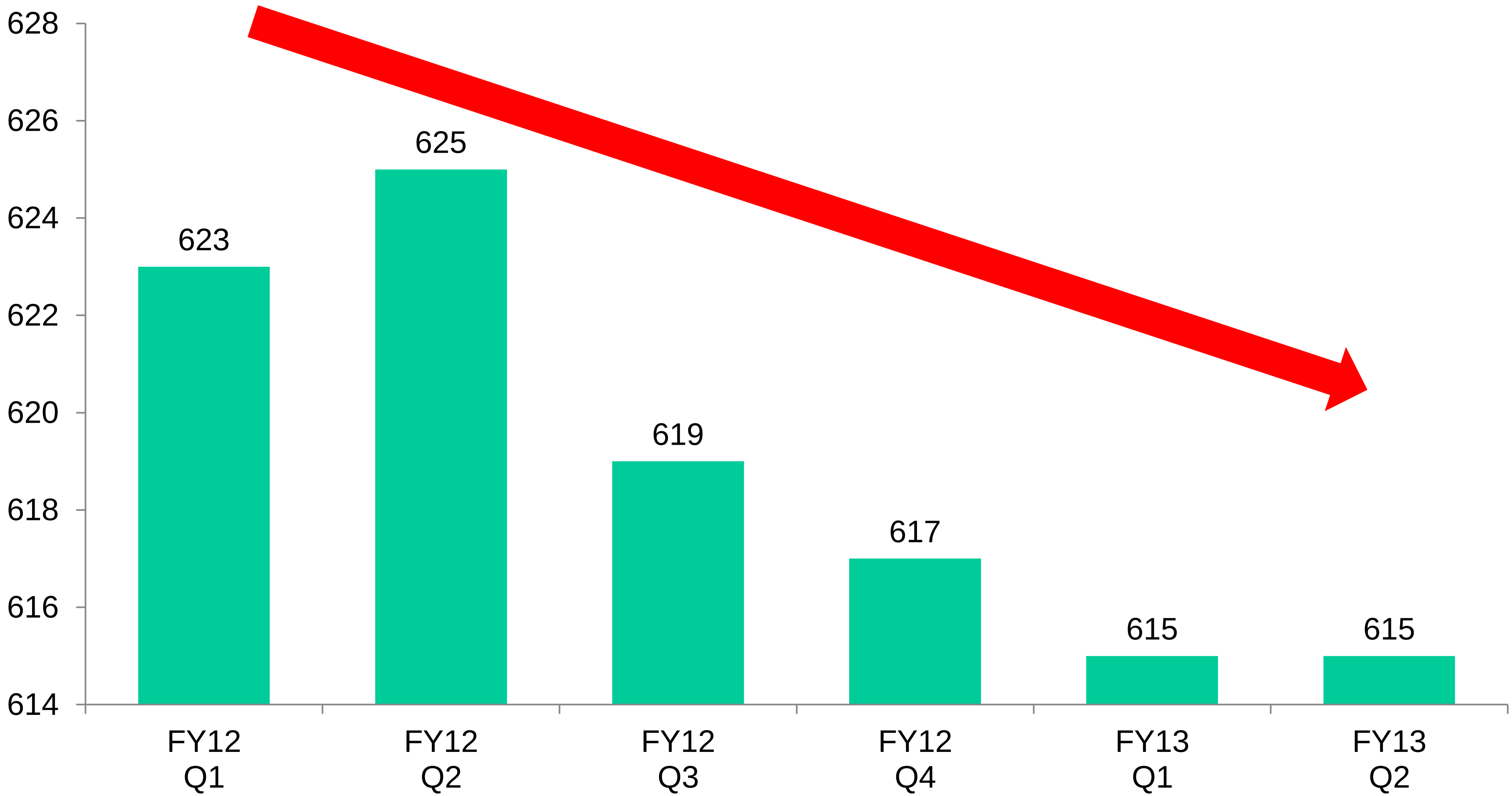
- The average down payment has been decreasing and is at its all-time low



2 Deteriorating Underwriting Standards → High Risk Credit Portfolio

Weighted Average Origination Credit Score of Sales Financed

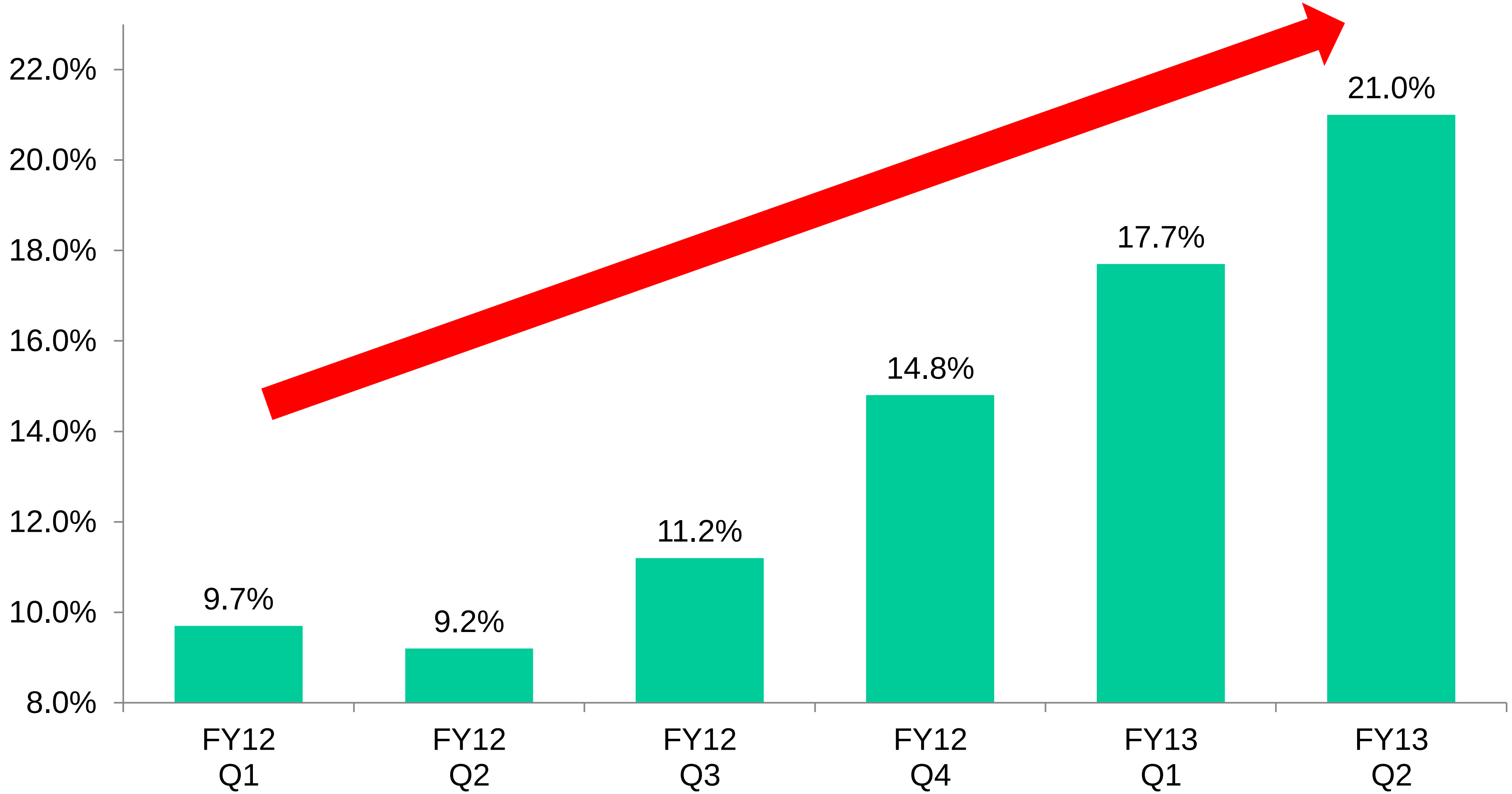
- The weighted average origination credit score of sales financed has been decreasing and is at its all-time low



② Deteriorating Underwriting Standards → High Risk Credit Portfolio

Promotional Receivables as % of Total Outstanding Receivables

- Promotional receivables (0% financing) has increased to its all-time high as CONN attempts to boost sales



② Deteriorating Underwriting Standards → High Risk Credit Portfolio

Current Credit Business Trends Will Lead to a Substantial Increase in Write-offs

1. Percentage of Sales Financed Increasing

\+

2. Down Payments Decreasing

\+

3. Credit Scores Decreasing

\+

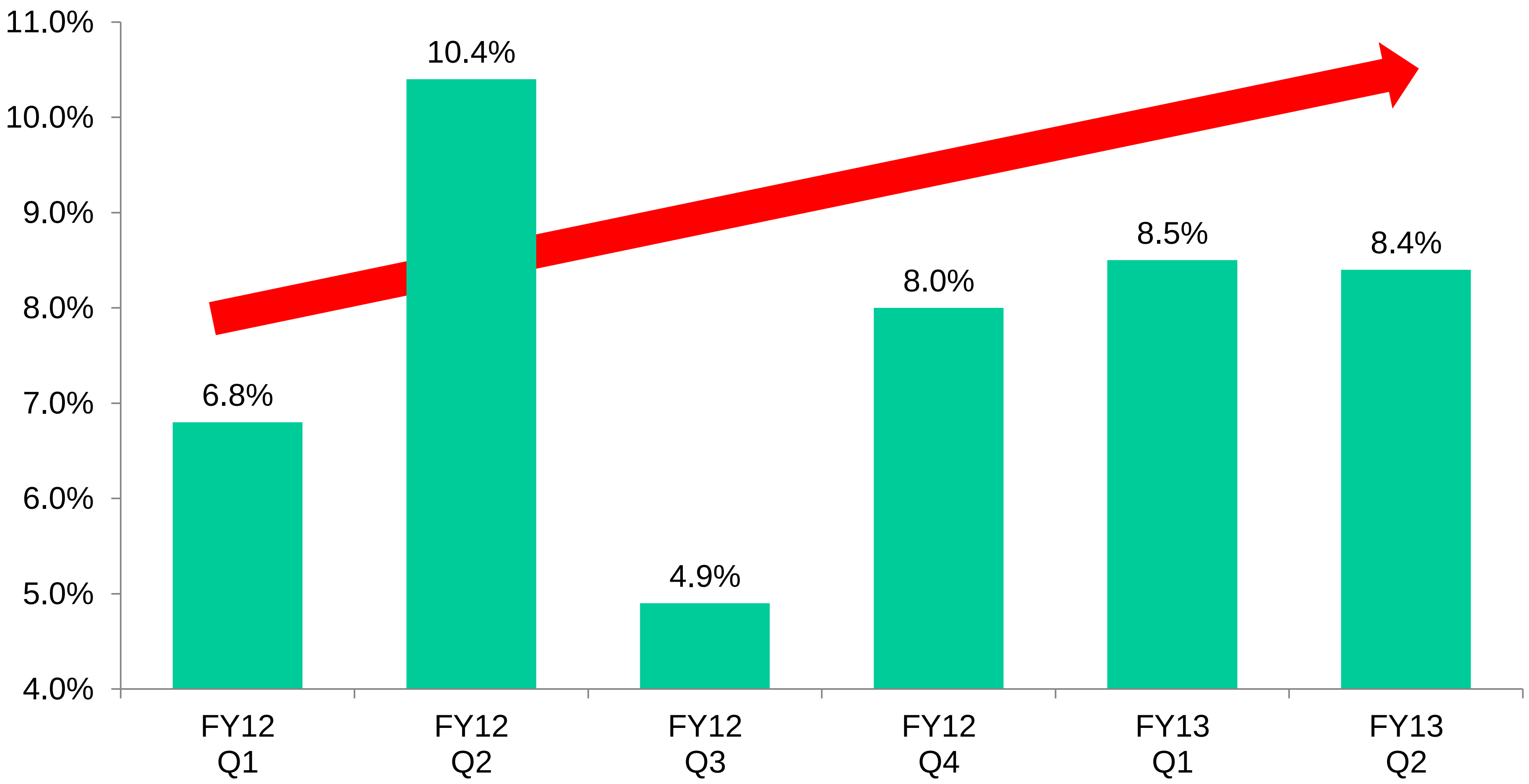
4. Promotional Receivables Increasing

High Risk Credit Portfolio → **Substantial Future Write-offs**

2 Deteriorating Underwriting Standards → High Risk Credit Portfolio

Write-Offs (net of recoveries) as a % of Average Outstanding Receivables Balance (annualized)

- As expected from the fundamentals of the portfolio, write-offs have been increasing and we expect them to get worse in future quarters



2 Deteriorating Underwriting Standards → High Risk Credit Portfolio

- With the industry facing secular headwinds, CONN has decreased its credit standards to sustain its sales figures. This has resulted in:
  - Inflated sales figures
  - Deteriorating quality of receivables portfolio
  - Higher expected future write-offs
- CONN's accounting policy allows delinquent receivables to stay on the company's balance sheet for 209 days before any write-offs
  - For comparison, AAN's policy is to write off lease receivables that are 60 days or more past due while RCII writes off delinquent accounts that are 90 days past due
- **CONN's increasingly risky practices and deteriorating quality of the portfolio will be exposed through substantial write-offs in its receivables portfolio in future quarters**

3 Aggressive Accounting Practices

Provision for Bad Debt

- Year-to-date FY Q2 2013, the company estimated Provision for Bad Debt to be 9% of sales financed by in-house credit. Given CONN's loose underwriting standards, we believe this should be at least at the 13% level experienced in FY 2012, if not greater
  - At the 13% level, operating margin would decrease from 19% to 4%

Credit Segment Financials

USD in millions	FY			Current		Pro Forma
	2010	2011	2012	YTD Q2'13		YTD Q2'13
Finance charges and other revenue	157.4	145.2	137.3	69.2		69.2
SG&A	61.7	64.0	57.3	26.5		26.5
Provision for bad debts	48.4	50.6	53.0	21.0		31.0
Interest expense	22.0	28.1	22.5	8.6		8.6
Normalized operating income (loss) (1)	**25.3**	**2.5**	**4.6**	**13.1**		**3.1**
Operating Margin %	*16%*	*2%*	*3%*	*19%*	--------->	*4%*
Segment % of total operating income	*140%*	*36%*	*28%*	*35%*		*12%*
Sales financed by in-house credit	455.7	405.6	394.8	230.8		230.8
Provision for bad debt as % of sales financed by in-house credit	**11%**	**12%**	**13%**	**9%**	--------->	**13%**

Note:
(1) Excludes loss from early extinguishment of debt and costs related to financing facilities terminated

4 Misleading Same-Store Sales Growth

CONN vs. Competitors

- Over the past four quarters, CONN has displayed impressive same store growth, while other brick-and-mortar competitors have struggled

	FY 2012				FY 2013	
	Q1	Q2	Q3	Q4	Q1	Q2
Same Store Growth						
BBY	-2%	-3%	1%	-2%	-4%	-2%
HGG	-11%	-13%	2%	4%	-1%	-5%
CONN	-4%	-13%	**19%**	**12%**	**18%**	**22%**

4 Misleading Same-Store Sales Growth

Store Count Growth

- A closer look at the numbers reveals reason for concern. CONN's same-store numbers are misleading for two reasons:
  - CONN has been closing its weakest stores, and therefore, the same store comps include only the most profitable stores

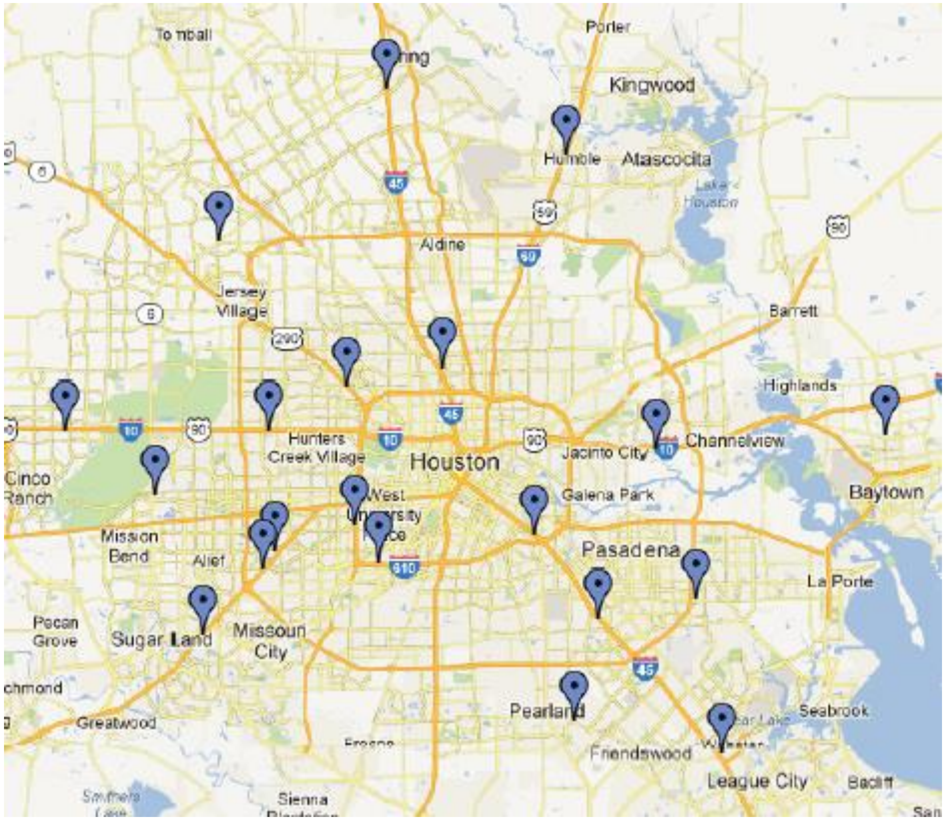
	FY 2012				FY 2013	
	Q1	Q2	Q3	Q4	Q1	Q2
Same Store Growth						
BBY	-2%	-3%	1%	-2%	-4%	-2%
HGG	-11%	-13%	2%	4%	-1%	-5%
CONN	-4%	-13%	**19%**	**12%**	**18%**	**22%**
Store Count						
BBY	1,335	1,367	1,425	1,447	1,468	1,460
HGG	173	180	204	208	208	210
CONN	75	72	70	65	64	65
Store Count Growth						
BBY	11%	10%	10%	10%	10%	7%
HGG	32%	15%	21%	20%	20%	17%
CONN	-1%	-5%	**-8%**	**-14%**	**-15%**	**-10%**

4 Misleading Same-Store Sales Growth

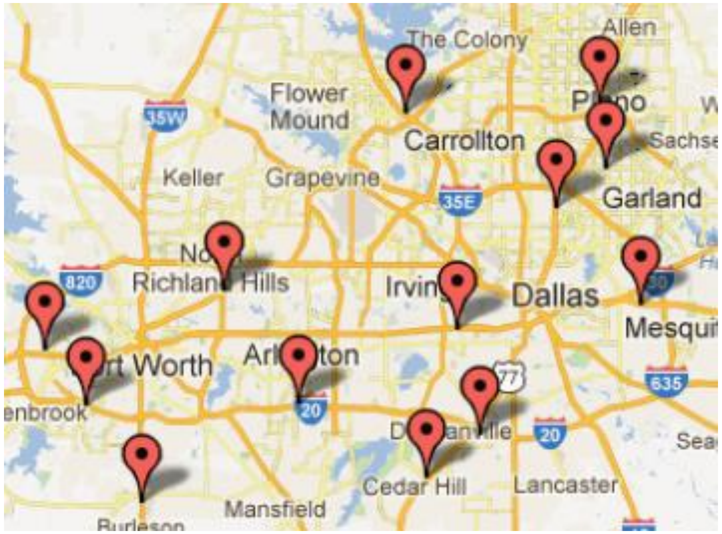
Store Density in Key Markets

- CONN's stores are densely located and to some extent cannibalize sales from each other. Thus, closing a store will result in an increase in sales at nearby stores

Houston: 20 CONN stores within a 25 mile radius



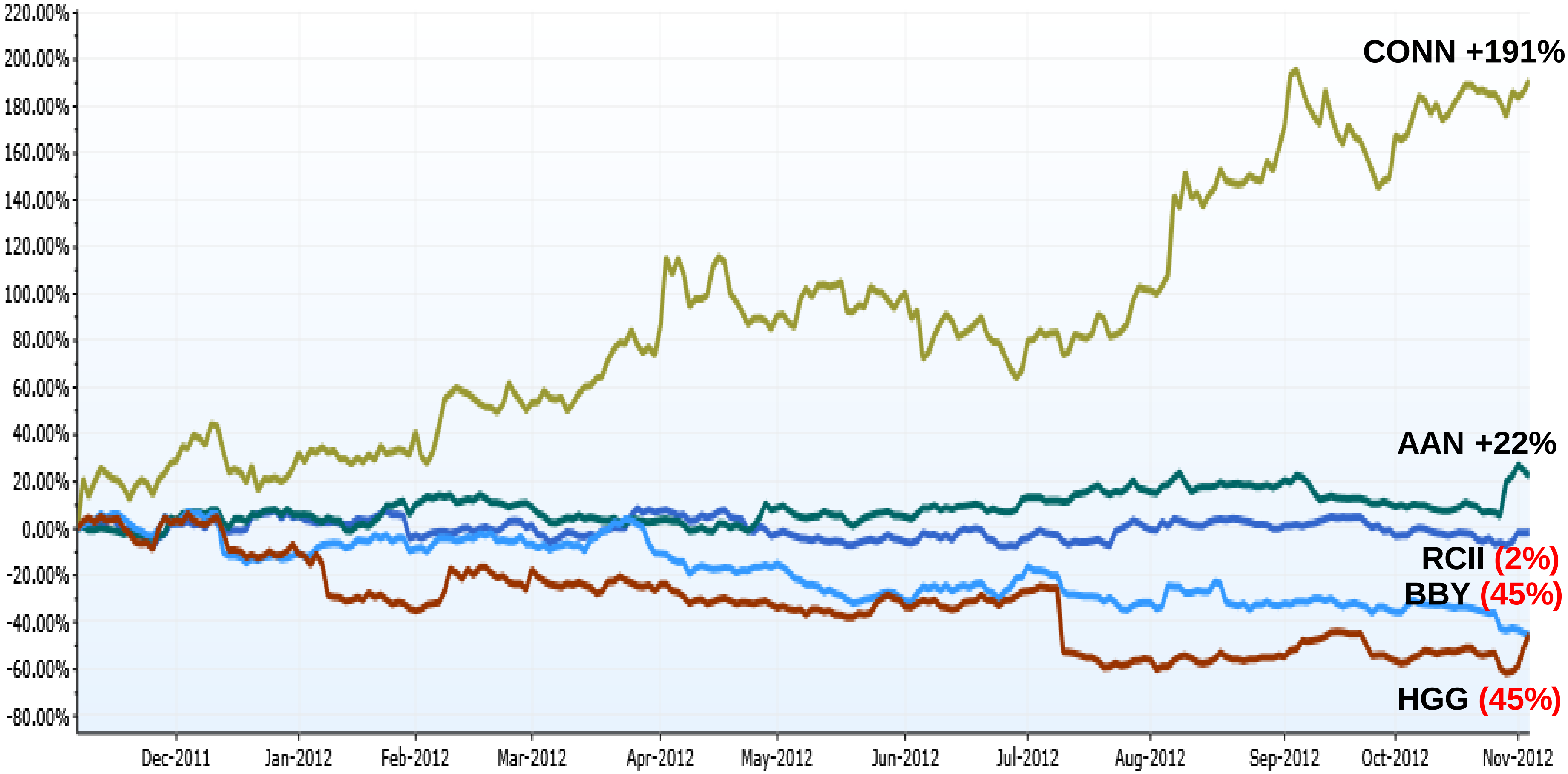
Dallas / Fort Worth:
13 CONN stores within a 30 mile radius



5 Extraordinarily High Valuation

Share Price Performance

- Over the past twelve months, CONN has significantly outperformed its peers



5 Extraordinarily High Valuation

Comparable Company Analysis

- On a multiples basis, CONN trades at a significant premium to its peers

	Current Price	Shares Outs.	Market Cap	Net Debt	Enterp. Value	Net Debt / EBITDA	# of Stores	Sales per Store	EV per Store	EV / EBITDA LTM	EV / EBITDA NTM	PE LTM	PE NTM
Primarily Cash Sales													
Best Buy	$14.47	337	4,872	1,009	7,014	0.3x	4,316	11.7	1.6	2.1x	2.9x	NM	5.7x
hhgregg	$8.50	35	294	(9)	286	-0.1x	210	12.0	1.4	3.0x	2.9x	4.2x	9.1x
Average						**0.1x**		**11.9**	**1.5**	**2.6x**	**2.9x**	**4.2x**	**7.4x**
Primarily Credit Sales													
Aaron's	$30.79	76	2,334	(31)	2,303	-0.1x				7.7x	6.9x	14.3x	13.7x
Rent-A-Center	$34.75	59	2,045	512	2,556	1.3x				6.4x	5.9x	11.2x	10.2x
Average						**0.6x**				**7.1x**	**6.4x**	**12.8x**	**12.0x**
Conn's	**$25.71**	**33**	**838**	**310**	**1,148**	**6.6x**	**65**	**12.6**	**17.7**	**24.4x**	**9.4x**	**46.3x**	**15.7x**

5 Extraordinarily High Valuation

Estimated Fair Value

Comparable Company Analysis

- We believe CONN should be valued at a blended average multiple of the four comps
- Based on price-to-earnings and EV/EBITDA multiples, this would imply a price range of $9.00 to $14.00 per share

Discounted Cash Flow Analysis

- Based on our discounted cash flow analysis (*Appendix C*), we estimate the intrinsic value of CONN to be $10.00 to $12.00 per share

Valuation Range

- Based on our valuation methodologies, we estimate the fair value of CONN shares to be in the $9.00 to $13.00 per share range, which represents a 50% to 65% discount to the current share price

Investment Risks and Mitigating Factors

- High Short Interest → Short Squeeze
  - In 2012, insiders have sold 1.5 million shares for $27 million, which has increased the public float by 10%
  - In addition, CONN has filed an S-3 to issue up to $150 million in primary shares and sell up to $100 million in secondary shares in the near future
    - Assuming shares are issued at a 10% discount to the current share price, this would increase the public float by 68%, from 16 million to 27 million shares

- Improvement in Credit Standards
  - If the company were to tighten its underwriting standards, this would negatively impact sales by shrinking the potential customer base

- Improvement in Delinquency Rates

Appendix

Table of Contents

Ⓐ Financials: Retail Segment

Retail Segment Financials

USD in millions	FY			YTD FY Q2		
	2010	**2011**	**2012**	**2012**	**2013**	*% Growth*
Product sales	666.4	608.4	596.4	282.5	308.1	*9%*
Repair service agreement commissions	40.7	37.8	42.1	18.8	23.7	
Service revenues	22.1	16.5	15.2	7.7	6.7	
Total net sales	**729.2**	**662.7**	**653.7**	**309.1**	**338.6**	*10%*
Finance charges and other	0.5	0.9	1.3	0.6	0.5	
Total revenues	**729.7**	**663.6**	**655.0**	**309.7**	**339.1**	*10%*
Cost of goods and parts sold	539.6	482.5	462.0	215.3	222.3	*3%*
Gross profit	**190.1**	**181.1**	**193.0**	**94.4**	**116.8**	*24%*
Gross Margin %	*26%*	*27%*	*29%*	*30%*	*34%*	
SG&A	184.6	163.5	170.6	80.5	88.0	*9%*
Depreciation	12.3	12.3	10.1	5.6	4.6	
Provision for bad debts	0.4	0.8	0.6	0.3	0.4	
Normalized operating income (loss) (1)	**(7.2)**	**4.5**	**11.8**	**8.0**	**23.8**	
Operating Margin %	*-1%*	*1%*	*2%*	*3%*	*7%*	

Note:
(1) Excludes impairment of long-lived assets, goodwill impairment, and costs related to store closings

B Financials: Credit Segment

Credit Segment Financials

USD in millions	FY			YTD FY Q2		
	2010	**2011**	**2012**	**2012**	**2013**	*% Growth*
Finance charges and other revenue	157.4	145.2	137.3	69.3	69.2	*0%*
SG&A	61.7	64.0	57.3	29.5	26.5	*-10%*
Provision for bad debts	48.4	50.6	53.0	16.4	21.0	*28%*
Interest expense	22.0	28.1	22.5	14.6	8.6	*-41%*
Normalized operating income (loss) (1)	**25.3**	**2.5**	**4.6**	**8.9**	**13.1**	
Operating Margin %	*16%*	*2%*	*3%*	*13%*	*19%*	

Note:
(1) Excludes loss from early extinguishment of debt and costs related to financing facilities terminated

(C) Discounted Cash Flow Analysis

	2012	2013	2014	2015	2016
Total Operating Revenue	848	907	971	1,039	1,111
Total NOPAT	42	45	48	52	55
Change in Net Working Capital	(6)	(6)	(6)	(7)	(7)
Change in Fixed Assets	(6)	(6)	(6)	(7)	(7)
Free Cash Flow	**31**	**33**	**36**	**38**	**41**
PV of FCF and Terminal Value	**778**				
Less: Debt and Operating Leases	428				
Plus: Pension & OPEB Funded Status	0				
Less: Minority Interests	0				
Less: Value of ESOs	6				
Plus: Excess Cash	0				
Implied Equity Value	**343**				
Shares Outstanding	32.6				
Implied Share Price	**$10.54**				
Share Price as of 11/5/12	**$25.71**				
Premium to Current Share Price	*59%*				

D Research Process

Resources Used

- 10-Ks, 10-Qs
- Earnings transcripts
- Sell-side research reports
- Investor presentations
- Company press releases
- Glassdoor employee reviews

People Contacted

- CONN investor relations
- Competitors
  - Best Buy investor relations
  - Hhgregg investor relations
  - Aaron’s investor relations
  - Rent-A-Center investor relations
- Sell-side analysts
  - Canaccord Genuity
  - Caris & Company