# Engine Capital and Red Alder Deliver Letter to ANN Board

State that the Company is Deeply Undervalued and that Opportunities Exist to Close the Significant Valuation Gap and Unlock Shareholder Value

Urge ANN to Retain Immediately a Reputable Investment Bank to Explore all Strategic Alternatives to Maximize Shareholder Value, Including a Sale of the Company

Believe ANN Could be Conservatively Worth Between $50 and $55 per Share to a Third-Party Acquirer in a Competitive and Robust Sale Process

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**Engine Capital LP →**
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NEW YORK, Aug. 25, 2014 /PRNewswire/ -- Engine Capital LP, together with its affiliates, and Red Alder LLC, who collectively own in excess of 1% of the outstanding shares of ANN, INC. ("ANN"), today announced that they have delivered a letter to the Board of Directors of ANN.

The full text of the letter is included below:

August 25, 2014

Independent Members of the Board of Directors
c/o Mr. Ronald W. Hovsepian, Chairman
ANN, INC.
7 Times Square, 5th Floor
New York, NY 10036

Dear Independent Board Members:

Engine Capital LP, together with its affiliates ("Engine"), and Red Alder LLC ("Red Alder") collectively ("we") own in excess of 1% of the outstanding shares of ANN, INC. ("ANN" or the "Company"). ANN represents a significant investment for Engine and Red Alder. We invested in ANN because the Company is deeply undervalued, and there are opportunities readily within the control of the Board to increase shareholder value substantially. As you know, Engine has had private discussions with members of management over the last couple of weeks. We had hoped following our discussions that the Company would take prompt action to announce that it is commencing a process to explore all strategic alternatives to maximize shareholder value, including a sale. Unfortunately, given the lack of progress and the importance to act with urgency, as further explained below, we have no choice but to share our thoughts publicly at this time.

Our extensive due diligence on ANN suggests that there is a significant gap between the trading value of ANN stock and the intrinsic value of its business. Over the last few years, private market transactions of specialty apparel retailers have taken place between 8x and 9x EBITDA. By contrast, ANN currently trades for around 5.5x EBITDA. We believe that it is incumbent upon the Company's board of directors (the "Board"), in accordance with its fiduciary duties, to explore all opportunities to close this significant gap and unlock shareholder value. Based on our significant experience investing in specialty apparel retailers and our diligence on ANN, we believe that ANN could be worth between $50 and $55 per share to a third-party acquirer, implying a premium of around 40% to the current stock price (assuming the midpoint of our valuation range).

In light of the current robust M&A environment, the recent arrival of Golden Gate Capital as the Company's largest shareholder, our public involvement, likely significant private equity interest, the aforementioned significant value gap, and the Company's suboptimal balance sheet, we think the status quo is untenable. Therefore, we urge the Board to retain immediately a nationally-recognized investment bank and establish a special committee of independent directors to explore strategic alternatives to maximize shareholder value, including a sale of the Company. We believe the vast majority of the Company's shareholders would support this course of action, especially given the uncertain retail environment that you highlighted in your recent Q2 earnings call. We intend to start communicating with potential buyers to further garner interest in the Company. As such, we would strongly encourage interested private equity firms to send indications of interest to the Company. This would put additional pressure on the Board to act expeditiously.

ANN is an incredibly suitable candidate for a private equity acquirer because of its consistent performance over the years, ability to further improve margins, significant and growing free cash flow generation (a combination of growing EBITDA and decreasing capex), quality and recognition of its brand, and size. It is also worth noting the unusually favorable credit markets - such an environment would likely allow an acquirer to borrow around 5x EBITDA at very attractive rates.  It is uncertain how long the credit markets will remain favorable, and we therefore encourage the Board to act with a sense of urgency so that this significant opportunity does not slip away.

A sale also makes sense strategically. ANN is a maturing business that should be paired with an appropriate capital structure. This can best be accomplished in a private setting with the backing of a deep-pocketed private equity partner. A private equity firm can pay a higher multiple for ANN because of its ability to optimize the Company's capital structure. While we are aware of the Board's historic reluctance to use debt to lower the Company's cost of capital, we remind the Board that its fiduciary duties are to ANN's shareholders and that a sale of the Company would allow the current shareholders to take advantage of this arbitrage by maximizing the value of their investment, while transferring the risk associated with leverage to the Company's new owners. Also, a private equity firm with significant retail industry expertise could be a lot more aggressive reducing capex and cutting expenses in a private setting, thereby generating significantly more free cash flow.

We also think strategic parties would be interested in participating in this process. Given the magnitude of synergies available, a strategic buyer could pay more than a private equity firm. A large international retailer could take ANN's iconic brands and significantly expand their presence internationally at a faster pace. For these reasons, we would expect a competitive and robust process for ANN and believe that the price range indicated above could prove conservative.

The Company may argue that the exploration of strategic alternatives today might not fully value the Company if it achieves its potential favorable prospects. We strongly disagree because:

- We assume that the Company has a 5-year plan with financial projections that reflect these favorable prospects. If these projections are credible, potential buyers will price ANN accordingly. The fact that a company has great prospects is hardly a reason not to explore a value-maximizing transaction. Just the opposite – often an ideal time to sell a company is when it has favorable prospects.
- As mentioned before, credit markets may never be as good. The ability of a private equity firm to pay up for ANN is directly tied to its ability to finance the purchase. Do not let this substantial opportunity slip by.
- <u>Factoring in the time value of money and execution risk, in order to try to justify not pursuing strategic alternatives now, by our calculation, the Board would have to be confident that the Company's stock would reach $75 per share within 3 years (at a 12% discount rate and assuming a $52.50 per share transaction). This means that the Board would have to be confident that EPS can reach $5.40 per share within 3 years (assuming the Company's historical price to earnings multiple of 14x) compared to EPS of $2.27 expected for the current fiscal year!</u>
- We seriously question whether the Board has this level of confidence in the Company's future prospects when no Board member has bought a single share of stock in the public market during the past 18 months despite the stock's trading at much lower levels. Instead, directors have been selling. In particular, we note that Mr. Burke has drastically reduced his position in ANN from 225,588 shares in 2010 to 40,904 shares currently. Mr. Burke sold 117,750 shares at $27.10 and 100,000 shares at $35.69. Mr. Hovsepian, the Chairman, sold almost half of his holdings at $33.44 in 2012 and was more recently selling a significant portion of his remaining holdings at $29.20 and $34.43. These directors and the other directors who have been selling clearly cannot argue that $52.50 per share today undervalues the Company. Though a sale may be an emotionally difficult decision, it is not an admission of failure; rather, it is simply a rational and analytical decision designed to maximize value and minimize risk for the owners of the business.

If the Board concluded a sale of the Company not to be in the best interest of the shareholders at this time because it would undervalue the Company, we would expect as a sign of confidence that all Board members buy in the market a significant number of shares of ANN (such as twice his or her annual Board compensation).  It is easier to take risks with other people's money, but the Board members should be willing to take risks with their own money. It is unacceptable for the Board members to disregard a review of strategic alternatives and prevent the opportunity for a sale at a significant premium, while continuing to receive their rich annual compensation packages (ranging from $180,000 for a regular director to $349,000 for Mr. Hovsepian as chairman), and not have to put their money where their mouths are.

As you meet with your bankers to consider the Company's options, you will likely evaluate a number of strategic alternatives, including potential acquisitions and leveraged recapitalization possibilities. While some of these ideas may have merit and may represent better alternatives than the status quo, we would urge the Board to consider their upside in light of their potential risk:

- Acquisitions – Acquisitions are fraught with execution risk and would complicate the business. One of the knocks on ANN over the years has been that when one of the divisions works, the other does not. An acquisition would merely compound this problem. In our opinion, this problem is why holding companies in specialty retail tend to trade at discounts to their pure play peers. Finally, the Company and its CEO Ms. Krill have never executed an acquisition in the past; acquisitions are not the Company's core competence and should be avoided.
- Levered Recapitalization – Though not as attractive as a sale, a levered recapitalization would create value. The Company could easily borrow $600 million (approximately 2x EBITDA), and for approximately $36 million per year in interest (assuming a 6% interest rate), repurchase a third of its shares outstanding through a tender offer at $40 per share. Such a transaction would certainly be highly accretive, lower the Company's cost of capital, and better enhance shareholder value relative to the status quo. Although we think a sale today delivers significantly more short- and long-term value with less risk, if the Board views a $52.50 per share sale as undervaluing the business, then it should instead immediately initiate a levered recapitalization and repurchase a third of its shares outstanding through a tender offer. The Board cannot have it both ways, at the same time arguing that a $52.50 per share sale would undervalue the business and not buying back a significant number of shares in the context of $40 per share. <u>If the Board does not have the confidence to lever the Company reasonably (approximately 2x EBITDA) to buy back a third of its shares outstanding, then it cannot argue that a sale at $52.50 per share is not the best outcome for the shareholders.</u>

Finally, we also request that the Board establish a special committee, consisting of only independent members of the Board with its own legal and financial advisors, to conduct the strategic alternatives review. We are concerned about management intentions and, in particular, are aware of Ms. Krill's preference for the status quo of remaining a public company. We and all of your shareholders expect the Company's directors and officers to follow proper corporate governance practices.

In conclusion, we believe that the Board has a unique opportunity to monetize the Company at a very attractive valuation, but in order to do so the Board must act with urgency. We hope that the Company will do the right thing and take the required steps to maximize value for all shareholders. We look forward to working constructively with the Board and intend to monitor closely the developments at the Company. We must, however, reserve our rights to take whatever actions in the future we believe may be required to protect the best interests of shareholders.

*Very truly yours,*

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| Arnaud Ajdler | Schuster Tanger |
| Managing Partner | Managing Member |
| Engine Capital LP | Red Alder LLC |

**About Engine Capital LP**

Engine Capital is a value-oriented special situations fund that invests both actively and passively in companies undergoing change.

**About Red Alder LLC**

Red Alder LLC is an SEC-registered investment adviser based in New York City that focuses on event-driven, value-oriented investment opportunities.

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