



Burlington Stores, Inc. | NYSE: BURL
INVESTMENT RESEARCH REPORT

"Broken Heart, No Love For Burlington Stores"

RECOMMENDATION: *Strong Sell*

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This Research Is Dedicated To My Mother

- Kind, caring, compassionate, intelligent, giving, and the source of my activism
- She loved to shop and find a bargain

About Spruce Point Capital Management

Spruce Point Capital is an industry recognized research activist investment firm founded in 2009

- Founded by Ben Axler, a former investment banker with 16 years experience on Wall Street. Ranked the #1 Short-Seller in the world by [Sumzero](#) after a comprehensive study of 12,000 analyst recommendations dating back to 2008
- Our forensic financial and accounting research focuses on disclosure and transparency issues, identifying break downs in managerial incentive structures. We support our research conclusions with unique primary research such as FOIA requests, product testing and field studies. Our research has a track record of driving tangible corporate change:

Spruce Point Report Date	Company	Enterprise Value at Release Date	Selected Update and Commentary	Stock Direction Post Spruce Point Campaign
8/19/15	Caesarstone	\$1.7 bn	Slashes 2016 Sales/EBITDA forecasts by 5 and 9% respectively in October after the CEO resigned in May	Down
12/17/15	The Intertain Group	\$1.1 bn	UK CMA launches investigation into online gaming industry just as Intertain seeks UK centric strategy and listing	Down
3/9/16	Planet Fitness	\$2.1 bn	The CEO starts selling stock , and its biggest owner liquidated . After touting a 1c EPS increase to guidance, Planet now wants to lever up to pay a dividend . It looks like a race to cash out fast!	Up
4/13/16	Sabre	\$11.2 bn	Company reduces cash flow guidance in Q2, warns it cannot give guidance on a GAAP basis , SEC releases comment letter mirroring some of our criticisms, misses Q3 estimates	Down
8/16/16	AECOM	\$9.3 bn	Revised annual guidance to the low end of the range after our AECOM Capital criticism	Down
9/10/16	Echo Logistics	\$1.1 bn	Echo misses Q2 earnings estimate by a wide margin and guided revenues to the low end of Q4 range	Down



Executive Summary

Spruce Point is Cautious on Burlington Stores For the Following Reasons:

Burlington (“BURL” or “the Company”) Is An Old School Retailer Now Being Spun As A Sexy New Growth Story Amidst An Intensifying and Ultra Competitive Retailing Environment

- [Burlington Stores](#) (formerly Burlington Coat Factory) is an “off-price” discount retailer based in Burlington, NJ that sells men’s and women’s clothing, home furnishings, and accessories. It competes with the likes of TJX Companies (T.J. Maxx, Marshalls), Ross Stores, and countless other retailers offering shoppers a discount to the M.S.R.P.
- [In January 2006](#), Bain Capital privatized Burlington by acquiring control for \$45.50 per share, valuing the company at \$2.0 billion, or 7x EBITDAR and 15.6x P/E according to the [proxy](#)
- Under pressure from a series of struggling retail investments (e.g. Toys R’Us, Guitar Center), Bain Capital seized the opportunity to [re-IPO Burlington](#) in 2013. Its IPO prospectus touted various growth opportunities to excite new investors including: a) Improve merchandising, b) improve the shopping experience for its mostly female customer base, c) refresh existing stores and grow to 1,000 locations, and e) invest in technology + supply chain initiatives to inc. inventory turnover, and improve operating leverage
- [With its share price up 330% since its IPO](#), Burlington has benefited both from low income shoppers searching for deals, and management’s aggressive financial and accounting tactics to engineer “beat and raise” quarters. However, in the brutally competitive retail business fortunes can change fast, and we believe investors are under-appreciating risks being signaled

Burlington Has Been Touting impressive Comparable Store Sales (“CSS”), Gross Margin, and EPS Gains, While Shrinking Same Store Inventory. We Don’t Think It Can Last. Spruce Point Has Identified Numerous Financial Presentation, Accounting, And Business Issues That Could Be Signaling A Slowdown In Future Financial Results

- [At IPO, Burlington touted the advantages of its large stores \(80k sqft\)](#). Now, the story keeps changing; it repeatedly talked down its optimal store size format (50-60k, now 40-50k). In our opinion, this [may create and apples-to-oranges problem for its comp store base](#), may allow it to juice its comps by reclassifying modified or relocated stores as new, and changes its unit economics
- [As an indicator of potential strain, recent sales growth rates have rapidly diverged from accounts receivables growth](#)
This type of divergence is a classic red flag. Burlington also bought-in its fragrance category, which allowed it to boost its comps
- [Burlington presents its gross margin, a key performance indicator, in a non-standard way](#), by excluding store occupancy costs and depreciation of certain fixed assets. [Burlington used to disclose its occupancy costs in SG&A but has repeatedly made changes to SG&A disclosures, and is now completely obscuring occupancy costs making it hard to evaluate trends](#)
- [Our recent store visits left us with the impression that stores were unoptimized](#). With comp store inventory declining, [existing and new competitors rapidly entering the discount segment](#), Burlington may be challenged to sustain recent performance.

Burlington's Inventory and Financials Signaling Potential Strain

In Our Opinion, The Crux of Burlington's Financial Stains Can Be Seen By Closely Evaluating Its Inventory Accounting, Pack and Hold Inventory Strategy, And Inventory Turnover

- [The Company uses the retail inventory method](#), which is open to significant management judgment and estimates including merchandise markon, markups, markdowns and shrinkage (aka loss of inventory from theft) which significantly impact the ending inventory valuation as well as the resulting gross margin
- [Shrinkage estimates reversed in Q4'15 for the first time ever](#), resulting in a \$3.5m hit to gross margin. We've identified a troublesome rise in reports of theft and violence at Burlington locations which suggests more reversals may occur
- Burlington always touts its ability to improve inventory turnover as a key driver of sustaining and improving its financial performance. [Burlington uses a non-standard inventory turnover calculation](#), stopped disclosing turnover inclusive of warehouses where pack and hold inventory resides, and recently stopped disclosing the annualized quarterly metric mid 2015
- [Pack and hold](#), an inventory management strategy to buy discounted merchandise and hold it for future periods, rapidly surged post IPO. In our opinion, the strategy provides management opportunity to manage gross margins and boost turnover. [We identified a misstatement of its pack and hold inventory value in Q3'15; at best an error, at worst accounting manipulation](#)

In Our Opinion, Another Big Area Of Concern Is Burlington's Store Unit Economics Appear To Be Deteriorating

- After its IPO in 2013, [Burlington stopped disclosing the unit economics of its stores](#), which it said cost an average of \$1.6m - \$1.8m for a typical 80k sqft location (\$21.25/sqft at the midpoint). In Q1'16, [Burlington recently stopped making the affirmative statement in its SEC filings](#) that a "vast majority of existing stores had positive Adjusted EBITDA"
- [With less than 1% of sales coming from ecommerce](#), store location and physical sales are critical to its success. It appears that in recent years, the [Company has been opening stores at locations of failed retailers](#) (Kmart, Sears, Filene's Basement)
- [A recent FOIA request](#) to obtain a building permit for a new 50k sqft location in Delaware supports our view that unit economics may be deteriorating. Based on conservative assumptions of inventory spend, pre-marketing costs ([which accounting rules dictate must be expensed but Burlington doesn't disclose](#)), we estimate per sqft costs have increased 17%-45%
- Burlington received large EPS and cash flow benefits from landlord incentives that were increased after its acquisition by Bain, and may have been facilitated by its larger store format and slack in the commercial real estate market in the post-financial crisis period. [Burlington's move towards smaller stores, may taper the benefits of these lease incentives](#). Its accounts are signaling a slowdown of EPS and cash flow benefits from incentives. Accrued deferred lease incentives are now declining, and net operating cash flow benefits from rent incentives recently turned negative

Spruce Point Has Uncovered Hard Evidence Suggesting Earnings Manipulation

Spruce Point Has Obtained Bona Fide Documentary Evidence Which Suggests Aggressive Accounting at Burlington, And May Explain Why Its Audit Committee Recently Adopted a Clawback Provision Covering Acts of Fraud

- Our suspicion that Burlington's accounting appears aggressive were heightened when [in Q1'16 the Company reported a \\$2.5m benefit from the sale of a NJ tax credit](#) (is the Company signaling a slowdown of income, or aggressively managing earnings?)
- Spruce Point filed a FOIA request with the NJ Economic Development Authority, the gov't agency that granted Burlington a \$40m tax incentive to maintain and create jobs in NJ. [To our disbelief, we found that Burlington legally sold the credits to Citigroup in August 2015 \(Q3'15\), yet booked the transaction to income in Q1'16.](#) This appears to be an extremely aggressive interpretation of GAAP, which usually dictates recording transactions in the period they occur
- In our opinion, Burlington's motivation appears clear: it needed to beat aggressive earnings estimates for Q1'16. The tax credit sale boosted its EPS by \$0.02 cents, resulting in a quarterly beat by \$0.04 cents and sending its shares up 7% by noon that day
- Coincidence or not? In February 2016, [Burlington's Audit Committee added a compensation clawback provision](#) for management, *"in the event of a financial restatement or significant financial harm to the Company arising out of willful actions, including without limitation fraud or intentional misconduct to cover fraud and financial misstatement."*

Significant Recent Turnover In Management, While Remaining Members of Burlington's Management Team In Key Financial, Accounting and Operational Roles Have Worked At Retailers Plagued with Accounting and Operational Issues

- [Numerous recent resignations of key executives for vague reasons include:](#) CFO Todd Weyrich in Jan 2015 for "personal reasons" while guidance was increased, EVP and Chief Merchandising Officer quietly resigned via 8-K filing in March 2015 to "pursue other interests" and long-time General Counsel Paul Tang quietly departed in July 2015, replaced by Janet Dhillon
- [CEO Kingsbury's track record deserves close scrutiny.](#) He was CEO of Filene's through 2006, which suffered declining sales each year. At Kohl's he was quietly removed from store operations, administration, and merchandising. Kohl's delayed its SEC filings in 2011 and restated results to 2008 for a material weaknesses and issues with "complex" lease accounting. What role, if any, did he play with leases as head of store ops and admin. and why does Burlington also have aggressive operating leases?
- [CFO Marc Katz previously was CFO at A.C. Moore, a retailer that disclosed substantial inventory accounting and supply chain challenges.](#) Its earnings restatement resulted in the company changing its FY 2006 results from earnings to losses. Katz is joined by other key A.C. Moore executives such as Mike Metheny (EVP of Supply Chain) and Dennis Hodgson (SVP and CIO)
- [Burlington's Chief Accounting Officer's John Crimmins record is also tainted by accounting scandal.](#) Crimmins was Timberland's Corporate Controller, Chief Accounting Officer, and later promoted to CFO. In April 2007, Timberland delayed its Q1 earnings, and its audit committee said its financials from 2001-2006 could no longer be relied upon

Burlington's Share Price Has 20% – 40% Downside Potential

With Burlington's Share Price Near All-Time Highs, And Bain Capital Cashed Out, Management is Selling Stock Fast

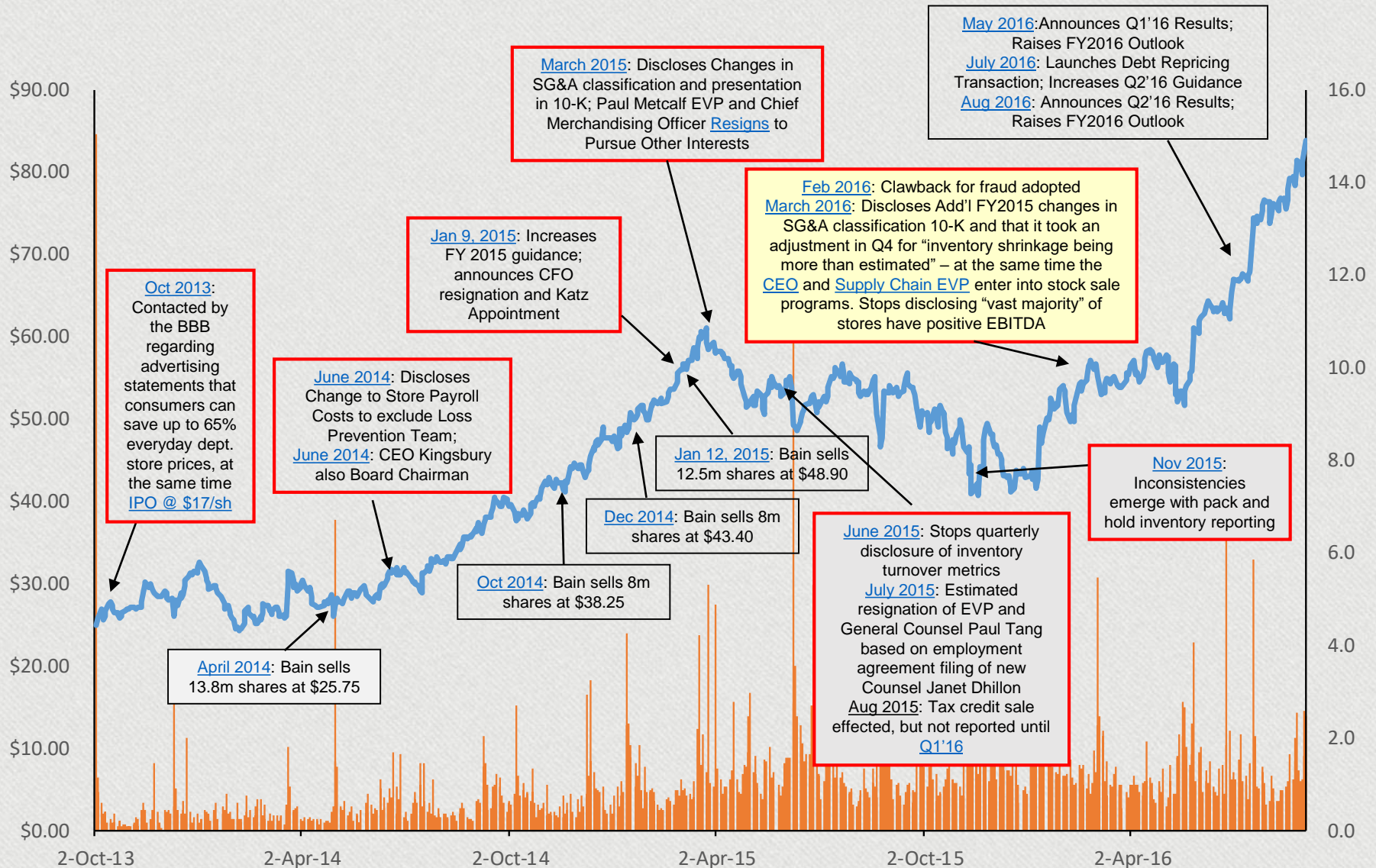
- In addition to the recently added clawback provision noted earlier, [a subtle change to management's Annual Incentive Plan for 2016 also may signal the unsustainability of its earnings growth](#):
 - To illustrate, the incentive compensation has historically been determined 50% by comparable store sales and 50% by Adjusted Net Income. In Feb 2016, the Board approved replacing the "Adjusted Net Income" portion of the Financial Component with "Adjusted Net Income per share."
 - The change in definition is important because Burlington has implemented two share repurchase programs in 2015, allowing it to repurchase a total of \$400m of stock. In effect, management can mask a declining earnings growth rate by accelerating repurchases and earning a bonus for repurchasing shares!
- [A total of seven insiders have sold shares this year and reaped \\$27m in proceeds](#):
 - CEO Kingsbury and EVP Supply Chain Metheny implemented 10b5-1 stock sale programs in March 2016 (shortly after the clawback provision), followed by the EVP of HR also initiating a program in June
 - Other key insiders selling include Katz (CFO), Seeger (EVP of Planning & Allocation and MIO), and Hand (EVP of Stores)

Burlington's Shares Are Priced For Perfection Without Incorporating Fresh Concerns We've Highlighted

- Burlington current trades at approx. 11x and 21x 2017E Adj. EBITDA and EPS, respectively, and is among the most levered retailer at approximately 2.5x Debt / 16E EBITDA. However, adjusting its financials for nearly \$2.5 billion in off-balance sheet leases, we estimate its true Adj. Debt / EBITDAR to be closer to 4.0x – dangerously high for an undifferentiated apparel retailer
- [Wall St. sell-side analysts see 24% upside to an average price target of \\$90/share](#). Analysts' are wildly optimistic that it can grow EPS 20% next year through continued CSS growth, and EBITDA margin expansion of 40 – 50bps – almost blindly taking management's word and extrapolating results into the foreseeable future without even raising any of our concerns
- Analysts' try to draw comparisons between Burlington and best-of-breed retailers TJX and Ross Stores in justifying its rich valuation and price targets. [However, Spruce Point believes that Burlington's vast operational inefficiencies and margin gap will be difficult to reach in the absence of substantially more capital investment](#). Not surprisingly, [Burlington is quietly ratcheting up spending for "supply chain" initiatives](#), which are [susceptible to aggressive cost capitalization which embellishes EPS](#)
- [Burlington's valuation multiple is stretched and trading near an all-time high](#) and discount none of the fresh concerns we've raised about the sustainability of its recent performance and the integrity of its accounting and financial reporting practices. By normalizing Burlington's valuation and trimming estimates, we see a share price range of \$45 – \$60, or 20% – 40% downside



Meteoric Rise of Burlington's Shares Deserve Closer Financial Scrutiny



Recent Retail Investments Have Been Dismal

Burlington stands out as an extreme performance outlier amongst recent Bain backed retail investments. How hard did Bain push Burlington's management to produce blow-out financial performance?

Company	Date	Enterprise Value	Bain Capital Quotes	Outcome
Toys "R" Us	March 17, 2005	\$6,600	"Toys "R" Us and Babies "R" Us are premiere franchises with strong global brand recognition and a collection of high quality product offerings including toys, children's apparel, and baby products and accessories. We are excited by the prospect of partnering with the management team and employees to strengthen the long-term operating and financial performance of the businesses." -Matt Levin, a MD at Bain	"Struggling" Toys "R" Us Tries New Strategy and Facing Credit Insurance Woes as it Restructures
Michaels Stores	July 1, 2006	\$6,000	"We are delighted to partner with the Michaels management team to help build on its already strong position in an attractive industry, and capitalize on the significant growth opportunities that lie ahead. Our deep experience in the retail sector reinforces our conviction that Michaels has the best store locations, a broad and attractive assortment of products for crafters of all ages, and a sustainable competitive advantage thanks to smart investments in systems and infrastructure. We look forward to helping Michaels achieve its full long-term potential." – Matt Levin MD	IPO prices at low end of range (June 2014)
Guitar Center	June 27, 2007	\$2,100	"As the leading retailer of musical instruments in the U.S., Guitar Center enjoys great brand recognition among musicians nationwide, a loyal customer base, and a track record of significant growth. We look forward to working with the Company's experienced and capable management team to continue to build the business." Jordan Hitch, a MD at Bain	The End of Guitar Center And Guitar Center Troubles Only Getting Worse
Gymboree	Oct 22, 2010	\$1,800	"Gymboree is a terrific company with incredible brand strength and a large population of extremely satisfied customers. We look forward to working with Matthew McCauley and the company's proven and experienced management team" Jordan Hitch MD at Bain Capital. "	Gymboree Hires Restructuring Counsel

Capital Structure and Valuation Overview

Spruce Point believes Burlington's leverage for a retailer is aggressive and its valuation is rich. The retail industry is brutally competitive and we believe Burlington's apparel and home furnishing offerings are largely undifferentiated, which exposes investors to above average business risk.

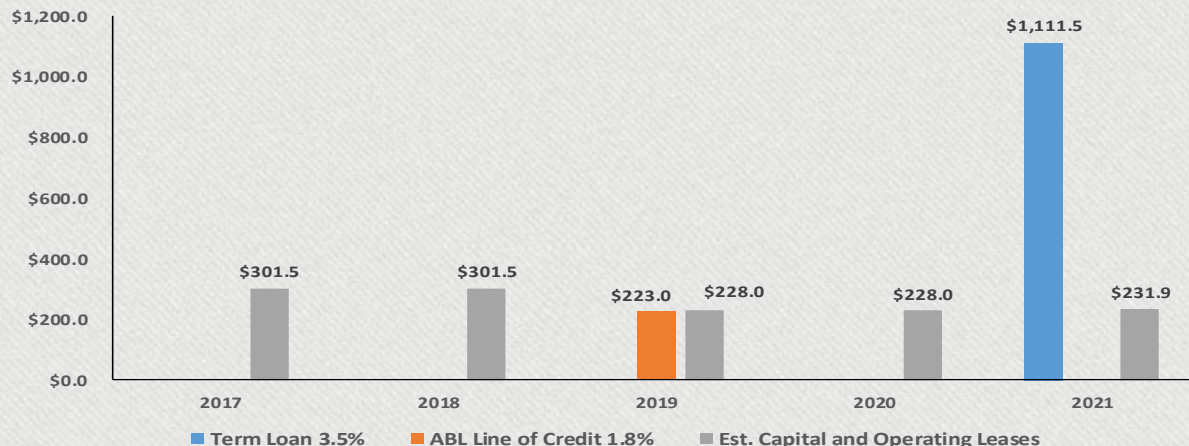
\$ in millions, except per share figures

Stock Price	\$73.00	Street Valuation	2015	2016E	2017E
Shares Outstanding	72.2	EV / Sales	1.3x	1.2x	1.1x
Market Capitalization	\$5,270.6	EV / EBITDA	13.6x	11.7x	10.5x
Senior Secured Term Loan - 3.5%	\$1,111.5	Price / GAAP EPS	36.6x	26.3x	21.1x
ABL Facility - 1.6%	\$223.3	Price / Adj. EPS	31.6x	24.5x	20.6x
Capital Leases	\$24.3	Debt / EBITDA	2.8x	2.4x	2.1x
Total Debt Outstanding	\$1,334.8	Spruce Point Adjusted			
Capitalized Operating Leases	\$2,026.4	Adj. EV / Sales	1.7x	1.6x	1.5x
Adjusted Debt	\$3,361.2	Adj EV / Adj. EBITDAR	11.7x	10.2x	9.6x
Less: Cash	\$30.5	Adj Debt / Adj EBITDAR	4.6x	4.0x	3.8x
Adj. Enterprise Value	\$8,601.3	Price / EPS	31.6x	24.5x	21.8x
Enterprise Value	\$6,574.9				

Estimates based on Wall St. Research and Spruce Point adjustments

Burlington's Debt Maturity Profile

\$ in mm



Burlington has recently taken advantage of generous credit conditions to secure low interest rates, and it has no near term debt maturities. However, it has significant operating lease obligations for stores which are a fixed form of debt that need to be carefully evaluated and factored into the company's valuation and business risk.

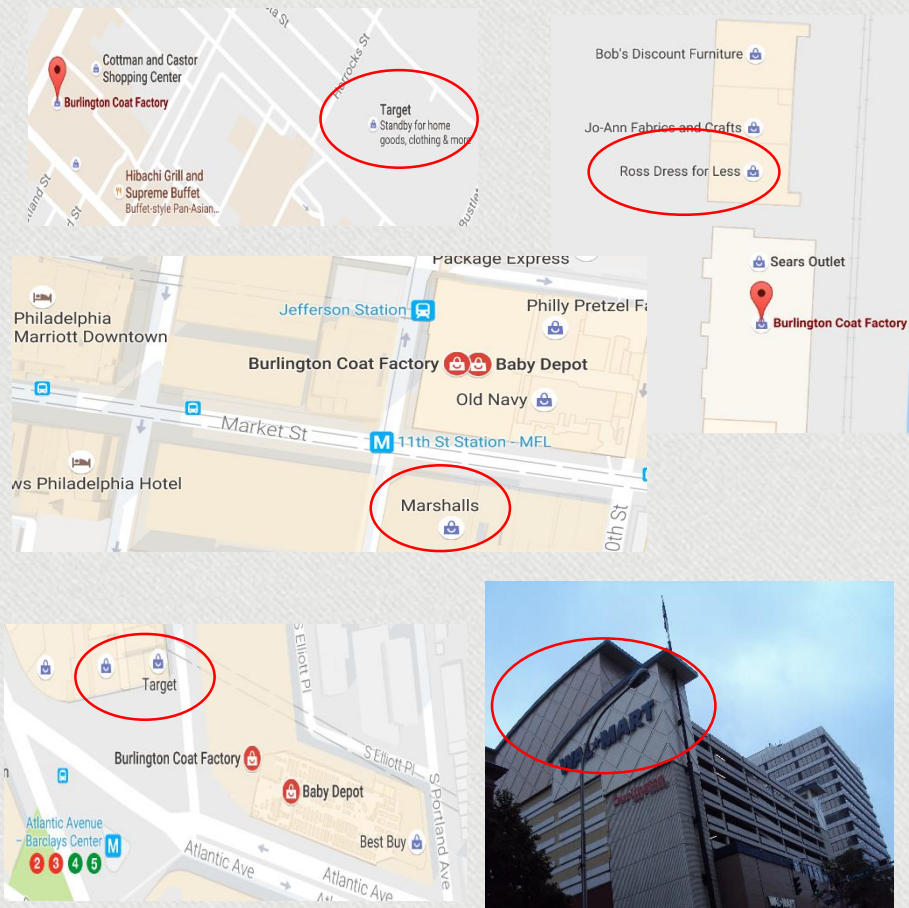


Signs of Financial Strain From Declining Transparency and Aggressive Accounting

Burlington Has Little Competitive Advantage As a Retailer

In our opinion, BURL is an undifferentiated retailer with limited advantages in price, product, promotion or locations

Similar Locations To Stronger Competitors



Same Pricing Promotions

SAVE UP TO 65% OFF OTHER RETAILERS' PRICES EVERY DAY

([source](#))

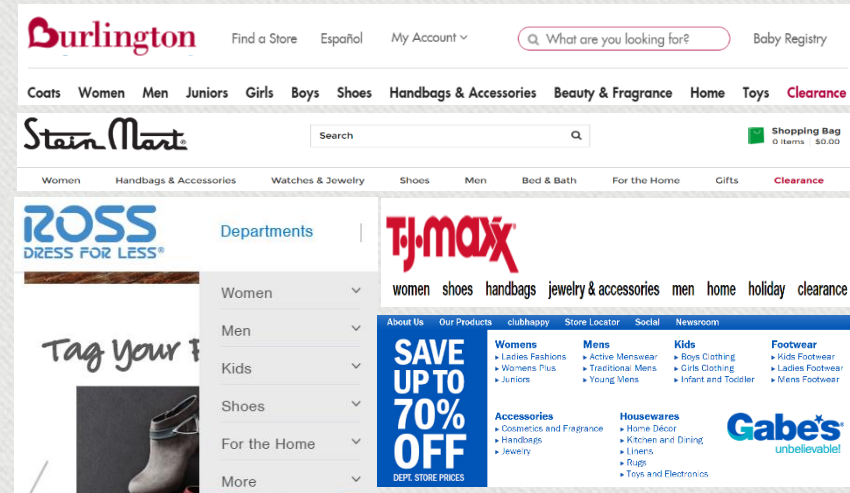
20-60% off department store prices every day! Gotta Go to Ross!

([source](#))

"At TJ Maxx, we deliver great value on ever-changing selections of brand name and designer fashions at prices generally 20%-60% below department and specialty store regular prices, on comparable merchandise, every day."

([source](#))

Similar Product Offering



Warning: Burlington's Competition Is Set To Rise Dramatically Going Forward

The recent success of the off-price / discount retail category is attracting new competitors (foreign retailers), and causing existing department store competitors looking to go down market to enter the playing field. Burlington's stated goal is to open 25 new stores per annum, but will have to compete for space amongst its competitors.

Competitor	Company	Expansion Plans Announced
Incumbent	Ross Stores	March 2016 : Ross plans to add 90 new stores in 2016
	TJX Companies	May 2016 : T.J. Maxx, Marshalls and HomeGoods plan to open thousands of new stores and increase its footprint by 50% from 3,700 to 5,600 stores
	Nordstrom's Rack	Oct 2015 : "Nordstrom is expanding its off-price chain Nordstrom Rack, like crazy." Planning to increase its current 180 stores up to 300 by 2020
	Off 5 th Saks	April 2016 : Hudson Bay (owner of Saks) details \$750-\$850m capital budget, with 30% towards growth initiatives to expand Saks and Off 5 th stores. Thirty two new Off 5 th Stores planned
	Aldi (German)	June 2015 : Aldi plans U.S. expansion; will open 25 stores in 2016 with a goal of opening 650 new stores and spending \$3bn over 5 years. While mostly a grocer, Aldi also sells home goods and clothing
New Entrant	Lord & Taylor	Oct 2015 : Lord & Taylor announced the launch of Find @ Lord & Taylor; First store to launch in NJ with 6 more opening planned for 2016
	Macy's Backstage	Nov 2015 : Macy's to launch 5 stores in 2015, and 50 more over the next two years
	Primark (Irish)	Sept 2015 : Discount fast fashion Primark enters US in Boston through old Filene's Basement location. Primark plans to open 6 new stores in 2016
	Lidl (German)	Nov 2015 : Lidl, a cross between a WalMart and Trader Joe's, will start opening stores in the US in 2018. Lidl offers deep discounts on groceries, household appliances, clothes and furniture

Burlington Has Limited Online Presence

Burlington's e-commerce initiatives have sorely disappointed. Having a weak online presence in an increasingly digital world could severely handicap Burlington.

Burlington's Sad E-commerce Reality

Burlington Touted Its Ecommerce Efforts at its IPO

"We have been selling to our customers online for more than a decade. We plan to leverage this heritage, along with our newly relaunched e-commerce platform, to expand our online assortment and utilize e-commerce strategies to drive incremental traffic to our stores." (Source: [S-1](#), p. 6)

And Continues To Promote It To Investors In Its Annual Report:

"We employ an e-commerce strategy currently focused on increasing awareness of the breadth of our merchandise selection, great brands and values, as well as driving traffic to our stores and selling merchandise directly from our website. We execute our strategy through our website and through social media platforms such as Facebook, Twitter and Pinterest. In Fall 2013, we re-launched our website with a significantly upgraded user experience – including improved navigation, shopping functionality and a more modern layout to increase site traffic and conversion rates. This re-launch also included an expansion of the online merchandise assortment to include additional items across women's ready-to-wear apparel, menswear, youth apparel, baby, accessories, home and coats." (Source: [2015 10-K](#), p. 4)

Recently on Sept 8, 2016 when asked about ecommerce at the Goldman Sachs Retailing Conference ([source](#))

Analyst: "On e-commerce, I know it's a different focus for you guys than for many other retailers, but we are asking everyone about online margins relative to store margins, whether they're higher, lower or the same?"

CFO Katz: "It's less than 1% of our business, it's not even worth (discussing)"

The Amazon Effect Is Real

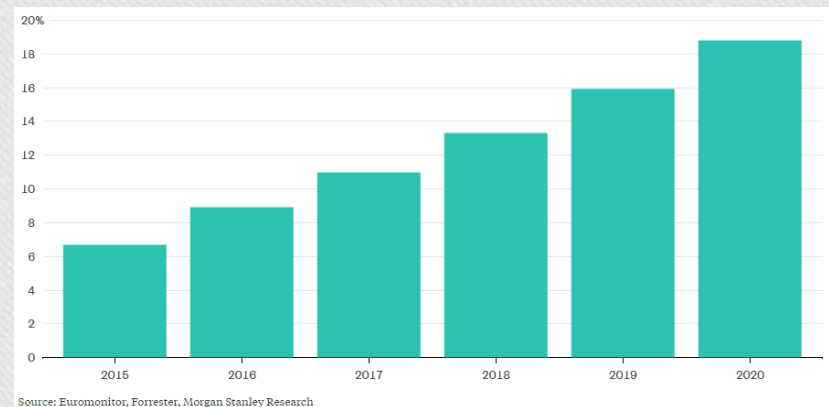
Most of What Is Sold At Burlington, Can Be Bought At Amazon

Home furnishings, apparel, accessories, and sundry items

Burlington is Especially Exposed To Apparel

According to its recent annual report, apparel and accessories amounted to 89% of its revenues! Just 11% of sales were classified as Home products.

Amazon's Apparel Share Expected To Triple In Next 5 Years



A recent Bloomberg article entitled "[Amazon Eats The Department Store](#)" underscores just how formidable a competitor Amazon has become to traditional retailers

Sales Comps Could Be Artificially Inflated

BURL's decision to shrink its sqft is noteworthy. According to old SEC filings, it considers modified stores as "new stores" which could inflate its comp store sales metric by allowing it to drop mature stores from the comp base, and then re-include them as new. Its comp base will have an apples-to-oranges problem (a mix of different format stores).

Burlington last reported that it treated modified stores as new stores in Jan 2010 ([source](#)). It then dropped its discussion about how it treats modified stores from SEC filings post January 2010, but did not conclusively say it changed its treatment of modified stores. (1) Burlington still warns the following: *"The method of calculating comparable store sales varies across the retail industry. As a result, our definition of comparable store sales may differ from other retailers"*

Company	Measurement Period For Same Store Sales	Include Website Sales	Treatment of Modified Stores	Recent Changes?
Burlington	<i>"Commencing on the first day of the fiscal month one year after the end of their grand opening activities, which normally conclude within the first two months of operations"</i>	Yes	<u>Burlington's historical disclosure</u> <i>"Existing stores whose square footage has been <u>changed by more than 20% and relocated stores</u> (except those relocated within the same shopping center) are classified as new stores for comparative store sales purposes"</i>	Yes, ownership of fragrance category added 0.5%
Ross Stores	<i>"Stores open for more than 14 complete months"</i>	No	N/A	No
TJX Companies	<i>"Stores that have been in operation for all or a portion of two consecutive fiscal years, or in other words, stores that are starting their third fiscal year of operation"</i>	No	<i>"Relocated stores and stores that have increased in size are generally classified in the same way as the original store, and we believe that the impact of these stores on the consolidated same store percentage is immaterial"</i>	No

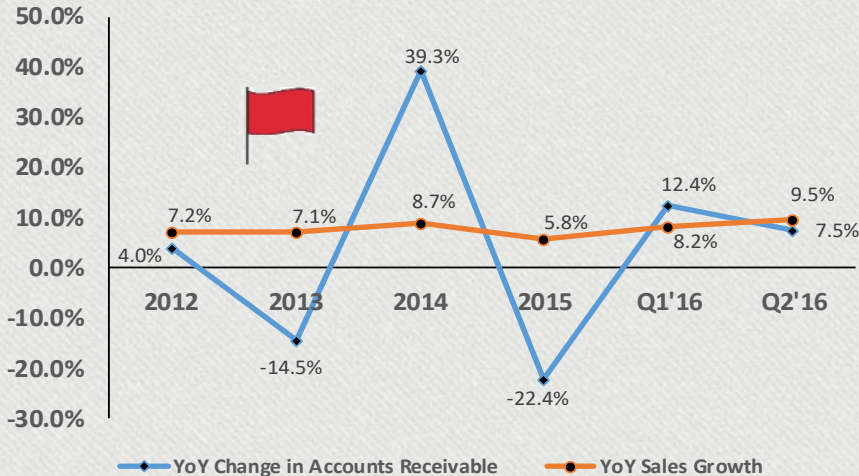
Source: TJX [10-K](#), Ross [10-K](#), Burlington 10-K and [press release](#)

(1) *"We now define comparative store sales as sales of those stores commencing on the first day of the fiscal month one year after the end of their grand opening activities, which normally conclude within the first two months of operations. Previously, we defined comparative store sales as sales of those stores (net of sales discounts) following their four hundred and twenty-fifth day of operation (approximately one year and two months)."* ([source](#))



Warning: Accounts Receivable and Sales Wildly Diverging

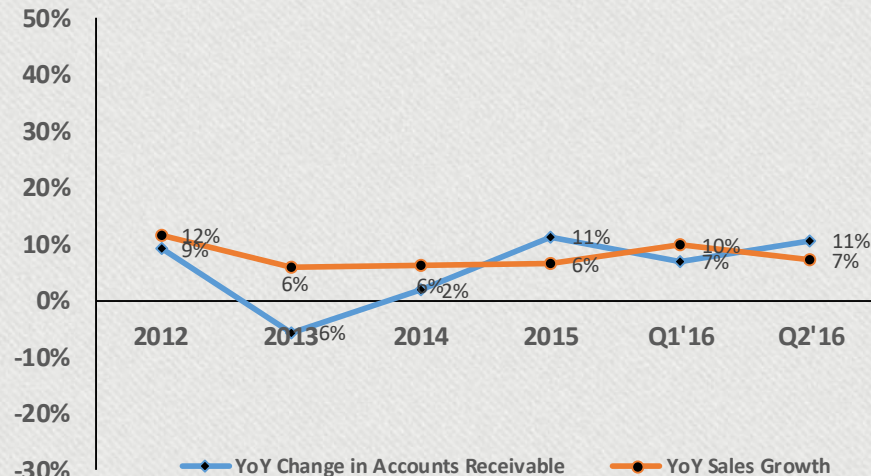
Burlington Stores: Large Variance



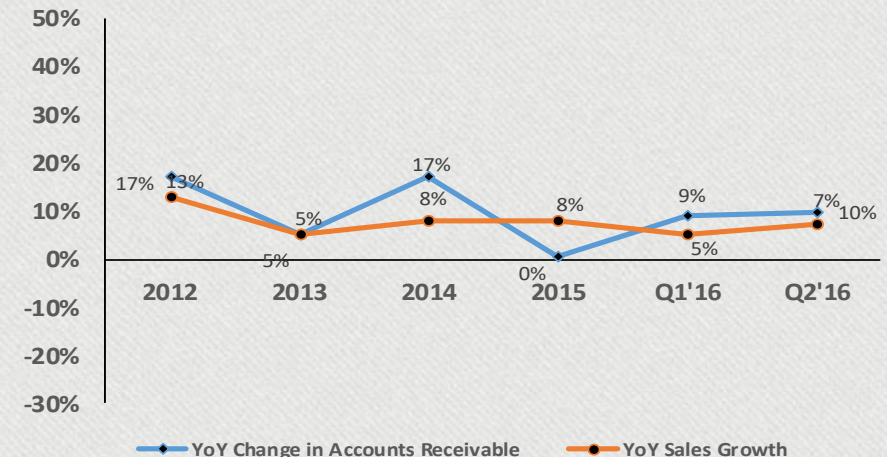
Diverging Sales vs. Account's Receivable Is a Classic Red Flag

- The retail industry is straight forward: a sale is accounted for at the point of purchase. Sales are in cash or credit, with credit sales generating an account receivable
- As a result, accounts receivable and sales should be closely aligned with any departures carefully evaluated
- Burlington's year-over-year revenue growth has been stable in the 6-10% range since 2012, yet its accounts receivable growth has widely diverged from 2013-2015
- Burlington's anomalous financials are illustrated by comparing its results with TJX and Ross Stores. As illustrated in the charts below, both companies report annual changes in sales which more closely follow accounts receivable

TJX Companies



Ross Stores



Unsustainable Gains From Inventory Liquidation

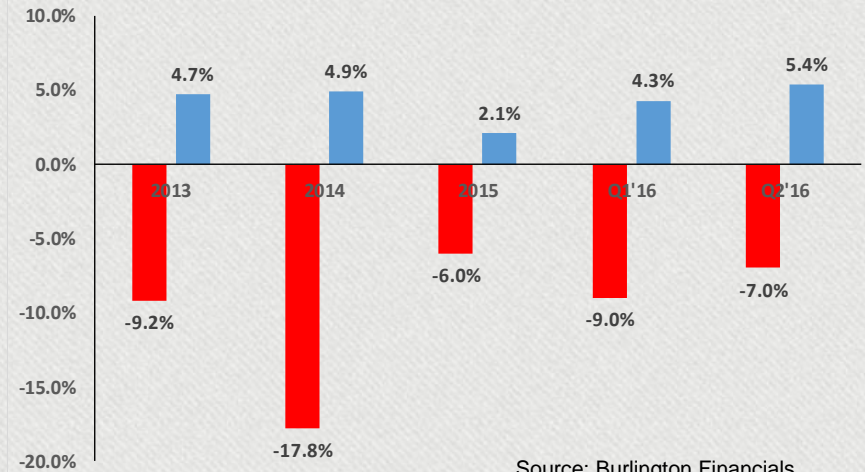
Burlington believes that shrinking its inventory per store will sustain higher inventory turnover:

- “We plan to continue to reduce comparable store inventories which we believe will result in faster inventory turnover,” and “We believe that as we continue to reduce our comparable store inventory, we will be able to reduce the square footage of our stores while continuing to maintain our broad assortment.” (2016 [10-Q](#), pp. 18 and 23)

Yet, Spruce Point believes Burlington may be challenged to sustain higher comparable store sales (“CSS”):

- Recent channel checks shows stores being practically liquidated with “clearance” promotions, empty racks, significant shelf space, and disheveled product
- How will it sustain CSS increases with shrinking inventory assortment in the absence of turning over higher margin product faster (next few slides discuss turnover concerns)

Comp. Store Inventory Decline vs. CSS Growth



Empty Racks



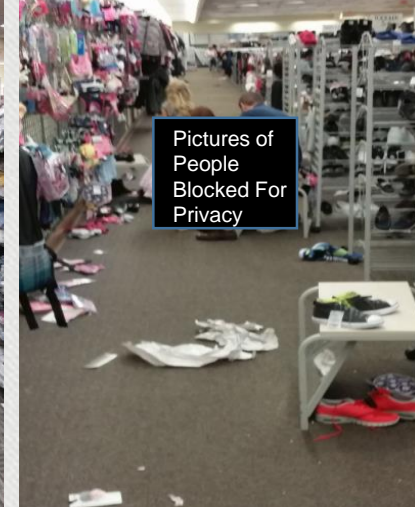
Store Clearance Promotion



Enormous Empty Floor Space



Disheveled Floor Space



Burlington Stores Appear Unoptimized (Cont'd)

More evidence of un-optimized space and empty racks from a recent store visit. How will Burlington be able to cover its overhead cost and maintain a healthy comp store sales and sales per sqft?



Burlington's Inventory Turnover Definition Non-Standard, Now No Longer Disclosed

Pre Bain Acquisition (Source: [Annual Report](#), Fiscal Year Ended May 2004)

"Inventory turnover is calculated by dividing the retail sales by the average stock for the period being measured"

Inventory Turnover Definition Changed April 2012 before IPO (Source: [10-K](#), page 19)

"Annualized Store Inventory Turnover is calculated by dividing comparable store retail sales by the average comparable store retail value of inventory for the period being measured. The calculation is based on a rolling 13 month average of inventory and the last 12 months' sales."

Burlington Used To Disclose Turnover Inclusive And Exclusive of Warehouse Inventory

- **At its IPO, Burlington disclosed the following:** *"Our annualized inventory turnover rate (**inclusive of stores and warehouse inventory**) was 3.2 turns and 2.8 turns per year at February 2, 2013 and January 28, 2012, respectively. Our annualized comparable store inventory turnover rate (**exclusive of warehouse inventory**) increased to 3.6 turns per year during Fiscal 2012 compared with 3.1 turns per year during Fiscal 2011."* (Source: [S-1](#), p. 56)
- **Post IPO, the Company stopped disclosing turnover inclusive of warehouse inventory** ([very important given increase in pack and hold strategy shift](#)): *"Comparable store inventory turnover is calculated by dividing comparable store sales by the average comparable store retail value of inventory for the period being measured. The calculation is based on a rolling 13 month average of inventory and the last 12 months' comparable sales. Our comparable store inventory turnover rate (**exclusive of warehouse inventory**) increased to 4.0 turns per year during Fiscal 2013 compared with 3.6 turns per year during Fiscal 2012."* (Source: [10-K](#), p. 31)

Burlington Also Stopped Disclosing Inventory Turnover Calculations on a Quarterly Basis

- **Through Q3 2014, Burlington regularly disclosed inventory turnover calculations on a quarterly basis:** *"Comparable store inventory turnover is calculated by dividing comparable store sales by the average comparable store retail value of inventory for the period being measured. The calculation is based on a rolling 13 month average of inventory and the last 12 months' comparable sales. Our annualized comparable store inventory turnover rate (exclusive of warehouse inventory) as of November 1, 2014 and November 2, 2013 was 4.5 turns per year and 3.8 turns per year, respectively."* (Source: [10-Q](#), p. 31)
- **In Q1 2015 Burlington Stopped Disclosing Inventory Turnover:** *"Comparable store inventory turnover is calculated by dividing comparable store sales by the average comparable store retail value of inventory for the period being measured. Our comparable store inventory turnover improved by approximately 18% for the first quarter of Fiscal 2015 compared to the first quarter of Fiscal 2014."* ([10-Q](#), p.36)

Warning: Burlington's Gross Margin Definition Highly Non-Standard

Burlington's gross margin is inflated by excluding store occupancy costs and certain costs of buying and distributing goods

Company	Description of Cost of Sales
Burlington	<p>"Cost of Sales" line item includes all costs of merchandise (net of purchase discounts and certain vendor allowances), inbound freight, distribution center outbound freight and certain merchandise acquisition costs, primarily commissions and import fees. <u>Our cost of sales and gross margin may not be comparable to those of other entities, since some entities include all of the costs related to their buying and distribution functions in cost of sales</u> Source: S-1, pp. 55 and 67</p>
Ross Stores	<p>In addition to product costs, the Company includes in cost of goods sold its buying, distribution and freight expenses as well as <u>occupancy costs</u>, and <u>depreciation and amortization related to the Company's retail stores</u>, buying, and distribution facilities. Buying expenses include costs to procure merchandise inventories. Distribution expenses include the cost of operating the Company's distribution centers and warehouse facilities. (Source: 10-K, p. 35)</p>
Stein Mart	<p>Cost of merchandise sold includes merchandise costs, net of vendor discounts and allowances; freight; inventory shrinkage; <u>store occupancy costs (including rent, common area maintenance, real estate taxes, utilities and maintenance)</u>; payroll, benefits and travel costs directly associated with buying inventory; and costs related to the consolidation centers and distribution warehouses. (Source: 10-K, F-11)</p>
TJX Companies	<p>Cost of sales, <u>including buying and occupancy costs</u>, includes the cost of merchandise sold including foreign currency gains and losses on merchandise purchases denominated in other currencies; gains and losses on inventory and fuel-related derivative contracts; <u>store occupancy costs</u> (including real estate taxes, utility and maintenance costs <u>and fixed asset depreciation</u>); the costs of operating distribution centers; payroll, benefits and travel costs directly associated with buying inventory; and systems costs related to the buying and tracking of inventory. (Source: 10-K, p. F-8)</p>

Warning: Burlington's Gross Margin Definition Highly Non-Standard

Burlington's peers report gross margins inclusive of occupancy costs and certain depreciation. We've adjusted its gross margins to more closely align its results with its peers. Starting in 2015, Burlington changed the reporting of its SG&A and no longer categorized expenses as occupancy costs, rendering it impossible to accurately compare results among peers.

Company	Gross Margin	2013	2014	2015	YTD 2016
Burlington Stores	Sales	\$4,427.5	\$4,814.5	\$5,099.0	\$2,549.0
	Gross Profit	\$1,731.5	\$1,913.7	\$2,039.3	\$1,022.7
	<i>Reported Gross Margin</i>	39.1%	39.7%	40.0%	40.1%
	Less: D&A of distribution and purchasing	\$14.1	\$15.3	\$18.3	N/A
	<u>Less: Occupancy Cost</u>	<u>\$418.4</u>	<u>\$440.3</u>	N/A	N/A
	Adjusted Gross Profit	\$1,299.1	\$1,458.1	N/A	N/A
	<i>Adjusted Gross Margin</i>	29.3%	30.6%	N/A	N/A
Ross Stores	Sales	\$10,230.4	\$11,041.7	\$11,939.9	\$6,269.9
	Gross Profit	\$2,869.4	\$3,103.7	\$3,363.0	\$1,841.9
	<i>Gross Margin</i>	28.0%	28.1%	28.2%	29.4%
Stein Mart	Sales	\$27,422.7	\$29,078.4	\$30,944.9	\$15,424.4
	Gross Profit	\$7,817.7	\$8,301.9	\$8,910.4	\$4,489.3
	<i>Gross Margin</i>	28.5%	28.6%	28.8%	29.1%
TJX Companies	Sales	\$367.4	\$386.7	\$385.3	\$198.3
	Gross Profit	\$1,263.6	\$1,317.6	\$1,359.9	\$675.5
	<i>Gross Margin</i>	29.1%	29.4%	28.3%	29.4%

Source: Company Financials

Warning: Reclassifying SG&A Expenses

Burlington used to clearly identify “Occupancy” costs as part of SG&A. Now it is impossible to understand what is considered occupancy costs for relevant comparison to peers, and to monitor changes in cost trends.

Pre-IPO through FY 2013 SG&A Disclosure

	Fiscal Year Ended					
	February 1, 2014	Percentage of Net Sales	February 2, 2013	Percentage of Net Sales	\$ Variance	% Change
(in thousands, except percentages)						
Payroll and Payroll Related	\$ 657,037	14.8%	\$ 620,240	15.0%	\$36,797	5.9%
Occupancy	440,270	9.9	418,357	10.1	21,913	5.2
Other Expenses	145,810	3.3	131,957	3.2	13,853	10.5
Business Insurance	36,185	0.8	32,234	0.8	3,951	12.3
Benefit Costs	29,208	0.7	26,368	0.7	2,840	10.8
Advertising	83,278	1.9	83,526	2.0	(248)	(0.3)
Selling & Administrative Expenses	<u>1,391,788</u>	<u>31.4%</u>	<u>1,312,682</u>	<u>31.8%</u>	<u>\$79,106</u>	<u>6.0%</u>

Source: FY 2013 [10-K](#), p. 33

FY 2014 – Current SG&A Disclosure

	Fiscal Year Ended					
	January 31, 2015	Percentage of Net Sales	February 1, 2014	Percentage of Net Sales	\$ Variance	% Change
(in millions, except percentages)						
Store Related Costs	\$ 1,005.4	20.9%	\$ 940.3	21.2%	\$ 65.1	6.9%
Product Sourcing Costs	204.1	4.2	168.1	3.8	36.0	21.4
Corporate Costs	158.3	3.3	132.0	3.0	26.3	19.9
Marketing and Strategy Costs	94.7	2.0	93.0	2.1	1.7	1.8
Other Selling, General and Administrative Expenses	58.4	1.2	58.4	1.3	—	—
Selling, General & Administrative Expenses	<u>\$ 1,520.9</u>	<u>31.6%</u>	<u>\$ 1,391.8</u>	<u>31.4%</u>	<u>\$ 129.1</u>	<u>9.3%</u>

Source: FY 2014 [10-K](#), p. 37

Warning: Reclassifying SG&A Expenses

More unspecified changes noted in the recent 10-K

“During Fiscal 2015, we changed the presentation of the amounts included within selling, general and administrative expenses in order to align our external reporting of these costs with how they are reviewed by senior management. Prior year amounts have been reclassified to conform to the current period presentation” (Source: FY 2015 [10-K](#), p. 34)

(in millions)

	Fiscal Year Ended					
	January 30, 2016	Percentage of Net Sales	January 31, 2015	Percentage of Net Sales	\$ Variance	% Change
Store related costs	\$ 1,057.7	20.7%	\$ 1,008.1	20.9%	\$ 49.6	4.9%
Product sourcing costs	229.4	4.5	204.1	4.2	25.3	12.4
Corporate costs	155.7	3.1	158.3	3.3	(2.6)	(1.6)
Marketing and strategy costs	94.5	1.9	94.7	2.0	(0.2)	(0.2)
Other selling, general and administrative expenses	60.4	1.1	55.7	1.2	4.7	8.4
Selling, general and administrative expenses	\$ 1,597.7	31.3%	\$ 1,520.9	31.6%	\$ 76.8	5.0%

	Fiscal Year Ended					
	January 31, 2015	Percentage of Net Sales	February 1, 2014	Percentage of Net Sales	\$ Variance	% Change
(in millions, except percentages)						
Store Related Costs	\$ 1,005.4	20.9%	\$ 940.3	21.2%	\$ 65.1	6.9%
Product Sourcing Costs	204.1	4.2	168.1	3.8	36.0	21.4
Corporate Costs	158.3	3.3	132.0	3.0	26.3	19.9
Marketing and Strategy Costs	94.7	2.0	93.0	2.1	1.7	1.8
Other Selling, General and Administrative Expenses	58.4	1.2	58.4	1.3	—	—
Selling, General & Administrative Expenses	\$ 1,520.9	31.6%	\$ 1,391.8	31.4%	\$ 129.1	9.3%

Burlington's Inventory Accounting Method

Burlington's inventory accounting choice is open to significant management judgement. When asked about pack on hold on the Q3'15 conference call, the CEO reiterated that it's the Company's highest margin product. This could have given management incentive to manipulate the pack and hold inventory accounting in order to artificially bolster gross margins.

Burlington's Inventory Accounting Method

*Our inventory is valued at the lower of cost or market using the retail inventory method. Under the retail inventory method, the valuation of inventory and the resulting gross margin are determined by applying a calculated cost to retail ratio to the retail value of inventory. The retail inventory method is an averaging method that results in valuing inventory at the lower of cost or market provided markdowns are taken timely to reduce the retail value of inventory. **Inherent in the retail inventory method calculation are certain significant management judgments and estimates including merchandise markon, markups, markdowns and shrinkage, which significantly impact the ending inventory valuation as well as the resulting gross margin.** Management believes that our retail inventory method provides an inventory valuation which approximates cost using a first-in, first-out assumption and results in carrying value at the lower of cost or market Source: [10-K](#), p.40*

Paul Lejuez, Citigroup Analyst on the [Q3'15 Conference Call](#)

"Thanks, guys. Just curious, what set of results are you seeing on pack-away merchandise and what sort of margins do you see on that product relative to the rest of your assortment? Do you look at that as more of a sales driver or margin driver or both? And then can you just fill us in on what categories were weaker for you guys and I'm just curious about CapEx next year, Marc, as you're getting through that planning process? Thanks.

Thomas Kingsbury, CEO of Burlington

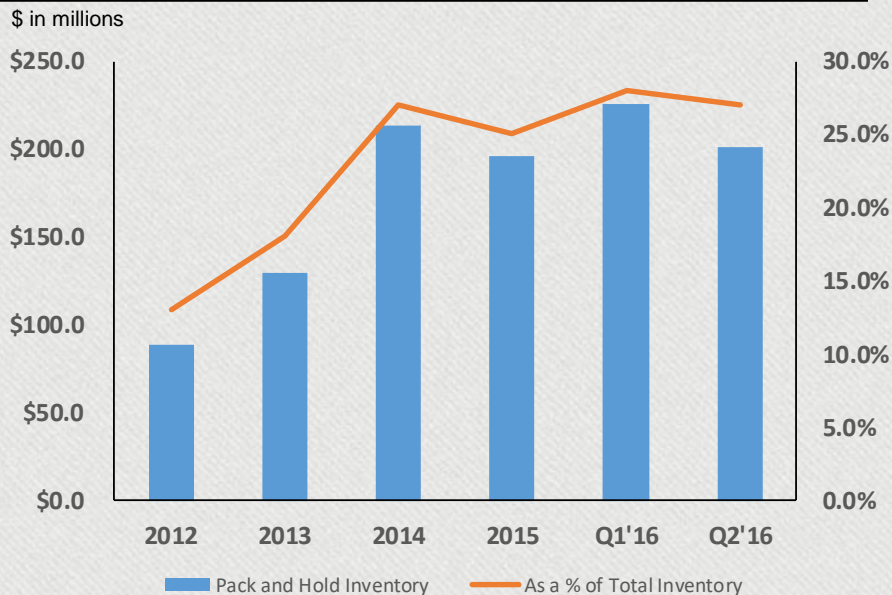
*"Okay. I'll take that Paul and I'll let Marc talk about CapEx. I'll take the first part of that. Pack and hold is our **fastest turning highest margin product** we have in our assortment because by definition it's great values – great brands, great values. **We have a very rigorous process in order to approve anything that goes into pack away.**"*

Burlington's Pack and Hold Strategy Should Be Scrutinized

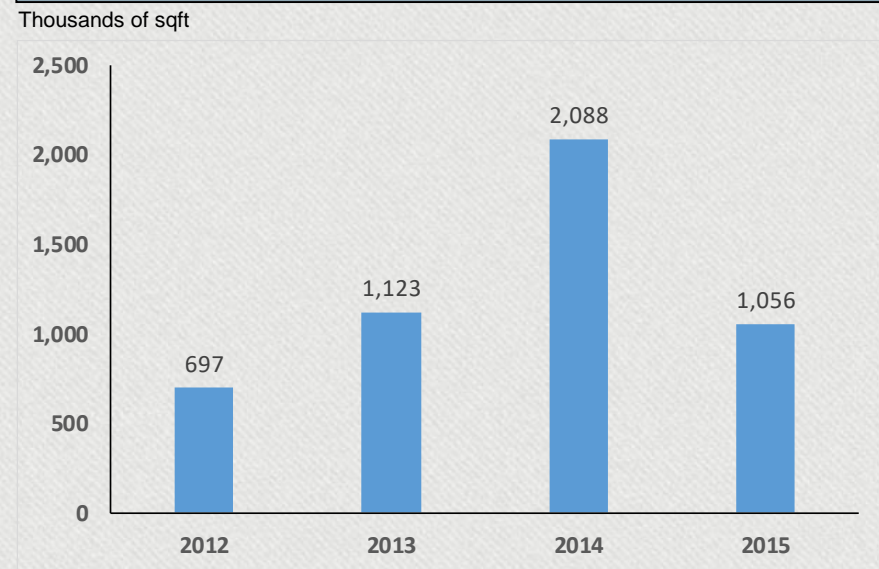
Pack and hold is a purchasing strategy that involves acquiring merchandise opportunistically, and storing it at warehousing or distribution facilities for sale at a future date

- **The pack and hold strategy has both risks and rewards.** The reward is that the merchandise is often purchased at a discount from vendors with cost overruns, or cancelled orders. This gives Burlington the opportunity to achieve a greater margin. The risk is that by the future date when it decides to sell the stored merchandise, that consumer preferences have changed and the inventory has to be marked down
- **Burlington has no stated pack and hold strategy.** Burlington has repeatedly told investors on conference calls it doesn't have a set pack and hold inventory target, but acts opportunistically in response to deals ([Source](#), [Source](#)). However, it has doubled its pack and hold inventory from 13% of total merchandise inventory in 2012 to 27% in Q2'16. In aggregate, the value of pack and hold inventory is up 127% since 2012, yet warehousing space has increased by approximately 51%

Burlington's Pack and Hold Surged Post IPO



Burlington's Warehousing Space



Source: SEC Filings



Pack and Hold Used To Manipulate Inventory and Gross Margins?

Pay very close attention. Burlington retroactively revised its disclosure for pack and hold inventory; at best an error, at worse evidence of weak controls over financial reporting and accounting manipulation. Also, remember that Burlington excludes buying and distribution costs from gross margin and that it stopped disclosing inventory turnover (inclusive of warehouses) which is where pack and hold inventory resides.

Here's why the math doesn't add up: 18% of \$899.9= \$162.0m of pack and hold inventory in Q3'14 and 14% of \$934.0 = \$130.8m in Q3'15. Pack and hold inventory thus fell by \$31.2m, yet Burlington says it increased by \$11m.

In the [Q3'14 Press Release](#), Burlington Disclosed 18% of Merchandise Inventories As Pack and Hold

*"Merchandise Inventories were \$899.9 million vs. \$902.4 million at November 2, 2013. The decrease was primarily driven by a comparable store inventory decrease of 13.7% as a part of the Company's ongoing initiatives to reduce inventory levels, increase inventory turnover and ultimately drive incremental sales through continually improved product offerings. This decrease was partially offset by a \$50.4 million increase in pack and hold purchases and inventory related to the opening of 18 net new stores since the end of the third quarter last year. **Pack and hold inventory represented 18% of total inventory at the end of the third quarter vs. 12% last year.**"*

One Year Later, in the [Q3'15 Press Release](#), Burlington Revised Pack and Hold Percentage Downward Without Explanation

*"Merchandise Inventories were \$934.0 million vs. \$899.9 million at the end of the third quarter last year. **This includes an increase in pack and hold inventory of approximately \$11 million vs. last year. Pack and hold inventory represented 14% of inventory at quarter end versus 12% last year.** Comparable store inventory decreased 7% compared with the third quarter last year."*

Warning: Shrinkage Estimates Now Rising

Shrinkage (Theft) assumptions for merchandise are open to estimation by management. We observe that Burlington is now disclosing shrinkage losses higher than estimated post Bain's share liquidation.

*"During the fourth quarter of Fiscal 2012, Fiscal 2011 and Fiscal 2010 we recorded shrinkage adjustments of \$7.5 million, \$5.7 million and \$2.8 million, respectively, as a result of **actual shrink being less than what we had estimated.**"*

(Source: [S-1](#) IPO Filing, p. 84)

*"During the fourth quarter of Fiscal 2013, Fiscal 2012 and Fiscal 2011 we recorded shrinkage adjustments of \$3.8 million, \$7.5 million and \$5.7 million respectively, as a result of **actual shrink being less than what we had estimated.**"*

(Source: [10-K](#), p. 45)

*"During the fourth quarter of each of Fiscal 2014, Fiscal 2013 and Fiscal 2012 we recorded shrinkage adjustments of \$10.0 million, \$3.8 million and \$7.5 million, respectively, as a result of **actual shrink being less than what we had estimated.**"*

(Source: [10-K](#), p. 50)

Coincidence or Not? Now That Its Biggest Investor Has Liquidated Shrinkage Losses Occur

*"Typically, estimates are used to record inventory shrinkage at retail stores for the first three quarters of a fiscal year. Actual physical inventories are typically conducted annually during the second or fourth quarter to calculate actual shrinkage. While we make estimates on the basis of the best information available to us at the time the estimates are made, over accruals or under accruals of shrinkage may be identified as a result of the physical inventory counts, requiring adjustments. **During the fourth quarter of Fiscal 2015, we recorded a shrinkage adjustments loss of \$3.5 million as a result of actual shrink being more than what we had estimated.** During the fourth quarter of Fiscal 2014 and Fiscal 2013, we recorded shrinkage adjustments gains of \$10.0 million and \$3.8 million, respectively, as a result of actual shrink being less than what we had estimated." (Source: [10-K](#), p.40)*

Recent Explosion of Headlines Involving Theft and Violent Crime Near Burlington's Stores

July 14, 2014: "Burlington Coat Factory Robbery Suspect Sought" ([Source](#))

Dec 10, 2014: "2 Charged In \$45,000 Theft From NJ Burlington Coat Factory" ([Source](#))

Dec 29, 2015: "18-year-old dead after shooting at Eastland Center Saturday" ([Source](#))

Jan 12, 2016: "Shoplifter's shove turns theft into robbery at Steelyard Commons in Cleveland" ([Source](#))

Jan 12, 2016: "Body Discovered Near Burlington Coat Factory in S. California" ([Source](#))

Jan 25, 2016: "Lubbock police searching for women accused of theft at Burlington Coat Factory" ([Source](#))

Jan 29, 2016: "Six arrested after clothing thefts on opposite sides of town Thursday" ([Source](#))

Feb 22, 2016: "Clothing crooks target three local Burlington Coat Factory stores" ([Source](#))

March 29, 2016: "Women robbers who stole armfuls of clothing hit cashier while fleeing scene in stolen vehicle" ([Source](#))

April 26, 2016 "Police search for suspect in West Knoxville clothing store robbery" ([Source](#))

May 5, 2016: "Detectives Investigate Theft at F.C. Burlington Coat Factory" ([Source](#))

May 12, 2016: "Burlington Coat Factory Theft Caught On Camera" ([Source](#))

May 27, 2016: "3 arrested on suspicion of robbing Burlington Coat Factory in Bakersfield" ([Source](#))

July 7, 2016: "Four face grand theft charges in Manatee County" ([Source](#))

July 27, 2016: "Cherry Hill Police searching for suspects in Burlington Coat Factory theft" ([Source](#))

Sept 21, 2016: "New Haven man fought with Burlington workers during theft" ([Source](#))

Reclassifying Loss Prevention Expenses

It doesn't make sense to Spruce Point why costs related to its Loss Prevention Team are no longer store payroll costs, but now part of "Product Sourcing"

*"Store payroll as a percentage of net sales measures our ability to manage our payroll in accordance with increases or decreases in net sales. The method of calculating store payroll varies across the retail industry. As a result, our store payroll as a percentage of net sales may differ from other retailers. We define store payroll as regular and overtime payroll for all store personnel as well as regional and territory personnel, exclusive of payroll charges related to corporate and warehouse employees. **During the first quarter of Fiscal 2014, we changed our definition of store payroll to exclude payroll associated with our loss prevention team. These costs are now included in our product sourcing costs which are included in the line item "Selling, General and Administrative Expenses" in our Consolidated Statements of Operations. This change aligns our external reporting of store payroll with how the metric is reviewed internally by senior management.** Under the current definition, store payroll as a percentage of net sales was 8.8% during Fiscal 2014 compared with 9.1% during Fiscal 2013 and 9.7% during Fiscal 2012. Under the previous definition, store payroll as a percentage of net sales was 9.2% during Fiscal 2014 compared with 9.5% during Fiscal 2013 and 10.2% during Fiscal 2012. The improvement in store payroll as a percentage of net sales was primarily driven by the benefit from efficiencies realized in our stores as we continue to simplify operating procedures and improve the execution within store operations.." (Source: [10-K](#), p. 35)*

Burlington Is Hiring!

Aside from Store Associates, Loss Prevention Is Burlington's Biggest Hiring Need!

<https://burlingtonstores.jobs/job-search-results.aspx>

Filter Your Results

By Job Field
Job Field

By Location
Country
State
City

By Keyword
SUBMIT

By Category

- ☐ Accounting-Finance-Audit (5)
- ☐ Administrative-Clerical (4)
- ☐ Associates (3126)
- ☐ Buying (10)
- ☐ College Internships (5)
- ☐ Distribution Center - Burlington, NJ (58)
- ☐ Distribution Center - Edgewater Park, NJ (51)
- ☐ Distribution Center - San Bernardino, CA (93)
- ☐ Facilities-Maintenance (1)
- ☐ Field Management (2)
- ☐ Human Resources (6)
- ☐ Legal (4)
- ☒ **Loss Prevention (194)**
- ☐ Management (2)
- ☐ MIS-Information Technology (11)
- ☐ New Store Openings (7)
- ☐ Operations (9)
- ☐ Planning and Allocation (6)
- ☐ Processors (1)
- ☐ Real Estate-Store Development (5)
- ☐ Store Management (75)
- ☐ Strategy (1)
- ☐ Supply Chain (9)
- ☐ Visual Merchandising (6)

Found 194 matching jobs.

Login View Job Cart

Showing Jobs 1 - 10 of 194

Asset Protection Greeter
Location: Columbia, SC
Address: 7201 Two Notch Road
Zip Code: 29223
Requisition ID: 1078104
Posting Date: 10/18/2016
Job Field: Stores
Category: Loss Prevention
Shift: Flexible
Status:
Details Apply Share Add

Asset Protection Greeter
Location: Los Angeles, CA
Address: 309 West 7th St
Zip Code: 90014
Requisition ID: 959-1078031
Posting Date: 10/17/2016
Job Field: Stores
Category: Loss Prevention
Shift: Flexible
Status:
Details Apply Share Add

Loss Prevention Assoc
Location: Houston, TX
Address: 555 Almeda Mall Almeda Mall
Zip Code: 77075
Requisition ID: Almeda-1077885
Posting Date: 10/17/2016
Job Field: Stores
Category: Loss Prevention
Shift: Flexible
Status:
Details Apply Share Add

Asset Protection Greeter
Location: Lakewood, CO
Address: 14500 W. Colfax Avenue Colorado Mills Mall Unit 365
Zip Code: 80401
Requisition ID: 774-1077948
Posting Date: 10/17/2016
Job Field: Stores

Warning: Irrefutable Evidence of Burlington's Low Quality EPS

While we've identified a plethora of financial disclosure and presentation concerns, nothing supports our concerns more strongly than uncovering primary evidence of accounting irregularities. To illustrate, Burlington received tax credits to stay in NJ and create jobs. Recently, it disclosed it sold some of these credits. Investors should heavily scrutinize this transaction and consider it a low quality source of earnings.

Burlington Receives \$40m State Tax Credit From the GrowNJ Program Administered by the NJEDA

- In [July 2012](#), Burlington received state tax incentives to retain and create jobs in NJ, and to build a new 180,000 sqft corporate office. These tax credits were intended to reduce state income tax.

Burlington Discloses Sale of State Tax Credits in Q1'2016 (May 2016) As Other Income

- From the [10-Q](#): *"Other income, net (consisting of investment income, gains and losses on disposition of assets, breakage income and other miscellaneous items) increased \$3.1 million, **primarily driven by the sale of certain state tax credits during the first quarter of Fiscal 2016.**"*
- From the [Conference Call](#): *"Other revenue and other income increased \$1.5 million from last year to \$10.4 million, **driven by a \$2.5 million benefit from New Jersey Grow Credit** as a result of our expansion of our corporate office space in Florence, New Jersey.... Given that the use of New Jersey Grow Credit is based on New Jersey taxable income, any unused credits are allowed to be sold through other company. The sale of the credits is viewed as the sale of an asset, and consequently we reported that sale in other income."*

Be Careful of Low Quality Earnings

- By noon on [earnings day](#), Investors bid up Burlington's stock by 7% as a result of the perception it had beaten EPS estimates by \$0.04 cents. However, without the one-time gain from the tax credit sale, the beat was just by \$0.02 cents (\$2.5m gain and assuming 37.6% tax rate and 72.4m diluted shares), Burlington's stock later gained >70% from May to Sept 2016



Primary Evidence Suggesting Extremely Aggressive Accounting

TRANSFER CERTIFICATE

State of New Jersey

Department of the Treasury
Division of Taxation

GROW NEW JERSEY ASSISTANCE ACT TAX CREDIT TRANSFER CERTIFICATE

Pursuant to P.L.2011, c.149 as amended by P.L. 2014, c.63

Burlington Coat Factory Warehouse

Corporation

Seller's Name

XXX-XXX-303/000

Seller's EIN

transfers the following Grow New Jersey Assistance Act Tax Credit to:

Citibank, N.A.

Purchaser's Name

XXX-XXX-470/000

for consideration in the amount of \$2,805,000.00 or 93.5% of \$3,000,000.00

The New Jersey Economic Development Authority has approved a transfer of a Grow New Jersey Assistance Act Tax Credit between the noted Seller and Purchaser.

2014
Current Tax Period

1/10
Incremental Year

\$3,000,000.00
Incremental Credit Amount

08/28/2015
Date

El-Rhonda Williams Alston
El-Rhonda Williams Alston
New Jersey Division of Taxation

El-Rhonda Williams Alston
Printed Name

Regulatory Officer
Title

8/29/2015
Date

[Signature]
Seller's Authorized Signature

SHOBNA DAGA
Printed Name

VP-TAX
Title

8/31/2015
Date

[Signature]
Buyer's Authorized Signature

Jessica Emery
Printed Name

Citibank N.A. Vice President
Title

08/28/2015
Date

Lisa Coane
Lisa Coane
New Jersey Development Authority

Lisa Coane
Printed Name

Managing Director
Title

NOTE: Attach this original certificate to the Corporation Business Tax Return or Insurance Premium Tax Return

We filed a [Freedom of Information Request](#) from the NJ Economic Development Authority (NJEDA). This is the official tax credit transfer document

Burlington sold the tax credit to Citibank which suggests it was a financially motivated transaction

The document was executed at the end of August 2015, which should have been reported in Q3'15 earnings ended October 31, 2015. However, [Burlington did not report the deal until Q1'16 \(May 2016\)](#) suggesting it cookie-jarred the income to manage earnings, and appears to have violated GAAP accounting by not recording the transaction in the period it occurred.



Signs of Strain in Burlington's Real Estate Strategy and Deteriorating Unit Economics

Warning: Competitive Advantage of Store Size Changes Post IPO

Burlington changed its story on optimal store size quickly after its IPO, and has continued to talk down the size of its optimal store by nearly 50%? What will the Company do with all of these big box stores?

Pre-IPO, Burlington Touts The “Competitive Advantages” of Being Large

*“Our average store size is approximately 80,000 square feet, which is two to three times the size of our largest off-price competitors’ stores. **Our larger store size has allowed us to offer more categories and substantially more breadth in each product category than our off-price competitors and to establish ourselves as a destination for select categories**, including coats, youth and baby, special-occasion dresses and men’s tailored apparel. We believe that our leadership in the off-price channel in select categories and our broad and diverse merchandise offering allow our stores to attract customers from beyond their local trade areas.”* (Source: [S-1](#) Filing, p. 1)

*“**We believe the size of our typical store represents a competitive advantage**. Our average store size is approximately 80,000 square feet, occupying significantly more selling square footage than most off-price or specialty store competitors. Major landlords frequently seek us as a tenant because the appeal of our apparel merchandise profile attracts a desired customer base and because we can take on larger facilities than most of our competitors. In addition, we have built long-standing relationships with major shopping center developers.”* ([S-1](#) Filing, p. 99)

Post-IPO the Story Completely Changes; Now Smaller and Smaller is Better!

CEO on [Q3’13 Earnings Call](#): “So we really think the sweet spot for our store **going forward is 50,000 to 60,000 square feet because we know, we feel very confident we can operate in a 50,000 square foot box also.**”

CEO on [Q4’13 Earnings Call](#): “The stores that are 60,000 square feet or smaller, **the dollar per square foot is better than the total average**. As far as what our future looks like in terms of 60,000 square foot stores or less, we opened 11 in 2013. Our average was slightly over 60,000 square feet. In ’14, we’re looking at an average of around 61,000 square feet. So just to remind you, the average was around 80,000 square feet, and **we’re really looking at stores that are 50,000 to 60,000 square feet in terms of size. We just feel that they’re going to be much more productive.**”

CEO on [Q1’16 Earnings Call](#): Yes, **we’re really comfortable with stores in the 40,000 to 50,000 range**. Last year, as I said in prepared remarks, so this year, as I said in the prepared remarks, the average is around 51,000 square feet, **it will be less than 50,000 square feet in terms of the new stores** that we will open in 2017”

Pay Close Attention to the Company's Real Estate Strategy

Burlington's dependency on leases, renewals, and landlord incentives are noted by the Company, but we believe underappreciated by investors as a risk to its business.

Burlington Touted its Real Estate Strategy Prominently in its IPO Prospectus ([S-1](#), p. 4)

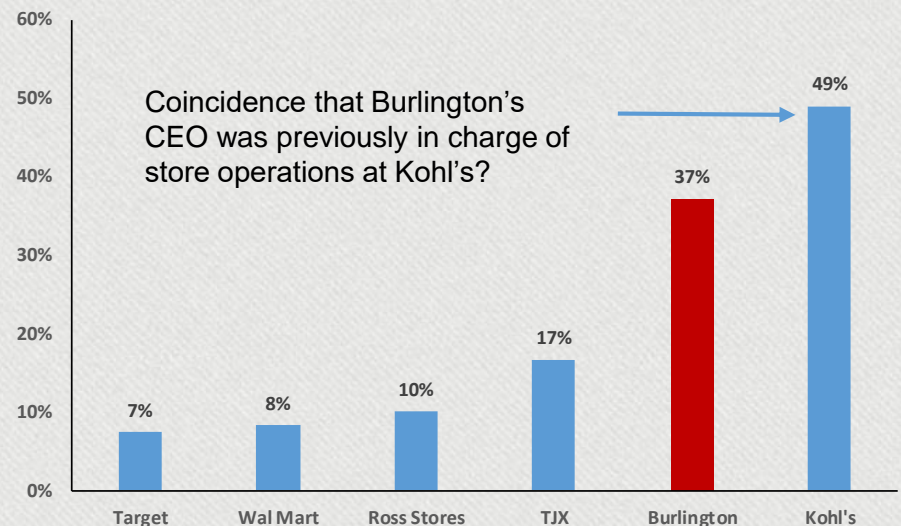
Enhanced Real Estate Analysis and New Store Selection Process

*"We have reengineered our new store development process to utilize more sophisticated criteria for real estate site selection and to reduce our total new store investment. Our real estate process consists of a review of demographics, population density, cannibalization impact, traffic patterns, competitive dynamics, co-tenancy considerations and ease of access, in order to meet acceptable return criteria. **We have partnered with landlords to increase the landlord funded tenant improvements in new stores** and have improved our opening inventory to increase cash-on-cash returns. Under our enhanced real estate selection process, we opened 15 new stores in Fall 2011 and 6 new stores in Spring 2012, which, on average, have performed in line with their initial sales projections during their first full year of operation."*

And A Risk Factor Noted High Dependency on Leases

"We currently lease approximately 92% of our store locations. Most of our current leases expire at various dates after five or ten-year terms, the majority of which are subject to our option to renew such leases for several additional five-year periods. Our ability to renew any expiring lease or, if such lease cannot be renewed, our ability to lease a suitable alternative location, and our ability to enter into leases for new stores on favorable terms will depend on many factors, some of which may not be within our control

Total Leases as % of Company Enterprise Value



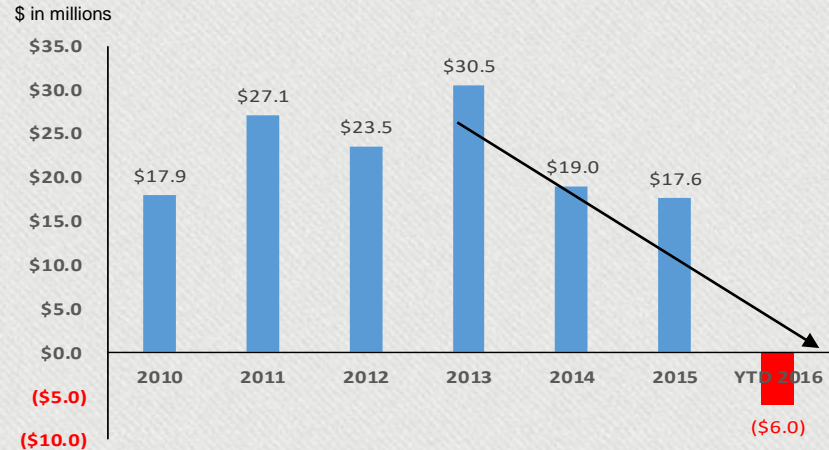
Note: Leases include both capital and operating leases. % based on unadjusted EV

EPS and Cash Flow Benefits From Rent Incentives Don't Appear Sustainable

Spruce Point Has Analyzed Burlington's Real Estate Strategy, its Accounting Implications and Has the Following Opinions:

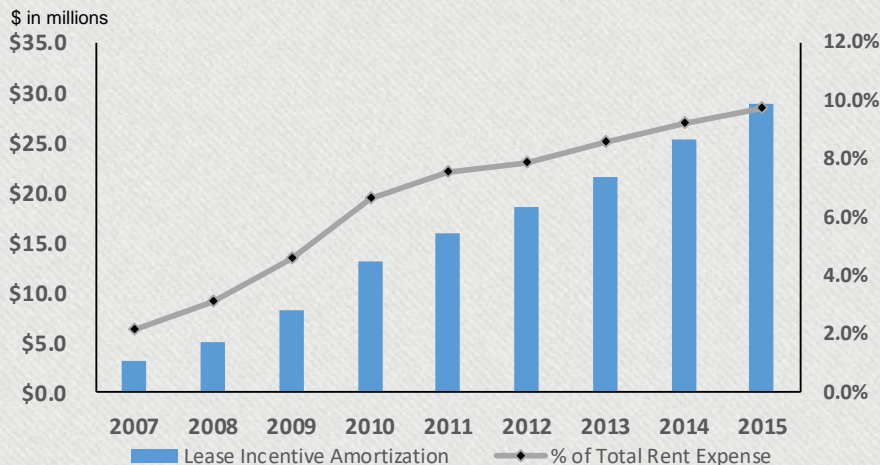
- Pre-IPO, Burlington touted the benefits of its large store format. It benefitted from the ability to negotiate large lease incentives from landlords
- Deferred lease incentives accrue on the balance sheet, with incentive amortization running as a credit against rent expense, ultimately benefitting EPS. Burlington's also runs changes in deferred rent incentives as increase to operating cash flow
- Burlington's move towards a smaller store format, and a more competitive real estate env't may hinder its ability to secure lease incentives. **Its accounts are signaling a slowdown of EPS and cash flow benefits from incentives.** Accrued deferred lease incentives (bottom right chart) are now declining, and net operating cash flow benefits from rent incentives recently turned negative (top right chart)

Net Operating Cash Flow Impact From Rent Incentives (1)



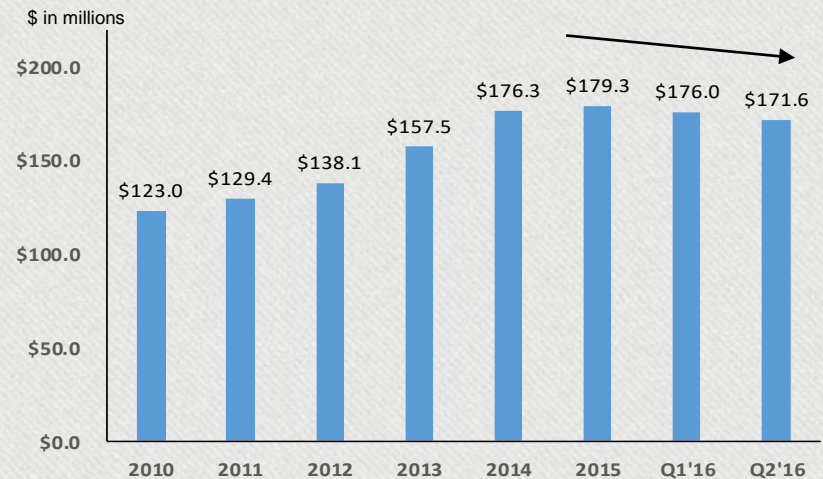
(1) Deferred rent incentives minus non-cash rent through operating cash flow

Growing Lease Incentive Amortization



Note: Lease Incentive Amortization Is Netted Against Rent Expense, Increases Earnings

Balance Sheet Deferred Lease Incentives Declining...



Note: Reported as a component of Other Liabilities; was not disclosed prior to 2010

Critically Analyzing Unit Economics

Burlington regularly touts its “Attractive Store Economics” as an investment highlight. However, it stopped disclosing the cost of its new store expansion post 2013, when it initially gave a range of \$1.6m – \$1.8m for its prototypical 80,000 sqft store (\$21.25/sqft at the midpoint).

Based on a FOIA request for a recently completed store in Delaware, Spruce Point has reason to believe that investors are under-appreciating the rise in new store costs, and deteriorating unit economics.

Burlington Promotes Its Unit Economics

Investment Highlights

- ✓ Leading destination for on-trend, branded merchandise at a great value
- ✓ Proven track record of performance with strong current business trends
- ✓ Flexible off-price sourcing and merchandising model
- ✓ **Attractive store economics and white space allowing for continued growth**
- ✓ Proven management and merchant team with extensive retail experience

Only Unit Economic Disclosures Identified By Spruce Point

“Our new store operating model, which is based on historical store performance, assumes an average store size of 80,000 gross square feet. Our average initial net investment, which varies by site and specific store characteristics, averages \$1.8 million per store and consists of store build-out costs (net of tenant improvement allowances), pre-opening expenses and average first year inventory (net of payables).”
(Source: [S-1](#), p. 89, June 2013)

“Importantly, we received significant landlord support on many of our stores; and we expect that our total investment in new stores will average about \$1.6 million and that our payback periods will average less than three years.”
(Source: [Former CFO Weyhrich](#), Dec 2013)

Pay Close Attention To Language Change

In every single SEC filing since its IPO, Burlington made the statement that a vast majority of its existing stores had positive Adjusted EBITDA.

Recently, Burlington changed its position and no longer makes this affirmative statement!

Recent Statement on Unit Economics Since May 2016

Maintaining Focus on Unit Economics and Returns. We have adopted a market focused approach to new store openings with a specific focus on maximizing sales while achieving attractive unit economics and returns. By focusing on opening stores with attractive unit economics we are able to achieve attractive returns on capital and continue to grow our margins. We believe that as we continue to reduce our comparable store inventory, we will be able to reduce the square footage of our stores while continuing to maintain our broad assortment. (Source: Q1'2016 [10-Q](#), p. 18)

Example of All Previous 10K/10Q Statements on Unit Economics Going Back to its IPO Included the Bolded Statement Below

Maintaining Focus on Unit Economics and Returns. We have adopted a market focused approach to new store openings with a specific focus on maximizing sales while achieving attractive unit economics and returns. **This focus is demonstrated by the fact that the vast majority of our existing stores had positive Adjusted EBITDA for Fiscal 2015.** By focusing on opening stores with attractive unit economics we are able to achieve attractive returns on capital and continue to grow our margins. We believe that as we continue to reduce our comparable store inventory, we will be able to reduce the square footage of our stores while continuing to maintain our broad assortment. (Source [10K](#), p. 24)



Evidence Suggests Rising Cost of New Store Expansion

Based on our FOIA request for a recently completed store in Dover, Delaware we found construction cost for a 50,000 sqft location to be \$1.5 million (most likely understated for conservatism). Making some conservative assumptions for new store inventory, pre-opening expenses, and tenant allowances we estimate unit economics costs have risen 17% – 45% from initial guidance in 2013.

Estimated Range For BURL's New Store Cost Per Sqft

Cost	2013 (1)	Low	High
Construction Cost	--	\$1,500,000	\$1,500,000
New Store Inventory (2)	--	\$1,100,000	\$1,300,000
Pre-Opening Costs (3)	--	\$150,000	\$250,000
Less: Tenant Allowance (4)	--	(\$1,500,000)	(\$1,500,000)
Est. New Store Cost	\$1,700,000	\$1,250,000	\$1,550,000
Store Square Footage	80,000	50,023	50,023
Est. New Store Cost / Sqft	\$21.25	\$24.87	\$30.84
% increase	--	17%	45%

- (1) Midpoint of company disclosed range of \$1.6m - \$1.8m
- (2) Estimated based on Burlington disclosures of inventory, stores, and same store inventory change
- (3) Burlington doesn't disclose this figure. Our estimate is based on peer company disclosures
- (4) Based on nationwide average allowance of \$30 per sqft per [JLL research](#)

City of Dover - BUILDING PERMIT APPLICATION
15 Lookerman Plaza • Dover, Delaware 19901 • (302) 736-7010 • FAX (302) 736-4217

Project Address/Tax Parcel Identification Number
515 NORTH DUPONT HWY SUITE # 200 (BCE)

Applicant's Name
EDWARD GEMOKA - MICHAEL CRISLIP ARCH. - PH. 216-223-3252

Owner Name and Address
DOVER DE RETAIL, LLC P.O. BOX 1049 CANTERBURY, OH 44406

E-mail address:
(LARRY OGRINC) LOGRINC@DOVER.COM

Contractor Name and Address
TBD 46 WINDY CIRCLE SUITE A WILMINGTON, DE 19814

E-mail address:
tbdo@windy.com

Dover Business License #

BUILDING DETAILS

Proposed Occupancy
M/S-1

Type of Construction
2B

Change in Occupancy or Use? Yes or No
(N)

If yes, describe the previous use

Number of Stories
1

Total Height in Feet
29'-0"

Total Land Area to be Disturbed (in SF)
200

Proposed Occupancy Load
1,400

Square Footage All Floors
50,260

Total Work Area (in SF)
50,260

Type of work: () New () Addition () Demolition
☒ Renovation - Interior ☒ Exterior ☒ Overlay # of layers
☒ Alteration () Siding () Solar panels
☒ Full Building Demolition () Selective Demolition
☐ Fence - Height () Pool () Elevator
☐ OTHER

Description of Work:
MERCANTILE TENANT FIT-OUT OF EXIST. TENANT LEASE SPACE FOR NEW BURLINGTON COAT FACTORY (BCE) (M-USE). EXISTING IS MODIFIED FOR NEW MAIN ENTRANCE CANOPY & SIGNAGE

Estimated Value of Construction: **\$1,500,000.00**

Before You Dig! Call Miss Utility 1-800-282-8555 or other authorized locator.

Attention! Please post your issued permit on site and visible from the street.

CE - Yes 15-793-1117 Vacant Building Ord.
HD - No

Office Use Only
Permit Number **16-422**
Roll Plans Fold Plans CD with Plan Revisions
Date Received **3/30/16**
Date Issued
Flood Plain Y N Taxes Y (N)
Public Works Y N KGD Y N
C/O Required YES
Review Agencies
Building Plan Date Initials **4/6/16 GCA**
Fire Plan Date Initials **4/6/16 GCA**
Total Fee **12,017.00**
Fees Paid () **6,008.50**
Check # Cash
Collected By
Certification in Lieu of Oath
I hereby certify that I am the owner of record or a contractor authorized by the owner of record to make this application, and that all work will be performed in accordance with the applicable Codes and Ordinances.
Signature **Edward Gemoka**
Date **3/24/2016**

Received pursuant to Freedom of Information Request, City of Dover, DE

Dead Retailer Walking: Failure looms large at a sample of some recent Burlington site selections.

Burlington's Flagship New York City Store (former Filene's Basement now bankrupt)

"Filene's left the three-story space at the south end of Union Square vacant late last year after its parent company, Sym's, filed for bankruptcy and closed two dozen locations, including another Manhattan outpost on the Upper West Side. That 92,000-square-foot retail spot will become Burlington's flagship location in Manhattan." (Source: [DNAinfo](#), April 2012)

Burlington Enters Holland, MI (former Sears)

"Burlington Coat Factory will be an anchor tenant for the center, leasing 50,000 square feet in the former Sears store at the north end of the building." (Source: March 2016, [Mlive.com](#))

Burlington enters Hemet, CA (former Wal-Mart)

"The site has been vacant since 2004, when Wal-Mart built a larger store nearby. The new project introduced by developers to city planners in January was welcome news to the city council who had waited since 2004 when Wal-Mart closed the Florida Avenue store to see new tenants move in. The store over the 12 years it was closed, began to deteriorate, the landscaping began to die off and it became a temporary haven for some homeless that had to be moved by police." (Source: [Valley News](#), Sept 2016)

Burlington Enters Dover, DE (former Kmart)

"Also, the mayor confirmed a Burlington clothing store will occupy about 80 percent of the old Kmart, which closed in July 2014." (Source: [Doverpost](#), March 2016)

Burlington Enters Colonial Heights, VA (former Kmart)

"The landlord, Roslyn Farms Associates LLC, took back the Kmart anchor spot this spring when the retailer closed its store. The landlord subsequently demolished the 104,228-square-foot building. That space is now being redeveloped for junior anchors, with Burlington occupying a major portion." (Source: [Richmond.com](#), Sept 2015)

Warning: Burlington Doesn't Disclose Store Pre-Opening Cost

Pre-opening costs of new stores should be expensed to the income statement. Burlington does not disclose these expenses, and we worry they are potentially being capitalized on its balance sheet to inflate its earnings

Company	Pre-Opening Cost Clearly Disclosed	Disclosure on Store Pre-Opening Expenses
Burlington	No	NO DISCLOSURE
ULTA Cosmetics	Yes	Pre-opening expenses include non-capital expenditures during the period prior to store opening for new, remodeled and relocated stores including rent during the construction period for new and relocated stores, store set-up labor, management and employee training and grand opening advertising. (Source: 10-K)
Ollie's Bargain	Yes	Pre-opening expenses consist of expenses of opening new stores and distribution centers. For new stores, pre-opening expenses include grand opening advertising costs, payroll expenses, travel expenses, employee training costs, rent expenses and store setup costs. Pre-opening expenses for new stores are expensed as they are incurred, which is typically within 30 to 45 days of opening a new store. For distribution centers, pre-opening expenses primarily include inventory transportation costs, employee travel expenses and occupancy costs. During the fiscal years ended January 30, 2016, January 31, 2015 and February 1, 2014, we opened 28 new stores and closed one store, opened 22 new stores and opened 23 new stores, respectively. In connection with these store openings, we incurred pre-opening expenses of \$6.3 million, \$4.6 million and \$4.8 million in fiscal years 2015, 2014 and 2013, respectively. (Source: 10-K)
Five Below	Yes	Costs incurred between completion of a new store location's construction and its opening (pre-opening costs) are charged to expense as incurred. Pre-opening costs were \$4.9 million, \$4.6 million and \$4.3 million in fiscal 2015, fiscal 2014, and fiscal 2013, respectively, and are recorded in the accompanying consolidated statements of operations based on the nature of the expense. (Source: 10-K)
Dick's Sporting Goods	Yes	Pre-opening expenses, which consist primarily of rent, marketing, payroll and recruiting costs, are expensed as incurred. Rent is recognized within pre-opening expense from the date of building turnover to the Company through the date of store opening. (Source: 10-K)
Ross Stores	No	Store pre-opening costs are expensed in the period incurred. (Source: 10-K)
Target	No	Expenses included in Selling, General and Administrative Expense include "Pre-opening costs of stores and other facilities" (Source: 10-K , Note 3)



Management and Governance Concerns

In our opinion, Burlington's management has "extensive retail experience" that has "proven" to be associated with prior retail failures and accounting debacles....see next slides for details.

Investment Highlights

- ✓ Leading destination for on-trend, branded merchandise at a great value
- ✓ Proven track record of performance with strong current business trends
- ✓ Flexible off-price sourcing and merchandising model
- ✓ Attractive store economics and white space allowing for continued growth
- ✓ Proven management and merchant team with extensive retail experience



Background on Burlington's CEO


According to his bio, Kingsbury was the President and CEO of Filene's / Kaufmann's from 2000 – 2006.

■ **Under Kingsbury's Leadership, Filene's (May Dept. Stores Largest Segment) Showed Declining Sales Every Year**

- May was [acquired](#) by Federated Dept. Stores in 2005. In 2006, Filene's was merged with Macy's and phased out the name

\$ in mm	2001	2002	2003	2004
Filene's/Kaufmann Revenues	\$3,250	\$3,096	\$3,020	\$2,654
% Decline	--	-4.7%	-2.4%	-12.1%

■ **Kingsbury Has Recruited Various Executives From Filene's To Work At Burlington:**

- [Dec 2009](#): Burlington hired Michael Geraghty as COO of Burlington commencing Jan 4, 2010. According to his bio: "Mr. Geraghty served as the Chairman of Filene's/Kaufman's, a division of Macy's-Federated, from September 2004 to May 2006. Mr. Geraghty served as Chief Financial Officer of Filene's/Kaufman's from November 1996 to August 2004."
-  [Red Flag](#): Burlington failed to disclose that Mr. Geraghty was named Chief Financial Officer and Administrative Officer of Fortunoff in Dec 2006, which later [filed for bankruptcy](#) in Feb 2009 due to a "[severe liquidity crisis](#)"
- [Dec 2010](#): Geraghty abruptly resigned from Burlington a year later citing "personal reasons"
- [Nov 2015](#): Burlington hired Rick Seeger as EVP of Planning & Allocation and MIO
- "Mr. Seeger served in various management positions with The May Department Stores Company from 1994 through 2006, most recently as Senior Vice President, General Merchandise Manager of the Filene's division from 1999 through 2006"
 - Mr. Seeger later followed Kingsbury to Kohl's (see next slide): where he served as [Executive Vice President, General Merchandise Manager of Kohl's Corporation from 2006 through November 2014](#)"
- [Feb 2008](#): Kingsbury is also joined by Fred Hand, EVP of Stores. According to his bio: "From 2001 to 2006, Mr. Hand [served as Senior Vice President, Stores and Visual Merchandising of Filene's Department Stores](#)"

Kingsbury joined Kohl's in 2006. Why was he removed from store operations and administration at Kohl's and what role, if any, did he play in the complex lease arrangements that required restatement?

▪ **Prior To Joining Burlington Stores, Thomas Kingsbury Was Employed By Kohl's Corp. From 2006 - 2008**

- [May 2006](#): Kohl's names Kingsbury SVP, and will oversee "store operations and information technology"
- [Sept 2007](#): Kingsbury was previously responsible for "merchandise presentation, store administration, store operations, information technology, and e-commerce," and "will now oversee marketing, business development, e-commerce and information technology"
- [Dec 2008](#): Kingsbury named CEO of Burlington, he most recently oversaw marketing, business development, e-commerce and information technology



Spruce Point Observation: Kingsbury was subtly removed from store administration, operations and merchandise at Kohl's and his [current bio](#) continues to omit any role or involvement with Kohl's merchandising or store operations

▪ **On August 4th 2011, Kohl's Warned Investors It Had Identified Errors Related to "Complex" Lease Accounting And Restated Results from 2008 – 2011.**

- [Warning](#): "On August 9, 2011, the audit committee of Kohl's board of directors, in consultation with management, concluded that because of these errors, investors should no longer rely upon the financial statements"
- [The principal factor](#): "that contributed to this material weakness was the misinterpretation of complex standards related to leases where we, as the lessee, are involved in asset construction pursuant to ASC 840.....We are often involved extensively in the construction of leased stores. In many cases, we are responsible for construction cost over runs or construct non-standard tenant improvements (e.g. roof or HVAC systems). As a result of this involvement, we are deemed the "owner" for accounting purposes during the construction period, so are required to capitalize the construction costs on our Balance Sheet..."*"Upon completion of the project, we perform a sale-leaseback analysis pursuant to ASC 840, Leases, to determine if we can remove the assets from our Balance Sheet. In many of our leases, we are reimbursed a portion of the construction costs via adjusted rental and/or cash payments or have terms which fix the rental payments for a significant percentage of the leased asset's economic life. These items are generally considered "continuing involvement" which precludes us from derecognizing the assets from our Balance Sheet when construction is complete"*

Background on Burlington's CFO and Chief Accounting Officer Raise Potential Concerns

Burlington's key financial executives, including its CFO and Chief Accounting Officer, held leadership roles with companies requiring financial restatement.

- **Prior to joining Burlington and later becoming CFO, Marc Katz held the CFO role at A.C. Moore (Nasdaq: ACMR), a specialty retailer of Arts & Crafts based in Berlin, NJ:**
 - [September 2006](#): Marc D. Katz joins A.C. Moore as CFO: "*Marc Katz has proven financial expertise through his experience as the controller of a large multi-store retail company, in addition to a strong background in retail information systems,*" said Rick A. Lepley, A.C. Moore's Chief Executive Officer. "
 - [Oct 2007](#): **ACMR disclose internal review of its inventory accounting methods tied to inventory valued under the retail inventory method (RIM)**; based on prelim. data, total inventory is estimated to be overvalued by \$15-\$25m from 12/31/04 – 6/30/07
 - [March 2008](#): Files 10-K and discloses material weakness of internal financial controls and restatement of financial results. FY 2006 EPS results restated from \$0.12 cents to a loss of (\$0.02) cents
 - [June 2008](#): Katz resigns as ACMR's CFO and in [July 2008](#) Katz appointed EVP and Chief Accounting Officer at Burlington
 - [Dec 2009](#): Katz assumes role of EVP of Merchandise Planning and Allocation and relinquishes accounting role
 - [Jan 2015](#): Katz, EVP of Merchandise Support and IT, appointed EVP and CFO
 - Also joining Burlington from A.C. Moore are [Mike Metheny](#) (served as ACMR's SVP of Supply Chain) and is now BURL's EVP of Supply Chain) and [Dennis Hodgson](#) (served as ACMR's SVP and CIO) and now holds the same role at BURL
 - According to a Philadelphia Inquirer article "A.C. Moore Crafting a Turnaround," an analyst said, "*The stores, and especially the supply-chain infrastructure, had really been neglected by the prior management team for a long time*"
- **Prior to being appointed SVP and Chief Accounting Officer at Burlington, John Crimmins III was CFO at Timberland (NYSE: TBL), a retailer of men's and women's clothing apparel, accessories and footwear**
 - [March 2007](#): Crimmins appointed CFO. An executive with the company since 2002, Crimmins also has held positions as corporate controller and chief accounting officer.
 - [April 2007](#): **Timberland delays Q1 earnings, audit committee says financials from 2001-2006 cannot be relied upon as a result of accounting matters related to derivative accounting**
 - [Sept 2009](#): Crimmins leaves Timberland
 - [March 2011](#): Burlington appoints Crimmins as SVP and Chief Accounting Officer

Recent Burlington Executive Resignations

Last year, three key Burlington executives resigned under mysterious circumstances. The timing of the resignations ahead of the company's recent outstanding financial results is noteworthy.

Date of Departure	Date Hired	Executive	Title	Reason and Note
Jan 9, 2015	2007	Todd Weyhrich	EVP and CFO	"spend more time with my family and pursue other interests"
March 25, 2015	2012	Paul Metcalf	EVP and Chief Merchandising Officer	"To pursue other interests"
July 2015	1993	Paul Tang	EVP and General Counsel	No disclosure was given of Mr. Tang's departure, however, the company hired his replacement Janet Dhillon on July 20, 2015

Warning: Clawback Provision For Fraud By Management Added Recently

Burlington's Audit Committee recently adopted a "clawback" provision which allows the Company to reclaim compensation if actions by management result in the event of a financial restatement or significant financial harm to the Company arising out of willful actions, including without limitation fraud. Coincidence or not: The policy was adopted in the same quarter it booked the tax credit.

"In February 2016, the Committee adopted a compensation recoupment policy, providing that, in the event of a financial restatement or significant financial harm to the Company arising out of willful actions, including without limitation fraud or intentional misconduct, or gross negligence by any officer of the Company, the Committee shall have the discretion and authority to determine the appropriate action to take, which may include requiring relinquishment of previously awarded equity-based compensation and/or repayment of previously paid incentive cash compensation."

Source: [Proxy Statement](#), p. 30, filed April 1, 2016



Burlington Stores, Inc. Announces Fourth Quarter and Fiscal Year 2015 Results

03/03/2016

- *Fiscal Year 2015 Adjusted Net Income per Share rose 26% to \$2.31 vs. \$1.83*
- *Fiscal Year 2015 Net Sales exceeds \$5 Billion, a Comparable Stores Sales increase of 2.1%, on Top of Last Year's 4.9% Increase*
- *Comparable Store Inventory decreased 6% and Turnover improved 10%*
- *The Company expects Fiscal 2016 Comparable Stores Sales to increase 2.5% - 3.5% and Adjusted Net Income per Share in the range of \$2.62 to \$2.72*

Source: [Burlington Press Release](#)

Burlington Stores, Inc. Announces First Quarter 2016 Results, Exceeding Guidance; Raises Fiscal Year 2016 Outlook

05/26/2016

- *On a GAAP basis, net sales rose 8.4%, net income increased 46% and diluted net income per share rose 53%*
- *On a Non-GAAP basis,*
 - *Comparable store sales increased 4.3%*
 - *Adjusted Net Income per Share rose 39% to \$0.57*
 - *Adjusted EBITDA increased 19% to \$121 million*
 - *Comparable store inventory decreased 9% and turnover improved 7%*

Source: [Burlington Press Release](#)

Pay Close Attention To How Burlington Started Qualifying its Comp Store Sales and Inventory With A Non-GAAP Disclaimer, Shortly After The Clawback Policy Was Instituted Between Q1 and Q2 2016

Subtle Change of Incentive Structure Signaling Earnings Slow Down?

Burlington recently disclosed a subtle change in a key financial target used to determine 50% of management's annual incentive target.

We believe the change signals to investors a slow down in its earnings growth rate, and gives management credit for repurchasing shares.

Burlington's Recent Share Repurchase Programs: Shareholder Friendly With a Footnote (1)

- In June 2015, during its [Q1'15 earnings announcement](#), Burlington announced its first \$200m repurchase program
- The company announced an additional \$200m program during its [Q3'15 earnings announcement](#),
- At the time of both announcements, Burlington's share price had returned almost 0% for the entire year
- By reducing its share count, Burlington can improve its earnings per share, while masking slow down in earnings

(1) Management is now paid on a per share metric, thus rewarding them for repurchasing shares, and potentially signaling to investors a view that net income growth will slow

"As our performance is predominately measured on the basis of Adjusted Net Income per share rather than Adjusted Net Income, the Committee in February 2016 approved replacing the Adjusted Net Income portion of the Financial Component with Adjusted Net Income per share commencing with our 2016 Annual Incentive Plan. The Adjusted Net Income per share and comparable store sales targets for our 2016 Annual Incentive Plan were approved by the Board in February 2016." Source: [Proxy Statement](#), p. 39, filed April 1, 2016

Rounding Error or Worse? Burlington beats its target by just \$0.50m, Then Changes The Target for 2016

Metric	Target	Actual	Percentage of Target	Achievement Percentage
Adjusted Net Income	\$174.1	\$174.6	100.3%	101.8%
Comparable Store Sales	3.4%	2.1%	62.3%	81.1%

Rampant Insider Sales in 2016

The CEO adopted a stock sale program in the same quarter the clawback policy was adopted. Five key insiders have reaped at least \$23.5m from stock sales YTD. Insiders own just 2.2% a of the [last proxy statement](#) and still decided to sell!

CEO, Tom Kingsbury

Date	Shares Sold	Sale Price	\$
1/4/2016	3,600	\$42.22	\$0.15
1/4/2016	26,400	\$43.11	\$1.13
2/1/2016	5,400	\$53.08	\$0.28
2/1/2016	20,912	\$54.01	\$1.13
2/1/2016	3,688	\$54.56	\$0.21
3/1/2016	14,818	\$55.86	\$0.82
3/1/2016	15,182	\$56.36	\$0.85
4/1/2016	26,429	\$56.32	\$1.48
4/1/2016	3,571	\$56.89	\$0.20
6/1/2016	3,498	\$60.47	\$0.21
6/1/2016	11,619	\$61.60	\$0.71
6/1/2016	14,883	\$61.92	\$0.92
7/1/2016	17,170	\$67.00	\$1.15
7/1/2016	2,830	\$67.50	\$0.19
8/1/2016	20,000	\$76.21	\$1.52
9/1/2016	1,800	\$81.42	\$0.14
9/1/2016	16,946	\$82.36	\$1.39
9/1/2016	1,254	\$82.75	\$0.10
10/3/2016	15,049	\$79.61	\$1.12
10/3/2016	4,951	\$80.11	\$0.39
Total	230,000	\$61.90	\$14.27

[10b5-1 plan adopted 3/21/16](#)

Supply Chain EVP, Mike Methany

Date	Shares Sold	Sale Price	\$
5/31/2016	1,963	\$60.03	\$0.11
5/31/2016	2,037	\$60.45	\$0.12
5/31/2016	266	\$60.68	\$0.01
7/12/2016	4,000	\$67.08	\$0.26
8/12/2016	4,000	\$76.46	\$0.30
9/12/2016	1,000	\$81.79	\$0.08
9/12/2016	3,000	\$82.50	\$0.24
10/12/2016	4,000	\$78.49	\$0.31
Total	20,266	\$72.76	\$1.47

[10b5-1 plan adopted 3/24/16](#)

CFO, Marc Katz

Date	Shares Sold	Sale Price	\$
3/7/2016	11,000	\$52.22	\$0.57
3/7/2016	1,000	\$53.71	\$0.05
5/31/2016	10,000	\$60.25	\$0.60
8/29/2016	10,000	\$81.00	\$0.81
Total	32,000	\$63.77	\$2.04

EVP of HR, Joyce Magrini

Date	Shares Sold	Avg. Sale Price	\$
5/31/2016	22,001	\$60.21	\$1.32
9/1/2016	700	\$81.36	\$0.05
9/1/2016	2,900	\$81.99	\$0.23
9/1/2016	3,700	\$82.59	\$0.30
10/3/2016	3,601	\$79.64	\$0.28
10/3/2016	2,699	\$80.02	\$0.21
Total	35,601	\$68.19	\$2.42

[10b5-1 plan adopted 6/17/16](#)

EVP of Stores, Fred Hand

Date	Shares Sold	Sale Price	\$
3/9/2016	25,000	\$53.18	\$0.57
6/8/2016	22,000	\$63.77	\$0.05
8/29/2016	12,000	\$81.10	\$0.60
Total	59,000	\$62.80	\$3.70



Substantial Room For Valuation Correction in Burlington's Shares



Bull vs. Bear Debate



Talented, Proven
and Successful
Management Team



“B Team” mgmt. with questionable history of value creation and association with accounting plagued companies. Mgmt. incentives changing with insiders cashing out and modifying bonus plan definition to be paid for share repurchases



Opportunity To Grow to
1,000 Stores in the U.S.



Competing with existing and new competitors for prime locations in a smaller store format. May not be able to get the same lease incentives as before. Appears to be taking lower quality locations where other retailers failed long-term



Superior Financial Model
Driving Continuous Comp
Store Sales Growth and
Increased Inventory Turns



Difficult to sustain comp levels and it will be less instructive with new (smaller) stores and modified stores being added to the mix. Company has non-standard inventory turn definition and has obfuscated its recent disclosure. Tax credit income shifting and new clawback clause calls into question the integrity of the financials



Significant Long-Term
Margin Expansion
Opportunity



Difficult to assess true gross margin as a result of non-standard presentation and changes in presentation. BURL may be artificially boosting margins through aggressive pack and hold strategies, and suppressing shrinkage estimates. Rising new store costs may also blunt margins



Ability To Be The Next
TJ Maxx / Ross Stores



Large gap in operational performance unlikely to be bridged without substantially more capital investment. Capex costs for “supply chain initiatives” creeping higher

Unabashed Optimism In BURL's Price!

A majority of analysts have a “buy” recommendations for BURL, and see an average of 24% upside. Guggenheim, [the most recent analyst to initiate coverage](#), assumed a “neutral” and declined to issue a price target.

Broker	Recommendation	Price Target
JP Morgan	Overweight	\$98.00
BMO	Outperform	\$96.00
Buckingham	Buy	\$95.00
MKM	Buy	\$95.00
Bofa/ML	Buy	\$95.00
SunTrust	Buy	\$94.00
Goldman Sachs	Buy	\$92.00
Cowen	Outperform	\$90.00
Telsey Advisory	Market perform	\$86.00
RBC	Outperform	\$86.00
Morgan Stanley	Overweight	\$82.00
Credit Suisse	Neutral	\$75.00
Wells Fargo	Outperform	--
Guggenheim	Neutral	--
Average Price Target		\$90.33
% Upside From Current (1)		24%

(1) Assumes \$73 share price

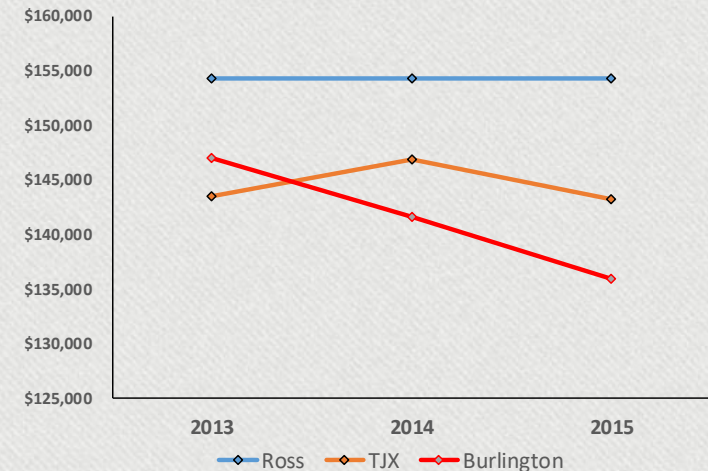
Market Values Burlington Incorrectly

The market values Burlington like a best of breed retailer like Ross and TJX. Based on our analysis, Burlington significantly lags peers in its ability to drive sales and operating cash flow on a per employee and square footage basis (1).

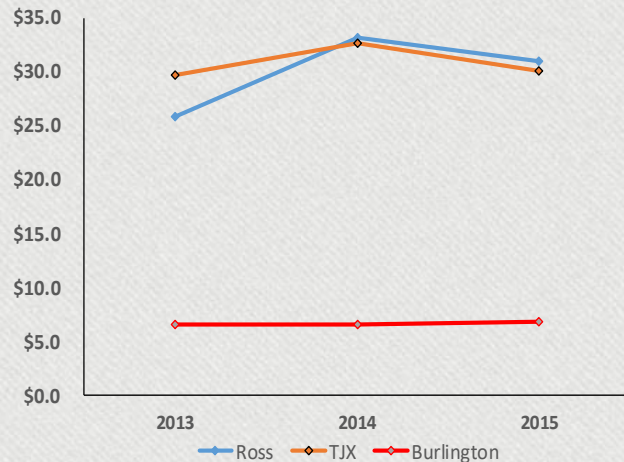
Ever Since its IPO, Burlington has sold investors on its ability to “Drive Operating Leverage,” but in our view it remains illusive (Source; [S-1](#), p. 7)

- Investors have been cheering headline SSS and EPS gains, but digging a little deeper into key operational metrics, we are concerned that Burlington may never close its performance gap to peers
- Recent revenues per employee (right hand chart) have been trending downward in the past few years, and are well below key peers ROSS and TJX
- We’ve also analyzed Burlington’s ability to drive sales and operating cash flow through its entire distribution footprint vs. peers. Burlington has invested significant capex resources into IT, supply chain, distribution facilities and a new HQ, yet has seen minimal improvements

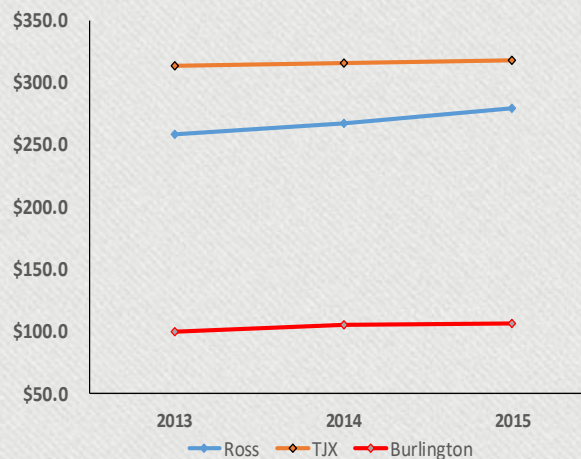
Sales Per Employee



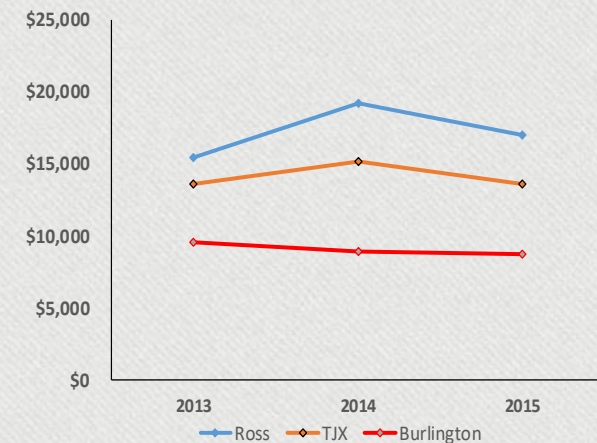
Operating Cash Flow Per Total Sq. Footage



Sales Per Total Sq. Footage



Operating Cash Flow Per Employee



(1) Includes retail stores, distribution, warehousing, and corporate square footage

Hitting Its Store Targets Will Require Substantially More Capital Investment

Company	Key Metrics	
Burlington (Today)	Stores / States+ Territories	571 / 46
	Distribution Facilities	4 (2 in CA / 2 in NJ)
	Warehouses	3 (1 in CA / 2 in NJ)
	Distribution Sqft	2.8
	Warehouse Sqft	1.0
	<u>Corp Office Space</u>	0.2
	Total Sqft	4.0
	Vendors	5,000
Ross Stores (2010)	Stores / States + Territories	1,005 / 28
	Distribution Facilities	4 (2 in CA, 1 in SC, 1 in PA)
	Warehouses	4 (PA and SC)
	Distribution Sqft	4.3
	Warehouses Sqft	1.2
	<u>Corp Office Space</u>	0.4
	Total Sqft	5.9
	Vendors	7,700
TJX Companies (1996)	Stores / States+ Territories*	1,083 / 50
	Distribution Facilities **	8 (4 TJX/ 4 Marshall's)
	Distribution Sqft	5.1
	Warehouse Sqft	N/A
	<u>Corp Office Space</u>	0.7
	Total Sqft	5.6
	Vendors	N/A
	Employees	58,000

We analyzed Burlington's current footprint vs. Ross and TJX's footprint when each retailer was at ~1,000 stores. To reach 1,000 stores nationally, we believe Burlington will have to invest further resources in distribution centers, along with greater resources into supply chain technology.

We observe that Burlington has distribution centers on each coast, without any presence in the Midwest/South or Central US

Based on our conversation with a retail technology and supply chain industry expert, the capital costs necessary could be upwards of \$500m vs. \$200m estimated expenditures by Burlington (not including further distribution centers).

Warning: Capex Costs Rising Driven By Frequent Revisions to “Supply Chain Initiatives”

To illustrate our point, Burlington’s management doesn’t appear to have a handle on its spending plans, and has consistently revised spending plans this year for “supply chain initiatives” while its head executive starts selling stock.

FY 2015 “We estimate that we will spend **\$145 million to \$150 million**, net of approximately \$30 million of landlord allowances, in capital expenditures during Fiscal 2015, including \$85 million to \$90 million, net of the previously mentioned landlord allowances, for store expenditures (new stores, store refreshes and remodels and other store expenditures). In addition, we estimate that **we will spend approximately \$17 million to support our supply chain initiatives**, with the remaining capital used to support our information technology and other business initiatives.” Source [10K](#), p. 37 filed March 15, 2016

On March 24, 2016 Mike Metheny, Burlington’s EVP of Supply Chain, Corp. Services and Asset Protection, [enters into a 10b5-1](#) to begin liquidating shares.

Q1’16 “We estimate that we will spend **\$150 million to \$160 million**, net of approximately \$30 million of landlord allowances, in capital expenditures during Fiscal 2016, including \$85 million to \$90 million, net of the previously mentioned landlord allowances, for store expenditures (new stores, store refreshes and remodels and other store expenditures). In addition, **we estimate that we will spend approximately \$22 million to support our supply chain initiatives**, with the remaining capital used to support our information technology and other business initiatives.” Source: [10Q](#), p. 22

Q2’16: “We estimate that **we will spend approximately \$160 million**, net of approximately \$30 million of landlord allowances, in capital expenditures during Fiscal 2016, including \$85 million to \$90 million, net of the previously mentioned landlord allowances, for store expenditures (new stores, store refreshes and remodels and other store expenditures). In addition, **we estimate that we will spend approximately \$24 million to support our supply chain initiatives**, with the remaining capital used to support our information technology and other business initiatives.” Source: [10Q](#), p. 30

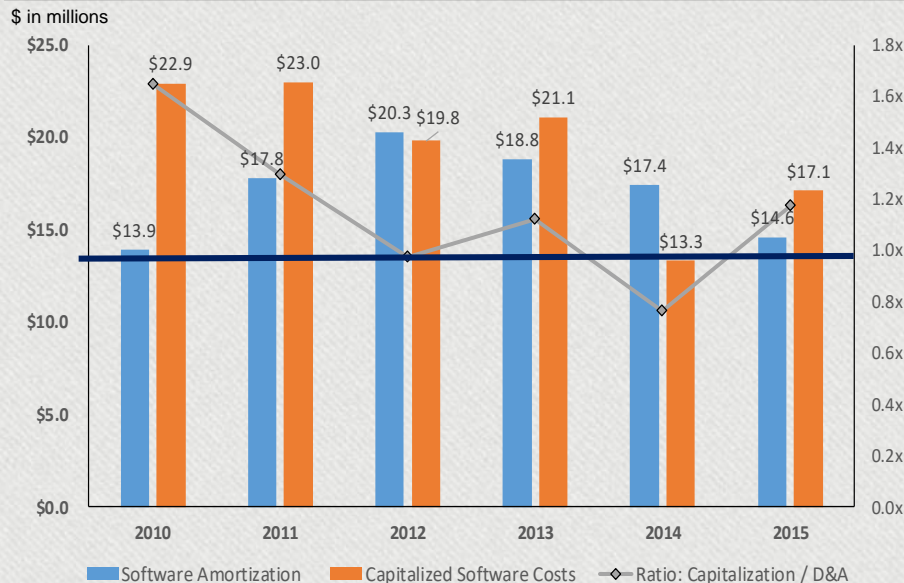
Goldman Sachs Conf (Sept 9, 2016): “Supply chain, as Tom mentioned, spent \$100 million over the last three years, **\$25 million was this year, 2016. Next year is probably going to be higher than that only because we continue to add capacity and efficiencies to our distribution centers. So, we see a little bit more next year. But that's the one area that we see a continual spend in.**”

Warning: Evidence Suggesting Aggressive Software Development Cost Capitalization

To make matters worse, based on our analysis of Burlington's financials and field research, it appears that Burlington may be aggressively capitalizing IT, software and supply chain technology costs on its balance sheet, enabling earnings overstatement.

- During our research, we learned that most of Burlington's IT systems were historically home grown and built ad hoc over the years
- We estimate Burlington has spent more than \$200m on IT hardware/software since 2010, much of it going towards standardizing its platforms (Oracle) upgrading its infrastructure, implementing disaster recovery programs, improving data warehousing, and providing more information to vendors and merchants for supply chain improvements
- A majority of these costs have been capitalized and are being amortized over 3-5 years. After software has been developed, tested, and implemented, post implementation costs must be expensed; Burlington has never disclosed how much it expenses
- We observe that Burlington's software capitalization / amortization ratio has generally been excess of 1:1, which may suggest aggressive use of capitalization

Capitalized Costs > Amortization Costs



Book Value of Internally Developed Software

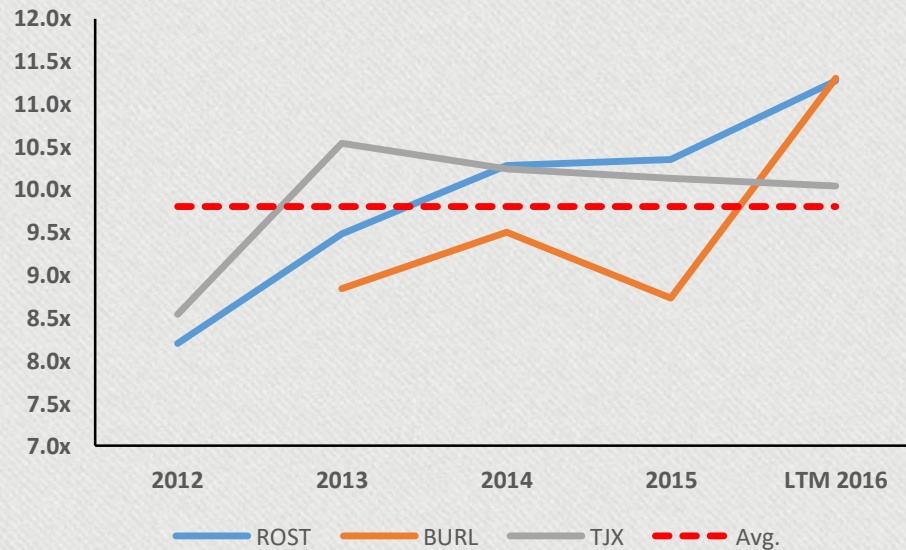


Source: SEC filings

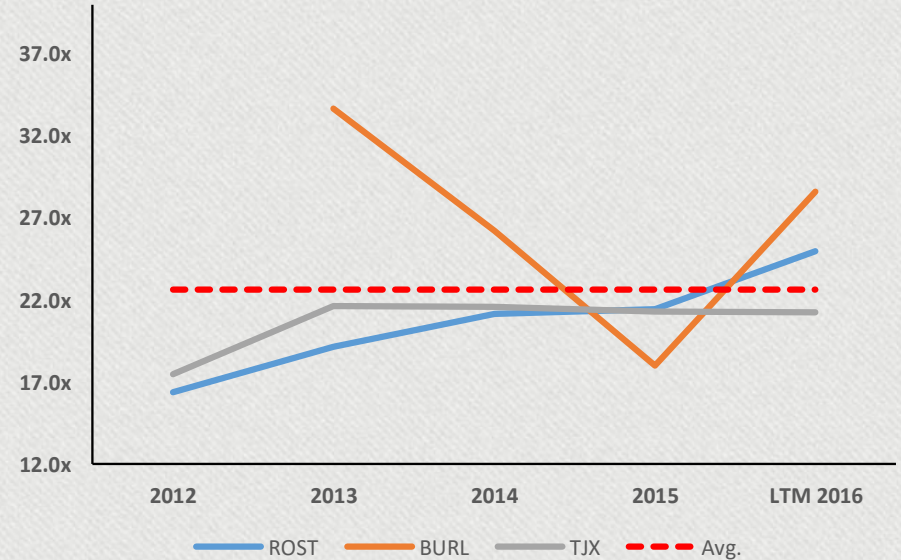
Burlington's Valuation At Historic Highs

The discount retailers are trading above their historical multiple ranges and near all-time highs. However, we believe threats have increased from the entrants of new competitors, and the continued disruption of the market from Amazon. Burlington trades as if it were a best-of-breed retailer, but in our opinion, we believe it should trade at a discount to peers, and closer to the long-term industry average multiple given that we expect a moderation of its recent financial performance.

Ad. Enterprise Value / Adj. EBITDAR



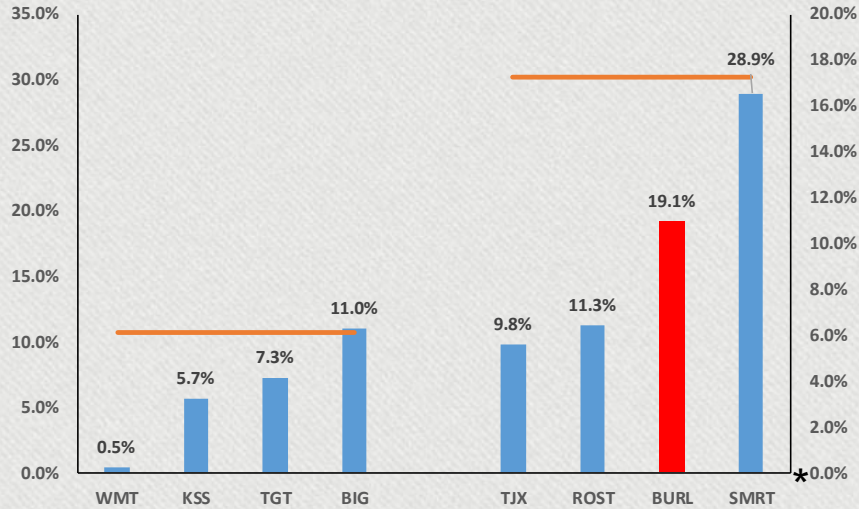
Price / Adj. EPS



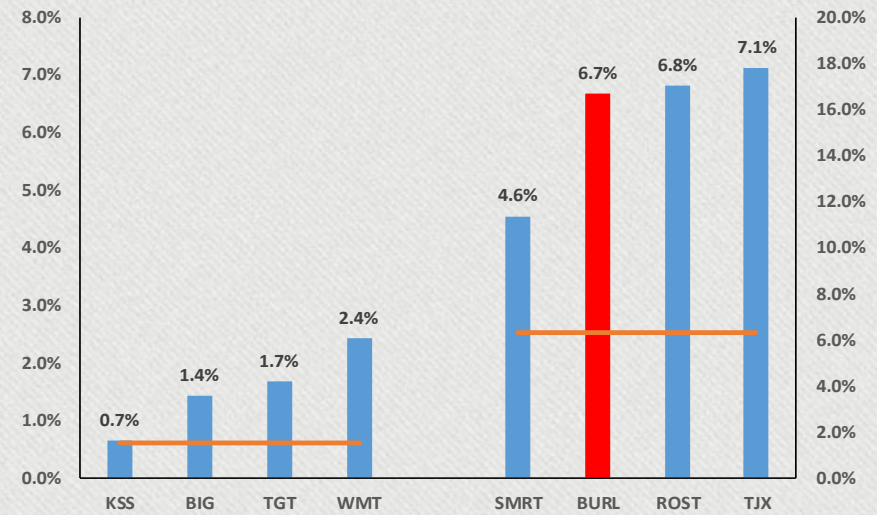
Source: Company filings
Enterprise value adjusted to include 8x rent expense

Market Expects Off-Price Retailers To Outperform; Burlington To Grow EPS 20%

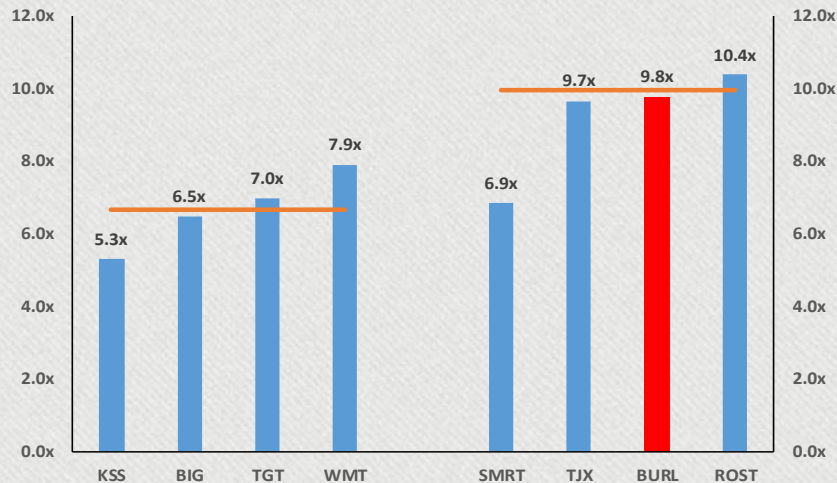
Wall St. Estimated 2017 EPS Growth



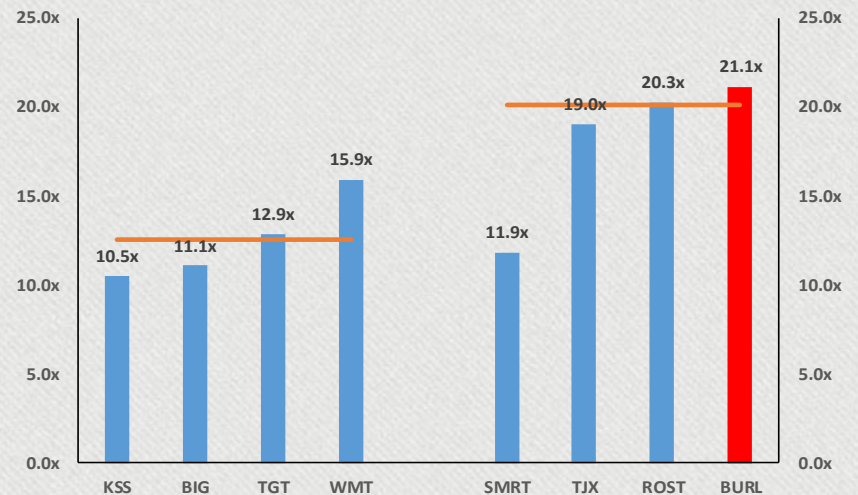
Wall St. Estimated 2017 Revenue Growth



Adj. Enterprise Value / 2017E EBITDAR



Price / 2017E EPS



* SMRT growth from a low EPS share level; its [CEO recently resigned](#) and it pre-announced negative comps. Source: Company filings and Wall St. estimates

Spruce Point Estimates 20% – 40% Downside

Spruce Point believes a moderation of financial performance in 2017 will result in expectations being reduced. Furthermore, in our opinion, Burlington's valuation multiple should contract to reflect the reality that it is not a best-of-breed off-price retailer, and should trade at a discount to peers as a result of our documented concerns about its financial presentation and accounting practices.

Spruce Point View vs. Street View

\$ in millions, except per share amounts

Metric	Street	Spruce Point	Note
Sales % Growth	\$5,880 6.7%	\$5,787 – \$5,815 5.0% – 5.5%	Moderation of comps, increased competition
Adj EBITDA % margin	\$625 10.6%	\$579 – \$593 10.0% – 10.2%	Higher tech spending, rent expense, payroll and shrinkage
Adj EPS % Growth	\$3.55 19.1%	\$3.28 – \$3.41 10% – 14%	Deleveraging effect

Spruce Point Price Target Reference Ranges

\$ in millions, except per share amounts

Metric	Low	High	Note
Adj EPS P/E Mult. Price Tgt. % Downside	\$3.28 14x \$46.00 -39%	\$3.41 18x \$61.00 -18%	Should trade at a discount to Ross/TJX at 20x. Avg. P/E for all peers is approx. 16x
EBITDA Mult. EBITDA Cash Debt Dil. Shares Price Tgt. % Downside	7.5x \$579 \$30.5 \$1,334 72.2 \$42.00 -45%	9.5x \$593 \$30.5 \$1,334 72.2 \$60.00 -20%	Ross/TJX trade at avg. 10.5x. Avg. EBITDA multiple for all peers is 7.5x

Note: Peers include WMT, TGT, TJX, ROST, KSS, BIG, SMRT