J.P.Morgan

North America Equity Research
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Office Superstores

4Q Previews; Lowering Estimates; Still No Reason to be a Hero

Hardlines Retail

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Office Superstores: 4Q Preview. Below we preview earnings for ODP, OMX and SPLS, including detailed income statement forecasts and our thoughts on the stocks. OMX and ODP report earnings on Feb. 18th and 24th, respectively. SPLS reports results on Mar. 11th.

- **Bracing for a Tough 2009; Lowering Estimates.** Looking at 2009, we are lowering our estimates on all three companies primarily due to our revised expectation for limited sales improvement in 2H09. Previously, we anticipated trends to see a steeper recovery.
- **The Most Negative Second Derivative.** Given the consumer and business exposure of the office superstores, we believe that these companies will see the greatest deterioration in sales trends from 3Q (i.e., getting even more negative). The worst sequential trend is likely to be seen in the contract and international divisions. Moreover, it is becoming increasingly difficult for these retailers to ratchet down their cost structures (although incentive comp may aide 4Q results).
- **SPLS/CXP Synergies: A Big Cookie Jar.** SPLS's acquisition of CXP allows the company to manage margins during this sharp global slowdown. While this won't completely offset the sales pressures, we are currently modeling ~$230MM of explicit synergies in 09 (on top of ~$25MM in 08). This equates to nearly $0.20 of EPS. As indicated in our Jan 12 note highlighting our meeting with SPLS' COO, margin opportunities only improve with each passing day of the integration. 2009E moves to $1.25 from $1.40 previously.
- **ODP and OMX: Sustainability Remains the focus.** The outlook for ODP and OMX is very different. Both companies are working to simply maintain liquidity and weather the economic hurricane. From store closures, asset divestures, and/or payroll/dividend cuts, each are balancing the difficult job of not cutting to the bone (which diminishes upside when trends recover) against rightsizing the cost structure to the environment. We expect that this will be the thematic focus of both calls.
- **Dial-in Information:**
  - ODP – Ph: (210) 234-0011 Pwd: 4Q08 ODP.
  - OMX – Ph: (800) 374-0165.
  - SPLS – TBA.
- ***Please refer to page 3 for our detailed 4Q income statement forecasts.***

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Office Depot (ODP;ODP US)

Company Data	
Price ($)	1.70
Date Of Price	13 Feb 09
52-week Range ($)	14.78 - 1.46
Mkt Cap ($ bn)	0.46
Fiscal Year End	Dec
Shares O/S (mn)	273
Price Target ($)	9.00
Price Target End Date	31 Dec 09

	2008E	2009E *(Old)*	2009E *(New)*	2010E *(Old)*	2010E *(New)*
EPS (Operating) ($)					
Q1 (Mar)	0.29A	0.03	(0.01)		
Q2 (Jun)	0.04A	(0.13)	(0.18)		
Q3 (Sep)	(0.01)A	0.06	(0.03)		
Q4 (Dec)	0.00	0.12	0.01		
FY	0.31	0.07	(0.22)	0.60	0.25
P/E (Operating) FY	5.4	24.2	NM	2.8	6.7

Source: Company data, Reuters, J.P. Morgan estimates.

OfficeMax Inc. (OMX;OMX US)

Company Data	
Price ($)	4.49
Date Of Price	13 Feb 09
52-week Range ($)	24.90 - 3.00
Mkt Cap ($ bn)	0.34
Fiscal Year End	Dec
Shares O/S (mn)	76
Price Target ($)	9.00
Price Target End Date	31 Dec 09

	2008E	2009E *(Old)*	2009E *(New)*	2010E *(Old)*	2010E *(New)*
EPS (Operating) ($)					
Q1 (Mar)	0.68A	0.30	0.23		
Q2 (Jun)	0.24A	(0.28)	(0.17)		
Q3 (Sep)	0.36A	0.20	0.09		
Q4 (Dec)	0.15	0.18	(0.04)		
FY	1.42	0.40	0.11	0.70	0.55
P/E (Operating) FY	3.2	11.2	40.4	6.5	8.2

Source: Company data, Reuters, J.P. Morgan estimates.

Staples (SPLS;SPLS US)

Company Data	
Price ($)	15.74
Date Of Price	13 Feb 09
52-week Range ($)	26.57 - 13.57
Mkt Cap ($ bn)	11.22
Fiscal Year End	Jan
Shares O/S (mn)	713
Div. Yield	1.8%
Dividend ($)	0.29
Price Target ($)	20.00
Price Target End Date	31 Dec 09

	2008E	2009E *(Old)*	2009E *(New)*	2010E *(Old)*	2010E *(New)*
EPS (Operating) ($)					
Q1 (Apr)	0.30A	0.26	0.23		
Q2 (Jul)	0.21A	0.19	0.17		
Q3 (Oct)	0.42A	0.43	0.40		
Q4 (Jan)	0.45	0.52	0.45		
FY	1.38	1.40	1.25	1.70	1.60
P/E (Operating) FY	11.4	11.2	12.5	9.3	9.8

Source: Company data, Reuters, J.P. Morgan estimates.

Summary Ratings and Estimates

Company	Price	Rating	Price Target	PT End Date	Metric	Current FYE	Next FYE
Office Depot	($) 1.70	N	($) 9.00	Dec-09	EPS (Operating)	($) 0.31	($) (0.22)
prior						*($) 0.25*	*($) 0.07*
OfficeMax Inc.	($) 4.49	N	($) 9.00	Dec-09	EPS (Operating)	($) 1.42	($) 0.11
prior						*($) 1.45*	*($) 0.40*
Staples	($) 15.74	N	($) 20.00	Dec-09	EPS (Operating)	($) 1.38	($) 1.25
prior						*($) 1.40*	*($) 1.40*

Source: Company data, Reuters, J.P. Morgan estimates. All prices as at 13 Feb 09.

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Detailed Income Statement Forecasts

Exhibit 1. Fourth Quarter Estimates

	Office Depot			OfficeMax			Staples		
	4Q08E	**4Q07**	**Change**	**4Q08E**	**4Q07**	**Change**	**4Q08E**	**4Q07**	**Change**
EPS	($0.00)	($0.01)		$0.15	$0.65		$0.45	$0.47	
Sales ($ billions)	$3,400	$3,867	(12.1%)	$1,901	$2,198	(13.5%)	$6,889	$5,324	29.4%
Retail Sales	*$1,418*	*$1,668*	*(15.0%)*	*$908*	*$1,029*	*(11.8%)*	*$2,600*	*$2,795*	*(7.0%)*
Contract Sales	*$905*	*$1,065*	*(15.0%)*	*$993*	*$1,169*	*(15.0%)*	*$2,604*	*$1,717*	*51.6%*
International Sales	*$1,078*	*$1,135*	*(5.0%)*	-	-	-	*$1,686*	*$812*	*107.6%*
Retail Same-Store Sales	(15.0%)	(7.0%)	(800)	(13.0%)	(7.3%)	(570)	(11.0%)	(6.0%)	(500)
Gross Margin	28.6%	26.4%	220	24.9%	25.6%	(77)	28.2%	29.1%	(89)
Operating Expense Ratio	28.4%	26.4%	205	23.4%	21.6%	182	20.0%	19.4%	62
Operating Margin	0.2%	0.1%	15	1.4%	4.0%	(259)	8.2%	9.7%	(151)

Source: J.P. Morgan estimates; company reports.

Investment Thesis

ODP: Maintain Neutral Rating. While we acknowledge that ODP "looks cheap" at its current price, we don't believe the stock will recover until financial trends progress and the macro backdrop marginally improves. Office superstores are highly macro sensitive, with top line correlations in the 70-80% range to YOY GDP and industrial production growth. With Europe now following down the path of the U.S., the stock is likely to remain tied to trends in the overall market. Moreover, this sector is later cyclical vs. the rest of retail (which is early cyclical), and ODP has one of the highest debt to EBITDAR ratios in our coverage. Finally, concerns regarding management's long term strategic plans and their execution, combined with high potential returns when the macro environment rebounds, encourage patience (i.e., "I can miss the first 50% move and still capture the next 100%.").

OMX: Maintain Neutral Rating. OMX is currently one of the "cheapest" names in our coverage universe, nevertheless (as is the case with ODP) we don't believe the stock will recover until financial trends stabilize and the macro backdrop marginally improves. The company faces further challenges as its unfavorable mix of large domestic contract customers. We believe OMX has shown an impressive ability to manage its overhead cost structure, but inevitability OMX will need top line trends to improve to drive more positive results. Finally, the same investor sentiment to "be patient" exists for OMX, in our view.

SPLS: Maintain Neutral Rating. The company is a best-in-class retailer with industry leading financial metrics and an experienced/deep management team. Moreover, we expect the Corporate Express (CXP) acquisition to be truly transformational given the sales, buying, supply chain, and overhead synergy prospects.

However, we believe these positives factors are balanced by the ongoing weakness in the fundamental backdrop across all three of its segments. The retail segment is not improving (and facing an increasing rate of fixed cost de-leverage), while the International and Delivery segments continue to deteriorate. Net-net, we are simply being patient given the current macro backdrop and the complexity/timing of the

CXP integration. *Overall, we are gaining increasing confidence that SPLS will be able to manage earnings through costs/synergies in 2009, but are waiting for a better entry point in the stock considering the weakening top line outlook and the strong performance by retail stocks since November.*

Valuation and Price Target

ODP: Maintaining Our $9 Dec 2009 Price Target. ODP is trading at 6.7x our 2010 estimate on a P/E basis, compared to 10.0x for both our coverage universe and S&P 500. On an EV/EBITDA basis, this equates to 2.6x using our 2010 forecasts. While our price target equates to ~7x PE and is lower than its historical FY2 average of ~13x, we believe that at this point in the earnings cycle, EV/EBITDA is a more relevant metric. Indeed, our $9 target equates to 7.7x our 2010 forecasted EBITDA and compares to its historical average of ~6.5x (we believe a premium is warranted given that 2010 is likely to see a recovery from trough earnings).

OMX: Maintaining Our $9 Dec 2009 Price Target. OMX is trading at ~8x our 2010 estimate on a P/E basis, compared to 10.0x for both our coverage universe and S&P 500, respectively. Our Dec 2009 price target is based on a 4x EV/EBITDA and ~17x PE, which compares to historical two year averages of ~8x and 13x, respectively. Our target reflects a mix of both metrics as PE would result in an artificially low target, in our view, while EV/EBITDA would drive an overly optimistic upside scenario.

SPLS: Maintaining Our $20 Dec 2009 Price Target. SPLS is trading at 10x our 2009 estimate on a P/E basis, compared to 10x for both our coverage universe and S&P 500, respectively. We are maintaining our December 2009 price target of $20 per share based on 12-13x PE and ~7x EV/EBITDA using our 2010 forecasts. This is in line with its current out- year valuations of 13.6x and 6.6x, respectively, and compares to historical 5YR averages of ~16x and 8x, respectively. We believe SPLS should trade at a discount to its historical averages given the macro backdrop and the high correlation to factors such as YOY GDP, industrial production, and payroll growth.

Risks to Our Rating

Key upside risks:

- **An unexpected near-term recovery in GDP growth.** Office Superstore top line growth is highly correlated to macro factors. In the near term, we expect weak office supply sales concurrent with GDP growth. If macro trends were to make an unexpected rapid recovery, it would likely drive an earlier than expected rebound in top-line results.
- **Industry consolidation.** Industry consolidation could buoy the results particular office supply retailers, as the market is highly fragmented.

Key downside risks:

- **Dependence on continuation of rational pricing.** Will a relatively rational pricing environment hold? An irrational pricing environment may pressure margins beyond expectations.
- **Weaker-than-expected business spending.** Office superstore results are highly correlated to the macro environment and the outlook for business spending is weak.

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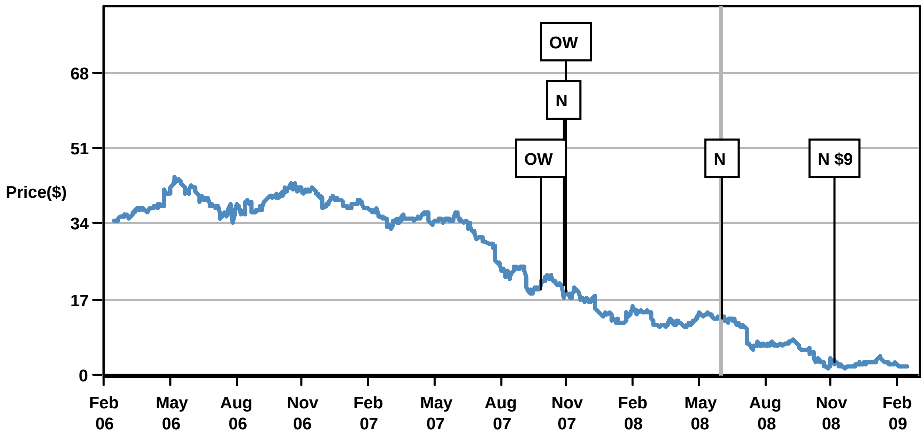
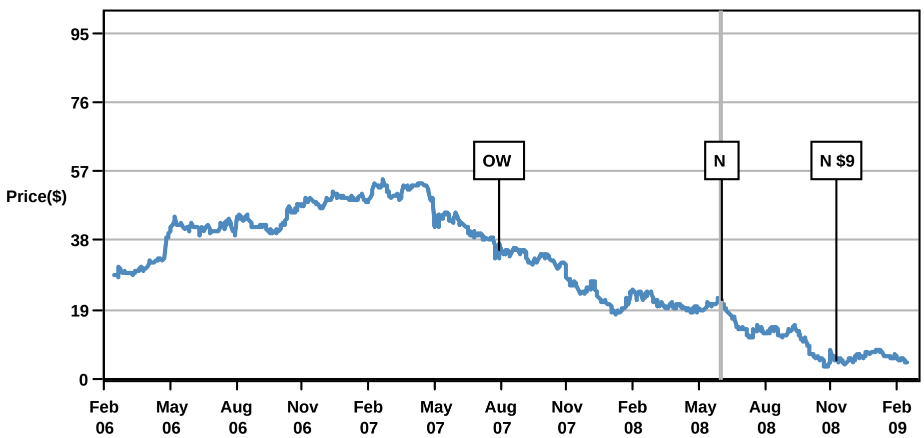
Office Depot (ODP) Price Chart



Date	Rating	Share Price ($)	Price Target ($)
26-Sep-07	OW	19.22	--
29-Oct-07	N	20.29	--
01-Nov-07	OW	18.76	--
02-Jun-08	N	12.71	--
04-Nov-08	N	2.88	9.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.
Break in coverage Mar 16, 2004 - Dec 22, 2005, and May 31, 2008 - Jun 02, 2008. This chart shows J.P. Morgan's continuing coverage of this stock; the current analyst may or may not have covered it over the entire period.
J.P. Morgan ratings: OW = Overweight, N = Neutral, UW = Underweight.

OfficeMax Inc. (OMX) Price Chart



Date	Rating	Share Price ($)	Price Target ($)
02-Aug-07	OW	35.11	--
02-Jun-08	N	21.52	--
07-Nov-08	N	5.17	9.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.
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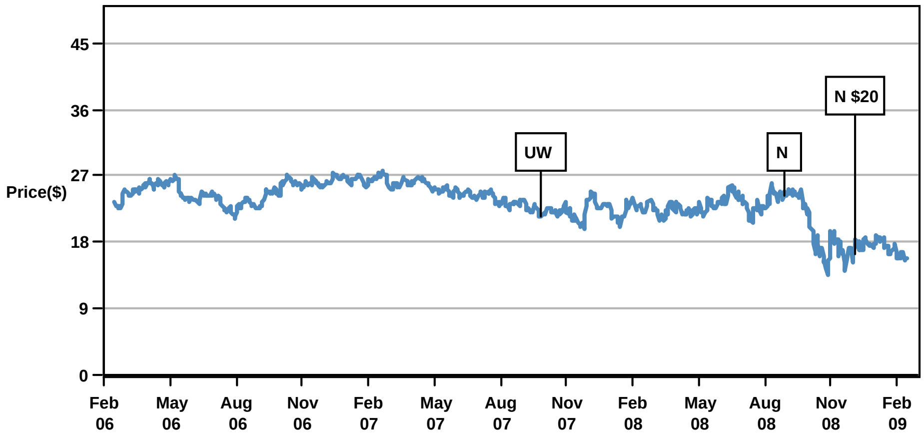
Staples (SPLS) Price Chart



Date	Rating	Share Price ($)	Price Target ($)
26-Sep-07	UW	21.47	--
28-Aug-08	N	24.30	--
03-Dec-08	N	16.32	20.00

Source: Reuters and J.P. Morgan; price data adjusted for stock splits and dividends.
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