



Published: 25 August 2008

Weak Economy Has Lenders Skittish; As many companies find cash hard to secure, inventory levels are squeezed and letters of credit begin to resurface

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NEW YORK— In life, and the financing of apparel companies, timing is just about everything, and men's wear firms picked just the right moment to be on the upswing.

Recent sales strength should to some degree insulate men's wear firms from the credit crunch that's migrated from the worlds of subprime mortgages and banking to retailers and consumers. But those unlucky merchants needing to borrow to keep their business afloat might well find themselves sinking as loans are expensive and harder to come by.

"Well-capitalized, well-run companies in the men's wear marketplace are faring reasonably well," said Stanley Officina, president of factoring firm Ultimate Financial Solutions. "For the moment, we're pretty content with the way things are going."

Much of the recent success of men's wear companies comes down to fashion business basics.

"It seems like there's more fashion out there for men, more choices," said retail analyst Margaret Whitfield of Sterne, Agee & Leach Inc. "Guys are liking to dress up, notably younger guys. It's not just a difficult job market where they're buying suits, but there are just many more interesting brands nowadays for men in their twenties, thirties and younger as well."

Jos. A. Bank Clothiers Inc. is actually gaining market share in this tough environment, she said, while Casual Male Retail Group Inc. is holding its own with flat to negative 2 percent comparable-store sales.

Still, with increased cost pressures on producers, a rash of significant retail bankruptcies and a wary consumer, there's plenty to worry about.

Companies that post decent sales and can fund their operations with their own cash flows are much better positioned than those hoping that fall turnover will be good enough to keep the lights on.

"There's just an overall hesitancy to think that this marketplace is going to get better anytime soon," said Matt Katz, managing director at Alix Partners LLC, a restructuring and advisory firm.

"The cost of capital continues to go up and, while there's money out there to borrow, I think folks are very skittish about wanting to lend money," Katz said. "You need to establish credibility with the bank group first and foremost. That means your third-quarter plan better be right."

That's a delicate balance. Just as stores need to keep their banks happy, or at least satisfied, it's dangerous to burn vendors in order to do so, since they will continue to be vital to retailers through the credit crunch and beyond.

"Canceling orders today so you can maintain liquidity in the fourth quarter is not a great strategy," said Katz.

One solution most stores are employing is to be extremely conservative with the amount of inventory they carry. This reduces working-capital needs and ensures stores aren't caught with goods that need to be marked down and sold at a loss or lower profit.

Keeping up this balancing act, though, can change the way stores operate and how they look to the customer, and sometimes what looks good on the balance sheet in the near term can also look relatively lousy to the shopper.

"I'm sure there are a lot of retailers that are playing it safe in terms of new product or making higher-risk bets on their inventory, but I don't know that it's the right thing to do," said David Cumberland, retail analyst at Robert W. Baird & Co. Inc.

Harris Hester, CEO of The John Forsyth Shirt Co., said smaller vendors wanting to borrow against their inventory might find themselves under more intense scrutiny and pressure.

"If those banks get nervous about the quality of that collateral, then they lower the amount they'll loan the company and the company gets squeezed," said Hester.

Clamping down even more, vendors also have a limited ability to up their prices on goods despite rising transportation and raw material costs.

Stores and vendors in recent seasons have moved to open-account arrangements, where vendors more or less ship goods based on faith and the promise of additional orders, but some are now moving back to letters of credit, where lenders guarantee payment from stores.

"There is definitely a renewed interest [in letters of credit]," said James Hogan, HSBC's head of trade and supply chain for North America, noting that interest might well be temporary.

In addition to making sure they get paid, producers are moving back to letters of credit so they can borrow against the forthcoming payment of their shipment.

"With a letter of credit they can get financing locally; they can go to a bank," said Hogan.

Despite all the concern, the gears in the industry's financial machinery are spinning.

"Even over the last quarter we have been extending new facilities," he said. "We wouldn't do this if we didn't feel confident in the future of the business."

Overall, some degree of confidence is appropriate, since the business of making and selling apparel is not going to go the way dot-com start-ups did at the beginning of the decade.

But for undercapitalized or marginal players the credit crunch is a real concern.

"The pipe is swelling, it has yet to burst," said Jack Hendler, president of Net Worth Solutions Inc. "All the tough stuff is really ahead of us."

Companies that get squeezed might find themselves with a limited number of choices.

"The options are you either sell, find a strategic partner or you bring money from home," Hendler said.

Ultimately, as the weaker companies start closing stores and filing for bankruptcy, stronger companies will begin gobbling up more market share.

The credit crunch has already left some victims in its wake, such as Mervyns, Goody's Family Clothing and Boscov's—all of which recently declared bankruptcy—and the hard-hit specialty lender CIT Group Inc.

CIT stopped approving credit to Mervyns in May for about \$40 million worth of orders. In the same month the lender was also forced to sell assets and borrow \$7.3 billion to repay debt and provide financing. This came after CIT shut its home lending operations last summer.

Even though it's tough to get credit now, it should eventually become easier again, assured Richard Yamarone, chief economist at Argus Research.

“On the whole, I don't really think it's going to be overly caustic to the retail and related industries,” he said. “Banks are going to have to start opening up the lending windows because that's what banks do—banks lend. If you're a bank and you're not lending, then what do you do?”