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WHAT IS GOTTSCHALKS' FUTURE?; Potential buyers run the gamut from Wal-Mart to the United Arab Emirates.

By Bethany Clough

After nearly 103 years in business, Fresno-based Gottschalks is preparing for change.

It could be as drastic as a sale that spells the end of the department store chain or a behind-the-scenes financial shift that few shoppers would notice.

"Anything is possible," said Howard Davidowitz, chairman of Davidowitz & Associates Inc., a national retail consulting and investment banking firm in New York, who advised the company more than a decade ago.

The company has said little following an announcement in November that it would explore "strategic alternatives," including possible sale. But speculation has grown -- and the company's stock price has become more volatile -- in recent weeks.

Potential buyers cited by those who watch the company include Wal-Mart, the oil-rich government of the United Arab Emirates, even Houston-based Peebles and Stage, a fast-growing department store chain.

Gottschalks' locations and popularity among customers make it attractive, Davidowitz said.

"It's a powerhouse in the marketplace," he said.

What happens to the company if it is sold depends upon the buyer. An investment group could make cuts, but continue running Gottschalks as a department store.

A larger retailer, attracted by the locations of Gottschalks 60 stores, could convert the buildings to its own brand, ditch the Gottschalks name and close the Fresno headquarters.

The stock has begun dropping -- down to \$12.53 a share Friday from a high this year of \$14.80 in April -- as investors wait and watch.

Gottschalks officials have declined to discuss the company's plans, but other people in the industry are busy talking about the company's future. The Bee asked several experts their opinions on potential suitors:

Wal-Mart

Trade publication Women's Wear Daily recently reported that Wal-Mart received information Gottschalks is providing potential buyers. Neither company would comment on the report.

Wal-Mart buying Gottschalks would be "a very tough deal" to pull off, said Jack Hendler, president of Net Worth Solutions, a New York-based firm specializing in mergers and acquisitions.

Wal-Mart would be interested in Gottschalks because of its real estate, said Richard West, a commercial real-estate appraiser for Newport Beach-based CB Richard Ellis.

"It's an opportunity for Wal-Mart to get locations that otherwise would be much more expensive to get," he said. Infill locations in small, older malls in low- to middle-income areas would be ideal, he said.

The retail giant has said it hopes to open 40 supercenters in California over the next few years but has run into resistance from communities and other retailers.

Buying Gottschalks and converting its stores would be a way around that opposition because municipalities probably would not be required to give their approval, said Cheryl Carner, a Boston managing director of CapitalSource, a commercial finance firm.

But there are hurdles to such a plan, she said. Leases often contain provisions requiring approval from a landlord or mall owner if the lease changes hands, she said.

Size also would be an issue: The average Wal-Mart store is 200,000 square feet, Hendler said. Gottschalks has just two stores that size or larger, with most between 40,000 and 149,000 square feet. Many Gottschalks locations are also multilevel stores, which Wal-Mart is not set up for, he said.

In any event, such a purchase would be unusual as the company has never bought another retailer before, Hendler said.

It also would be a large purchase for the few locations of interest to Wal-Mart, said Russell Jones, who follows the retailer and is a director at the New York office of retail consulting firm AlixPartners.

"It wouldn't make sense for Wal-Mart to purchase Gottschalks," he said.

Stage Stores Inc.

Stage Stores owns the Stage, Peebles, Bealls and Palais Royal department stores, which operate 660 stores in the East, South and Midwest.

Hendler listed the company as a likely suitor, speculating it would convert Gottschalks locations into Peebles or Stage stores.

"They're formidable merchants, and they probably would be the best group that should be interested and would have interest in the Gottschalks stores," he said.

The company plans to open 70 new stores a year starting in 2008, according to its annual report.

It is also looking for a third distribution center. Gottschalks leases a 420,000-square-foot distribution center in Madera.

Stage is accustomed to running multilevel department stores with escalators, making for a smooth conversion, Hendler said.

And although many Stage stores are smaller -- between 5,100 and 52,000 square feet -- Hendler thinks they could fit.

Stage did not return calls seeking comment.

Dillard's

Dillard's department store has been mentioned as a potential buyer several times in the past few years. The company has 330 stores, mostly in the Eastern and Central regions of the country.

Hendler said the company is struggling with its own difficulties and is an unlikely buyer. Despite record earnings in late 2006, Dillard's is still incorporating other department store chains it bought and needs to focus on increasing sales, he said.

"I don't think that Dillard's is ready to make any kind of a move or an acquisition of that size," he said.

A Dillard's representative did not return calls seeking comment.

J.C. Penney Co.

Gottschalks stock jumped almost 25% in 2005 when a Barron's report mentioned the retailer as a potential buyer.

Although Carner could not comment on the likelihood J.C. Penney would buy Gottschalks, she said it may be more practical than Dillard's because Penney's is already national.

Although J.C. Penney is planning to open 50 stores a year, spokesman Tim Lyons said he could not comment on Gottschalks.

He said Penney's has "plenty to keep us busy" with its existing growth plans.

Hendler said Penney's already has many stores in California and the Northwest.

"They're not going to make an acquisition of this type," he said. "They have no interest in owning Gottschalks."

Private equity

Private equity firms, or investment groups, also are among potential buyers.

"Are they the most likely buyer? I think so," retail consultant Davidowitz said. "They have unlimited money."

Such investors are everywhere lately, snapping up 67% of clothing store Express and all of automaker Chrysler earlier this month.

Typically, the firms buy a company and take it private, often replacing management and cutting costs, Davidowitz said.

Likely, in the case of Gottschalks, investors would continue to operate the company though they might close some stores, he said.

It typically would be sold or taken public again in five to seven years when new management makes the company more profitable, he said.

Hendler said Gottschalks' financial performance makes it a bargain.

"Gottschalks has not been doing all that well," he said. The retailer suffered a \$12 million loss in 2002, and its stock dropped as low as \$1.05 a share in 2003.

After that, the company's performance improved, but financial results recently have disappointed investors.

In 2006, the company's profit was \$2.6 million -- exactly half of 2005 earnings.

Those numbers limit what potential buyers will pay, Davidowitz said. The company also has more than \$100 million in debt.

But the six stores Gottschalks owns -- in Hanford, Palmdale, Eureka, Yuba City, Antioch and San Luis Obispo -- can make up for much of the risk.

A deal could include selling the stores and leasing them back to Gottschalks -- a good way to pay off some of the purchase price, Carner said.

The company's Fresno headquarters is owned by a limited partnership in which Gottschalks has a 36% interest.

One possible private-equity buyer is investment holding company Istithmar, which was mentioned by Women's Wear Daily. The Dubai-based firm is the investment arm of the emirate's government and is on an investment binge, in part fueled by high oil prices.

Istithmar did not return messages seeking comment. The group bought department store Loehmann's, owns several upscale hotels in New York and is part of the same group that tried unsuccessfully to run ports in the United States.

Hendler said Istithmar may not have to borrow money to buy Gottschalks, making it a likely candidate.

The Gottschalks outcome is anybody's guess.

Until a deal is finalized, no one is talking publicly about what is happening behind closed doors. Gottschalks officials are not required to make anything public until the board votes, Davidowitz said.

Davidowitz said the longer investors wait for an announcement, the more they may get antsy and the stock price may drop. That would make shareholders unhappy, distract employees and potentially hurt the company's performance, he said.

"As the clock ticks ... people start to wonder, where is the buyer?" he said. "I think if the deal doesn't happen by August, I think it's a problem for Gottschalks."