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Wholesale Giants Morphing into Retailers

By Whitney Beckett

Forget the distinction between wholesaler and retailer. Today's breed are brand managers.

Once simply manufacturing giants, VF Corp., Liz Claiborne Inc., Jones Apparel Group, and Kellwood Co. are mutating into multiheaded beasts, with their direct-to-consumer sides becoming an increasingly large part of their identities.

As traditional retailers consolidated and upped their own production of private label, retailers' reliance on wholesalers has declined.

"Obviously when you look at how much power department stores carry over them, vendors need to do something to get power back in their own hands, but how they do that is up for debate," said Brad Stephens, an analyst for Morgan Keegan & Co. Inc. "Specialty retail is one of the hardest businesses out there, and you can open yourself up for more - not less - risk."

Jones Apparel Group's 1,000-plus retail stores made up about 31 percent of the \$4.74 billion firm's sales last year, up from 21 percent in 2005 and 17 percent in 2004, the year Jones acquired Barneys New York. In five years, Jones president and chief executive officer Peter Boneparth would like to see retail contributing between 35 and 40 percent of group revenues - but that doesn't mean the company is walking away from wholesale.

"Everything we do is about balance," Boneparth said. "Our roots are in wholesale. We're a wholesale business, and we aren't abandoning that."

Most of Jones' stores are outlets, but the company is expanding its full-priced segments. Boneparth thinks Bandolino can grow from the 30 stores it has today to 100 within a few years. Still in the beginning retail stages, Anne Klein will get half a dozen new specialty stores this year.

"Our focus is going to be maximizing our productivity in the things we've got," Boneparth said. "The new concept is Anne Klein, but the existing concepts are where we are going to spend a lot of time and energy. The idea is not to open a bunch of doors, but rather to do them profitably. While store numbers are increasing, our goal is to make sure the retail represents the brand properly, because it's the face of the brand on a day-to-day basis."

For Nine West, Boneparth wants to return the retail stores to a double-digit operating margins business - which it has not had of late due to rent increases and "under-investing in the store experience," according to Boneparth. He points to the Nine West store on Madison Avenue in New York that opened in February as the new "cleaner, less cluttered and consumer-centric" model.

The feather in Jones' cap has been Barneys New York, which the firm acquired at the end of 2004 to mixed reviews, but which now seems to have paid off. Opening two flagship stores last year, plus Co-op off-shoots, Boneparth projects Barneys will be a "billion dollar business" in the next three years.

Jones has Barneys, and Claiborne has Mexx, a less-pricey retailer with roots abroad. While about 27 percent of Claiborne's current \$4.99 billion business is direct-to-consumer, up from 25 percent in 2005 and 18 percent in 2001, the company projects retail will climb to upwards of 40 percent in the next few years. Claiborne's store numbers today are almost evenly distributed between outlet

and specialty stores with about 250 full price and about 200 outlet stores. Going forward, the company speculates growth in the specialty retail sector will outpace outlet growth, so the ratio will be more like 70-30.

Most of that will come from Claiborne "power brands." In the next few years, the group plans to roll out about 100 stores each for Juicy Couture, Lucky Brand and Kate Spade. Under new ceo William L. McComb, Claiborne is closing retail divisions for brands that won't reach that level. Earlier this year, Claiborne said it would shutter the four Mexx stores in the U.S. and the three Laundry stores. The plan is to focus marketing and capital resources - plus attention and man hours - to the brands that have the greatest growth potential.

"It's important to reach 100 stores to have scale and critical mass," said Jill Granoff, group president for direct-to-consumer at Claiborne. "We certainly view retail as a key growth engine."

Granoff, former president and chief operating officer of Victoria's Secret Beauty, joined Claiborne in September in the newly created post, which made her responsible for the company's specialty retail and outlet stores, plus e-commerce Web sites, in the U.S. In McComb's recent shakeup of group presidents' responsibilities, Granoff gained oversight of Lucky Brand and Sigrid Olsen, two of Claiborne's retail power brands. "One of the reasons we brought Jill in was to ensure we aren't wholesalers doing retail," said a spokeswoman for the company.

Granoff is also focusing on how to increase comparable store growth. "The best retailers are the ones with a really compelling shopping experience," she said. "You really have to focus on the retail experience, which is a combination of the product and the shopping environment. You need to scintillate all of the senses - not only what you are seeing, but also what you are hearing, smelling and even tasting. When you are a wholesaler, you focus on the product and not as much on the selling environment."

Analysts agree that other wholesalers could take a page from VF's retail business, with its largely successful North Face and Vans lifestyle stores. VF added company-owned retail operations as a new plank in its growth strategy at the end of 2005, announcing it would grow its stores from about 500 back then, or 12 percent of its business, to about 800 stores, or 18 percent, over about four years. Retail contributed about 14 percent of revenues in 2006. After opening 62 stores last year, the company plans to invest about \$45 million in its retail locations this year and open 75 to 100 stores.

A lot changed leading up to 2005 to prompt the manufacturing giant to change its retail strategy. Since 2000, VF has acquired lifestyle brands including North Face, Nautica and Vans - "a lot of brands that have owned monobrand retail potential," noted Eric Wiseman, VF's president and chief operating officer. Its experience with North Face, whose stores have consistently delivered double-digit comparable-store sales growth over the last few years, taught VF the benefits of controlling its distribution channel.

"The brands that we want to acquire should be strong global lifestyle brands," Wiseman said. "Those brands have an owned retail component or at least an opportunity."

Although VF may be "late to the game," as one analyst put it, and garnering a smaller percentage of sales from retail than Claiborne and Jones, which have Mexx and Barneys, the \$6.14 billion VF is still doing almost \$1 billion a year in direct-to-consumer sales. Wiseman said VF opens stores for three reasons, which the other companies echo:

First, to strengthen brands. "If you look at how any one of our brands is presented by our retail customers, they tend to not bring the whole brand to life in one place," Wiseman said. "We think we can help bring brand strength by putting it all together in an environment like we would like it to be. Because our brands are lifestyle brands, you get to see the lifestyle in our own stores, and consumers respond in those environments."

Second, to improve wholesale business in a geographic market. "Opening the North Face store in New York made our business in New York stronger, so much so we opened a second in New York in the fall," Wiseman said. "When we invest in our retail in the right way, our wholesale business gets better."

Third, to open a brand to new consumers. For VF, retail strategy plays into global strategy. Five years ago, global sales made up about 19 percent of business, compared with about 27 percent this year, and the new target is 30 percent. A lot of VF's store openings are outside the U.S., including India, where Nautica, Lee and Wrangler stores are popping up. "Our own retail stores allow us to introduce the brand to a geographically new market in exactly the way we want to present it," Wiseman said.

For Kellwood, its 2004 Phat Fashions acquisition is helping the group travel globally. Only one of the 10 Phat Fashion doors today is in the U.S., and in the next three years, there may be as many as 50 Phat Fashions stores, which house Phat Farm and Baby Phat, most of which will be international.

Kellwood is actively acquiring more brands that could have retail legs. Both fall 2006 acquisitions, Hollywould will get about 10 new stores in the next few years, and Vince, which currently does not have its own doors, will open a few test stores - though those stores will be domestic.

"Our strategy is to be a brand-focused marketing enterprise," said Robert C. Skinner Jr., Kellwood president, chairman and ceo. "The distinction between wholesalers and retailers is blurring or even disappearing as we all find the best ways to connect with our consumers as we integrate our brands. The Internet, retail consolidation and private label all have changed the landscape to make it advantageous to be a retailer too."

With about 100 stores, Kellwood has been "experimenting" with retail for about two years and will still be in that "embryonic stage of retail" for another year, according to Skinner. Currently Kellwood has outlet and full-price stores for both its Sag Harbor and Koret brands, plus 10 specialty Phat Fashions and two Hollywould stores. Although the majority of Kellwood's stores today are outlet, future openings of specialty stores will outnumber outlet openings. Kellwood does not break out the percentage of its business that comes from direct-to-consumer sales, because "it's not significant," Skinner said. "When it is significant, we'll break it out. I can see it becoming significant." But he added, "We don't consider it to be a race with other wholesalers."

"Wholesalers becoming retailers is just going to accelerate," said consultant Robin Lewis. "The supply chain is going to be absolutely flat. Direct to consumer is the future. There will be no wholesalers or retailers. They will all be brand managers. The words retail and wholesale will be thrown out of the dictionary at least within 10 years, maybe sooner."

John Henderson, a director at Net Worth Solutions Inc. and a former president of Kellwood's Sag Harbor division, cautioned that retail is a competitive, high-risk, capital-intensive business, which requires companies to own the inventory and make long-term commitments on space.

"There's a trend for wholesalers to think retail is more exciting than what they are doing," Henderson said. "Instead of being an opportunity, it can be a distraction. If your business isn't good at wholesale, it most likely won't be good at retail."

Injecting retail into a wholesale business model skews earnings and sales.

"They are in two different worlds in two different cycles but with one reporting period," said consultant Emanuel Weintraub. "The vendor is preceding the retailer by a certain number of

months, when you put those together you will have two different sets of numbers, and as vendors' retail businesses grow, the retail numbers are going to be increasingly important. Now the analysts are going to have to dig into those two different sets of numbers and make sense of it. You need a crisp breakout of retail and a crisp breakout of wholesale from firms that have both."

While retailers typically end their fiscal years in January to smooth seasonal disparities, adding January's clearance sales to the robust holiday sales instead of to sleepy February, most traditional wholesalers follow a traditional calendar year, pointed out Margaret Mager, retail analyst and managing director for Goldman Sachs & Co. "Wholesalers need to become even better retailers if they continue to pursue that strategy as specialty retail as a key strategy for growth," Mager said.

VF, which analysts applaud for its appropriately-paced retail growth, was the only company of the four not to take a hit in the first quarter of 2006, while each company grew its retail sector. VF reported a 24.6 percent rise in earnings, while sales rose 5.3 percent in that quarter.

At Jones, first quarter earnings last year dropped 7.8 percent on a 10.8 percent sales gain. Part of the hit came from a 3.7 percent same-store sales drop in its footwear and ready-to-wear stores, excluding Barneys New York.

Claiborne's first quarter of 2006 saw profits fall 34.3 percent on a 3.4 percent drop in sales. The company attributed much of the decline to retail consolidation, but also to its own retail changes.

McComb labeled this not as a problem but rather a reality to be accepted. But planning, particularly when Claiborne returns to giving guidance, is a mutable factor, said Granoff.

"There certainly is a shift in financial planning," she said. "In a wholesaler model, the Christmas revenues are recognized in Q3. There is a shift in timing of when we recognize revenue."

As Claiborne continues to expand its retail segment to its projected 40 percent, this will only become a larger issue, according to analysts.

"The retail business is a black box for Liz," said Elizabeth Montgomery, analyst for Cowen & Co. "This year, they need to anticipate the change in seasonality for the first quarter, especially because they have been adding a lot of stores in the back half of 2006."

As Kellwood inches into the retail game, it too will need to anticipate potential hits in its first quarter, analysts caution. It took a 22 percent hit in its first quarter last year, largely due to restructuring costs.

"Now Kellwood has been testing these retail stores, what is going to happen for Q1?" asked Montgomery. "Q1 is a tough quarter for the retail business, and that's what these companies are finding as they go into retail."

Skinner dismissed the concern. "It's just a reality in retail," he said. "Until we can find a way to make Valentine's Day as big as Christmas, that is."