

Industry Report: Department Stores

Introduction

The downturn in discretionary consumer spending in 2008 affected virtually all department stores—from higher end retailers such as Nordstrom to value-priced companies such as Target and Kohl's. Stores offering lines of dry goods, apparel, accessories, furniture and hardware under one roof struggled to maintain normal levels of foot traffic amidst the national economic recession. Comp. sales for the month of December 2008 declined at several large national chains, including Nordstrom (-10.6%), Macy's (-4.0%) and Target (-4.1%). Meanwhile, Wal-Mart reported same store sales for December rose 1.7% (excluding gasoline) while BJ's Wholesale Club's comp. sales increased 5.9%. Bankruptcy filings at regional department stores increased as companies such as Goody's, Boscov's and Mervyn's shuttered locations in 2008.

Appraisal Factors

Tiger Valuation offers the following factors for consideration when analyzing department stores:

- ❖ **End-of-season markdowns** – Department stores typically increase markdown activity at the end of each season. For example, end-of-season spring merchandise is put on deep discounts during April and May as summer goods arrive on sales floors. A GOB commencing during the transition between seasons may return lower NOLVs as liquidators' discounts would have to exceed promotions already in place.
- ❖ **Discounting activity** – The increased number of liquidating stores over the past year may lead to an overall shift in consumers' attitudes toward price points. During the 2008 holiday sales season, many stores increased promotional signage and discounting to generate store traffic. As the U.S. recovers from the economic recession, customers may be more reluctant to purchase goods that are not discounted or part of a sale promotion. Significant increases in average discounts can affect gross margins and, consequently, the gross and net recovery value of merchandise.
- ❖ **Multi-level pricing** – Department stores occasionally include a MSRP or "list" price on merchandise tags in addition to the company's day-to-day price (e.g. "our price"). The MSRP/list price is typically higher than the company prices and included on item tickets to relay the everyday value of goods. When evaluating stock ledgers and determining discounting structure, appraisers must identify the definition of "retail value" and whether it reflects original price or the day-to-day (after POS) price.
- ❖ **Inventory mix** – Lending activity has tightened throughout the retail sector in recent months as sales projections in 2009 become increasingly conservative. Consequently, some department stores plan to narrow the range of products that will be offered on shelves while also limiting the number of vendors supplying goods to stores. Lenders should take note of changes or interruptions in shipment activity from merchandise suppliers. Changes to a particular company's product mix may have adverse affects on inventory valuations if the amount of goods with higher recovery values decreases.
- ❖ **Augmentation** – Liquidators often augment original inventory with fresh goods during a GOB event in order to optimize discounting activity as complementary merchandise arrives at stores. In an augment scenario, the estate receives a negotiated percentage of net sales in exchange for its support of the inclusion of additional goods in a GOB sale. The ability to round out the product mix through augmentation generally has a positive affect on recovery values and may ultimately lead to more aggressive bidding activity on original inventory.
- ❖ **Brand names** – Private label goods and in-house brands typically do not recover as well as brand names during GOB events. Retailers that carry a significant amount of name brand goods are likely to generate higher recovery values in a liquidation sale than stores stocking lesser-known private labels.
- ❖ **Projected inventory levels** – Significant discrepancies between previously projected inventory levels and actual merchandise in stock can often signal diminished sales capacity in a GOB event. Lenders should take note of the accuracy of company forecasts for the amount of merchandise on hand over a 12-month period. Merchandise levels exceeding projected amounts may lead to longer sale terms and higher operating expenses while lower-than-expected inventories could undercut achievable recovery values.

Conclusion

According to MasterCard's SpendingPulse, 2008 holiday season sales declines as compared to 2007 were highest in categories such as luxury goods (-35%), electronics (-27%) and women's apparel (-23%). Industry analysts expect consumer spending will remain conservative in 2009. In the wake of these projections, executives at department stores such as JC Penney Co. and Saks Inc. recently joined the National Retail Federation in asking Congress to pass a measure that would establish three separate 10-day tax-free shopping periods in 2009 to help stimulate spending. As the retail industry attempts to rebound from sales decreases, the level of discounting and the product mix available are likely to play a key role in measuring the health of department stores. Tiger Valuation recommends that lenders remain diligent in tracking the aforementioned appraisal factors as retailers respond to the macroeconomic challenges that swept through the industry in 2008.