

Industry Report: Retail Jewelry

Introduction

The recent slowdown in consumer spending has had a profound effect on jewelry retailers in 2008. Store closings, consolidations and downward sales trends mark the struggles of a jewelry industry operating in a weakened economic environment. After a disappointing 2007 holiday season and poor sales performances at the beginning of the year, national mall-based chains such as Friedman's, Crescent and Whitehall Jewelers were forced into bankruptcy and have begun liquidating inventory totaling well over \$1 billion at retail. Meanwhile, same store sales at other industry leaders have decreased over the past 12 months. Signet Group, the parent company of Kay and Jared Jewelers, reported first half "like for like" sales decreased 3.4%. Finlay Enterprises reported first half 2008 same store sales decreases of 4.6% at its locations, many of which are found in large department stores such as Macy's and Bloomingdale's. High-end jeweler Tiffany's reported comparable store sales declined 2% over the first half of 2008, punctuated by a 4% second-quarter decrease.

Industry Outlook

Experts predict that middle-market jewelers will continue to be challenged by pricing extremes created by value-based jewelry products within big box chains such as Wal-Mart, Target and Costco and luxury offerings at stores such as Tiffany's. While store counts will continue to decrease due to GOB events at chains such as Whitehall and Friedman's, competing jewelers will be forced to ramp up promotional activity and discounting. As the key holiday selling season approaches, both mega-chains and smaller companies will likely alter merchandise mixes in order to attract increasingly price-conscious consumers. Online jewelry retailers such as Blue Nile, which grew 27% in 2007, and auction site Bidz.com provide additional pressure industry-wide. Although less than 5% of fine jewelry sales in the U.S. are completed online, retailers with well-established Web sites hold a key advantage as store locations are shuttered and consumers increasingly utilize the Internet to research products and/or make purchases.

Appraisal Factors

Based on recent liquidations and appraisal experience, Tiger Valuation offers the following factors for consideration when evaluating a retail jewelry business.

- **Increasing discounts** – Store closing events at jewelry chains such as Whitehall, Friedman's and Crescent have saturated the marketplace with discounted product over the past year. Similar middle-market retailers will likely be forced to increase discounting to keep pace with the spike in promotional activity. As customers become more and more accustomed to lower prices and sales events, average discounts are likely to increase, resulting in lower recovery values.
- **Inventory augmentation** – Where allowed by law, jewelry liquidators often augment GOB events by bringing in additional goods for sale with existing store inventory. Augmentation allows the risk premium associated with the original inventory (O.I.) guarantee to be allocated to the profit and loss of augment goods, ultimately raising net recovery values on the O.I. In this scenario, the estate typically receives a negotiated percentage of augment merchandise net sales in exchange for its support of the augment program.
- **Wholesale inventory** – Many jewelry retailers stock wholesale pieces within warehouses and distribution centers that are either sold in bulk to opportunistic buyers or used to create special orders for customers. Appraisers must account for labor and manufacturing costs associated with converting loose pieces into finished goods that could be sold in stores during a GOB event.
- **Buyback provisions** – Many companies, such as Rolex and David Yurman, utilize buyback provisions that disallow jewelers from selling their brand names during a liquidation sale. The removal of popular brands from a store's inventory mix can negatively affect net recoveries due to the unlikelihood that customers would substitute a sale with a different brand if particular name brand goods were made unavailable.
- **Store services** – During a GOB event, it is advantageous to continue in-store services that are critical to finalizing a sale, including cleaning, repairs and ring-fitting. However, custom design offerings would likely be discontinued during a liquidation sale. Consequently, historical sales of custom-made goods are often excluded when projecting recovery values.

Conclusion

National Jeweler reported that the total store count among the jewelry industry's top 50 retailers has dropped 3% since 2007. Bankruptcy filings and store closings have created a market that has become increasingly dependent on promotional activity and mark-downs. Lenders should closely monitor discounting levels as store closing sales may have a considerable impact on price points and gross margins.