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JBT News



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August Industry Overview

Retail Overview:

August comp sales fell just under 3%; not as poor as July's 5% drop. There was pretty much no merchandise category left unscathed, but results continued to vary by retailer segment.

The New York Times (9-2-09) carried a quote from analyst **John D. Morris** of BMO Capital Markets who said **retailers** are... "learning the native tongue of the new consumer...It's not only that you need to dangle value in the face of the consumer...(he is) bored with the same old promotions. The smarter companies are...changing the marketing message."

Discounters continued to do relatively well with **TJ Maxx** leading the pack, **up 5%**. Both **Target (-3%)** and **Kohl's (flat)** were reported to have increases in traffic that haven't yet moved their comps into positive territory, but are expected to drive better results this Fall.

Wal-Mart reports only quarterly

now; but Costco saw a 2% decline and BJ's Wholesale Club fell 6%.

The department store segment saw continued weakness with declines of about 20% at Neiman and Saks, 8% at Nordstrom; 12% at Dillard's, 8% for Penney and Macy's and 5% for Bon Ton.

One bright spot – the drugstore segment, where traffic is pretty much guaranteed and innovative operators like CVS who has increased its focus on beauty products **have seen good results**. As a segment **this group saw a 4%+ increase** in comps for August.

STORES Magazine (September 2009) reported on research from **Shop.org** and **Forrester's Online Q2 survey** and "**State of Retailing On-line**" including the following:

Average quarterly sales growth for retailers surveyed was **just under 12%**, suggesting increasing market share for this sales channel.

- **Free shipping is an important competitive advantage.**
- **Top five areas of focus** for on-line retailers are **checkout process redesign; richer product content pages; enhanced search; home page design and help functions.**
- **Forecast U.S. online retail sales are \$229 billion in 2013** based on a 10% compound annual growth rate of 10% each year beginning in 2008.

As if **retailers** didn't have enough problems, they **are confronting a**

sharp increase in shoplifting and employee theft, up about 7% in '08 according to Jack L. Hayes International's annual Retail Theft Survey (www.com 9/2/09). **The value of goods shoplifted increased about 30% and employee theft rose 3%.** An NRF/U. Florida study put the total losses just under \$37 billion for the companies it surveyed. Electronics and luxury goods are the most popular categories: J.C. Penney recently reported the loss of significant amounts of jewelry from Texas and Louisiana stores from what appeared to be a well-organized string of robberies.

CIT Group Inc., an important lender/factor to the apparel industry and many small businesses **continues to struggle**, announcing on 9/2/09 it would defer a \$23 million interest payment due 9/15/09 to preserve liquidity; the deferral is permitted under the terms of the notes.

WWD.com (8/27/09) reported on a recent study on retail published by Granton Thornton LLP, as follows:

- **Continued consumer migration from bricks and mortar to on-line.**
- **Online jewelry/watch sales decline in '08 of 34%** overall, yet only 24% for the online sales segment.
- **Sustainability, customer service and online marketing are key retailer success factors.**

On the economic front, despite consumers' increased urge to roam the retail space, **there remain formidable obstacles to a resumption of**

spending. Unemployment rose to 9.7%; prime borrowers are now defaulting on their mortgage debt at a greater rate than sub prime ones; gold reached the \$1,000 mark as overseas investors shifted their sights away from the U.S. dollar on concerns about the alarming rate of increase in America's debt. A 10% annualized decline in consumer spending for July exceeded forecasts and dampened expectations for a consumer led recovery. **Credit conditions** (Banks' decreased willingness to lend and tighter credit terms) **are a continued damper on growth.** And the Conference Board, reporting on August trends forecast a flat jobs picture through year end.

Globally, manufacturing output seems to be picking up steam even in the **U.S.** which **recorded a 4 point increase** to an index of 52.9; **China saw a .7 point increase** to 54.0; and the **Euro zone rose 1.9 points** to 48.2. The U.S. increase passed the all important 50 point threshold for the first time since January '08, paper and printing products; apparel and textiles were categories of strength. Inventory re-stocking and government stimulus programs account for some of these upticks. The IMF recently revised its forecast for global economic growth in 2010 to about 3%, up from 2.5% previously.

Major Retailers:

Neiman Marcus Group Inc. reported on its fiscal Q4 (8/1/09) as follows:

- **\$168.5 million loss** vs. \$35.6 million in '08.
- **\$143.1 million vs. \$31 million in "impairment" charges.**
- **25% decline in sales to \$768 million; comps down 23%.**
- **23% reduction in inventories.**
- **24.1% gross margin;** down from 30.5% Q4'08 and 40% in Spring '08 as markdowns took their toll.

- **The online/catalog segment saw a lesser revenue decline at 18%.**
- For the '09 fiscal year **Neiman generated a \$668 million loss** vs. \$143 million of income in '08.
- **Private equity funds Warburg Pincus LLC and TPG Capital own Neiman.**
- Recall that **Moody's rated Neiman "Caa1"** or "subject to very high credit risk" **before these results were released.**

Belk Inc. reported a 15% increase in net income to \$9.4 million for the quarter ended 8/1/09 on an 8.3% decline in net sales to \$760 million and a 9.4% decrease in comps. Tighter management of inventories and expenses helped to put the Company in the black.

Valuevision Media, Inc. (Shop NBC), which released its 8/1/09 results (6 mos) in August, **supplied additional disclosures in its 10Q:**

Jewelry sales dropped from \$118 million to \$58 million; this category fell to 24% of total sales vs. 41% a year prior as the Company sought to increase the diversification of its product mix.

- **Overall sales declined 15% to \$253 million.**
- **Watches, coins and collectibles, and consumer electronics were growth categories** and represented 33% and 23% of total sales.
- **The Company's principal source of liquidity is its cash, totaling \$36 million** at 8/31/09; with \$8.5 million restricted; "As a **result of our recent and continuing operating losses,** it is possible that our **existing cash...may not be sufficient to fund obligations and commitments** as they come due beyond fiscal 2009 and we may need to raise additional financing..."
- **The Company used about \$29 million** (or the equivalent

of its unrestricted cash) to fund its operations for the six months ended 8/1/09.

- **To address its liquidity needs the Company continues to work on initiatives to increase profitability,** is considering potential sale of its Boston TV station and other real estate assets, and is in the process of negotiation for an asset-backed line of credit.
- **Extended payment terms from Vendors are being used to fund the asset conversion cycle** (inventory – receivables – cash). As a result, payable days have increased by 20% year-over-year.
- Shop NBC has average annual required cash payments of approximately \$50 million from 2009-2012 for cable/satellite agreements and operating leases.
- **The Company's accounts receivable have grown** as a result of "increased use of our ValuePay extended credit as a promotional tool to stimulate sales"; this comes with potential risk should customer payment delinquencies increase.
- And from the Company's discussion of **"RISK FACTORS"**, "If we are not able to attain profitability and generate positive cash flows from operations or obtain cash from other sources, we may not have sufficient liquidity to keep operating."

Jewelry Industry:

Diamond industry analysts are commenting increasingly on the disconnect between activity in rough (fueled by suppliers pushing goods into the market) and "pull" for polished goods on the consumer side, especially in the U.S. One analyst suggested there is about \$700 million of excess (not sold) in recently polished goods awaiting sale as we embark on the Fall selling season. Seems like an imbalance in supply and demand....

Members are telling us they **saw a modest uptick of business in the summer months;** but August was somewhat soft.

The industry banking situation is still very difficult, even companies with strong balance sheets and low reliance on debt are finding their bank deals (if they can keep them) priced upward with tightened covenants and a "take it or leave it" As often happens in financing cycles, things got way too loose and liberal; now **lenders have moved to the opposite extreme**; those who will fare best are those who can self-finance as much as possible, tough for an industry with high investment in inventories.

One member said that being forced "to become lean" over the past two years is serving the Company well now – it takes less sales to drive profitability, and the better independents are starting to "turn up" their business.

Companies that can combine a high level of creativity with low price points seem to be getting a good share of the business to be had right now.

DeBeers has a new diamond jewelry design concept called the "Everlon Diamond Knot", ready for Fall promotion. Retailers and sightholders who want access to this product campaign will need to "participate" financially in the cost of the promotion, reported to roll out to consumers in mid-November. Everlon is a follow-up to previous campaigns such as Journey, right-hand rings and three-stone jewelry.

WWD.com (8/31/09) reported on a **new Star of Africa ring collection** rolled out by Royal Asscher with stones "floating" in a snow globe configuration. The line's proceeds are reportedly earmarked for the benefit of children in Sierra Leone, Africa.

Jewelry Retailers:

Zale Corporation has twice postponed its quarterly (Q4 and full year ended 7/31/09) earnings call and results announcement

pending resolution of accounting issues around prepaid advertising costs/prior period expenses.

Signet Jewelers Ltd. announced results for the half-year ended 8/1/09 as follows:

Same store sales down 7%.

Pre-tax income of \$80 million – down 1.6% (before one-time charges).

Total sales decline of 7.4% or \$1,473 million, adjusted to a decline of 2.2% at constant exchange rates.

UK and US comp declines were roughly even, down 4%.

While **operating income increased about 19% to \$99 million**, Signet offset \$10.5 million in non-recurring relisting costs with a \$10 million benefit from U.S. vacation policy changes.

The Company improved its cash/leverage position taking net debt down by \$270 million vs. a seasonal increase of \$60 million a year prior, reflecting tight working capital (inventory) management; no shareholder distributions and earnings from operations.

- **Average sale price declined 7.3% in mall brands and 9.2% in Jared.**
- **U.S. net store space is expected to decrease 2% in 2010**, including closing 75 mall stores as leases expire.
- Because over 50% of Signet stores are held by U.S. residents, as of 1/31/10 Signet will file its SEC reports as 10K and 10Q.
- **Signet's Board assessed no material change** in the Company's expected principal risk factors for the balance of its fiscal year (to 1/31/10).
- **Leverage has declined from .77x to .62x on reductions in debt**, \$100 million of which was

associated with renegotiation of its credit agreements in March of '09. Signet experienced increased pricing and covenant amendments as well as \$6 million in fees and costs associated with this renegotiation.

- **Walker Boyd**, longtime Finance Director, **will retire in June 2010**; a search for his successor is underway.

Tiffany & Co. announced its Q2 and 6 mos. results through 7/31/09, including lower sales and earnings but "exceeded expectations" of management":

- **Net sales for the six months fell 19% to \$1,130 million.** Comps, adjusted for exchange rates fell 18%.
- **Net earnings from continuing operations of \$84 million fell 44%.**
- **U.S. comp store sales dropped 30%** with branches down 29%, NY flagship down 36% and Internet/catalog down 12%.
- **Asia-Pacific (ex-Japan) was strong with a 5% decline.**
- **Europe saw overall sales growth** due to new store openings; on a comp. basis sales grew 4%.
- **Wholesale diamond sales fell 72% to \$9 million.**
- **Gross margins declined to 55.5%**, down 200 basis points on higher product costs.
- **Interest expense increased** due to increases in rates and amount of debt.
- **Net inventories**, although down 4% since the start of the fiscal year, **increased 2% year-over-year.**
- **Cash more than doubled to \$334 million**; about 60% of this increase came from increased debt to \$752 million.
- **Leverage** (debt: tangible net worth) **has increased** from .90x at 1/31/08 to 1.10x.

Blue Nile is revamping its website for the first time in 10 years with the **goal of attracting**

more female buyers; recall that the Company's initial target market was the male engagement ring customer. Other changes include improved imaging to more realistically represent the product and an easier to navigate one-page engagement ring building page with adjustable size scales. **The Wall Street Journal (9-1-09)** reported that

Blue Nile estimates it has added 1% market share (U.S.) for engagement rings in the past six months to get to a cumulative 5.5%.

Jewelry Manufacturers:

On 9/1/09 **Lazare Kaplan International Inc. filed a Notification of Late Filing** form 12b-25 with the SEC **stating it was unable to file its Annual Report** on Form 10-K for Fiscal 2009 without unreasonable effort and expenses, primarily **due to its inability, at this time, to resolve a material uncertainty concerning the collectability and recovery of certain assets** and the Company's potential obligations under certain lines of credit and a guaranty, and the Company is unable to assess the potential effect the ultimate resolution of these matters will have on the financial position and results of operation of the Company. The independent auditors have advised the Company they will not be able to deliver an unqualified opinion with respect to the Company's Fiscal 2009 financial statements as a result. Lazare further reported "In light of current adverse market conditions impacting the Company and the global diamond and jewelry industry...the Company anticipates that its reported results of operations for Fiscal 2009 will reflect significant changes from the fiscal year ended May 31, 2008..." The company anticipates net sales of approximately \$192 million for Fiscal 2009 vs. \$370 million for Fiscal 2008.

Bulgari closed three U.S. stores

(Palm Beach, NY-Madison, Aspen) and will open new doors in Dallas, Las Vegas, and San Francisco. Veronica McMahon Trenk was named managing director of Bulgari U.S.

Richemont reports a 16% (21% at constant exchange rates) **decline in sales for the five months ended August 31.**

Expectation for the six months thru 9/30/09 are for lower profitability as well. The Asia market (ex-Japan) is holding its own, up 5%. According to a **Wall Street Journal (9/10/09)** report, Richemont management is not certain "the worst is over for its markets". The article commented that the Company is rich in cash (\$1.19 billion) and expected, longer-term "to play a role in any industry consolidation...(but) so far...is struggling to find any interesting targets."

Movado Group, Inc. announced six-month ended 7/31/09 results including

- **Net sales decline of 32% to \$157 million**
- **Gross margin decline from 64% to 57%**
- **28% decrease in operating expenses.**
- **Operating loss of \$8 million** vs. income of about \$13 million in '08.
- **Cash decreased from \$84.5 million at 7/31/08 to \$47 million** after approximately \$40 million in debt reductions and a \$10 million increase in inventories to \$248 million.
- The balance sheet remains at **low leverage** at .30x tangible equity, down from about .40x a year prior.
- On a segment basis **the U.S. market generated \$15.3 million in operating losses**, offset by \$7.4 million in income from International.
- **Movado recently renegotiated its credit agreement with Bank of America and Bank Leumi;**
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these are secured by all assets and cross-guaranteed by Movado's affiliates. At 7/31/09 the Company had \$8.5 million of unused availability under this \$55 million facility which is subject to a number of covenants.

Bankruptcies/Failures:

The next **milestone in the Finlay bankruptcy** remains the **auction of its assets later in September.**

Whitehall Jeweler's intellectual property was auctioned to **Bidz.com, Inc.**, Culver City, CA on September 16, 2009. **Bidz** now owns the trademark registrations and domain names for Whitehall Jewelers, Lundstrom Jewelers, Marks Brothers and White Star Private Label, as well as customer mailing lists with more than 800,000 names, addresses and transaction numbers.

JBT Statistics/Updates:

After two months of modest year-over-year increases, **credit inquiries tanked in August**, down about 11%. **Year-to-date reports ordered are off 9%** vs. '08.

Listed accounts of 29,960 declined 2.3% year-over-year and broke through the 30,000 mark. Year-to-date business failures of 80 are just about double the level of '08. **Total discontinuances of 1417 are up 56%** (vs. 906) year-over-year.

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