Assessing Turnaround Opportunities

Two years of deep same-store sales declines can easily feel like a death sentence for most retailers. However, the data suggests it is indeed far from that.

We analyzed all specialty retailers with sufficient public data over the last 20 years—nearly 70 retailers—and found that the majority of retailers who substantially underperformed the market ended up turning their comps positive in relatively short order.

First, sustained poor performance is more common than many would think. Eighty-eight percent of the retailers we studied had at least one year of double-digit negative comps. And 47% of our set followed that bad year with another negative one.

But all hope is not lost for this set. In fact, we found that 51% of those poor performers averaged positive comps in the two years after their slump. And 60% of the set had turned positive within five years.

This analysis has been adjusted for changes in personal consumption expenditures by category, so we were able to distinguish between retailers struggling from individual decisions and those struggling as a result of macroeconomic factors.

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EXHIBIT 1: Percentage of Companies by Worst Year of Adjusted Comps

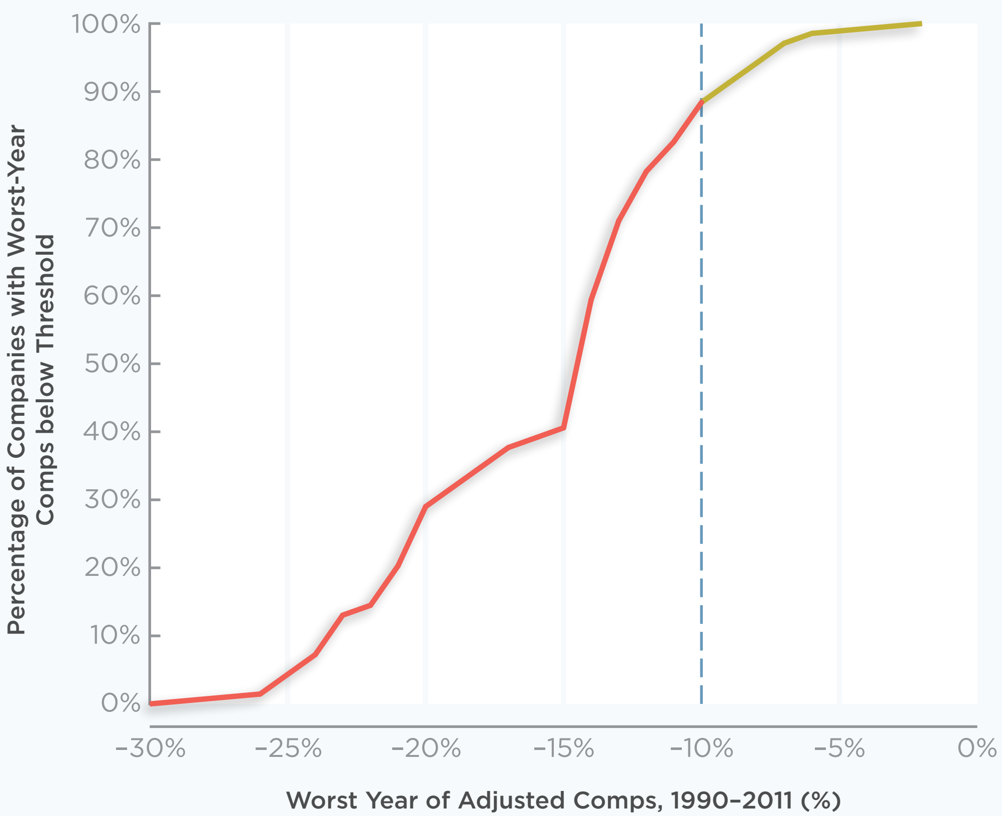
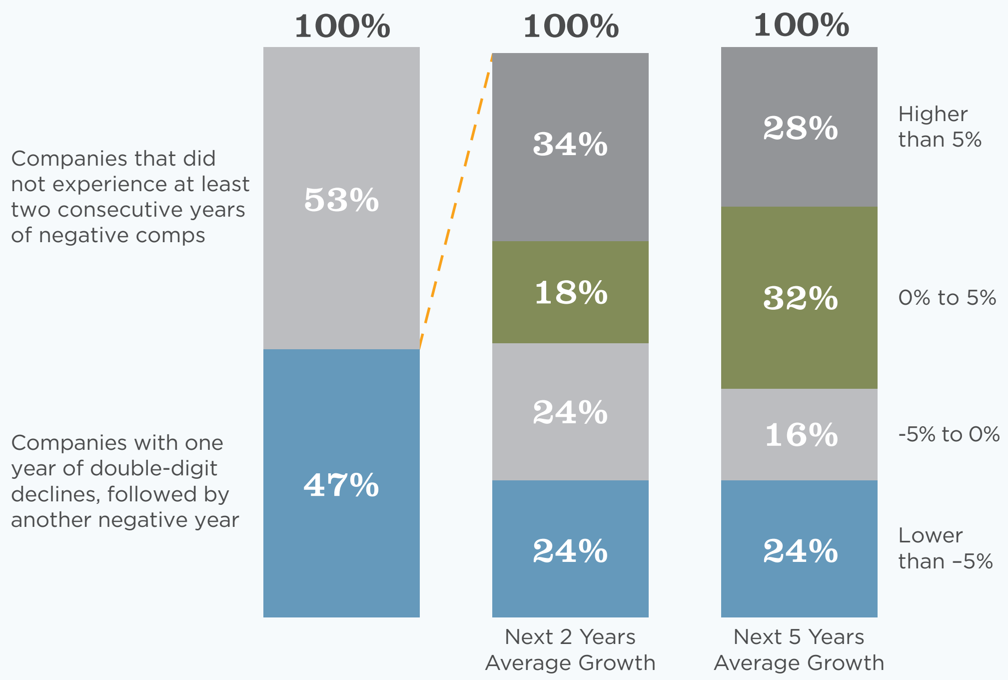


EXHIBIT 2: Charting the Progress of Poor Performers



We found that overcoming such a significant slump is made more challenging by four factors:

1. Tarnished brand. Once-desired brands can lose advocacy or cachet as a result of changing trends or a loss of quality control. TGI Friday's is one example.

2. Rapidly increasing market competitiveness. The popularity of a given category encourages a sea change in the number of brands and retailers playing in it, as well as e-commerce influences like Amazon keeping prices relatively low.

3. Secular shifts or a changing industry. An obvious example is the shift from physical to digital books—Barnes & Noble is an interesting investment opportunity in this space.

4. Operational missteps. Risky management decisions with lasting consequences can do as much damage as any macro trend. Sears and JC Penney are both currently experiencing headwinds created by past decisions.

None of these challenges alone means that a brand is beyond hope. They simply mean that reinvigorating the brand will require major strategic changes and time.

The following case studies help illustrate some of these strategic changes.

Case Studies

Great Turnarounds

2003–2007: J. CREW

ISSUE: J. Crew experienced -16% comps in 2001 and -11% in 2002. These results were symptomatic of significant internal strife and turnover, including three CEOs in five years, and poor merchandising and real estate decisions. At the same time, its competitive landscape only intensified.

SOLUTION: Starting with significant management changes, including hiring Mickey Drexler as CEO, J. Crew sought to instill a design-driven focus throughout the organization. It also revamped its products to include more color and added new higher-end pieces, categories and a bridal collection. J. Crew also upped its product flow and improved the store experience.

RESULTS: J. Crew turned in 16% same-store sales growth (SSSG) in 2004 and 13% in 2005, plus a 17% increase in total revenues to $804 million and a gross margin increase of 15%. It was taken public in 2006 with a market capitalization of $1.1 billion and has since spawned several successful new businesses, including Madewell and crewcuts.



2006–2011: KATE SPADE

ISSUE: Kate Spade faced double-digit comp declines as a result of suffering retailer relationships, internal strife and real estate in poor locations.

SOLUTION: When it was purchased by Liz Claiborne, Kate Spade underwent significant management changes. New leadership redeveloped its core products, making its traditional designs more contemporary through bold colors, and entered new categories—jewelry, apparel and denim. Kate Spade also launched a new advertising campaign to promote these products, as well as a best-in-class social media strategy. Finally, the brand focused on improving its distribution, both by strengthening relationships with retailers like Nordstrom and Bloomingdales and by revamping its e-commerce site.

RESULTS: Kate Spade's SSSG increased 24% in Q2 2012, and total sales were up 86% to $313 million. The brand's e-commerce sales are growing at over 30%, and it is carried by over 300 premier department stores, plus 50 full-price and 30 Kate Spade outlet stores.

2007–2012: EXPRESS

ISSUE: Express had experienced many ups and downs in SSSG over the past decade as a result of misaligned products, assortments and store execution. It also suffered from a lack of focus and too many strategic changes, which left it unable to withstand the pressures of increased competition.

SOLUTION: Golden Gate Capital acquired Express in 2007 and started by hiring a new CEO. Management then implemented a new merchandising strategy that was more responsive to consumer preferences and launched an e-commerce site in 2008. Finally, Express rationalized its store fleet, combining men's and women's stores to use fewer square feet but growing their overall store base.

RESULTS: SSSG was at 10% in 2010 and 6% in 2011, total sales increased 11% to $2.1 billion and gross margin increased from 26% to 36%. It was taken public in 2010 with a market capitalization of $1.3 billion—60% more than when it was originally purchased. Express was also able to reduce markdowns from 20 million items in 2007 to 14 million in 2009, resulting in a 4% increase in merchandise margins.

Many of these strategic decisions are best conducted away from the intense glare of the market. For private equity sponsors, the lesson is clear: Brands that have a strong heritage but are suffering from several years of bad performance may not be forever doomed. In fact, some may be hidden investment gems. ❖

AUTHOR

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