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# Putting Cash to Work

by WWD Staff

NEW YORK — The cash divide is widening.

As weaker companies scramble to keep goods flowing and the bankers at bay, the powerhouses that managed to sock away money during the credit crunch might start putting their extra millions to work. Options include new lines of business, IT makeovers, store refurbishments and even acquisitions.

“Cash is a funny thing — you want to do something with it,” said Leon Nicholas, director of retail insights at MVI Retail Insights. “But unemployment has passed that ‘magic number’ of 10 percent now, which is a big psychological hurdle. Right now, there’s a lot of caution, which translates into restraint in terms of spending — both by companies and by consumers.”

Still, the world hasn’t stopped. Retail stocks recently hit fresh highs, and the Dow Jones Industrial Average has remained above the 10,000 mark for at least two weeks. Baby boomers are headed toward retirement, the Hispanic population is growing and new media continue to make their mark.

“There’s too much happening to simply ignore it,” Nicholas said.

And the longer profitable companies wait, the bigger the cash hordes can become — helped, of course, by an ongoing eye on controlling expenses. For example, Coach Inc., which reported its fiscal first-quarter results last month, added \$194.3 million to its coffers for the three months ended Sept. 26, making a total of \$994.7 million readily accessible to the firm.

With earnings season in full swing, analysts have focused on the impact of cost cuts on gross margins and profits. But the amount of money firms have saved up could be a better indicator of long-term strength.

The companies that have huge cash holdings largely have gotten them by being successful at the retail game, incorporating a degree of conservatism into their businesses and cutting back on store openings and other expenditures when the economy went south. So far, Polo Ralph Lauren Corp. has a \$925.7 million kitty. Kohl’s Corp. put aside \$1.53 billion. And Wal-Mart Stores Inc. — oversized, as usual — has a war chest of \$6 billion. And those are just some of the largest companies suffering an embarrassment of riches.

Specifically in the footwear space, Jones Apparel Group Inc. ended the most recent third quarter with \$156.9 million in cash, while Nike Inc. had \$3.63 billion at the end of its latest quarter, more than \$1 billion more than the previous year. VF Corp. had \$379.1 million in cash and equivalents, up by about \$153 million year-over-year. Steven Madden Ltd. closed the last quarter with \$125.7 million in cash, cash equivalents and investment securities. Skechers USA Inc. had \$276.4 million in cash at the end of its last quarter, and Deckers Outdoor Corp. ended up with \$125.6 million in cash, including short-term investments.

The stockpiles give these firms the ability to drastically alter the retail sector. Not only do they have the underlying businesses that produced that cash but the funds give them the flexibility to adapt and take advantage of the shifting retail and fashion landscape.

“You have even more formidable competitors than you had in the past,” said Joel Bines, director at AlixPartners. Cash did not matter as much during the debt-boom years earlier in this decade, when just about any fashion firm could borrow to expand. “The

world didn't differentiate between strong, fundamentally cash-generating businesses and less healthy, more cash-constrained businesses," Bines said.

### **Cost Cuts Pave the Way**

One of the big ways many firms have been able to generate such cash stashes has been the recent and intense focus on expenses. While expense management is expected to continue, at least while the fate of the economy remains uncertain, it also puts firms in a position to make money when sales begin to pick up because operations are already so lean.

"Everyone will continue the belt tightening," predicted Brian Tascher, an investment banker at BB&T Capital Markets. "They will come out of the recession so much stronger because they're really focused on how to drive business with the minimal costs, to avoid needless expenses that people had become complacent with. Even moderate top-line growth will drive huge earnings growth because they have the engine tuned much better."

Controlling spending on inventory and not overbuying also played a major role in expense management this year, noted Sam Poser, an analyst at Sterne Agee.

"The best companies out there now are questioning everything," said Poser. "There are no sacred cows, and [retailers and vendors] don't want to sacrifice who they are, but they are willing to look at every aspect [in the cost structure] on the surface of how it looks or how long a certain standard has been in place. Everything has to be looked at. The ones that are really eliminating the sacred cows are the ones that in the long run are going to be the most successful."

But cost cutting can't go on forever. Reinvestment eventually will be necessary to push growth.

At Jones Apparel, the firm already shed \$70 million in costs in 2009 by reducing marketing and closing retail stores, and it expects selling, general and administrative expenses to be down about 9 percent in 2009 year-over-year.

But CEO Wesley Card noted on the firm's late-October earnings conference call that the firm will likely start giving salary increases again — something not done in 2009 — while also acknowledging the general increase in medical costs.

Firms that generate a significant amount of cash will also find it easier to build their businesses and take on new ventures.

"Shareholders are always like, 'Pay dividends, give it back to me, buy shares back,' and that may not necessarily be the best use of cash for the long term," said Christine Chen, an analyst at Needham & Co. "You have to look for new cycles of growth."

Many of the companies taking on new lines of business are doing so with at least some cushion on their balance sheet.

Coach, for example, is funding Reed Krakoff's namesake fashion line, which will launch in fall '10 and could open up new avenues of growth for the company that cut its teeth in the accessories business.

Jones Apparel also spent a significant amount of money this year launching its Rachel Roy contemporary footwear line at Macy's, in addition to expanding its newest retail concept, Shoe Woo.

Skechers earlier this year launched its Shape-Ups line, while Steven Madden recently announced plans to manufacture footwear for Olsenboye, a brand owned by Mary-Kate and Ashley Olsen.

Now might also be the time to funnel more funds into IT and other areas that help improve operations, said Madison Riley, retail strategist and senior partner at Kurt Salmon Associates.

"If you can employ that money around [research and development] and around product innovation, around improving your analytical systems, analytic capabilities and investing in store experience, those are all great things to do right now because they'll play critical roles down the road for the next five, 10 years," Riley said.

### **M&A Rebound?**

There are also some scant signs of life in the mergers-and-acquisitions market. For instance, private equity firm Advent International Corp. bought Charlotte Russe Holdings Inc. for \$380 million last month.

The types of deals ultimately cut in the fashion industry are expected to be on the smaller side.

Though they aren't actively for sale, there are a bevy of smaller, private footwear brands that are bucking general business trends, sources said, making them interesting potential targets, if the price were right. There are also plenty of brands that are struggling and need a buyer to stay afloat. Titan Industries Inc., for example, is expected to buy Penny & Kenny Shoes LLC out of bankruptcy this week.

**“When the environment does pick up and becomes better, you may see more strategic acquisitions,” said Tom Chin, managing director of consulting and analytics at Telsey Advisory Group. “They may not be big, multibillion-dollar transactions. Generally speaking, it’s tough to raise the debt financing that you would need to make a larger, game-changing acquisition.”**

Among firms known to be on the hunt is Steven Madden. CEO Edward Rosenfeld said after the firm's third-quarter earnings report, when profits jumped 61 percent, that his firm is pursuing acquisitions and that he expects to complete a deal in the \$30 million-to-\$40 million range by year end.

And Jones Apparel executives recently told Footwear News that the firm is “ready to handle an acquisition now.”

But plenty have been holding off, perhaps creating some pent-up demand.

According to Robert W. Baird & Co., there were only 43 M&A deals with price tags under \$1 billion in the first half of 2009, a 38 percent decline from the 69 deals cut a year earlier.

Joe Pellegrini, managing director of investment banking at Robert W. Baird, said he expects that some potential acquirers will wait until after the holiday season to make a move.

Though there are some signs of strength in the economy, “we could dip back down,” he said. “Housing-start numbers [recently] came back low, and foreclosure rates are at an all-time high. Housing is still in peril,” which can psychologically impact consumers' desire to spend money.

Pellegrini said top-line retail sales numbers will ultimately show if the economy is rebounding. An increase — combined with the fact that the financial markets have improved of late — would then help prop up the M&A market.

“The best acquisitions that Nike and VF [Corp.] made [are] The North Face and Vans [by VF] and Converse [by Nike],” he said. “They were bought coming out of a down [economic] cycle. ... Even though they paid good premiums for the businesses, those have all turned out to be huge home runs.”

Already, the recession has led to some unusual deals as companies focus on rebuilding their balance sheets. This summer, Finish Line Inc. gave Jimmy Khezrie, owner of Jimmy Jazz, \$7.7 million to take the 75-door Man Alive chain off its hands and assume any debts.

In the end, before you can spend it, you have to make it. And not everyone has the knack for building up a billion-dollar cash hoard. Amassing that type of load starts with the decision to keep tight tabs on money as it flows through your business.

Most companies with big rainy-day funds share one simple trait: They hold on to each nickel as long as they can.

“The best way to amass cash is to have a very profitable business model and to be managing it very closely,” said Kurt Salmon's Riley. “Obviously you pay your vendors, but you wait until the last darn minute to do so.”