



Personal Finance

Retailers On The Ropes

Asher Hawkins, 06.21.10, 8:00 AM ET

The recession that began nearly two years ago hit retailers hard. Among the casualties: Electronics giant Circuit City, department store Filene's Basement, outdoorsy outfitter Eddie Bauer, skin care specialists Crabtree & Evelyn, fast food franchise Fatburger and photo experts Ritz Camera were among the chains that have reorganized or liquidated since 2008.

The early post-crash boom in corporate busts has subsided, but with U.S. economic growth lackluster and unemployment hovering near 10%, the retailer sector continues to face an uncertain future.

Over the course of this year we've been working with Audit Integrity, a Los Angeles, Calif., accounting boutique, to screen more than 2,000 of the largest publicly traded U.S. companies for signs of financial trouble ahead.

AI's risk model incorporates the usual factors that go into credit ratings, like balance-sheet strength and earnings. But it also figures in a measure of "accounting and governance" quality. The idea is that historical data can uncover push-the-envelope accounting and help predict which firms are likely to undergo financial restatements, regulatory troubles, class actions or severe financial distress.

A number of retailers are among the businesses rated the riskiest by Audit Integrity. Does that mean their investors will suffer severe losses or be dragged through bankruptcy courts? Not necessarily. Even among the riskiest companies, Audit Integrity acknowledges that the chances are small any one will be declared insolvent.

That's a risk some investors willingly assume. In fact, troubled companies have been among the market's hottest buying opportunities in the past year. Many investors have taken the bet--often correctly--that such enterprises will often manage to muddle through rough patches and recover.

Their stocks sometimes jump in response to such expectations. Fragrances chain Perfumania, for example, hasn't posted a net profit since fiscal year 2006. Yet its Nasdaq-listed stock has quadrupled in price in the last year.

Here are ten retail chains that ranked high in our most recent financial-risk rating. The first seven retailers listed below were among a short-list of 50 public companies published on June 10 (to view that list, visit www.forbes.com/distress) The remaining firms were not far behind. A few of the companies we're listing wished to offer responses defending their financial health; their comments are included below. The rest of the companies declined to comment on our rankings.

No. 1

Zale Corp.

This Irving, Texas, jewelry retailer suffered a 13% decline in sales and a net loss of \$155 million in the latest 12 months. A mall staple, Zale has racked up nearly \$100 million in unusual expenses in the last four fiscal quarters. In the fall of 2009 no fewer than seven plaintiffs' law firms announced the filings of shareholder class-actions suits against Zale in federal court in northern Texas; the suits accused the retailer of misleading investors about its financial health between 2006 and 2009. Zale is fighting the claims. Last month the company received a much-needed five-year, \$150 million loan from San Francisco's Golden Gate Capital.

No. 2

Rite Aid Corp.

The drugstore chain's revenues fell 2% and it posted a \$507 million net loss during the most recent 12 months. The Camp Hill, Pa., company has boosted sales despite the recession (to \$26 billion in fiscal year 2009) but has still racked up more than \$4.5 billion in net losses over the last three fiscal years. Rite Aid took a \$1.8 billion goodwill write-off at the end of fiscal 2008, and its shareholder equity has fallen to a negative \$1.7 billion.

No. 3

Great Atlantic & Pacific Tea Company

Parent of famed grocer A&P, the company also controls the Food Emporium, Pathmark and Super Fresh chains, among others. Three straight years of losses (including a net loss for the last 12 months that was \$877 million) have followed lackluster sales; revenues fell 7% in the latest 12 months. Total shareholder equity for the Montvale, N.J., company fell to a negative \$396 million at the end of fiscal 2009 from \$267 million in fiscal 2008. President and Chief Executive Eric Claus made what was described by the press as an abrupt departure last October; Ron Marshall, former head of Borders Group (see No. 5), was selected as Claus' permanent replacement in January.

No. 4

Trans World Entertainment Corp.

The Albany, N.Y., company is little known to the general public, but millions of mall-goers are familiar with its f.y.e and Suncoast Motion Picture Company music and video chains. Sales fell 18% in the latest 12 months, resulting in a \$40 million net loss. The company has been operating in the red for the last three fiscal years. The good news for Trans World is that it continues to boast \$193 million in shareholder equity, although that is down from nearly \$400 million in fiscal 2005. President and Chief Operating Officer James Litwak resigned in February in what he said was a voluntary move. Investors have shown confidence in Trans World by pushing up its stock 34% year-to-date and by nearly 100% over the past 12 months.

No. 5

Borders Group

The Ann Arbor, Mich.-based bookstore chain has suffered four straight fiscal years of net losses; for the last 12 months the loss was \$88 million on a 15% sales decline. Total shareholder equity now stands at \$158 million, down from \$928 million as of fiscal 2005. Chief Executive Ron Marshall, known as a turnaround artist, departed in January after roughly a year at the helm to take a job at grocery store company A&P (see No. 3.) Replacing him is corporate raider Bennett LeBow, who earlier this year became Borders' largest shareholder after investing \$25 million in the company.

No. 6

The Bon-Ton Stores

This York, Pa., clothes retailer operates 280 department stores, mainly in the Northeast. Bon-Ton eked out an \$18 million profit in the latest 12 months, despite a 4% sales decline. The company is still reeling from a \$170 million net loss in fiscal 2008. Nevertheless, investors have been snapping up Bon-Ton stock in the last 12 months, leading to a 190% share-price gain. Bon-Ton had this to say about its high position in our financial-risk rankings: "We...refinanced our revolving debt in late 2009, replacing it with a new revolving credit facility scheduled to expire in June 2013 and a second lien term loan that matures in November 2013; thus, our first material debt maturity occurs mid-2013. We also ended 2009 with an improved performance in the fourth quarter that significantly reduced our debt to EBITDA ratio (defined by Bon-Ton as debt, including capital leases, divided by EBITDA) to 4.9 times, compared with 7.4 times at the end of fiscal 2008."

No. 7

Perfumania

The fragrances retailer from Sunrise, Fla., boosted sales by 19% in the latest 12 months but still saw a net loss of \$16 million. Perfumania hasn't posted a net profit since fiscal 2006. Its accounts receivable, which mostly represent bills that remain unpaid by its wholesales customers, have ballooned to more than \$25 million from just over \$1 million in fiscal 2007. Despite such troubles, Perfumania's stock has roughly

quadrupled over the past year. Here's what Perfumania had to say about its inclusion in our financial-risk rankings: "We are pleased that our present liquidity is very strong and our comparable sales [sales at outlets open at least one year] have been trending very positively since our year ended Jan. 30, 2010. All of us at Perfumania feel positive about our present and future performance."

No. 8

ValueVision Media

Consumers will recognize this home-shopping venture under another name: ShopNBC. General Electric sought to make this Eden Prairie, Minn., company a shopping corollary to its TV network, but it hasn't matched the popularity of rivals QVC and HSN. With the exception of fiscal 2007, when it earned a \$23 million profit, ValueVision has suffered net losses throughout the past decade, including \$41 million in the latest 12 months on a 5% revenue decline. Total shareholder equity has fallen to less than \$100 million from \$246 million at the end of fiscal 2005.

No. 9

CONN'S

This Beaumont, Texas, appliance and electronic retailer had a 15% drop in revenues in the latest 12 months, resulting in a razor-thin \$1.7 million profit. CONN'S remained in the black as the recession set in, but not by much: It went from nearly \$40 million in net income in fiscal 2007 to \$8 million in fiscal 2009. Accounts receivable--representing sales for which bills remain unpaid--have grown to \$125 million from \$36 million in fiscal 2007. The company attributes the rise to new accounting rules that forced it for the first time to add receivables for its consumer-loan business to its balance sheet. Historically, 60% of sales to individual customers have been financed by the company. CONN'S has pared that figure to 58% in recent months but doesn't believe it should pull back further. "Our customer is a blue-collar customer--the electrician, the plumber, the pipe-fitter. These are individuals that pay their bills," Chief Executive Officer Tim Frank tells Forbes.

No. 10

Liz Claiborne

The tony clothing retailer also controls fashion brands Juicy Couture, Kate Spade and Lucky Brand Jeans. Sales for the New York City-based firm fell 23% over the latest 12 months, leading to a \$286 million net loss. The company has lost money for three straight years. Goodwill write-offs totaling nearly \$1 billion between 2007 and 2008 have eaten into shareholder equity, which fell from \$1.5 billion at the end of fiscal 2007 to \$217 million in fiscal 2009. Here's what Liz Claiborne had to say about its inclusion on this list: "We believe Forbes' list has no merit or value to investors, and we should not be included by any standard. The Forbes/AI rankings have never been an effective leading indicator of anything. Most important, as disclosed in early May with our amended and extended bank facility, \$165 million net-income tax refund and current debt balance, we believe it is clear that Liz Claiborne Inc. is in a good liquidity position. Also per this disclosure, among our core direct brands, Juicy Couture continues to be very profitable, with high sales per square foot in its stores, Kate Spade is growing, with strong gross margins and comp store sales. Lucky Brand Jeans and Mexx, led by top management teams, are in the midst of product re-launches and financial results are expected to improve. For more information, visit <http://lizclaiborneinc.com/web/guest/pressreleases>.