

Industry Report: Department Stores

Recent Trends

The retail spending climate thawed considerably over the course of 2011. However, middle-market department store chains such as JC Penney, Kohl's, Sears and Kmart felt the effects of an increasingly competitive marketplace. Despite the closures of chains such as Boscov's and Mervyn's in recent years, many businesses struggled to meet sales targets in 2011. At Kohl's, a 6.2% decline in November comp. sales negated much of the gains made during the first half of the year as fiscal 2011 comp. sales grew a modest 0.5%. A sluggish start to the holiday season similarly affected JC Penney, which saw comp. sales increase 0.7% in 2011. Meanwhile, citing deepening sales declines in the weeks leading up to Christmas, Sears Holdings Corporation announced plans to shutter over 100 Sears and Kmart locations during 2012.

By contrast, sales at upscale/luxury concepts exhibited sustained growth during the past year. Strong sales during the 2011 holiday season led Macy's Inc. (Macy's and Bloomingdale's) to 5.4% comp. sales growth for the year. Saks Fifth Avenue (9.5% increase), Nordstrom (7.3% increase) and Neiman Marcus (8.0% increase as of month-end October) likewise reported prolonged improvements in comp. sales during fiscal 2011.

Appraisal Factors

Based on liquidation data and appraisal experience, the following considerations are key points when analyzing department store chains:

- **Multi-level pricing** – Department stores often include a MSRP or "list" price on merchandise tags in addition to the company's day-to-day price (e.g. "our price") that rings up at the point-of-sale (POS). The MSRP/list price is typically higher than the company's sell prices and included on item tickets to relay the everyday value of goods. When evaluating stock ledgers and determining discounting structure, appraisers must identify the definition of "retail value" and whether it reflects original price or the day-to-day (after POS) price.
- **Discounting Activity** – Due to the significant amount of store closures throughout the retail industry, consumers are increasingly accustomed to making purchases during periods in which discounts are being offered. This heightened expectation of discounts impacts liquidation values because markdowns offered during a GOB event must exceed historical levels in order to efficiently sell through merchandise.
- **End-of-season markdowns** – Department stores typically increase markdown activity at the end of each season. For example, deep discounts may be applied to spring merchandise at the end of the April as summer goods begin to arrive in stores. A GOB commencing during transitional periods may return lower NOLVs as liquidators' discounts would have to surpass promotions already in place.
- **Brand names** – Private labels and in-house brands typically do not recover as well as brand names during GOB events. Retailers that carry a large amount of name brand goods are likely to generate higher recovery values in a liquidation sale than stores stocking lesser-known private labels.
- **Augmentation** – Liquidators often augment original inventory with fresh goods during a GOB event in order to optimize discounting activity as complementary merchandise arrives at stores. In an augment scenario, the estate receives a negotiated percentage of net sales in exchange for its support of the inclusion of additional goods in a GOB sale. The ability to round out the product mix through augmentation generally has a positive effect on recovery values and may ultimately lead to more aggressive bidding activity on original inventory.

Outlook

Appraisal values for department store chains generally held steady in 2011 despite the lingering volatility within the retail marketplace. However, the sector remains in flux as consumers adjust spending habits and tightly manage non-essential, discretionary purchases. While businesses focused on luxury apparel offerings have rebounded since the economic recession, middle-market chains face an uphill battle as they strive to offer a product mix that meets buyers' evolving shopping needs. Sales growth within the department store sector has been significantly hampered by industry fragmentation and increased competition from specialty retailers, including both brick-and-mortar and Web-based businesses. For example, deepening sales declines of big-ticket offerings such as electronics, which at one time bolstered business at many department stores, increasingly strained margins and negated much of the positive impact of returning consumer dollars to soft lines such as apparel. Future appraisal values will be dependent upon the effective response to these shifts.