

Retail Geeks – Weekly Spin Cycle

February 13, 2012

Welcome to the *Weekly Spin Cycle*. Each week, we'll deliver some news and commentary about the retail industry. We'll pay close attention to the "managerial spin" and will on occasion offer a contrarian view. You are encouraged to provide any feedback to info@RetailGeeks.com.

Retail's Worst Forecasters Try Again – ANF Management Now Guiding to \$3.50 to \$3.75 in FY 2012

In February 2011, ANF management was 'guiding' to a 15.0% EBIT margin in FY 2012. Then, in April 2011, ANF management dramatically increased its international store growth plans and unveiled a \$4.75 EPS target for FY 2012.

The problem was that the \$4.75 EPS target for FY 2012 implied an 11.5% to 12.0% EBIT margin... well short of the prior 15.0% target. Traditional sell-side analysts were so enamored by the incremental international store openings and the higher than consensus EPS target that they failed to focus as to why the company's 15.0% EBIT margin target dramatically declined over the short two month timeframe (despite an increased mix of theoretically higher margin international sales).

Recently, the company unveiled what could be construed as its 3rd EBIT margin target for FY 2012 over the past 12 months. We estimate that the low-end of ANF's current \$3.50 to \$3.75 EPS guidance range for FY 2012 implies a 9.5% EBIT margin.

In addition, on the Q1 2011 conference call in May 2011, ANF management suggested that its MG&A Expense would "moderate significantly" in 2H 2011. Three short months later, ANF management pointed towards positive double-digit year-over-year percentage increases of MG&A Expense in 2H 2011. Erratic much?

Simply, after effectively providing the company's 3rd EBIT margin guidance target for FY 2012... do you believe them now? Not us. Relying on the current ANF management team to provide a reasonable expectation of forward earnings performance has been a losing proposition.

What makes the latest FY 2012 EPS guidance range even more interesting is a continuation of "charges for impairments and write-downs of store-related long-lived assets" and store closures that likely have materially improved (and continue to improve) the company's level of profitability versus the prior year. Also, let's not forget about the DC consolidation that is set for FY 2012 that will be a profitability driver this year versus FY 2011.

FY 2011 was ANF's 4th straight year in which its GPM% declined versus the prior year. This is all the more troubling because most apparel retailers reported materially higher GPM% in both FY 2009 and FY 2010.

While GPM% declines will decelerate as the year progresses in FY 2012, we're betting that ANF is poised to report its 5th straight GPM% decline versus the prior year in FY 2012.

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Potential *HauteLook* Earn-Out Liability Reversal?

JWN has effectively “muddied the waters” re: the outlook for *HauteLook* expenses in FY 2011. How?

JWN management has guided to *HauteLook*-related Retail SG&A expenses of \$110M in FY 2011. This amount includes both operating expenses and “purchase accounting charges associated with the *HauteLook* acquisition.”

The problem is that the ‘composition’ of the \$110M has not been explained. Therefore, the \$110M number essentially means nothing to investors.

The company’s latest 10-Q filing suggests that \$16M will be expensed in FY 2011 related to the amortization of intangible assets. What’s the composition of the remaining \$94M? How much of the remaining \$94M was expected to be a function of an adjustment to the *HauteLook* “earn-out” liability? Only the company knows.

In Q3 2011, JWN reversed the *HauteLook* “earn-out” liability to the tune of \$5M versus the ending liability at the end of Q2 2011... presumably, due to worse than expected financial performance of the acquired company.

There’s another \$39M of *HauteLook* “earn-out” liability (at end of Q3 2011) that could conceivably be reversed if the online retailer continues to underperform.

Competition for *Keurig*? *CBTL* Machines Prominently Displayed at *BBBY*

As part of our weekly *Shopping Cart* report this week, we included a discussion re: new *CBTL* coffee/espresso machines at *BBBY*.

In addition to continued strength of *Keurig* brewers, coffee/espresso elitists are making the switch to \$149.99 *Coffee Bean & Tea Leaf* “high BAR” pressure machines that are prominently displayed in many *BBBY* stores today.

CBTL machines compete more closely with *Nestlé’s* \$250+ *Nespresso* single cup coffee/espresso machines (sold at *W-S* and *Macy’s*). Unlike *Nespresso* cups that are only sold online, *BBBY* sells a broad assortment of *CBTL* compatible cups (cheaper than *K-cups* and filled with “handpicked” beans). Also, the *CBTL* machines make real espresso versus espresso FLAVORED coffee from the *Keurig* brewers. The *CBTL* milk frother is only \$49 versus \$79 for the *Keurig* version.



CBTL single serve brewing machine at *BBBY* for \$149.99

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