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Retailers Will Face Darwinian Fight as Losses Mount

By Allison Abell Schwartz

Dec. 18 (Bloomberg) – U.S. retailers will face a Darwinian fight for survival next year as they run out of cash as early as January and competition forces thousands of store closings, according to private-equity buyers and restructuring experts.

Probably 50,000 stores could close without any effect on consumer choice, Gregory Segall, a managing partner at buyout firm Versa Capital Management Inc., said yesterday during a panel discussion held at Bloomberg LP's New York offices.

"The United States is massively over-stored in all categories," Segall said. He said his firm is in "a wait mode" and he expects banks to squeeze retailers after Jan. 1.

Plunging home prices, rising unemployment and tightening credit have led consumers to rein in spending, resulting in what may be the worst holiday season in at least four decades. Macy's Inc., Kohl's Corp. and other retailers have marked down items 50 percent to lure customers, eroding margins at a time when store owners hope to make a third or more of their annual profit.

Only retailers with healthy balance sheets will survive the recession, said Matthew Katz, a managing director at consulting firm AlixPartners LLP.

"This is a very Darwinian time," Katz said.

At least a dozen U.S. retailers have entered bankruptcy this year, according to data compiled by Bloomberg. Circuit City Stores Inc. and Boscov's Inc. have said they will reorganize and leave court protection as smaller chains, while Linens 'n Things Inc., Sharper Image Corp., and Value City Department Stores LLC all plan to liquidate.

"Cautious Approach"

There are some "fires that need to be left to burn" in retail, Segall said. "At the moment we think it's a time for a very cautious approach."

Increases in consumer confidence, reductions in credit spreads and a lower jobless rate would be indicators that the retail sector is beginning to turn around, panelists said.

"Americans are inherently optimistic," said Cathy Leonhardt, a managing director at boutique investment firm Peter J. Solomon Co. "And when the credit markets open back up, and they will, our optimism comes back."

The Standard & Poor's 500 Retailing Index had shed 30 percent this year, with only three of its 27 members posting gains. The index doesn't include Wal-Mart Stores Inc., the world's largest retailer, which has climbed 17 percent.

Wal-Mart rose 22 cents to $55.41 at 4:01 p.m. in New York Stock Exchange composite trading. The S&P 500 Retailing Index fell 1.3 percent to 286.62.

While Wal-Mart will continue to be important, smaller specialty stores are returning, said James Schaye, chief executive officer of Hudson Capital Partners LLC. The liquidation firm's clients have included Kmart and Linens 'n Things.

"People are going back to the one or two or three store chains," he said. "People are getting a little tired of going to the mall and buying all the same thing."

Getting Worse

Overall, the retail market will get tougher starting next month as banks start to see all "the messes that have been left to fester," Versa's Segall said. With the turmoil in the financial sector, banks have been focused inwardly for the past few months and that will change come January, he said.

There are also some perfectly healthy companies trading at distressed values, according to Leonhardt at Peter J. Solomon.

"For acquirers, this is an unprecedented period," she said.