

November 18, 2015

By Mark Heschmeyer (mheschmeyer@costar.com)

Pizza, Pants, Plants & Perfume? Mall Retailers Struggle To Find Winning Consumer Combo

Based On Reaction to Urban Outfitters' Plans to Some Clothing Retailers are Struggling to Draw Shoppers Back into Stores; Need for 'Fashion Newness'

This week, a collective “What the what?!” sounded out after teen apparel retailer Urban Outfitters Inc. announced plans to acquire award-winning eatery Pizzeria Vetri and other restaurants from The Vetri Family group of restaurants.

The move also appeared to baffle investors: Urban Outfitters stock dropped about \$2.25/share (10%) following news of the pending acquisition and the chain's disappointing October sales results.

For some, the strategy provided more evidence that mall-based clothing retailers continue to search for answers in the face of declining same store sales and foot traffic. And retailer results from October just now coming out show the trend growing.

"We've had lower traffic throughout the quarter and the traffic got a little bit worse in October," Richard Hayne, Urban Outfitters' CEO, told analysts yesterday. "The primary thing driving that is lack of newness and fashion. I think the current fashion look is getting a little long in the tooth and I wouldn't be surprised if we start to see some signs of it changing a little bit more radically than it has, let's say, over the last four or five years."

"There are a number of categories that are doing very well, so I don't think the customer is without money," Hayne added. "I think she's without fashion newness."

Specifically, Hayne said beauty and intimate apparel were bucking the downward trends.

Cooking Up a Different Concept

Urban Outfitters' move into pizzerias isn't its first foray outside of clothing. In 2008, the retailer opened its first Terrain garden center and café with plans to open 45 more in the following year. However, the retailer found that it's just not that easy to switch gears. As of January of this year, only two Terrain cafes were in operation.

Now though, with casual dining growing rapidly and pizza one of the most popular foods in the country, Hayne said he believes there is tremendous opportunity to expand the Pizzeria Vetri concept, and he believes it can be done in conjunction with Terrain.

Currently, the Vetri Group operates two pizza restaurants in Philadelphia and is scheduled to open three more in the next 12 months.

Last week, in a related move, Urban Outfitters launched its new Space 24 Twenty project in Austin just across from the University of Texas campus. This project includes an expanded Urban Outfitters store and several food and beverage concepts, including Pizzeria Vetri and Michael Symon's Burger Joint. The store and the restaurants are clustered around an open air courtyard that offers restaurant seating and a stage for special events and concerts.

"In addition to a large Urban Outfitters store, we've assembled award winning pizza and burgers serving beer and other beverages and offering live music. This is all directly across the street from 60,000-plus UT students," Hayne said. "We

CONTINUED: Pizza, Pants, Plants & Perfume? Mall Retailers Struggle To Find Winning Consumer Combo

believe the project has a high probability of success.”

The Vetri pizza concept is not limited, however, to pairing only with Urban Outfitters brands. In early 2017, the retailer said it plans to open a project in Devon, PA, a high-end suburb of Philadelphia. This time, the firm plans to pair a larger-format Anthropologie stores with a Terrain Garden Center outdoor cafe, a Glass House cafe, a Pizzeria Vetri and one of the Vetri Group's higher-end restaurants.

“We're excited to add foodservice to our brand portfolio and believe the Vetri Family group of restaurants compliments our brand nicely,” Hayne said.

Combining foods and clothes is not an untried or unsuccessful concept.

“I have always loved great restaurants in stores if well executed,” Soozan Baxter, principal of Soozan Baxter Consulting, a landlord-focused advisory firm in New York, who is currently working with Related Cos. on the retail portion of Related's Hudson Yard redevelopment. “Barneys in NYC, ABC Kitchen at ABC Home, and the Cellar at Macy's in NYC have all been fantastic collaborations,” said Baxter. “No one has done it on a wide scale basis and at a cheaper price point like [Urban Outfitters and Vetri Family], so I am excited to see something new and innovative coming out of these two brands. I think all retailers must evolve to stay relevant.”

Fashion First

“The issue is how do you get the teens back to the mall, and specifically, back into Urban Outfitters,” Baxter said. “I think that with Urban Outfitter's core audience supposedly being teens, a restaurant in-shop is a great idea.”

There is no easy answer, though, Baxter added, as even attempts like opening a pizzeria can send a confusing message:

“Who is our customer?” Baxter asked. “I liked Banana Republic in high school and college. I am now 40 years old. Am I the customer, or is it still a 20-something year old?”

It's a question many retail brands are wrestling with. Last week, The Gap Inc., operator of Banana Republic, reported that net sales for October were down 3% from last year, a direct result of sagging results at its struggling Banana Republic brand, where comparable sales - which constitute 18% of Gap's total sales - fell 15% in October.

The company is also getting hit on another front as its namesake Gap brand, which accounts for 38% of sales, has shown declining comparable sales for the past seven quarters.

“Although the company has made management changes to address troubles at Banana Republic, we expect that challenges at the brand will continue for a few more quarters,” said Scott Tuhy, vice president - senior credit officer of Moody's Investor Services. “New fashion designs had product acceptance challenges. And although the company replaced the creative director at the Banana Republic brand, it will take some time for newer fashions to produce results.”

The latest year-over-year same store sales show significant declines for a litter of fashion retailers, according to Mike Palenchar, CEO and founder of MR Group LLC, a retail recruiting firm in Columbus, OH. Among the leading brands that reported declines in year-over-year same store sales were: American Apparel, which filed for Ch.11 bankruptcy in September 2015, (-17.2%); Vera Bradley (-15.0%); Christopher & Banks (-12.4%); JCrew (-11.0%); Guess (-10.0%); Aeropostale (-8.0%); Lands' End (-7.5%); and Abercrombie & Fitch (-4.0%).

There were winners too, Palenchar said: L Brands +5.0%; Perry Ellis +5.0%; TJX Companies +6.0%; Michael Kors +6.9; American Eagle +11.0; Lululemon Athletica +11.0%; and Kate Spade +16.0%.

Palenchar said he particularly likes the approach taken by L Brands.

L Brands is the operator of Victoria's Secret, Pink and Bath & Body Works. The square footage of stores has averaged 1% net growth from 2009 to 2014. In 2015, the company expects about 3% growth, and about 4% in 2016.



CoStar Group | 1331 L Street, NW, Washington, DC 20005 | costargroup.com | 800-204-5960

CONTINUED: Pizza, Pants, Plants & Perfume? Mall Retailers Struggle To Find Winning Consumer Combo

Les Wexner, the founder, chairman and CEO of L Brands, said from the first day a store open, he knows everything could be wrong at the end of its 10-year lease, Wexner told investors at his annual investors' day conference last week.

"Sure as hell this location might be at risk, the designs are going to be wrong, and probably the fixtures were designed to match an assortment, which we know is going to be wrong," he said.

"This constant evolution of how do we change the merchandise mix, how does the brand evolve, how does the store design evolve, is (because) we know it's coming. If you walk down a mall and you say, well, here's a store design and a mix that hasn't changed in a decade, it's probably dead."

L Brand takes the same strategy with its merchandise.

As Wexner told his investors: "If you have good merchandise, people do come to your store, shoppers come in. If you don't have good merchandise, the word gets out and no one comes in your store, then you say you don't have traffic."

"If you don't have great product, compelling newness, fashion, technical details, design, marketing, creating an emotion from a product standpoint, you don't have a business," added Stuart Burgdoerfer, L Brands' vice president and CFO. "We have great brands to start with, we dominant the categories that we're in, we're very focused on newness and speed. This is not about selling the same thing year after year after year. It's about how do we create a reason for her to buy?"



CoStar Group | 1331 L Street, NW, Washington, DC 20005 | costargroup.com | 800-204-5960