

Apparel Strategist

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knowledge equals profit

apparelstrategist.com

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HOLIDAY SEASON NOT SO BRIGHT BUT NOT A TOTAL BUST EITHER

The year is over, and while we still have another month to go for the retail fiscal year, January is a month of sales and clearance and has little impact compared to November and December. While the importance of these two months has diminished a little over the past couple of decades, they are still critical to sales and earnings of retailers.

As has been the case over the past several years, consumers waited out the bargains, procrastinating until the last minute to seek out their holiday purchases. Unfortunately for

our industry, apparel was not one of the "have to have" items for this holiday season, losing out to iPods and other electronics. We did see a surge in the last part of the month in the gift card business, and we will probably see a little bit of a positive impact in January as consumers continue to redeem these now popular gifts.

Overall, the holiday season was not great. While there were pockets of strength amongst retailers, in aggregate we saw only slow to moderate growth throughout the industry. Of

special note was Wal-Mart, reporting a sales increase for December of only around 2%.

So now we are off to the races again, clearing out the inventory and getting ready for Spring. We remain relatively pessimistic for retail over the next few months, as consumers regroup and the impact of higher interest rates filters through the economy. It remains a zero sum game across many sectors...to get growth you have to take it from somebody else, and turn their customers into yours.

INSIDE

Retail The holiday season...it's finally over, to the joy of some and the dismay of others.

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Consumers Confidence bounces up to once again go over the benchmark 100 level. P 4

Supply Side Some inflation is evident in producer prices. P 5

International Trade The first year of no quotas is over, and the US industry is still adjusting to the "new world." Pp 6-7

Financials Stocks finish the year on a weak note, with investors taking some of their money off the table.

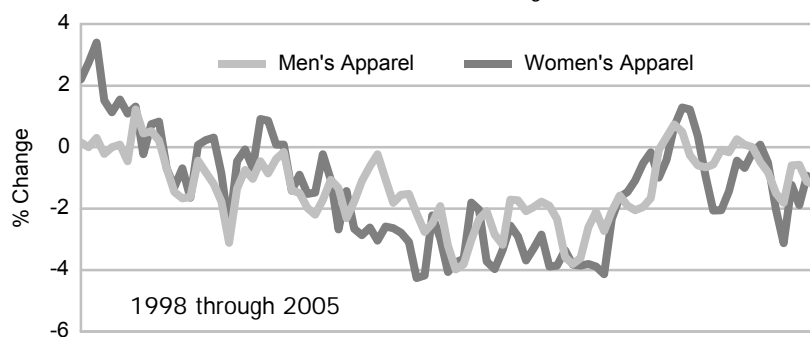
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THINK IT'S EASY TO MAKE A PROFIT IN APPAREL?

Consumer Price Index - Percent Change from Prior Period



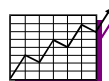
NOTABLE QUOTES

"When one door closes another door opens; but we so often look so long and so regretfully upon the closed door, that we do not see the ones which open for us." **ALEXANDER GRAHAM BELL**

"A banker is a fellow who lends you his umbrella when the sun is shining, but wants it back the minute it begins to rain." **MARK TWAIN**

"Many people want the government to protect the consumer. A much more urgent problem is to protect the consumer from the government." **MILTON FRIEDMAN**

"You always miss 100% of the shots you don't take." **WAYNE GRETZKY**



The holiday season is over, the receipts are all tallied, and overall it turned out about like we expected. Most preliminary indications are that the holiday season was at the middle to low end of expectations for most retailers, and apparel retailers for the most part didn't fare very well.

Consumers held off their purchases until the retailers blinked, and blink they did, with promotions rampant throughout the retail sector and the discounts running deep for most of December.

According to MasterCard's SpendingPulse survey, women's apparel sales rose 8.4% in December while men's apparel sales rose 6.2%, and overall they put the number for apparel at a 5.8% increase for the holiday season. These numbers seem a little steep to us, but they do include both on-line sales and sales of gift cards, which would bump the number up.

But as we always say, the bottom line is the bottom line. With promotions starting early and prices being slashed, even with 6-8% sales increases on the top line, the bottom line promises to be a challenge in the fourth quarter for many retailers.

Wal-Mart was one of the disappointments this holiday, saying that their sales for December should come in at the low end of expectations, or around a 2% increase. Fuel prices certainly had a bigger impact on those that serve the lower-income consumer...the higher end and luxury retailers showed little impact, and by all indications had a good holiday season.

Total US Retail Heading into the holiday, the trend certainly didn't look good for overall US retail. Sales growth fell from a high of 12% in July to just 5% in November, and when December's sales figures come out we expect a further decline in growth. Inventories

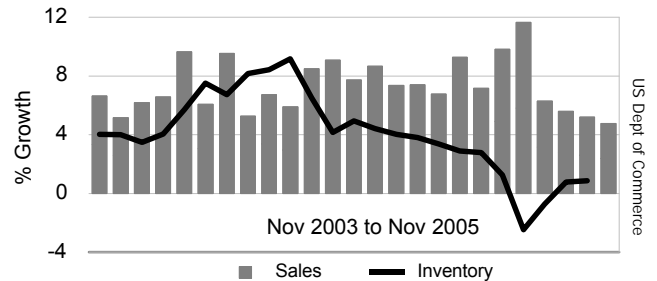
RETAIL SALES & INVENTORY

Millions of Dollars - Adjusted for Seasonality

	Nov '05	Oct '05	Nov '04
Total US Retail Sales	353,866	352,960	333,002
Department Store Sales	18,065	17,977	18,008
Apparel Specialty Stores	17,213	17,181	16,040
Total Dept & Specialty	35,278	35,158	34,048
	Oct '05	Sep '05	Oct '04
M & B Specialty Sales	827	808	808
W & G Specialty Sales	3,176	3,139	3,038
Total Retail Inventory	462,803	462,272	454,864
Dept Store Inventory	38,240	38,379	37,974
Apparel Specialty Inv	39,756	39,634	37,628
Dept & Spec Inv:Sales	2.22	2.27	2.21

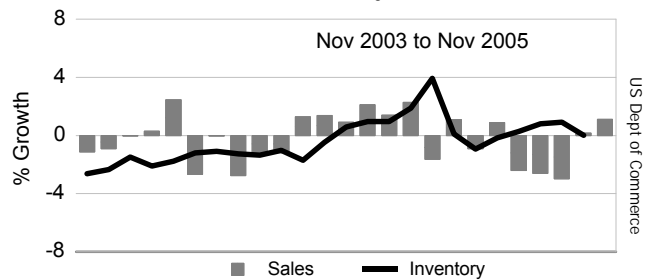
DECLINING GROWTH FOR US RETAIL

Total US Retail Trade
Sales and Inventory Growth



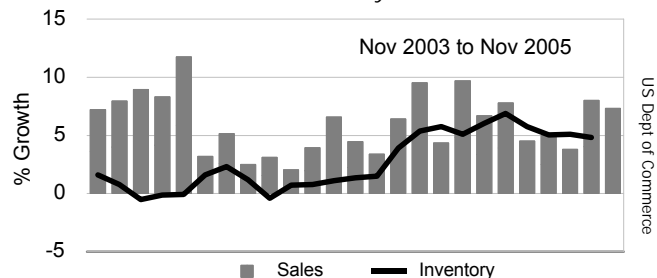
THE BIG STORES EKE OUT SMALL GAINS

Department, Chain & Discount Stores
Sales and Inventory Growth



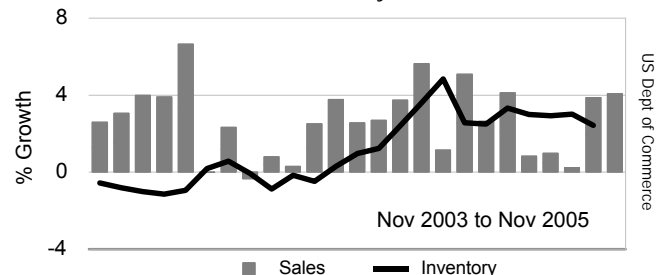
SPECIALTY IS PRETTY SOLID

Apparel Specialty Stores
Sales and Inventory Growth



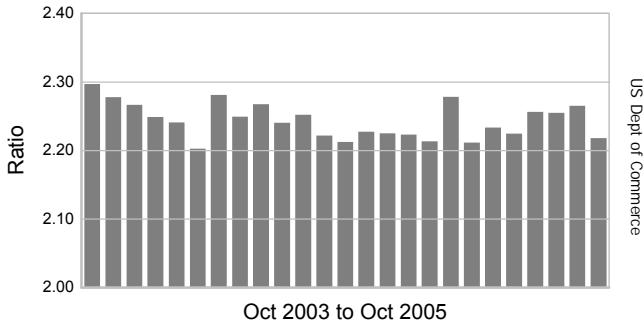
DEPARTMENT STORES DRAGGING RETAIL GROWTH DOWN

Department, Chain, Discount and Specialty Stores
Sales and Inventory Growth



& STORE PERFORMANCE

INVENTORY UNDER CONTROL
Dept, Chain, and Discount and Specialty Stores
Inventory to Sales Ratio

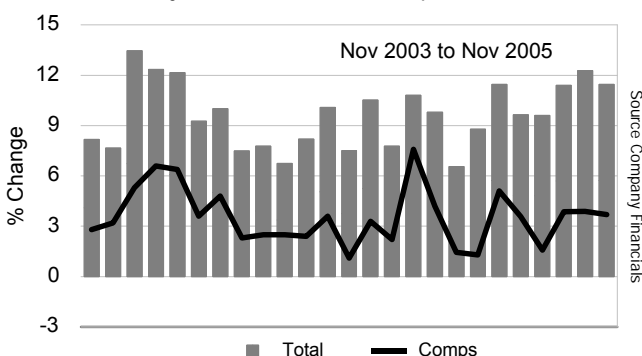


for the total US are now growing at just 1% annually, and the inventory to sales ratio stands at just 1.31, a relatively low level historically.

Department, Chain and Discount Stores We have already mentioned Wal-Mart, and while they are by far the biggest they are certainly not alone in their troubles. This sector as a whole has struggled, with sales growth in the negative for most of the year, and we would be surprised if the numbers were positive for the holiday season. One bright spot in this sector has been Target, which said they expect December comp store sales to be in the range of a 4-5% increase over last year.

What can we expect from this sector in the coming year? The discounters will just continue to do what they do...try to get bigger, source stuff cheaper, and bring the consumers in with the promise of value. The department stores (it pains us to say) will probably do the same thing they have been doing as well...try to scoop up more stores through acquisition, close or sell off the underperforming stores, cherry pick the good ones, and hope they can grow their bottom line along with the top. There will be some *major* fallout in this sector before the end of this decade.

TOTAL SALES STRONG, BUT COMPS AREN'T GREAT
Monthly Sales – Total and Comp Store Sales



STORE PERFORMANCE: NOVEMBER 2005

Sales for month and fiscal year-to-date

Company	% Total vs LY		\$ Millions		% Comps vs LY	
	Nov	FYTD	Nov	FYTD	Nov	FYTD
Federated	89.3	30.4	2,738	15,787	-3.4	0.8
Children's Place	40.0	59.1	166	1,295	12.0	8.0
Aber & Fitch	33.6	36.8	251	2,080	23.0	24.0
Charming	31.5	13.7	234	2,188	9.0	3.0
Aeropostale	27.0	28.5	135	903	7.3	0.9
Chico's	25.6	31.0	111	1,140	11.8	13.9
Ann Taylor	24.8	-0.4	182	1,506	12.9	NA
Gymboree	24.7	14.2	65	535	22.0	NA
Ross	15.3	16.5	451	3,983	5.0	6.0
Pacific Sunwear	12.1	13.5	107	1,074	3.0	3.6
Kohl's	10.9	14.2	1,494	10,244	-0.1	3.4
Wal*Mart	9.4	10.0	25,768	166,941	4.3	3.7
Target Corp	9.1	12.2	4,583	39,285	2.6	5.8
Limited	7.2	1.9	818	6,975	5.0	-2.0
American Eagle	6.8	25.1	202	1,747	1.7	17.4
Dollar Genl	6.7	11.5	686	6,800	-0.2	3.1
Nordstrom	5.8	7.6	707	6,134	2.8	5.7
TJX	5.0	7.0	1,500	12,800	-1.0	1.0
JC Penney	4.0	8.5	1,856	14,434	3.6	3.1
Dillard's	0.5	0.0	561	5,782	1.0	0.0
Gap	0.0	-1.6	1,400	1,260	-4.0	-5.0
Men's Wrhse	-0.4	12.3	134	1,362	5.8	9.0
Talbots	-4.1	7.4	131	1,454	3.3	3.0
Saks	-14.5	-5.6	544	4,697	0.1	2.0
Total	11.5	11	44,824	310,404	3.7	4.0



THE APPAREL STRATEGIST RETAIL SOFTLINES WEATHER INDEX NOVEMBER 2005



CONSUMER DATA

Consumer Confidence Another good month as far as consumer confidence, with the Conference Board's Index climbing to 103.6 for the month, further improvement from the surge we saw in November, and back to the level that we saw for the greater part of the year.

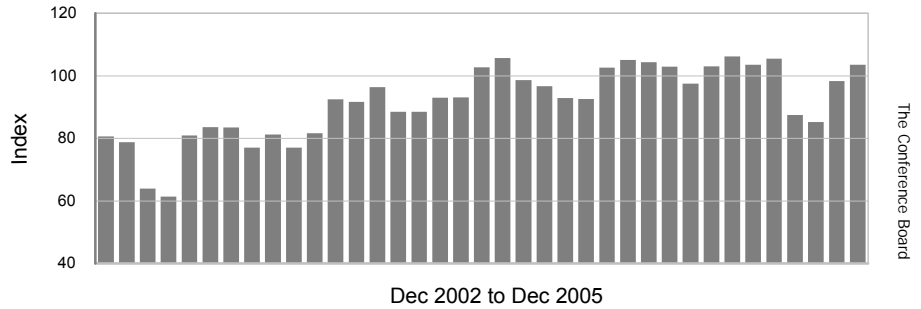
Lower prices at the pumps has made consumers feel better, as has the resiliency of our economy and the job markets.

And don't forget that consumers have short memories...we saw confidence take a big hit when Katrina and Rita struck the US. While the people and businesses affected by the disaster are still contending with the aftermath, for the rest of the country the memory has faded and they've moved on.

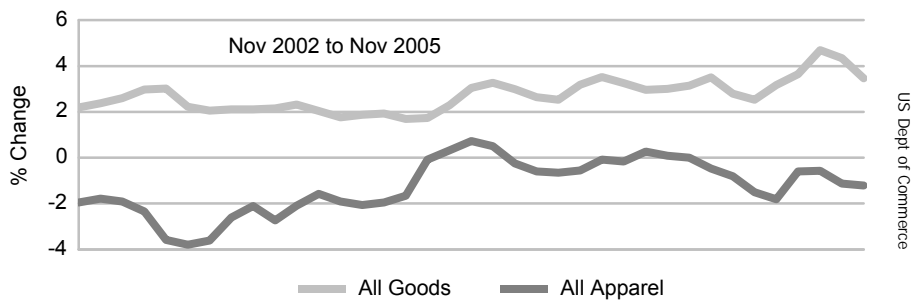
Consumer Prices Overall inflation is now at around 3.5% ahead of last year, while apparel prices remain 1% down from the same time last year. This is one trend you can certainly count on continuing into the new year...apparel retailers, with the exception of a few smaller specialty shops, are in no position to demand any kind of price increases from consumers.

Consumer Savings Rate As you can see by the chart below, we've seen eight straight months of consumers spending more than they are earning...not good news.

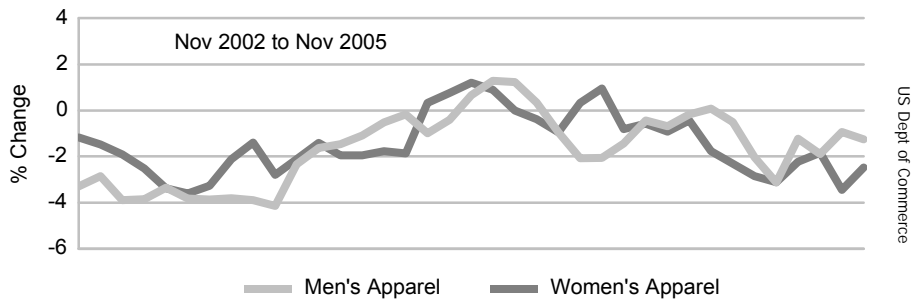
CONFIDENCE PUSHES HIGHER
Consumer Confidence Index



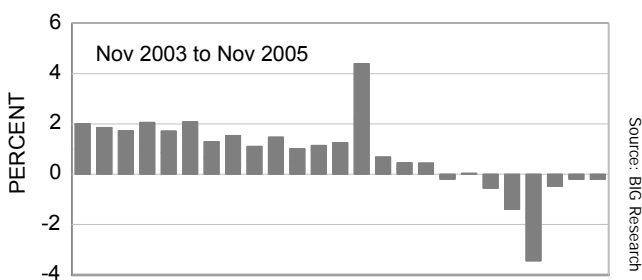
INFLATION COOLS OFF
Consumer Price Index - Percent Change from Prior Year



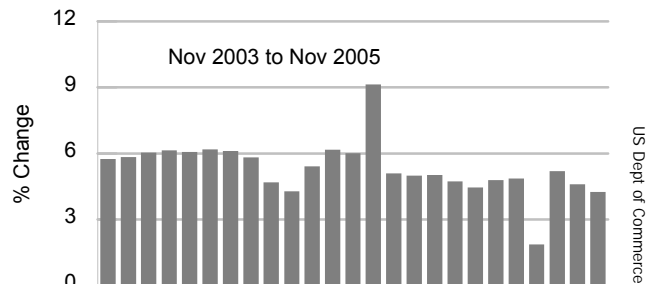
NO PRICE INCREASES FOR RETAILERS THIS YEAR
Consumer Price Index - Percent Change from Prior Year



Consumer Savings
Annual Rate - as Percent of Disposable Income

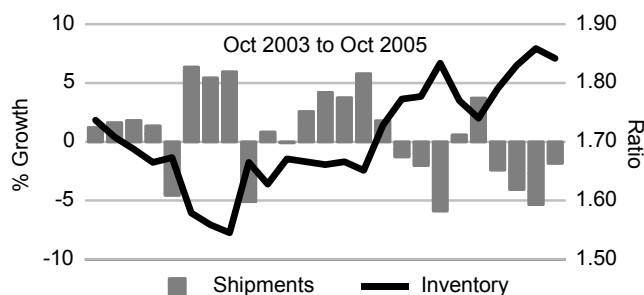


Personal Disposable Income
Annual Rate - Percent Change from Prior Year

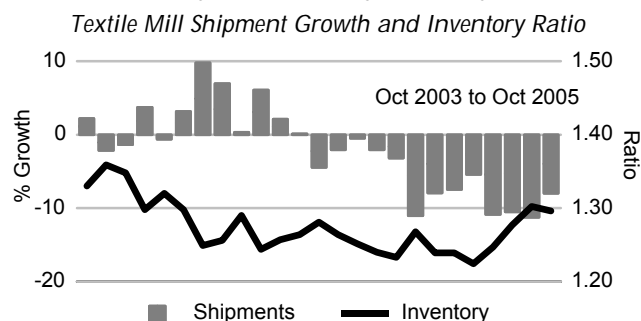


THE SUPPLY SIDE

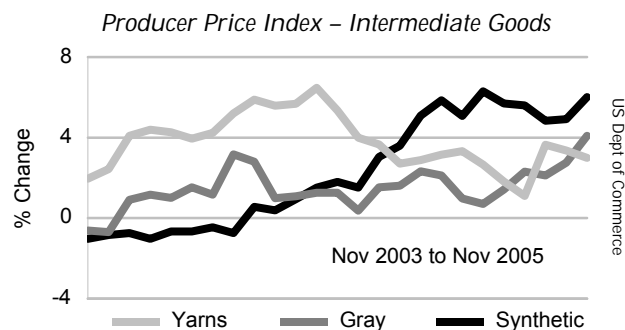
A LITTLE IMPROVEMENT ON THE SUPPLY SIDE FOR APPAREL Apparel Manufacturing Shipment Growth and Inventory Ratio



MISERABLE TIME FOR TEXTILES



SUPPLY SIDE INFLATION EVIDENT



2005 was a tough year for the supply side of the industry, and in fact the first half of this decade was no picnic, but the past year was especially tough.

The elimination of quotas, as expected, hit the industry pretty hard, and while there were a few casualties already, we're sure there are more to come in 2006 and beyond.

The other trend you can expect to continue is the one of consolidation. Size does matter in today's apparel world, and while fashion will always have a place for startups and entrepreneurs, the big companies will continue to gobble up the small and medium-sized companies that have good brands and can give them some growth beyond their core products.

Producer Prices We're just not used to talking about inflation in this industry these days, but now we are definitely seeing a trend toward higher material and gray goods prices, especially of the synthetic variety. Yarn prices are up about 3% from last year overall, gray goods are up 4% and climbing, and synthetic prices have risen again after a brief respite, up 6% from the same time last year.

These price increases are not being passed on though ...producer prices for apparel remain flat to down.

PRODUCTION NUMBERS UP SLIGHTLY



WHOLESALE AND MANUFACTURING SHIPMENT DATA

Millions of Dollars, Ratio

	Oct '05	Sep '05	Oct '04
Sales \$			
Apparel Mfg	3,416	3,358	3,504
Textile Mills	3,295	3,259	3,526
Textile Products	2,881	2,930	2,775
Wholesale Apparel	10,114	9,588	9,007
Inventory \$ (EOM)			
Apparel Mfg	6,292	6,242	5,819
Textile Mills	4,269	4,242	4,517
Textile Products	3,736	3,681	3,673
Wholesale Apparel	16,606	16,473	15,099

PRODUCTION AND EMPLOYMENT DATA

Index and Percent - Workers in Thousands

	Nov '05	Oct '05	Nov '04
Apparel			
Production Index	86.5	85.6	88.2
Capacity Index	108.6	109.5	120.1
Capacity Utilization	79.6	78.2	73.4
Textile			
Production Index	93.6	93.2	91.4
Capacity Index	118.5	118.8	122.3
Capacity Utilization	79.0	78.4	74.7
Production Employment			
Textile	399	399	413
Apparel	249	250	273

It's hard to believe, but we made it through the first year with no quotas on textiles and apparel. Although the lag in data publication doesn't allow us to see the total impact of this first year of quota elimination, the period for which we do have data pretty much tells the story. Imports from China surged as expected for both textiles and apparel (and in many other categories outside the scope of this publication as well).



It's interesting to note that Hong Kong has shown the biggest decrease through the first ten months of the year for which we have data, down 22% for the period, the biggest decline of any major importer to the US.

We're sure this number is inflated somewhat (or deflated, whatever your point of view) by the fact that goods made in China no longer have to be shipped through Hong Kong on their quota, but it is a substantial drop nonetheless.

Total US Imports and Exports Imports for the month increased nearly 16% for the US while exports increased

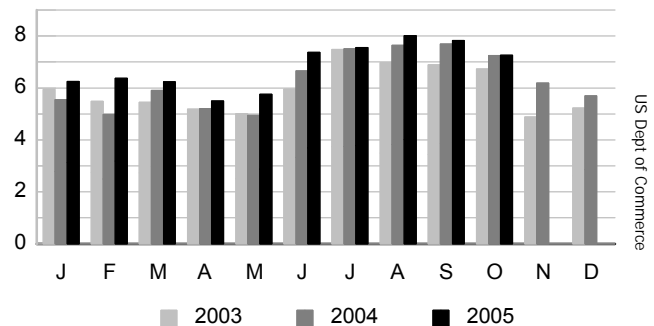
INTERNATIONAL TRADE STATISTICS

Millions of Dollars - Percent Change From Prior Year

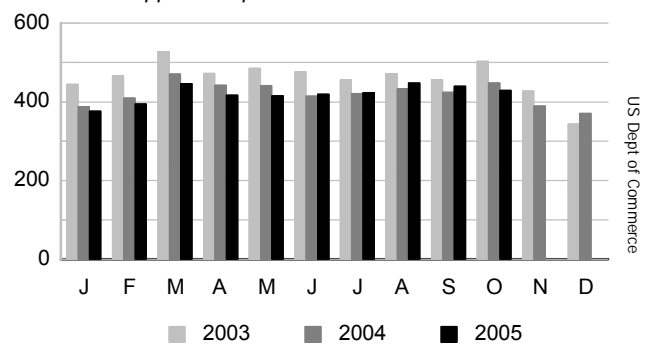
	% Chg vs LY	Oct 2005	Sep 2005	Oct 2004
Total US Imports	15.6	156,730	146,389	135,555
Total US Exports	7.8	78,424	73,208	72,731
Total US Deficit	24.6	78,306	73,181	62,824
Apparel Imports	0.2	7,268	7,829	7,256
Apparel Exports	-4.1	430	440	448
Apparel Deficit	0.4	6,838	7,390	6,808
Textile Imports	12.0	1,862	1,807	1,662
Textile Exports	-4.6	1,009	1,010	1,058
Textile Deficit	41.2	853	797	604
App & Text as % of Tot Def		9.8	11.2	11.8

Source: Dept of Commerce. Prior month figures are revised. Imports are CIF and therefore differ from figures from Office of Textile and Apparel figures which are Customs Value. Export values are FAS.

IMPORTS ABOUT FLAT WITH LAST YEAR
Apparel Imports - Billions of Dollars



EXPORTS FADE FURTHER
Apparel Exports - Millions of Dollars



APPAREL IMPORTS: YTD OCTOBER 2005

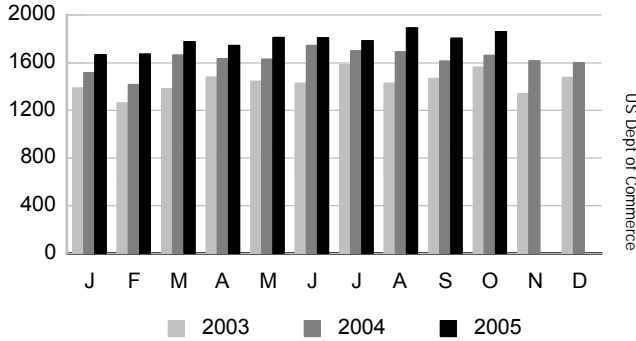
Millions of Dollars and Units

Country	Dollars Millions	SME Millions	% Chg Dollars	% Chg SME
World	58,529	18,647	7.1	11.1
China	13,469	5,131	77.2	104.9
Mexico	5,177	1,450	-8.4	-9.8
Hong Kong	2,862	488	-12.1	-22.4
India	2,523	668	30.6	26.4
Indonesia	2,427	693	18.4	15.8
Vietnam	2,290	670	1.2	0.8
Honduras	2,169	1,030	-1.0	4.9
Bangladesh	1,991	949	18.3	19.4
Dom Rep	1,542	603	-8.7	-3.2
Guatemala	1,534	395	-4.1	-3.9
<i>Rest of world</i>	<i>22,545</i>	<i>6,570</i>	<i>-8.9</i>	<i>-11.6</i>
CBI	7,978	3,353	-2.4	1.8
PRC,Ko,HK	18,282	6,253	33.0	50.2
HK, Tn, Kor	4,813	1,122	-21.7	-32.4
ASEAN	10,039	3,056	5.8	4.4
CAFTA	7,569	3,146	-3.2	1.3

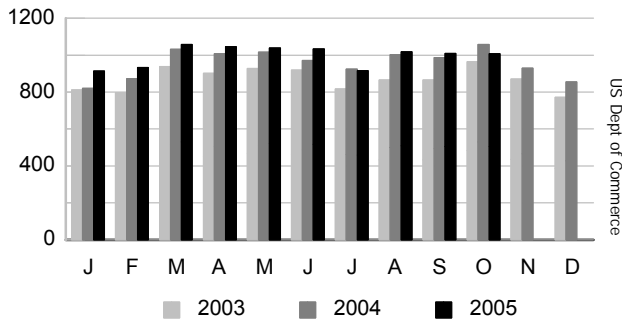
Source: Office of Textiles and Apparel. Customs Value. SME=Square Meter Equivalents.

IN TEXTILES AND APPAREL

IMPORTS JUMP 12% FOR THE MONTH
Textile Imports – Millions of Dollars



BAD SHOWING ON THE EXPORT SIDE OF THE LEDGER
Textile Exports – Millions of Dollars



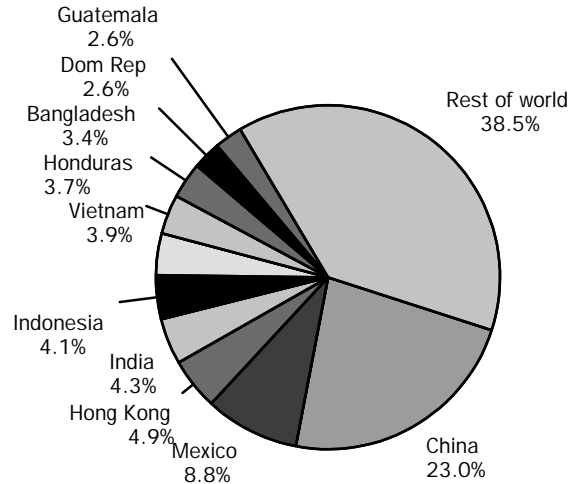
TEXTILE IMPORTS: YTD OCTOBER 2005

Millions of Dollars and Units

Country	Dollars Millions	SME Millions	% Chg Dollars	% Chg SME
World	17,194	24,175	10.9	6.7
China	6,071	9,117	28.9	25.2
India	1,363	1,300	15.3	17.9
Pakistan	1,361	2,248	14.5	8.2
Canada	1,329	2,386	-0.4	-7.3
Mexico	977	1,831	4.8	-1.6
Korea	631	1,359	-2.1	-1.8
Turkey	572	520	13.9	-9.9
Taiwan	439	583	-6.7	-5.2
Israel	221	436	5.0	-3.5
Indonesia	173	439	-8.4	-5.6
<i>Rest of World</i>	<i>4,056</i>	<i>3,956</i>	<i>-2.3</i>	<i>-7.1</i>
OECD	4,704	5,928	1.0	-5.5
PRC, HK, Kor	7,227	11,174	22.1	19.1
HK, Kor, Tn	1,155	2,057	-4.3	-1.9
ASEAN	706	1,224	-15.4	-14.0
EU 15	2,021	1,503	-0.6	-5.3

Source: Office of Textiles and Apparel. Customs Value. SME=Square Meter Equivalents.

Share of Total Apparel Imports in Dollars
YTD October 2005

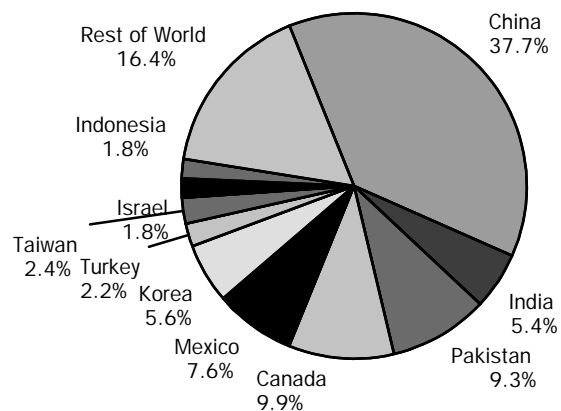


just 8%, leading to an increase of nearly 25% in the trade deficit from last year. While apparel and textiles have added to the burden, the deficit in electronics and computers dwarfs our industry, with a trade deficit of nearly \$120B for the YTD compared to around \$71B for apparel and textile products.

Apparel Imports were basically flat with last year's level. Imports from China were up 105% in units (SME) for the year-to-date, and were up 77% in dollars. Imports from India have grown by 26% and 31% in units and dollars, respectively, for the YTD.

Textile Imports and Exports Imports of textiles grew by 12% for the month, while exports fell nearly 5%. China and India are the leaders here as well, up 25% and 18% respectively.

Share of Total Textile Imports in Units
Square Meter Equivalent – YTD October 2005



It was, as usual, a tumultuous year in the stock market, but when all was said and done, in 2005 the market went virtually nowhere. The Dow Jones Industrial Average dropped on the last day of the trading year to finish slightly in the negative, down 0.6%, and our own Apparel Strategist Retail Stock Index also finished the year in the red, down 0.4% from the start of the year.

Despite the index numbers, there were plenty of retail stocks that showed good returns in 2005, and things could have been much better had the holiday turned in a better showing. It seems like investors decided to take some profits on the retail side at the end of the year, sending our index down nearly 4% for the month and into the red for the full year. Overall it was a good year to be invested in retailers.

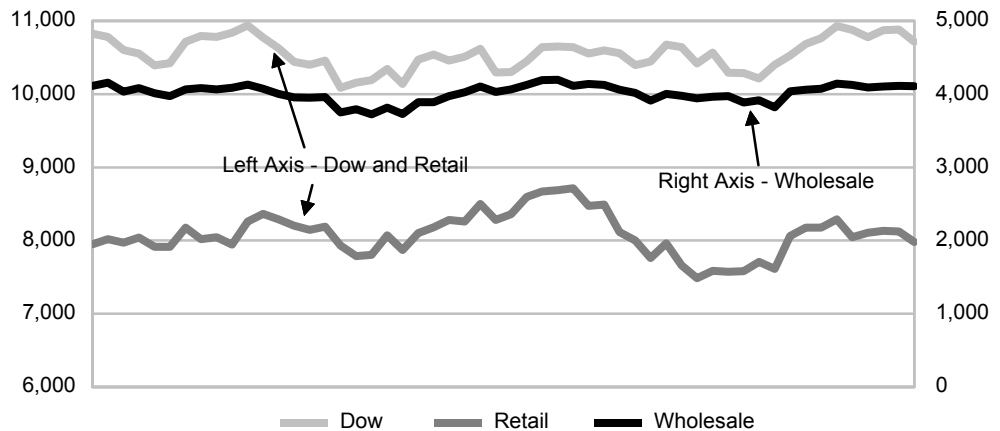
Our Wholesale/Manufacturing Index fared worse, finishing the year down 1.2%. Despite the seeming volatility in this sector, with the sale or potential sale of several venerable brands, and other merger and acquisition talk, this sector's index remained relatively steady throughout the year, hovering around the 4,000 level for much of the year.

So who were the big winners and losers in 2005? On the retail side? United Retail Group rose over 200% in the past year...granted, it only started at around \$4.00, but that's still quite a move. Dress Barn turned things around, to the delight of their shareholders, with their stock climbing 120% in 2005. Charlotte Russe and Payless Shoe saw their stocks more than double for the year; Chico's and Gymboree both approached the "double," up 93% and 82% respectively.

For the supply side stocks, Guess? was the big winner, with their stock up 189%, although they are really a hybrid retailer/wholesaler and their retail performance certainly helped to push their stock to new heights. Gildan Activewear saw their stock rise over 150% for the year, and while they are obviously well run and executing to a "tee," they are in the beleaguered activewear business and, well, who'da thunk it? This one really surprised us. Carters also did well, capitalizing on their acquisition of Oshkosh to help push

MARKETS END THE YEAR ON A DOWN NOTE

December 24, 2004 to December 30, 2005



Stock Averages	11/25/05-12/30/05	YTD
Dow Industrial	-2.0%	-0.6%
Retail Index	-3.7%	-0.4%
Wholesale/Mfr Index	-0.8%	-1.2%

their stock up 73% for the year. Oxford and Reebok were also winners, with both stocks climbing over 30% in 2005.

The Losers? Bebe, the former darling of Wall Street, saw their stock decline 22% for the year, and was cut in half from its yearly high of \$30 to end the year trading at below \$15. Hott Topic also had a well-documented difficult year. After running up to \$23 in the early part of the year, Gap saw their stock decline 16% for the year, and Wal-Mart and Aeropostale were both down more than 10% for the year.

On the Wholesale and Manufacturing side, Decker Outdoors saw their stock price nearly chopped in half, down 40% for the year. Russell, contending with Mother Nature and a difficult environment overall, saw their stock lose more than 30% of its value for the year. Kellwood also saw their stock drop more than 30%, and is now trading at about half of the near-\$45 price that it attained at the start of 2004.

United Retail gained 35%, with comp store sales climbing 5% for the month and 11% for the year-to-date. **Dress Barn** up 34%, the company reporting net income of \$20.4M or 64 cents per share for their fiscal first quarter compared to \$7.1M or 24 cents per share in the same period last year. Total sales for the quarter surged 62% which included their Maurice's acquisition,

& COMPANY NEWS

and comp store sales rose 9% for the period. **Christopher & Banks** rose 19%, with December total sales climbing 9% and comp sales increasing 2%. **Dillard's** rose 14%. The company reported a net loss of \$2.7M or 3 cents per share for their fiscal third quarter, much improved from the same quarter last year when they posted a loss of \$18.7M or 23 cents per share.

Merrill Lynch subsequently raised their rating on the stock to "neutral" from "sell." **Ann Taylor** gained 11% to cap a year in which their stock rose 61%. Comp store sales for the month increased 13%, including a 19% increase at their Ann Taylor stores, while total sales rose 25% for the period. **Payless Shoe** rose 10%, with comps climbing 9% for the month and 3% for the YTD. **Joseph**

GAINERS & LOSERS

Retail	Month % Chg	12/30 Price	YTD % Chg
United Retail	35.2	13.10	202.5
Dress Barn	33.9	38.70	119.9
Mothers Wrk	28.2	12.76	-6.3
Chrltte Russe	19.9	20.76	105.5
Chrst & Bnks	19.3	18.80	1.9
Gymboree	14.7	23.39	82.4
Dillard's	13.6	24.89	-7.4
Ann Taylor	11.2	34.60	60.7
Payless Shoe	10.4	25.18	104.7
Ross	7.2	28.94	0.2

Urban Outftrrs	-22.7	25.35	14.2
Jos. A Banks	-13.4	43.44	53.5
Bebe	-13.3	14.01	-22.1
Too	-11.7	28.24	15.5
Wet Seal	-11.7	4.38	93.0
Coldwtr Crk	-10.5	30.58	48.6
Pac Sunwear	-7.5	25.08	12.7
Wal-Mart	-7.0	46.96	-11.1
Hot Topic	-6.6	14.31	-16.8
Cache	-6.3	17.38	-3.6

Wholesale/Manufacturing

Decker Outdrs	29.3	27.96	-40.5
GIII Apparel	28.8	12.91	87.1
Gildan	14.4	42.85	152.1
Tefron	13.8	8.73	126.8
Quiksilver	11.0	13.85	-7.0
Angelica	10.8	16.55	-38.8
Mossimo	5.9	5.76	66.5
Jones Apparel	5.6	30.68	-16.1
Paxar	5.0	19.66	-11.3
Sara Lee	4.6	18.95	-21.5

Russell	-17.1	13.56	-30.4
Kenneth Cole	-13.4	25.59	-17.1
Wellman	-11.4	6.82	-36.2
Tommy Hilfiger	-10.6	16.10	42.7
Coach	-8.5	33.51	18.8
Cutter & Buck	-8.0	11.09	-23.9
Sup. Uniform	-7.3	10.35	-30.8
Avery Dennison	-6.5	55.58	-7.3
Phillips-Van Hsn	-5.8	32.43	20.1
Genesco	-3.9	38.90	24.9

WHO'S NEWS

Kellwood Robert C. Skinner, Jr., current president and chief executive, has been elected to the additional office of chairman. Mr. Skinner succeeds Hal J. Upbin who is retiring. Mr. Upbin will continue working for Kellwood as a consultant.

Christopher & Banks Bill Prange resigned as chairman, chief executive and a director, citing health concerns. Mr. Prange was succeeded as chairman by Larry Barenbaum, a director since 1992 and a consultant to the specialty retail and service industries. Joseph Pennington, who has been president and chief operating officer since 1999, was named CEO. Chief Merchandising Officer Matthew Dillon was named president. Monica Dahl, who was responsible for human resources and information systems, was named executive vice president and chief operating officer.

Wet Seal named John Luttrell as executive vice president and chief financial officer. Mr. Luttrell was previously executive vice president of finance for Cost Plus Inc.

VF Corp. named George Irion as vice president for procurement for the company, a new position aimed at identifying more purchasing efficiencies. Irion had been director of purchasing and procurement for the company's giant Jeanswear division.

A. Banks dropped 13% despite posting a 45% increase in earnings per share for their fiscal third quarter. The company also announced a 25% stock dividend. **Bebe** fell 13%. Sales for the month increased 13% and comp store sales rose 4%...good, but not what investors have come to expect from this retailer. For the YTD comps rose 11% and total sales increased 18%. **Wal-Mart** down 7%. Not much good news coming from this behemoth during December, with the company saying that they expect sales to be at the low end of their original forecast of 2-4%. **Decker Outdoors** gained 29%. This stock got a late-year surge after an analyst at Piper Jaffray said the company's UGG boots were going to be a hot holiday item and that the company was reporting strong sell-throughs on UGG products. **GIII Apparel** rose 14%. The company reported fourth quarter earnings of \$29.2M or 48 cents per share last year, driven by a 24% increase in sales. They also announced that they expected first quarter 2006 earnings to be at least 64% higher than the same period last year. **Quiksilver** up 11%. The company reported an 82% increase in revenues for their fourth quarter and in increase in earning per share of 35% for the period. For the full year, revenues rose 41% to \$1.8B, and net income increased 32% to \$107M from \$81M last year. **Russell** down 17%. The company announced that they don't expect to meet sales and earnings expectations for fiscal 2005 as a result of lower than anticipated sales at retail and additional expenses associated with supply issues.

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LIZ CLAIBORNE

Liz Claiborne was started in 1976 by the namesake of the company, designer Liz Claiborne, along with Art Ortenberg, Leonard Boxer, and Jerome Chazen. Since then it has grown into a global powerhouse of multiple brands and several channels of distribution and is approaching the \$5 billion mark in sales.

Plenty has changed in the thirty years since Liz Claiborne started in the apparel industry; trade agreements, deflationary price pressures, increased competition from both wholesalers and retailers, and myriad other factors have impacted the business.

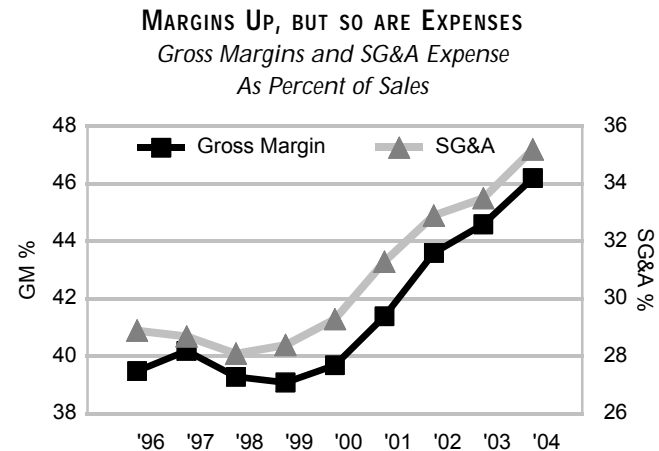
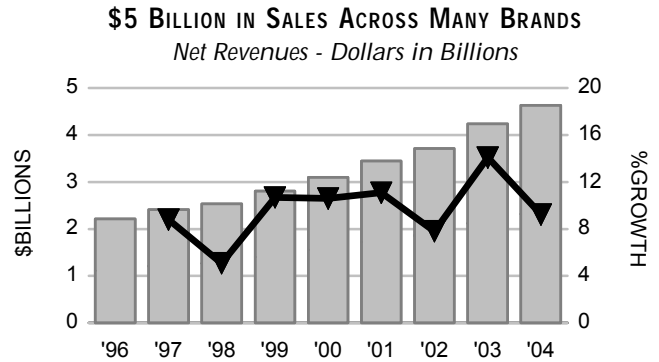
It has always been good for Liz, but over the past several years, with the leadership of Paul Charron who came on board in 1994, the company has shown solid growth in both sales and earnings. Much of this growth has come through acquisitions of existing brands, and we expect Liz will remain hot on the acquisition trail for the near future.

Business Liz Claiborne operates in the wholesale sector primarily, both with their own labels and through licenses. For the first nine months of fiscal 2005, wholesale apparel accounted for \$2.3 billion in sales, or 63% of the total, and wholesale non-apparel for around \$500M or 13% of total company sales.

They also have a substantial presence at retail, with 316 outlet stores, 309 specialty stores, and 620 international concession stores. Retail operations contributed \$840M or 23% of company sales through the third quarter 2005.

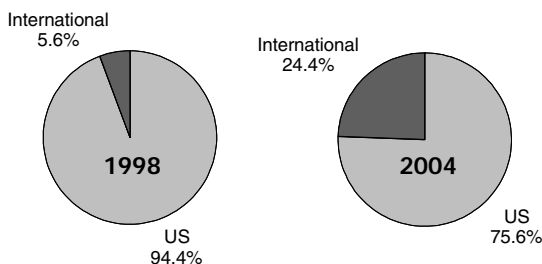
Brands Lots and lots of them...along with the Liz Claiborne brand and its offshoots, the company owns the Ellen Tracy, Axxess, Mexx, Monet, Sigrid Olsen, Spark, Trifari, Lucky Jeans, and Crazy Horse labels, along with many others. They also manufacture under license from Kenneth Cole, Candie's, DKNY Jeans and DKNY Active, and City DKNY.

Product and Distribution "They do it all" describes it pretty well. Product ranges from basic apparel and



sportswear up to better and bridge goods, along with accessories and cosmetics. Channels of distribution range from outlet stores all the way up through mass merchandisers, E-Commerce, and specialty stores to upscale department stores. They have substantial international business, accounting for about one-quarter of their sales volume and the same percentage of operating profits.

Acquisitions The most recent one, at the start of 2005, was their acquisition of C&C California, a marketer of premium apparel mostly through specialty stores. In 2003 Liz acquired both Enyce Holdings and Juicy Couture; in 2001 acquired Mexx Group B.V., an apparel company based in The Netherlands; in 2002 they acquired Mexx Canada Inc. This all followed their 1999 purchase of an 85% interest in Lucky Brand Dungarees, of which they purchased the remaining 15% in 2005. Recently there has been talk that Liz Claiborne is in talks with J. Jill regarding an acquisition.



LIZ CLAIBORNE

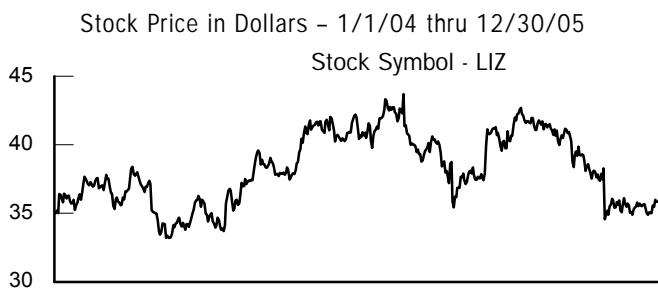
Are we seeing a pattern here? One of the biggest concerns for an apparel company like Liz Claiborne has to be the state of traditionally their biggest customer, the big department stores. We've talked about it enough that we won't delve into it here, but certainly Liz and their competitors aren't looking to this market sector for growth. You can take a bigger piece of a shrinking pie, but is this really a long-term strategy worth considering?

We don't think so, and from the looks of things Paul Charron and the management of Liz doesn't either. Their recent acquisitions, along with the potential J. Jill purchase, all give Liz a stronger foothold, or at least the potential for one, in markets outside the department store sector, whether it be specialty stores, international markets, or their own retail shops. The US department store base is not a vehicle for growth at this point, and they know it. To us, this is a sound strategy, and while it comes with some pain, it's refreshing to see a company positioning themselves for the long haul rather than trying to please Wall Street today.

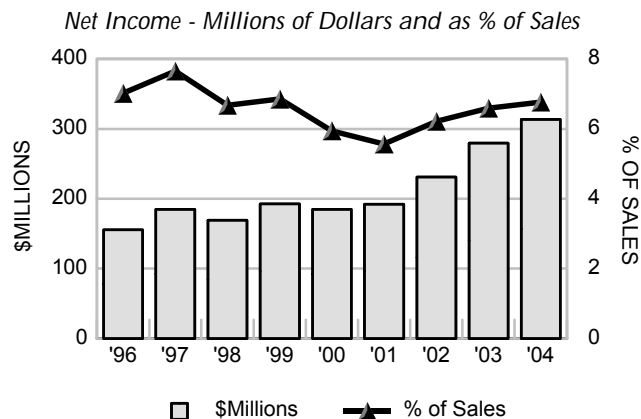
The Numbers that really stand out are in the chart to the left...both gross margins and expenses, as a percent of sales, have risen dramatically over the past five years. The increased margins come with the better brands and more direct retail sales...ditto for expenses though. This trend continued through the first nine months of fiscal 2005, and while it is not too worrisome at this point (easy for me to say), if margins start to slip it will definitely become an issue for management, and fast.

The first three quarters of 2005 were not great...sales grew only 6%, the slowest since 1999. While margins were still good, net income rose only slightly to \$239M from \$230M in the same period last year. Their stock took a hit when the news came out, falling to around \$35, or around 12 times trailing earnings.

Hard going in the short term, but we think that Liz Claiborne is setting itself up for the long term...a sound strategy, great leadership, and a clear sense of direction will keep Liz going strong through the rest of this decade and beyond.



EARNINGS TREND IS SOLID



FINANCIAL DATA

Millions of Dollars except for per share and store data

Fiscal Year	\$	\$	%	%
	2004	2003	2004	2003
Net Sales	4,632.8	4,241.1	100.0	100.0
Cost of goods sold	2,490.2	2,351.3	53.8	55.4
Gross Profit	2,142.6	1,889.8	46.2	44.6
SG&A	1,630.1	1,419.7	35.2	33.5
Restructuring (gain)	9.7	(0.7)	0.2	0.0
Operating Income	502.7	470.8	10.9	11.1
Other expense - net	9.6	(1.9)	0.2	0.0
Interest expense - net	(32.2)	(30.5)	-0.7	-0.7
EBIT	480.2	438.4	10.4	10.3
Income Taxes	166.6	158.7	3.6	3.7
Net Income	313.6	279.7	6.8	6.6
EPS, Basic	2.90	2.60	NA	NA
EPS, Diluted	2.85	2.55	NA	NA
Inventory	541.1	485.2	NA	NA
Long-Term Debt	476.6	440.3	NA	NA
	\$	\$	%	%
9 mnts End Sep	2005	2004	2005	2004
Net Sales	3,648.2	3,435.3	100.0	100.0
Cost of goods sold	1,926.0	1,851.2	52.8	53.9
Gross Profit	1,722.1	1,584.0	47.2	46.1
SG&A	1,327.1	1,203.9	36.4	35.0
Restructuring (gain)	(0.2)	(0.1)	0.0	0.0
Operating Income	395.2	380.3	10.8	11.1
Other expense - net	(1.5)	(1.5)	0.0	0.0
Interest expense - net	(23.6)	(22.4)	-0.6	-0.7
EBIT	370.1	356.3	10.1	10.4
Income Taxes	131.0	125.4	3.6	3.7
Net Income	239.1	230.9	6.6	6.7
EPS, Basic	2.24	2.13	NA	NA
EPS, Diluted	2.20	2.10	NA	NA
Inventory	636.8	621.5	NA	NA
Long-Term Debt	423.3	567.5	NA	NA

OUTLOOK: BUZZWORDS

In the business world, buzzwords are all around us. We hear them every day, and some have become so common that we don't even consider them buzzwords any more...they're just part of how we speak and communicate.

Some have an obvious meaning, and some are not so obvious, but after going through some old material (okay, I admit it, I was looking at a *Dilbert* book by cartoonist Scott Adams) and being the lover of words that I am, I decided to devote this Outlook to buzzwords or "consultant-speak" and how we can equate them to our industry.

Client-centric: A buzzword that means "focusing on the needs of the customer." The obvious question is, "Why would a business be focusing on anything but the needs of their customer?" How are you going to make any money if you are not giving your customers what they want, when they want it? Seems pretty straightforward, but clearly not in the forefront of the business strategy of many companies.

Out of Business The opposite of client-centric in today's business world.

Associates The buzzword for employees. Whatever you call them, all I can say is, find the best ones you can and do whatever you need to do to keep them. With so little margin for error, this could be the difference between success and failure.

Blocking and Tackling An obvious football reference that means "the basics." Today this means the right technology, solid distribution, a sound financial structure, and qualified "associates." Without these key building

blocks, all the vision, fashion, and talent in the world won't get you anywhere. If you're not good at blocking and tackling, you'd better get good quick...if you're good, you'd better get better.

Channibalism This is when a new marketing channel steals from an existing one without adding new growth. Clearly an issue in today's retail/wholesale/internet companies, including Liz Claiborne (the one we featured in this month's *Spotlight*) along with Ralph Lauren and many others.

Do you open your own stores at the risk of antagonizing your existing wholesale base? Do you sell wholesale and possibly take away from your own store sales? It's a complex issue, and certainly one answer is not right for every company. The only thing I would say is, clearly understand the ramifications of "crossing the channel" before you do it...if it doesn't work, the damage is hard to undo.

We must develop knowledge optimization initiatives to leverage our key learnings.

Scott Adams

Synergy Webster's defines it as, "The interaction of two or more agents or forces so that their combined effect is greater than the sum of their individual effects." Sounds complex, but in our world it simply means "does it fit?" Does the company/brand/license we are going to acquire fit our strategy, our product lines, our vision of where we want to be in the future?

Possumist One who ignores the truth in hopes that the facts will change or the problem will simply go away.

It astounds me sometimes to see the denial that comes out of senior management in this industry and others, and it is as widespread today as ever. If you don't think the paradigm has shifted (there's a classic buzzword for you) in today's industry, or that the "good ol' days" are coming back, I've got news for you. "Bankrupt" is fast becoming a synonym for denial.



Philip Black

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