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As Belts Tighten, Coach Feels the Pinch

By Jane Porter May 28, 2008

An accounting change has investors worried and may signal trouble for the luxury brand.

In April, Coach (COH) did something unusual for the retailing world: It stopped reporting sales from regular stores and factory outlets as separate items. Combining them makes it harder for investors to tell where the purveyor of leather bags and other luxury goods is getting its growth. Coach Chief Executive Lew Frankfort says the change provides a better overall picture of how the company is doing, adding: "Shareholders have enough confidence in Coach's management and our performance to give us the benefit of the doubt."

Some aren't convinced. Analysts, investors, and brand experts express surprise at the change and say Coach may hope to mask slowing sales at its full-price stores as consumers pull back. In the quarter ending Mar. 29, when Coach began combining outlet and full-price data, the company said sales at North American stores open more than a year grew a respectable 9%. But analysts say the growth came from factory stores—a trend that could harm the brand. "It's never a good sign when you reduce transparency," says Todd D. Slater, an analyst at Lazard Capital Markets (LAZ). "It's a sign of weakness." And a comedown for Coach, a bell- wether for affordable luxury since going public in 2000. By May 27, the stock was off 34%, from a 52-week high of 52 on May 30, 2007.

Keeping regular and factory stores distinct in the consumer's mind is a juggling act for any retailer, and few have done it better than Frankfort. Coach says it never discounts at its full-price stores, and you will find no mention of its outlets on the Web site. Originally, Coach used the factory locations to sell discontinued merchandise. But, says Frankfort, the outlets also attract people who want to "buy Coach but only on sale." So five years ago the retailer began creating less-trendy styles for the fortysomething women who frequent the factory stores.

In the fall came the first sign Coach was losing momentum. For the quarter ended Dec. 29, sales at full-price stores fell 1.1%, vs. a 20.8% increase a year earlier. Coach has since been discounting more steeply at its outlets, and Frankfort acknowledges building a bulwark against a tough economy.

One danger is that the factory stores could steal sales from the full-price shops. Anne Calatano, a stay-at-home mom in Kingston, N.Y., used to shop at regular Coach stores until realizing how much cheaper the outlets are. "I'll never buy a Coach product anywhere else but a factory store," she says. Plus, if Coach relies too much on the outlets to goose sales, its merchandise could seem less exclusive.

Meanwhile, Frankfort is pinning his hopes on a new collection that will appear in full-price stores this fall. It is something of a departure. The drapey bags are made of lighter-weight leather, and include patent, glazed, and metallic finishes that are new to the brand. The effect is more refined and sophisticated. "When consumers are reluctant to spend," says Frankfort, "you need to be particularly compelling."

Coach shareholders will be watching closely. "The truth usually outs," says money manager Patricia L. Edwards of San Francisco-based Wentworth Hauser & Violich, which owns 8,500 shares. "I've been known to stand outside stores comparing how many people are walking in versus how many people are walking out with bags. Eventually we'll know what's going on."