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[Delayed] Footwear Update: Still going strong in athletic categories
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Footwear Highlight's:

Footwear fell short for some in October (family in particular)
Surprising strength in Basketball - not dead with ongoing NBA lockout
Tailwind continues in Athletic and Outdoor segments Still not sold on SKX, while major issues are fading

October turned out to be a slower month for footwear than some had hoped, with an overall decrease in both units and sales in the marketplace. While we weren't surprised to see a sharp, but predictable decline in family footwear, led by the liquidation of Shape-Ups (SKX), it was interesting to see Basketball footwear deliver a slight increase after a dip in September and ongoing concerns regarding the current NBA lockout. The major brands have had aggressive campaigns to drive sales which appear to be working for footwear, which is generally more resilient to lockouts. However, NBA licensed apparel was off significantly for the month (see "Footwear update: Implications of a basketball lock-out" - October 5, 2011).

We continue to see strength in running, although Y/Y increases appear to be moderating from high-double digits to mid to high singles. The lightweight / minimalist trend that has been going strong for over a year now persists, and we don't see any weakness so far with related sales currently running 2x last year's volumes. However, we are seeing classic / traditional running shoes softening a bit, bringing comp increases down into the high-single-digit range, while cross-training sales comps remain in the low teens. Athletic brands continue to post solid gains (NKE trading at new highs), which parlays to the retailers that carry branded performance gear such as Foot Locker (FL) and Finish Line (FINL). We also see continued traction with a growing trend of popularity in "outdoor" categories, which we believe will continue to deliver a tailwind to vendors and retailers with solid exposure such as Wolverine Worldwide (WWW) through Merrell, Patagonia, etc. We continue to monitor developments at Timberland (VFC), as VF crafts a robust game plan for its recent acquisition without abandoning Timberland's social conscience. The latest development is collaboration with Ringo Starr on "canvas that cares" which will fund non-profit organizations through the auction of limited-edition footwear.

Also note Adidas' (ADS - Frankfurt) recent acquisition of Five Ten, demonstrating the company's desire to build exposure to the outdoor / alternative sports trend. Sketchers continues to struggle having recently reported a Y/Y decline of more than 25% in sales and eroding gross margins.

While checks suggest that more traditional ketcher's products are doing OK, the company has not been able to back-fill the hole left by

declining wellness sales. By early next year, we expect toning shoes to be in the rear-view mirror, and we've noted before (see "Footwear update: Will Running maintain its momentum?" - October 7, 2011) that Sketchers is trying to make a play in the performance running space with "GORun" to replace Shape-Ups sales. In fact, a championship marathoner, Meb Keflezighi, recently competed with GOrun shoes in the NYC Marathon. Nonetheless, we see performance running as a hard-sell for Sketchers, and we're not convinced that the company has the necessary ingredients for success here nor do we expect GOrun to have a material impact over the next 6 months. Going forward we see a slimmer Sketcher's with more modest expectations. Management will always be on the lookout for the next big thing and has found lightening in a bottle several times in the past. But, our recent checks suggest that they remain in search mode with nothing currently being tested making much of a splash in the marketplace.

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