Toys 'Were' Us?; Undercut by Big Discounters, Toys 'R' Us Is Indicating It May Get Out of the Business

Joseph Pereira, Rob Tomsho and Ann Zimmerman . Wall Street Journal , Eastern edition; New York, N.Y. [New York, N.Y]12 Aug 2004: B.1.

ABSTRACT (ABSTRACT)

"This just might be a sign that Toys 'R' Us is throwing in the towel," says Bill Simms, an analyst for Citigroup Inc.'s Smith Barney division. "Given the competitive threat of Wal-Mart today, Toys 'R' Us will not be able to continue as a going concern in the long term without drastic structural changes."

The irony is that Toys "R" Us declared victory as the dominant toy retailer 10 years ago, when it forced Child World and Kiddie City into back-to-back bankruptcies and liquidation, says Burt Flickinger, managing director, Strategic Marketing Group in New York. "It's a sad day in retailing when Toys 'R' Us declares victory, runs all the competition off the cliff and then Wal-Mart kills off the only surviving toy retailer."

Game Over?

Wal-Mart is beating up on the big toy chains that did the same to small toy stores two decades ago.

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1,200 stores.

Market Share: Where U.S. Consumers Buy Toys

ANNUAL ANNUAL
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Mass merchandisers/discounters (Wal-Mart, Target) 47.3% 48.6%
Toy stores (Toys "R" Us, KB Toys) 26.3 25.1
Specialty and hobby stores 8.8 7.0
Department/major chains (Macy's) 2.1 2.5
Food/drug stores (Rite Aid, grocery stores) 2.6 2.5
Direct mail/online-only toy sellers 5.1 4.5
Other 7.7 9.8

* Percentages based on all toy industry sales in the U.S. for each year.

Sources: NPD Group, NPD Funworld, Consumer Panel; WSJ research

FULL TEXT

IT COULD BE curtains for a onetime category killer.

After years of battling cut-throat pricing from Wal-Mart Stores Inc. and other discount chains, Toys "R" Us Inc. indicated it may be ready to get out of the toy business altogether.

In a surprise move, the once-dominant toy retailer said it is exploring a sale of its core 1,200-store toy chain. At the very least, the company said it plans to separate the toy unit from its smaller but faster-growing baby-products business -- in a possible spinoff -- and to significantly cut spending on the toy operation.

The retreat by Toys "R" Us is the most dramatic sign yet of Wal- Mart's growing supremacy over chains once thought to be category killers themselves. Toys "R" Us during the 1980s and early 1990s drove dozens of smaller toy operators out of business with lower prices and pile-'em-high selection.

But Wal-Mart, slashing prices even further and using toys as loss leaders, slowly eroded Toys "R" Us's grip on the market. The toy chain has seen its share of the U.S. retail toy market slip from 25% in the late 1980s to just 15% today, industry analysts estimate. Wal-Mart passed Toys "R" Us as the industry leader in 1998, and now commands about 25% of the U.S. market.

Aiding Wal-Mart's rise to the top has been a transformation of the toy industry from that of a fashion business in which consumers thronged stores in search of the hottest new crazes, to that of a commodity market of staples and evergreen products in which shoppers browse for bargains.

"This just might be a sign that Toys 'R' Us is throwing in the towel," says Bill Simms, an analyst for Citigroup Inc.'s Smith Barney division. "Given the competitive threat of Wal-Mart today, Toys 'R' Us will not be able to continue as a going concern in the long term without drastic structural changes."

The irony is that Toys "R" Us declared victory as the dominant toy retailer 10 years ago, when it forced Child World and Kiddie City into back-to-back bankruptcies and liquidation, says Burt Flickinger, managing director, Strategic Marketing Group in New York. "It's a sad day in retailing when Toys 'R' Us declares victory, runs all the competition off the cliff and then Wal-Mart kills off the only surviving toy retailer."

Toys "R" Us isn't the first category-killer to be bloodied by Wal- Mart and likely won't be the last. As the Bentonville, Ark., retailing giant has attempted to dominate more merchandise categories, the companies that once dominated them have become increasingly threatened. Today, Wal-Mart is the single biggest seller of consumer electronics, pressing players like Circuit City Stores Inc.

Viacom Inc.'s Blockbuster, the largest video rental chain in the country, has been struggling for the last several years -- in large part because Wal-Mart prices DVDs so low that it's almost as cheap to buy them as rent them. Wal-Mart's sales of health and beauty products are squeezing the giant drugstore chains. And its more than 1,500 combined grocery and discount stores are putting pressure on giant supermarket chains and have contributed to bankruptcy filings by 25 regional grocers, many of which drove scores of neighborhood grocers out of business earlier.

"Wal-Mart is putting pressure on everyone, indirectly and directly," says Jeff Lenard, spokesman for the National Association of Convenience Stores in Alexandria, Va.

In the toy business, Toys "R" Us has held out longer than other major chains. KB Toys Inc., a big mall-based chain, filed for bankruptcy last year, and FAO Inc., parent of FAO Schwarz Stores, slipped into bankruptcy for the second time last holiday season. Parts of the chain have since been bought by a private equity firm.

Toys "R" Us's announcement suggests that its management prefers to retreat from direct competition with Wal-Mart by focusing on its Babies "R" Us chain, which sells everything from diapers to strollers to baby furniture. With nearly 200 stores in the U.S., the Babies unit has been one of the rare bright spots for the company in recent years. In fiscal 2003, the Babies unit had operating earnings of $202 million, up 16% from a year earlier. It accounted for about 15% of the parent company's fiscal 2003 revenue of $11.6 billion.

Toys "R" Us, based in Wayne, N.J., said its vice chairman, 50-year- old Richard Markee, has been appointed president of its Babies unit and will become its chief executive officer and president after the separation is complete.

John Eyler, Toys "R" Us chairman and chief executive, said in a statement that the move reflects "the fact that our global toy business and our Babies "R" Us business operate in distinct markets and are at fundamentally different phases in their growth cycles." He said the separation would "provide a better opportunity for Babies 'R' Us to continue its healthy growth."

In a bid to cut costs, Toys "R" Us also said it would restructure operations at its headquarters and record $14 million in related charges in its fiscal second quarter. The company also said it plans to take $150 million in write-downs to liquidate inventory in its U.S. stores, and to cut operating expenses at its headquarters and U.S. toy unit by more than $125 million by fiscal 2005.

Toys "R" Us announced the moves following a seven-month strategic review. A company spokesman declined to elaborate beyond statements made in a press release.

Given the turmoil in toyland today, some industry observers say that the prospects for Toys "R" Us readily finding a single buyer for its toy business are uncertain -- particularly with its profit margins under pressure. "I have no idea who would buy it," said Chris Byrne, a private industry analyst.

George Whalin, president of Retail Management Consultants, a consulting concern based in San Marcos, Calif., said that, while some financial concern might be interested, he can't envision another player in the retail or toy industry making a bid.

Some predicted that the company's toy business might be divvied up among multiple buyers. "I could see different owners of the U.S. and international businesses, and I could see different participants in stripping out some of the real estate," said Matthew Fassler, an industry analyst at Goldman Sachs. Smith Barney's Mr. Simms reckons the company's toy business carries a market value of between $1.65 billion and $2.68 billion, but he adds he doesn't know how much the unit could fetch, if sold.

In recent years, Toys "R" Us has attempted to increase traffic by renovating its stores, in a much publicized effort termed "Mission Possible." It also sold more exclusive products, expanded distribution by offering its products in supermarkets and experimented with larger formats offering entertainment and services such as children's haircuts.

But revenues have been stagnant for the last several years, with profits seesawing in a generally downward direction. The price wars turned bloodier last Christmas, and Toys "R" Us reported U.S. same- store sales fell 5.1% in the fiscal year ended Jan. 31, 2004.

The toy industry has also been under pressure for some time due to changing toy tastes among children, who are migrating to electronic and computer games at earlier ages. But even in electronics, Toys "R" Us has also felt the heat from Best Buy Inc., Electronics Boutique and other videogame purveyors.

Earlier this year, Toys "R" Us shuttered its 146 Kids "R" Us clothing stores and all 36 educationally oriented Imaginarium stores. The company sold most of the Kids "R" Us stores to Office Depot Inc. and said it would convert 14 of the remaining stores to the Babies "R" Us format over the next two years.

Although Babies "R" Us may be thriving for the moment, Wal-Mart and rival Target Stores Inc. have both set their sights on that market as well. The giant discount chains have begun creating areas within their stores devoted to a broad array of baby merchandise, with strollers, car seats, cribs, clothes and food all in one section for easy shopping.

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Corrections &Amplifications

WAL-MART STORES Inc. in the past has sold certain toys below cost, according to executives at toy manufacturers and retailers. A Marketplace article Thursday didn't mean to imply that Wal-Mart sold all toys as loss leaders.

(WSJ Aug. 17, 2004)

DETAILS

Subject:	Competition; Market exit; Retail stores; Toys
Company / organization:	Name: Toys R Us Inc; Ticker: TOY; NAICS: 451120, 451110; DUNS: 00-698-5808
Classification:	8390: Retailing industry; 9190: United States
Publication title:	Wall Street Journal, Eastern edition; New York, N.Y.
Pages:	B.1
Publication year:	2004
Publication date:	Aug 12, 2004
Publisher:	Dow Jones &Company Inc
Place of publication:	New York, N.Y.
Country of publication:	United States, New York, N.Y.
Publication subject:	Business And Economics--Banking And Finance
ISSN:	00999660
Source type:	Newspapers
Language of publication:	English
Document type:	News
ProQuest document ID:	398915428
Document URL:	https://search.proquest.com/docview/398915428?accountid=30530
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Last updated:	2017-11-02
Database:	US Newsstream

Toys R Somebody Else; Chain's Sale Ignites Speculation About Direction, Strategy

Michael Barbaro and Ben White . The Washington Post ; Washington, D.C. [Washington, D.C]18 Mar 2005: E.01.

ABSTRACT (ABSTRACT)

In an interview, Toys R Us chief executive John H. Eyler Jr. said the three investors "believe in the Toys R Us brand" and that he expects they will leave the chain's management largely untouched. Under Eyler's watch the company has continued to lose ground to Wal- Mart, but has tried to battle back by renovating stores, striking exclusive product deals with toy companies and training its staff better.

Toys R Us founder Charles Lazarus opened Children's Bargain Town in Washington in 1948 and the first Toys R Us in Rockville nine years later. The company evolved into a powerful international toy vendor, with Kids R Us, Babies R Us and Toyrus.com. It operates 1,500 stores worldwide, including 681 Toys R Us and 218 Babies R Us stores in the United States.

The Bentonville, Ark., retailer dethroned Toys R Us as the nation's No. 1 toy seller in 1998. Today, Wal-Mart controls 22 percent of the U.S. toy market, compared with 17 percent for Toys R Us, according to Davidowitz &Associates Inc., a New York-based retail consulting firm.

FULL TEXT

Toys R Us Inc. executives yesterday said the company's takeover by an investment consortium will help the pioneering toy retailer survive in an industry dominated by discounters such as Wal-Mart, and played down predictions that the new owners will sell off the business store by store.

The nation's second-largest toy retailer, which started 57 years ago with a store on 18th Street NW in the District, announced yesterday it had agreed to be bought for $6.6 billion by the private equity firms Bain Capital LLC and Kohlberg Kravis Roberts &Co., and by Vornado Realty Trust, one of the country's largest owners of retail and office property.

In an interview, Toys R Us chief executive John H. Eyler Jr. said the three investors "believe in the Toys R Us brand" and that he expects they will leave the chain's management largely untouched. Under Eyler's watch the company has continued to lose ground to Wal- Mart, but has tried to battle back by renovating stores, striking exclusive product deals with toy companies and training its staff better.

"To the consumer, the message is that these new owners have embraced our strategy and Toys R Us is going to be around for a long time," Eyler said.

But analysts warned that Toys R Us still faces daunting challenges. Competition from much larger discount chains is only likely to stiffen, while changes in the way children play may force the store from the familiar territory of Barbies and Legos and further into the realm of digital entertainment.

Jim Silver, publisher of ToyBook, an industry trade publication, said the retailer must "transform itself into a store that sells all forms of family entertainment," from Legos to iPods.

"Five years from now, we may find a Toys R Us with as many problems up against an even stronger Wal-Mart," said Sean P. McGowan, a retail analyst at Harris Nesbitt Corp.

The proposed sale of Toys R Us highlights the decline of the first generation of big-box retailers, whose strategy of swallowing an entire category of goods, such as toys or electronics, drove scores of mom-and-pop stores out of business beginning in the 1950s.

Now, in a twist of fate, those same chains are under attack from discounters, warehouse clubs and, in some cases, more nimble imitators. Struggling electronics retailer Circuit City just fended off a takeover bid and investors in OfficeMax, the office supply store, are pressing managers to consider breaking up the company or selling it.

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Analysts predict a sell-off of more than 100 stores, noting that the company's real estate can be as valuable as its toy business. Such sales could leave some of this region's more valuable retail real estate up for grabs. Toys R Us operates about 20 stores in the region, many in prime shopping corridors.

"The hidden value of Toys R Us is in its real estate," said Steven B. Greenberg, president of the Greenberg Group, which advises retailers on real estate. Toys R Us owns about half of its stores - - a high percentage -- and pays relatively low rents for the rest, making the properties ripe for resale or re-leasing, Greenberg said.

But Eyler said the winning bidders' final price reflected their interest in the Toys R Us business, not merely in its real estate. Competing alliances, which offered lower bids, had focused on the value of Toys R Us after "spitting out the pieces" and capitalizing on the land and leases it controls, he said.

Those competing bidders "looked at the asset values," Eyler said. "The KKR team looked at the future of the business."

Spokesmen for the three investment groups declined to comment on the acquisition beyond their official public statements. It is not clear if the new owners intend to keep Toys R Us as a public company or take it private. The acquisition price amounted to $26.75 a share and included a takeover of the company's outstanding debt.

Toys R Us closed yesterday up 1 percent, at $26.

People close to the deal said the investors emerged as natural allies because each brought different strengths.

Vornado is among the largest real estate owners in the country, with deep expertise in acquiring and selling retail space or converting it to other more lucrative uses.

KKR, a longtime client of Toys R Us adviser Credit Suisse First Boston, is among the largest private equity firms in the nation and could take the lead in structuring an expected initial public offering of the Babies R Us franchise.

Bain is viewed as having strong expertise in improving managerial operations at troubled companies. Sources close to the deal said Bain's presence indicated that the acquirers would seek to restructure Toys R Us rather than liquidate it.

Retail analysts predict the new owners will separate the more lucrative Babies R Us from its parent company and eventually spin it off as a separate public company. The baby division posted operating profit of $198 million in 2003, twice that of the company's U.S. toy division.

"I'd be very surprised if you don't see Babies R Us as a public franchise in the near future," said Gregg Tenser of NWQ Investment Management, which as of December owned 4.6 million Toys R Us shares.

Analysts blame the bulk of the toy chain's troubles on a single competitor: Wal-Mart.

The Bentonville, Ark., retailer dethroned Toys R Us as the nation's No. 1 toy seller in 1998. Today, Wal-Mart controls 22 percent of the U.S. toy market, compared with 17 percent for Toys R Us, according to Davidowitz &Associates Inc., a New York-based retail consulting firm.

In 2000, Toys R Us lured Eyler away from competitor FAO Schwarz Inc. and tried to redefine itself. It built a new flagship store in New York's Times Square, complete with an indoor Ferris wheel, and remodeled hundreds of stores, at a cost of about $600,000 each.

But it could not stop Wal-Mart from beating it on toy prices. During the 2003 holiday shopping season, Wal-Mart undercut Toys R Us prices by an average of 20 percent, said ToyBook publisher Silver.

Toys R Us scrambled to match those prices, a move that propped up sales but dampened profits. The chain's profit fell 62 percent in its fiscal year 2003, to $88 million, and sales have remained flat at $11.6 billion.

Other large toy chains have suffered even more. FAO Schwartz and KB Toys Inc. have filed for Chapter 11 bankruptcy protection, both citing competition from discounters. FAO recently emerged from bankruptcy, but now operates just two stores.

Toys R Us has avoided that fate. Since 2003, the company has sold its 146-store Kids R Us clothing chain and closed 36 Imaginarium stores, which sold educational products. In early 2004, the company promised to cut spending by $175 million.

White reported from New York.

DETAILS

Subject:	Retailing industry; Investment companies; Acquisitions &mergers; Strategic planning
Location:	Washington DC

Company / organization:	Name: Bain Capital LLC; NAICS: 523110; SIC: 6799; Name: Kohlberg Kravis Roberts &Co; NAICS: 523110; SIC: 6020, 6720; DUNS: 06-022-3393; Name: Vornado Realty Trust; NAICS: 525930; Name: Toys R Us Inc; Ticker: TOY; NAICS: 451120, 451110; DUNS: 00-698-5808
Classification:	2310: Planning; 2330: Acquisitions &mergers; 8390: Retailing industry; 9190: United States
Publication title:	The Washington Post; Washington, D.C.
Pages:	E.01
Number of pages:	0
Publication year:	2005
Publication date:	Mar 18, 2005
Section:	FINANCIAL
Publisher:	WP Company LLC d/b/a The Washington Post
Place of publication:	Washington, D.C.
Country of publication:	United States, Washington, D.C.
Publication subject:	General Interest Periodicals--United States
ISSN:	01908286
Source type:	Newspapers
Language of publication:	English
Document type:	News
ProQuest document ID:	409870234
Document URL:	https://search.proquest.com/docview/409870234?accountid=30530
Copyright:	Copyright The Washington Post Company Mar 18, 2005
Last updated:	2017-11-02
Database:	US Newsstream