



JEWELRY RETAIL AN INDUSTRY STUDY

Things you will learn from this whitepaper:

1. How does competition & technology affect the industry's landscape?
2. What are the current challenges facing the jewelry retail industry?
3. Why is jewelry retail especially difficult in the current economic downturn?
4. What are the regional & international issues affecting the jewelry retail industry?

This whitepaper will have special interest to:

1. Attorneys consulting with jewelry retail owners considering mergers or acquisitions.
2. Judges presiding over business disputes & litigation cases.
3. Business mediators & arbitrators.
4. Financial & income tax advisors.
5. Those concerned with the valuation of the jewelry retail industry.

Notice & Disclaimer

In a forensic accounting setting, the purpose of an industry analysis is to allow a comparison of the subject company to its industry. This comparison is vital to assess the strengths and weaknesses of the subject company, as well as its industry and company specific risks.

The following study contains a brief, selected analysis of the specified industry. It is based upon a review of current economic statistics, articles in the financial press, reviews found in current business periodicals and information posted on numerous internet sites. It does not purport to be all-inclusive or to contain all of the information which a prospective investor or lender may require. Projections and opinions are based upon information provided by third parties. We make no representations or assurances that this information is complete or accurate. Neither Mark S. Gottlieb, CPA, PC nor any of its officers, employees, or representatives make any representation as to the accuracy of completeness of this report or its contents, nor shall any of the foregoing have any liability resulting from the use of the information contained herein or otherwise supplied.

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&
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Industry Overview

The U.S. retail jewelry industry is comprised of five main segments: bridal jewelry (30%), fashion jewelry (22%), watches (18%), precious stones (15%) and precious metals (15%). Bridal jewelry, the only “necessary” component of jewelry retail, is less influenced by economic conditions than fashion jewelry, which is considered a luxury good. The category of watches generally includes clocks as well as most jewelry repairs. Precious metals include gold, silver, platinum and palladium. Precious stones come in over 130 varieties, around 50 of which are commonly sold by retail jewelers.

The retail jewelry industry is highly fragmented, with the top ten jewelry chains comprising less than 25 percent of the market. No retailer claims more than 6 percent market share. Chains are prevalent in the industry, though independent retailers are firmly rooted throughout. Annual jewelry store sales run about \$27 billion; wholesalers and manufacturers account for an additional \$27 billion in sales.

There are nearly 50,000 stores engaged in jewelry retail, and the industry employs approximately 200,000 individuals. Wal-Mart is the largest retailer in the country. Next is Zale, the biggest specialty jeweler with over 2,000 stores and kiosks. U.S. retailers account for 15 percent of worldwide sales in the industry.

Competitive Landscape

The demand for jewelry is largely determined by the disposable income of consumers. The increasing amount of affluent individuals, working women, double-income households and fashion-conscious men has kept jewelry sales strong through 2005. When raw material prices fall, jewelry becomes more affordable, and consumer demand rises. Renewed confidence in the economy has also played a significant role.

Sales costs are both high and fixed, so profitability depends upon volume of sales. Gross margins, at 50 percent, are unusually high. Mass merchants have won market share by controlling costs and cutting prices. A 10 percent luxury tax levied on sales exceeding \$10,000 has raised concern among retailers, and environmental regulations have imparted extra costs to manufacturers. These costs are passed on to wholesalers and retailers, and affect profitability as well.

Over the past decade, online jewelry sales have risen steadily. This development has forced retail merchants to adapt and many have moved some component of their operations online. Increasing numbers of manufacturers and wholesalers are also conducting business online. Because jewelry is seldom branded, product differentiation is a key point of competition among retailers. Good designers are valued.

Jewelry sales are highest during the Christmas season and during the weeks preceding Valentine’s Day. Mother’s Day sees a spike in sales as well.



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Products, Operations & Technology

Jewelry is expensive and difficult for consumers to evaluate. It is seldom branded and varies widely in design and quality. Purchases require professional expertise. Because of this, consumers tend to buy jewelry from merchants they perceive to be trustworthy. Large retailers such as Wal-Mart and Tiffany benefit from this industry peculiarity; local jewelers with community roots and good reputations benefit as well.

Retailers generally purchase finished jewelry from manufacturers and wholesalers, though some retailers create pieces from unfinished or unmounted materials. In smaller retail stores, jewelers may be involved in all aspects of the work. Retailers may hold proprietary agreements with designers, who sell their designs exclusively through the company. Some retailers hold agreements with manufacturers to sell merchandise on consignment.

Marketing products and training sales staff are also important aspects of retail jewelry. Company buyers must be attuned to fashion trends, as well as technically savvy. Repair services are not standard, though many jewelers choose to offer them. Such services can account for 10 percent of annual revenue. In small retail shops, jewelers may be involved in all aspects of work.

Sales & Marketing

Because jewelry retailers must present an upscale appearance, store location, furnishings and professional staff are significant operating expenses. Companies may cater to various demographics, but an elegant and professional appearance is considered vital.

Most retailers market through print advertising, though mail and email campaigns are also utilized. These campaigns are narrowly focused, using demographic information gleaned from market research.

Finance & Regulation

Because jewelry is expensive, credit is a key issue for retail jewelers. About 50 percent of a typical jeweler's sales are transacted with credit cards. The introduction of in-house credit cards, offered by larger retailers in conjunction with banks, has served to boost sales by providing customers with lower interest rates and better terms. Most small retailers avoid risk by taking only third-party credit cards. Others extend company credit on purchases to trusted customers, a risky proposition that can backfire.

Jewelers must adhere to standard fair trade and credit laws, but are not encumbered by trade-specific regulations. The FTC provides guidance for jewelers to accurately advertise and describe gemstones. This is essential as firms like Gemesis, Corp. and Apollo Diamond Inc. are applying new technologies to gem creation. Technology for the creation of synthetic diamonds has been vastly improved, and Gemesis, Corp. has worked in imparting new shades to various stones.

Jewelry sales are both seasonal and cyclical in nature. A full 40 percent of revenue is generated in the fourth quarter, and 25 percent of annual jewelry sales occur in December alone. Overall sales



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can be affected by mineral availability, fashion trends, environmental regulations and international tariffs. Gold, silver, platinum and palladium are all exchangeable commodities, and fluctuations in market price directly affect sales volume.

Because jewelers believe it is much easier to sell product “in-hand”, merchandise inventories are high. An average jeweler may sell \$2 million in product annually, half of which is inventoried on site at a given time. To prevent embezzlement, retailers must be vigilant regarding inventory control. Receivables are usually high, particularly for companies such as Zale, which offers its own credit card.

Regional & International Issues

U.S. imports of jewelry have increased dramatically since the mid 1980s, and show no sign of slowing. In the early 2000s, the U.S. Department of Commerce identified 1,900 manufacturers of precious metal jewelry in the U.S., employing 32,400 people. This number is expected to dwindle as manufacturers face strong competition from their foreign counterparts, many of whom have low wage costs and increasing access to trade technologies.

The three largest markets for U.S. exports of precious metal jewelry are Switzerland, Japan and Thailand. The U.S. is by far the world’s largest purchaser of finished jewelry, with Israel and Belgium providing a significant share of its imports. Israel and Belgium are major centers for converting rough diamonds into finished gemstones.

Both supply and demand in the diamond market are controlled by De Beers, a South African company founded by the Oppenheimer family. Controlling over 70 percent of the rough diamond market, De Beers holds longstanding production and purchase agreements with most diamond producing countries. Recently De Beers has been challenged by growing competition from synthetic diamond manufacturers, as well as purveyors of diamond “imitators” (e.g. cubic zirconia). In response, the company has begun branding its diamonds to protect market share. Because De Beers operates a cartel, the company is not allowed to own companies in the US.

Human Resources

Due to the technical knowledge required to sell jewelry, stores must invest in specialized training for employees. Inventory is valuable, and bonding of employees is common. Salespeople frequently work on commission and are employed full-time.

Critical Issues

Sales linked to economic health – Disposable income and consumer confidence are key determinants to the success of retail jewelers. High-end sales in particular suffer in times of economic draught.

Competition from Mass Merchants – With sales by mass merchants nearing 50 percent of total retail sales, independent jewelers and department stores are scrambling to compete. Wal-Mart in particular has presented a stiff challenge to smaller U.S. retailers.



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Other Business Challenges

Dependence on Key Supplier – With the world diamond supply primarily controlled by De Beers, retailers find themselves at the mercy of the giant cartel's pricing and distribution decisions. Synthetic diamonds have begun to make inroads into De Beers' monopoly, and legal challenges by both the U.S. and E.U. have pleased many smaller retailers.

Exposure to Credit Risk – The practice of extending credit to well-known customers expands in periods of economic strength, since collection proves easier. Extending credit affords smaller retailers another competitive tool, though the possibility of customer default always exists.

Public Mistrust – The public's historic mistrust of jewelers is perpetuated by high markups and vagaries in pricing. Product quality can be difficult for laypeople to assess, and contradictory information seems prevalent. Reputation is extremely important in the industry.

Crime Exposure – Because merchandise is valuable, retailers are prominent targets for potential thieves. Employees must be screened, and security is important. The industry loses over \$100 million yearly to crime.

Business Trends

Private Credit Cards – Retailers with private credit cards have had some success in marketing services like credit insurance to customers. Almost half of all card holders purchase some form of insurance from their jeweler, and cards have been used to market promotional materials as well. Jewelers see cards as a means of engendering themselves to customers, and may use them to bundle promotional materials related to the store.

Internet Sales – Though most jewelers believe it is easiest to sell merchandise in person, the growing online market has attracted many vendors. By 2003, online purchasing accounted for 6 percent of customer retail spending in the U.S., and jewelers have been quick to establish a presence online.

Demographics – About 39 percent of the U.S. adult population purchases fine jewelry each year, and consumers from age 18 to 24 have the highest incidence of jewelry purchases. Americans age 45 to 65, the segment of the population with the highest income, is at the peak of their buying prowess. This group's demand for high-end jewelry is highest, and the demographic picture for retail jewelry markets is strong.



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