Case 1-4: True Religion Brand Jeans and the Premium Jeans Industry: Cyclical Downturn or Secular Slowdown?

August 27, 2010 (San Francisco—Reuters.) The words sounded ominous, especially coming from a jeans brand: "We are basically at the end of the denim dominance." But the co-founder of Guess, Maurice Marciano, who broke the news to analysts in an earnings conference call this week, said the change would mean more sales, not less. The fashion cycle is turning yet again, and next spring it's spinning toward a greater emphasis on other fabrics. Khaki, corduroy, and twill pants are expected to knock premium denim off of its pedestal and inspire fickle consumers to shop. Guess' pronouncement rattled the nerves of investors—already concerned about inventory levels and a conservative outlook—who sent shares down more than 7 percent the next morning. Shares of premium denim brand True Religion shed 7 percent from the beginning of the week.[1]

True Religion Brand Jeans

Founded in 2002 by Jeff and Kym Lubell, True Religion had become the second largest premium denim brand in the United States by 2010. The line sold through upscale department stores like Nordstrom, Neiman-Marcus, Bergdorf Goodman, Bloomingdales, and Saks Fifth Avenue as well in about 800 trendy boutiques in the United States. Despite the company's historically strong financial performance, the stock had a chart like a roller coaster. Investors worried that premium jeans, jeans priced over $100 per pair, would go the way of go-go boots as fickle "fashionistas" moved on to the next fashion trend. Moreover, the recent economic weakness accompanied by enormous improvements in bargain-priced jeans' fabric, fit, and styling raised the specter of consumers "trading down" from expensive brands to stalwarts like Levi's, Lee, and Gap jeans.

After years of skyrocketing sales, the premium jeans industry experienced its first slowdown in 2007 with sales down by about –5 percent. Although the premium jeans industry seemed to defy economic weakness with sales up by an estimated 17 percent in 2008, the industry saw revenues slump an estimated –8 percent to about $1.6 billion at retail in 2009 (see Exhibit 1). Upscale department stores and boutiques alike struggled in 2009. Premium industry bellwether Nordstrom reported over a –12 percent drop in same-store sales in 2008 and more than a –7 percent decline in comparable store sales in 2009 in its full-line department stores. Neiman-Marcus, Bergdorf Goodman, and Saks also reported major declines in same-store sales in 2009. In April 2009 alone, Neiman-Marcus reported a –27 percent drop in same-store sales for its namesake stores as well as for subsidiary Bergdorf Goodman. Similarly, Saks saw same-store sales plummet by –32 percent in the month.[2]

Upscale department stores experienced a significant improvement in same-store sales against easy comparisons in 2010. Nevertheless, premium denim sales remained "soft" in the pricey retail outlets. Retail buyers reportedly remained cautious—keeping inventory levels tight—and retailers increased their focus on store brand merchandise in order to boost profit margins. At the same time, a 2009 consumer survey by McKinsey and Company suggested that many Americans had traded down to less expensive products during the recession and had no intention of trading back up to premium goods after the economy recovered. Some analysts estimated that up to 70 percent of luxury brand sales and 50 percent of the growth in the luxury market was derived from the so-called aspirational shoppers prior to the recession.[3] Aspirational shoppers—middle-class consumers with luxury tastes—had household incomes between $75,000 and $150,000. Easy credit and rising home prices fueled spending and made the aspirational shopper the target of many brand marketing campaigns in the heady days before the housing bubble burst and unemployment surged to post-Great Depression highs.

Prior to the recession, many premium denim labels defined themselves as "aspirational brands"—expensive but not as pricey as couture brands who charged thousands for each piece of clothing. Numerous press articles declared the death of the aspirational shopper and a new "bargain hunting is cool" zeitgeist that would survive after the economy rebounded. In addition to weak demand, premium denim labels experienced cost pressures as cotton prices hit a post–Civil War high in 2010. At the same time, consumers had begun to shy away from embellished and distressed fashion jeans in favor of so-called clean styles that could last for several years. The trend toward wardrobe staples meant that it was increasingly difficult for premium labels to demonstrate their "value" to the consumer as it was harder to differentiate a plain, dark blue pair of expensive jeans from a less expensive basic jean. In an interview with Reuters, industry analyst Eric Beder said, "Premium denim slows

Exhibit 1 2009 Selected Financials—Jeans Companies ($ in thousands except per share amounts & betas)

	Buckle	Guess	Joe's	Levi's	Liz Claiborne	People's Liberation	True Religion	VF Corp
Sales	$898,287	$2,128,466[a]	$80,116	$4,105,766[c]	$3,011,859	$35,635	$311,001	$7,220,286[g]
Gross Profit	400,668	941,487	39,785	1,973,405	1,397,750	17,245	195,562	3,195,164
Gross Margin	44.6%	44.2%	49.7%	48.1%	46.4%	48.4%	62.9%	44.3%
Operating Profit	$199,462	$358,816	$8,523	$378,088	–$334,584	–$442	$77,597	$736,817
Operating Margin	22.2%	16.9%	10.6%	9.2%	–11.1%	–1.2%	25.0%	10.2%
Interest Expense	$0	$2,176	$388[b]	$148,718	$65,100	$208[e]	$0	–$85,902
Net Income	127,303	242,761	24,520	151,875	–305,410	484	47,332	461,271
EPS (fully diluted)	$2.73	$2.61		NA	–$3.26	$0.01	$1.92	$4.13
Shares Outstanding	46,381	91,592	61,121	NA	93,880	36,022	24,659	
Cash	$158,027	$502,062	$13,195	$270,804	$20,372	$2,734	$110,479	$731,549
Accounts Receivable	6,911	289,638	1,731	552,252	263,508	94	27,217	776,140
Inventory	88,187	246,197	22,887	451,272	319,713	2,732	34,502	958,639
Total Assets	488,903	1,539,175	79,624	2,989,381	1,605,903	8,990	229,806	6,470,657
Accounts Payable	$24,364	$195,075	$13,590	$198,220	$144,942	$3,455	$11,717	$373,186
Total Debt	0	90,055	0	1,860,265	658,151	0	0	1,187,126
Shareholders Equity	354,259	1,026,343	61,506	–333,119	219,879	4,711	197,854	3,813,285
Depreciation	$25,135	$56,521	$536	$84,603	$163,564	$536	$6,492	$153,707
Capital Expenditures	50,561	82,286	873	82,938	65,332	873	20,082	85,859
Company Owned Stores	401	711	6	414	240[d]	5	73	28[h]
Licensed Stores	0	775	0	1,500	0	0	0	0
Beta (as of 12/22/10)	0.82	1.78	1.74	NA	2.47	1.42	1.77	0.97
Share Price (12/22/10)	$37.78	$48.17	1.58	NA	$7.53	$0.14	$23.01	$86.75
Denim Sales as % of Total	43%	30%	97%	84%	50%	NA	13%	NA
Comparable Store Sales Change	7.8%	–4.5%	NA	NA	–16.2%	NA	NA[f]	NA

(a) Includes $ 97.4 million in licensing royalties. Denim estimate Source Reuters: Analysis-Garmentos Proclaim the End of Denim Dominance by Alexandria Sage http://www.reuters.com

(b) Interest on recourse accounts receivable sold to Factor, cash advances on inventory, and to maintain open Letters of Credit. Interest rate on accounts receivable assigned to Factor was 3.50% per month on 11/30/2009 or 0.25 + the Chase Prime Rate. Note receivables are sold to the Factor at 85% of face value. Pg. 79 JOEZ 10K 2009. Denim sales as a percentage of total sales source: Marc Crossman CEO, Company Press Release.

(c) Includes $82.9 million in licensing royalties. Operating income includes $5.2 million restructuring charge Denim percentage author's estimates.

(d) Lucky Brand stores only. Liz Claiborne owned 458 specialty retail stores and 363 outlet stores. Sales of Lucky Brand were $439.6 million-down 7.8% in 2009. Source Page 52, Liz Claiborne 2009 10K Denim as a percentage of Lucky Brand total sales source: WWD "Denim in Depth: New Lucky Brand CEO Seeks Sharper Focus" 5/20/10 accessed 12/23/10. http://WWW.WWd.com/WWd-publications/WWd-denim-in depth/2010-05-19/#/article/markets-news/new-lucky-brand-ceo-seeks-sharper-focus-3080889?navSection=issues&navld=3080751.

(e) Interest expense on factored receivables and inventory borrowings.

(f) Denim sales as a percentage of total sales for True Religion-Bonita Austin's estimate. TRLG did not release full-year comparable store sales gains for 2009. Comparable store sales were up 22% in 4Q:09.

(g) Includes $77.2 million in licensing/royalty income.

(h) 7 for All Mankind stores only. VF Corp owns and operates 757 stores worldwide with 681 of them monobrand stores dedicated to sales of Vans, The North Face, 7 for All Mankind, Nautica, Lucy Lee, and Wrangler.

down when the trend goes basic. How do you recognize its premium? How much differentiation is there in that pair of $189 jeans compared to a $79 pair when they are just dark and straight?"[4]

The combination of the consumer's tight pocketbook and the shift toward basic styles constrained the brands' ability to pass on the raw material price increases to their customers. Notably, one of the most expensive denim lines, Rock & Republic, declared bankruptcy in April 2010. Moreover, several jeans makers reported disappointing sales and earnings in the first nine months of 2010 and lowered their full-year forecasts.

The True Religion brand had weathered the economic storm relatively well. Fueled by the expansion of the number of company-owned retail stores, True Religion's revenues jumped 30 percent per year on average accompanied by a

28 percent average annual increase in earnings per share from 2006 to 2009. However, the company reported surprisingly disappointing third-quarter sales and profits and cut its full-year forecast in 2010. While sales rose 16 percent in the first nine months of 2010, earnings per share plunged—18 percent in the period. Growth in company-owned stores and international markets was robust in 2010, but the company's domestic wholesale jeans business was quite weak for the second straight year as department-store accounts and boutique stores continued to cut back on orders.

Recent changes in the competitive landscape raised questions about the relevance of the True Religion brand as brands targeted to women over 40, and women with "curvy figures" gained strength. Women over 40 spent more and had more spending power than younger consumers. While "curvy women" received attention from the likes of Gap and Levi's, premium denim makers mainly ignored them. Jeff Lubell so far had kept the brand on track and on the cutting edge of denim fashion. True Religion's sweet spot was the very young, very slim, and fashion-forward woman. Until 2009, the company offered its products only up to a misses size 8, while the average American woman was two sizes larger at a misses size 12. The line's focus on the very young and very slim consumer created an opportunity for brands such as Not Your Daughter's (NYDJ) Jeans with its famous tummy tuck line to carve out a potentially sizeable niche of the premium market. It was not clear how well True Religion would fare if fashion jeans remained out of favor. Given the average American woman had seven pairs of jeans in her closet in 2009, would she shop for new premium jeans if her jeans remained fashionable for years rather than for a few seasons?[5] More to the point, would she turn to True Religion brand rather than less fashion-oriented lines like 7 For All Mankind or Joe's Jeans?

Lubell's goal was to boost worldwide revenues to $1 billion from $311 million in 2009. In order to hit this target, True Religion had to diversify away from denim into other apparel and related categories. Could Lubell persuade consumers to view True Religion as a diversified "lifestyle brand" like Ralph Lauren or would the line remain predominantly a denim jeans label? Given the shifts in the market, did Lubell have to achieve lifestyle brand status for True Religion merely to survive over the next few years? While non-denim sales stood to about a quarter of unit sales in company-owned stores in 2009, other retailers largely remained uninterested in the company's offerings outside of the jeans category. As a result, non-denim revenues came in at an estimated 13 percent of revenues in 2010.

The firm's management expected retail store expansion to be the company's major growth engine in the future. Nearly all of True Religion's important competitors had similar plans and long-term growth strategies. Would retail store expansions by the likes of 7 For All Mankind keep True Religion from obtaining the most productive retail sites for its stores? How did the unexpected resignation of company President Michael Buckley in May 2010 impact True Religion's long-term strategy? True Religion had hired industry-veteran Mike Egeck (former CEO of 7 For All Mankind) as Buckley's replacement in June, but Egeck had yet to make any public comments about his plans for the business.

In the meantime, VF Corporation snapped up the assets out of bankruptcy of trendsetter Rock & Republic in mid-2010. A private equity group led by former Reebok President Paul Fireman purchased a stake in Hudson jeans for $30 million in 2010. In addition, Star Capital purchased a majority stake in J Brand premium jeans for about $50 million. Private equity investors were attracted to the sector due to the high profits and returns the larger established brands earned. All of these investments in the sector increased the likelihood that competition would become fiercer as the smaller brands had more financial flexibility to aggressively fight for market share.

Could True Religion successfully navigate the changes in broad industry trends, the shifts in the competitive landscape, and a possible consumer move-away from denim? Would True Religion survive all of its challenges and emerge as a powerful $1 billion brand or would the brand fade as many others had in the volatile apparel market over the years? Investors had many questions about the long-term viability of the company.

A Brief Recap of the Recent History of the U.S. Denim Market

Calvin Klein popularized the concept of premium jeans in the late 1970s. The designer burst onto the jeans scene with shockingly high prices, a skin-tight fit, and a controversial advertising campaign featuring a very young Brooke Shields. As Brooke Shields confided to U.S. consumers that nothing came between her and her "Calvins," the $35 per pair jeans flew off store shelves. At the time, mainstream Lee and Wrangler blue jeans retailed for about $12 per pair on average. Suddenly, jeans were no longer functional wardrobe staples. They were sexy fashion statements. The jeans craze peaked in 1981 when retail sales jumped to a record $6 billion and 520 million pairs.[6] As designer jeans fell out of favor, and the prime 14–24-year-old jeans-buying cohort aged, domestic annual jeans sales slid to 416 million pairs by 1985.

Following a protracted decline in the 1980s, the market surpassed its earlier peak and hit annual sales of 511 million pairs in 1995. Denim jeans unit sales grew at a strong 7–10 percent per year from 1990 to 1996. Then in 1997, the denim market experienced a sharp slowdown in growth that lasted until the end of 1999—rising just 3 percent per year on average. For some industry players the slowdown meant disaster. Levi Strauss saw its sales plunge over 13 percent in 1998, almost 14 percent in 1999, and nearly 10 percent in 2000. U.S. textile giants, Cone, Swift, and Burlington, cut prices and idled production lines—all victims of a denim glut at retail caused by a shift in fashion trends.

The introduction of new stretch fabrics and widespread acceptance of "casual Friday" and other office "dress down" days stimulated demand for khakis, carpenter, and cargo pants and cut into denim demand in the late 1990s. Casual wear for work became so socially acceptable during the "dot-com bubble" that even staid Wall Street firms permitted employees to wear "golf casual" rather than formal business attire to work on Fridays in spring and summer. Nevertheless, even as demand for basic five-pocket denim jeans suffered from the shift in consumer preferences in casual wear in the late 1990s, demand for women's fashion jeans grew. Angelo La Grega, president of VF Corporation's Mass Market Denim Division, noted in a 1997 interview with *Women's Wear Daily* (*WWD*), "The business is moving from pure commodity to fashion basics."[7] The primary reason for the resurgence in demand for fashion jeans was the availability of denim jeans in exciting new washes and finishes.

"Distressed" and "dirty" denim hit retail shelves in spring 2000. The new distressed jeans tapped into consumers' taste for vintage denim. Distressed, dirty jeans were already "broken in," wrinkled, stained, and looked as if the owner had worn them for years. The Italian jeans maker Diesel had pushed dirty denim for several seasons before it gained approval from other designers. A few designers like Kenneth Cole also experimented with the new stretch denim, a cotton denim that incorporated 2 percent Lycra spandex to improve wearing comfort.[8]

Against that backdrop, Jerome Dahan and Michael Glasser introduced their 7 For All Mankind premium denim line to a consumer market hungry for fashion innovations. The new denim label would fuel the hottest upscale denim market since the late 1970s, and eventually would spark product improvements at every price point in the jeans spectrum. Aspiring as well as established designers would introduce literally hundreds of denim labels in the new decade as they answered the siren call of high growth and high profit margins. Retailers eagerly snapped up new offerings as their customers demanded the latest hot jeans. The premium denim market, defined as jeans retailing for $100 or more, would jump from a dollar market share of about 1 percent in 2000 to about 12 percent or an estimated $1.6 billion in retail sales in 2009.[9] Premium denim's hold on the $8.3 billion women's jeans market was greater as 75 percent of premium denim sales were made to women—putting the product's dollar share at an estimated 15 percent of the women's segment.[10]

According to *WWD*, the premium segment drove the women's denim market to double-digit growth from 2001 to 2005, but total denim sales fell about 5 percent in 2007 as the premium market softened. Sales of jeans priced above $60 per pair fell about 18 percent in 2007—causing some industry observers to predict that a "shake out" was in the making. Indeed, Michael Buckley, then president of True Religion brand jeans, said on a November 2008 conference call with investors, "I think what we've seen over the last probably year to year and a half is a consolidation in brands where there [were] 20 brands . . . and then it was 10, and now it is five or six brands that you really see front and center in most of the major accounts . . . premium denim overall open-to-buy might only be going up slightly, but they're giving more dollars to fewer brands." Jeff Rudes, founder and designer of J Brand Jeans, commented in a 2010 interview for the Sundance Channel documentary *Dirty Denim*, "In 2006 it got narrower and in 2007 it got even narrower and then in 2008 it was about the brands that were . . . doing well at retail. [They] were the only ones that survived."[11]

In 2008, premium denim sales jumped 18 percent even as the U.S. economy weakened and most apparel categories struggled to maintain the 2007 sales levels. The overall denim market eked out about a 2 percent rise in revenues in 2008. However, the cutback in consumer spending hit the premium denim segment in 2009, which saw sales fall an estimated –8 percent. The first nine months of 2010 were difficult ones for many premium denim labels as department-store sales stayed weak for the category. Along with the new frugality forced upon consumers as housing prices plunged, there remained the possibility that consumers permanently would eschew paying $100–$200 per pair for a part of their wardrobes that until recently had been regarded as comfortable casual wear. After all, American women paid a mere $23.44 per pair on average for jeans in 2009.[12] Was the market still "rich & skinny"—like denim guru Michael Glasser's premium brand—or had it become more like Cheap Monday, the Swedish line of mid-priced jeans?

Competitive Landscape

Despite weak category sales and reports of an ongoing industry shakeout, the premium denim market remained crowded. With an estimated $800 million in manufacturer's sales, the top four premium jeans brands held an estimated combined 75–80 percent share of the market in 2009—up from an estimated combined share of 65–68 percent in 2007. The largest premium denim brand, 7 For all Mankind, had slightly less than two times the market share of the number two player in the premium segment. The remaining 20–25 percent of the market was split between dozens of denim labels. Retailers constantly were on the lookout for the next hot brand as premium denim buyers were fickle. In a recent Cotton, Inc., survey of premium denim consumers, 84 percent of those surveyed indicated they were willing to try a new brand.[13] In fact, jeans designers launched new brands even in the depths of the recession and downturn in the market. Current/Elliott, "the most refreshing denim line to come out of LA's jeans scene in a long, long time" according to a *Vogue* magazine article, launched in 2008, gained traction in upscale department stores as the new "it-jeans." CJ by Cookie Johnson, launched in summer 2009, also got play from the same retailers. The line was a collaborative effort between Cookie Johnson (wife of basketball star Magic Johnson) and Michael Glasser (founder of 7 for All Mankind and Citizens of Humanity) designed for "curvy women of all sizes." CJ by Cookie Johnson claimed to be the jeans "made with just a little bit of self-esteem."

As Exhibit 2 shows, a December 2010 Internet survey of the six major U.S. upscale department stores and nine prominent boutiques revealed that each carried about 21 different brands of premium jeans on average. However, some retailers sold many more brands. Notably, trend-setting California-based Revolve Clothing offered 55 different brands of premium women's jeans and 34 denim labels for men. In total, the retailer offered 75 unique brands of premium denim. Similarly, Nordstrom sold 45 brands of women's premium jeans and 18 men's premium denim lines. Overall, the upscale retailer offered 63 unique brands of premium denim to shoppers.

Exhibit 2 Number of Women's Premium Brands Sold by Type of Retailer; Six Upscale Department Stores and Nine Boutiques Sampled

	December 2010	
	Total	**Avg/Store**
Department Store	66	20.5
Boutique Store	94	20.9
Total Brands Carried	126	
Brands Carried in Both Types of Retail Stores	34	

Source: Bonita Austin's calculations.

While a handful of jeans brands dominated the premium space in 2010, the market remained highly competitive. New brands entered the space frequently and grabbed shelf space as upscale retailers continued to try to differentiate their stores from their rivals' stores through product offerings and a fashion "point of view." Established large brands had to fend off the advances of upstarts and smaller brands as jeans lines attempted to segment the premium market and carve out their own niches. The high margins and returns of the larger players along with low capital requirements enticed new "jeaners" or denim specialists to enter the segment. As denim designer Mik Serfontaine stated in a 2010 interview for the Sundance Channel documentary *Dirty Denim*, "Make up some samples and take it to the trade show—you're in business."[14] Moreover, established fashion designers such as Donna Karen and Helmut Lang could knock out a few jeans styles and get shelf space on the strength of their broad apparel lines. While these designers might not pose a serious threat to the big premium brands, if industry growth remained low after the economy rebounded, the premium denim labels would have to deal with them as every market share point would be important.

Exhibit 3 shows the top 16 women's premium jeans brands by "e-shelf space" or Internet shelf space devoted to them by the six major upscale department stores and nine boutiques in December 2010. No other brands held more than a 2 percent share of the available shelf space in either type of retail outlet. J Brand and NYDJ both appeared poised to gain market share and break into the ranks of the large brands. J Brand, now majority owned by Star Capital, had been an up-and-comer prior to the recession. NYDJ commanded more e-shelf space than any other women's premium brand in upscale department stores—including industry leader 7 for All Mankind. Note 7 for All Mankind, Citizens of Humanity, True Religion, and Joe's Jeans along with Diesel, AG Jeans, and Rock & Republic each had a substantial position in the men's premium market.

Nevertheless, NYDJ had appeared from nowhere in previous years. The line was targeted at women over 40 and utilized the company's patented lift tuck technology. The jeans were designed to make women look a full size smaller by holding in their stomachs (the tummy tuck) and lifting their derrières (the lift). The company's pitch to customers included the following; "Here's to our Lift Technology that will make you look a full size smaller. Here's to defying gravity with denim. Here's to jeans that will never let you down. Here's to NYDJ."[15] The appeal apparently resonated with retailers and consumers alike as the company reportedly had sales "approaching $80 million" in 2008.[16]

Exhibit 3 Top Women's Premium Jeans e-Shelf Space Percentage of Available Space on Sites by Brand Selected Department Stores and Jeans Boutiques

	eShelf Space Share		
	Department Stores	**Boutique Stores**	**Total**
7 for all Mankind	12.5%	11.0%	11.3%
AG Jeans	2.1	3.4	2.9
Citizens of Humanity	9.0	11.5	10.5
CJ by Cookie Johnson	3.1	0.0	1.0
Current/Elliot	6.1	3.6	4.4
Genetic Denim	1.8	2.8	2.4
Hudson	4.6	2.2	3.0
J Brand	11.3	5.7	7.5
James Jeans	1.7	2.1	1.9
Joe's Jeans	3.8	8.3	6.7
Not Your Daughter's Jeans	13.5	0.1	4.5
Paige Premium	5.5	6.2	5.9
Rock & Republic	1.3	2.5	2.1
Siwy	0.2	3.3	2.2
True Religion	4.2	5.3	4.9
William Rast	0.7	2.6	1.9
Total for Selected Brands	81.4%	70.6%	73.1%

Source: Barneys.Com; Bergdorfgoodman.com; Bloomingdales.com; NiemanMarcus.com; Nordstrom.com; Saks.com http://stores.intuitwebsites.com/TMcKnight/stores.html; couturecandy.com; jules-boutique.com; nationaljeancompany.com; net-a-porter.com; www.poshboutique.com; revolveclothing.com; shopbop.com; and http://store.solutionsdenim.com. Websites Accessed 12/20/10-12/28/10.

The premium jeans market was characterized by its first ever round of price cuts between 2008 and 2010 as jeans lines tried to stimulate demand. Premium denim prices overall fell 10–15 percent over the period. Designers used several tactics to attempt to maintain their premium positioning, while also attracting price conscious consumers. Industry leader 7 For All Mankind shifted more of its product mix away from jeans priced over $200 to jeans priced under $200. A recent survey of the brand's Web site showed 81 percent of the line's jeans priced under $200, while pre-recession levels stood at 70 percent. Notably, Nordstrom did not offer any 7 for All Mankind Jeans priced above $200 at the end of 2010.

True Religion Brand Jeans sold about 45 percent of its line at price points under $200 in 2010. For the first time in three years, True Religion's average selling point in its full-line stores dropped below $200 per pair in 2009. The company's average selling price was $213 per pair for women's and $217 per pair for men's jeans in 2007. Its average selling price per pair dropped about –3 percent to $207 for women's jeans and –7 percent to $202 per pair for men's jeans in 2008. Prices fell an additional –5 percent in 2009 to $196 for women jeans and $192 for men's jeans. True Religion's absolute price points were higher in company-owned stores than in other retail stores, but the price changes were representative of the trends in entire jeans business over the period. Rock & Republic, known for jeans priced at $250 and up, launched two lower-priced lines called the "Recession Collection" and "Plain Wrap."

Capitalizing on the staying power of so-called skinny jeans, every major premium denim brand launched "jeggings" in 2009. The product was essentially a denim legging and many retailed at substantially lower price points than skinny jeans—giving denim lines both a new fashion twist and a lower entry price for cost-conscious consumers. While many women simply did not look good in either skinny jeans or leggings, the jegging was a bit more forgiving to those without the ideal figures for the skin-tight look. The typical jegging was made of knit-fabric with 25–50 percent stretch compared to 2 to 5 percent stretch for denim. Unlike a legging, the jegging featured a zipper, a waistband, and pockets. The fashion item looked like a "super skinny jean" and stretched like a legging but never sagged like leggings.

Manufacturing Process and Supply Chain

One bale of cotton can be made into 215 pairs of men's jeans or 250 pairs of women's jeans, according to the National Cotton Council.[17] At 480 pounds per bale and a 2010 average world cotton price of about $0.99 per pound, raw cotton accounted for an estimated $1.91 per pair of women's jeans. How did less than $2 per pair of cotton result in jeans that retailed for $100–$350 per pair?

Premium jeans ranged from traditional 100 percent cotton denim jeans to jeans made from stretch denim—a combination of cotton and spandex—to jeans made from denim fabric composed of cotton and small amounts of polyester. Nevertheless, cotton was the major raw material for premium jeans. The top five cotton-producing nations were China, India, the United States, Pakistan, and Brazil in 2010. The big five accounted for 79 percent of the world's cotton supply, according to the U.S. Department of Agriculture. China alone produced 26 percent of the world's supply of cotton in 2010. Number two producer, India, supplied 23 percent of the world's cotton. At number three in the world, the United States produced about 18 million 480-pound bales of cotton or 16 percent of the world's supply.[18]

Cotton prices had been in a long-term decline as worldwide production costs fell with farm technology and farming practice improvements. After hitting their lowest levels in over 30 years in 2001, cotton prices rebounded in 2002 only to slump for another four years. Prices rose slightly over 10 percent in 2007 and about 14 percent in 2008.[19] As a result of the "worst global consumption contraction in 65 years," cotton prices fell by –12 percent on average in 2009. Unusually low stockpiles, heavy rains and flooding in China and Pakistan, and export restrictions in India reduced the cotton supply and pushed prices up to a 140-year high in 2010. Calendar year prices were up by 60 percent on average through November to nearly $1.00 per pound, but prices surged to over $1.60 per pound in December 2010. According to the University of Georgia agricultural service, cotton prices were expected to soften somewhat in 2011 due to increased crop production but were likely to remain at historically high levels.[20]

Many U.S. cotton farmers, "ginners," and merchants banded together into cooperatives and trade associations in order to try to maximize their bargaining power. About half of the domestic annual cotton supply fell under the control of four large cooperatives—Calcot, Plains Cotton Cooperative Association, Staplcotn, and Cotton Growers Cooperative. The four cooperatives were linked through membership in Amcot, an international sales agency representing 30,000 cotton growers. While not uncommon in developing countries, only one of the U.S. cooperatives was vertically integrated into fabric production, the Plains Cotton Cooperative Association (PCCA). The cooperative, through its American Cotton Growers division, produced about 38 million yards of denim fabric or about 27 percent of the 141 million yards of domestically produced denim in 2009. In 2009, PCCA purchased the assets of a jeans manufacturer and formed a new company to produce fashion jeans in Guatemala. The company, Denimatrix, used PCCA's denim fabric and had a 60–90-day shorter production cycle than its competitors in the Far East.

U.S. denim producers dominated worldwide production and exports of the fabric for many years but had been surpassed by China due to its favorable production costs. U.S. production had declined for years as manufacturers closed American mills and relocated capacity to lower-cost countries. North Carolina–based Cone Mills, known as the "King of Denim," was the world's largest producer of denim fabric for most of its 117-year existence. While the company remained a major player in the industry, Cone struggled against low-cost international competition and the phaseout of U.S. denim fabric quotas. The company was known for its ability to produce high-quality denim and had been the sole supplier of denim for Levi's for nearly 40 years. Established in 1891 by the Cone brothers, Cone Denim was a subsidiary of the publicly traded International Textile Group in 2010. Massive restructuring efforts and a focus on high-valued added materials allowed the company's denim division to turn a profit in 2009 and remain profitable in the first nine months of 2010. While Cone was unable to completely recoup higher cotton prices with denim price hikes in 2010, the company planned to gradually pass on its higher input costs to customers.

Some premium jeans companies like True Religion preferred to source denim fabric from U.S. suppliers like Cone's famous White Oak mill because their designers felt the fabric was superior in quality and gave their jeans "authenticity" associated with being made in the United States. Other premium jeans makers swore by Japanese and Italian denim fabric. At any rate, denim fabric makers like Cone and privately held Swift Denim had low margins and little bargaining power. As it had been for most of the decade, the issue for U.S. denim makers in 2010 was survival in the face of intense competition from foreign competitors.

In jeans made of stretch denim, cotton content typically ranged from 95 to 99 percent, with spandex making up the rest of the fiber in the stretch denim fabric. The incorporation of spandex into cotton denim allowed women's jeans to be form fitting, but comfortable due to the "give" of the spandex fibers. The use of "stretch" in premium jeans was limited by spandex's inability to withstand harsher finishing treatments like bleaching as well as the lack of rigidity of high spandex content denim and its relative lack of durability.

Each pair of jeans used about 1.5 yards of denim fabric. While basic denim went for $2–$3 per yard, premium denim typically sold for about $7 per yard but could wholesale at as much as $15 per yard. Some designers experimented with denim woven with cotton and alternative fibers like linen and cashmere, which could push up cost per pair significantly. Denim with cashmere fibers wholesaled at about $23 per yard—putting the fabric cost per pair at about $35. However, the usual fabric cost per pair was around $11. Upscale jeans companies did not own their own manufacturing capacity, rather they used contract manufacturers to cut and sew the fabric into jeans. There were thousands of cut and sew operations around the world, but the U.S. premium brands all used U.S. manufacturers. The premium denim companies liked the shorter lead times and lower shipping costs as well as the high-quality control they got by using domestic suppliers. In addition, they felt U.S. consumers wanted and expected their expensive jeans to be "made in America"—the inventor of blue jeans. Manufacturing costs came in at about $10 per pair with another $2 per pair spent on shipping.

The contract manufacturing model worked well for denim designers, but it created an opportunity for jeans cut and sew operators to forward vertically integrate into jeans design and marketing. Drawing on its experience in manufacturing denim, Grupo Denim launched Vintage Revolution premium jeans in fall 2010. The Mexican company was vertically integrated into pattern design, manufacturing, and finishing. Grupo Denim hired premium denim veteran, Michael Press, as CEO. Press previously served as the president of Earnest Sewn and vice president for Paige Premium. Vintage Revolution debuted in 400 major department and specialty stores in the United States. Vintage Revolution jeans retailed for $118–$140 per pair as Grupo Denim had a significant cost advantage compared to other premium jeans marketers and chose to pass on some of its savings to consumers.

Garments went from the factory to denim laundries, which were responsible for the all-important finishing process. Many jeans designers hung their shingles out in Los Angeles due to the prevalence of laundries in the LA area. "Raw" jeans underwent a variety of labor-intensive finishing processes including special washes, sand blasting, painting, bleaching, ripping, tearing, the addition of whiskers, the application of resins, baking, and pocket embroidery. One popular process, stonewashing, literally involved putting jeans in huge washers full of pumice stones in order to break the denim fibers down and make them softer. One pair of jeans could undergo 15 different treatments before achieving the desired "look."

The finishing process added about $12 per pair to the cost of a pair of premium jeans.[21] However, some washes could run to $16 per pair or even much higher. In the documentary, *Dirty Denim*, Chip Foster points out a pair of jeans with a $25 wash made to give the appearance of having been worn extensively.[22] According to the designer and co-owner of Chip N Pepper Jeans, it would take approximately six years of wear to get the same look provided by the expensive wash.

While it was possible for the jeans companies to backward vertically integrate into the finishing end of production, very few U.S. designers had opted to do so as it generally fell out of the area of management expertise and required meaningful capital investment. One notable exception was Adriano Goldschmeid, founder of AG Jeans. Goldschmeid had owned his own "wash house" since 2004. Moreover, different laundries had developed distinctive skills with different types of finishes. LA's washhouses were known for their high levels of technical skill and innovation. As industry growth slowed, more denim companies might opt for the ownership of denim laundries despite the barriers to entry. The wash and other finishing treatments had become increasingly important in differentiating the features of premium denim lines, and thus the keeping of finishing details proprietary was critical to success. Washhouses typically did not work exclusively for one premium denim customer. While the designers endeavored to keep details about fit and finish secret, it was extremely difficult to do so given the nature of the denim laundries and their processes.

Once the jeans were finished, the jeans designer companies applied a markup of about two times to the wholesale cost of each pair before shipping them to retailers. The jeans designers paid sales commissions, inventory holding, labor, marketing, and administrative costs out of their markups. Retailers marked each pair of premium jeans up 2.0 times to 2.5 times their cost. Through this markup process, the designers and their retail partners captured the lion's share of the profits in the industry.

Premium denim designers and retailers alike for the first time faced the challenge of passing on increased raw material prices to the final consumer. The favorable cotton price environment coupled with the strong demand for premium denim made denim prices largely a non-issue prior to the recession. Questions about premium denim's ability to maintain high price points had surfaced for the first time in 2009. Given the four- to six-month order lead times on most apparel items, the companies had not yet felt the brunt of the third- and fourth-quarter 2010 spike in cotton prices. As Ilse Metchek, president of the California Fashion Association, noted in a September 2010 interview with CNNMoney.com, "Add $2 to that $10 T-shirt next year."[23] Some jeans companies planned to raise prices in 2011 to offset their increased costs. Eric Wiseman, CEO of VF Corporation, said in the same CNNMoney.com interview, "Clearly, price increases will be part of the formula for protecting our gross margins in 2011." Would consumers accept the price increases or stay away from premium denim in 2011?

Lifestyle Brands and the Diesel Model

The ultimate in product differentiation, many companies attempt to create so-called lifestyle brands that transcend product category and inspire deep consumer loyalty. Four of the five best selling premium denim companies were attempting to transform their denim labels into lifestyle brands in 2010. Once thought to be the key to continued high growth, "lifestyle brand status" might have become critical to survival.

In the 2007 Touchstone movie *Wild Hogs*, the character Dudley Frank (played by William H. Macy) proudly declares: "I got a tat." He pulls down his black leather jacket to reveal a multicolored version of the Apple corporate logo tattooed on his right shoulder. Dudley Frank, a computer programmer, identifies so closely with the Apple brand and its core values, he chooses to have it etched into his skin.[24]

Only a handful of companies have been able to establish such a strong association with a particular way of living that their brands symbolize the core values embodied in that lifestyle—Ralph Lauren, Harley-Davidson, Nike, Apple, Abercrombie & Fitch, Diesel, and a few others. Examples of failed attempts to transform regular brands into lifestyle brands abound such as McDonalds, Starbucks, Microsoft, and Uggs.

The appeal of the lifestyle brand is threefold—potential for sales growth, brand premiums (high margins), and protection from downturns in product cycles. Developing a strong emotional bond with consumers that goes beyond product functionality can allow a company to go beyond using mere line extensions to generate growth. Lifestyle brands have the potential to move into a whole host of related product categories. In some cases, a brand can be used as a growth platform even in product categories that are seemingly unrelated to its original market due to the strength of the brand's identity with its associated lifestyle. Harley-Davidson, the motorcycle manufacturer, successfully extended its brand to a wide variety of product categories including clothing, footwear, eyewear, jewelry, Christmas ornaments, trucks, and wine bottle stoppers among others.

The creation of a strong sense of identity with a brand by consumers also has the potential to let a company charge a premium for its products as relative prices can be less important than the consumer's relationship with the brand. In addition, diversifying into related product categories such as footwear for an apparel label can help protect a brand from downturns related to changes in fashion trends—thus, reducing risk in the volatile fashion business. The measure of success in creating a lifestyle brand is the degree to which revenues and profits are diversified away from the original product line.

Within the domestic premium denim market, three of the top four premium denim companies were attempting to do just that—create lifestyle brands that would allow them to move outside of the denim business. All three—7 For All Mankind, True Religion, and Joe's Jeans—were attempting to emulate the Diesel brand model. Although the brand's roots were in the denim market, only about 35 percent of Diesel's revenues are derived from denim sales in 2010. Sales of products as diverse as wine, cars, fragrances, sunglasses, shoes, and watches as well as non-denim apparel generate the remaining 65 percent of revenues.[25] In addition to product diversification, the company was forward vertically integrated into wholly company-owned and partly owned (with distributor partners) retail stores around the world. It also operated a Web site that both promotes the Diesel lifestyle and sells products. The company's motto, [Diesel] "For Successful Living," and its Web site's invitation to consumers to join "the cult" highlight the strong linkage between the brand and its customers.

Founded in 1978 by Renzo Rosso and Adriano Goldschmeid, the Italian denim company sells through 5,000 distribution points in 80 countries including 300 Diesel brand stores. With 50 stores in the United States in 2010, the *Wall Street Journal* put the privately held company's worldwide sales at $1.81 billion.[26]

At the same time, premium denim juggernaut, 7 For All Mankind, planned to take its store count from 10 in the United States in 2008 to 100 worldwide by the end of 2012. There were 22 domestic and 46 international 7 For All Mankind stores at the end of 2010. True Religion expected its U.S. store base to go from 89 in December 2010 to 100 full-priced stores and 20 outlets in the longer term. Joe's Jeans operated 15 stores in the United States in 2010. It also expects to expand its U.S. retail footprint over the next few years. All of these new monobrand stores would be located in A plus and A shopping malls and lifestyle shopping centers around the United States.

In a March 2008 interview with *WWD*, Diesel's Steve Birkhold said: "It will take these brands a long time to get to what Diesel already has, which is the full lifestyle. You can't go from being a flat denim brand with a huge wholesale distribution to being a lifestyle denim brand with a niche retail distribution unless you have the product engine to fuel it. That's where I think Diesel is differentiated."[27]

7 For All Mankind and the Premium Denim Market

The premium denim market was populated with fanciful brand names and was characterized by all the melodrama of the best television soap operas. Chip 'n Pepper, Citizens of Humanity, Earnest Sewn, True Religion, Joe's Jeans, Rock & Republic, People's Liberation, Paige Premium, Antik, and NYDJ were some of the premium denim labels launched on the heels of 7 For All Mankind's successful debut. "Seven," as it was affectionately referred to in the fashion press, was the brainchild of L.A. designer Jerome Dahan and salesman Michael Glasser.

Dahan was the head designer for Lucky Jeans and a former designer for Guess jeans. Glasser started the sportswear brand Democracy in 1990. The two men approached Peter Koral, owner of California sportswear maker L'Koral, in 2000 with the idea of launching a new jeans line at the nearly unheard of price points of $100–$160 per pair. In contrast, the average price paid for jeans in the U.S. market was just under $21. Over half of the jeans sold in the United States that year retailed for under $20 per pair. "Designer" denim had been all but dead for nearly 20 years. Nevertheless, Koral agreed to provide financial backing to the venture in return for a 50 percent ownership stake in the line.

For the first time in denim's history, designers turned their attention to creating a pair of jeans whose function was to flatter and enhance women's figures rather than to serve as durable casual wear or a skin-tight spot to paste a designer name for those fortunate enough to both afford it and carry it off. Jerome Dahan deconstructed the basic five-pocket jean and re-engineered it with an eye toward enhancing and flattering women's bodies. He added a distinctive stitching design to the back pockets of Sevens, so consumers could easily identify the product, and be identified with it. Dahan used a stylish bootcut coupled with a low rise, slim fit, high-quality denim, and subtle detailing to create a one-of-a-kind silhouette. One twenty-something woman commented in a 2003 *Boston Herald* industry article, "I remember when Seven jeans would pay for themselves because when you went out you'd look so good that guys would buy you drinks."[28] As Charles Lessor, the former CFO of competitor True Religion Brand Jeans noted succinctly in the same article, "It's all about the butt."[29] Sevens made a woman's derriere look great, and women rushed to stores to buy them. Celebrity trendsetters like Cameron Diaz were photographed wearing Sevens in everyday life. The line's popularity exploded, and it generated an unprecedented $13 million in first year sales accompanied by $2 million in net profits. Two years later in 2003, the brand did $80 million in sales before jumping to $130 million in revenues in 2004.

The brand's success did not go unnoticed. Los Angeles became the denim capital of the world despite the fact that North Carolina–based mega-brands Lee and Wrangler's operations were far from the glitz of the City of Angels, and brand leader Levi's was headquartered in San Francisco. There was a veritable volcanic eruption in the number of premium denim brands between 2001 and 2003. According to STS Market Research, consumers purchased 297 denim brands in 2001. That number jumped to 350 in 2002 and 438 in 2003—a 47 percent increase in two years, accounting for a third of all apparel brands purchased in the United States.[30] The new brands mimicked the Seven model of in-house design, outsourcing production and finishing, using the highest-quality denim, and selling to trendy upscale boutiques and high-end department stores.

Below the surface at 7 For All Mankind, things were not going well between the partners. Jerome Dahan and Michael Glasser left Seven and filed a $20 million lawsuit against Peter Koral in 2002. The lawsuit accused Koral of using profits from Seven to prop up his knitwear business and failing to live up to the partners' oral agreement to establish Seven as a separate entity once sales hit $12 million. Koral claimed he plowed all the profits back into the brand. Further, he maintained that his partners gave up their share of the company by leaving to start a competing product line. A judge awarded the two men $55.5 million in September 2004, $50 million for the combined 50 percent share of Seven, and $5.5 million in profits from 2001 and 2002.

With $20 million in net profits on $60 million in sales in their second year of business, it is no wonder that Dahan and Glasser immediately applied their expertise to creating another premium denim brand. The two started Citizens of Humanity in 2002 using the same general business model that had served them so well with 7 For All Mankind. Glasser focused his merchandising and marketing efforts on the same accounts he did business with at Seven like Nordstrom, Barney's, and Neiman-Marcus. Dahan updated his designs and added new washes and detailing.

Citizens had an even bigger first year than Seven due to soaring demand for high-priced denim. In 2003, the line generated $23 million in sales. Sales leapt to $80 million reportedly accompanied a whopping $35 million in profits in 2005. The brand sold in 35 countries with about 90 percent of its revenues coming from the sale of women's jeans. Dahan bought out his partner in 2005, and then sold 66 percent of Citizens to the Boston venture capital firm, Berkshire Partners in 2006. According to press accounts, the majority stake in the privately held firm fetched $250–$300 million or

3.8–4.5 times estimated 2006 sales of $100 million. With the backing of Berkshire Partners, Citizens purchased GoldSign Jeans from Adriano Goldschmeid along with his denim laundry in 2007 for an undisclosed sum.

In March 2005, Peter Koral sold 50 percent of 7 For All Mankind to the investment bank Bear Sterns. Although specific terms of the deal were not disclosed, Koral confirmed publicly that Bear Sterns paid $75–$100 million for its stake in the firm. The brand had sales of about $200 million in 2004 so the deal was valued at 0.75 times to 1.0 times sales. The buzz on Wall Street was that the line had the potential to morph into a large global lifestyle brand. Denim giant, VF Corporation, picked up all of 7 For All Mankind in mid-2007 for a cool $775 million. The maker of Lee, Wrangler, and Rustler jeans pegged 2007 sales of the number one premium denim brand at about $300 million, valuing the brand at nearly 2.6 times sales.

VF Corporation and 7 For All Mankind

VF Corporation was the world's largest apparel company with 2009 revenues of $7.2 billion. The company began in 1899 as a glove and mitten manufacturer, but diversified into women's silk lingerie in 1914. The company retained the initials "VF" after dropping the Vanity Fair moniker following the acquisition of Lee jeans in 1969. Lee was one of the oldest apparel brands in the United States, having been established in 1899 (about 25 years after Levi Strauss). VF went on to acquire Wrangler and Rustler as part of its friendly acquisition of Blue Bell in 1986. In 2007, VF Corporation acquired 7 For All Mankind, the leading premium denim brand in the United States.

VF Corporation adopted a new corporate strategy in 2004. Its vision was to "grow by building leading lifestyle brands that excite consumers around the world."[31] In other words, the company wanted to transform itself into a global lifestyle apparel company with 60 percent of revenues being derived from lifestyle brands by 2015. As part of that initiative, it sought to stay on top of the apparel market by combining design and science to create value-added products for consumers. According to company statements, "innovation is about much more than delivering a new product, fabric, or style. . . . Innovation is a holistic process, one that touches every aspect of our enterprise—branding, supply chain management, global expansion, even our corporate citizenship initiatives."[32] Management saw growth in lifestyle brands, an increase in company-owned stores, and international expansion as keys to longer-term success. In particular, VF Corporation planned to double the number of company-owned stores and increase its product mix to 60 percent lifestyle brands by 2015.

VF had massive global operation in which it managed 400 million units and 500,000 stockkeeping units (SKUs) across 30 brands in nearly every country in the world in 2009. Unlike many of its competitors, VF used a mix of 30 company-owned and -operated manufacturing facilities, and 1,600 contract manufacturers. As is noted in VF's 2009 10K filing, company-owned facilities in the Western Hemisphere generally delivered lower-cost product, but contractor-sourced goods offered more flexibility and shorter lead times. As a result, VF balanced the need for lower manufacturing costs with the ability to hold lower inventories, resulting from the use of contractors. In addition to global sourcing of raw materials and manufacturing, the company used "best of class" technology to manage its resources. Best of class technology extended to inventory management at the retail level. VF employed a point-of-sale inventory management system that allowed it to gather daily sales information down to the individual store and SKU level (size, style, and color detail). The company believed that this point-of-sale inventory system gave it an advantage over its less sophisticated competitors. Its 10 largest customers accounted for 27 percent of 2009 sales and were all located in the United States.

The company's brands were organized into "coalitions" including jeanswear, outdoor, imagewear, sportswear, and contemporary. The jeanswear coalition was made up of the so-called heritage brands Lee, Wrangler, and Rustler. VF management felt the jeanswear and imagewear (licensed and work apparel) coalitions would likely generate strong profits and cash flow with low-single digit growth in the longer term. The outdoor, sportswear, and contemporary coalitions were to be the growth engines of VF in management's view. These lifestyle brand groups were expected to grow at a mid-single digit to low-double digit rate in the long term.

Seven For All Mankind was placed into the newly created contemporary group in August 2007, which also included the recently acquired Lucy, a women's activewear company. When acquired in August 2007, Lucy's domestic sales accounted for 75 percent. By the end of 2009, international revenues had jumped to about one-third of brand sales. While some of the increase was due to VF Corporation's aggressive expansion in international markets, the U.S. business had suffered due to the recession and slumping premium denim industry sales. 7 For All Mankind's large share of the premium segment made it difficult for the brand to outperform the category. Prices dropped as Seven increased its emphasis on lower-priced items in order to stimulate demand. Before the recession, about 30 percent of sales were derived from jeans priced above $200 per pair. In late 2010, only 19 percent of Seven's women's jeans carried a price tag above $200, and more than a third of the women's line was priced below $175 per pair. Moreover, 70 percent of Seven's women's jeans were heavily discounted on its e-commerce site at year-end 2010. Some items regularly priced at $155 per pair were discounted to $89–$99 per pair. A late December store check of a Utah Costco store revealed 7 For All Mankind women's jeans regularly priced at $155 were offered at $109 per pair.

A strong competitor in all of its markets, the North Carolina–based VF Corporation spent $329 million on advertising and promotions in 2009. The company possessed a formidable stable of brands including The North Face, Nautica, Vans, Reef, and Majestic. As of September 2009, the company had $732 million in cash and $1.1 billion in total debt. Shareholder's equity stood at $3.8 billion.

Rock & Republic Goes to VF Corporation in Late 2010

VF announced it had picked up the assets of rival premium denim label Rock & Republic out of bankruptcy in December 2010. The deal was expected to close in spring 2011. Details of the deal were not disclosed, but the assets were valued at about $57 million in the California bankruptcy filing. Notably, VF did not retain the services of the brand's flamboyant founder, Michael Ball.

According to company press, Rock & Republic "transcends the denim world with its luxe yet edgy approach to fashion." Its first collection "mixed an edgy, rebellious style with sophistication," which "inspires music and fashion industries alike." The company paired with Victoria Beckham (Posh Spice) to create signature jeans marketed under the Rock & Republic brand name, but the relationship soured and was dissolved. Co-founded by Michael Ball and Andrea Bernholtz in 2002, Rock & Republic retailed its premium denim jeans for $186–$330 per pair. The privately held company had become something of a force in the premium denim market by appealing to the fickle tastes of the most fashion forward, affluent young consumers. Rock & Republic was all about trendy and fast. Nevertheless, the company moved in sync with the rest of the premium denim segment away from embellished jeans to cleaner and less provocative styling, and raised its waistlines in 2007. Company co-founder Andrea Bernholtz commented to *WWD*, "It's [the rise is] just not as low as it was before with everything hanging out. It's that quarter of an inch between sexy and slutty."[33]

Rock & Republic reportedly did $2.4 million in sales in 2002, and around $23 million in 2004. Michael Ball claimed the company did over $100 million in sales in 2006. The outspoken Ball said he had a plan that would allow Rock & Republic to "literally dominate our market in the next fifteen years."[34] Ball's plan revolved around transforming Rock & Republic into a full-line lifestyle brand including shoes, eyewear, and retail store ownership.

While it was easy to dismiss the outspoken Michael Ball as an insignificant player in the denim market, Rock & Republic's success with the fashion-forward consumer had other companies looking over their shoulders. The jeans featured a distinctive, stylized "R" on each back pocket, high quality denim, and a flattering fit. The brand commanded even higher price points than True Religion, and consumers appeared willing to pay them. As Ball told the *Daily News Record* in a 2006 interview, "If you want Rock, you have to pay top dollar—you have to pay to be in the VIP section."[35] Michael Ball's view of the brand's cache may ultimately have been its downfall.

There were several questions for VF Corporation's premium denim competitors. Would the addition of VF Corporation's financial resources allow Seven and Rock & Republic to extend the company's already large market share lead in the category? Was Seven's recent decline completely related to slumping industry sales or had the brand lost some of its cache? Could the Rock & Republic sensibility add to Seven's presence in the fashion-forward segment of the market or would the trend toward basic, clean styles mean Rock's heyday was over? If VF Corporation pursued an aggressive store expansion plan with both lines, would the company snap up the best locations, leaving competing brands only less productive sites for their own retail stores? Was there room for more than one denim-based lifestyle brand in the United States?

Joe's Jeans

Moroccan-born Joe Dahan (no relation to Jerome Dahan of 7 For All Mankind and Citizens fame) entered the fashion business with a line of men's formal wear and dress shirts in 1986 that rang up $8 million in sales when Joe was just 17 years old.[36] From 1996 to 2001, Dahan was the head designer for Azteca Productions, a private label manufacturer of sportswear and denim. Dahan entered the premium denim market in 2001 with five styles of fashion jeans under the Joe's Jeans brand. The products retailed for $124 to $155 per pair. In March 2001, Innovo Group purchased the rights to the Joe's Jeans brand from Azteca and moved into the premium denim market. Innovo later changed its name to Joe's Jeans and trades on the NASDAQ market under the JOEZ symbol.

Joe's Jeans emphasized fit rather than the hottest trend. As Dahan said in a 2005 interview, "We've always been about clean, even when the market was embellished. We're not about fast or trendy."[37] Joe's Jeans aficionados sang the praises of the line claiming the jeans had an "insanely good fit." Joe Dahan's attention to fit paid off with first year sales coming in at $9.1 million. The line retailed at tony department stores like Barney's New York, Nordstrom, Bloomingdale's, and Macy's as well as boutiques catering to affluent shoppers. Nordstrom, Bloomingdale's, and Macy's together accounted for 47 percent of 2009 sales. Total sales rang up at more than $80 million in 2009.

Like its competitors, Joe's outsourced production and sales in order to attempt to keep capital investment and manufacturing costs low. Additionally, Joe's outsourced packing, order picking, and warehousing. Nevertheless, the line's gross margin was only 50 percent in 2009 compared to 63 percent for True Religion in the same period. Similarly, Joe's operating margin was only about 11 percent in 2009 compared to True Religion's 2009 operating margin of 25 percent.

After several years of financial difficulty, Joe's made some important management changes. The company's CFO, Marc Crossman, became CEO in January 2006. Crossman was an investment banker who focused the company on developing and exploiting opportunities for the licensed Joe's Jeans brand and closed its unprofitable private label business. In August 2007, Joe's added Hamish Sandhu as CFO. Joe Dahan remained on board as the company's creative director and designer as well as a major shareholder. Later that year, Joe's Jeans acquired the Joe's Jeans brand from Joe Dahan. As part of the deal, Joe's agreed to pay Dahan 11.33 percent of annual gross profits as long as gross profits fell between $11.25 million and $22.5 million. Dahan's payout would fall to 3 percent of gross profits when they exceeded $22.5 million up to $31.5 million. Dahan's payout scale declined further as gross profit rose beyond $31.5 million. Dahan received an estimated payout of just under $800,000 in 2009. The agreement was in force through 2017 and provided Dahan with a substantial financial incentive to help the company be successful. However, it was unclear if Dahan planned to stay with the company after 2017.

Crossman and his team specifically worked on boosting gross margin through more effective outsourcing relationships with an increased number of contract manufacturers, improving the existing account penetration, increasing distribution in the Midwest, and re-entering international markets. Joe's moved to expand into retail through company-owned stores. The company owned 15 stores as of August 2010 and planned to open three more before the end of fiscal 2010. Crossman and Dahan also expanded successfully the Joe's Jeans line into related apparel categories. In 2009, non-jeans items accounted for a mere 3 percent of sales. On the strength of its unisex woven shirts (called The Shirt) and its jeggings, non-jeans items jumped to 16 percent of sales in the first nine months of 2010. Despite the challenging environment for premium denim, Joe's reported a 36 percent jump in sales accompanied by a 27 percent increase in gross profits in the first nine months of 2010. Gross margin fell primarily due to the shift in product mix of non-jeans products. Overall profits fell sharply (−26 percent) for the period as Joe's incurred significantly higher expenses related to the addition of distribution facilities and headcount to support the business's larger size.

Cash flow from operations was −$5.5 million compared to $5.3 million in the same period the year before. Given the management's plan to increase the number of company-owned stores over the next few years, Joe's negative cash flow raised questions for investors. Would the company be able to fund its expansion plans via internal cash flow or be forced to consider a stock or debt offering? Joe's Jeans' balance sheet was solid with no debt and $64 million in shareholder's equity. Long-term operating leases committed the company to $37.5 million in payments for the next four years. With a beta of 1.65 and a recent stock price of just $1.62 per share, a stock offering was likely to prove expensive. However, it was unclear whether a debt offering would be feasible for the small company over the next year or so. There seemed to be an appetite for investing in the sector by private equity groups as evidenced by the recent investments in J Brand and Hudson, but both companies were smaller than Joe's. Back in 2008, Falcon Head Capital purchased a 50 percent stake in NYDJ for $50 million (also a smaller company than Joe's). VF Corporation or Diesel might be interested in acquiring Joe's down the road, as both companies had recently made acquisitions. However, Dahan might balk at selling his namesake company rather than continuing to build the brand without being hampered by the goals of a corporate parent.

With wholesale sales up 27 percent and company-owned store revenues up 173 percent, Joe's brand appeared to be quite strong. Same-store sales increased 23.5 percent in the third quarter—indicating the business was very strong and was not just benefiting from the addition of new stores. Joe's Jeans positioning seemed to be working in its favor, as did the line's relatively affordable prices. The line's average women's jeans price point in December 2010 was $163—far below True Religion's average of $196 per pair.

Levi Strauss

Levi Strauss invented the denim jean in 1874. The company's iconic 501 five-pocket jean still remains the brand leader in the global denim market. Nevertheless, the company struggled to combat upstart premium denim labels in this decade. The $4.1 billion company remained largely unsuccessful in its attempts to penetrate the luxury denim segment in 2010. Part of the problem stemmed from the company's eight-year battle to turn around its operations. From 1997 to 2005, Levi Strauss experienced a dramatic drop in sales from $6.9 billion to $4.1 billion. The company focused on stabilizing sales and profits, paying down debt, and later on regaining momentum in its basic denim business. For the first time in its history, Levi's was forced reinvent itself as a company. In order to be competitive, Levi's had to shutter nearly all of its worldwide manufacturing facilities and to mainly replay on outsourced finished goods produced by independent contractors.

The company appeared to be back on track from 2005 to 2007 with sales rising about 2 percent per year on average to $4.3 billion. Operating profits excluding restructuring charges increased by about 4 percent per year to $655 million in 2007. Revenues were flat in 2008 and operating profits fell about –19 percent due to increased expenses associated with the company's retail store expansion plan and investments in global information technology infrastructure. Results for 2009 were weaker, with revenues down by about –7 percent accompanied by a –28 percent drop in operating profit due to economic weakness in Europe and the United States as well as a stronger dollar. Things looked up for Levi's in the first nine months of 2010 due to favorable currency trends, the acquisition of retail stores, and growth in the Levi's brand. Levi's brand products accounted for 81 percent of company revenues in the first nine months of 2010. Total revenues were up about 7 percent in the period. The company's gross margin improved as a higher percentage of revenues came from retail stores, which carry significantly higher gross margins than wholesale goods. Operating margin fell though as advertising and promotional expenses jumped by 39 percent to $222 million, as the company spent more to drive the sales of Levi's and Dockers brands worldwide.

Levi's growth strategy outlined in the 2009 10K included five initiatives—build on brands' leadership in jeans and khakis, diversify and transform the wholesale business, accelerate through dedicated company-owned stores, increase operational efficiency, and capitalize on the company's global footprint. The company intended to focus on growth through innovation and "premiumization." Levi's management felt the company could use its brand heritage and design and marketing expertise to lead innovation in the jeans category. As part of this initiative, Levi's intended to target underserved segments of the market—especially women's jeans and "attractive price segments." Management had identified a greater focus on more premium categories as a priority back in 2007.

Levi's launched a major campaign with newly designed jeans for women in August 2010. The new product line, dubbed Levi's Curve ID, featured three different fits for women with different body types. According to a company press release, Levi's worked with scientists to analyze 60,000 body scans of women in 13 different countries to understand body types and fit problems especially the hip to seat placement.[38] The result was jeans in "the slight curve—to celebrate straight figures," "the demi curve—to fit even proportions," and "the bold curve—to honor genuine curves." Levi's claimed its new line would fit 80 percent of women. The company planned to launch Levi's Extreme Curve, which would fit an additional 16 percent of women, in late 2010 or early 2011. As part of its consumer research, Levi's found 54 percent of women try on 10 pairs of jeans to find one pair they would buy; 87 percent of women wish they could find jeans that fit better, and 67 percent of women feel jeans are designed for women with "ideal" bodies (not theirs). The new line retailed for $102–$121 per pair—far below most premium denim lines but well-above the traditional Levi's price points.

Changing consumer perceptions of a brand found in such disparate retail locations as Wal-Mart and Barney's New York had proved to be a difficult task in the past. Nevertheless, the Levi's brand had incredible name recognition and a reputation for quality. Moreover, the company had re-engineered its products and increased its fashion quotient throughout the decade. Even so, questions about the company's prospects remained. With the improvements in design and fabric quality, could Levi's build a leadership position in the premium sector? Would Levi's scientific approach to fit resonate with women tired of trying on so many pairs of jeans to find one that fit properly? On the one hand, the weak U.S. economy could cause consumers to take another look at the more reasonably priced Levi's line now that its design team had updated the fit and finishing details on the line. According to Cotton Inc.'s 2009 Lifestyle Monitor, 55 percent of women cited fit as the single most important determinant of jeans selection.[39] On the other hand, the brand's strong identity as a durable, reliable, and authentic vintage product could keep it from ever converting consumers interested in the cache of premium denim labels. Premium denim buyers placed more emphasis on style (36 percent) than fit (31 percent) in selecting jeans to buy.[40]

True Religion Brand Jeans

Jeff Lubell had struck out on two occasions previously in his attempt to shift from textile salesman to independent jeans designer. He and his wife launched two jeans labels in the late 1990s—Bella Dahl and Jeffri Jeans—and lost both after running out of cash. Events turned ugly when Bella Dahl, Inc., could not keep up with payments to its factor and had to file for bankruptcy in late 2000. Several lawsuits later, Jeff Lubell was on his own with no assets or ownership in his jeans creations. In 2002, the Lubells launched a new premium denim line, True Religion Brand Jeans. Lubell registered his new line's trademarks in his name and formed a holding company that he owned and controlled called Guru Denim. Things would turn out differently this time for the 46-year-old Los Angeles resident.

The brand hit store shelves in December 2002 with five styles of women's jeans available in five different "washes" under the True Religion label. (Sevens were only available in two basic styles at the time.) The corporate logo appeared on every tag and featured a fat, smiling Buddha strumming a guitar. According to a November 2002 *WWD* article, "True Religion has an 'evolutionary' mannish styling." *WWD* interviewed Lubell for the article and quoted him as saying "there are a lot of women who love to wear their boyfriend's jeans or husband's jeans. This plays off of that." The jeans had one of the lowest rises on the market and some of the highest prices. Lubell created "buzz" for the line by sending celebrity trendsetters free pairs of jeans with the hope they would appear in photos in the popular press wearing jeans with True Religion's signature horseshoe-shaped back pocket stitching. The strategy worked, and the line's sales took off. First year sales came in at $2.4 million and jumped to $27.7 million in 2004.

The popularity of "distressed," "destroyed," and "embellished" jeans had helped drive growth in the premium denim segment for years. The Joey Destroyed model had been one of True Religion's best selling products. The jeans model featured pre-washed denim that had been artfully aged and ripped so that most of the front of the left thigh was made up of strings rather than solid fabric. The designers added in a ripped left knee and extensive tearing on the front of the right thigh to complete the destroyed look (an extreme version of distressing). Embellished jeans also had been very popular for a number of years in the early part of this decade. So-called embellishments ranged from elaborate embroidery to the addition of sparkly crystals and metallic threads. True Religion marketed women's jeans with intricate embroidery on the back pockets like the Miss Groovy, Buddha, Fairy Girl, Godiva, and Geisha Girl designs. All of these popular "looks" required a substantial amount of additional labor to produce relative to basic denim looks. They all commanded a significant premium to the more basic models in the True Religion portfolio with prices starting well above $200 per pair. Some True Religion models went for over $500 per pair at retail.

In 2008, premium denim designers responded to the mood of the times and moved away from elaborate finishing details back to more basic styles as consumers became interested in styles that would stay fashionable for years rather than for a season. True Religion followed suit and emphasized the lower-priced, more basic items in its lineup. Nevertheless, the brand remained one of the highest priced on the market with an average selling point of $196 for women's jeans and $192 for men's jeans in 2009. The company had not been as successful historically in the basic end of the premium market as had Seven and Citizens. Indeed, True Religion's wholesale sales plummeted –20 percent during 2009 and –16 percent in the first nine months of 2010.

The company relied on Jeff Lubell's fashion sense and ability to spot the right trends to sell the "hottest" jean styles. Lubell had an impressive track record, but True Religion's sales to the wholesale off-price channel had become worryingly large by 2009. The company used off-price retailers such as Nordstrom Rack as well as its own outlet stores to sell slow-moving and obsolete inventory. Sales to the off-price channel accounted for nearly one-third of U.S. wholesale sales in 2009. Most likely, the magnitude of sale of slow-moving inventory had more to do with the economic weakness than with Lubell's ability to develop appealing jeans styles.

Investors worried that if the new consumer distaste for conspicuous consumption lingered after the U.S. economy rebounded, the company would not be able to differentiate its product and demonstrate its "value" to consumers. The brand had been built on fashion not on fit and classic styling. If fashion were no longer the key determinant of brand selection by consumers, would True Religion survive? Moreover, if price points came down significantly in the category, could True Religion change its mindset and its cost structure enough to compete and maintain high-profit margins and returns? Evidently, Rock & Republic had not been able to do so and had ended up in bankruptcy.

Recent changes at industry trendsetter Diesel also raised questions about the viability of True Religion's and other premium denim lines' approach to design. Traditionally, the premium denim brands relied on one or two designers to create the next "hot" look and drive consumer demand. That's what made Diesel's new design philosophy so interesting and unusual. Renzo Russo decided to redefine the role of Diesel's creative director. Rather than the traditional all-powerful designer who "pushed" his vision to consumers, Diesel now employed a creative director whose job was to spot broad trends in society and translate them into a "look" for the Diesel line that fit what consumers were looking for at the time. He did not draw or make samples nor was his name closely associated with the brand. Moreover, Diesel's creative director reported to the head of marketing rather than directly to the CEO. As Russo told the *Wall Street Journal* in a late December 2010 interview, "[Designers] think they are idols . . . The consumer doesn't care [about the designer]. They just want to see the right product at the right moment."[41] Russo tapped a fashion magazine editor as Diesel's creative director and shifted the firm's emphasis squarely to product development—away from design.

True Religion's Strategy

The company's initial strategy was to emphasize distribution through upscale department stores and boutiques and outsource every function except design and marketing to third parties. By the end of 2005, True Religion jeans sold in about 600 specialty stores and boutique doors as well as about 200 upscale department store doors through Nordstrom, Neiman-Marcus, Saks Fifth Avenue, Barney's, Henri Bendel, Bergdorf Goodman, Bloomingdale's, and Marshall Fields. By September 2010, the company sold its line through six major department-store accounts (due to consolidation in the retail channel) and about 800 boutiques in the United States.

By late 2006, True Religion's focus had shifted away from selling products wholesale to selling its products through company-owned stores. True Religion management, under then President Michael Buckley, had started to vertically integrate into retail for several reasons. First, the company had faced resistance from retailers when it tried to diversify away from denim jeans into adjacent clothing categories such as sportswear. Big retailers viewed True Religion as a denim label—not as an apparel brand. Owning its own stores allowed True Religion to introduce a broader range of apparel to its customers. Management hoped that the sell-through figures from company-owned stores on non-denim items would convince its retail accounts to carry the full line of True Religion apparel. Diversifying into other apparel categories and related product lines was absolutely critical to achieving management's goal of creating a lifestyle brand. In its full-priced company-owned stores, non-denim items had increased from 10 percent of unit sales to 26 percent of unit sales by September 2010. Non-denim items only accounted for an estimated 13 percent of dollar sales, as the company largely had been unable to convince its retail accounts to carry its non-denim items. The firm's non-denim items carried lower price points than its jeans.

Second, the margins in the company-owned stores were even higher than True Religion's very high denim margins as the company captured the retail markup as well as its traditional wholesale markup. Management estimated that retail store gross margin would come in at 75 percent and "four-wall contribution margin" would be about 40 percent as the company captured the benefits of the typical retail markup on its products as well as the existing wholesale margin. Management's prediction turned out to be an accurate one, as gross margin for the consumer direct segment (company-owned stores and e-commerce) leapt to nearly 77 percent in 2008 before dipping to 74 percent in 2009. The consumer direct segment's operating margin was 37 percent in 2008 and about 35 percent in 2009.

True Religion's total gross margin was about 53 percent in 2006 but rose to almost 63 percent by year-end 2009 as the consumer direct segment grew in importance. Operating margin came in at 29 percent in 2006 but was down to 25 percent by the end of 2009. The combination of heavy spending behind the rapid store-rollout program, weak sales in the 15 original True Religion stores, and a $30 million drop in wholesale revenues pushed margins down. Sales to major department-store accounts fell (–15 percent) and sales to boutique customers fell even more sharply as the premium denim category suffered from economic weakness in the United States.

Third, company-owned outlet stores gave True Religion a place to sell seconds, irregulars, and slow-moving merchandise. Without these outlet stores, True Religion brand products could surface in any type of discount outlet—potentially damaging the brand's premium positioning. Prior to 2007, True Religion jeans appeared in Filene's Basement, Costco, Century 21, and similar outlets on occasion.

Fourth, retail industry mergers and bankruptcies periodically caused manufacturers to miss sales and earnings forecasts. Using company-owned stores helped reduce the firm's dependence on retailers and reduced the risk of major disruptions in sales. Company-owned stores and e-commerce accounted for 41 percent of revenues in 2009 compared to 17 percent in 2007. In total, True Religion owned 70 stores in the United States at year-end 2009 and 89 stores as of September 30, 2010. Over time, management planned to open 100 stores in the United States. Nevertheless, the company still relied heavily on one major account, Nordstrom, for a significant portion of its sales. In 2005, Nordstrom and Neiman-Marcus together accounted for 11 percent of net sales. In 2009, Nordstrom alone accounted for 15.2 percent of net sales.

Given the recent results, it was difficult to characterize True Religion's retail strategy as completely successful at meeting management's goals. However, one thing was

Exhibit 4 True Religion Brand Jeans Operating Segments ($ in thousands)

				First Nine Months	
Net Sales	**2007**	**2008**	**2009**	**2009**	**2010**
U.S. Consumer Direct	$29,268	$75,314	$129,029	$83,885	$126,611
U.S. Wholesale	111,390	153,235	123,203	91,621	76,748
International	31,728	40,044	54,479	39,862	45,564
Other [(a)]	870	1,407	4,289	2,795	3,884
Total	$173,256	$270,000	$311,001	$218,163	$252,807
Gross Profit					
U.S. Consumer Direct	$22,380	$57,669	$95,276	$62,129	$92,323
U.S. Wholesale	60,007	78,670	65,882	49,862	39,904
International	15,498	19,255	30,115	22,067	24,106
Other	870	1,407	4,289	2,795	3,884
Total	$98,755	$157,001	$195,562	$136,853	$160,217
Operating Profit					
U.S. Consumer Direct	$11,875	$27,810	$44,766	$27,354	$41,214
U.S. Wholesale	36,405	47,452	30,763	24,511	9,209
International	14,718	16,761	25,167	18,792	13,711
Other [(b)]	−15,856	−23,147	−23,099	−16,943	−20,402
Total	$47,142	$68,876	$77,597	$53,714	$43,732
Assets					
U.S. Consumer Direct	$10,167	$36,603	$55,763	$58,491	$63,272
U.S. Wholesale	41,248	43,030	31,159	33,616	46,057
International	6,519	8,362	16,897	11,309	29,038
Other	55,324	78,457	125,987	109,329	134,734
Total	$113,258	$166,452	$229,806	$212,745	$273,101

(a) Licensing revenues generated by royalty agreements.
(b) Unallocated corporate.

Sources: True Religion Apparel Inc. 10K-2007, 2008, 2009. 10Q September 2010. All figures are actuals unless noted otherwise.

clear. The True Religion brand had grown in the U.S. market as a result of the retail strategy. Adjusting for retail markup, True Religion's total U.S. sales in manufacturer's dollars had grown at an estimated 21 percent per year between 2007 and 2009. Three questions remained with regard to the company's focus on company-owned stores. Would True Religion's major competitors bid up the cost of retail space in so-called "A" locations or create scarcity in desirable locations as they all tried to expand their retail footprints? Was a target of 100 company-owned stores in the United States an appropriate number or was there potential for more stores? What would happen to the retail business if True Religion management was not successful in restarting the domestic growth of the wholesale business? In other words, were the stores viable without a strong and growing wholesale brand?

Along with forward vertical integration into retail, True Religion's management team decided to staff an in-house sales force. The sales function formerly was handled by third party independent sales reps. Prior to 2007, reps received a 10 percent commission on sales to specialty shops and boutiques in the United States. The firm's major U.S. distributor, L'Atelier, exclusively sold the product to upscale department stores, receiving a 7 percent commission in the process. L'Atelier's owner, Jana Rangel, had 15 years experience successfully positioning and branding denim lines AG-Adriano Goldschmied, Ya Ya, Earl Jeans, and Paul Gaultier jeans. With her help, several denim lines went from a start-up position to sales in the $30–$40 million range. True Religion successfully renegotiated terms with L'Atelier in 2007. L'Atelier's commissions dropped to 4 percent for department stores and 8 percent for specialty boutiques. True Religion ended its relationship with Rangel and L'Atelier as of December 31, 2010. Management felt that having its own sales force would enhance the firm's relationships with important retail accounts and allow it to improve customer service.

Similarly, True Religion changed its distribution strategy in international markets in 2008 and 2009. The company's original model was one that used exclusive third-party distributors to gain access to upscale retailers in foreign markets. Beginning in 2008, the company moved to a combination of in-house sales forces and strategic alliances with distributors. True Religion originally sold its products to outside distributors at a 25 percent discount to wholesale. The distributors then sold the product line to retailers. The strategy worked very well for True Religion for a number of years. It was especially successful in the Japanese market, which accounted for a whopping 29 percent of net revenues in 2005.

True Religion's brand positioning as a "Made in the USA" product based on a unique combination of a Wild West cowboy heritage paired with a California-hippie-bohemian image played well in the Japanese market where affluent consumers paid top-dollar for American icons like vintage Levis. Unlike many jeans manufacturers, True Religion purchased the majority of its denim from an American supplier, Cone Mills. Like most other premium denim brands, True Religion relied upon U.S. manufacturers a to produce its jeans and LA washhouses to finish them. Management felt the "authenticity" of an American made jean played well in both the domestic market and in many international markets. Eric Beder, an analyst with Brean Murray, told the *LA Times* in 2009, "In the US, people care that their jeans are manufactured here. To consumers outside the US, it's crucial...In order to be considered a real premium brand, you need to have the Made in the USA label on it."[42] True Religion off shored production of non-denim items such as hoodies and T-shirts, where country of origin was not important to consumers.

An enormous disappointment in Japanese sales in 2006 prompted management to reconsider the distributor model. Full-year sales to Japan plunged 50 percent and the company fought accusations from the financial press that it had "stuffed" the Japanese retail trade with product in the back half of 2005 in order to meet aggressive sales forecasts. Management's analysis of the retail distribution for the brand in Japan suggested that the company needed to pull back and eliminate marginal accounts in order to preserve the brand's exclusive image. As a result, management decided to switch from the distributor model to a company-owned subsidiary in some countries such as Japan in order to better control the brand's retail placement and image.

In addition to establishing in-country sales forces in some markets, True Religion announced in July 2010 that it had formed a joint venture with its German distributor UNIFA. The joint venture took over the wholesale distribution of True Religion products in Germany, Austria, Switzerland, The Netherlands, Belgium, and Luxembourg as well as a company-owned store in Germany in August. Jeff Lubell stated, "We established the joint venture to expand our wholesale business in each of these countries and to roll out branded retail stores in the territory."[43] True Religion owned 60 percent of the joint venture, which was managed by UNIFA. Prior to the deal, UNIFA was True Religion's largest international distributor.

At the end of 2009, international sales stood at about $55 million or 18 percent of sales and 32 percent of operating profits. With over a 46 percent operating margin in 2009, the international division was by far the company's most profitable business. After falling from about $46 million in sales in 2005 to $32 million in 2007, the international business regained its momentum as Japanese sales rebounded and the company gained share in Europe.

Management Changes

The company named denim industry veteran Michael Buckley to the newly created post of president in April 2006. Buckley was president and CEO of Ben Sherman's North American business from 2001 to 2005. Prior to 2001, Buckley served as a vice president of denim giant Diesel USA for four years. He was to be responsible for day-to-day operations, including retail expansion, licensing, sourcing, and production. Jeff Lubell would remain in his post of chairman and CEO but devote more of his time to product design. Lubell commented to *WWD*, "Now I feel like I have a true partner and associate to help build the company and realize my vision of becoming a $1-billion brand."[44]

In August 2006, the company tapped Levi Strauss Europe designer Ziahaad Wells to be its design director. The following March, True Religion named Peter Collins as CFO. Pete Collins was the former corporate controller for Nordstrom. Collins managed a staff of 100 and was an expert on compliance with Sarbanes-Oxley requirements. In addition, Pete Collins had valuable accounting experience in international operations. He reported to Michael Buckley in his new position at True Religion. In January 2010, True

Exhibit 5 True Religion Brand Jeans Selected Financials ($ in thousands except per share amounts)

				First Nine Months	
	2007	**2008**	**2009**	**2009**	**2010**
Revenues	$173,256	$270,000	$311,001	$218,163	$252,807
Cost of Goods Sold	74,429	112,999	115,439	81,310	92,590
Gross Profit	$98,827	$157,001	$195,562	$136,853	$160,217
Gross Margin	57.0%	58.1%	62.9%	62.7%	63.4%
Selling, General & Administrative Exp.	51,685	88,125	117,965	83,139	116,485
Operating Profit	47,142	68,876	77,597	53,714	43,732
Operating Margin	27.2%	25.5%	25.0%	24.6%	17.3%
Other Expense (Income)	−1803	−1065	−169	−94	−205
Pretax Profit	48,945	69,941	77,766	53,808	43,937
Taxes	21,100	25,570	30,434	21,111	16,137
Tax Rate	43.1%	36.6%	39.1%	39.2%	36.7%
Net Income	$27,845	$44,371	$47,332	$32,697	$27,800
Redeemable Noncontrolling Interest	0	0	0	0	0
Net Income Attributable to True Religion	$27,845	$44,371	$47,332	$32,697	$27,708
Net Margin	16.1%	164.4%	15.2%	15.0%	11.0%
Earnings Per Share (Diluted)	$1.16	$1.83	$1.92	$1.35	$1.12
Average Shares Outstanding (Diluted)	23,949	24,270	24,659	24,146	24,807
Selected Balance Sheet Figures					
Cash & Short-Term Investments	$34,031	$62,095	$110,479	$93,681	$127,718
Accounts Receivable	27,898	33,103	27,217	28,546	27,036
Inventory	20,771	25,828	34,502	37,835	51,565
Propterty, Plant & Equipment	11,579	28,006	39,693	38,284	46,089
Total Assets	113,258	166,452	229,806	212,745	273,101
Accounts Payable	$9,597	$10,633	$11,717	$15,310	$17,605
Total Debit	0	0	0	0	0
Shareholders' Equity	95,247	142,250	197,854	180,101	231,162
Total Liabilities & Equity	229,806	166,452	229,806	212,745	273,101
Rent Expense	$3,700	$9,300	$16,200	$11,600	$17,200
Capital Expenditures	8,765	18,187	20,082	15,636	12,986
Number of Company–Owned Stores	15	42	73	66	89

Sources: True Religion 10Ks 2007-2009, 10Q September 2010.

Religion added Lynn Koplin as COO. Koplin was formerly president of Tommy Bahama's women's division.

True Religion's financial performance generally was strong between 2006 and first quarter 2009. The company was well on its way to establishing 100 company-owned stores in the United States. The True Religion brand appeared strong at the number two position in the U.S. market. Then, in May 2010, Michael Buckley abruptly resigned from the company. Two days before his resignation, Buckley sold over 193,000 shares of stock. The company offered no explanation for Buckley's resignation and promptly replaced him with Mike Egeck about two weeks later. Egeck had served as the CEO of 7 For All Mankind. Four months later, True Religion reported disappointing sales and earnings and lowered its full-year 2010 forecast. The timing of Buckley's departure and the speed at which he was replaced suggested that Lubell was aware that Buckley planned to leave—or had forced him out. As chairman and CEO, Lubell had an enormous amount of influence with the company's board of directors.

The company's strategic initiatives under Buckley were outlined in its 2009 10K. The initiatives were to continue to develop trendsetting styles, grow the consumer direct business by adding company-owned stores, increase True Religion's international presence, improve the U.S. wholesale business by changing to an in-house salesforce, and reduce the company's sales to the wholesale off-price channel. Would these initiatives change under the new company president Mike Egeck?

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