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EXECUTIVE SUMMARY

Since inception in 1892, the Abercrombie & Fitch Company (A & F) has been known for its high quality merchandise. Today, the Company is one of the largest and most successful retail apparel companies in the U.S., and one of the most successful as well. Since making a public stock offering in 1996, the Company has seen more than a three-fold increase in its stock price as well as a successful domestic and international physical expansion.

Although highly successful, A & F are continuing to assess their financial situation and market position. One main strategic concern is of the company is the need to maintain and expand the “aspirational positioning” of its brands to secure its premium pricing position. The Company also seeks to continue the trend that of its approximately 76, 100 employees, not one was a party to a collective bargaining agreement. In this report, Gotham Global focuses on three strategic issues facing the Company: domestic and international expansion, brand expansion, and diversity policies.

In the past, A & F has been very methodical and successful in regards to the North American expansion of Abercrombie and Fitch, Hollister, and Abercrombie, and RUEHL 925. However, the Company would be smart to learn from one of their top competitors, the Gap Inc., who experienced tremendous financial strain from international overexpansion. The Company recently opened a flagship European store in London, and it remains to be seen whether or not this international venture will be successful. If it is, the Company can start to estimate just how profitable international expansion could be. Apart from analyzing the financial situation in the flagship London store, our company will also provide strategic suggestions for continued expansion into the Canadian, Japanese, and British markets (a store is slated to open in Tokyo in 2008.)
A & F has been incredibly successful at growing its existing four brands, as RUEHL 925 has become more and more profitable over the past few years. Gotham Global would like to assure that this trend continues by offering advice on the location and business plan of the fifth store concept that the Company wants to open.

In light of the recent diversity issues the company has experienced, we are also compelled to address current diversity policies and provide new intuition strategy to the Company’s current approach. Our motivation for this part of the job will emanate from the fact that low expectations are easily exceeded. Initially we would suggest trying to exceed, and not simply meet, the government's demanded “benchmarks” as a starting strategy.
Abercrombie & Fitch Company was founded in 1892 by David Abercrombie and Ezra Fitch and specialized in selling world-class outdoor gear. During the early 20th century, A & F outfitted some very famous excursions including Theodore Roosevelt’s many African safaris. The company also served Charles Lindbergh, Amelia Earhart, and John Steinbeck along with many others. Despite the company’s success, the partnership between Abercrombie and Fitch deteriorated and eventually crumbled.

Fitch wanted to change the company’s business model to sell more than just professional gear to professional outdoorsman, but Abercrombie was tentative to expand. Eventually, in 1907, Fitch bought Abercrombie’s half of the business and began to pursue his dream of selling the outdoors to the general public.

Fitch not only wanted to change who his company sold to, he wanted to change the entire A & F shopping experience. Determined to provide a more outdoorsy experience in his store, he decided display his stock in a novel way. Instead of keeping his inventory behind glass cases, he took out his tents and travel stoves and set them up in the store, much like outdoor equipment stores such as REI do today. He even had real campfires burning in his stores as well as professional guides on staff to answer any questions customers may have had. His greatest contribution to the company may have been the A & F catalog that he created in 1909, almost at the cost of the entire company, which in the end became a great marketing tool. By 1913, the company had a store just off Fifth Avenue in New York and by 1917, their flagship store was located on Madison avenue in a twelve-story building adorned with their slogan: “Where the Blazed Trail Crosses the Boulevard.”

Success continued for Abercrombie & Fitch even after Ezra Fitch retired in 1928. The company continued to expand both physically and philosophically. In 1939
they were proud to call themselves “The Largest Sporting Goods Store in the World.” In 1962 the company had stores in Chicago, San Francisco, Colorado Springs, Palm Beach, Sarasota, Southampton, Hyannis and New York.

In the seventies A & F began opening stores in upscale suburban malls. Despite the apparent success of the company, financial problems led to the sale of the company to Oshman’s, a competitor in the sporting goods arena. The store continued to struggle even under new ownership.

The 1990s marked a historic change for Abercrombie & Fitch. In 1988, A & F was acquired by The Limited Inc. (now Limited Brands), and would undergo a change in concept engineered by the same company responsible for companies such as Express and Victoria’s Secret. CEO Mike Jefferies helped rebuild the company as a teen apparel merchandiser beginning with a few stores in the Midwest. The company finished the decade with a West Coast expansion that targeted teenagers and college students between the ages of 18 and 24 with “casual luxury” apparel products. The clothing line was marked by denim, miniskirts, polo shirts, t-shirts and an aggressively marketed underwear line. With all the success the new A & F was having, the Limited took Abercrombie & Fitch public in 1996 and gradually phased out ownership.

Despite the great resurgence under the ownership of Limited, Abercrombie did experience some bumps in the road over the last nineteen years. The Company published a racy magazine called A & F Quarterly which brought the company bad press until the periodical was discontinued. Besides the Quarterly, some of the t-shirts sold in the store caused a negative media storm and had to be pulled from the store, including a t-shirt which said “Wong Brothers Laundry Service—Two Wongs Can Make It White.” The biggest problem A & F has is the controversy that has surrounded its employment practices. In 2005 a class-action lawsuit was settled for $50 million in favor of potential employees that felt that they were not hired by the company because they were not good looking white males. The court also ruled that the company would have certain
“benchmarks” to meet when hiring new employees and that the company would be required to report to the court on their progress until at least 2009.

Despite these problems, the company has a market capitalization of more than $7.17 billion dollars and its stock is valued at around $81 a share, up from $16 in 1996. Today Abercrombie and Fitch Co. operates four clothing retailers\(^1\) as well as three e-commerce sites\(^2\). Currently, A & F is planning to expand internationally and has just opened its first European store in London. The next international opening is planned for Tokyo in 2008. In addition to expanding internationally, the Company is also seeking to expand its number of store concepts to five, but is still trying to decide on a new store concept.

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\(^1\) Abercrombie and Fitch, abercrombie, Hollister Co., RUEHL 925

\(^2\) abercrombie.com, abercrombiekids.com, hollisterco.com.
COMPETITIVE ANALYSIS

INTERNAL RIVALRY

Abercrombie and Fitch Company operates in the specialty retail apparel market and sells its products mostly in the United States and Canada. Sales not made in North America are due to the company’s strong e-commerce presence, namely abercrombie.com, abercrombiekids.com, and HollisterCo.com. This market contains several direct competitors including The Gap, American Eagle Outfitters, and J. Crew. Abercrombie and Fitch Company also competes against larger retailers like Target, Sears, Wal-Mart, J.C. Penny, T.J. Maxx, Marshall’s and Macy’s. It is important to realize, however, that significant differences exist between the quality and price of the apparel sold at the preceding stores. In fact, it could be argued that Target and Wal-Mart are indirect competitors with Abercrombie and Fitch because they sell low-priced, lower quality clothing.

More precision is required in the definition of Abercrombie and Fitch’s market since they have four specialized stores that target certain demographics. Abercrombie and Fitch sells high quality “casual luxury” apparel to college students at high prices. A & F competes with stores like J.Crew, American Eagle Outfitters, and Banana Republic (a division of The Gap Inc.). abercrombie (with a lowercase “a”) targets teenagers with clothing quality and prices similar to those at A & F and competes with stores like Gap Kids. The third store, Hollister Co, sells “California style” clothes to a target audience between 15 and 25 years old at lower prices and lower quality than the previous stores. Hollister directly competes with “surf shop” apparel stores like PacSun. Lastly, RUEHL 925, sells luxury clothing to college graduates and competes with apparel stores like Brooks Brothers, Armani, and Joseph A. Bank.

Due to the large number of competitors that the Abercrombie and Fitch Company has in the apparel industry their market is considered extremely competitive in
both price and nonprice dimensions. Historically, the specialty apparel market has shown slow but consistent growth. This market characteristic implies that if firms in the industry want to gain market share and grow, they must take market share away from their competitors. It is important to note that consumers in this market have almost no switching costs since the clothing is only superficially differentiated from other brands. The differences in branding are important and paramount for firms in the market. These differences are what create preferences in producers, and so we can say that competition arises from fashion. Firms want to keep their current customer base and grow their popularity, and winning this popularity is the key to success in the industry.

**Substitutes and Complements**

Clearly, there are few substitutes for clothing, so demand for apparel keeps rather constant and fluctuates with the overall economy. With a strong economy, apparel firms can expect increased demand for their products, and vice versa. Since there are no substitutes for clothing, traditional price theory tells us that price increases by one firm will cause consumers to switch their clothing consumption to another cheaper firm. If price increases span the entire apparel industry, then consumers will demand less clothing overall. The Abercrombie and Fitch Company believes that their marketing campaigns are vital to their market positioning, and invest considerable effort in advertising. The Company has learned from other companies’ mistakes, including one of its main competitors. The Gap experienced declining sales during 2001-2002 which were attributed to a poorly designed marketing campaign that “was too focused on small portions of the target market.” In a market that is so dependent on consumer tastes, A & F must be wary of the changing preferences of its target consumers.
Although people do accessorize according to their clothing, there is very little information indicating that demand for apparel is affected by changes in jewelry, shoe, handbag, and similar markets.

**Supplier and Buyer Power**

In the apparel industry, suppliers are those firms which provide raw materials for clothing production and the factories that produce them. The Abercrombie and Fitch Company supply chain behaves in much the same way as its competitors’ supply chains. The Company operates two distribution centers (both in New Albany, Ohio) that manage the receipt, storage, sorting, packing and distribution of merchandise to all of its stores and direct-to-consumer—online and catalog—customers. However, the company does not own or operate any manufacturing facilities and thus depends on third parties for the manufacture of all merchandise. Due to this structure, we would expect that there is little supplier power in the market since one supplier will not be able to successfully demand higher prices in such a competitive industry. However, if only one factory has gained some type of expertise in production, there could possibly be some supplier power in the industry. Vertical integration of this industry is highly unlikely because most of the suppliers are outside of the United States and there are strong barriers to entry in the very competitive apparel industry.

Another group of key suppliers in this industry are the third party delivery companies that handle the transportation of goods to and from the distribution centers. The Abercrombie and Fitch Company depends on the timely receipt of merchandise to keep their business running efficiently. The companies that A & F have contracted all employ unionized labor. Work stoppages by employees of this third party could seriously hurt the efficiency of the company.

Individuals have almost no power to negotiate purchase prices in this industry. All prices are non-negotiable at Abercrombie and Fitch and its affiliate stores.
The only buyer power that consumers wield is that they can shop around for the best prices, but this leverage develops because of the competitive nature of the industry.

**ENTRY**

Price competition will probably not increase through entry in the apparel industry. Start-up apparel stores and small boutiques can compete locally but not on the large scale that Abercrombie and Fitch and its competitors do. The economies of scale in the industry are such that entrants will struggle to make money while garnering brand recognition. For these reasons, existing apparel stores have huge advantages in the industry despite the fact that the raw materials and labor are not particularly hard to come by or pay for. Perhaps the biggest hurdle for an entrant would be spending enough money on effective advertising in order to claim a portion of the market.
SWOT ANALYSIS

STRENGTHS

Abercrombie & Fitch has a large number of strengths compared to competitors in, and possible entrants to the apparel industry, which stem from a number of factors, including their economies of scale and length of time in the industry. A & F enjoys strong brand recognition and brand loyalty due to effective marketing as well as the historically high quality of their merchandise. In addition to this brand loyalty, the Company has a great financial situation that is allowing it to expand both domestically and internationally. As a result of a balance sheet that shows no debt, strong direct-to-consumer sales, and a strong, efficient, and dependable distribution network, the Company is confident that expansion will be feasible and not detrimental to the already existing business.

Due to the fact that A & F has a huge physical infrastructure in the United States, entrants in the market will have a hard time competing against the Company. A start up apparel store will have to find buildings with good lease terms, efficient and trustworthy distributors, competent staff, and effectively market to become even marginally successful in the industry. Even if these tasks are completed, the new entrants in the business will still struggle to compete with the larger apparel companies on the margin. Traditionally this market is considered to have few barriers to entry, but the success of an entrant in this market is not guaranteed, especially if they look to compete on the margin.

Perhaps one of the biggest strengths that the Company has is that none of its more than 70,000 employees are unionized. Moreover, most of this workforce is part-time, which is great for A & F because they present a minimal threat to unionize, thus allowing the Company to pay low wages.
WEAKNESSES

Most of the weaknesses that the Company has stem from the nature of the apparel industry, and apply to most apparel retailers.

Sales in the industry depend highly on consumer tastes and fashion, which are both hard to anticipate and highly volatile. The highly competitive market also leaves little room for increasing prices since higher prices may lead loyal customers to switch brands. This change will only be facilitated by the low switching costs in the industry. You can imagine how easy it is for a customer to simply leave an A & F store in a mall and cross the hallway to the Gap to continue shopping. As competitors grow, the Company has been spending more and more money marketing to hold onto market share. If A & F expects to grow in the future, advertising will become more and more expensive due to the ascendance of their competitors in the industry.

The last weakness discussed in this section is a problem that most companies wish they had: A & F has experienced tremendous growth over the past decade, most notably in 2005. In 2005, comparable store sales increased by 26%, possibly overstating the true growth potential of the Company. The following year the comparable store sales of A & F only increased by 2%, catching many analysts’ attention. This precipitous drop in growth was cause for concern for investors, even though this concern may have been unwarranted. It is unrealistic for investors to believe that a company in this industry could post 26% growth in same store sales every year, but the strong performance in 2005 has given the company a precedent that is hard to maintain. In the near future, the growth of this company will always be compared, perhaps not fairly, to the excellent growth that the company enjoyed in 2005.

OPPORTUNITIES
It is clear from direct-to-consumer data as well as industry analyst reports that there is opportunity for physical expansion in international markets. Statistics from direct-to-consumer sales show increasing demand for online and catalog sales in languages other than English, leading the Company to emphasize international expansion as a goal in their annual reports. These data collected from direct-to-consumer sales may indicate the most profitable locations for domestic and international expansion. As mentioned in the strengths section, the financial success allows the Company to pursue these stated opportunities.

**Threats**

The highly competitive market that A & F operates in is always a matter of concern for the Company. Small miscalculations in price can lead to huge profit losses, or perhaps worse, loss of brand loyalty and good reputation. The expansion mentioned throughout this paper has high potential, but can cause significant problems if it is not pursued with the utmost care. Overexpansion, including poor public reception of the fifth concept store, could completely destroy a company that has taken 104 years to build.

Pending legal proceedings could lead to unwanted negative media attention, forcing the company to focus less on expansion and diversity and more on legal representation and public perception of the brand.

The unreasonably high expectations of shareholders and analysts may too prove to be a weakness for the Company. Unexpected shifts in fashion trends and consumer preferences, breaks in the supply chain, and unforeseen legal situations always threaten a company of A & F’s size and stature.

**Financial Analysis**
STOCK ANALYSIS

The Abercrombie and Fitch Company stock outperformed both the specialty apparel industry as well as the market for fiscal year 2006. In the graph below, you can see how Abercrombie and Fitch stock (ANF) has grown compared to its main rivals American Eagle Outfitters (AEO), J. Crew Group (JCG), and The Gap Inc. (GPS) as well as the S&P 500 (GSPC) as a whole. Presently, The Company has a market capitalization of $7.17 billion with 87.69 million outstanding shares, leading to a stock price of $81.78. According to Standard & Poors proprietary quantitative model, ANF stock is actually undervalued by $24.19, which would yield a true stock value of $105.97.

EARNINGS AND REVENUE ANALYSIS
A & F’s revenue comes from four divisions: Abercrombie & Fitch (which generated $1.52 billion in 2006, or 46% of revenues), abercrombie ($405 million, 12%), Hollister ($1.36 billion, 41%), and RUEHL ($34 million, 1%). Over the past two fiscal years, net sales have grown at 38% and then 19% while comparable store sales grew 26% and 2% over the same time period. Over the past three years, net retail sales per square foot have also grown in for each of the four stores, and RUEHL’s sales per square foot doubled from 2004 to 2005. These trends are tracked in the table below.

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td><strong>Net Sales by Brand</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>(thousands)</strong></td>
<td>$3,318,158</td>
<td>2,784,711</td>
<td>2,021,253</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Abercrombie and Fitche</td>
<td>$1,515,123</td>
<td>1,424,013</td>
<td>1,210,222</td>
<td>6%</td>
<td>18%</td>
</tr>
<tr>
<td>abercrombie</td>
<td>$405,820</td>
<td>$344,938</td>
<td>$227,204</td>
<td>18%</td>
<td>52%</td>
</tr>
<tr>
<td>Hollister</td>
<td>$1,363,233</td>
<td>$999,212</td>
<td>$579,687</td>
<td>36%</td>
<td>72%</td>
</tr>
<tr>
<td>RUEHL</td>
<td>$33,982</td>
<td>$16,548</td>
<td>$4,140</td>
<td>105%</td>
<td>NM</td>
</tr>
<tr>
<td><strong>Change In Comparable</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Store Sales</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Abercrombie and Fitche</td>
<td>-4%</td>
<td>18%</td>
<td>-1%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>abercrombie</td>
<td>10%</td>
<td>54%</td>
<td>1%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hollister</td>
<td>5%</td>
<td>29%</td>
<td>13%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>RUEHL</td>
<td>14%</td>
<td>NM</td>
<td>NM</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Net Retail Sales per Square Foot</strong></td>
<td>$500</td>
<td>$464</td>
<td>$360</td>
<td>8%</td>
<td>29%</td>
</tr>
<tr>
<td>Abercrombie and Fitch</td>
<td>$450</td>
<td>$432</td>
<td>$352</td>
<td>4%</td>
<td>23%</td>
</tr>
<tr>
<td>abercrombie</td>
<td>$513</td>
<td>$446</td>
<td>$282</td>
<td>15%</td>
<td>58%</td>
</tr>
<tr>
<td>Hollister</td>
<td>$568</td>
<td>$528</td>
<td>$423</td>
<td>8%</td>
<td>25%</td>
</tr>
<tr>
<td>RUEHL</td>
<td>$363</td>
<td>$315</td>
<td>$136</td>
<td>12%</td>
<td>NM</td>
</tr>
</tbody>
</table>

**Competitive Analysis**
A & F’s profitability numbers are very strong in comparison to its main competitors, the specialty apparel industry, and the market. Only American Eagle has a higher net profit margin than A & F and no competitor has a higher return on equity.

<table>
<thead>
<tr>
<th>Profitability</th>
<th>ANF</th>
<th>GPS</th>
<th>AEO</th>
<th>JCG</th>
<th>Industry</th>
<th>Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Profit Margin</td>
<td>66.60%</td>
<td>35.40%</td>
<td>48.00%</td>
<td>41.80%</td>
<td>34.90%</td>
<td>51.60%</td>
</tr>
<tr>
<td>Pre-Tax Profit Margin</td>
<td>20.30%</td>
<td>7.90%</td>
<td>22.50%</td>
<td>0.70%</td>
<td>6.40%</td>
<td>6.60%</td>
</tr>
<tr>
<td>Net Profit Margin</td>
<td>12.70%</td>
<td>4.90%</td>
<td>13.90%</td>
<td>0.40%</td>
<td>4.30%</td>
<td>5.10%</td>
</tr>
<tr>
<td>Return on Equity</td>
<td>35.20%</td>
<td>14.70%</td>
<td>30.10%</td>
<td>-0.60%</td>
<td>18.00%</td>
<td>9.60%</td>
</tr>
<tr>
<td>Return on Assets</td>
<td>20.90%</td>
<td>9.00%</td>
<td>21.60%</td>
<td>1.20%</td>
<td>9.00%</td>
<td>1.60%</td>
</tr>
<tr>
<td>Return on Capital</td>
<td>27.80%</td>
<td>11.50%</td>
<td>28.00%</td>
<td>2.20%</td>
<td>12.00%</td>
<td>4.20%</td>
</tr>
</tbody>
</table>

A & F has less impressive numbers for operations, indicating that there is a need for improvement on the back end of operations. Inventory turnover numbers are poor when compared to industry and competitor figures. Typically this implies that there are poor sales and excessive inventory. However, our company believes that these problems stem from a noted lack of investment in inventory management software as well as a company policy that frowns upon seasonal sales. Although our company believes that A & F is well managed and acknowledges the fact that we are not planning to advise on the topic, we insist that there is no reason why A & F should be so far behind the industry average concerning inventory turnover. A inventory management system that takes advantage of current technology, as well as a change in company policy allowing liquidation of inventory through sales could help increase profit margins, potentially on a large scale.
### Operations

<table>
<thead>
<tr>
<th></th>
<th>ANF</th>
<th>GPS</th>
<th>AEO</th>
<th>JCG</th>
<th>Industry</th>
<th>Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Days of Sales</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Outstanding</td>
<td>8.40</td>
<td>3.57</td>
<td>9.64</td>
<td>3.29</td>
<td>6.02</td>
<td>57.89</td>
</tr>
<tr>
<td>Inventory Turnover</td>
<td>2.80</td>
<td>5.90</td>
<td>6.00</td>
<td>5.40</td>
<td>4.5</td>
<td>5.80</td>
</tr>
<tr>
<td>Days COGS in</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventory</td>
<td>130.00</td>
<td>62.00</td>
<td>61.00</td>
<td>67.00</td>
<td>80</td>
<td>63.00</td>
</tr>
<tr>
<td>Asset Turnover</td>
<td>1.60</td>
<td>1.80</td>
<td>1.60</td>
<td>3.10</td>
<td>1.9</td>
<td>0.60</td>
</tr>
<tr>
<td>Net Receivables</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Turnover Flow</td>
<td>44.90</td>
<td>n/a</td>
<td>37.30</td>
<td>106.40</td>
<td>59.6</td>
<td>6.50</td>
</tr>
<tr>
<td>Effective Tax Rate</td>
<td>37.20%</td>
<td>38.40%</td>
<td>38.40%</td>
<td>42.50%</td>
<td>37.50%</td>
<td>29.60%</td>
</tr>
</tbody>
</table>

The Company's price to earnings ratio is worrisome, suggesting that investors are expecting The Gap and American Eagle to have more growth in the future than A & F. In fact, investors see the industry out performing the Company in the future as well. Since the stock began trading in 1996, however, it has grown steadily, showing only minimal volatility in the short run, usually marked by seasonal changes which affect the industry as a whole.

### Valuation

<table>
<thead>
<tr>
<th></th>
<th>ANF</th>
<th>GPS</th>
<th>AEO</th>
<th>JCG</th>
<th>Industry</th>
<th>Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price/Sales Ratio</td>
<td>2.04</td>
<td>0.94</td>
<td>2.40</td>
<td>2.37</td>
<td>0.95</td>
<td>2.26</td>
</tr>
<tr>
<td>Price/Earnings Ratio</td>
<td>16.12</td>
<td>19.65</td>
<td>17.50</td>
<td>n/a</td>
<td>19.65</td>
<td>19.35</td>
</tr>
<tr>
<td>Price/Book Ratio</td>
<td>4.82</td>
<td>2.91</td>
<td>4.73</td>
<td>n/a</td>
<td>3.04</td>
<td>2.21</td>
</tr>
<tr>
<td>Price/ Cash Flow Ratio</td>
<td>11.63</td>
<td>12.05</td>
<td>8.95</td>
<td>39.70</td>
<td>12.39</td>
<td>13.54</td>
</tr>
</tbody>
</table>
**KEY ISSUES**

**INTERNATIONAL EXPANSION**

One integral step in international expansion is to identify suitable markets and possible store locations in countries of interest. Luckily, the information that The Company collects from its direct-to-consumer sales is very helpful in isolating potentially high-earning locations for expansion. We would recommend that A & F examine their online and catalog sales to isolate information on their direct-to-consumer sales trends. These data should include the geographic as well as demographic information. Analysis of these will lead to informed decisions on where to locate new stores (countries and cities). The demographic information can lead to a concrete definition of the Company’s international target audience, which has yet to be articulated in any company strategy. By beginning international expansion with detailed analysis of their current international customer base, the Company will reduce their risk of unsuccessful expansion by locating in areas where strong brand loyalty already exists. The demographic information collected will help target future advertisement and in-store services (such as music and employees) to the most profitable audience. It is important for the Company to realize that the most profitable target audience abroad may not be the same target audience that A & F traditionally has catered to domestically. Gotham Global also urges A & F not to overlook the demand for catalogues and retail websites in languages other than English, especially in Japanese, Korean, Cantonese, and Mandarin.

Once these prospective locations are established, The Company’s Real Estate division should focus their search on buildings for lease located in already successful commercial areas. The Company has always done well to establish new stores in locations that give them the most exposure to their target audience, and this should be the goal in international expansion as well. Once general locations are decided on, and acceptable lease terms are negotiated, the training of employees, preferably of the target demographic will begin.
The Abercrombie and Fitch Company believes that the customer’s in-store experience “is the primary vehicle for communicating the spirit of each brand.” The customer experience in company stores is marked by store design, furniture, fixtures, music, fragrance, and the sales associates’ appearance, knowledge, and helpfulness. To recreate this experience in countries that may not have the same tastes as we do in the United States, a certain amount of research is needed to identify not only fashion trends but also The Company’s competitors in the new countries. Assessing the competition abroad is a good tool in refining the company’s country specific image. Above all, all competent employees must be trained and retained to help assure that the brand will grow in these emerging markets.

These employees will be key assets to The Company because it must gain acceptance from its new foreign customers. Although Abercrombie and Fitch Company has a strong and loyal customer base in the United States, foreign consumers still have to be convinced that they need Abercrombie and Fitch merchandise.

The Company will also need to allocate resources to research and then contract third party vendors that are capable of shipping merchandise. Also, inventory management should mirror the efficient process that exists now in the United States and Canada. To date, no distribution center exists outside of North America, and if international expansion meets with success there will be a need to expand infrastructure in England, and then Europe. Since the Company has already entered the United Kingdom market, it makes sense that the company would establish their first distribution center in England. However, the location of a distribution center is a critical step in international expansion, and a misstep can lead to huge costs that would have been avoided with more strategic placement of the center. If the company holds off on the creation of a distribution center for a couple of years, and successfully expands into Europe, a more central distribution center would make financial success if we assume that
transportation costs rise as the distance that merchandise travels increases. If A & F can successfully expand across Europe, a distribution in a more central country (Germany, for example) may indeed be more cost effective than a distribution center in England. Gotham Global strongly suggests that The Company direct sufficient resources to analyze the efficient placement of their European distribution center before any action is made.

Although The Company is financially successful in North America, we recommend a cautious pace for international expansion. It is true that the potential international physical expansion will be able to facilitate the growth that stockholders and analysts will be looking for, but success must not be taken for granted. Our company recommends a slow and steady expansion to avoid problems like The Gap Inc. experienced abroad when it over-expanded. The Company should develop some measure of success on the overseas level to give an indication of whether or not more expansion will be feasible and profitable. The Company has been very successful in monitoring expansion in the domestic arena, helped by the fact that A & F does not franchise any stores, and should strive to continue this trend internationally.

**BRAND EXPANSION**

Apart from international expansion, the Abercrombie and Fitch Company can also use brand expansion to maintain growth. Although the Abercrombie and Fitch, abercrombie, and Hollister Co. brands have deeply penetrated the domestic market, a new initiative to create a fifth store will be a way to expand domestic sales. Since its inception in 2004, REUHL 925 has enjoyed tremendous success catering to college grads aged 22 to 35 years old. Gotham Global feels that Abercrombie and Fitch will be most successful by opening another apparel store that offers its customers a unique and appealing experience.
The Company could start from scratch, and build an entirely new brand of clothing and customer experience, or the company could attempt to acquire a smaller company that has already succeeded in gaining market share.

If A & F attempts to build a new brand from scratch, they must continue to follow their successful strategies of the past. The in-store experience they provide must be second to none, and their employees must be well trained and appeal to their target demographic. Applying their tried and proven differentiation strategies to the new market will be essential in their success.

Our company believes that The Abercrombie and Fitch Company should seriously consider entering the urban apparel market for a number of reasons. By entering the urban apparel market, the Company could diversify its portfolio of apparel stores. It is clear that A & F markets to white men and women, and by entering the urban apparel market, the Company could expand its target market, leading to more growth opportunities. It is important to note that the scale of the operations of their main competitors are dwarfed in relation to the A & F infrastructure. The main competitors that A & F would face in this specialty retail group would be Rocawear, Phat Farm, and Sean Jean. All three of these companies market their brand as a lifestyle, much like the “casual luxury” lifestyle that A & F promotes, sell internationally by direct-to-consumer methods, and pride themselves on high quality. However, none of the companies have distribution centers, operate on as large a scale as A & F does, or sell only from their own retail outlets.

The Company’s margins would be much lower than their competitors due to economies of scale in the fashion industry, and could capture market share by giving some of these marginal benefits to the consumers in the form of slightly cheaper prices or enhanced shopping experience. This enhanced shopping experience will be a product of well-trained, attentive employees, well-designed and outfitted stores, and no sales being made in boutiques or department stores. All of the urban clothiers sell their products in departments stores such as Macy’s.
or smaller retailers that generally carry competitor’s products as well. Our company believe that A & F can significantly improve the urban apparel customer’s shopping experience by selling their products only in the A & F urban apparel outlet. This way, the Company can better manage the public image of their merchandise and not have to worry about product presentation outside of their stores.

Gotham Global suggests one company to emulate or acquire who has garnered success in the urban apparel industry. Over the past decade, Rocawear has become a dominant lifestyle apparel brand for a wide range of customers, with annual retail sales over $700 million. The brand has expanded its appeal beyond the national borders and has become a brand of international significance (offices can be found in the UK, Japan, Canada, and Europe), which are the current target markets of the Company. The brand prides itself on setting fashion trends and marketing their products aggressively, a strategy parallel to that of A & F, and a seemingly good fit for the Company.

However, the Company must not emulate the practice mentioned earlier of selling in other retail outlets. This novel approach to selling urban fashion could be the key for A & F to have a successful entry into this market.
DIVERSITY “BENCHMARKS”

The Abercrombie and Fitch Company was recently mandated (when??) by the Supreme Court to increase diversity in its hiring practices as well as its advertising campaigns. The following quotation comes directly from the court’s mandate:

Abercrombie believes that the artistic aspect of its marketing materials is a critical factor driving the success of Abercrombie and its brand. As a company committed to achieving diversity in its store associates, as reflected in the other terms of this decree, Abercrombie will reflect diversity, as reflected by the major racial/ethnic minority population of the United States, in its marketing materials.

It is clear that the government does not have confidence that The Company will fulfill its diversity commitments, the best thing that Abercrombie and Fitch can do is exceed expectations. This may be achieved by surpassing the benchmarks stipulated in the court settlement. Perhaps by exceeding the benchmarks, Abercrombie and Fitch can prove to the court and to America that it is committed to promoting diversity with new advertising campaigns and employments practices. However, this would suggest revision of their core strategies concerning target audience and the demographics of their employees. It is not clear what the financial effects a move towards a more diverse (non-white) target audience, but it could be argued that this could increase the Company’s consumer base.

Our company proposes that a more feasible option to exceed low expectations would be the expansion into the urban apparel market mentioned above. The Company could stand to make a large profit from entry and then diversification of product as discussed above, and would also benefit by attracting new consumers and investors who would not have supported the Company before their diversification. The entry into this market would not be meant to replace the court ordered diversity mandates but instead would serve to bolster The
Company’s new dedication to diversity for its employees, marketing, and merchandise.
CONCLUSION

The Abercrombie and Fitch Company is not in financial trouble; there is no need for a drastic change in the strategic direction of The Company at this point in. The problem is that for the past decade, The Company has experienced tremendous yearly growth, and it is going to be difficult to maintain this trend in the future without physical and brand expansion. Gotham Global believes A & F can gain domestic urban apparel market share as well as international apparel market share. By securing this market share, they can continue their growth for years to come, which will satisfy analysts and stockholders alike.
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