

# MARKETPLACE



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# Empty Mall Stores Trigger Rent Cuts

### Remaining Tenants Point to Occupancy Guarantees to Shave Overhead Costs or Escape Leases

Retail chains are using the fine print in their leases to demand rent reductions, eking out critical savings and pressuring mall owners already struggling with vacancies.

**Gap Inc., Williams-Sonoma Inc. and AnnTaylor Stores Corp.**, among others, are poring over their leases and dispatching staff to track store closures that trigger "cotenancy clauses." The clauses, relatively common in retail leases, let tenants demand cuts in rent—or, eventually, a penalty-free pullout—if key tenants or a specified number of stores leave the center.

By Elizabeth Holmes, Vanessa O'Connell and Kris Hudson

**Chico's FAS Inc.** has saved \$8.1 million so far through its rent-relief negotiations, including the aggressive enforcement of cotenancy clauses. Chico's, which has more than 1,000 stores, relies on its regional sales managers to police the malls. They study the cotenants named in the leases of each store, then walk the malls on the lookout for violations, taking photographs as evidence and reporting back to the corporate real-estate team.

**Charming Shoppes Inc.**, with brands such as Lane Bryant and Fashion Bug, estimates that it will save roughly \$10 million this year by pursuing rent relief, including the use of cotenancy clauses.

The breach of a cotenancy clause typically allows the retailer to pay as little as half the rent while the landlord searches for a new tenant to replace the one that departed. If none is found within the allowed grace period of a year or more, the re-

tailer can break its lease without the usual, hefty cancellation fee. Retailers that want to stay put are using the triggered clauses to negotiate multi-year rent reductions from their landlords, often in exchange for adding more years to their leases. Some cotenancy clauses allow retailers to pay lower rent if a mall or shopping center's occupancy falls below a certain threshold.

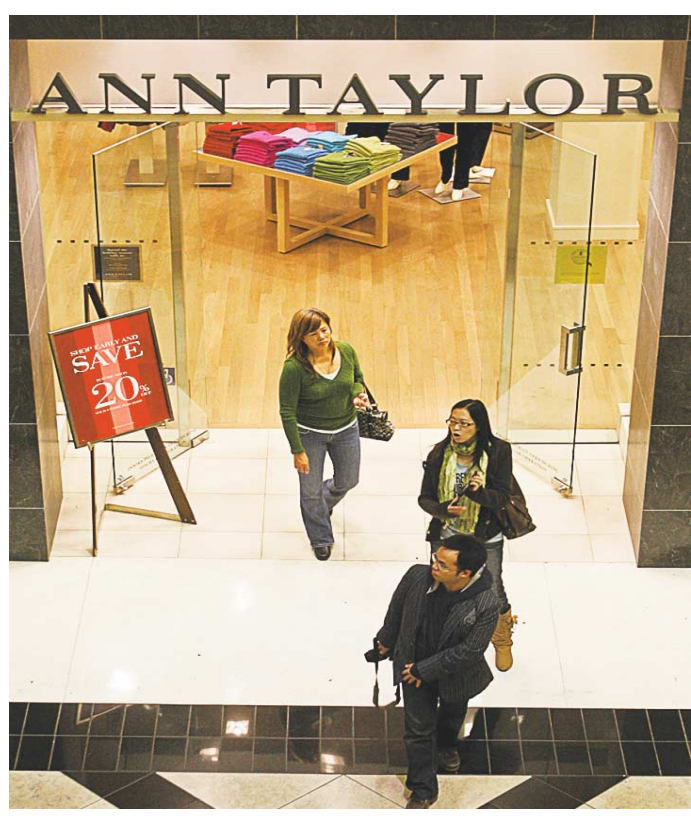
Rent is among the biggest expenses for retailers. As sales continue to drop, the fixed cost of rent eats away at already thin profit margins. The average specialty retailer spent roughly 12% of sales on rent last year, up a percentage point from 2007. Citigroup estimates that the figure could reach 13% this year.

Reflecting a decline in revenue, Chico's rent as a percentage of sales reached 10% in 2008, up from 7% two years earlier.

For commercial landlords, the cotenancy demands are one part of a miserable picture as they suffer through the current recession.

According to data released Wednesday by real-estate research company Reis Inc., the average lease rate at shopping centers—defined as open-air centers and big-box centers as opposed to enclosed malls—in the top 77 U.S. markets declined in the second quarter for the fifth consecutive quarter. In the 29 years it has tracked the figures, Reis says it has never seen a stretch of declines that long. At enclosed malls, average lease rates declined for the third consecutive quarter. Store vacancies are also hitting multiyear highs.

With a recent boom in the construction of open-air shopping centers—which depend on chains of smaller shops rather



than department stores—many retailers insisted on adding clauses requiring that other key specialty retailers be signed as tenants, to ensure ample drawing power. As chains now either shutter stores or curtail expansions, use of the clauses is on the rise.

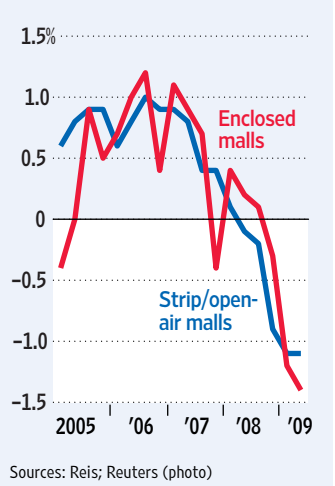
"We all sort of locked arms and said, 'Let's jump in the pool together,'" says David Zoba, senior vice president of real estate for Gap. "Now some of us are getting out of the water."

The result is a ripple effect, as failures trigger cotenancy violations, which in turn lead to canceled leases, more vacancies and more violations.

Bankruptcies have led to

## Mauled

Quarterly change in the average lease rates for strip malls and enclosed malls in the top 77 U.S. markets.



Sources: Reis; Reuters (photo)

Shoppers exit the Ann Taylor store at the Glendale Galleria shopping mall in California.

# Army Awards Afghan Deals To DynCorp And Fluor

By August Cole

**DynCorp International Inc. and Fluor Corp.** won Army contracts that could be valued at \$15 billion over the next five years to build bases and other infrastructure for U.S. forces in Afghanistan.

The deals show how lucrative logistics contracts in Afghanistan will be, since the country has a far less developed infrastructure than Iraq. Each company could receive up to \$7.5 billion, depending on the Pentagon's needs.

**KBR Inc.** held the predecessor contract that covered Afghanistan, Iraq and elsewhere, but lost out in bidding for the new Afghanistan work. KBR could still be retained down the line. KBR said Wednesday it would request a briefing on the selection and would decide later whether to lodge a protest.

The Obama administration's strategy in Afghanistan is at a turning point as Gen. Stanley McChrystal assesses how many troops are needed for a new counterinsurgency strategy.

Meanwhile, Pentagon acquisition officials are trying to make sure logistics contracts avoid the types of snafus and scandals that dogged work in Iraq.

**Fluor, Aliso Viejo, Calif.**, said this latest round of work, on a large Army contract known as Logistics Civil Augmentation Program IV, will cover 74 bases in northern Afghanistan. It will include power, water, housing, construction services, base operations, and logistics support.

**DynCorp, Falls Church, Va.**, said its first year of work, which will cover southern Afghanistan, will be valued around \$644 million. DynCorp gave a conservative value for the total contract at about \$5.9 billion for the next five years.

While the Obama administration has been pushing to bring thousands of systems-engineering and weapons-acquisition jobs back onto the government payroll, logistics work such as that won by Fluor and DynCorp hasn't received the same level of attention, said David Bertheau, who directs defense-industry research for the Center for Strategic and International Studies, a Washington think tank. "We're clearly at the point where there's a dependency on contractors by the military," he said. "There's not a lot being done to change that dependency."

KBR's previous work sparked criticism from lawmakers and government watchdogs that the work was poorly run. Houston-based KBR said it has worked to keep down costs, which were often high because of difficult and unpredictable wartime conditions.

# GM's Fate Will Ride on the Success of Chevy

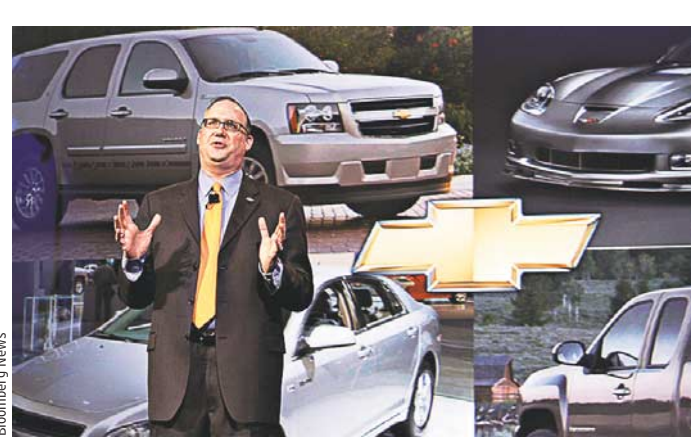
By Kevin Helliker and John D. Stoll

Late this week, **General Motors Corp.** and the Obama administration are expected to launch the new GM as a house of four brands. But forget Buick, Cadillac and GMC. The fate of GM will mainly ride on Chevrolet.

"In the next year, Chevy could get upward of 70% of total GM sales," says Ed Peper, the Chevy chief at GM.

Is Chevy fit to carry that load? The built-for-duty image of the division's Silverado pickups may suggest that Chevy can carry anything, but the trucks illustrate a problem.

To lift the fortunes of a parent company that is closing or casting off three car brands—Pontiac, Saturn and Saab—Chevrolet will probably need to recapture the



Chevrolet could get upward of 70% of GM sales, says Chevy head Ed Peper.

glory days of its sedans. But two-thirds of its sales and most of its profit now come from trucks, and its most celebrated cars are sports models, the Corvette and the newly launched Camaro.

Among Chevy cars, says David Champion, senior director of Consumer Reports' auto test division, the subcompact Aveo "is dismal," as is the compact Cobalt. He adds, the Impala is pretty long in the tooth, and the Malibu is the only model in the

lineup "that is legitimately able to help them get back on their feet."

But that isn't how many Chevy dealers see it. In their view, the brand boasts strengths that have been overlooked amid the eight brands that have long vied for parent-company resources and attention.

For several years, for instance, Chevy has been the first- or second-ranking brand in the U.S., selling more vehicles than every other brand with the occasional exception of Toyota. Inside GM, it already accounts for about 60% of sales.

Surveys of brand strength also consistently rank Chevy among the leaders world-wide. "Chevrolet is as well known as McDonald's," says Ron Pinelli, president of Autodata Corp., which tracks vehicle sales in the U.S.

In contrast, the three other GM brands expected to remain after a judge approves the company's emergence from Chapter 11 serve niches, with Cadillac selling luxury vehicles, Buick premium vehicles and GMC only trucks.

Chevy, meanwhile, sells everything from subcompact cars (the \$13,000 Aveo) to SUVs (the \$40,000 Suburban) to sports cars (the \$105,000 Corvette ZR1). Of the 33 nameplates to be sold by the new GM, half will be Chevrolets, up from 31% under the auto maker's previous eight-brand portfolio.

In the new GM, Chevy is "going to get a lot more marketing dollars," says Mr. Peper, who boasts that the Chevy brand is already mentioned in 900 songs. Late next year, Chevy is also positioned to take charge of GM's

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# Panasonic Reaches Wide—and Low—with Appliances for Emerging Market

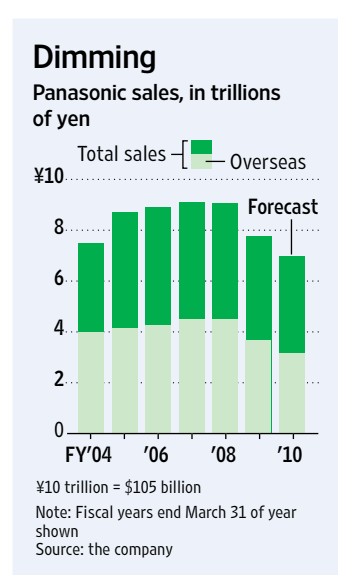
By Daisuke Wakabayashi

TOKYO—**Panasonic Corp.** wants a bigger share of sales in developing markets, but knows that its \$1,200 large-screen plasma-display TV sets and \$3,000 nanotechnology refrigerators are beyond the reach of low-wage families.

So the company is planning a new line of offerings that could include TVs for \$50, air conditioners for \$100 and washing machines in the \$200 range—but reaching those prices means offering scaled-down models that lack many of the features typically found in such products.

By reducing features and localizing design and manufacturing, Panasonic believes it can save money on labor, materials and overall development, and offer such products to millions of people in Asia, Russia, Latin America, Africa and elsewhere.

In pursuing the strategy for emerging markets, Panasonic will be going head to head with local bargain brands with years of experience squeezing costs to maintain razor-thin profit margins. To cut costs, Panasonic said it will need to perform a complete overhaul of how it conceives, designs and manufactures its products.



The electronics maker said it isn't ready to reveal details about its product strategy, but Panasonic acknowledges it will have to make tough decisions about what is essential and what can be left out.

The number of doors on a refrigerator is one example. Models in Japan often have four to six doors, because Japanese consumers like compartments, even though it reduces usable space. But eliminating extra doors simpli-

fies the manufacturing process and requires fewer parts, reducing the overall cost.

The company already has some experience tailoring products to different markets. For instance, a refrigerator sold in Vietnam has a big freezer and makes ice cubes in under two hours, as consumers there like ice.

"To compete at this level, we have to change completely how the entire company thinks about these products," said Hitoshi Otsuki, 62 years old, who runs Panasonic's overseas consumer-products business.

Such a shift in production methods and prices is already transforming other industries. India's **Tata Motors Ltd.** is selling a car, the Nano, for a bargain price of \$2,500. With the Nano, Tata installed only one windshield wiper, used narrow tires and didn't include a radio or air conditioning. **Nokia Corp.** and other cellphone makers also have introduced barebones phones for emerging markets, although the skimpy profit margins have led some, such as **Motorola Corp.**, to back away.

While Panasonic would be the first Japanese company to go after ultralow-price customers in emerging markets, it has got

that which does not kill you only makes you stronger...

A good attitude is key in times like these. Focus on what you can do and do it. Be one of the companies that pulls the economy forward. [pwc.com/us/advisory](http://pwc.com/us/advisory)

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