



**NEW**  
**ADVICE THAT'S WORKING**  
Latest picks developed from top performers

**MarketWatch**  
**HULBERT ON MARKETS**  
WHAT'S WORKING NOW

**FREE 4-WEEK TRIAL**

Dow Jones Reprints: This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Order Reprints tool at the bottom of any article or visit [www.djreprints.com](http://www.djreprints.com)

[See a sample reprint in PDF format.](#)

[Order a reprint of this article now](#)

**THE WALL STREET JOURNAL.**  
WSJ.com

BUSINESS | MAY 25, 2010

## Retailers Temper Recovery Hopes With Caution

By [ANDRIA CHENG](#)

NEW YORK—As retailers close the book on a strong first quarter, they're sounding a common refrain: Hope for a steady consumer-spending recovery carries a note of caution.

The results so far this year have been encouraging. About two-thirds of the nation's retailers have turned in earnings that topped analysts' expectations, with profits up a healthy 26% on average from a year earlier, according to Thomson Reuters.

But that doesn't appear to be sustainable. Wall Street analysts forecast retail-profit growth will slow to 17% in the second and third quarters this year and to 11% in the fourth quarter, Thomson Reuters data show.

"There are headwinds coming," Robert Samuels, an analyst at brokerage Phoenix Partners said in an interview. "The second half of the year could be a lot tougher than the first half. Consumers are still very cost-conscious and not exactly free-spending. Business is still very unpredictable."

While such major retailers as [Wal-Mart Stores Inc.](#), [Home Depot Inc.](#), [Gap Inc.](#), [Macy's Inc.](#) and [Kohl's Corp.](#) reported improved first-quarter results, the upswing in consumer spending wasn't enough to alter earlier full-year outlooks for many of them beyond minor adjustments to capture results from the strong first quarter.

Several retailers' second-quarter forecasts actually fell short of Wall Street's heightened expectations.

"People are willing to consider spending and making discretionary purchases," said John Mahoney, chief financial officer at office-supplies retailer [Staples Inc.](#), in an interview last week, when the company reported a 32% jump in first-quarter profit but gave a cautious outlook for the second quarter and the year.

"We are continuing to see steady improvement, Mr. Mahoney said, but "there's no rapid recovery. Without increase in the headcount, our growth will remain slow. We are somewhat moderate in terms of our optimism."

Among the challenges: Retailers face tougher year-on-year comparisons. After the financial-sector meltdown clobbered results in late 2008 and early 2009, retailers adjusted their businesses by aggressively cutting costs and inventories to revert profit back to a more normal growth rate the rest of 2009. That made this year's comparisons with the year-earlier results tougher, said John Butters, an analyst at Thomson Reuters.

Other headwinds: Unemployment remains near a record high while the rising price of key commodities is threatening margins at retailers from [Abercrombie & Fitch Co.](#) to [Lowe's Cos.](#), analysts said.

"We are going to be facing inflationary pressures, and I think they are going to get even more significant as we get into 2011," said [Jones Apparel Group Inc.](#) Chief Executive Wesley Card on a conference call when the company reported its first-quarter results.

"Raw-material prices are up in the single- to low-double digits, whether it's cotton prices or leather prices. Labor costs in China, as the economy has rebounded there, are also moving dramatically up," Mr. Card added.

Abercrombie's CEO, Michael Jeffries, last week called the rising price of cotton a "serious problem" that's intensifying company efforts to cut average unit costs.

Lowe's and Home Depot both say they are feeling the pinch of higher lumber prices, with Lowe's adding that intense competition is keeping it from raising prices to cover the higher costs.

There also are concerns that retailers' other expenses are rising as they step up incentive compensation, marketing, store remodeling, and other capital and technology investments needed to stay competitive and defend market share, analysts said. After stricter inventory control eased the need for discounts and boosted profit, retailers such as Gap are now in the process of stocking up again.

Retailers fear mall traffic will decrease, and profits will slow in coming quarters.

"Most retailers have started to build their inventories beginning in [the first quarter] as they saw a pop in consumer demand," said Weeden & Co. analyst Amy Noblin. "With costs and inventory up, as well as more talk about reinvestment in the business, we expect our group to remain volatile until we see more visibility in the [sales] trend."

The fragile state of many European economies also is hurting investor sentiment, while a decline in the euro and British pound against the dollar may dent companies with bigger exposure to Europe's market, analysts said.

Abercrombie and [Tiffany & Co.](#) "face the biggest potential drag" to profit, said Credit Suisse analyst Paul Lejuez, adding that they also may be hurt if the stronger dollar reduced tourism to their New York flagship stores.

[Phillips-Van Heusen Corp.](#), meanwhile, has lost 21% of its stock-market value since it reached a high on April 25 due to concerns that half its Tommy Hilfiger business is vulnerable to conditions in Europe, said Morgan Stanley analyst Chi Lee, adding that he considered the concerns overblown.

In the near term, cooler weather in early May, coupled with a timing shift in Memorial Day weekend, is expected to dent May same-store sales. Within the past two weeks, Wall Street's second-quarter profit estimate has declined by an average 0.7%, with analysts adjusting lower Kohl's second-quarter profit estimate by 12% and reducing [J.C. Penney Co.](#)'s by 5%, Thomson Reuters data showed.

"We'll be watchful of what the May numbers look like," said BMO Capital Markets analyst Wayne Hood. "It'll be important for June to show good growth. First quarter sets up for difficult profit comparison."

**Write to** Andria Cheng at [andria.cheng@dowjones.com](mailto:andria.cheng@dowjones.com)

Copyright 2009 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our [Subscriber Agreement](#) and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit [www.djreprints.com](http://www.djreprints.com)