Retailers Sink Into the Doldrums
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The retail industry appears to be skidding toward its first big wreck in 17 years.

Chains are slamming the brakes on store openings, cutting back on inventory and girding for leaner times as consumer spending chills. The speed with which sales slowed during the holidays caught even cautious retailers off-guard, prompting a flurry of profit warnings.

And while data on December consumer spending won't be released until the end of the month, plummeting sales suggest consumers are snapping shut their pocketbooks.

"The consumer is very cautious," says Trudy Sullivan, chief executive officer at clothing retailer Talbots Inc., which will pare store inventories by 7% to 8% this year and use more frequent markdowns. Retailers haven't faced so many difficulties since the deep economic downturn of 1990-1991 pushed many off track.

An expected 4% sales increase for the November-December holiday period at stores open at least a year rang in at only 3% compared with the 2006 holidays, according to trade group National Retail Federation -- the smallest increase since 2002. Even then, sales were propped up by inflation-boosted prices of food, fuel and drugs. Apparel, jewelry and home-products chains reported same-store sales declines.

It will be a discouraging first half of the year, economists warn. "It will feel like a recession to many people even if we technically avoid one," says Frank Badillo, senior economist at market researcher TNS Retail Forward. "Financial stress from high energy costs, the fallout from the housing slump and sluggish employment and income growth" will weigh on shoppers, projects Rosalind Wells, chief economist of the National Retail Federation.

It's too early to judge how deep or prolonged the slowdown may be. Mr. Badillo and other experts forecast weak gains in retail sales, but some investors see a deep retail recession. Wall Street sentiment is at the lowest level in decades, measured by price-to-earnings ratios, the price of a stock divided by its earnings per share. The forward price-to-earnings ratios of affordable-luxury goods maker Coach Inc. and department-store chain Kohl's Corp. recently touched historic lows, and discount department-store chain Target Corp. is near a 12-year low.

In hopes of averting a recession, Democrats and Republicans in Washington have called for tax rebates and interest-rate cuts to stimulate the economy. Such measures helped contain the recession of 2001, which lasted just eight months, less than half the usual duration of modern recessions.

Complicating the retail outlook is a decade of new and intense competition. The number

of retail chains and sales outlets is
dramatically larger now than in 1991. The Internet, which has changed how customers price and buy goods, didn't even exist as a place to do business.

How would a recession change the industry today? A look back suggests that low-cost approaches survive best, while companies that are financially weak or loaded with debt could be forced to restructure. From late 1989 -- when holiday sales first slowed -- through April 1991, at least 50 major retailers representing $23.7 billion in annual sales sought bankruptcy-court protection.

That recession weakened regional and even some national chains, setting the stage for the explosion of big-box and discount retailers in the following years. The recession helped Best Buy Co., Home Depot Inc., Target and Wal-Mart Stores Inc. take off as weaker companies struggled.

Even the milder 2001 recession, which was largely due to a decline in business investment after turn-of-the-century Y2K and dot-com capital- spending booms, presaged the later consolidation of department-store chains. In 2005, Macy's corporate parent acquired May Department Stores Co., becoming Macy's Inc., and Kmart completed its purchase of Sears, Roebuck & Co. to form Sears Holdings Corp.

For the past few years, sales have been inflated by consumer spending supported by skyrocketing home values. With incomes stagnant for many Americans and the housing market in a slump, it will be difficult for consumers to match the spending of recent years.

Big investors are already prodding retailers facing slumping sales to spin off operations. William Ackman, an activist investor who pressured Wendy's International Inc. to spin off its Tim Hortons chain, has taken stakes in hard-hit Sears and Target. In July Mr. Ackman began pushing Target to increase its share buybacks and sell its $8 billion credit card portfolio. Yesterday he said he expects the Minneapolis retailer's shares will double over the next three years. "They have great consumer mindshare and will continue to innovate," he said. Nelson Peltz, another activist investor who is a partner in Trian Fund Management LP, this week upped his holdings in Tiffany & Co.

"Being a strong company in a weak environment presents significant opportunities," says Pat Connolly, chief marketing officer of home- goods retailer Williams-Sonoma Inc. It has renegotiated supply contracts to more favorable terms as its rivals have cut orders with their suppliers. It is seeing more timely deliveries and fewer price increases, he says.

In some ways, retailers are better equipped to handle a recession, thanks to improved inventory management, labor scheduling and pricing tools that didn't exist two decades ago.

"Retailers are leaner and have worked on getting costs out," says Edward Henderson, senior retail analyst at debt-rating firm Moody's Investors Service. The amount of inventory per $1 of sales has declined 18% since 1992.

Analysts say chains that already have been struggling, including Circuit City Stores Inc.,RadioShack Corp., Rite Aid Corp., Sears, and Talbots, will find turnarounds more difficult if consumers back off their spending. A consolidation of weaker, regional retailers could follow.

Yesterday, jeweler Zale Corp. said it would close 60 stores in the next 90 days. Talbots plans to pare store openings and use more frequent markdowns to entice shoppers. Chico's FAS Inc., another clothing retailer, is cutting $100 million of capital spending, including scaling back a distribution center expansion and delaying a new computer project until 2009.

In March, Macy's intends to cut 271 jobs in Chicago, Detroit and Minneapolis, and it has already closed most of its in-store wine shops and several food operations. Over the next 90 days, it will shutter nine underperforming stores in Indiana, Ohio, Louisiana, Oklahoma, Utah and Texas.

--Vanessa O'Connell and Ann Zimmerman contributed to this article.

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