INDUSTRY TIMELINESS: 37 (of 98)

The Retail (Special Lines) Industry has been a mixed bag lately, in terms of operating performance. With summer in full swing, some retailers have had a tough time getting shoppers into their stores, while others have seen some improvement in customer traffic. Based on recent trends, late spring to early summer likely proved to be a challenge for many companies in this diverse group, as poor weather and sluggish consumer spending, among other factors, kept mall traffic light across the country. And with shoppers still spending cautiously against an uncertain economic backdrop, we believe business will remain difficult through the important back-to-school period. Near-term sales and earnings prospects, thus, don't appear to be overly upbeat.

Our momentum-driven Timeliness Ranking System currently places the Retail (Special Lines) Industry in the top half of all sectors covered, with quite a few names that stand out for year-ahead relative price performance. That said, long-term investors may find some worthwhile bargains here, as many of these equities are trading at historically low valuations.

Tightening the Purse Strings

Amid difficult macroeconomic conditions, many consumers are continuing to snap shut their wallets and keeping discretionary purchases to a minimum. Some readings on the economy have shown improvement, which is a welcome change and a possible sign of better things to come. However, other parts of the economic picture suggest otherwise. Indeed, the lengthy recession, highlighted by the housing market slump, tight credit, rising unemployment, and shrinking nest eggs, is weighing on both the minds and pockets of consumers. Especially noteworthy is the sharp rise in the U.S. jobless rate, which recently hit a 26-year high at 9.5% in June (the latest monthly reading available).

Meanwhile, consumer confidence (a key metric that gauges the public's sentiment on the economy and its direction) is still relatively low. Under these circumstances, many people are being forced to pass on nonessential or big-ticket items, and instead are paying only for such necessities as food and fuel. While Congress and the White House are counting on the stimulus program to pull the economy out of its rut, our sense is that it will take time for the situation to return to normal, especially since unemployment may head higher in the next few months.

Deep Discounts

With most consumers continuing to tighten their belts with regard to discretionary purchases, it is no wonder that mall traffic has remained light in recent months. To entice shoppers, many retailers have turned to aggressive promotions and markdowns. Steep discounts have certainly done a fine job attracting bargain hunters. But, while in many cases slashing prices has helped to spur customer traffic and reduce inventory levels, margins and profits have ultimately been sacrificed.

Survival of the Fittest

Without a doubt, most retailers remain in the doldrums. To cope in these tough times, a number of merchants have closed stores, scaled back capital expenditures, and implemented expense-reduction initiatives, which have consisted mainly of layoffs and employee pay cuts. Thanks to these moves, operating margins have improved for some in this group. But a few have been able to weather the storm better than others. *Gymboree* is one particular standout here. This childrenswear retailer has successfully used promotions and money-saving events to draw shoppers into its stores. Meanwhile, its diversified three-tiered retail platform, which targets different affordability levels, has enabled it to stay afloat in this environment. Despite weak comps, a lower cost structure has helped to cushion margins and alleviate pressure on the bottom line.

Conclusion

To be sure, the success of companies within the Retail (Special Lines) Industry is dependent on a variety of factors. The economy plays a particularly essential role. Admittedly, there are several retailers that seem to be better positioned for the near term. But, by and large, we think brighter days are in store for this group over the 3- to 5-year time frame, assuming economic conditions are much improved by then. Even so, investors should peruse each stock report individually before making any commitments.

J. Susan Ferrara

Composite Statistics: Retail (Special Lines) Industry

2005	2006	2007	2008	2009	2010		12-14
196939	220077	235412	218547	***205000***	***207500***	Sales ($mill)	***240000***
37.9%	37.4%	37.0%	36.2%	***36.0%***	***36.5%***	Gross Margin	***37.0%***
11.4%	10.7%	10.5%	9.7%	***9.5%***	***10.0%***	Operating Margin	***10.5%***
70741	71963	74331	72568	***72500***	***72500***	Number of Stores	***73000***
9809.9	10527.5	10853.1	7384.5	***7250***	***7500***	Net Profit ($mill)	***10000***
36.6%	36.3%	36.7%	40.0%	***39.0%***	***39.0%***	Income Tax Rate	***39.0%***
5.0%	4.8%	4.6%	3.4%	***3.5%***	***3.6%***	Net Profit Margin	***4.2%***
26705	28680	25393	22100	***22000***	***23500***	Working Cap'l ($mill)	***30000***
14605	14162	18382	19630	***19630***	***19630***	Long-Term Debt ($mill)	***19630***
52311	58934	57066	48191	***48000***	***51000***	Shr. Equity ($mill)	***70000***
15.3%	15.1%	15.2%	11.8%	***11.5%***	***11.5%***	Return on Total Cap'l	***12.0%***
18.8%	17.9%	19.0%	15.3%	***15.0%***	***14.5%***	Return on Shr. Equity	***14.5%***
16.3%	15.0%	15.6%	11.1%	***11.0%***	***10.5%***	Retained to Com Eq	***11.5%***
13%	16%	18%	28%	***28%***	***27%***	All Div'ds to Net Prof	***21%***
19.2	19.2	18.7	18.5	*Bold figures are Value Line estimates*		Avg Ann'l P/E Ratio	***18.0***
1.02	1.04	.99	1.11			Relative P/E Ratio	***1.20***
.7%	.8%	1.0%	1.5%			Avg Ann'l Div'd Yield	***.9%***