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Talbots' Credit Crunch Raises Alarms

By Jeanine Poggi and Evan Clark

Talbots Inc.'s credit crisis might not be an isolated event, as lenders grow more nervous about the retail sector, experts said.

Shares of Talbots continued on a downward spiral Thursday, falling 14.5 percent to \$7.83. That followed a 28.7 percent decline Wednesday after the Hingham, Mass.-based retailer said Bank of America and HSBC would pull lines of credit. The Dow Jones Industrial Average finished fractionally ahead on Thursday as the S&P Retail Index crept up 0.2 percent.

A Securities and Exchange Commission filing on Tuesday revealed that Bank of America canceled its \$130 million letter of credit as of April 8. HSBC reduced its letter of credit to \$60 million from \$135 million and will phase out financing entirely by Aug. 8.

“Retailers are already experiencing a credit crunch from their banks,” said Jack Hendler, president of Net Worth Solutions Inc., a financial advisory firm. “There are a number of stores that are on credit watches and credit holds to some degree.”

“It is a bigger-picture story,” said Emanuel Weintraub, of the consulting firm that bears his name. “Banks don’t trust each other and don’t want to lend to each other overnight. There is so much fear and mistrust about every kind of paper out there.”

While Talbots has been attempting to turn around its business under the stewardship of Trudy Sullivan, who joined as chief executive officer last July after serving as president of Liz Claiborne Inc., Weintraub noted that lenders want zero risk exposure, which the company cannot provide.

Reeling from the meltdown of the subprime mortgage markets, they are especially on edge.

“Banks, if they aren’t already, are going to be closely combing for trouble, hopefully ahead of the actual alarm going off,” said William Detwiler, partner at Watch Hill Partners, an investment firm. “A lot of these guys can’t afford any more problems in their portfolio.”

Banks became even more nervous after J.C. Penney Co. Inc. on March 28 made a surprise cut in its earnings guidance, which for many signaled a slowdown in retail.

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“Could this be the onset of a liquidity crunch for some of the retailers? Sure,” said Tiffany Co, a credit analyst at Fitch Ratings Co. “Were it to come from anywhere it would probably come from specialty — specialty apparel or specialty home.

“The smaller operators in the specialty retail segment that are going through a turnaround,” she said. “We could see a liquidity crunch for them, just because the credit market is a little bit more volatile and terms are more strict than they used to be.”

However, Kimberly Greenberger, retail analyst at Citigroup, said the majority of the multiunit specialty retailers she covers have at least \$100 million in cash on their balance sheet, which makes lending to them less risky for banks. She also does not believe Talbots is indicative of the entire retail sector.

"Talbots has the most leverage...of any company I cover," she said. "Their credit metrics have been deteriorating for two years, ever since they acquired J. Jill."

Since that acquisition, during the first quarter of 2006, the specialty retailer has consistently missed its financial plans and has been forced to lean on vendors.

But for the most part retailers have been taking action to shore up their operations in the face of the financial turmoil.

"Despite the challenging conditions in the U.S. from a consumer demand perspective, we have seen a number of retailers recently adjust their business models in order to come through this period," said James Hogan, HSBC's head of trade and supply chain for North America.

For instance, some stores are extending the period in which they pay suppliers and enhancing their inventory management processes so they can keep less stock on hand, he said. With fewer options, vendors also have been forced to work with their hard-press retail accounts.

"There's a lot more pressure on [suppliers] to take what they can get and stay in business, even at a loss, and hope they can run out the clock on the U.S. economy, until it comes back up," said Brenda Jacobs, a trade attorney with Sidley Austin. "Everybody's got to find creative ways to deal with the slacking demands and the increased costs. Retailers are going to have to pick up some additional costs. They're asking manufacturers to absorb some, too."