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Target and Walmart paint a challenging near-term picture

Article

The news: Target and **Walmart** both posted Q1 results that fell short of expectations due to a host of factors that impacted their bottom lines, including rising fuel and transportation costs, staffing challenges, and a shift in the products shoppers were looking to purchase.

- While **Target's comparable sales grew 3.3% year-over-year** (YoY), higher costs led its net income to fall 52% to $1.01 billion YoY.

- **Walmart's comparable sales rose 3.0%**, but its net income declined 25% to $2.05 billion YoY.

Challenging days ahead: The headwinds faced by Target, Walmart, and other retailers are unlikely to resolve anytime soon, which was reflected in the companies' guidance.

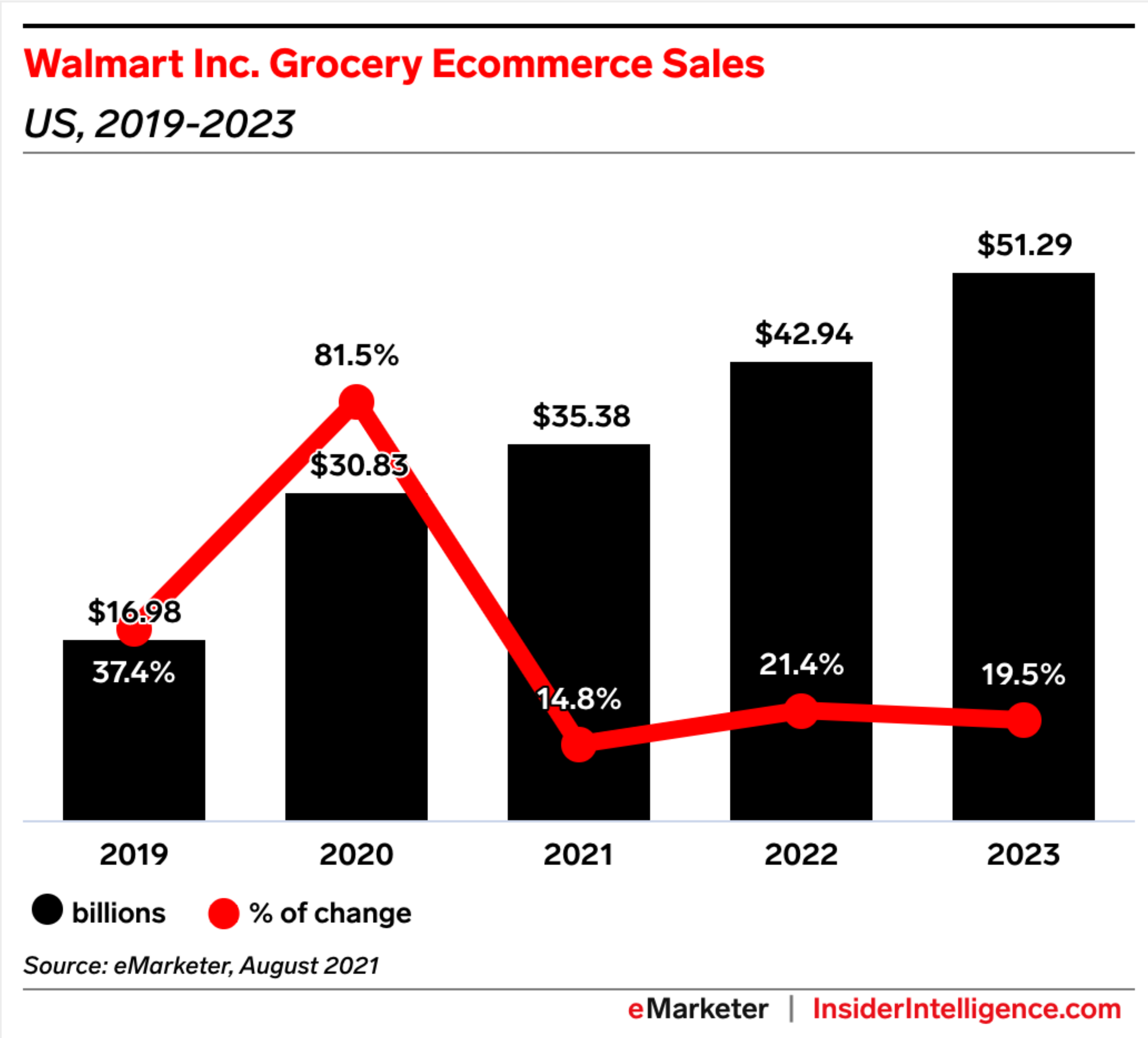
- Target, which had a 9.8% operating margin in Q1 last year, saw its **operating margin shrink to 5.3% in Q1**. That was "well below expectations" due to the "rapidly shifting macro backdrop and changing consumer behavior," said CEO **Brian Cornell** during the retailer's earnings call.
- The retailer expects its full-year **2022 operating income margin rate to be around 6%**, which is far short of its previous forecast of around 8% of sales. In the short term, it projects its Q2 operating margin will be about 5.3%.
- Walmart expects robust consumer demand and higher prices on some products will help it grow its FY23 net sales 4%, up from the 3% it forecast in February. But **rising costs will mean that its operating income and earnings per share will be "flat to up slightly,"** down from the low- to mid-single-digit growth it expected earlier this year.

Divergent explanations: The two merchants offered different perspectives for their product mix misfires.

- Target says it continues to see healthy spending from consumers, but that they have abruptly shifted their behavior as they return to pre-pandemic activities. For example, **luggage sales grew over 50%** as people resumed traveling, while sales of items such as TVs and kitchen appliances dropped off.
- Walmart, on the other hand, noted that some cost-conscious customers traded down from market brands to private label, particularly for items such as lunch meat, bacon, and dairy products.

Short-term pain for long-term gains: Target and Walmart both benefit from cost-conscious consumers looking for a deal, particularly given the current climate in which consumers' assessment of their financial situation relative to a year ago is at its lowest reading since 2013.

- **The situation has helped Walmart gain market share in grocery**, which is its top sales category, per CNBC. While that suggests Walmart may be attracting more grocery shoppers, in the short term those low-margin sales pressure its profits.
- **Target plans to lure shoppers by focusing on value**, even if it means absorbing some costs.



The big takeaway: Retailers need to navigate a difficult terrain as inflation continues to rage, supply chain challenges persist, and consumers' behaviors shift.

- A confluence of factors—the slowing economy, persistent inflation, high gas prices, and rising interest rates, among others—is making some consumers increasingly price-conscious.
- However, US retail sales grew 0.9% in April month-over-month, which suggests that the economy has not (yet) hit a wall and there's ample opportunity for retailers to adjust their strategies to boost their bottom lines.