

ARTICLE

Retail Today: How to Manage COVID-19 Disruption and Make It to the Other Side

Shopping with friends or family is considered a potentially perilous excursion for many of us these days, yet it was a normal activity of daily life only a few short weeks ago. COVID-19 has stunned the U.S. economy and shuttered vast portions of the retail sector, with over 630,000 stores closed since March (Coresight estimates).

Retailers are familiar with business continuity plans — they are annual exercises for many retailers, given extreme weather events, distribution center closures and other local disasters. However, few, if any, retailers planned for a black swan event that would close the entire store fleet for weeks, if not months.

Essential vs. Non-Essential Businesses

The government's designation of "essential" and "non-essential" businesses has exaggerated the divide between the "haves" and "have nots" in retailing. Although businesses classified as essential have been impacted by the pandemic, these retailers can still maintain store operations and preserve cash flow. A handful of essential retailers — notably supermarkets — are even managing to grow during this time of crisis.

The reality is starkly different for retailers deemed non-essential by government mandate. With over 90% of the U.S. population under stay-at-home orders, non-essential retailers have ceased store operations.

The Outlook for Non-Essential Retail

Even if eCommerce is still operating, the shuttering of retail store fronts has brought cash inflow for most non-essential retailers to a halt. It's that "non-essential" subset of retail that we'll focus on in this article.

Consumer (and employee) confidence has been, and will continue to be, shaken. Latest projections from Goldman Sachs estimate unemployment will top out at 32% and GDP will decline by a record 34% in 2Q20.[1] In addition, some consumers (we estimate about 10% to 25%) will not return to their old ways — their shopping and lifestyle habits will be forever changed.

For non-essential retail, we see this translating into a 50% decline in volume compared to last year. In our view, sales will be down by 66% in first and second quarter 2020, down 40% in third quarter, and recovering to down 30% for the holiday season.

Non-essential retailers therefore need to brace for continued disruption of their business and be able to change course in order to succeed in this new operating environment.

1 https://www.goldmansachs.com/insights/pages/gs-research/us-daily-20-mar-2020/report.pdf

What savvy retailers are doing to stay healthy

As we look at the reaction from retailers to COVID-19, we expect to see smart retailers taking a series of actions over the short to medium term to conserve cash and structure their company for post-COVID-19 operations.

The immediate priority is to stabilize and protect the business. This will involve using online and digital platforms to stay in touch with consumers and generate income; creating a **Minimum Viable Platform** that aligns functional areas against a revised sales forecast; developing a liquidity platform from which to operate; evaluating and securing access to relief funding; and ensuring clear, consistent and continual stakeholder engagement. The immediate playbook is focused on stabilizing and protecting the business.

Stabilize and Protect the Business | Immediate to Near-Term

Respond to Crisis | Communications

- Retailers are making difficult decisions to ensure survival through the pandemic; brands will be defined by how they treat people in communicating the news and how they step up to be part of the solution.
- Ensure that the right feedback and listening strategies are in place to anticipate emerging issues and adjust plans.
- Develop a strategy to stay in front of employees and customers (even while stores are closed).
- Provide updates from both a business and humanitarian perspective.
- Preempt the need for daily check-ins and real-time updates with employees, customers and vendors, which can be time-consuming and impractical.
- Ensure you have the right feedback and listening mechanisms in place to anticipate emerging issues and adjust strategies.

Respond to Crisis | Hoard Cash

- **Reduce expense and cash outflow**
  - Suspend payment of dividends.
  - Defer lease, property taxes, debt service and other vendor payments (one exception: pay rent on high-performing centers or where lease cost is below market; the same is true for vendors of strategic importance).
  - Stop all discretionary capex spending, except for technology projects that are +80% complete with a 2-year ROI.
  - Reduce all advertising and marketing spending, except email and digital where ROI positive.
  - Freeze any travel and P-card spending.

  - Reduce salary expense:
    - Furlough store employees, but cover medical insurance costs.
    - Terminate interns and contractors.
    - Reduce corporate staff by at least 25%.
    - Reduce corporate salaries by 20%-25% for duration of crisis, except for employees earning less than $40,000.
    - Decrease top executive cash salary by ~50% for duration of crisis, with upside to come from bonus.
    - Freeze hiring of any non-essential roles; defer start dates for any new hires in the pipeline.
- Rapidly monetize owned real estate assets.
- Cancel seasonal purchases and reduce/decrease open orders.
- Draw down available lines of credit and evaluate all available financing options.
- Execute CARES Act funding opportunities, such as immediately deferring the employer portion of payroll taxes
- Assess tax benefits and liquidity available as a result of extended NOL carrybacks per the CARES Act.

Revise Cash Flow Forecasts

- Complete a detailed, 13-week liquidity forecast with varying scenarios.
- Create a Minimum Viable Platform — a footprint for the organization to maintain the business during the shutdown.
- Identify near-term cash improvement options (e.g., lessor/lender concessions, supply chains, inventory consolidation).
- Review ongoing initiatives for strategic impact, projected benefit/ROI, cash and other resource requirements.

Test Business Plan / Contingency Scenarios

- Recast business plan and drill down on business unit profitability.
- Determine achievability of plan under a variety of likely and “could never happen” scenarios.

Secure Funding

- Understand the process for securing rescue financing from private equity and special situation/hedge funds.
- Directly engage with government stakeholders.
- Prepare for the public and government scrutiny that is sure to follow.
- Encourage any franchises to pursue SBA loans.

Plan for Re-Opening

- Develop communication and execution cadence for when the decision is made to reopen stores.
- Coordinate with key partners (landlords, security, cash management, marketing partners).
- Create contingency plans:
  - Closure of all stores that are not cash flow–positive.
  - Closure of all "C" and "D" mall stores.
- Close 25%–33% of total fleet; plan any promotions to align with re-opening of stores.
- Design appropriate loss-prevention protocols.
- Assess inventory positions and timing of new product launches/merchandising reflows.

Once the business is stabilized, companies must shift their attention to manage through the downturn and be well positioned to emerge from the pandemic environment. There are a number of important steps that businesses should take to protect and strengthen their position, including communicating with customers; optimizing operations; monitoring the likely state of recovery; strategizing and stress-testing exit plans; launching a public affairs program to mitigate any scrutiny associated with government relief assistance; and clearly articulating mitigation plans to stakeholders.

Leading Through the Downturn | Near-Term to Post-Pandemic

Strategize

- Engage with customers to understand implications for long-term spending and purchase drivers of key customer segments. We think shopping and life habits will be forever changed for at least 10% of consumers.
- Evaluate longer-term restructuring solutions with landlords and lenders, including closure of low-volume/low-profit stores.
- Define promotional strategy and cadence for remainder of year.
- Develop communications and change management program to help teams understand the shifts that need to happen in order to more quickly implement plans.
- Create messaging platform for the recovery period that puts people first, highlights the underlying strengths of the business, establishes a path forward, and conveys confidence in the future.

Optimize

- Evaluate corporate and SG&A functions for cost reduction opportunities, which may include corporate downsizing.
- Assess broad range of scenarios (including possible resurgence of COVID-19) for fall/winter inventory; define balance between lost sales and inventory sell-through risk.
- Finalize end-of-life strategies for inventory not sold through by the end of the season (e.g., delay floor set of fall styles, integrate spring styles into the fall line, return inventory to the DCs to hold for next year).
- Reduce working capital.
- Evaluate vendor agreements to identify contracts that are no longer competitive and consider using force majeure language to terminate the agreement.

Monitor

- Monitor signals of economic recovery (acceleration/deceleration) and adjust inventory strategy.
- Monitor traditional and social media, analyst reports and other forums to understand how stakeholders are thinking and what competitors are doing.
- Monitor inventory levels across all nodes of the network and redeploy as necessary to maximize sell-through.
- Monitor expenses and update scenario planning.
- Identify supply chain constraints/disruptions and define strategy to minimize the impacts on operations.

Engage

- Communicate a clear vision for the future, specifically highlighting steps the company is taking to care for employees, customers and other partners while also protecting enterprise value.
- Engage, as appropriate, with media, investors, analysts and other third parties to shape the narrative around the business, mitigate any criticisms and build confidence in the future.
- Train and support functional and field leaders in establishing clear expectations, accelerating the adoption of any new ways of working, and keeping teams motivated and sharing progress.
- Leverage non-exempt store employees to complete critical operations at the stores, including shipping inventory to the DCs to support online orders, changing signage and marketing, process reflows, etc.



The nation's response to contain the COVID-19 virus has caused an economic shock unprecedented in its speed and intensity. Its effects are just starting to be felt and will intensify in the weeks ahead. Even as new cases appear to be peaking in some locales, it likely will be a couple of months before life as we knew it resumes. Many Americans will remain apprehensive about large public gatherings and close contact for months thereafter, until they are firmly convinced that this threat has passed. This presents a quandary for retailers and other consumer-dependent businesses, as challenges will remain long after the "all clear" is given and store doors are reopened. The challenges are twofold, as retailers will have to contend with the economic impact of recession on shoppers as well as their likely reluctance to fully embrace pre-COVID-19 lifestyles. Things will be different for the foreseeable future, and retailers need to be prepared to adapt to a new reality that we cannot yet completely envision, but one that almost certainly will heap new challenges upon an already beleaguered industry.

Bankruptcy: Is now the time for a retailer to file?

In short, the answer is no, not now — if it is avoidable. Few retailers are filing for bankruptcy now, and we expect this trend to persist over the short term due to the following:

- DIP financing is highly problematic, given market uncertainty.
- It is not advantageous for companies to start the clock on the 210-day timeline to accept/reject leases until more is known about what a post-COVID-19 world will look like (U.S. Code § 365.D.4).
- Liquidation is impossible during "stay at home."
- Banks are working with retailers to make it work. Many banks are working with impacted retailers to modify loan terms, including a 90-day moratorium on debt service/loan covenant compliance (it appears that modifications made on a good-faith basis to borrowers who were current prior to COVID-19 do not need to be classified as a TDR). Other banks are deferring payment, waiving fees and offering extensions.

As the economy and credit markets stabilize post-pandemic and companies adjust to the new normal, we expect to see bankruptcies resume and increase. We estimate the volume of retail bankruptcies to resume in 60-120 days.

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