Grant Thornton

Retail

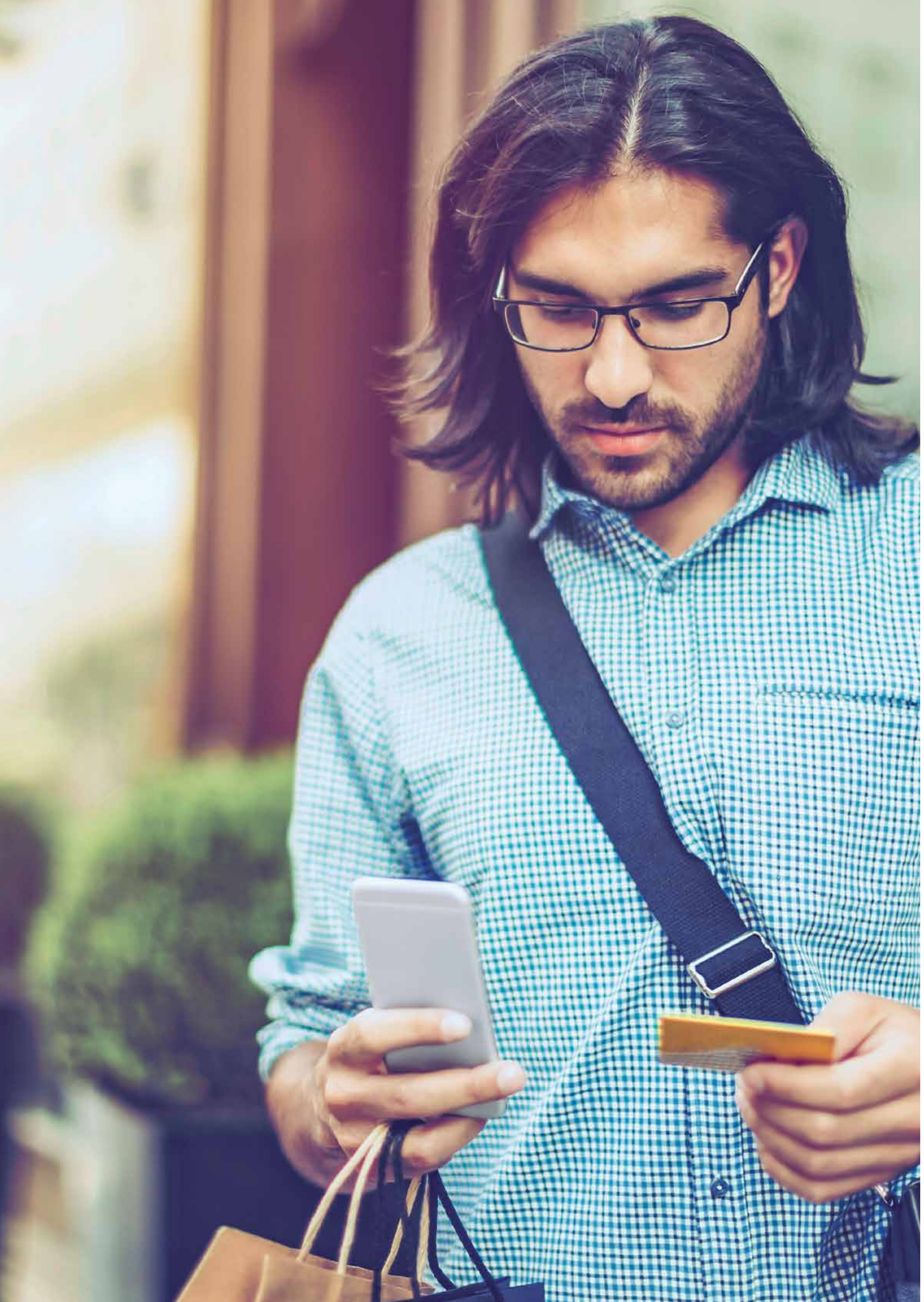
Global

Trends

Retail: navigating the impact of COVID-19

Building flexibility and resilience in the new normal

2020



Introduction

The retail industry is currently in a period of disruption unique in its scale and severity. The global outbreak of COVID-19 has impacted parts of the industry in different ways. While businesses in the grocery sector grapple with supply chain issues, those selling consumer goods and apparel have been challenged by store closures and rapid growth of online sales.

This report looks at the steps retail businesses need to take to put themselves in the best position for the 'new normal' that will emerge once lockdown restrictions are eased. From liquidity to debt and restructuring, the challenges retailers face are diverse and complex. We also consider implications for employers and how financial planning for the medium and long term will be affected.

We will cover:

- Liquidity
- Cost management
- Debt and restructuring
- Preparing for the new normal
- What Grant Thornton is doing to help retailers

The challenges posed by COVID-19

The picture for the retail industry at the midway point of 2020 is vastly different than any one of us could have predicted at the end of 2019. The global spread of the virus has brought a temporary halt to all non-essential trading in many parts of the world. The discretionary sector has seen a significant drop in revenue with closed stores and large numbers of staff on government furlough schemes or working reduced hours.

The grocery sector, on the other hand, is dealing with unpredictable demand and a huge increase in demand for online delivery services. For many companies the sharp economic shock has been exacerbated by operating very tight businesses that carried little cash. Add to this high fixed costs, and it becomes clear many in this sector are in a vulnerable position.

Liquidity
Just like a wide variety of sectors, cashflow forecasting and management has become a serious challenge for many retailers, big and small. An immediate priority over the short to medium-term is preserving cash and increasing liquidity. While government schemes all over the world have allowed businesses to temporarily reduce or defer some of their operating costs, particularly with regards to staff and tax payments, these measures will not go on indefinitely. Retailers that have an established online presence are better placed to adapt their operations and continue to bring in some level of sales. The feasibility of prioritising an online model requires an ability to balance lower profitability per sale and reduced staff with potentially higher operating costs. The extent to which supply chains have been affected will also be a big factor in whether retailers can adapt their processes.

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While the grocery sector has seen an unexpected boost to revenues, this has come with a range of additional challenges. Spikes in demand have caused stock shortages and supply chain issues, as data driven stock planning and merchandising models failed to make it easier to plan what products were needed. Social distancing and increased cleaning have created additional operating costs, but it is the spike in demand for online services that has caused significant pressure. Some brands simply did not have the infrastructure in place to deal with the surge in orders. For shops that are closed or sitting on large amounts of stock that they cannot sell, fixed costs are a serious issue. If they cannot move online, these businesses will need to seek help from the government, lenders or their shareholders.

Cost management
Cost reduction has become an immediate strategic objective across the sector, and we are seeing many businesses looking carefully at their lease and infrastructure costs as well as their physical footprints. For most retailers, the three biggest costs are stock, property and labour. While staff can be furloughed, reducing the other costs may be more difficult.

Many landlords are granting businesses three-month payment holidays, and we may see more flexibility built into the system, such as leases as a percentage of sales. But without revenue coming in there is still uncertainty about how long businesses can operate. For apparel retailers in particular, many of which are sitting on large amounts of unsold seasonal stock, we are already seeing heavily discounted prices. Many other brands will be looking to purchase distressed merchandise at very low prices to sell themselves once their stores are reopened.

For those stores that remain open, COVID-19 has affected almost every part of their supply chains. Social distancing and increased cleaning is, in many cases, increasing costs and slowing processes down, meaning many companies will be looking for profit improvement strategies. In the grocery sector, the need to drive efforts upstream in supply chains could lead retailers to stock less individual brands and instead opt for deeper relationships with particular suppliers. Those with bigger cash reserves will continue to implement automation and self-service solutions, while others could be further incentivised to prioritise these technologies in the medium to long-term.

Debt and restructuring
With revenues flat and many retailers facing a sustained period of depressed demand, finding constructive solutions for debt payments is a major priority. It is important that businesses maintain clear communication with landlords, shareholders, banks and other stakeholders about their ability to operate. Banks may be willing to reschedule debt payments, but only if companies can demonstrate the viability of their recovery strategy. The big concern for lenders when agreeing these kinds of extraordinary measures, or committing to additional lending, is what shape retailers will emerge from the crisis in. For businesses, this means putting together funding proposals for shareholders, using insolvency tools to restructure quickly or even exploring options like bankruptcy protection.

But for those companies that are able to survive into the short and medium-term, it is important to have a viable business strategy in place. COVID-19 could act to speed up the existing trend of retail chains looking to downsize their physical footprints and boost their online activities. But while investors may be looking to pick up brands or acquire capabilities to bring in-house, securing additional physical store space is unlikely to be high on the list of strategic objectives.

Preparing for the new normal
The disruption caused by COVID-19 has undoubtedly accelerated the shift towards online retail, but it could also have other wide-ranging effects too. If a significant number of businesses decide to retain homeworking as an operating model, the numbers of commuters could reduce as well. This would directly impact the long-established strategy of locating retail stores in and around train stations and other commuter hubs. Apparel brands need to create viable solutions for ensuring that changing rooms align with social distancing and increased cleaning requirements, while consumer goods stores should consider if they are going to allow consumers to pick up and browse their stock. It is uncertain just how much this global public health crisis is going to alter consumer behaviour and whether these changes will extend into the long-term.

Retailers need to ensure their businesses are as resilient and flexible as possible going forward. Lenders and stakeholders need to know there is a working strategy for transitioning from the present disruption to operating in the new normal. This means reducing physical footprints, growing online, creating a multichannel presence and restructuring, but the aim should always be identifying a target market and creating a core group of loyal customers.

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Critical considerations for your response

The value chain of the retail industry is highly interconnected with other industry groups and domestic, regional and global economic and social activity. Many of the forces impacting the retail industry are driven by factors outside of its control; this complexity has been highlighted by the impact of COVID-19.

Current market conditions are driving clear liquidity and operational challenges, but can also provide opportunities to those with strong balance sheets and access to supportive lenders and investors. The interconnectivity of the retail industry drives the need for well thought-through, integrated solutions that critically address the needs of multiple stakeholders, particularly where there is separation between asset ownership, the operator and the funders.

We consider the questions on the next page are some of the more important areas to focus on for the industry when looking to assess, protect and restore value – some will be more relevant to your business than others. Grant Thornton can help you to define the next steps in your response.

Key questions to consider

Assess	Protect	Restore

Liquidity, refinancing and communicating the plan

- How much time does my business have before covenants are breached/liquidity runs out?
- How can I effectively manage liquidity, what sources of short-term finance/funding are available? What options are available to restructure my existing debt obligations?
- How can pinch points like rental/lease payments and debt service/repayments be managed/negotiated?
- What sources of finance are available (including government support) and how do I access them at speed and at the right price?
- What is the turnaround plan, how can this be best positioned and negotiated with my stakeholders?
- What is the right communication strategy for my people, customers, suppliers and financial stakeholders?

Operations and performance improvement

- How will I restart operations effectively and attract business?
- How can I retain the people critical to my business?
- How can I make the business as operationally efficient as possible given likely footfall and a pressure to further integrate physical and digital operating models?

Taking advantage of opportunities

- Are there any attractive investment opportunities driven by market conditions?
- How can I position myself to be ready to take advantage of these opportunities?

Governance, risk and compliance

- How can the brand's reputation be protected?
- What risk does the 'new normal' for working remotely and delivering services bring to the business?
- Is my cybersecurity strategy robust?

How Grant Thornton's solutions can help you

Our approach in supporting you to assess, protect and restore value in your business starts with helping you to regain control by stabilising the business, whilst developing a robust and realistic turnaround plan. We draw upon our deep expertise across a range of different areas, customised to your specific needs.

Successful turnarounds require the development of a credible plan that has been stress tested against various scenarios, along with a transparent communication strategy that meets the needs of all stakeholders. Building trust, and not breaking promises, will be critical if the plan is to be realised.

Stabilisation, turnaround, and business plan assessment

In the early stages of a turnaround the right support is necessary to create financial stability, assess cashflow and identify opportunities to improve short-term liquidity.

Through independent diagnostic analysis and challenge, we provide stakeholders with a clear understanding of the options available, including strategic and tactical opportunities.

This crucial activity provides comfort and support to management teams and can underpin the credibility of the plan as part of the assessment process of financial stakeholders.

Our solutions

Operational and financial restructuring

Our multi-disciplinary operational and financial restructuring specialists provide support to realise significant business process improvement, implement new business strategies, divest noncore businesses and design new capital structures aligned to the dynamics of the business.

Retail operational consulting

Running a successful bricks-and-mortar retail space involves a lot of behind the scenes activity. Using our specific industry experience, we can help with workforce planning, back of store process efficiency, rostering/labour efficiency, in-store fulfilment of online orders, space optimisation, format development, and store renewal. In order to remain competitive in today's market most retailers are investing in their online offering and our experience includes working with retailers to optimise online capability and support efficient product delivery to the customer, including: online fulfilment; model rollout and optimisation; integration of online into merchandise and store operations; and order management system design and delivery.

Real estate advisory

Our real estate advisory team can help you create a flexible real estate strategy and plan, allowing your business to adapt when it needs to. With the foundation, strategy and plan in place, we will help you optimise your business' efficiency and productivity. Capital raised as a result and in addition to strategic disposals can be re-invested elsewhere and support your business growth. Finding the right space, in the right location, provides a foundation to promote success through your business' operations, people, technology and access to market, enabling you to focus on your business goals.

Debt advisory

We provide specialist advice on the raising and refinancing of debt. Through our deep understanding of the funding landscape and detailed knowledge of the credit process, we devise tailored funding solutions as part of a sustainable capital structure in line with the strategic ambition of our clients.

Exit strategy services

We apply a tailored methodology and fully project-manage and implement the sale or closure of underperforming or non-core corporate entities at maximum value.

Valuations to support asset-backed lending decisions, restructuring and transactions

We provide valuations to support asset-backed financing, including valuing shares and intangible assets, and provide periodic valuations of assets to confirm that the terms of the loan agreement continue to be met. For mergers, acquisitions, restructuring and proposed financial structures, we provide an independent view on value delivering robust advice within the constraints placed by the deal deadlines.

Accelerated M&A

We provide advice and manage transactions associated with the acquisition or disposal of distressed assets or businesses, frequently to short timescales.

Asset recovery and tracing

Asset recovery and tracing normally form part of formal insolvency processes such as liquidations, or are carried out in support of ongoing litigation or fraud investigations. We use specialist approaches to identify and recover misappropriated assets, including those held in offshore trusts, to provide cost-effective value recovery.

Corporate insolvency

Where a business cannot be saved or where a formal insolvency process is required to affect a restructuring, we provide advice and support to distressed companies, their creditors and other stakeholders in order to protect assets and maximise recoveries. In some situations, we take on the role of Chief Restructuring Officer.

Pension schemes solvency

In many parts of the world, we offer a specialist capability to advise corporates and trustees on the solvency of pension schemes.

Enterprise risk management

Our enterprise risk management (ERM) specialists help organisations implement the leading approach to managing and optimising risk. We are able to tailor the approach to our client's individual challenge and create bespoke strategies that work, enabling them to strategically identify, analyse and monitor potential risk to their organisation.

Cybersecurity

Our cybersecurity solutions are designed for clients seeking to address a variety of complex security requirements. We can help organisations assess their security vulnerability, establish or improve their IT security processes and remediate breaches or compliance failures.

Business Process Outsourcing and Shared Service Centres

Increasingly, large organisations are looking to fully outsource their transactional end-to-end finance and accounting processes, leaving them free to focus their finance resources on important strategic business value. We typically commit to reduce costs and/or improve productivity and quality. We also advise organisations on optimising finance and accounting processes, and can take our recommendations through to implementation, whether this involves building a full-scale Business Process Outsourced delivery capability or setting up a Shared Services Centre.

Back office outsourcing

We provide outsourced accounting, payroll, human resource and tax services to domestic SMEs or local branches of international organisations. Our services are managed centrally to deliver a consistent experience for each of our clients, however widespread their operations. We exploit innovative digital technology to give our clients access to their data round the clock; the same technology gives our large corporate clients access to new and cost-effective offshore platforms. Where our clients face complex tax and payroll challenges, our tax, global mobility and wealth management specialists provide expert, value-adding advice.

Global compliance partnering

Our global compliance partnering solution delivers all local statutory financial reporting, centralised statutory audits, tax compliance (corporate, sales and payroll), payroll administration and local country filings for multinational organisations through a single point of contact. We are the leading adviser to dynamic organisations delivering a solution that improves reporting efficiency and enhances risk management. By providing full transparency, real-time monitoring and highlighting upcoming deadlines, we enable local and central management teams to ensure full compliance at all times.

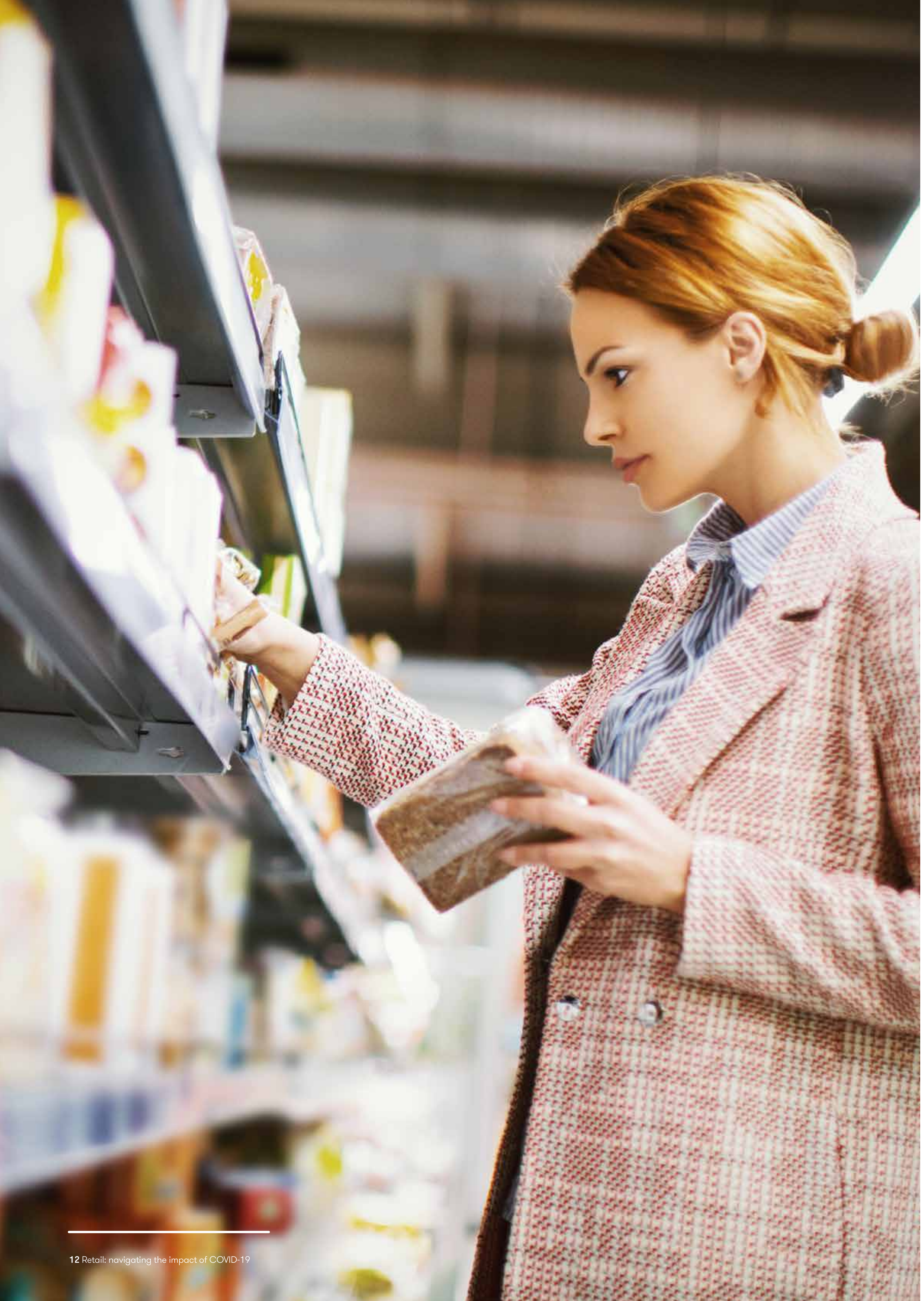
Financial reporting advisory

We provide clear and practical solutions to address complex accounting and financial reporting issues. We support businesses in navigating the accounting and reporting of government stimulus packages. We're also able to help navigate the accounting and reporting of complex areas including leases, impairment and going concern.

Restructuring tax

Our restructuring tax teams specialise in providing tax advice in all aspects of restructuring scenarios. In particular, this includes advising on the tax aspects of:

- independent business reviews, options reviews and contingency planning
- business restructuring, eg debt restructuring
- mergers and acquisitions
- disposals of trade and assets or wind down of businesses
- corporate insolvencies
- fraud investigations.



Credentials

Profitability optimisation

Client Business description: A leading department store chain which has operated across the country for well over 100 years. The business offers customers products and services from leading local and international brands in fashion, beauty, homewares and technology.

Engagement description: Our client required a review of the full suite of trading terms for its supplier base, with the objective of driving material improvements in profitability. Our team was engaged to scope and size the opportunity, craft the approach, and execute alongside the buying and merchandise teams within the business.

Challenge: Supplier trading terms from a corporate end-to-end view had not been forensically reviewed for some years. The initial challenge was to establish a baseline opportunity for supplier rebates and income, before adding additional strategic elements to the negotiation process, including opportunities for the retailer to share new insights with the supplier base.

Solution: Grant Thornton initially scoped a *Discovery* project, implementing our standard supplier trading terms toolkit, using two years of historical supplier data across all categories. This helped to generate the size of the opportunity. The results were quantified and prioritised to a set of opportunities across the full supplier base.

The second stage was a structured *Negotiation and Implementation* project, developing tailored and quantified supplier negotiation packs for each of the top 100 suppliers. The team worked collaboratively with each of the buying teams to manage the strategic approach for each individual supplier, supporting iteratively with each specific supplier negotiation.

Outcome: In collaboration with internal stakeholders the team delivered multiple millions of dollars in-year P&L benefit, driving significant improvement to the company bottom line. Further, the streamlined trading terms drove working capital benefits across all categories.

Operational restructuring

Client Business description: US$0.5bn Jewellery Retailer based in the United States.

Engagement description: A well-known jewellery company with a storied past was beginning to experience signs of profitability underperformance. Executive leadership engaged Grant Thornton to evaluate the firm's operations and identify areas to enhance near-term profitability to enable future success.

Challenge: The distant memory of historical financial success paralysed leadership's ability to successfully navigate emerging threats that are disrupting historically dominant industry players. As a result of the organisation's failure to overcome these compounding threats, profitability began to weaken, accentuated by a particularly underwhelming holiday season.

Solution: Through a series of interviews with key stakeholders throughout the organisation, including executive leadership coupled with extensive financial and operational analysis, the engagement team identified a series of opportunities with an annual EBITDA improvement of 25%.

The client engaged Grant Thornton to establish and support a Transformation Office tasked with accelerating the value capture of strategic initiatives. Immediately thereafter, COVID-19 hit and the company's executives faced the impending challenge of navigating through the pandemic. The Grant Thornton team was quickly re-aligned with helping the client to prepare, respond, and recover from the economic impact of mandated store closures, including the development and execution of a datacentric store reopening strategy and a corporate workforce optimisation initiative. Through close collaboration, the Grant Thornton team helped guide the client to capitalise on this opportunity to "rightsize" its retail footprint, optimise corporate costs, and prioritise reopening stores that would accelerate their profit recovery.

Outcome: The Grant Thornton team partnered with the client to develop a transformation roadmap to realise the various opportunities with an annual EBITDA improvement of 25%. Specific to COVID-19, the data-centric store reopening strategy allowed the client to realise an additional US$1m in income. In addition, Grant Thornton helped guide the company through a series of internal cost optimisation efforts, resulting in an additional per annum savings of US$6m.

Transaction advisory

Client Business description: A Brazilian company that operates iconic retail brands across a footprint of more than 1,000 stores with net revenue of approximately US$5bn.

Engagement description: Grant Thornton were engaged to undertake to financial, tax, and labour/social security due diligence in divisions focused on logistics, app development and digital payments.

Challenge: As part of a strategic review, the group decided to accelerate its investment in e-commerce and the infrastructure required to support this. Investing in start-ups was an important way of achieving this and securing a point of differentiation in a highly competitive landscape. Identifying the right opportunities and assessing the financial status of carefully selected opportunities was key to the group's success.

Solution: Grant Thornton undertook an analysis of the key risks associated with the businesses that were targeted and conducted a financial review of their operations and forecasts; informing the crucial go/no go decision on acquiring these business.

Outcome: The group was able to rapidly establish its digital financial services solutions, putting it ahead of its competitors at a critical time during the COVID-19 pandemic.

Acquisition, business separation and operating cost review

Client Business description:
Two separate retailers in the home appliance and furniture retail space with a combined 300 stores and revenues of US$950m.

Engagement description: Our client engaged Grant Thornton to provide due diligence and cost saving analysis to assess their acquisition of two businesses.

- Target A was a retailer of home appliance and furniture with 130 stores that were being carved out from another distressed retail business
- Target B was a low cost furniture retailer with 170 stores that had grown rapidly.

We were engaged to perform financial and tax due diligence, tax structuring and purchase agreement advisory. We were also asked to review the cost saving initiatives and management's synergy analysis from combining the two businesses and to identify additional potential areas for cost savings and synergies through our work. A subsequent work stream included Grant Thornton establishing a carve out plan for the post acquisition integration of the businesses.

Challenge: Separating a business from its wider operations is complex and challenging as it is a 'live' activity that affects all aspects of the business operation. Care had to be taken not to disrupt operations while designing and supporting the implementation of a smooth carve out process.

Solution: Through extensive financial and operational analysis, the engagement team established a business carve out and integration plan, and identified significant cost savings and synergies related to:

- Target A was a retailer of home appliance and furniture with 130 stores that were being carved out from another distressed retail business
- Corporate headcount
- Field organisation headcount
- Marketing spend
- Freight costs
- Corporate occupancy costs

The Grant Thornton team was also able to critically examine a proposed store closure programme, providing challenge and insight to the decision-making process.

Outcome: Grant Thornton supported its client through the successful closing of both transactions, the raising of debt and a smooth integration of the businesses. We also helped our client structure the transactions in a tax efficient manner and helped the client negotiate the accounting elements of the purchase agreement and net working capital targets.

As part of our work, in addition to the items mentioned above, we were also able identify further potential cost savings across:

- Supply chain operations
- Facilities and warehouse utilisation
- Employee benefit plans
- IT and vendor costs.