RETAIL IN THE RED: BDO QUARTERLY BANKRUPTCY UPDATE

AN OVERVIEW OF U.S. RETAIL BANKRUPTCIES AND STORE CLOSURES IN THE FIRST HALF OF 2017

In the first six months of 2017, over 20 retailers filed for bankruptcy, more than 4,000 retail stores shuttered and headlines referred to the current state of retail as the "Retail Apocalypse." E-commerce—and specifically, Amazon—has been blamed for the decline of brick-and-mortar retailers. But what has led to the bankruptcies and store closures that took place in the first half of 2017 and what does this mean for the rest of the year?

RETAILERS WITH 30 OR MORE STORES THAT FILED FOR BANKRUPTCY

between Jan. 1, 2017, and June 30, 2017

Company	Month of Filing	Type	Result	Stores as of Petition Date
Gymboree	Jun-17	Apparel	Seeking Reorganization	1,344
Cornerstone Apparel (Papaya Clothing)	Jun-17	Apparel	Seeking Reorganization	80
Rue21	May-17	Apparel	Seeking Reorganization	1,179
Payless Holdings	Apr-17	Footwear	Reorganization with Store Closures	>3,500
Agent Provocateur, Inc.	Apr-17	Apparel	Asset Sale	30
Gander Mountain	Mar-17	Specialty Stores	Asset Sale	160
Gordmans Stores	Mar-17	Apparel	Liquidated	>100
General Wireless Operations (RadioShack)*	Mar-17	Electronics	Liquidated	>1,500
hhgregg	Mar-17	Appliances	Liquidated	220
Vanity Shop of Grand Forks	Mar-17	Apparel	Liquidated	137
Eastern Outfitters*	Feb-17	Apparel	Asset Sale	86
Marbles Holdings	Feb-17	Specialty Stores	Liquidated	37
BCBG Max Azria	Feb-17	Apparel	Asset Sale	146
Michigan Sporting Goods Distributors	Feb-17	Sporting Goods	Liquidated	68
The Wet Seal*	Feb-17	Apparel	Liquidated	142
The Limited Stores	Jan-17	Apparel	Partial Sale	250

– *Table sourced from Reorg Research and Bankruptcy Court documents.*
* *Denotes second bankruptcy filing within two years.*

The plethora of retailers that filed for bankruptcy in the first half of 2017 had accumulated over $5 billion of liabilities in aggregate. Certain larger retailers that filed for bankruptcy had burdensome levels of debt resulting from their private equity owners' uses of financing in acquiring the companies. Fixed interest and lease payments proved too onerous for these leveraged retailers as sales and margins deteriorated. Other failing retailers will likely opt for leveraged buyouts in the second half of 2017 as private equity-backed retailers struggle to restructure their high levels of debt. Nordstrom also recently announced its decision to go private, which could set a new precedent for retailers looking for alternative capital sources.

Reducing debt levels through a formal or out-of-court restructuring is generally not enough for retailers that lack a profitable strategy. RadioShack, The Wet Seal and Eastern Outfitters filed for bankruptcy for the second time within two years. Each of these so-called "Chapter 22s" exited their first bankruptcy with fewer stores in an effort to achieve profitability. However, the restructured retailers did not make adequate strategic changes to align offerings with customers' needs and were forced to file for bankruptcy a second time. These situations strongly suggest that retailers need to turn around products and services as efficiently and strategically as possible.

A wide variety of brick-and-mortar retailers have closed more than 4,000 stores in the first half of 2017 due to declining sales and profitability. For comparison, 6,163 stores shut down in 2008, the worst year ever for store closures.

RETAILERS THAT CLOSED TWENTY OR MORE STORES

in the first half of 2017

Company	Type	Number of Store Closings	Last Available LTM Sales ($MM)
General Wireless Operations (RadioShack)*	Electronics	>1000	3,706
Payless Holdings*	Footwear	808	2,300
Rue21*	Apparel	400	1,137
Gymboree*	Apparel	350	1,006
The Limited*	Apparel	250	425
hhgregg*	Appliances	220	1,770
The Wet Seal*	Apparel	171	488
Sears Holdings Corporation	Department Stores	155	21,045
Vanity Shop of Grand Forks*	Apparel	137	80
BCBG Max Azria*	Apparel	120	615
GNC Holdings, Inc.	Specialty Stores	102	2,484
Destination Maternity Corporation	Apparel	69	416
Michigan Sporting Goods Distributors*	Sporting Goods	66	175
CVS Health Corporation	Pharmacy	63	180,785
Eastern Outfitters*	Apparel	48	400
Gordmans Stores*	Apparel	48	611
Perfumania Holdings, Inc.	Specialty Stores	47	462
Gander Mountain*	Specialty Stores	43	1,087
Guess?, Inc.	Apparel	40	2,219
Marbles Holdings*	Specialty Stores	37	29
The Gap, Inc.	Apparel	31	15,518
Crocs, Inc.	Footwear	26	1,014
Tuesday Morning Corporation	General Merchandise Stores	23	966
L Brands, Inc.	Apparel	20	12,397

– *Information sourced from Capital IQ, SEC filings, and Bankruptcy Court filings.*
– *Store closure data sourced from Capital IQ's "Stores Closed" screening criteria. Criteria represents the total number of stores, both owned and franchised, that were closed during the latest six month period.*
* *Denotes retailers that filed for bankruptcy in the first half of 2017.*

Traditional retailers have been closing stores partially in response to the rise of e-commerce, but that isn't the sole contributor to these changes. According to the U.S. Census Bureau, monthly retail sales excluding food services increased 3 percent from $404.7 billion in June 2016 to $417.5 billion in June 2017, and e-commerce sales only accounted for 8.5 percent of total retail sales in Q1 of 2017. The vast majority of retail sales continue to be captured at physical locations, meaning in-store sales are still a force to be reckoned with. This year's large decrease in retail store locations and increase in bankruptcies appear to primarily result from the oversupply of physical locations and changes in consumer spending behavior. The most recent data shows that the United States has 23.6 square feet of available retail floor space per capita, while Australia has 11.1 square feet per capita and the United Kingdom has 4.6 square feet per capita.

While the rise of e-commerce is likely to lead to further store closures, retailers also have the opportunity to refine in-store experiences. Some retailers have added cafes, fitness studios and even wellness spas to entice more customers to visit stores. Notably, consumers are now spending a smaller share of their wallets on clothing and accessories. But some brick-and-mortar retailers have been slow in responding to millennials' shifting spending habits, which are more focused on experiences than goods. This shift in spending patterns is also driving sales away from many mall-based retailers who have primarily sold clothing and accessories, as consumers are more willing to spend money on technology products, travel and food. As a result, foot traffic is down dramatically in many malls, causing traditional retailers to close stores.

However, not all retailers are contracting their physical presence. Discount stores and grocery chains, including Dollar General, Dollar Tree, AutoZone, Ulta Beauty, Tractor Supply, Lidl, Ross Stores, Sephora, TJX (T.J. Max and Marshalls) and Hobby Lobby have all announced plans to open 60 or more stores in 2017.

BDO'S TAKE:

Brick-and-mortar retailers, particularly those focusing on clothing and accessories, that do not take aggressive action to make product offerings more competitive will likely need to continue cutting store count and overhaul strategies. For the remainder of 2017, we expect a continuation of the same trends seen in the first half, with distressed retailers closing additional stores in order to improve financial performance. We also expect that retail bankruptcies will continue, but likely with fewer filing for bankruptcy in the second half of the year while interest rates remain low and retailers have the opportunity to increase liquidity due to the back-to-school and holiday shopping seasons.

Since retailers' value dips quickly after filing for bankruptcy, a tight turnaround in operations and strategy is crucial to staying afloat. Whether this means moving more products online or reorganizing designers, manufacturers and supply chains depends on each retailer's unique vulnerabilities. Reviving retail sales requires efficient, forward-thinking changes to internal operations, product portfolios, customer engagement and delivery services. Likewise, rising store closures shouldn't discourage retailers just yet. Customers' expectations of products and services are evolving, meaning the most effective ways of engaging them are also changing. Leaner store portfolios don't have to weaken sales if retailers can successfully reimagine concepts to better fit consumers' changing desires. While impending bankruptcy and slimmer store numbers can certainly be daunting challenges for retailers of all sizes, applying ingenuity and agility may prove to be a saving grace.

For more information, contact

DAVID BERLINER, New York
212-885-8347 / dberliner@bdo.com

NATALIE KOTLYAR, New York
212-885-8035 / nkotlyar@bdo.com

MIKE METZ, Minneapolis
952-656-2612 / mmetz@bdo.com

JENNIFER VALDIVIA, Los Angeles
310-557-8274 / jvaldivia@bdo.com

TED VAUGHAN, Dallas
214-665-0752 / tvaughan@bdo.com