RETAIL IN THE RED:

BDO BI-ANNUAL BANKRUPTCY UPDATE

AN OVERVIEW OF U.S. RETAIL BANKRUPTCIES AND STORE CLOSURES IN THE FIRST HALF OF 2018

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For the first six months of 2018, more than a dozen retailers with 20 or more stores filed for bankruptcy–a figure which aligns closely with the pace of retail bankruptcy filings during the second half of 2017. In July and August 2018, at least six other retailers filed for bankruptcy, including Brookstone, National Stores, Heritage Home, Real Mex Restaurants, Gumps and Samuel Jewelers.

What does this trend signal for the balance of 2018?

BANKRUPTCY UPDATE

Large retailers that filed for bankruptcy in the first six months of 2018

Company	Month of Filing	Type	Result	Stores as of Petition Date
A'Gaci	Jan 2018	Apparel	Reorganization, with Store Closings	76
Kiko USA	Jan 2018	Beauty	Reorganization, with Store Closings	29
The Bon Ton Stores	Feb 2018	Dep't Stores	Liquidation	260
Tops Friendly Markets	Feb 2018	Supermarkets	Pending Reorganization	174
The Walking Company	Mar 2018	Footwear	Reorganization	208
Claire's Stores	Mar 2018	Accessories	Pending Reorganization	1400
Southeastern Grocers (a)	Mar 2018	Supermarkets	Reorganization, with Store Closings	700
Nine West	Apr 2018	Footwear	Asset Sale	70
Bertucci's	Apr 2018	Restaurants	Reorganization, with Store Closings	59
AcuSport	May 2018	Distributor	Asset Sale	N/A
Gibson Brands	May 2018	Specialty Stores	Pending Reorganization	14
Rockport Company	May 2018	Footwear	Asset Sale	27
Color Spot Holdings	May 2018	Garden	Asset Sale	N/A

(a) Includes Winn-Dixie, Harvey's and Bi-Lo stores

Several of the consumer businesses that filed for bankruptcy in the past 18 months had burdensome levels of debt, resulting in part from their private equity owners' use of financing in acquiring the retailers. The fixed interest and lease payments proved too onerous for these leveraged retailers, as sales and margins deteriorated. A majority of these retail bankruptcies resulted in major asset sales and several liquidations. However, in the first half of 2018, more of the retailers filed seeking a reorganization with store closings than those that did so in 2017. These trends point to some private equity owners potentially placing too much debt on their retail companies. It also highlights the importance of partnering with the right bank, investment or PE firm that understands the cyclical nature of business and will not overreact when there's a dip in business.

In 2017, the retail industry saw a record number of brick-and-mortar store closures. Although the pace of store closure announcements is down somewhat in 2018 thus far, we are still seeing a heavy dose of store closings. As anticipated, retailers are consolidating underperforming stores and wrestling with declining foot traffic.

While the economy has been expanding in 2018, the sizable number of brick-and-mortar store closings and retail bankruptcy filings reflect shifting consumer preferences, the continued growth of e-commerce and the United States' over-built retail footprint. Consumers are spending a smaller share of their budgets on clothing and accessories than in the past, and younger generations continue to spend more on experiences than goods. These shifts in spending patterns continue to drive sales away from mall-based retailers that primarily sell clothing and accessories.

Still, there are too many brick-and-mortar stores selling apparel in malls. In response, certain legacy brands are re-evaluating their market strategy and several newer brands are focusing on direct-to-consumer marketing as opposed to selling their products through retail stores. Additionally, some retailers are selling via pop-up shops to facilitate authentic connections with consumers through novel experiences. Pop-ups allow consumers to connect with the brand off-line, and don't require the commitment of a lease agreement that traditional brick-and-mortar retailers are bound to.

STORE CLOSURE UPDATE

Retailers that announced closing 50 or more stores in the first six months of 2018

Company	Type	Number of Store Closings	Store Closings Announced
Toys R Us*	Specialty Stores	735	Bankruptcy Liquidation
Subway	Restaurants	500	Apr 2018
H&R Block	Specialty Stores	400	Jun 2018
Ascena Retail (a)	Apparel	268	Summer 2018
Bon Ton Stores*	Department Stores	256	Bankruptcy Liquidation
Best Buy Mobile	Specialty Stores	250	Mar 2018
GNC	Specialty Stores	200	Apr 2018
Signet Jewelers (b)	Jewelry Stores	200	Mar 2018
Sears / Kmart	Department Stores	274	Various
Foot Locker	Footwear	110	Mar 2018
Brookstone*	Specialty Stores	102	Aug 2018
Orchard Supply	Hardware Stores	99	Aug 2018
Southeastern Grocers (c) *	Supermarkets	94	Mar 2018
Claire's Stores*	Accessories	92	Mar 2018
Nine West*	Footwear	70	Apr 2018
Chipotle	Restaurants	65	Jun 2018
Sam's Club	Warehouse	63	Jan 2018
Abercrombie & Fitch	Apparel	60	Mar 2018
	Total	**3,838**	

* *Denotes retailers that filed for bankruptcy*
(a) *Includes Ann Taylor, Loft, Dress Barn, Lane Bryant and Justice stores*
(b) *Includes Kay, Zales, Jared and Piercing Pagoda stores*
(c) *Includes Winn-Dixie, Harvey's and Bi-Lo stores*

The overall retail sector has performed well in the first half of 2018 and the results have trended toward the higher range of the National Retail Federation's growth forecast of 3.8 percent to 4.4 percent. In particular, the second quarter showed strong results with most retailers reporting increases in comp store sales. Meanwhile, consumer confidence remains high, jobs are being created, wages have been rising and unemployment is very low.

However, U.S. retail sales posted their weakest gain in six months in August. Retail sales were up only 0.1 percent in August, the Commerce Department reported—a large decrease from the upwardly revised gain of 0.7 percent in July. Retail sales were constrained by weakness in clothing and department store sales, which saw sales drop 1.7 percent and 1.0 percent, respectively, from July.

On the other hand, consumer confidence in the U.S. economy is nearing a 14-year high. The University of Michigan's consumer sentiment index rose to 100.8 in September, marking the second highest point since 2004.

BDO'S TAKE: WHAT TO EXPECT IN 2018

Overall, the positive economic signs bode well for retailers for the remainder of 2018.

The increase in retail sales will likely continue into the second half of the year. Nevertheless, there is the ongoing threat of possible additional tariffs, which would likely drive up the prices of retail goods and also create some short-term supply chain disruptions. In addition, gas prices have been increasing and the Federal Reserve continues to gradually raise interest rates.

As such, we expect to see some more store closings announced, as well as some larger retailers file for bankruptcy, especially those that are too highly leveraged to fund a transformation to a new omnichannel strategy, or those that assume simply shutting doors will keep them afloat. That said, a retailer that is not Amazon must be realistic about its status quo before beginning any sort of transformation, taking steps to evaluate its financial strengths and weaknesses, and considering issues such as internal digital capabilities, supplier and distributor liabilities and core differentiators. Only at that stage can a retail business be optimized to prepare for calculated change and refining its business strategy to better align with customer needs. Then, retailers can initiate next steps on a better foundation without losing sight of the full picture.

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