CONSUMER AND RETAIL GROUP

THE STATE OF U.S. RETAIL

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ALVAREZ & MARSAL

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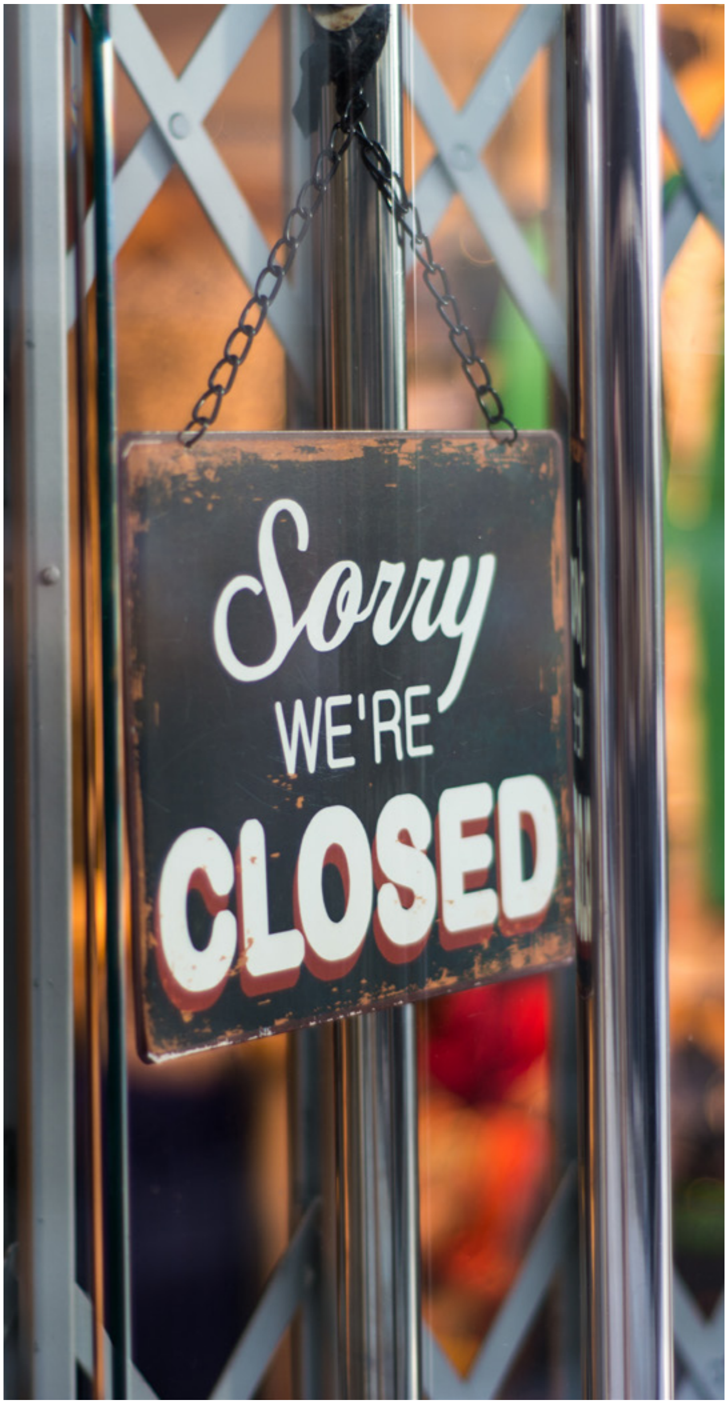


The retail industry has been under pressure for years and COVID-19 has only accelerated these changes. As a result, retail will emerge from the pandemic with a completely different landscape.

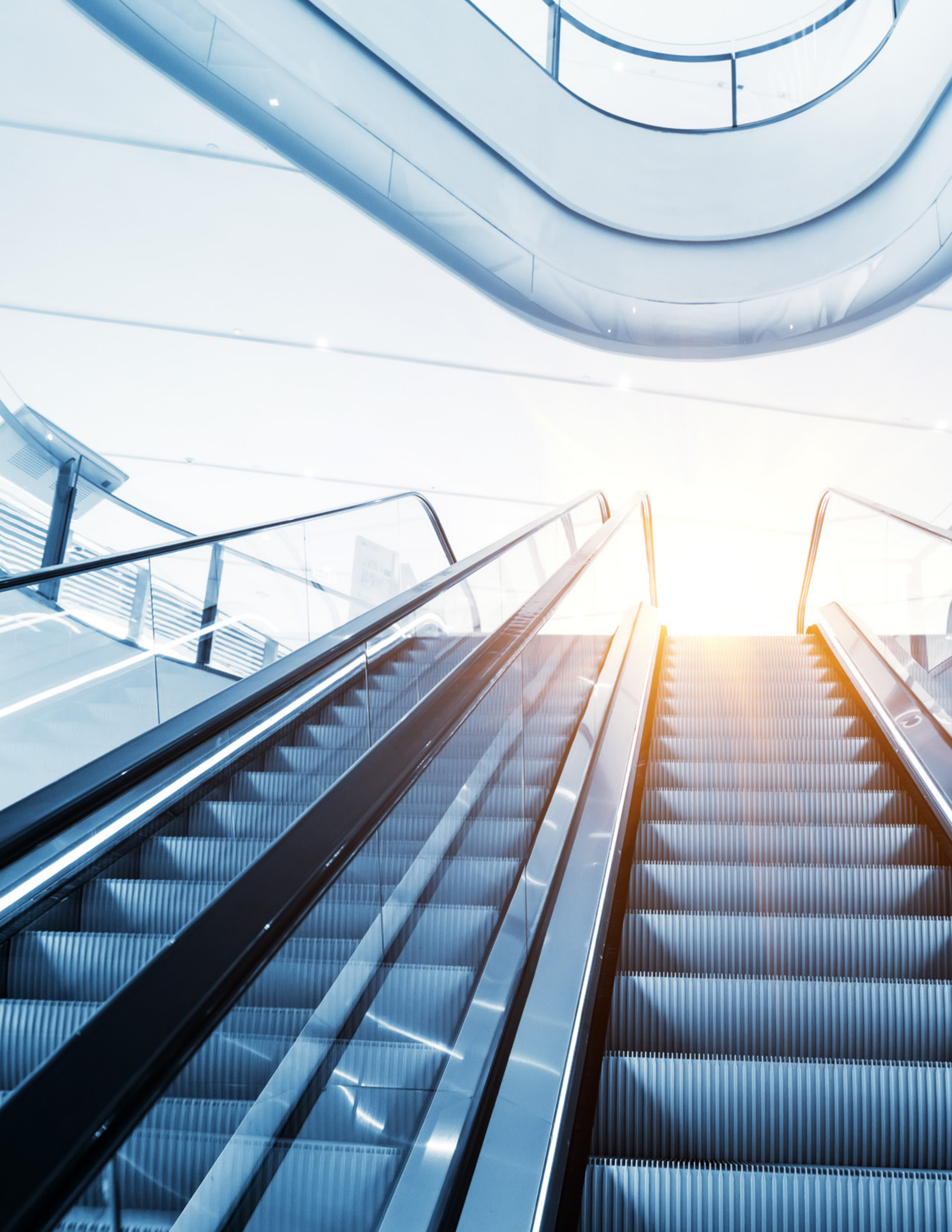
The pandemic has forced retailers to take a hard look at their store networks, resulting in an unprecedented number of store closures. According to Business Insider, 6,300 stores closed or will close this year, including many iconic retail brands such as Nordstrom, Victoria's Secret, Men's Wearhouse, Lord & Taylor, and JCPenney.[1]

Between the pressure of dramatically reduced store traffic and troubled financials, often laden with debt, retailers are having to file for Chapter 11 bankruptcy in droves. In the past four months, well-known brands like Ascena, Brooks Brothers, J Crew, Neiman Marcus and Pier 1 have all filed for Chapter 11.[2]

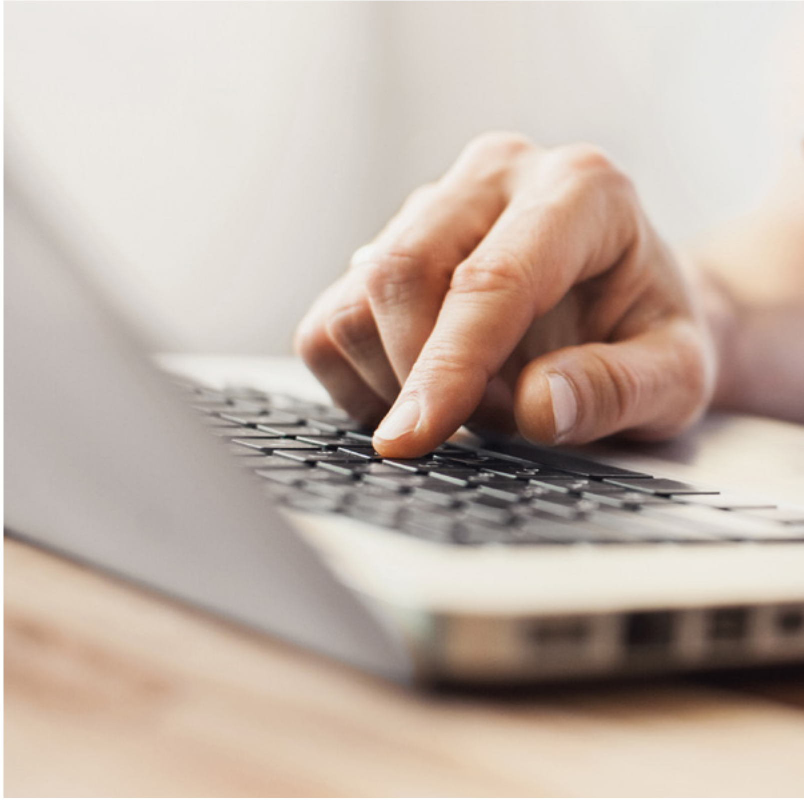
The pandemic has also forced a bifurcation of businesses and performance into an essential and non-essential categorization. Department stores and other "non-essential" retailers saw a tremendous deceleration with shutdowns and capacity limits, declining by 25% in Q1 2020 and by 75% in Q2 2020. For the full year, IBM Insights projects department stores to decline by more than 60%.

"Non-essential" retailers declining by 25% in Q1 2020 and by 75% in Q2 2020.

[1] *Hayley Peterson, Business Insider (Aug 17, 2020)*
[2] *Andy Markowitz, AARP (September 14, 2020)*



Consumers have spent $211.5 billion online during the second quarter, up 45% from last year.



Essential retailers, however, experienced the exact opposite with a massive boom in business. Grocery stores saw a 12% growth as consumers shifted entirely from dining out to eating at home. This change in consumer behavior can also be seen at a category level, as consumers have gravitated more toward alcohol consumption, home improvement and electronic use (up 16%, 14% and 23% respectively).[3]

Additionally, the pandemic has accelerated retail e-Commerce by an estimated 5 to 10 years with growth across all sectors. According to the National Retail Federation, consumers have spent $211.5 billion online during the second quarter, up 45% from last year. Omni-channel commerce is no longer a long-term vision, but an immediate necessity for most retailers. As such, this explosive growth has caused a huge increase in competition and innovation; for example, traditional powerhouse Amazon's Prime offer being challenged by Walmart+.

These seismic shifts in the retail space, along with fluctuations in category consumption, have led to meaningful and unexpected changes in customer behavior including:

- Challenges to brand loyalty
- Stockpiling as a commonplace behavior
- A decrease in general spending

COVID-19 caused a shock to the supply chains of many products. When consumers could not get their preferred brand of product, they switched brands quickly and, in some cases, permanently. According to Retail Dive, 75% of United States consumers have tried new brands and retailers as a result of the pandemic. Furthermore, 73-80% intend to continue using that new brand in a post-COVID world.[4]

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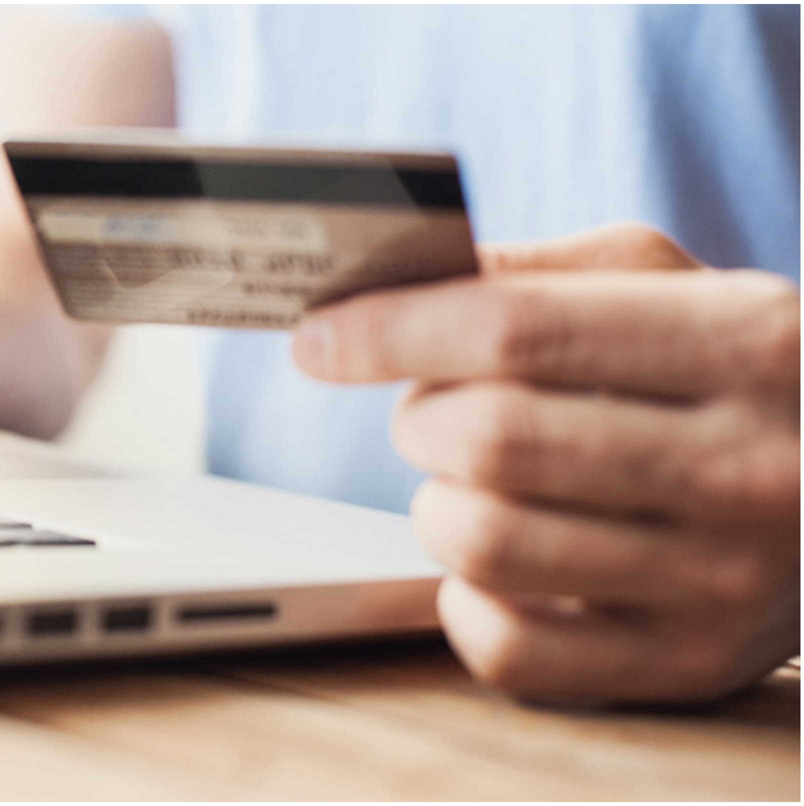
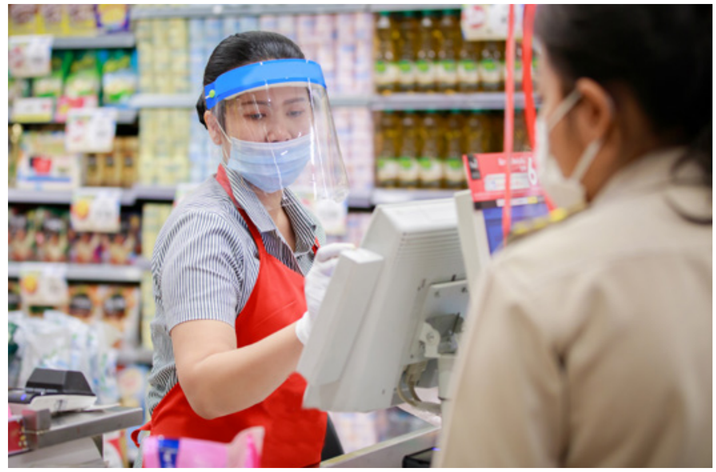
[3] "Coronavirus Has Sped Up Retail E-Commerce by about 5 years", Retail & Hospitality Hub (August 24, 2020)
[4] Caroline Jansen, Retail Dive (August 12, 2020)





Grocery Stores saw a

12%

Growth

Concerns over product availability have caused stockpiling, especially with essential categories such as food and household supplies. According to a survey by CPG sales and marketing firm Acosta, 38% of shoppers stocked up on groceries at the start of the pandemic, with 53% saying they plan to stockpile groceries, hygienic products and school supplies in the event of another public lockdown.

Typical customer behaviors and preferences have been permanently altered as well. According to the National Retail Federation, boomers (aged 55-74) typically made less than half of their purchases online pre-COVID, but two-thirds now say that accelerated adoption of technology like online buying, in-store pick-up and curbside pick-up have improved their shopping experience. 60% of boomers are also utilizing Amazon Prime, Shipt and other delivery services more now, specifically because of COVID-19.[5] Interestingly, boomers appear to use these hybrid offerings more, compared to younger generations.

Finally, consumers are making a hardline distinction between what they deem essential and what is discretionary, and decreased spending reflects this. According to the U.S. Department of Commerce, the intent to spend on more discretionary items during September 2020 is down 6%. Non-durable goods have been hit hardest by spending decreases, with clothing and footwear down 15.3% from Q1 2020, and food and beverages down 1.6% during that same time period. Around 40% of U.S. consumers have reduced spending in general and they expect to continue cutting back specifically on non-essentials. Future stimulus checks could impact this trend and should be monitored closely; however, reduced spending appears to be a reality at present.

[5] *Nkongho Beteck, National Retail Federation (August 18, 2020)*

With the reality of a difficult business climate and the future of many retail brands at stake, we believe that retailers must immediately focus on six core areas:

Targeted reset of strategy to align with new market dynamics

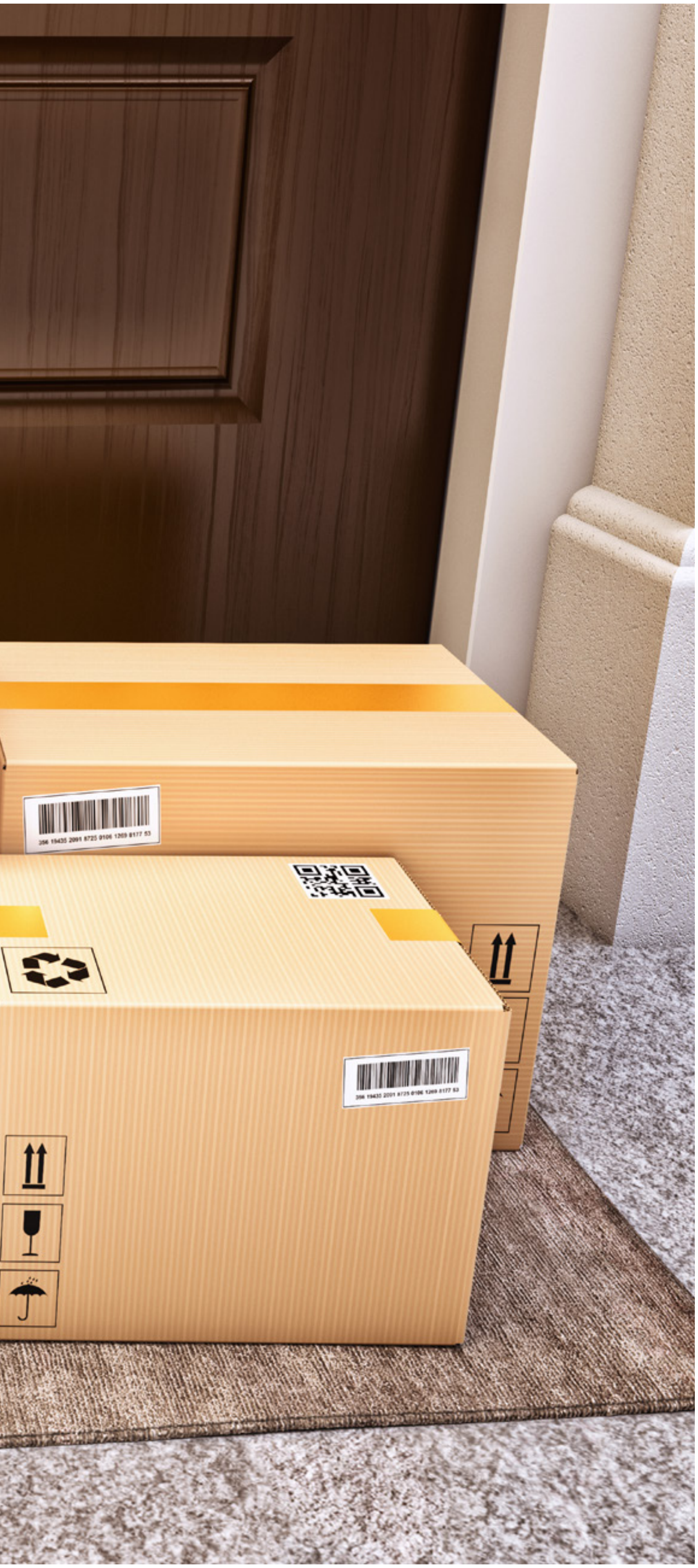
- Revisit overall strategy in light of structural shifts and evaluate which trends are short-term and which will have lasting impacts that reshape the market
- Rethink the role of the physical store as not only a commercial location, but also a logistical hub
- Ramp up long-term scenario planning given a wide range of potential market outcomes

Digital as the number one priority in capital, mindshare and growth

- Build a complete omni-channel offer including web, app, buy online/pick-up in store (BOPIS), curbside and delivery options
- Consider partnerships to rapidly accelerate core digital capabilities
- Focus on new innovative technologies to differentiate in digital (e.g. AR/VR virtual store)

Resilient leadership with a passionate focus on prioritization

- Continue to act as a force for prioritization with more visible communication
- Rethink external communication to Board and investors in a new, virtual Board Room



Refreshed customer focus

- Adapt pricing and promotions, and communicate value to increase demand (but do so with caution)
- Focus on core, high demand products
- Reduce SKUs to improve customer experience and prop up margins while simplifying assortment

Strong and flexible supply chain and store operations

- Consider adjustments to the holiday promo cadence, given stress on supply chains
- Increase safety stocks to ensure availability of core products in high demand
- Make assortment adjustments and reset allocation tactics

Ruthless and relentless focus on cost

- Take a zero-based approach and evaluate every cost and spending strategy in the new environment
- Rethink budgeting process, as many standing S&OP approaches linked to last year will fail

The state of retail in 2020 is incredibly challenging, but executing a prioritized set of actions in conjunction with resilient leadership will yield strong financial results and positive business growth. Ultimately, as the retail landscape continues to evolve, this will provide a chance for strategic, thoughtful leaders to further differentiate, reinvent, and serve as a springboard past 2020.

At A&M, we are prepared to assist and be a steady partner for you during these rough times. Reach out to our team today.

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