A&M INSIGHTS

Unlocking the value in retail restructuring

Is retail in crisis?

With the collapse of a series of retailers in the headlines recently Alvarez & Marsal (A&M) provides some timely, expert insight into why so many traditional retailers are financially struggling at present, and into the business of managing restructuring projects.

Why are there so many retailers in financial distress at the moment? What's the difference between a Company Voluntary Arrangement (CVA) and a pre-pack administration? Why might one approach be preferred over another?

The retail restructuring business feels busier now than it was in the wake of the 2008 Financial Crisis, according to Richard Fleming, European Head of Restructuring at A&M. We take a look at the factors responsible for the surge in activity.

Why are so many retailers in trouble?

There are several reasons that together add up to a deadly cocktail for retailers, including:

Consumer confidence is at four-year low (albeit, overall spending levels remain resilient)

Fixed costs for doing business are rising due to the National Living Wage and business rate reviews

Consumer credit has been growing faster than household incomes

Structural challenges – Being overly reliant on traditional bricks and mortar retail formats is proving costly for retailers and no longer fit for purpose for consumers.

A weak economic outlook in the U.K.

Behavioural shifts:

- Flight to leisure spend from retail – consumers no longer view retail as leisure
- Consumers' preference is increasingly digital, not bricks and mortar, and mobile is the device of choice.

Brexit and FX changes are discouraging immigration, which might be leading to long-term labour shortages

What is a Company Voluntary Arrangement?

A Company Voluntary Arrangement (CVA) is an insolvency process for businesses that are holed below the waterline but are still viable businesses.

It allows a compromise to be entered into between a company and its creditors to manage debts to enable the company to trade out its difficulties. A CVA is generally favoured by retailers because it helps reduce large store footprints and lower the fixed costs of doing business.

A CVA is not a way for healthy businesses to close underperforming stores. Contrary to popular opinion CVAs do not allow healthy businesses to compete unfairly with their peers. The vast majority of CVAs in the U.K. are entered into by small businesses across all sectors, while the larger-scale CVAs are favoured by retail and leisure businesses.

When might a CVA be preferred over the alternatives?

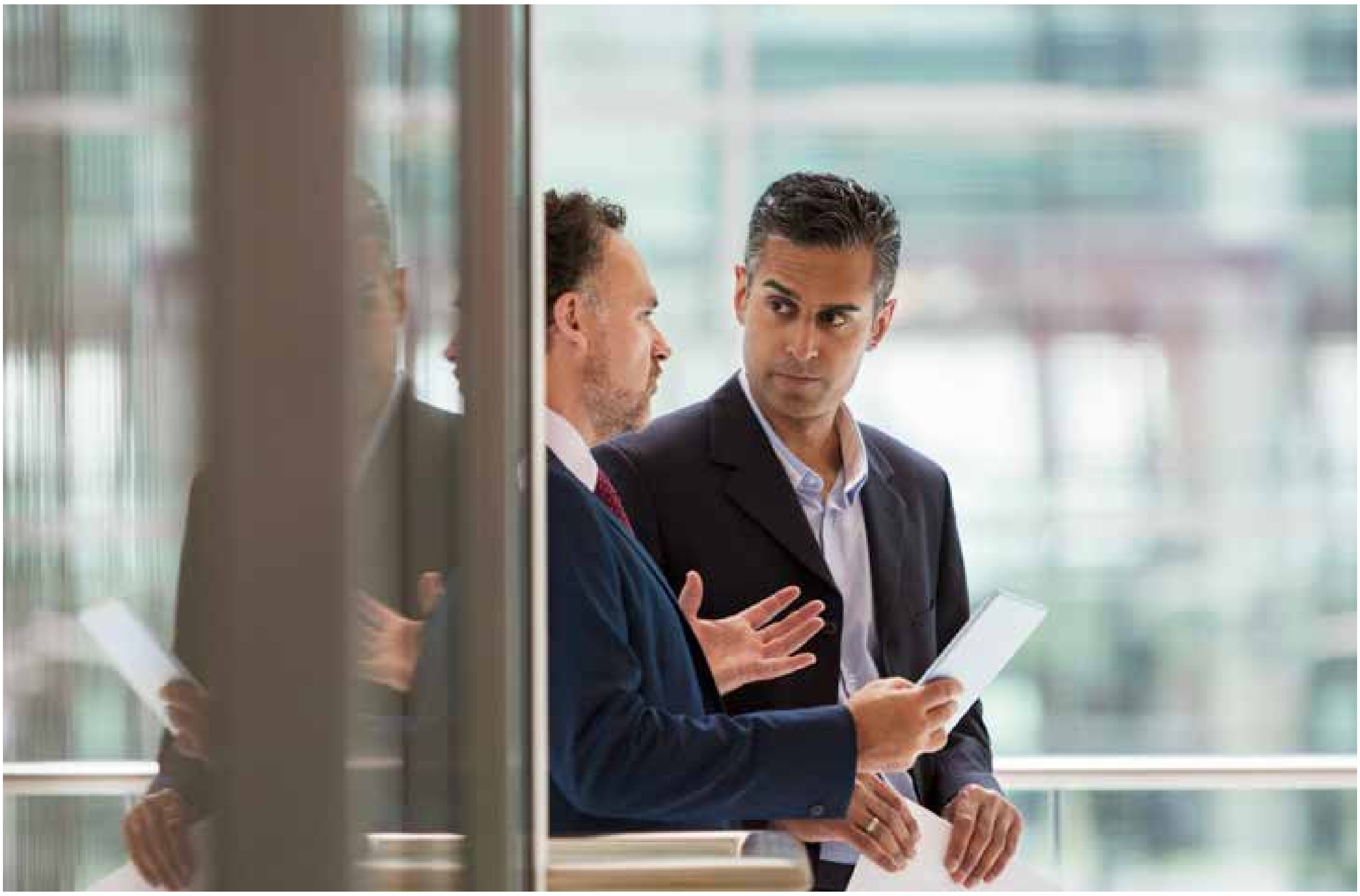
Shareholders prefer a CVA because it promotes the survival of the legal entity itself, providing a chance to reinvest and reboot the business.

It allows **management teams** to retain control of the business rather than having to hand it over to administrators.

The CVA process is good for **suppliers and employees**, because suppliers get paid in full, and employees have more security about their job.

Even though **landlords** take the biggest hit in a CVA, many also prefer them to the alternative. A CVA provides a landlord with a window of opportunity in which to find another occupier, a period when the rates and insurance will be covered, and the landlord will not have to shoulder these costs alone.

It is crucial to remember that carrying out a CVA is not a 'silver' bullet and is often only part of the overall restructuring process. It is not a turnaround plan, or a debt restructuring plan, which are separate but equally important parts of the process.



What are the success factors for CVAs?

- **A good management team** with a decent turnaround plan.
- **Access to additional capital or debt.** A CVA doesn't fix the business it just allows the management to size the portfolio appropriately.
- **Attention paid to financial restructuring.** Often a financial restructuring needs to happen in parallel for a CVA to be successful. However, debt is not typically dealt with in a CVA.

Can a CVA be used outside retail?

A CVA can be applicable for any businesses with large physical spaces, such as hotels, gyms, bowling alleys, cinemas – anywhere where reducing the store portfolio and its associated costs is part of the answer.

When might a pre-pack be the preferred option to a full, trading administration?

If there is no buyer for a retailer and an insolvency process is required, full trading administration is usually the best way to deliver value from the assets of the company that can be realised for cash. However, saving a piece of the business through a pre-pack can protect jobs and brands adding value for creditors.

- **To help deliver a buyer** – Businesses, which end up in pre-pack have almost certainly been talking to potential buyers, but the buyers aren't interested in the business in its current form. A pre-pack facilitates a sale of the business by enabling agreement on reduced footprint and overheads to be negotiated before the administration process begins.
- **Speed of sale** – One of the major advantages of pre-pack administrations is the speed of sale, which gives higher value to creditors and continuity to customers.
- **Specialist investors and experienced buyers prefer pre-packs** – For specialist distressed retail investors who understand the sector, the risks and the opportunity, pre-packs can be a great opportunity to unlock value at speed, whilst providing downside protection through stock / inventory acquired.

Is retail really in crisis?

Retail is likely to experience more upheaval, probably lasting another 12 months, but it will not last forever. Just as restructuring was "on fire" between 2009-2012, it has been relatively quiet in the past four years. Landlords are becoming more flexible over long term lease contracts, but we are still dealing with a legacy of long leases, which will take time to shake out.

One of the longer term 'unknowns' for retailers is related to the labour market and finding suitable workers in a post-Brexit world.

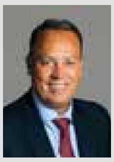
Retail is not in crisis because the fundamentals are strong – not least that people are still spending money. However, it is the bricks and mortar retailers who will continue to struggle, and their outlook is less clear. They will need to consider shrinking their physical presence, as well as rethinking customer experience and interaction if they are to be successful in the next decade.

Our expertise

When faced with tight cash flow and critical timings our Restructuring Advisory Services team will see you through the entire recovery plan – from designing of plans and processes to full implementation:

- **Lead the restructuring process**
- **Mange creditor negotiations**
- **Develop and sensitise business plans**
- **Stabilise operations**
- **Evaluate revenue enhancement opportunities**
- **Implement operational restructuring**
- **Facilitation communications processes**
- **Implement cash conservation guidelines and controls**

KEY CONTACTS



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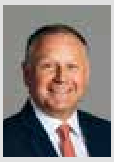

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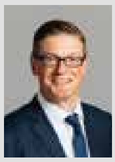

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ABOUT ALVAREZ & MARSAL

Companies, investors and government entities around the world turn to Alvarez & Marsal (A&M) when conventional approaches are not enough to make change and achieve results. Privately held since its founding in 1983, A&M is a leading global professional services firm that provides advisory, business performance improvement and turnaround management services.

With over 3000 people across four continents, we deliver tangible results for corporates, boards, private equity firms, law firms and government agencies facing complex challenges. Our senior leaders, and their teams, help organizations transform operations, catapult growth and accelerate results through decisive action. Comprised of experienced operators, world-class consultants, former regulators and industry authorities, A&M leverages its restructuring heritage to turn change into a strategic business asset, manage risk and unlock value at every stage of growth.

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