



SURVIVING THE CASH CRUNCH

THE IMPACT OF COVID-19 ON MAJOR U.K. RETAILERS

A blue, distressed sign hanging from a chain, reading "Sorry WE'RE CLOSED". The sign is weathered and has a white border. The background is a dark, moody image of a building at night.

Sorry
WE'RE
CLOSED

ALVAREZ & MARSAL



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Introduction

COVID-19 shockwaves felt across the high street

The world is facing an extraordinary crisis. The COVID-19 pandemic has sent shockwaves throughout global communities, dislocated international supply chains and triggered steep selloffs in financial markets. It has already become clear that the high street will take on a very different form once the pandemic is over. Weaker players will unfortunately cease to exist, leaving behind a smaller but more resilient sector that has acted fast.

The International Monetary Fund (IMF) reassessed prospects for global growth in 2020 and 2021, declaring that we have entered a recession as bad or worse than that of the 2008 global financial crisis.

Against this backdrop, Retail Economics forecast a hit to the U.K. economy in the region of -15% of GDP in the second quarter of 2020 (quarter-on-quarter), before rebounding in the third quarter as the impact of the virus dissipates. At present, an accurate assessment of the duration and trajectory of the virus is difficult to determine.

Coordinated action from global policymakers and central banks has been swift. The U.K. Government has taken unprecedented action to support businesses and protect jobs, while the Bank of England has cut interest rates to new record lows. The result is a flood of cheap credit, quantitative easing, liquidity injections, loan guarantees, cash-hand outs, tax breaks and generous employment subsidies which will cushion the blow to a certain extent.

The trauma will be acute for retailers, despite an unprecedented government support package.

Retail Economics estimate that non-food retailers could see a decline in sales of c.17% over 2020 – equating to over £37 billion of lost revenue.¹

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Government aid has provided significant support for retailers to manage cash flow. A 12-month business rates holiday and the Job Retention Scheme² are particularly significant for the retail sector, given these two components comprise a large proportion of operating costs. Further concessions including the option to defer Value Added Tax (VAT), the Coronavirus Business Interruption Loan Scheme, the COVID-19 Corporate Financing Facility and protection from eviction for commercial tenants will undoubtedly help those under intense pressure.

These support measures, in combination with lending facilities offered by banks, will be a lifeline for retailers of all sizes and across all channels which are pivoting towards a focus on cash and rightsizing their operations.

With these measures in place, **our scenario analysis suggests that near-term liquidity over an initial three-month lockdown period looks manageable for most large retailers.** But working capital demands would intensify from June and beyond.

However, should a lockdown persist beyond June, and without further government intervention, large parts of the sector would come under intense pressure, with many retailers falling into administration by September as cash reserves and credit facilities become exhausted.

¹ Retail Economics forecasts are heavily dependent on Government policies, correct as of 6 April 2020

² 80% of employees' wages up to £2,500 per month



Consumer focus

The impact on retail sales and consumer behaviour

The COVID-19 pandemic has already fundamentally altered consumer behaviour. Lockdowns, social distancing and other restrictions are forcing many households to jostle parental and home-schooling responsibilities while working from home. The closure of gyms, cancellation of sporting events and social distancing are challenging how people spend their time, re-ordering priorities and altering routines.

The sudden shock to everyday life has forcibly introduced new shopping behaviours, but the impact will be felt unevenly across retail sub-sectors. The closure of non-essential retail stores has necessitated a shift towards online, forcing many consumers to engage new customer journeys. Around a third of consumers³ suggest that they have switched to purchasing products online that they have previously (and exclusively) purchased in-store. These consumers will have to overcome the initial friction of setting up online accounts and become familiar with online payment systems. In the future, many unadventurous and apprehensive internet shoppers may emerge as full 'online converts'.

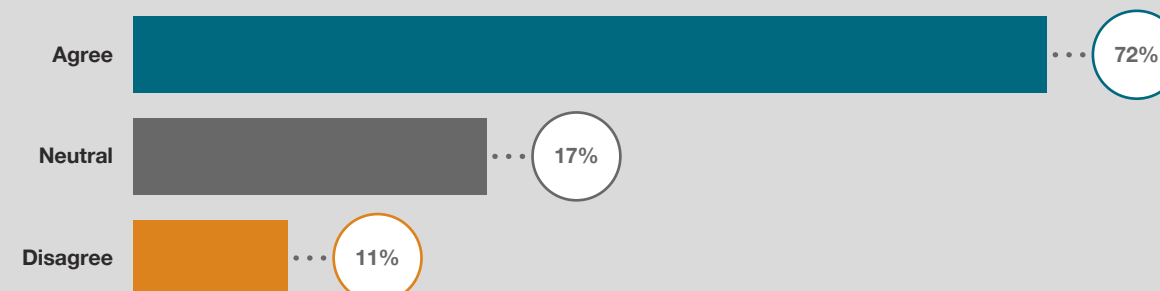
The initial shift towards online shopping will fail to offset the overall decline in demand. Non-food retailing is expected to fall by 16.7% in 2020⁴ as most stores remain affected until June 2020 and demand is undermined by weak consumer confidence and elevated levels of unemployment.

Elsewhere, food retailers will benefit from increased volumes as almost all meals are now consumed in the home. The transfer of spending from the closure of restaurants, bars, cafes and pubs will flood the grocery sector with increased demand across both foods and alcoholic beverages. Data from Kantar suggested that grocery sales in March 2020 rose by 20.6% on the previous year, making it the largest month of grocery sales ever recorded. It's estimated that an additional 503 million meals⁵ will be prepared and eaten at home every week for the foreseeable future. This will clearly boost spending across the sector.

Simultaneously, growing concerns over the impact on the economy and job security has undermined confidence in personal finances. Our research found that more than half of consumers⁶ are worried about their personal finances and they have little or no savings to support them through this period of heightened uncertainty.

As expected, consumers have prioritised spending on essentials such as food and health, avoiding discretionary spending, especially on clothing, homewares and electricals. Indeed, almost **three quarters (72%) of consumers have prioritised essential purchases since the outbreak of the virus.**

Since the outbreak of the coronavirus, I have prioritised my spending on essentials rather than discretionary purchases?



Source: Retail Economics

³ Retail Economics COVID-19 consumer panel survey, conducted 29 March, sample = 2,000

⁴ Retail Economics forecasts are heavily dependent on Government policies and correct as of 6 April 2020

⁵ Kantar World Panel

⁶ Retail Economics COVID-19 consumer panel survey, conducted 29 March, sample = 2,000

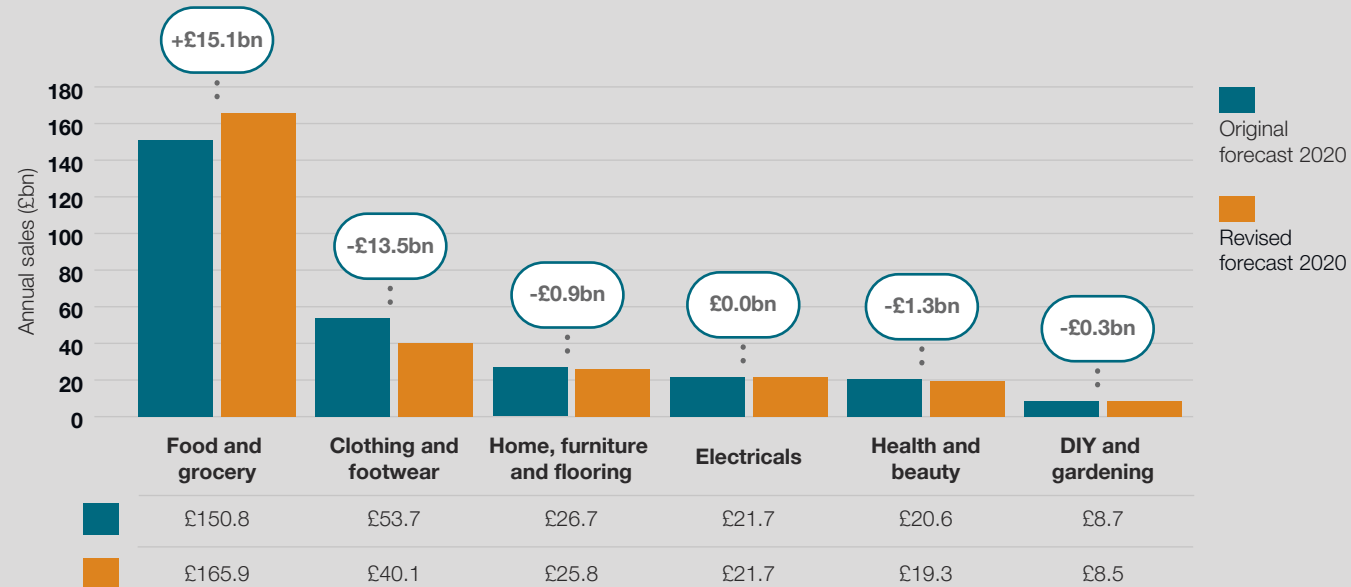
Given the significant shock to the economy in the second quarter of 2020, the prospect for a retail recovery in the second half of the year is highly dependent on the effectiveness of government policy, whether any additional measures will be announced to further support businesses and households, and the duration of the pandemic. Until further clarity emerges on when the outbreak will end, the longer-term scale of the negative economic impact remains uncertain and very difficult to quantify.

Businesses will undoubtedly fail as they fall through the Government's safety net which could drive a sharp rise in unemployment from current historic lows. While it may be too early to quantify the scale of job losses, the weakening of the labour market will lead to an inevitable

dampening of consumer spending, while the longer-term impact on confidence will undermine households' propensity to spend.







As was witnessed in the aftermath of the financial crisis, consumers prioritised value over range and quality, boosting the growth of discounters which became entrenched as a feature of the U.K. retail industry. Although born of a completely different nature, this crisis will also present previously unexplored paths to purchase for many consumers. Some of these behaviours will undoubtedly be short-lived, others are likely to persist, enduring into the economic recovery period.

Retail sector sales forecast for 2020 have been downwardly revised for non-food



Source: Retail Economics

Sector summary and forecasts for 2020

Sector	Summary	Original growth forecast 2020	Revised growth forecast 2020
Food and grocery 	Food will remain a clear winner. The continued closure of food service operators (e.g. bars, cafes, restaurants, pubs) will result in on-going transference of spending toward the grocery sector.	+2.6%	+7.5%
Apparel 	Apparel is likely to be one of the hardest hit sectors given its non-essential nature, particularly in the absence of social interaction and events. While the shift to online may support some sales, it will do little to insulate against the overall decline across the market. Many retailers such as Next, River Island, Moss Bros and Quiz have temporarily ceased trading online which will further damage the prospects for the sector. Spring/Summer will be a write-off for most retailers and excess levels of stock will flood the market in June and July leading to significant discounting and margin erosion. Given that various clothing retailers were plagued with underlying issues prior to the pandemic, administrations will be inevitable.	+0.5%	-26.7%
Electricals 	Electrical retailers are likely to benefit in the short run as companies switch to home working, requiring laptops, software and accessories. Tablets and low-priced laptops are also in high demand as parents look to occupy their children and assist with home teaching. High levels of online penetration will also support sales growth here. Movement restriction is also likely to cause consumers to think about getting outside for health and fitness reasons. Online sales of home fitness equipment and smart fitness devices are also likely to benefit. White goods are also in higher demand with consumers looking to stockpile frozen foods.	+1.0%	+0.7%
Home, furniture and flooring 	Homewares and furniture retailers are likely to experience an initial sharp decline in sales as consumers prioritise essentials and store closures eradicate impulse purchases. A blow to the housing market also undermines home moves which was showing signs of revival. But with home viewing plummeting and mortgage providers applying more stringent lending criteria, the housing market is expected to suffer significantly in coming months. As COVID-19 restrictions become normalised, spending longer periods indoors may support improvement of living spaces.	+1.2%	-3.5%
DIY and gardening 	DIY and gardening is likely to suffer less than other non-food sectors as home-bound consumers focus on home improvement projects. However, the all-important Easter Bank Holiday is usually the starting gun to Spring sales and stores will remain closed for this critical period for many. That said, increased gardening-related activity in coming months will support gardening equipment sales. Low online penetration will favour retailers with an attractive proposition.	+1.8%	-2.9%
Health and beauty 	The notable boost in bathroom toiletries, paper products and over-the-counter medicines will stimulate sales growth in the short run as consumers stockpile essentials. However, short-term gains will come to the detriment of sales later in the year. Categories such as fragrance and cosmetics will come under intense pressure as consumer self-isolation undermines demand and department store closures decimate sales of beauty brands. With under 10% of sales generated online, smaller online specialists may benefit offering alternative and enticing propositions.	+2.1%	-7.2%

Source: Retail Economics

Note on above table: our working assumption is for a period of significant disruption until late May, with non-food spending beginning to recover in June but not returning to long-run historic levels until early 2021.



Retailer focus

The cash crunch – impact assessment for U.K. non-food retail

The impact of COVID-19 has caused a mandated lockdown of around 70% of non-food retailing in the U.K. The initial period of store closures will last for three weeks before it is subject to review. However, it is widely expected to be extended.

Retail shops allowed to remain open include:



Supermarkets and other food shops



Health shops, pharmacies including non-dispensing pharmacies



Petrol stations, bicycle shops, home and hardware shops



Laundrettes and dry cleaners



Bicycle shops, garages, car rentals, pet shops



Corner shops, newsagents, post offices, and banks

Even retailers allowed to remain open have faced significant challenges. Enforcing social distancing measures in the workplace has created a significant issue. Food retailers are limiting the number of shoppers into their stores at any one time while also providing staff with Personal Protective Equipment (PPE). Clear protective screens have also been installed at checkouts to further safeguard staff at retailers such as Aldi, Morrisons, Iceland and Sainsbury's.

Elsewhere, other retailers have been caught in a difficult middle ground; technically allowed to open under Government guidelines but finding significant operational challenges when servicing customers effectively. For example, hardware stores are unaffected by the lockdown, but B&Q stores are closed, only allowing online ordering for home delivery, but also servicing click-and-collect in car parks with a contact-free service. Furthermore, Next, River Island and TK Maxx have all temporarily stopped their online operations, raising concerns that pure-online retailers may not be immune to staff shortages and pressures of social distancing in the workplace. External pressure also exists to be seen 'doing the right thing'.

Virtual queues across a vast number of websites suggest inadequate capacity to cope with a spike in demand, but also highlights the difficulty in scaling operations with social distancing in place and the tension put on operating capabilities with increased staff sickness.

The impact of the virus will push many companies from a positive to negative cash flow within weeks. It will take time for earnings visibility to emerge, but our analysis focuses on this immediate crisis for retailers. In this section an analysis is conducted concerning the impact of the current retail environment (incorporating supportive government measures) to assess how long non-food retailers can continue operating *without* seeking additional financial aid.

The methodology uses company cash flow estimates and current levels of working capital to simulate how company balance sheets will evolve in coming months, based on reduced revenue scenarios. Estimates are then created for a specified cohort of non-food retailers, as to when they will exhaust their liquidity (if at all) and will have to cease trading or attempt to raise additional finance beyond their current debt facilities.



Government measures

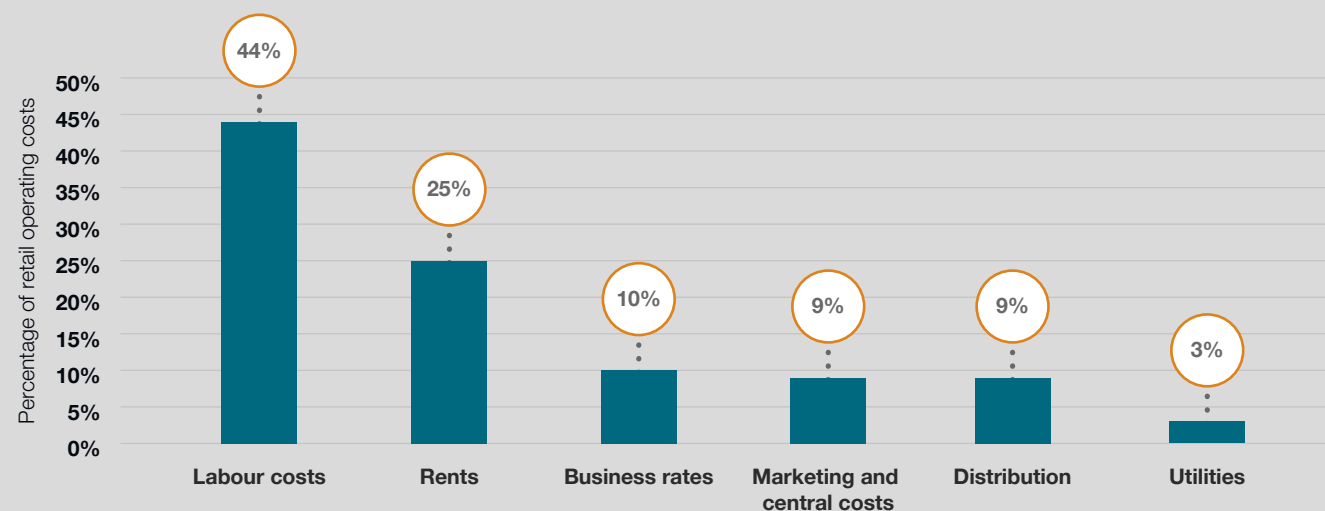
The Government policy response has been swift, announcing a range of measures to alleviate immediate pressures on cash flow including:

- 12 months business rates holiday
- Job Retention Scheme to pay 80% (up to £2,500 per month) for furloughed workers' monthly salaries for three months
- VAT deferral for payments due between 20 March – 30 June 2020.

Firstly, the sensitivity of non-food retailers' cash flow was modelled to incremental falls in revenue. This provides a gauge as to how far sales would have to decline before a large proportion of retailers reach negative monthly cash flow, at which point their survival depends on the strength of their balance sheet, access to revolving credit facilities, support of investors and the duration of the downturn.

Our analysis includes a total of 34 non-food retailers listed on the London Stock Exchange, accounting for over £85 billion worth of sales in 2019/20.

Breakdown of operating costs for non-food retailers



Source: Retail Economics

A key observation is that even prior to the pandemic, five out of the 34 non-food retailer sample already had negative cash flow. This can be the case even for large, profitable companies, as they rely on credit and capital markets to fund investment, growth, and return cash to shareholders.

Nevertheless, even with **a 10% reduction in revenue, over two-thirds of our sample of non-food retailers fall into immediate negative cash flow. A 20% reduction in sales captures over 90% of the sample, and a 30% reduction in sales plunges all firms in the sample into immediate negative cash flow** – based on monthly averages.

How long can retailers survive in the current status quo assuming a 70% reduction in sales?

We addressed the question of how long non-food retailers can survive the current status quo – assuming an on-going lockdown of stores for the foreseeable future – without access to further capital.

Assumptions are based on the likely hit to revenue from store closures as of 23 March, the wider impact on consumer spending and Retail Economics' retail sales and consumer panel data.

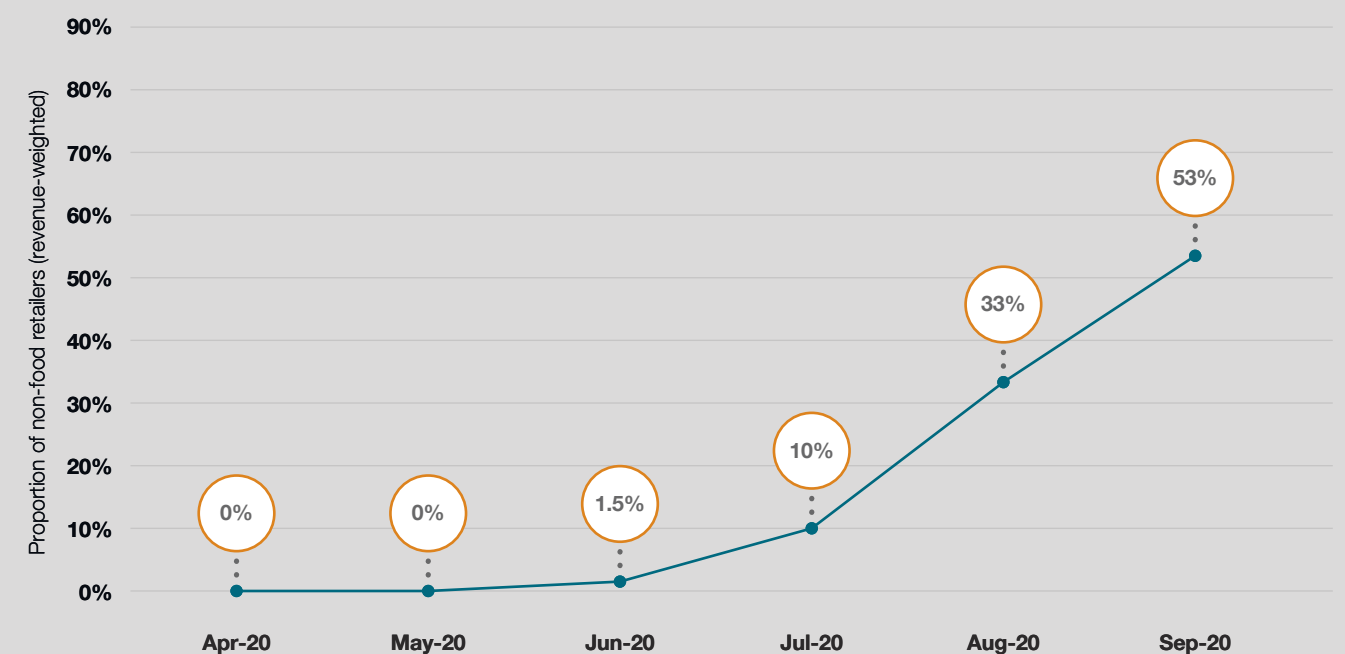
As a result, it is expected that non-food sales are likely to fall in the region of 70% during the period of lockdown.

Empirical judgements are also included in the methodology regarding how much operating expenses, investment, and cash returns to shareholders would decline as a result of falling sales and inclusion of Government measures to support businesses.

Revolving credit facilities are also factored for, together with a lagged decline in the cost of goods sold and other carefully-considered assumptions (e.g. retailers will try to reduce labour costs by 50% through furloughed employees; and essential retailers will continue to see sales hold up better than retailers whose stores that have been forced to close).

Retailers will try to reduce labour costs by 50% through furloughed employees.

Proportion of non-food retailers whose cumulative losses would deplete their working capital over the next 12 months – based on a 70% reduction in sales.



Source: Retail Economics, company filings, DataStream

Our research shows that 10% of retailers (weighted by revenue) will experience liquidity issues within four months from 23 March. However, **cumulative losses for a period of five months would see a third of non-food retailers in our sample deplete their entire working capital**, thus needing to either seek additional financing or face administration. Should the pandemic persist, and measures remain in place until the end of the summer, more than half of non-food retailers in our sample could face administration.

Our research shows that 10% of retailers (weighted by revenue) will experience liquidity issues within four months from 23 March.

We estimate that non-food retailers in our sample stand to lose around 18% of available liquidity from mid-March to mid-April as the initial impact of a 70% fall in revenue hits operations. Thereafter, the sample of **non-food retailers will deplete around 10% of available liquidity each month for as long as the store lockdowns continue, or available capital is exhausted.**

A continuous decline in sales of 70% is not expected to persist indefinitely. But, it offers a timeline based on today’s trading reality of how long non-food retailers are likely to be able to continue to operate before depleting their available working capital – a good benchmark for further scenarios.

It is important to note that our scenario is based on listed retailers which have better access to credit and potentially stronger balance sheets compared to small and medium sized firms.

Small retailers account for over 95% of VAT registered retailers in the U.K. and form the backbone of many communities they serve. While government support will help some of these retailers weather the storm, the impact of the cash crunch is likely to be much worse.

Scenario comparisons for alternative sales decline

There is considerable uncertainty around the quantum of sales declines for the various retail sectors as certain categories are more insulated than others.

The table below offers a comparison of a decline in non-food sales of 50%, 70% and 90% to capture a range of potential outcomes over the next six months for the proportion of non-food retailers that could encounter liquidity issues.

Comparisons of sales decline scenarios.			
	Sales decline scenarios		
	-50%	-70%	-90%
Apr-20	0%	0%	0%
May-20	0%	0%	7%
Jun-20	0%	1%	34%
Jul-20	0%	10%	61%
Aug-20	0%	33%	76%
Sep-20	1%	53%	76%

Proportion of non-food retailers who deplete entire working capital

Source: Retail Economics, company filings, DataStream

The comparisons table shows that for a more aggressive sales decline of 90%, a third of non-food retailers in the sample would deplete all working capital within three months, and three-quarters of retailers within five months.





The future

What's next for the industry?

Government measures to support businesses will be a lifeline for retailers of all sizes and across all channels. Our scenario analysis suggests that near-term liquidity over an initial three-month lockdown period looks manageable for most large retailers with government support in place. Working capital demands intensify from June and beyond.

By August, an ongoing lockdown would decimate large segments of the sector and see swathes of retailers fall into administration as cash reserves and credit facilities are exhausted without further government intervention. Distressed discounting would erode margins significantly as retailers desperately trade over the summer months.

While the duration of the pandemic remains uncertain, being nimble, innovative and quick to react in a fast-paced environment will be critical, as will offering something that is meaningful to the customer in this challenging time. This unprecedented environment has dictated fundamental changes to most retailers' operating models.

Inditex, owners of Zara, have switched some of their supply chains to the production of clinical face masks and hospital gowns. Likewise, Burberry has started the production of PPE equipment from its West Yorkshire factory and shared plans with the Government to dedicate its global supply chain to delivering more than 100,000 surgical masks to the NHS for use by medical staff.

Boots is also supporting the Government to establish new 'drive-through' testing stations that provide COVID-19 tests for frontline NHS staff. Along with Amazon, they are also planning to help in the distribution of antibody tests that people will be able to conduct themselves at home.

Elsewhere, Brew Dog, Coty and Louis Vuitton have started to produce hand sanitiser. Dunelm and B&Q have introduced a carry-to-car option for online orders and have also scrapped signing on delivery to reduce the spread of the virus. Sweaty Betty has also introduced free online workouts.

Strategic partnerships are also likely to emerge as mutually beneficial and collaborative arrangements are used to cut costs and leverage sales opportunities.

For example, WHSmith and Sainsbury's recently unveiled a partnership to offer more fresh food in some of their outlets in hospitals. Meanwhile, McColl's and Marks & Spencer have partnered with Deliveroo for home delivery of essentials.

The current government measures may not be enduring. If the crisis becomes more protracted, an extension of existing measures is likely and the Government also has scope to:

- Adjust the rate of VAT
- Defer National Insurance payments
- Delay Corporation Tax
- Alter statutory minimum wage
- 'Helicopter' money into households.

The fiscal rule book has already been torn up and previously unimaginable levels of support could be announced.

Assumptions concerning the timeframe for recovery is highly debatable and are completely dependent on the duration and trajectory of the pandemic. Should the rate of infections ease over the coming weeks, as hoped, a lifting of restrictions in May should see a recovery in consumer spending start in June/July. However, despite best efforts by policymakers, measures may fail to curb unemployment which could lead to a deep-rooted recession. For many retailers it is critical to take action immediately in order to ensure survival or to emerge from this crisis with a stable future.

As the dust begins to settle from the impact of the pandemic, it's unrealistic to assume that businesses will wholly revert to a pre-COVID-19 era and discount the new partnerships and more agile operating models that the crisis has brought-about.

Leadership teams will review risk management strategies which will include an impact assessment on supply chains, reassess the purpose of their stores and stress test their 'just in time' models, while starting to consider 'just in case' models that ensure business continuity in times of crisis. The industry will undoubtedly see permanent change.

How A&M can help

A&M has worked with some of the largest European and global retailers to stabilise financial performance, transform operations, catapult growth and accelerate results through decisive action. When traditional improvement activities are not enough, A&M's restructuring and turnaround heritage brings fact-based, action-oriented leadership to transformation and delivers rapid results.

Our professionals have both operational and advisory experience together with a proven track record in leading businesses through tough, complex situations:

- **Cash forecasting and working capital optimisation** to create a cash-focused culture with accurate forecasting as well as strategic drivers to conserve cash and drive sustainable change
- **Operating model transformation and cost reduction** to ensure the resources and skills of an organisation are organised to deliver the strategy and ensure future success
- **Margin management** to ensure the customer value proposition leads to EBITDA improvement via improved sourcing and clear pricing and promotions strategy
- **E-Commerce and Digital optimisation** to align operating model, skills, and CapEx and OpEx budgets to deliver profit and leading customer experience
- **Store operations assessment** across both store performance (sales and margin) and store productivity (costs) to deliver a better customer experience and operational efficiency
- **Store locations, formats, sizes and rents assessment** to eliminate loss-making stores, renegotiate rental agreements to deliver improvements to EBITDA and geographic network optimisation
- **Marketing effectiveness** to analyse and improve marketing effectiveness and efficiency to save costs and optimise budget spend to provide the best return.

If you are interested in discussing how we could help to improve your profitability, please get in touch with one of our experts.



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For further information about the modelling or data sets used in this report please get in touch with A&M.





ABOUT ALVAREZ & MARSAL

Companies, investors and government entities around the world turn to Alvarez & Marsal (A&M) when conventional approaches are not enough to drive 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 4,000 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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