Retail
Spring 2023

Sector Overview

The majority of the traditional UK retail sector is going through a prolonged period of upheaval, even though some areas are performing well. Following on from the impact of Covid-19, there continues to be several challenges facing the sector, including high rent and debt burdens along with increased energy prices. Supply chains continue to be disrupted, combined with significant inflationary pressures and the cost-of-living crisis putting pressure on household discretionary spending.

Clothing and footwear retailers reported having to increasingly resort to discounting. Demand for durable goods, such as furniture, furnishings and household appliances continued to weaken, as consumers are choosing to repair rather than replace. This was evidenced through a number of furniture retailers such as Made.com, Snug and Eve Sleep collapsing into administration in 2022.

Despite the pressures, there have been some positives for the sector amidst the ongoing postal service strikes and the wider economy reopening after lockdown, High Streets and Shopping Centres saw a growth in footfall from the lows experienced during the COVID period. High Street footfall increased by 8.6% in the year to March 2023 and Shopping Centre footfall increased by 8.2% in the same period. There is a clear demand for discounters and those selling lower-priced goods as consumers trade down.

In addition, the Health and Beauty market has proved resilient and has demonstrated its robustness in the face of the widespread economic slowdown. There was particular strong growth in fragrances and cosmetics sales attributable to Christmas and Mother's Day gifting. The likes of Boots, Superdrug and Lush reported double-digit growth after a very strong Christmas trading.

E-commerce continues to challenge the traditional bricks and mortar retailers with sales remaining 17% higher than pre-pandemic levels of 2019 (IMRG). This is despite online sales having declined every month since April 2021, bar a slight rise in November 2022, as the wider economy has reopened. Those retailers which have a strong offering in both, such as NEXT, have performed well in the current environment.

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Notable Insolvency Events

According to the Office for National Statistics, during 2022, the Retail and Wholesale sector experienced the second largest number of insolvencies, after the Construction sector. The industry accounted for 14% of total company insolvencies for England and Wales in the first half of 2022 and it registered 802 company insolvencies in the second quarter of 2022, which is the highest level since the first quarter of 2012.

On the 26th of March 2022, the restriction that prevented landlords from issuing winding-up petitions against tenants ended and this action alone saw insolvencies rise in the sector. There were 288 compulsory liquidations in March 2023, which is more than twice the number in March 2022.

In recent years the sector has seen some notable insolvencies, with such failures as:

Planet Organic (April 2023)

David's Bridal UK Limited (April 2023)

Kettle Interiors (March 2023)

Tile Giant (January 2023)

Snug Shack Limited (January 2023)

M&Co (December 2022)

Joules (November 2022)

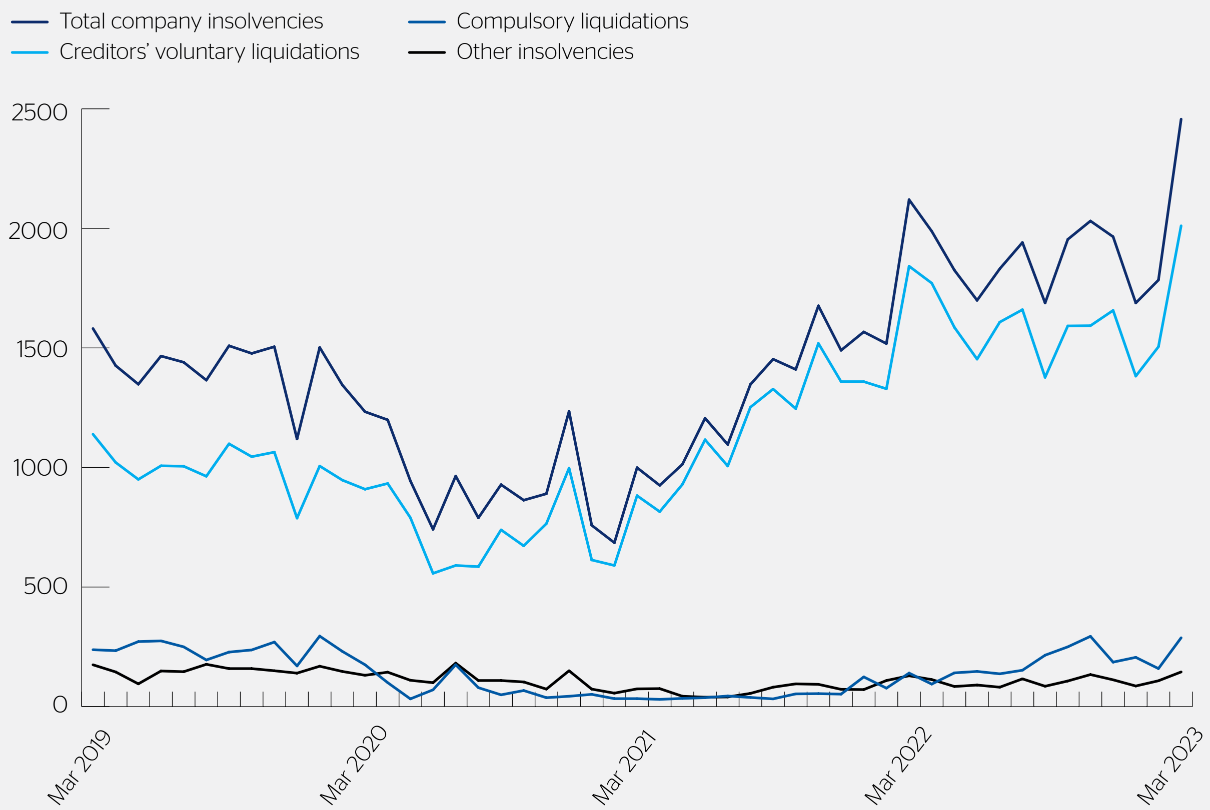
Made.com (November 2022)

Eve Sleep (October 2022)

McColl's Retail Group (May 2022)

Missguided (May 2022)

The historical trend of company insolvencies from March 2019 to March 2023 in England and Wales



Sources: Insolvency Service (compulsory liquidations only); Companies House (all other insolvency types) www.gov.uk

Data

- The Office for National Statistics (ONS) reported that The Consumer Prices Index (CPI) rose by 10.1% in the 12 months to March 2023, down from 10.4% in February, mainly driven by housing and household services (principally from electricity, gas and other fuels).
- The Bank of England increased the base rate to 4.50% in May 2023, taking borrowing costs to their highest level since 2008.
- The GfK Consumer Confidence index rose to -30 in April 2023 from -36 in March. The six-point jump in how those surveyed see prospects for their personal financial situation suggests that household finances are stronger than we anticipated. While it remains negative, it is still significantly above the lowest score in 2012 (-42) and it is also the first successive period of improved sentiment since 2021. Improvements in consumer sentiment suggests the sector is slowly improving.
- Some downward price pressure is expected as commodity price inflation stabilises and the Bank of England expects inflation to fall from mid-2023.
- In the three months to January 2023, average weekly earnings of total pay in the United Kingdom grew by 5.7% (ONS). As per the PwC Consumer Sentiment Survey, this indicates that national living wage increases will outstrip inflation by the year end, and disposable incomes will start to rise in real terms.

Key Trends

- **ESG:** Consumer behaviour has seen a greater shift in demand towards retailers who adopt a more ESG-friendly approach to their practices. Ethically sourced goods and a lower carbon footprint are increasingly important for consumers.
- **Demand for energy-efficient goods:** Consumer demand for more energy-efficient products is rising in response to consumers' growing awareness of energy issues and their costs, which will continue to be a primary driver of new product development and innovation.
- **Hybrid shopping:** Most consumers now engage in a hybrid approach, where a single shopping experience involves both in-store and digital presence. Many retailers are introducing new features to accommodate changing shopping habits such as click and collect services.
- **Trading down:** This will continue to be a top trend in 2023. About 38% of shoppers are already buying cheaper essential products from their usual retailers, while 13.8% are switching to cheaper chains, according to GlobalData.
- **AI and Metaverse:** Technology investment in fields like artificial intelligence or virtual and augmented reality will also become more and more crucial over the coming years. For example, Nike has recently acquired RTFKT, a brand that creates metaverse sneakers that people can use and wear in online space.

Outlook

> The outlook for 2023 is for insolvencies to increase as COVID-related government initiatives have ended and the sectoral challenges start to bite.

> Inflation is expected to continue to be a significant concern throughout 2023.

> As the cost of living rises and disposable income is squeezed, retailers focusing on big-ticket items or discretionary items will see demand falling even further.

> Despite this, the British Retail Consortium expects the growth rate of retail sales to pick up in the second half of 2023, reaching 3.6% to 4.7%.

> Retailers are unlikely to see additional support on their energy bills from April 2023 and any support is expected to be significantly reduced. This will undoubtedly put pressure on rising operating costs.

> Competition for hourly workers remains fierce, as hiring and retention of employees is an ongoing problem, forcing retailers to offer higher wages and greater flexibility.

> Given elevated cost pressures coupled with repayment of government loans, we can expect many businesses defaulting on their payment terms.

Underwriting Approach

> **Information is key:** We remain in regular dialogue with a variety of businesses across the Retail sector. We seek to obtain updated management accounts to fully understand the trading performance in the current environment and the funding facilities that are being made available to support working capital.

> **Refinancing:** When meeting with the key buyers in the Retail sector, we will seek to understand how they are mitigating inflation and the impact of increasing interest rates.

> **A case-by-case underwriting stance:** Each business is reviewed on their own financial merits.

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