

Retail update Spring 2022



Sector overview

The UK retail sector has experienced a turbulent few years, with store closures during national lockdowns, supply chain crises, Brexit red-tape, driver shortages and most recently, pressures from rising costs. Whilst there has been much relief within the sector at the ending of national lockdowns, the challenge ahead will be the rising cost of living in the UK and how this will impact consumer confidence and therefore demand in general.

Prior to the global pandemic, the retail sector was transitioning from a historically bricks and mortar dominated model, towards a more blended e-commerce and physical store model. This brought about a period of negotiation between landlords and retailers as tenants looked to restructure onerous leases. Where negotiations seemingly failed, we saw several 'landlord CVA's', which is an insolvency process that specifically targets a retailer's store portfolio. This trend has seen an increasing number of vacancies on the high-street with an estimated 50 shops closing per day. The global pandemic naturally moved more shoppers towards e-commerce, and it is likely this

will have a lasting impact on consumer behaviour with an estimated 30% of retail purchases to be made online.

There have been notable successes in the past couple of years, with those retailers allowed to remain open during lockdowns which has naturally benefited results. Equally, many retailers operating in home-improvement/entertainment or outdoor leisure experienced a spike in demand as people spent an increasing amount of time at home, or outdoors, and therefore looked to spend their disposable income with said retailers.

Notable insolvency events

Government Covid measures during 2020 and 2021 - such as furlough schemes, business loans and the closure of insolvency courts - ensured that the insolvency environment remained relatively benign. In recent years the sector has seen some notable insolvencies with such failures as: Debenhams, Arcadia, Peacocks, M&Co, Oakfurnitureland, Benson beds, Harveys Furniture, TM Lewin, Go Outdoors, Poundstretcher, Monsoon Accessorize, Oasis and Warehouse.

The outlook for 2022 is for insolvencies to increase as government Covid initiatives end and the aforementioned sectoral challenges start to bite. On the 26th of March restrictions that prevented landlords from issuing winding-up petitions against tenants ended and it is expected that this action alone will see insolvencies rise in the sector.

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Strengths

- > Businesses that can reinvest in their business model will hold an advantage over their competition. Investment in supply chain models is critical, plus the ability to operate with a more capital-intensive model, ensuring a smoother running business with a leaner cost base.
- > Retailers who can find a successful blend of having physical stores whilst also a modern e-commerce platform, will be well placed to take advantage of market movements.
- > 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.

Challenges

- > As the cost of living rises and disposable income is squeezed, retailers focussed on big ticket items or discretionary items will possibly see demand fall.
- > Supply chain management is an increasing focal point for companies. The need to modernise supply chain systems and methodologies is critical. Stock shortages or delays can have significant impact on revenues and working capital cycles so the need for a more agile and adaptable approach is vital.
- > As restrictions on landlords' ability to wind-up a tenant end, retailers with onerous leases will once again feel the pressure of needing to restructure their cost base.
- > Inflationary pressures will be keenly felt by all retailers as costs increase. A retailer's ability to pass this cost onto their customers is a key challenge for the year ahead.

Data

- > The latest data from the British Retail Consortium highlighted that footfall in February 2022 improved 2.2% compared to January as lockdowns eased and workers started returning to city centre offices; however, when compared to two years prior, footfall still fell by 14.9%.
- > PWC reported that 17,219 stores closed in the UK during 2021 with 7,160 opening, a net decrease of c.10,000 stores.
- > The ONS reported that the Consumer Price Index (CPI) rose by 5.5% in the 12-months to January 2022. This is the highest 12-month rise since records commenced in 1997. Inflation is predicted to reach levels of 7% this year as key supply chain components such as fuel costs continue to rise.
- > In March 2022 the GfK consumer confidence index fell for the fourth month running to -31 (-26 in February), the lowest level since November 2020. This was impacted by inflation, higher interest rates and the Russia/Ukraine conflict.

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

Contacts

Jamie Calder
Risk Underwriting Manager - Light
Industries
Credit & Surety Europe
QBE European Operations
Email: james.calder@uk.qbe.com

QBE European Operations

30 Fenchurch Street
London EC3M 3BD
tel +44 (0)20 7105 4000
QBEurope.com

