Another Retail Bankruptcy Wave May Be On Its Way

By **George Angelich and Brett Goodman** (July 15, 2022)

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After years of large retailers and malls struggling prior to the COVID-19 pandemic and the most vulnerable retailers filing for bankruptcy relief in its immediate wake in early 2020, the U.S. economy rebounded strongly with the aid of government assistance and low interest rates.

As a result of sustained economic growth and consumer spending, Chapter 11 bankruptcy filings, particularly those in the retail sector, reached historic lows toward the end of 2020 and through 2021.

However, certain economic changes have begun to trigger an uptick in distress across the retail sector.

Since the economy rebounded following the initial months of the pandemic consumer demand has risen while pandemic-related shutdowns have caused global supply chain issues. The costs for food, vehicles, electricity and housing, among others, have increased exponentially, causing inflation to rise at the fastest pace in 40 years.[1]

The U.S. Bureau of Labor Statistics reported that the consumer price index for all items rose 7% for the 12 months ending Dec. 31, 2021 — the largest 12 month increase since June 30, 1982 — and have continued to rise into 2022.[2]

Jobs data from the Bureau of Labor Statistics also found that while average hourly earnings rose, inflation eroded pay at the same time that consumers have taken on more debt than in any year since before the 2008 financial crisis.[3]

In a move to curb rapid inflation, the Federal Reserve System raised interest rates by 0.75 percentage point on June 15, the third rate hike this year and the largest since 1994. Even as the economy continues to slow, and recession fears mount, the Fed has signaled that another rate increase of as much as 1 percentage point is likely to come later this month in an effort to restore pricing stability.

As a result of rising interest rates, mounting consumer debt and the expiration of government stimulus credits, consumers have begun to cut back on discretionary spending in order to meet their debt obligations.

Retail sales in the U.S. fell 0.3% month over month in May, the first decline so far in 2022 despite sales at gas stations increasing due to swelling fuel prices, with regular unleaded reaching at or above $5 a gallon. The decline follows a downwardly revised 0.7% increase in April, as inflation, gasoline prices and borrowing costs hurt spending on nonessential goods.

Auto sales recorded the biggest decline, and sales also fell at electronics and appliance stores, miscellaneous store retailers, nonstore retailers, furniture stores, and health and personal care stores.[4]

However, retail sales in the U.S. jumped 1% month over month in June, beating forecasts of a 0.8% gain, and recovering from an upwardly revised 0.1% drop in May.

The June sales figures showed that consumer spending remained robust but also reflected an increase in prices for goods and services. Excluding automobiles, gasoline, building materials and food services, core retail sales rose 0.8% in June, after a 0.3% drop in May.[5]

In addition, as inflation continues to erode pay, consumers, who have weathered the inflation wave using savings and credit card debt to adjust for higher costs, are likely to begin pulling back on spending over the second half of 2022. As a result, retailers may be forced to make difficult decisions in this new environment, including reverting to various forms of discounting measures in order to fight for market share.

Rising inventory levels also have the potential to lead to problems for retailers sitting on product due to supply chain disruptions. Retailers, including Gap Inc., Abercrombie & Fitch Co. and Kohl's Corp., have announced that they have too much inventory after shipments arrived late and consumers changed shopping patterns.

As the holiday season approaches, these factors could create distress across the industry going into early 2023. Direct manufacturers, as well as suppliers to producers of retail goods, should be cautioned by the backlog of certain retailers' inventory levels and monitor their production risks accordingly in the current climate.

Moreover, despite the creation of a record number of jobs in 2021, retailers have struggled to find employees for their stores or warehouses.

While these staffing shortages have caused distribution, inventory and operational problems for retailers of all sizes, smaller retailers have struggled disproportionately with their ability to combat labor issues, supply chain disruptions, manufacturer preferences and inflation when compared to larger retailers.[6]

Despite the low number of retail bankruptcy filings in the second half of 2021 and through the first half of 2022, record high inflation, increased inventory levels and a potential recession could result in an increase in distressed retailers seeking bankruptcy protection.

Last month, cosmetics giant Revlon Inc. became the first consumer brand to seek bankruptcy protection in several months. Revlon cited a need to reorganize due to its troubled capital structure and struggles with supply chain and inflation issues.

A number of struggling drug stores, apparel retailers and department stores have also announced efforts to right-size and close stores. In fact, Rite Aid Corp. announced the results of its fiscal fourth quarter earnings in April, and reported that it plans to generate $170 million in cost savings during the next fiscal year through, among other things, the closing of 145 unprofitable stores.[7]

Rite Aid also received a FRISK score of 1 from Creditriskmonitor.com Inc., the lowest score available indicating the highest risk for bankruptcy.[8] At the end of 2021, CVS Health Corp. also announced its plans to close 300 stores per year between 2022 and 2024 as part of a shift to e-commerce.[9]

In the apparel space, American Eagle Outfitters Inc. announced its plans to close 225 stores in January.[10]

Other notable retailers to watch include Party City Corp. and The RealReal Inc., each having carried a FRISK score of 2, as well as Serta Simmons Bedding LLC, Rodan & Fields LLC, Anastasia Beverly Hills LLC, Isagenix International LLC, various Chapter 22 candidates — those retailers that recently emerged from a Chapter 11 bankruptcy and could refile — and certain movie theater and fitness center chains.[11]

While bankruptcy filings continue to remain low, the combination of continuing inflation, rising interest rates, supply chain disruptions, labor issues, consumer debt and spending, and the expiration of government assistance may create another wave of distress and bankruptcy.

Retailers, landlords, manufacturers, vendors and lenders should remain nimble and consider alternatives to be prepared for the changing economic climate and its impact on consumer spending habits and retail operations across the sector.

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[1] See David Berliner, Retail In The Red: BDO Bi-Annual Bankruptcy Update, An Overview of U.S. Retail Bankruptcies, Store Openings and Closing in the Second Half of 2021, March 2022, BDO United States, https://www.bdo.com/insights/industries/retail-consumer-products/retail-in-the-red-bdo-bi-annual-bankruptcy-upd-(5).

[2] Id.

[3] Id.

[4] U.S. CENSUS BUREAU, CB22-98US, ADVANCE MONTHLY SALES FOR RETAIL AND FOOD SERVICES, MAY 2022 (June 15, 2022), available at https://www.census.gov/retail/marts/www/marts_current.pdf.

[5] See U.S. CENSUS BUREAU, CB22-113, ADVANCE MONTHLY SALES FOR RETAIL AND FOOD SERVICES, JUNE 2022 (July 15, 2022); U.S. Retail Sales – June 2022 Data, TRADINGECONOMICS.COM, https://tradingeconomics.com/united-states/retail-sales (lasted visited July 15, 2022).

[6] See Berliner, supra.

[7] Bloomberg, Rite Aid Corporation Reports Strong Fiscal 2022 Fourth Quarter and Full Year Results and Provides Fiscal 2023 Outlook, Apr. 14, 2022, https://www.bloomberg.com/press-releases/2022-04-14/rite-aid-corporation-reports-strong-fiscal-2022-fourth-quarter-and-full-year-results-and-provides-fiscal-2023-outlook.

[8] Marshall Kay, Will Any Retailers File For Chapter 22 In 2022?, Forbes, Feb. 24, 2022, https://www.forbes.com/sites/marshallkay/2022/02/24/will-any-retailers-file-for-chapter-22-in-2022/?sh=75cf5bf72aa2.

[9] Jordan Valinsky, CVS is closing 900 stores, CNN Business, Nov. 18,

2021, https://www.cnn.com/2021/11/18/investing/cvs-store-closures/index.html.

[10] See Berliner, supra.

[11] See Kay, supra.