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SMARTER PERSPECTIVE: RETAIL INDUSTRY

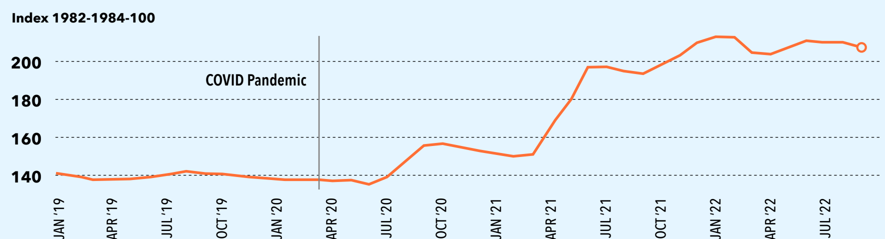
2022 Has Been a Near-Perfect Economic Storm but Partly Sunny Skies May Be in the Forecast

By Ian Fredericks

Early 2022 was characterized by a high level of consumer demand, still relatively reasonable fuel prices and continued low interest rates. This continued to drive a continued high level of demand for consumer goods and renewed spending on experiences such as vacations and events, which had been largely inaccessible to consumers from early 2020 through most of 2021. Meanwhile, supply chain constraints persisting from the impacts of COVID continued to limit production and associated supply across multiple industries, further inflating prices beyond 2021. One of the most visible examples of these impacts was the automotive industry, where a trickle of new car production met by high demand also resulted in accelerated used car inventory depletion despite higher than normal prices.

Used Car Prices Are Falling Slowly

Used car prices are starting to fall back after soaring last year.



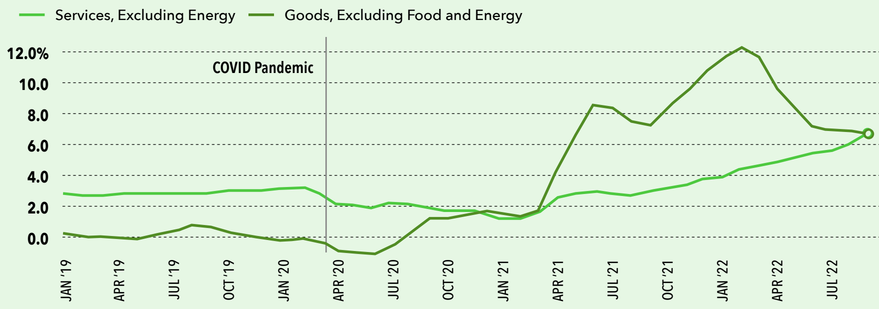
Source: Bureau of Labor Statistics Consumer Price Index for all urban consumers: Used cars and trucks in U.S. city average, seasonally adjusted.

Anticipation of coming interest rate increases and a new level of work-from-anywhere flexibility being realized, and acted upon, by working individuals and families also led to a prolific level of home sales at record high prices in desirable relocation areas such Florida, Arizona and Tennessee. Prices were boosted in part by the continued high cost of construction materials, including lumber and a shortage of labor up and down the supply chain. Many consumers also scrambled to locate vehicles for purchase or lease in order to lock in lower monthly payment rates, only to find their local dealerships had tacked on innocuous "COVID-19" and "Vehicle Acquisition" fees, in some cases adding thousands of dollars to a vehicle's price.

Once the Fed took decisive action to attempt to stem inflation toward the end of Q1 2022, the game started to change. Rates surged from near 3% to close to 7%. Fuel prices driven by OPEC actions rose sharply adding to consumer road and air travel costs. These have remained elevated but with some relief. Across durable and non-durable goods, consumers witnessed prices skyrocket on virtually everything from milk and perishables to appliances and furniture. While these have since receded somewhat over the course of this year, service prices – including rents and medical services – have risen quickly to meet them.

Services Prices Accelerating as Goods Prices Fall

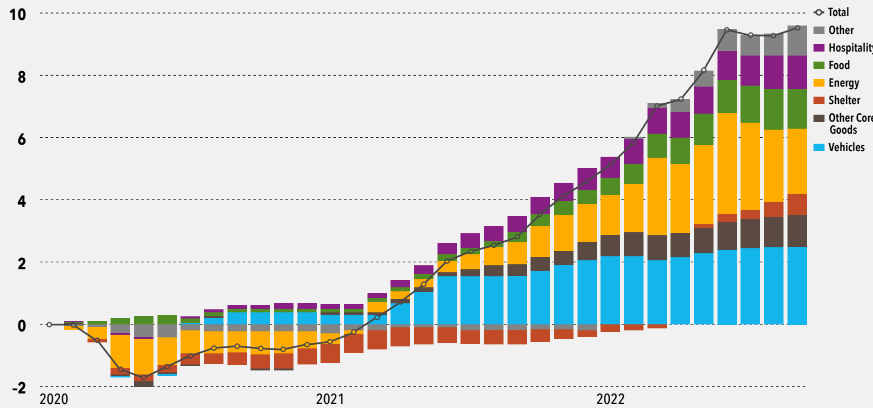
The cost of rents, medical services, and other services are now rising as quickly as for goods.



Consumer Price Index for all urban consumers: Services less energy services in U.S. city average, and commodities less food and energy commodities in U.S. city average. Seasonal Adjustment. Percent change from year ago

Source: Bureau of Labor Statistics

CPI Excess Inflation, % Contribution



Source: Morningstar

SO WHAT'S ON TAP FOR 2023 AND BEYOND?

While inflation in the short term continues to be a daunting factor, we do not expect this to lead to what might be termed a classic "recession" in the year ahead. Why this partly sunny forecast? For starters, despite economic headwinds, unemployment remains historically low and there are millions of open jobs across the country and consumer spending remains strong. We also continue to see wage inflation and available capital – albeit more expensive capital.

SO WHAT CAN WE EXPECT?

Partly sunny by its very nature also means partly cloudy, and it is true that inflation is not going away anytime soon. Most notably, this is due to the fact that the government printed money at unprecedented levels. We saw similar inflation in the 1970s when President Nixon removed us from the gold standard. Afterall, transitory inflation – as Federal Reserve Chairman Powell initially referred to it – should recede once the variables causing the inflation are removed, such as supply chain disruption. Even though ports have become less crowded and container prices have dropped, inflation has not subsided. Indeed, when you combine the prior two years of inflation by month, you will see that the 2 year trend has remained almost flat over the course of the last six months.

Moreover, with a shift to onshore more manufacturing both by the U.S., right here in North America, as well as by countries elsewhere around the world, we will continue to experience transitory inflation as companies seek to build new facilities and hire more employees. Compound that with the ongoing retirement of the baby boomers, and we should expect inflation to remain above the Federal Reserve's 2% annual target for some time.

Stock Outs

These should be anticipated on items ranging from apparel to automobiles. As we transition to a period of deglobalization, the wonderful world of "always in stock" is, sadly, behind us and may never return.

Political Gridlock

Republicans have retaken the house, while Democrats retained the senate in the recent November elections. A divided government translates to low likelihood of any forthcoming government bailouts. Even if government was not divided, printing money partially created this problem and printing more money will only make it worse.

Interest Rate Increases

The Fed is on a mission and has stated its position clearly. By committing to raising rates "forcefully and thoughtfully," they have put the country on alert that while painful, these incremental steps are necessary and should be expected moving forward. Unfortunately, raising interest rates and time are the only obvious solutions presently available.

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So What Steps Should Be Taken By Retail Operators Given This Outlook?

At the present time, we are advising our clients to plan accordingly and make some relatively tough decisions now rather than push them out. These include:

Shore Up Your Liquidity

The availability of capital remains fairly robust, but there is no guarantee that will last. Moreover, if the holiday season is weak, it will make it much harder to secure additional liquidity. Even though there isn't much time left, start this process NOW!

Conducting SKU Rationalization

Trim the number of SKUs. Consumers are now being conditioned to the fact that they cannot always get what they want when they want it. This is a shift from the previous norm. We encourage retailers to lean into this now by focusing on SKUs that are known to drive sales and margin. Post-holiday clearance season can be used as an opportunity to get rid of filler SKUs and slow movers.

Making Technology Enhancements

Labor challenges are not going away and many operators will find it necessary to conduct some level of RIFs. We have already seen this in the tech sector. Importantly, there are easy-to-implement enterprise technology enhancements, such as one offered by ReStore for Retail, that can make labor more efficient in a relatively short timeframe and at reasonable cost, without the need for painstaking IT integration. This can help minimize the extent of RIFs required moving ahead and enable valued store and other personnel, in whom operators have invested significantly over time, to remain onboard. The key to success here is to be ready to make some changes in a thoughtful and strategic way without hesitation, STARTING NOW.

Becoming Lean & Mean

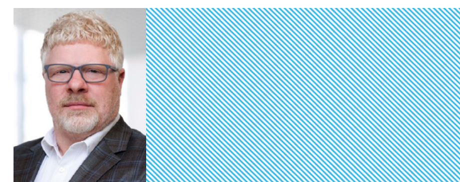
There is still time to plan now for next year. Use the remaining weeks of 2022 to closely scrutinize store performance and if some are losing money now, think seriously about closing them quickly as they are not likely to start miraculously making money next year. Now is also not the time for big, flashy changes to your business that have unproven revenue and profitability potential and require capital. That will be expensive. Instead, go back to basics. Think retail 101 and focus on helping frontline employees in the stores. Those individuals drive sales more than anyone, or anything, else. Lean into them and ask what changes or enhancements they believe would help them become better at their jobs.

Shifting the E-Commerce Mindset

It may be hard to accept after so much focus and hope has been heaped upon it, but e-Commerce is not a universal solution to current retail challenges. In fact, everything about it has and will become even more expensive. Shifting time and money away from trying to "win at e-commerce," and viewing it instead as just one more store, can enable an operator to manage the channel in much the same manner as other individual store locations. Just like other stores, it needs to run profitably and any number of costs need to be considered in assessing that profitability. There are, of course, ways to run e-commerce profitability as a component of a larger business. Doing so requires leveraging other parts of the business – namely an operators physical store locations – properly. Importantly, this requires thought and planning, not just a decision to place more responsibility on the same teams in the stores. Consider the fact that those teams might need to be expanded and given more resources/tools to make the overall effort successful.

We'll build on thoughts presented here and provide more details on tackling these and other tough challenges currently facing operators in our next Perspectives article early in 2023. In the meantime, if your operation or retailers in your portfolio of companies are facing challenges in these partly sunny/partly cloudy days, we encourage you to reach out to our team at Hilco for a discussion. We are here to help.

Hilco Retail Group offers broad and deep expertise in all retail sectors. Our seasoned professionals deliver a wide range of analytical, advisory, asset monetization, and capital investment solutions to help define and execute client strategic initiatives.



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After a successful career as a stressed and distressed Mergers and Acquisitions and Corporate Restructuring attorney, Ian joined Hilco in 2011 and has been an instrumental part of the growth of Hilco's retail, lending, and technology offerings. Since joining Hilco, Ian was awarded the M&A Advisors' Future Leaders award in 2017, and has focused on the overall growth of the organization, including co-founding ReStore Capital with Ben Nortman in 2019 and co-founding ReStore for Retail a retail SaaS platform. Over the course of his career, Ian has negotiated and closed transactions involving tens of billions of dollars of assets. Among an expansive list of other work, Ian is credited as one of the principal architects of the transaction to save Aeropostale. Contact Ian at ifredericks@hilcoglobal.com or 847.418.2075.