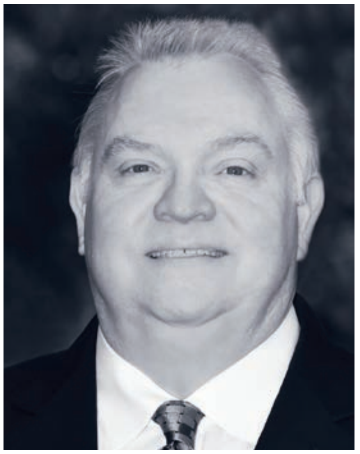
FEATURE STORY

The State of Retail:
How Did We Get Here and What's on the Horizon?

BY CASSIE ROSENTHAL

While retail data reported at the mid-summer mark pointed to a strong labor market, steady consumer spending in certain categories and retail sales up from last year for several straight months, the data only tells one side of the story. The numbers are merely inching forward, as growth across many sectors has been sluggish, if not altogether flat. This year has unexpectedly been a mixed bag for the retail and credit market, and with continued volatility and an overall lackluster economic forecast, businesses and lenders must be prepared for any scenario.

A seasoned team of commercial finance experts from Rosenthal & Rosenthal joined *The Secured Lender* for a roundtable discussion on the current state of the retail and credit market and its impact on factoring, asset-based lending and purchase ordering financing. Rosenthal's EVP and head of credit, Anthony Verrilli, and three of the firm's portfolio managers, Derek Sigler (EVP, Northeast Region portfolio manager), Bertie Pujji (EVP, Western Region portfolio manager) and Kirk Brown (EVP, Southeast Region portfolio manager) shared their observations and insights on the challenges clients and prospects are facing in the current economic climate and how they are responding. With a unique vantage point spanning multiple industries and geographic regions, the Rosenthal team weighed in on where we are right now, what we can expect to see more of in the second half of 2023 and how we should be preparing as we look ahead to 2024.



KIRK BROWN
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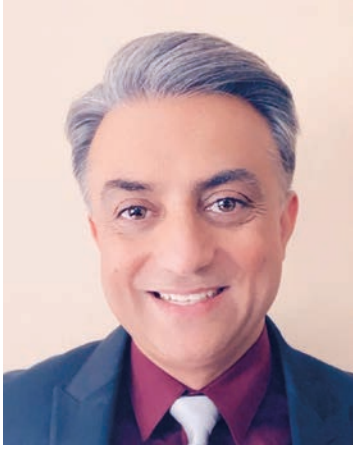

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Where We Are Now is Not Where We Thought We Would Be

What are you seeing and hearing about the credit environment right now and how is it impacting the retail sector?

Verrilli: Most economists covering retail thought we'd be in a better place than we are. Rising interest rates are affecting everyone – consumers, manufacturers and retailers alike. And having to borrow money at more than twice what it cost to borrow two years ago really puts a damper on liquidity.

Sigler: The outlook going into 2023 was mostly positive and borrowers were excited about lower freight costs, better pricing and what we hoped would be increased demand. Activity was expected to pick up by now, but things are still very sluggish. It's looking more and more like it won't be until the second half of 2024 before things bounce back.

Pujji: Consumer demand continues to be weak in many industries and sales for most clients are way down, neither of which we expect to improve this year. That, coupled with the cost of borrowing being through the roof, and clients are really seeing a hit to their bottom line.

How are inventory issues playing into the current dynamic?

Brown: Many retailers have adopted a "wait and see" attitude, which, given the circumstances, makes a lot of sense. They're remaining very cautious and don't want an influx of inventory like they had during and after the pandemic, so they're pushing back on clients. For example, furniture and home furnishings was one of the most robust sectors over the last few years and now it is really taking a hit. Inventory has more or less been rightsized and higher-cost inventory has been pushed out. But even though inbound freight costs are significantly lower than they had been, there is still a lot of hesitation around adding new inventory to the mix.

Pujji: The businesses who have been effectively managing inventory are now being rewarded. By contrast, those who didn't manage inventory well are now giving out heavy discounts to retailers to shed their excess inventory and losing money in the process. Retailers are pushing out their orders and being more careful about placing new orders. Those retailers struggled with their own inventory issues last year, most of which have improved, but many are still spooked.

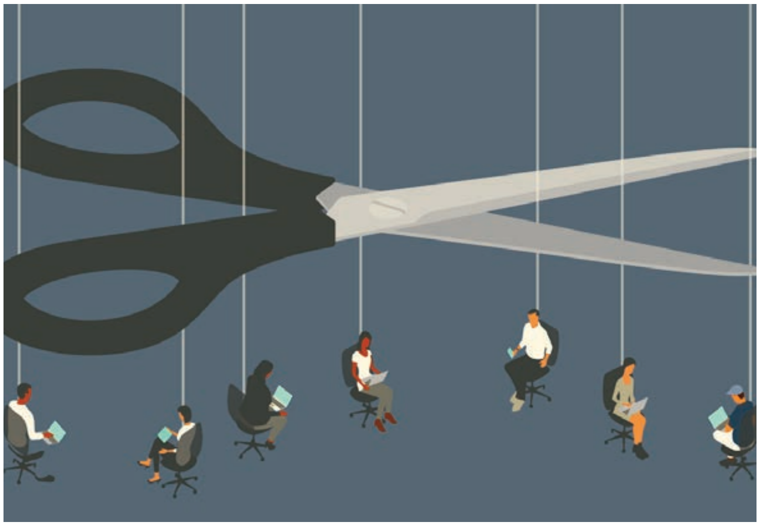
ANTHONY VERRILLI
Rosenthal & Rosenthal

Verrilli: When you look at the inventory positions of retailers, it's really a mixed bag. Some who had struggled with high freight costs, port issues and supply chain disruptions got smart and dumped their inventory quickly, while other less-progressive retailers got stuck with it. Many are more conservative and are buying leaner and meaner, sometimes to a fault. But without enough inventory on the shelves, it's been difficult to bring customers back to the stores, so it's a bit of a Catch 22.

Brown: The supply side has also shifted dramatically. A few years ago, it was nearly impossible to get products on a ship overseas and now it's hard to find one that's full enough to leave the port. Oftentimes, product will arrive at an overseas port and it will sit on the ship for 4-5 weeks before leaving. Those delays aren't just frustrating the retailers, but consumers too.

How are clients responding to these challenges?

Sigler: Some clients are mitigating the lower sales by adding new licenses or seeking acquisitions to break into new customers and cross sell existing product. Some are exploring DTC, but if they don't already have that expertise, they would prefer to acquire a company that has the experience and the reach already. The businesses that learned how to pivot are the ones that are staying afloat through this uncertain period. They've faced a lot of hurdles these last few years—COVID, supply chain disruptions, port closures—and that has made them more resilient.



The biggest hope now is for lower interest rates to kick in, but I don't see that happening anytime soon either. These high rates are here to stay and, as a result, it's going to be very difficult to jump start the industry now or even in 2024. In fact, it's likely that a real recession is brewing on the horizon.

Pujji: Generally, we're seeing that private label is doing better than brands, unless it's a very established brand. The health and beauty segment does not seem to be impacted as much as other sectors, but that may be because they have better margins to begin with and more room for marketing and social promotion. But that industry is really an outlier. Just look at apparel and you'll see how poor the demand is.

Second Half of 2023: More of the Same

Without much hope of things improving in the latter half of 2023, what should clients be focused on?

Sigler: As a lender, it's our job to monitor the profitability of a business and how they're reacting to lower sales volume. Our most successful clients are the ones that are nimble and that adjust accordingly when they need to.

Brown: Clients should really know their financing options. In a tricky environment like this, we've seen credit insurers pull back and banks draw a line in the sand when it comes to advancing on collateral other than receivables. Reliance on inventory has increased in this category because banks have said they're not going to leverage into inventory to supplement liquidity, and many stopped altogether. Independent alternative lenders like Rosenthal are fortunate that they can lend to many of these clients when bank financing is no longer feasible.

Verrilli: We're collateral lenders and because we're not bank-owned, we are uniquely positioned to support businesses in this environment. What a bank might classify as a risky loan, might not be as risky to Rosenthal because we have adequate collateral that we can turn into cash. With rising interest rates, non-bank lenders are well positioned in this climate because speed and flexibility are paramount.

Sigler: Our clients have learned their lessons and have gotten much better at reading the tea leaves. If volume is down, that's not the time to bring in more inventory. We're seeing an uptick in buying against confirmed orders, which allows clients to react quickly if there's a credit risk or another issue. As a factor, we have direct access to customer portals and can monitor AR performance in real-time and change course if there is a credit or collection issue.

Do you predict it will be more of the same for the rest of 2023?

Pujji: It's become very difficult to predict what will ultimately sell, which has made retailers hesitant about building up their inventory. The summer season was a good test. We saw a lot of push back from retailers when it came to summer-related apparel and other goods. So, it will be interesting to see what happens with winter and holiday goods over the next few months and whether they get pushed out too.

Brown: What's happening in furniture is another good indicator. Thirty percent of Rosenthal's business in home furnishings is container direct, meaning large containers out of Asia shipped direct to retailers. But no one is betting on inventory like that right now, so that segment of the home furnishings sector has become painfully slow. Just recently, we started seeing orders for containers for late Q4 2023 in anticipation of some pick-up in the first part of 2024. But it's still too early to tell if that will be a one-off or the spark the industry needs to restart growth in the sector.

Looking Ahead: What 2024 Will Bring is Anyone's Guess

Given where we are today, what can we expect for the early part of 2024?

Pujji: With losses and higher inventory levels, banks are getting concerned. Clients that have a good balance sheet, but have higher inventory levels and show a loss from last year, are getting pushed out of their bank lending relationships, but lenders like Rosenthal are often able to look beyond the loss and see the whole picture. As a result, I expect we'll see more clients looking for alternatives to bank financing as we head into 2024.

Verrilli: The public has a rather poor perception of the state of the economy right now. Consumers may be more inclined to save money than to spend it. If morale increases, you might see an uptick in activity in 2024, but I don't see us turning the corner that quickly. Also, in an election year, when an incumbent candidate is polling so low, you may often see an effort by the government to get more disposable income in the hands of lower- and middle-class voters for political purposes.

Brown: The biggest hope now is for lower interest rates to kick in, but I don't see that happening anytime soon either. These high rates are here to stay and, as a result, it's going to be very difficult to jump start the industry now or even in 2024. In fact, it's likely that a real recession is brewing on the horizon. If it gets to that, unemployment will rise, costs will fall, wage inflation will ease up. With no supply side, demand will weaken and prices will start to drop, inflation will stall out and the economy will come to a grinding halt. Unfortunately, that's the kind of seismic shift that may be required to jumpstart the economy and kickstart the retail sector again. As frightening as it sounds, that scenario may not be that far off.

How should clients prepare for what will clearly be a long haul in 2024?

Brown: For lenders, it's important to remember that while a challenging market like this can certainly create opportunities, it can also be dangerous depending on how much risk you take on. We need to be mindful of how much risk we're willing to take on and who we choose to partner with. As a lender, you never want to be caught in an upside down situation.

Pujji: My advice to clients in this climate is to watch your inventory carefully and pay close attention to your overhead. Continuing to monitor inventory effectively will be the key to whether businesses will survive this period. I also tell clients to continue to find ways to pursue new growth opportunities, even if it feels like they don't exist. For example, to help mitigate a downturn in sales, many clients are looking to align with other brands and licenses to win more market share. If they already have a platform and can put that brand or license in their existing platform, it's an easy way to grow their business and bottom line.

Sigler: Now is the time to be more conservative and mindful of inventory and the cost of running a business. Proper inventory management and reporting is critical. Clients should monitor the fees being incurred for holding onto slow-moving inventory. It is probably not the time to make big purchases trying to swing for the fences.

Cassie Rosenthal is the chief marketing officer and executive vice president with Rosenthal & Rosenthal, managing both business development strategy and marketing efforts for the company. She led the efforts to revamp the firm's branding, website, content, social media, messaging and develop its first client mobile app. She has also been instrumental in developing and launching Pipeline, Rosenthal's newest division focused on e-commerce and direct-to-consumer companies.

Prior to joining her family's business in 2012, Rosenthal co-owned and operated two art galleries (Goff + Rosenthal) for a decade, one in New York and one in Berlin. She serves as president of the Board of Directors for Women Helping Other Women (WHOW), a charitable professional networking group that helps women and children in need, and is Co-Founder of BABE, a networking community for women executives, business owners and entrepreneurs. She is also a former board member and champion of Let's Get Ready, a nonprofit supporting first generation college-bound men and women and low-income high school students through the college-going process.

Rosenthal is on the board of the New York Institute of Credit (NYIC) and was the inaugural recipient of the NYIC's Women's Division Renaissance Award. She has been featured in The Wall Street Journal, The New York Times, WWD and Footwear News and has appeared on BBC Radio and CNBC. Rosenthal received a BA from Colgate University and a master's in art history from the Sotheby's Institute in London.