INSIGHT REPORT

US Store Closures 2019 Outlook: No Light at the End of the Tunnel

Coresight Research tracked 5,524 U.S. store-closure announcements in 2018. While this figure was down 32% from the prior year, the number of store closure announcements so far in 2019 is up 23% versus this time last year, with potentially many more on the way due to companies currently in the bankruptcy process and more on the horizon. This report analyzes drivers of store closures, including the following factors:

- E-commerce continues its relentless share gains in retail, and market forecasts call for this rate to accelerate.
- Consumer retail spending remains at a high rate, so spending can only decrease from "peak retail."
- Retailers in the U.S. continue to open stores at a rapid pace despite flattish store-based retail sales per capita.
- Interest rates continue to rise in the U.S., putting increasing pressure on retailers with high debt loads.
- Retail bankruptcies continue at a rapid pace, with the number of filings in the first six weeks of 2019 already at one-third of last year's total.

Executive Summary

Coresight Research expects store closures in 2019 to look a lot like store closures in 2017–2018.

Surprisingly, extreme disruption continues in the retail sector amid a time of bounty. According to the recent forecast from the National Retail Federation (NRF), U.S. retail sales grew 4.6% in 2018, exceeding its 4.5% forecast, and the NRF forecasts that retail sales will grow 3.8–4.4% in 2019, both ahead of the Fed's estimate for U.S. GDP of 3.0% in 2018 and forecast of 2.3% in 2019. The near-perfect state of U.S. employment, income, and GDP has led many to conclude that the current environment represents "peak retail," i.e., this is the best environment that retail sales can experience within the constraints of the U.S. economy.

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Despite this near-ideal environment, its benefits are not being enjoyed equally, with some retailers flourishing and others languishing. In stark contrast to the NRF's projection of a 4.3-4.8% increase in holiday sales, several major department stores posted holiday sales gains of under 1.5%, although Target posted a sales gain of 5.7%.

At the time of this report's writing, five companies in the consumer discretionary sector have filed for bankruptcy, Sears was working its way through the bankruptcy process, and there are expectations of other large retailers filing for Chapter 11 in the coming months.

One and a half months into 2019, U.S. retailers have announcements of 1,678 store closures, which, annualized, would equal roughly double the 5,500-7,000 store closures announced in 2017-2018.

The flood of store closures will likely continue for quite some dime due to the following factors:

1) E-commerce continuing to take share from brick-and-mortar retail.
2) A continuing excess of store locations in the U.S. (exacerbated by item #1).
3) Weak financial conditions among retailers, owning to high debt levels.

The above factors are additive in terms of store closures. The relentless encroachment of e-commerce and saturation can push stores to be low-margin or even loss making, leading to closures. A single retailer bankruptcy can mean a large number of closures. And, the mechanics of the bankruptcy process has changed so creditors often choose to liquidate completely rather than repair, which results in 100% of a retailer's stores being closed.

On a positive note, the huge number of store closures was partly offset by openings: New openings amounted to about 65% the number of store closings in 2018, although dollar and discount stores accounted for the majority of openings, while the majority of closures were apparel specialist stores.

Given disparate performance under optimal economic conditions, there is likely to be a shakeout if the economy turns down, as the negative effects are magnified by the excessive debt many companies carry on their balance sheets.

Outlook for Store Closings

Store closure announcements peaked at 8,139 in 2017 with a further 5,524 closures in 2018; and they are off to a strong start in 2019. The slowdown in the rate of store closures appears to have reversed thus far in 2019: the number of store closures decreased 30% in 2018, but has increased 23% year to date. These figures are also highly dependent on the individual retailer. While our year-to-date figure includes 72 stores for Sears, it operated 1,002 stores as of February 2, 2019, according to S&P Capital IQ, and the status of these stores could quickly change depending on how bankruptcy proceedings go, dramatically affecting the total.

The table below summarizes factors influencing store closures this year, which shows predominantly negative factors for store closures in 2019.

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Figure 1. Summary of Factors Influencing Store Closures

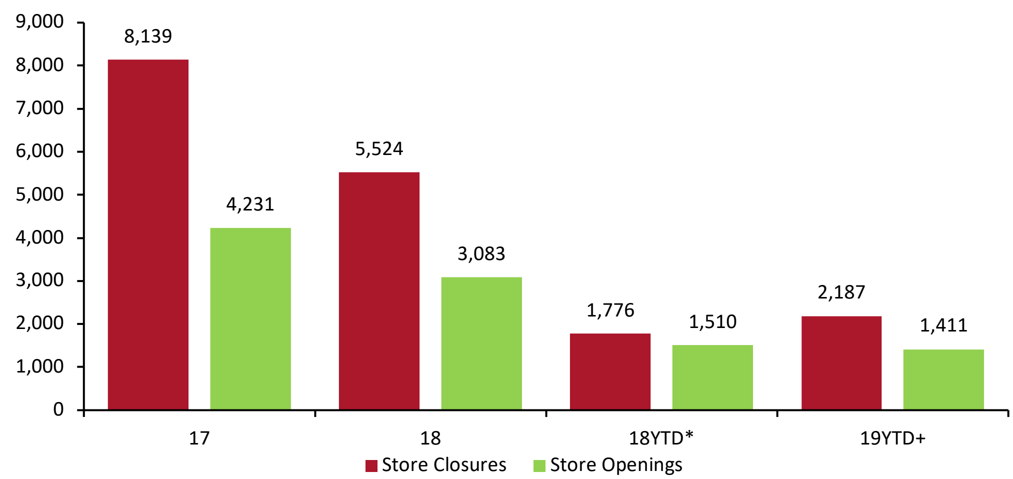
Item	Influence	Commentary
E-commerce	↓	E-commerce penetration appears to be accelerating
Macroeconomy	↔	Economy still offering peak retail conditions
Store saturation	↓	Store count continues to rise despite flat-to-down retail sales per capita
Interest rates	↓	Rising interest rates place a greater burden on indebted retailers
Bankruptcies	↓	Retail bankruptcies are already at one third of last year's level

Source: Coresight Research

Year-to-Date Store Closings

There have been 2,187 U.S. store closing announcements thus far in 2019, with Gymboree (749) and Ascena Retail (400) accounting for more than half the total. This year's total is up 23% from the 1,776 announcements a year ago. Year-to-date, retailers have announced 1,411 store openings, offsetting 65% of store closures.

Figure 2. US Retail Store Closure Announcements



** Through 2/9/18.*
+ Through 2/8/19.
Source: Company reports/Coresight Research.

U.S. store closures in 2018 were led by apparel specialist stores, with 766 closures, whereas general-merchandise stores (led by dollar stores) led store openings in the year. Figure 9 in the appendix illustrates 2018 store openings by sector side-by-side.

Drivers of Store Closings

There are several reasons a retailer might want to close stores, even simply for profit-margin maximization. Below, we discuss the key drivers of U.S. retail closings, which include:

- The relentless encroachment of e-commerce
- An excess of stores in the U.S.
- Over-indebtedness or retailers

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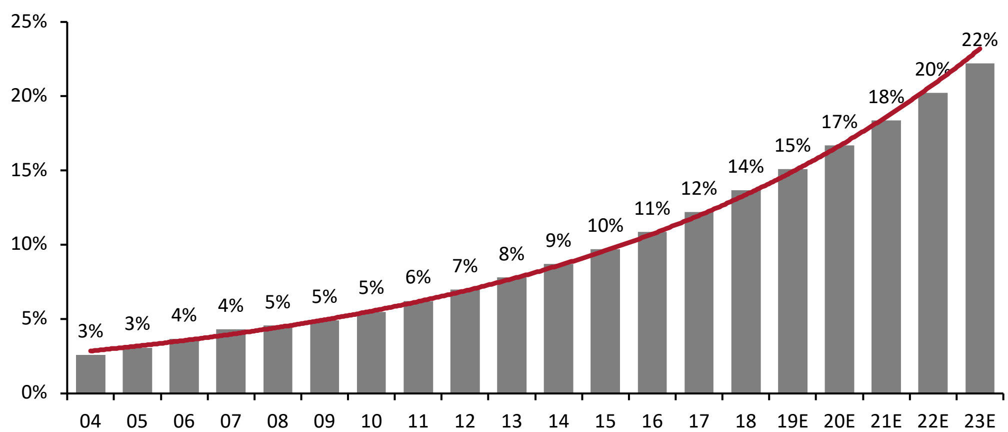
Encroachment of E-Commerce

E-commerce continues its relentless march, gaining share of total retail, putting steady pressure on all types of retailers, both in terms of evaporating demand and increasing financial pressure. The graph below shows e-commerce's share of total retail sales, in which the penetration of e-commerce appears to be accelerating. In many retail sectors, such as apparel, e-commerce's share is even higher. In certain sectors, the Internet's share is even higher: Internet-based retailing accounted for 21.9% of apparel and footwear sales in 2018, according to Euromonitor.

Figure 3. Internet Share of Retail Sales



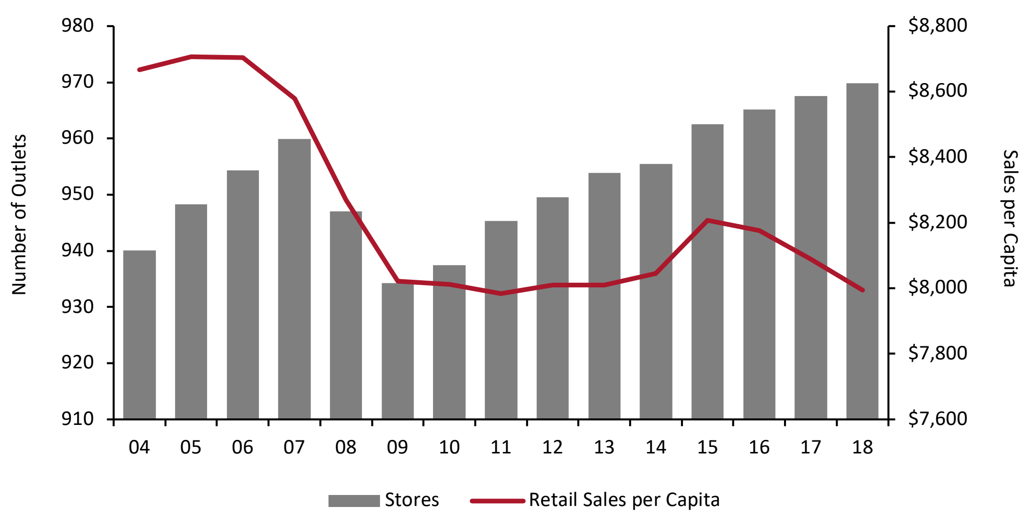
Source: Euromonitor International/Coresight Research.

The US Remains Overstored

The U.S. has significantly more retail space per person than most countries, with 23.5 square feet per capita versus 16.4 square feet in Canada and 11.1 in Australia, according to a 2016 report from Morningstar.

The figure below shows a dramatic increase in U.S. retail outlets during 2004–2017, which retreated during the Global Financial Crisis, before increasing again and setting new records starting in 2015. At the same time, in-store retail sales per capita declined sharply through 2009 and have been flattish, though with some ups and downs, with declines during 2016–2018.

Figure 4. Number of Retail Outlets (Thousands) Versus Store-Based Retail Sales per Capita



Note: Figures in fixed 2018 dollars.
Source: Euromonitor International.

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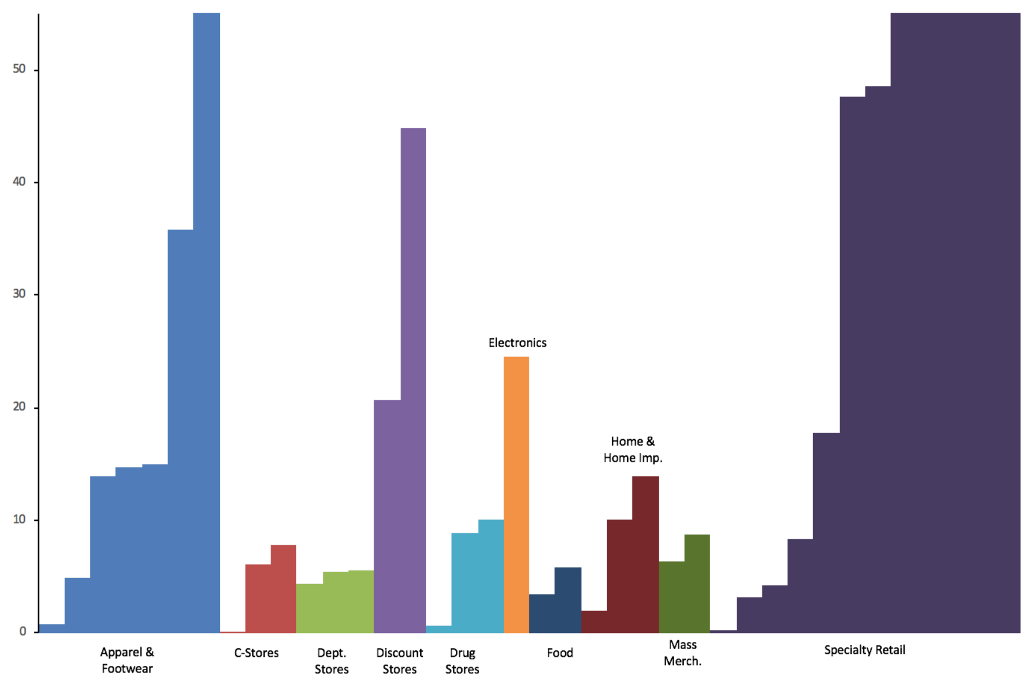
High Debt Levels in a Rising Interest-Rate Environment
Debt is a double-edged sword: Companies (and retailers) can access cheap funding when economies are strong and lending standards are loosened, and debt is a primary financing medium for private equity. However, debt can come back to bite a company during an economic downturn, or in a dynamic environment under pressure, such as e-commerce's relentless attack on retail.

The figure below shows interest coverage ratios for selected retailers, grouped by sector. The metric is defined as earnings before interest and taxes (EBIT), divided by total interest payable, also known as times interest earned representing the number of times operating earnings can pay interest expense. A ratio below 2.0 is considered a warning sign, and a ratio below 1.0 indicates that a company has insufficient operating earnings to cover its interest payments, and there are four retailers in the graph that have interest-coverage ratios below 1.0. Retailers with negative operating earnings are not included in the graph, and their outlooks are even more unfavorable.

Figure 5. Interest Coverage Ratios for Selected Retailers, by Sector



Note: Each vertical bar represents one company within its respective segment. The graph has been truncated at the high end to improve readability.
Source: Bloomberg/Coresight Research.

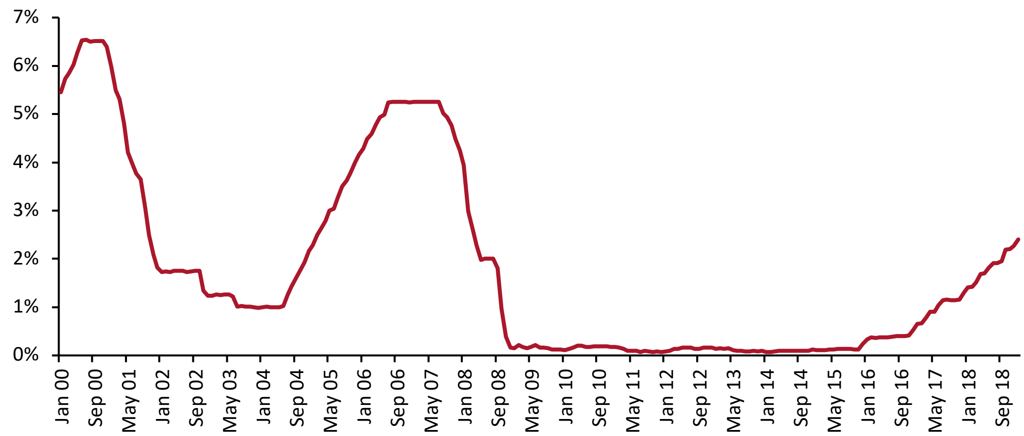
In the current environment of rising interest rates, retailers with insufficient operating earnings will face challenges making payments on their debt.

After several years of near-0% interest rates aimed at combating the Global Financial Crisis (GFC), the U.S. Federal Reserve has embarked on a steady stream of interest rate increases, raising the benchmark for federal funds to 2.25-2.5%, still above the 2.40% in January 2019.

The language from the most recent Fed meeting in January 2019 called for being "patient" on future rate hikes, following previous plans for two subsequent rate hikes in 2019. These targets were based on the Fed's estimate for 3% GDP growth in 2018 and 2.3% in 2019 (down 20 basis points from the previous estimate), alongside a long-run estimate for GDP growth of 1.9% (up 10 basis points from the previous estimate).

The graph below shows the roughly 200-basis point rise in interest rates from 0.41% in November 2016 to 2.40% currently.

Figure 6. Effective Federal Funds Rate (%; Jan. 2019 = 2.40%)

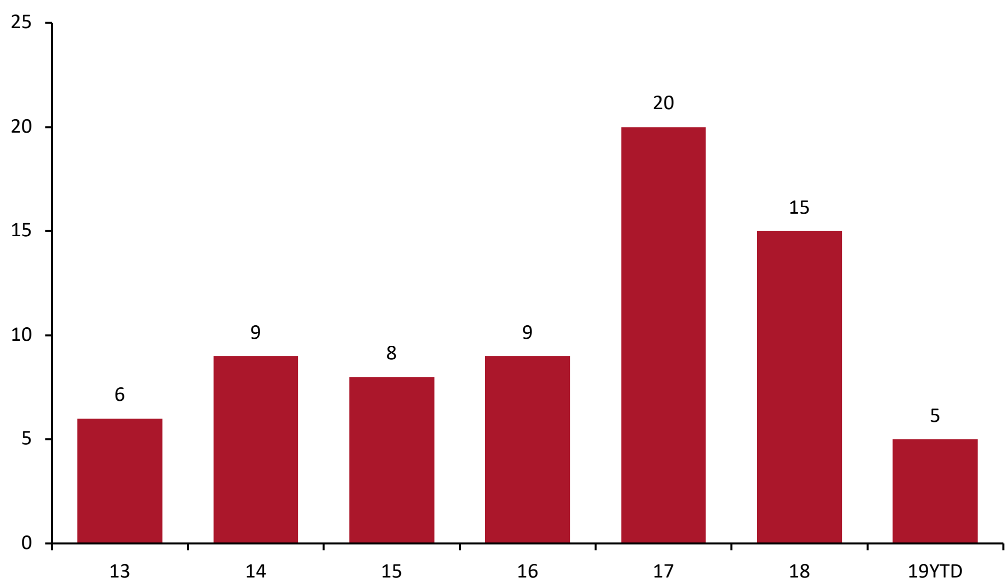


Source: Board of Governors of the Federal Reserve System (U.S.).

The Multiplier Effect of Bankruptcies

Bankruptcies in the consumer discretionary sector numbered in the single digits during 2013–2016. However, the total climbed into the teens during 2017–2018, and there have been five filings year to date, according to Bloomberg data. The figure below shows the number of bankruptcies in the consumer discretionary sector from 2013 through year-to-date.

Figure 7. Selected Consumer Discretionary Bankruptcies by Year



Note: Excludes automotive, restaurants and professional services.
Source: Bloomberg.

The table below lists year-to-date bankruptcy filings.

Figure 8. Selected Retail and Apparel Retailer Bankruptcy Announcements in 2019 Year to Date

Month Announced	Company
January	FullBeauty Brands
January	Charlotte Russe
February	Gymboree
February	Shopko

Source: Bloomberg

Conclusion

U.S. store closure announcements continued in 2018, despite the year being a banner one for retail. Store closure announcements are also off to a strong start in 2019, up 23% from the same time a year ago, on the heels of this positive year and despite forecasts of another year of healthy retail sales. Factors driving store closure announcements — in addition to profit-margin enhancement — include the continuing encroachment of e-commerce into retail, continuing to open new stores despite flattish retail sales per capita, rising U.S. interest rates (which puts increasing pressure on retailers with high debt loads) and the continuation of a high level of retail bankruptcies, with the annualized number of filings year-to-date in 2019 already outpacing the number in 2018.

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Appendix

Figure 9. 2018 Store Opening and Closing Announcements by Category

Segment	No. of Openings	No. of Closures	Difference
General Merchandise Stores	1,472	99	1,373
Other Specialist Stores*	190	115	75
Food Retail	323	265	58
Sporting Goods	26	4	22
Internet and Direct Marketing Retail	14	3	11
Warehouse Clubs	9	0	9
Bookstores	1	2	(1)
Stationery Specialists	0	6	(6)
Luxury	35	48	(13)
Mass Merchandisers	48	65	(17)
Home Improvement Retail	64	99	(35)
Apparel, Footwear and Accessories	172	286	(114)
Health & Beauty Specialists	179	325	(146)
Jewelry Stores	74	308	(234)
Electronics Retail	37	306	(269)
Footwear Specialist Stores	5	419	(414)
Apparel Specialist Stores	349	766	(417)
Department Stores	34	514	(480)
Drugstores	2	493	(491)
Furniture and Home Furnishings	49	666	(617)
Toy Stores	0	735	(735)
Grand Total	**3,083**	**5,524**	**(2,441)**

*Note: *Includes niche retailers such as frames seller Aaron Brothers, camping gear retailer Camping World, outdoor activity retailer Gander Outdoors and crafts retailer Hobby Lobby.*
Source: Company reports/Coresight Research.

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