A&M CONSUMER AND RETAIL GROUP

Winter is Coming:
Holiday Survival of the Fittest

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Sweeping inflation continues to paint a dark cloud over the U.S. economy, with many predicting a looming recession. We believe the official inflation rate grossly understates the day-to-day inflation typical families are facing and how much that has really impacted their holiday season spending budgets. While the official inflation rate is hovering around 8%, food prices are up 12-15% for groceries, and gas prices have seen increases of up to 40% over the course of the year. A consumer study by Alvarez and Marsal's Consumer and Retail Group in October revealed that 60% of consumers cite price as their #1 barrier to spend today, a measure that is up 20% from the same time last year.

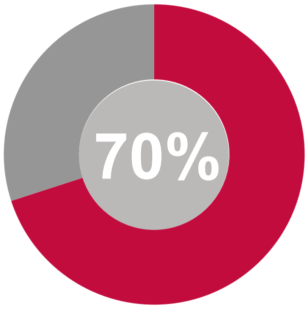
In a typical year, the last quarter holds a lot of optimism for retailers: the holiday season draws heavy foot traffic to stores, increased spending on digital, and accounts for a significant portion of annual sales. In fact, November and December alone can generate up to a quarter of annual sales (and significantly more in profit) for department stores and specialty retailers[1].

1. The New York Times

The Retail Holiday Apocalypse

Prepare for the Worst

This year, there is a very different story beginning to unfold. A&M's survey revealed that 70% of consumers will alter their holiday spending habits compared to last year, with nearly 50% of consumers saying they have already been forced to alter their spend on various items. We are potentially on the cusp of one of the most disappointing holiday seasons in over a decade.



Of consumers will alter their holiday spending habits compared to last year

The Impact on Retailers

Retailers are already seeing the impact of this cost-conscious consumer behavior, and the results are not pretty. On Wednesday, Target announced third quarter results—profit fell around 50% in the quarter, and its stock rapidly tanked—down 15%. The big box retailer is anticipating a decline in sales for the fourth quarter compared to the same time last year—and they are not alone.

With a recession looming or in its early stages, retailers across formats are finding themselves in a serious jam. For one, retailers are sitting on way too much inventory, a dilemma sparked by the irrational exuberance of over-ordering after years of pandemic and supply chain-driven product availability challenges. In addition, the lower customer demand and spending is creating significant challenges in developing holiday promotional strategies to drive traffic with a range of questions around optimal markdown timing and depth. Finally, retailers have massive sunk costs in seasonal marketing and hiring campaigns that will have negative impacts on the bottom line.

On top of this incredibly complicated problem, there is an "elephant in the room"—the new work-from-home model has reduced the effectiveness in cross-functional decision-making, which is arguably the most important element in reacting to a crisis. Additionally, misaligned incentive structures can create friction and difficulty in aligning on cross-functional selling, markdown, and inventory strategies.

Keys to Surviving a Downturn
Mobilize ASAP—Time is Money

Most retailers can expect to find themselves in a similar serious dilemma during the upcoming holiday season. Many retailers and manufacturers of consumer goods have been reading these demand signals closely and have already mobilized plans to protect the P&L and shareholder interests. However, companies taking a wait-and-see approach are at risk of "missing the boat."

We recommend taking some or all of these actions immediately:

1 Don't wait for bad news to start planning a structural reset

The writing for a recession is on the wall. Do not wait to tweak your day-to-day way of doing business. Strategic adjustments to product mix, promotional cadences, inventory management, and operational expenditures today will have meaningful implications tomorrow.

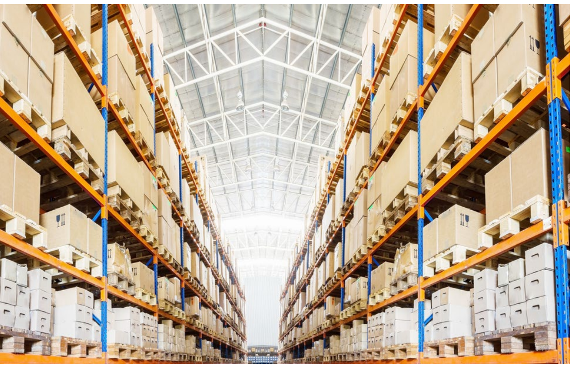
2 Go after cost of goods (COGS) aggressively

Impacting SG&A alone will not allow consumer companies to achieve their financial goals. The core of all companies' spend resides in their COGS, and no matter how efficient you believe your existing sourcing capabilities are, there is more to get. You must challenge specifications of what you buy and make sure that the products you are sourcing actually match the needs of the consumer and their willingness to pay.

3 Establish an agile markdown calendar

Retailers absolutely must learn from past mistakes and begin to mark down earlier than usual. Rather than waiting and scrambling to sell off product at deep discounts, protect margin now by rolling out discounts sooner—25% today is immensely better than 75% tomorrow. Our study revealed that sales and coupons remain a top consumer habit in a world where consumer behavior is changing to stretch their dollar—capitalize on this sentiment and markdown early.

4 Manage inventory levels by leveraging store network and engaging suppliers



With inventory at suffocating levels, retailers have no choice but to get creative in how they manage product. All options have to be on the table, beginning with a deliberate discussion on what to do with existing inventory. What items will be boxed up and held for next year? Which items will be pushed to the store? What stores will take which products? These are the key questions retail leaders must ask themselves.

Additionally, for product that has yet to be received, evaluate how you can work with suppliers to limit overstock. Can seasonal orders be cancelled? Which orders can be delayed? How can you leverage your position as a key account with suppliers so that they go above and beyond in accommodating your organization?

5 Do not lose sight of the long-term strategy

It can be easy to get distracted with all of the noise that comes with a recession. Short to medium-term adjustments to your business model should not overtake long-term initiatives to build competitive advantage. Having a dedicated team in place to right the ship in the short-term will allow your leaders to keep their focus on the long-term health of the business.

Speed Over Perfection

The next months are sure to be choppy for EVERY retailer. Every week that goes by represents approximately 2% of value you can capture in a year. Don't wait to get everything designed perfectly or use the "holiday freeze" to delay action. Executing a partially right answer fast will ultimately give you better cushioning than following a more traditional approach to multiple iterations of design. In this rapidly changing environment, a test-and-learn and adapt-and-execute approach will be critical. Use external help and experts if it helps you get there faster.

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