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SUPPLY CHAIN ISSUES MAY SPUR MORE RETAIL BANKRUPTCIES IN THE YEAR AHEAD

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As most restructuring professionals would attest, 2021 was a historically slow year for corporate bankruptcy filings. Across the industry, filings in all chapters were down almost 25% from 2020 levels, and November 2021 recorded the fewest cases with a $10 million liability threshold since 2015.

While the early stages of the global pandemic brought a surge in bankruptcy filings, would-be struggling companies have since been able to take advantage of stimulus money and low interest rates to pursue new deals that added liquidity and pushed maturities. In the retail industry, recent changes in consumer spending habits and the rollout of vaccines, in addition to the loosening of pandemic-related restrictions, have also led to optimism.

Despite these positive signals, historic supply chain disruptions, which have had a hand in a number of retail bankruptcies to date and continue to mount, have the potential to wreak havoc on business for many retailers, potentially thwarting any return to normalcy that was seemingly on the horizon.

A Leading Cause of Distress

Factors contributing to current supply chain issues include factory shutdowns, backups at ports, and labor shortages, among others. These supply chain issues are disconcerting for struggling retailers and their creditors (who have generally faced low recoveries in retail bankruptcy cases). Of the retailers that filed for Chapter 11 protection in 2021, many cited supply chain disturbances as a leading cause of their financial distress.

For example, when Furniture Factory Ultimate Holding L.P. and its affiliates filed for bankruptcy in November 2020, it cited inventory supply chain challenges caused by increased prices in raw materials and a decrease in the labor force as negative impacts on the company's revenues. The company is a low-price provider of home furniture in the South Central and Midwestern United States. Ultimately, the company chose to pursue a quick sale to fund the significantly increased expenditures necessary to build up inventory for the industry's peak shopping season, which historically occurs in the middle to end of the first quarter of the year.

In the late-July 2021 bankruptcy filing of GBG USA Inc. and its affiliates, the company cited supply chain disruptions as impacting both its

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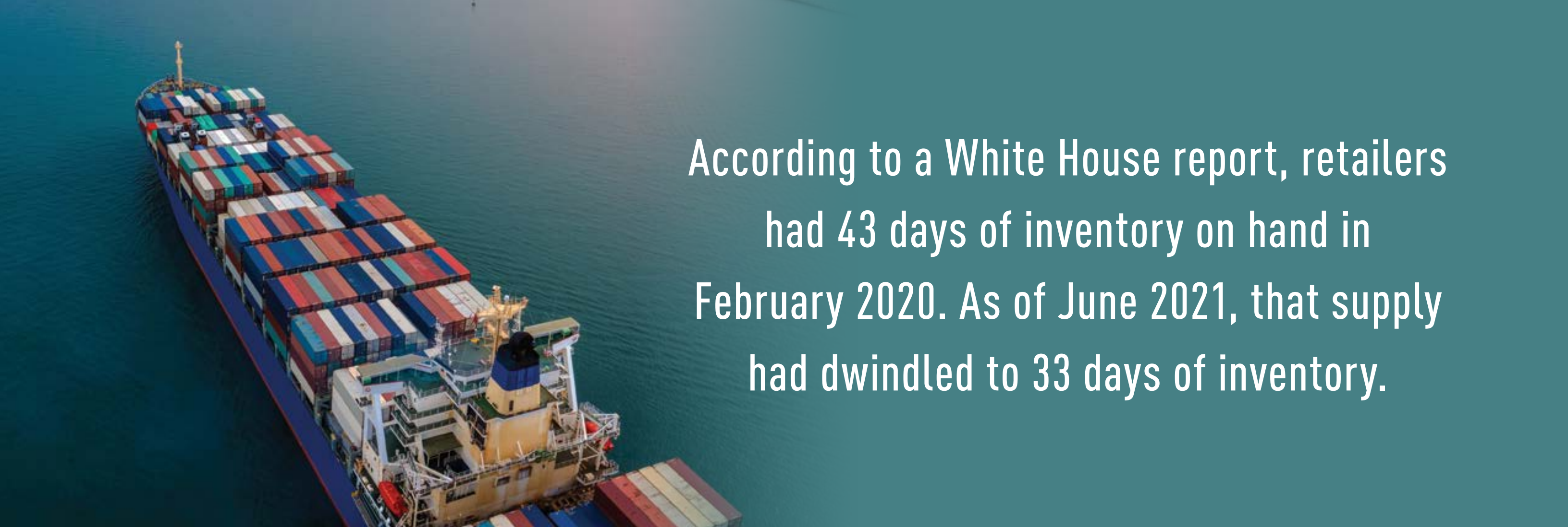

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operations and balance sheet. GBG is a branded apparel, footwear, and brand management company with operations in North America, Europe, and Asia. Like many retailers, the company did not manufacture its own merchandise and instead relied on a network of manufacturers, vendors, suppliers, and third-party logistics providers. Upon completion of the manufacturing process at foreign facilities, products were transported across Asia and Europe, shipped via ocean freighters to ports in the United States, and then delivered to retail locations or directly to customers.

Disruptions in this process, including the lack of materials and capacity to produce products and significant backlogs in the distribution networks, put significant strain on the company. Unable to recover from these and other factors that resulted in a significant decline in sales, the company decided to pursue the sale of its fashion brands under Bankruptcy Court supervision.

Likewise, the debtors in the Chapter 11 cases of Sequential Brands Group Inc., which filed for bankruptcy relief in

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August 2021, partially attributed their downfall to "the economic impact of COVID-19, which caused supply chain disruptions for the Company's licensees as well as retail store closures." The company, which owned brands such as Jessica Simpson, Joe's Jeans, Avia, and AND1, ended 2020 carrying more than $450 million in debt. The Bankruptcy Court recently approved a sale of some of the company's most popular divisions for more than $400 million to various stalking horse purchasers.

A.B.C. Carpet Co. Inc. and its affiliates also suffered a similar fate, filing for bankruptcy protection in September 2021. The company is an iconic home furnishing retailer in New York City. Like GBG, A.B.C. Carpet historically relied on a supply chain comprised of more than 1,000 vendors to ensure an uninterrupted flow of merchandise to its retail locations and e-commerce customers. Disruptions in this supply chain caused reduced inventory levels and extended order lead times, resulting in canceled customer orders and lost revenue and leading to the company's bankruptcy filing and going concern sale.

These and similar supply chain issues continue to plague the retail industry and show no signs of abating. According to a White House report, retailers had 43 days of inventory on hand in February 2020. As of June 2021, that supply had dwindled to 33 days of inventory. This lack of inventory can depress sales as well as increase the cost of goods, as seen in the Chapter 11 cases of the retailers mentioned in this article.

Moreover, fourth quarter predictions of many large retailers suggest that increased supply chain costs will continue to be a significant consideration. Victoria's Secret & Co. estimates that supply chain disruptions will increase its freight and product costs by as much as $100 million in the fourth quarter. Similarly, Bath & Body Works Inc. is forecasting a $90 million to $110 million increase in costs attributable to raw materials, supply chain, and transportation.

Conclusion

Recognizing the impact that supply chain disturbances have on their business, many companies are looking for solutions. For example, Macy's has indicated that it has implemented several measures to mitigate its supply chain disruptions, such as integrating its store and warehouse inventory.

Still, not all businesses are as well-equipped to solve such supply chain issues, as innovative solutions are likely to come at significant cost. Accordingly, these issues, which have been a factor in a number of retail filings to date, are likely to continue to be a source of future distress in the industry.

The issues could well be exacerbated as the availability of stimulus and other government funding decreases, inflationary pressures and prospective higher interest rates increase the costs of inventory and capital, and eviction moratoria expire. As such, distressed retailers that were fortunate enough to survive the earlier stages of the pandemic and have eyes on a recovery must be cautious because they very well may not be out of the woods yet. In any case, these issues bear scrutiny as the calendar turns to 2022.