Industry Top Trends Update

# Retail and Restaurants

## Rising prices will lead to consumers pulling back

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## What's changed?

**The unrelenting rise in inflation has hit consumer confidence.** Rapid--and, in some cases, very steep--rises in fuel, energy, and food prices, and continued tensions from Russia's invasion of Ukraine have severely dented consumer sentiment.

**A slowdown in retail sales is in the cards.** In the EU and U.K., retail sales have sustained their strong momentum through first-quarter 2022 on high household savings and pent-up demand, but signs of decreased spending are emerging.

**Retailers need to maintain favorable price perception.** Retailers have passed on higher input and operating costs and prices from their suppliers. However, with consumers looking to moderate their spending,  retailers now face the challenge of becoming more price competitive, even as costs are escalating.

## What to look out for?

**Higher labor, energy, and order-fulfillment costs.** Retailers will look to rationalize brick-and-mortar store costs and numbers further as the e-commerce channel remains robust. However, given the high operating leverage, many retailers will struggle to cut these costs to offset a meaningful portion of cost increases.

**Already-low retail margins coming under further pressure.** Higher input and operating costs will hit margins, because sales volume could decline as consumers are hurt by continued high prices. The persistent supply chain and logistical bottlenecks also impede initiatives to gain efficiencies and limit operating costs.

**The ability to defend free cash flow.** Retailers will be tested on their ability to protect their free cash generation, particularly because working capital needs will be high as sales volumes and margins moderate and supply chain disruptions continue.

## What if there's a recession?

**Consumer spending is likely to decelerate.** Consumers will turn more cautious and begin to cut spending, especially on discretionary items. Some parts of apparel retail, or retailers that didn't fully regain their financial footing from the pandemic, could struggle the most.

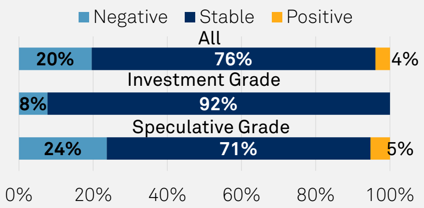
**Discounters and value retailers will gain market share.** Consumers will favor private label over higher-priced branded products. Discount and value retailers will continue to gain market share as consumer look for ways to cut spending.

**Highly leveraged retailers and restaurants will suffer the most downgrades.** Weaker profitability and cash flow will lead to elevated leverage. The share of entities in EMEA rated 'B-' and below will rise to more than one-fourth (from below 20% currently). Many of these will see their capital structures becoming unsustainable and, inevitably, a few businesses will suffer financial distress.

## Latest Related Research

- Consumer Goods: Unrelenting Inflation Puts Pricing And Brand Power To A Grueling Test, July 13, 2022
- European Retailers: Forced To Raise Prices While Wary Of Consumers Cutting Back Spending, June 9, 2022

### Outlook Distribution




### Ratings Statistics (YTD)*

| | IG | SG | All |
|---|---|---|---|
| **Ratings** | 13 | 38 | 51 |
| **Downgrades** | 0 | 5 | 5 |
| **Upgrades** | 1 | 4 | 5 |

Ratings data as of end-June 2022. * Year-to-date

### Ratings Outlook Net Bias