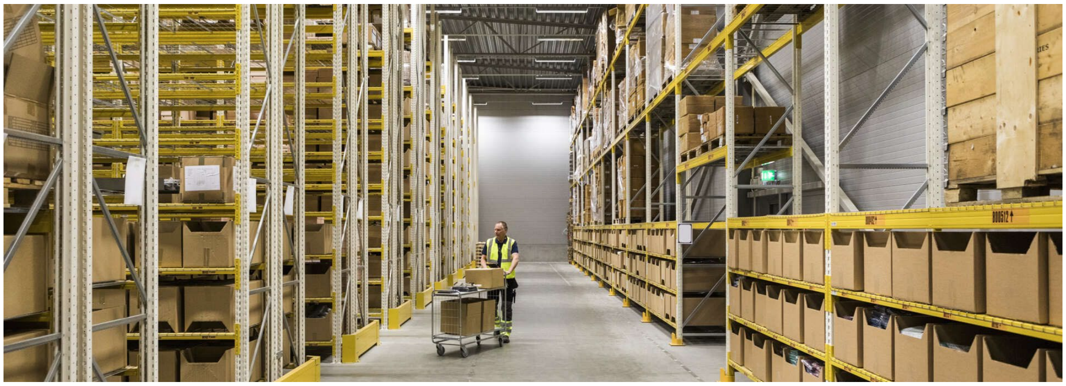
Retail and Restaurants

Cautious consumer discretionary spending persists

January 14, 2025

This report does not constitute a rating action.



What's changed?

High prices are sticky despite lower input costs. Retailers have not lowered prices on goods across the board, but strategically promote to retain market share or drive traffic.

Increased tariffs and geopolitical risks. Higher tariffs could spur inflation, trade wars, and supply chain constraints. Geopolitical conflicts and tensions could weaken consumer sentiment.

Consumers remain cautious. They are deferring discretionary spending and trading down. Larger retailers gain market share with their value propositions and continued e-commerce growth.

What are the key assumptions for 2025?

Household budget pressures persist. Interest rates remain high and credit card delinquencies are rising. Consumers will continue prioritizing staples like food over discretionary items.

Costs remain high and cost cutting continues. Elevated input and labor costs limit margin expansion and will require store closures. Companies will struggle to pass along price increases.

Financial policies remain consistent. We expect prudent financial policies within a weak consumer backdrop, and opportunistic mergers and acquisitions (M&A) in certain segments.

What are the key risks around the baseline?

Tariffs trigger inflation and potential retaliatory trade wars. Retailers will likely try to pass along higher costs to an already stretched consumer, which could hurt demand and profits.

Inventory levels rise by purchasing ahead of anticipated tariffs, elevating leverage, pressuring cash flow, and increasing overhang or obsolescence risk if demand stays weak.

Interest rates remain higher for longer, which will hurt consumer spending. Highly leveraged issuers may struggle to refinance upcoming debt maturities or default.

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Ratings Trends: Retail and Restaurants

Chart 1

Ratings distribution

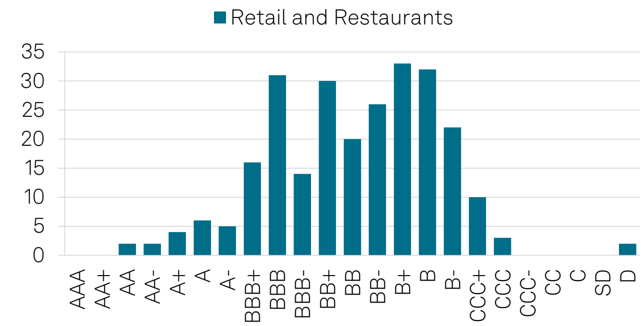


Chart 2

Ratings distribution by region

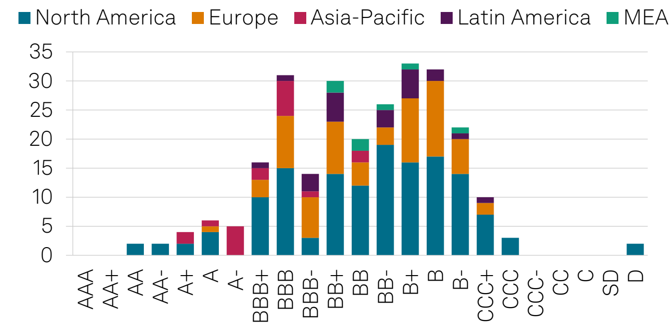


Chart 3

Ratings outlooks

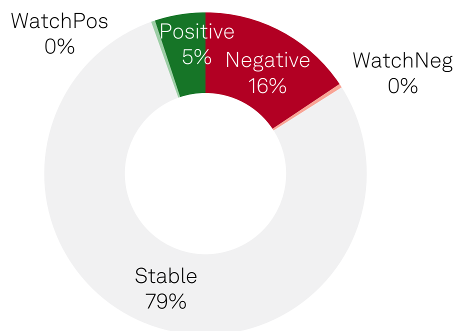


Chart 4

Ratings outlooks by region

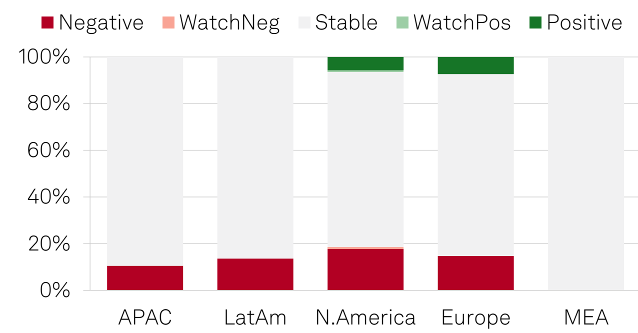


Chart 5

Ratings outlook net bias

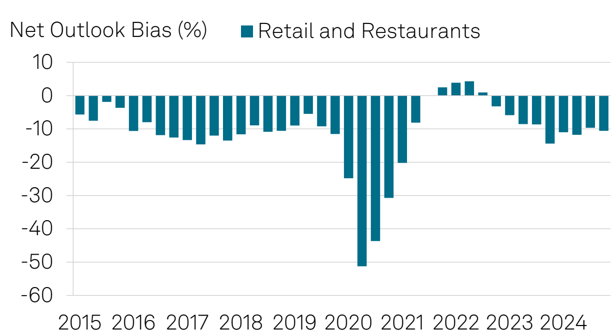
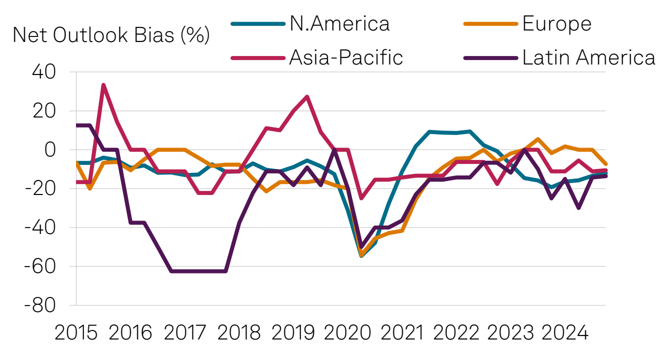


Chart 6

Ratings net outlook bias by region



Source: S&P Global Ratings. Ratings data measured at quarter-end.

Industry Outlook

Ratings trends and outlook

Global retail and restaurant rating actions remained negative in 2024 because consumers in general have less buying power due to lingering high prices. Still, the consumer remained relatively resilient as recessions in the U.S. and Europe were averted. About 16% of global retail and restaurant issuers had negative outlooks in 2024 compared with 22% in 2023. Only 5% have positive outlooks, the same as in 2023.

As expected, downgrades were most pronounced in the 'B' category and lower. While gradual rate cuts allowed for some refinancings, some of these issuers will remain challenged, and issuers in the 'CCC' category, most likely in North America, could default or restructure their debt in 2025, especially as liability management transactions become increasing prevalent.

In the U.S. we expect negative ratings trends in 2025 due to stagnant discretionary spending. The consumer remains stretched between high prices and interest rates. The lower-income consumer is most impacted. This is starting to weigh on sales, as indicated by real restaurant sales tracking down and sales of value brands and staples like food. Real income growth is running behind real spending growth since mid-last year. The household savings rate is at a two-year low, and the delinquency rate for credit cards and autos are above pre-pandemic levels and trending higher. Walmart, Amazon, and Costco outperform their industry peers because they provide unique value propositions.

About 80% of U.S. retail and restaurant ratings are speculative grade. In 2024, negative rating actions outnumbered positive by a ratio of 1.5 to 1. Heading into 2025, 27% of ratings have a negative outlook while only 8% have a positive outlook or are on CreditWatch with positive implications. The highest negative outlook bias is in the subsectors most exposed to discretionary spending. Of the negative outlooks, about 13% are investment grade.

In Canada, high interest rates and the cumulative effect of inflation have caused consumers to limit spending. With unemployment forecast to be higher in 2025 and shelter expenses remaining high, we expect Canadian consumers to be less focused on discretionary spending. Our 2025 Canada GDP forecast indicates a slow-growth macroeconomic environment with higher unemployment levels. Even though we forecast CPI will stabilize around 2%, elevated inflation, interest rates, and shelter costs will force consumers to manage spending prudently.

Price- and value-conscious consumers will continue to benefit Dollarama's sales, particularly the sale of consumable items, while home-goods retailers such as Canadian Tire will have to balance between promotions and operating efficiency to defend EBITDA margins. However, given the mostly investment-grade nature of the Canadian retail portfolio, we expect a combination of financial flexibility and management's focus on balance sheets will support the stable outlook on Canadian ratings.

In Europe, consumers have been quite resilient as declining inflation and strong labor markets have supported spending. This also reflects retailers' stronger operating performance on the back of carry-over price pass-throughs to the end consumer, with only a moderate impact on trading volumes, as well as improved cost control and tight management of operating expenses. In this context, about three-quarters of the rated Europe, the Middle East, and Africa (EMEA) retail and restaurant portfolio have a stable outlook, about 14% have negative outlooks, and 9% have a positive outlook. We also assigned nine new ratings, of which there were two new investment-grade ratings (El Corte Ingles S.A. and ITM Enterprises, the financing subsidiary of

Société Les Mousquetaires S.A.S.). Nearly half of the rated companies in the EMEA retail and restaurant portfolio are rated in the 'B' category and below.

In Europe, upgrades and downgrades were balanced. There was one fallen angel with ELO (Auchan Holding) downgraded to 'BB+' in March 2024, and then to 'BB' in August 2024, due to its significant exposure to the challenging hypermarket store format in France. The other downgrades in Europe were on speculative-grade retailers and restaurants, and two of them led us to lower the ratings to 'CCC+'.

There were 17 outlook changes, but only five were outlook revisions to negative. These trends are indicative of the growth in real incomes because of disinflation and resilient labor markets across the European economy. We expect the pickup in real disposable income will boost consumption and support the European retail sector in 2025.

Overall, our forecast for low-single-digit percent top-line growth and slightly better margins in 2025 reflect our broadly stable outlooks. While we expect inflation will continue to moderate amid relatively slow economic growth, the extremely competitive retail landscape will prevent European retailers' margins and cash flows from meaningfully improving in 2025 and 2026, thereby limiting their rating headroom. Higher labor costs in Europe, especially in the U.K. with the rise in minimum wages and employers' national insurance contributions, will continue to be a drag on the profit margins.

All rated retail and restaurant companies in Europe except one have adequate liquidity. Barring a handful of companies rated 'B-' and below, we expect limited near-term refinancing pressure for most of the rated portfolio and a sound ability to bear the interest burden. As is natural after a period of prolonged cost headwinds and higher-for-longer interest rates, most companies have tight headroom under our downgrade thresholds, especially for free operating cash flow (FOCF) after leases and EBITDAR coverage.

In China, we expect retail sales to expand 4%-5% in 2025, similar to 2024. Government subsidies through a targeted trade-in program supported retail sales growth in 2024. Home appliances and electronics such as computers and, to a smaller extent, smartphones have been the key beneficiaries. While the program ended in December 2024, the government is guiding to an extension, possibly with expanded categories. We see a high likelihood for an additional stimulus—given ongoing property weakness and the potential U.S. tariff hikes to hurt exports—and have assumed a similar level of stimulus as in 2024 in our 2025 China retail outlook.

Still, consumers have been cautious. Impulse purchases were down in 2024. Big drops in average selling prices for retailers and restaurants that we saw in the first half of 2024 started to ease in the second half, and we believe prices aren't likely to fall materially in 2025 as consumer confidence stabilizes and competition among merchants turns more rational. Small areas of retail (such as niche apparel) might see higher growth, driven by perceived quality and value. Otherwise, low prices on everyday items will prevail.

Credit health for the sector is bifurcating. Smaller retailers are losing share and exiting the market as costs rise. Lower gross profit margins from discounts and a higher portion of value product in the mix, along with increasing fulfilment costs from higher returns and refunds, have hurt performance. Meanwhile, larger retailers with stronger balance sheets have more resources to prefund subsidies or discounts to gain market share; they also have the scale and ability to improve operating efficiencies to maintain or grow margins.

In Japan, we expect ratings to remain stable. Prices of everyday items and utility costs remain high, likely leading to slow domestic consumption in 2025. Headline inflation was 2%-3% in 2024, hitting a 40-year high, which also curbed consumer spending. We expect continued trade-downs from price-sensitive consumers, which will pressure top lines. An increase in operating costs, including labor, will pressure profits for retailers. Cost-saving initiatives may mitigate pressure on earnings for some retailers, as will selling more private-label products and revamping sales floors and store networks.

In Australia and New Zealand, consumer sentiment is gradually improving, albeit from a low base. We attribute this to a resilient labor market, recent tax cuts, and government stimulus that was targeted to alleviate inflation pressure. Retail spending in Australia grew steadily during 2024, with total annual seasonally adjusted retail turnover rising 3.4% as of October 2024. Decreasing interest rates in New Zealand and anticipated rate cuts in Australia will improve household purchasing power in 2025, increasing consumer spending.

With cost-conscious consumers gravitating toward private-label and discount products, retailers are competing aggressively. We expect promotional activities to remain high. Amid recent regulatory focus on market power and supplier treatment, companies with significant market share may have a limited ability to pass promotional expenses onto their suppliers.

We also anticipate wage costs will remain elevated, pressuring earnings margins. We expect union actions in Australia during late 2024 will not deter retailers from implementing cost-efficiency programs and investing in productivity enhancements.

In Brazil and Chile, we anticipate real GDP growth of approximately 2% in 2025, which we expect will contribute to a continued recovery in the retail sector, following similar trends observed in 2024. While we forecast both economies will maintain relatively controlled inflation, interest rate trajectories will differ. We project Brazil will keep its policy rates elevated for longer, whereas rates in Chile will decrease. We believe this will facilitate growth in both revenue and profit margins, enabling some debt reduction.

Traditional retailers are increasingly challenged by pure e-commerce competitors and evolving consumer preferences. Digitalization will be key for retailers in the coming years, with e-commerce and omnichannel in the center of the companies' strategy. During 2024, we revised the ratings outlook on a few retailers to stable from negative, notably Falabella (BB+/Stable/--) in Chile due to a recovery in its profitability and reduced leverage, Magazine Luiza (brAA-/Stable/--) due to its strong sales performance and sustained profit margins throughout the year, despite a still challenging macroeconomic environment, and Grupo SBF (brAA-/Stable/--) due to an improved FOCF generation and liquidity position.

In Mexico, we expect a stronger slowdown in consumption in 2025 than what we saw last year, in line with our GDP growth expectations of 1.2%. For our rated portfolio, we expect revenue to grow about 7% in 2025, similar to 2024 levels; nonetheless, we believe a weaker product mix will lead to slight contractions in EBITDA margins. We expect real wage growth will continue to back up consumption to a certain extent. We forecast this, along with a lower fiscal deficit, will cascade into lower disposable income for households. Moreover, we believe the recent depreciation of the MXN/USD exchange rate will also affect the pricing of imported goods.

Omnichannel capabilities remain key to serve and attract customers given the growth of Chinese online retailers in the country, which have gained popularity quickly, especially in soft-line categories.

Main assumptions about 2025 and beyond

1. Consumer spending will remain slow, although sentiment is rebounding.

Consumers will continue to seek value by waiting to buy during promotions and buying less, shrinking their average ticket purchases. Retailers with distinct value propositions will gain market share. Consumer sentiment has rebounded in recent months due to a resilient labor market and cooling inflation (see chart 7).

2. Margins will remain flat to modestly improved.

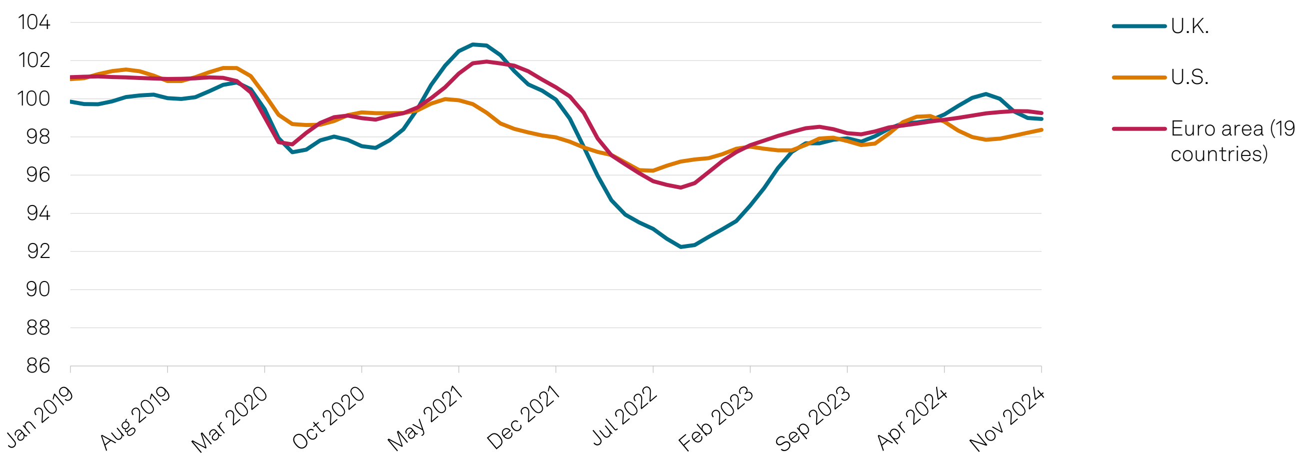
Input costs will remain manageable but high labor costs are sticky. Lower commodity, shipping, freight, logistics, and warehousing costs will continue to benefit gross margins, partially offset by higher promotions. Ongoing cost-savings measures will mitigate high wage costs and lower demand to preserve margins.

3. Cash flow and capital allocation priorities will remain steady.

Companies will continue to manage tight inventory levels to preserve solid cash flow. Higher tariffs are the biggest risk to cash flow if companies decide to buy in anticipation of price hikes on goods. Investment-grade issuers will maintain their financial policies, and large M&A will be opportunistic. Lower rates could help speculative-grade issuers refinance but higher rates for longer could trigger more downgrades or defaults.

Chart 7

Consumer confidence index



Sources: OECD, S&P Global Ratings.

North America

Big box: In 2024, big-box retailers navigated a challenging environment marked by constrained discretionary spending and persistent, though easing, inflation that has continued to pressure household budgets. In response, many retailers recalibrated their inventory strategies to address potential supply chain disruptions. Notably, companies such as Walmart, Target, and Costco outperformed their purely discretionary counterparts, primarily due to their strong presence in grocery and essential categories. Walmart significantly outperformed in the third quarter in the U.S. across both grocery and general merchandise. In contrast, Target reported a modest decline in comparable sales along with lower guidance due to softer-than-expected sales in discretionary categories, resulting in elevated inventory levels and higher-than-expected supply chain costs.

Looking ahead to 2025, we expect big-box retailers to grow revenue at 3%-7% and continue performing relatively well as consumers seek ways to stretch their budgets. We expect a very slight uptick in margins amid expected stable performance. While supply chain issues have largely diminished, elevated inflation and uncertainty regarding future interest rate cuts will continue to impact U.S. shoppers. Consequently, we expect a shift in the sales mix toward consumables, which typically yield lower margins. We also expect the larger big-box retailers to continue fending off pressure from Amazon by refining their omnichannel strategies and leveraging their physical store networks as a competitive advantage. Although Target and Costco have traditionally focused on brick-and-mortar sales, both reported significant growth in their e-commerce businesses, with segment revenue increasing in the double-digit percent area. In the near term, we foresee an emphasis on optimizing e-commerce platforms and real estate assets to improve delivery speed and operational efficiencies.

Specialty: Sales dipped across many specialty retailers in 2024 as consumers pared spending on discretionary categories and prioritized essentials. While customer traffic varied across the sector, comparable sales were challenged by many retailers lowering prices to highlight value to budget conscious consumers without seeing an offsetting increase in basket size. We believe the current macroeconomic environment continues to favor big box, discount, and online retailers that offer broad selections and low prices. However, in our view, specialty retailers that can provide unique, on-trend merchandise with convenience and good service will have a better opportunity to grow market share in a highly competitive marketplace.

We expect pet retailers to generate modest top-line growth in 2025, averaging 3%, led by stabilizing industry trends and company-specific initiatives around merchandising and services. Pet ownership continues to increase, and we expect pet humanization trends will continue. Online pet retailer Chewy (not rated) recently noted that pet adoptions are up in the high-single-digit to low-double-digit percent range year over year. Still, we expect consumers will remain value-focused in 2025, likely concentrating spending around consumables and keeping overall price increases limited. We expect margins will improve modestly following meaningful compression in 2024 as merchandise mix headwinds ease and cost reductions and sales leverage benefit earnings. Petco's ability to execute on its initiatives of improving merchandising, customer service, and efficiency will be key to driving traffic and improving conversion at its stores in 2025. PetSmart is investing in price and digital to strengthen performance, but margins may be pressured through 2025 if sales don't inflect or offsetting cost reductions aren't enough.

Industry conditions for home-focused specialty retailers remain challenging. Headwinds including elevated interest rates, the shift of consumer spending toward services and away from goods, and low housing turnover have led to tepid demand for home categories, including décor, flooring, improvement, and furnishings. We expect many of these headwinds to stabilize throughout 2025 but still expect industry demand to remain soft as housing affordability continues to be a challenge. Still, companies with sharp execution stand to grow market share regardless of overall industry performance. On the cost side, we believe there is less room to cut and fewer opportunities for additional supply chain savings. Additionally, the risk of incremental tariffs could delay stabilization.

Hobby retailers, including arts and crafts-focused Michaels and fabric-centered Joann will remain challenged in 2025. Both companies are in the midst of leadership transitions and are contending with ongoing soft demand and the risk of higher tariffs. Both also have customers that are loyal but price-sensitive, limiting additional price increases and basket building next year.

We expect the soft performance trends of 2024 to carry over through the first half of 2025 for aftermarket auto part retailers. Constrained budgets of lower-income consumers continue to weigh on do-it-yourself (DIY) industry sales, while sales to professional customers remain relatively solid. We anticipate maintenance or repairs that have been deferred in 2024 will gradually be addressed in 2025. Additionally, the relatively inelastic demand and normalizing inflation will support modest price increases this year. This, in addition to ongoing new store development, will lead to low- to mid-single-digit percent revenue growth in 2025. We forecast

EBITDA margins will remain roughly flat as sales leverage is offset by investments in store operations and labor.

Department stores: Throughout 2024 most department store operators faced secular declines, prompting them to implement operational changes and turnaround strategies. Kohl's continues to struggle with operating performance and leadership transitions, with its CEO stepping down in January 2025. The company also significantly lowered its full-year guidance, highlighting an uncertain holiday season for the department stores, as competitors like Walmart and Amazon attracted more value-conscious customer. While Macy's reported stronger-than-expected preliminary results for the third quarter, it delayed release of its full quarterly results due to erroneous accounting over several quarters. Capri also announced leadership changes at its Michael Kors brand to turnaround performance.

As we move into 2025, we expect department stores to continue experiencing pressure on discretionary demand, relying on increased discounts to drive customer traffic and manage costs. We forecast revenue growth of negative 1% to positive 2% and relatively flat EBITDA margins for the sector in 2025. To mitigate volume declines and promotional pressures, department stores will likely focus on tighter inventory management, enhancing sell-through rates, and implementing cost-saving measures. We expect companies to prioritize capital expenditures toward strengthening supply chains, refreshing stores, and enhancing omnichannel capabilities, with minimal expansion of store footprints. Additionally, we expect store closures to persist as companies streamline their operations to better align with market conditions. Consequently, we expect limited M&A after the Saks and Neiman Marcus transaction (expected to close in early 2025), along with modest share buybacks aligned with broader capital allocation and leverage targets. There is also continued interest from activist investors and pressure to creatively structure balance sheets to leverage real estate assets, reflecting a focus on short-term returns over the long-term health and flexibility of the retail operations.

e-Commerce: More retail spending is set to shift online in 2025 as short-term pressure from cautious consumer spending is offset by longer-term secular trends of increasing consumer adoption. Total U.S. e-commerce sales rose 8.1% through the 12 months ended Sept. 30, 2024, outpacing total retail sales growth of 2.4% for the same period according to Census data. We expect e-commerce penetration will continue to expand as wallet share grows, more consumers shop online, and retailers increase their digital capabilities. We forecast revenue will increase roughly 6% on average across our U.S. e-commerce issuers in 2025, with companies more exposed to discretionary categories facing softer top-line prospects. Margin performance will vary next year, but we anticipate companies experiencing weaker top-line demand will pull cost levers to keep earnings growth intact.

We believe Amazon will absorb further market share as its wide product offering, competitive prices, and fast delivery draws more customers to its platform. Amazon's regionalized inventory placement and expanding same-day fulfilment centers are strengthening customer loyalty, leading to bigger baskets and greater purchasing frequency. Wayfair meanwhile is navigating a weak sales environment for the home goods category. Although stabilizing housing starts and the prospect of additional federal rate cuts could spur growth in the housing sector, we expect demand for home categories to remain soft in 2025. EBay returned to positive gross merchandise volume growth in 2024 as consumers have been responding to the company's investments in its focus categories. We expect eBay to generate modest low-single-digit percent top-line growth in 2025 as consumers seek out value and unique merchandise across the company's marketplace amid a choppy macroeconomic environment.

Rising competition from Chinese e-commerce players, including Shein and Temu, also poses a risk to both traditional and online retailers. These marketplaces, which specialize in low-priced goods, are expanding categories and lowering merchant fees to bring more merchandise to their platforms. Price-sensitive consumers may increasingly make the trade-off between quality and slower order fulfilment in return for deeper savings.

Restaurants: We expect low- to mid-single-digit percent sales growth and modest margin improvements in 2025. Casual diners that provide value will likely win in 2025. As food-away-from-home inflation continues to exceed food-at-home inflation (the opposite held true through all of 2022 and part of 2023), we expect traffic levels to be dictated by operators' ability to draw in value-seekers. While promotions will be part of the equation, value-promoting advertising, menu innovation, loyalty programs, and digital sales will play large roles in driving transactions. We believe higher wages will be offset by the positive impact of improved labor retention rates, leading to 2025 margins moving in a narrow band compared with 2024, with cost efficiencies essential to preserving margins.

Quick service restaurants (QSRs): We expect 0%-1% same-store sales growth in 2025, slightly lower than average but improved from 2024. We believe the investment in value offerings across the second half of 2024 will continue in 2025 and reestablish the perception of fast-food restaurants as a source of good value, especially with lower-income consumers. That said, we expect continued competition from fast-casual restaurants like Chipotle, Five Guys, or Jersey Mike's, which generally offer higher-priced but still high-value meals. Casual restaurants are also offering discounted meals to compete directly with QSRs. This also reflects a shift to dining at home, which is still above historical averages. We expect QSR franchisors to continue to invest in advertising and limited-time offerings, which we believe will result in similar or slightly improving margins for the year. At the restaurant level, we expect continued targeted discounting with combination meals priced at $5-$7, given these deals have generally resulted in higher overall ticket size. We believe restaurants with better perceived relative value will continue to outperform, including Taco Bell, Dunkin', and Tim Hortons.

Grocery: We expect low-single-digit percent sales growth in the U.S. grocery sector in 2025 as we expect food-at-home inflation to stay near the expected 1% 2024 levels in 2025 and the industry is two years removed from the fast-paced inflationary days of 2022 (11.8%; 5% in 2023; U.S. Department of Agriculture). As a result, we expect margins to be relatively flat for the industry next year. At the same time, vendors have attempted to curtail a soft volume environment by providing elevated levels of trade dollars (to fund, for instance, promotions). We expect both conditions to remain at these levels through at least the first half of 2025, the combination of which portends flat to slow growth for grocers. A bright spot for the industry continues to be private label, with those that possess a robust offering poised to benefit from significantly better margins. With Kroger Co. and Albertsons Cos. Inc. terminating their merger, the two will now go it alone as they try to stem share losses to nontraditional players like Walmart and Costco.

Retail pharmacies: Overall in 2025, we expect mid-single-digit percent revenue growth primarily from drug inflation. At the same time, we expect modest EBITDA declines, primarily driven by pressure from branded pharmaceutical reimbursement (including GLP-1s), below-average generic approvals, and front-of-store weakness from a cautious consumer. Additionally, we expect some incremental pressure from competition of non-brick-and-mortar delivery pharmacies but believe this is less impactful than reimbursement dynamics. We forecast pharmacies will offset these pressures by closing unprofitable stores, reducing costs, improving working capital, and paying down debt to right-size capital structures in the challenging operating environment. We also expect pharmacies will work to improve contracting terms with suppliers and pharmacy benefits managers to improve the predictability of reimbursement and dispensing fees, but this will likely be a multiyear initiative.

Canada: Canadian grocers will continue to operate in a steady fashion, and we expect low-single-digit percent revenue growth in 2025. Consumers' shift to discount, increasing private-label penetration, and the expanding scope of services at drug stores all support top-line growth, with Loblaw and Metro benefitting most out of the big three Canadian grocers. Like the U.S., promotions from vendors and loyalty programs continue to bring in foot traffic. We expect margins to remain steady as high-margin pharmacy operations and an increased focus on operations (e.g., automated distribution centers) support profitability. However, U.S. competitors' (Costco, Walmart) continued investments in Canada have paid off, and following the pandemic, they are at 20%-25% of the Canadian grocery market share.

Europe

Grocery: Although this sector remains extremely price competitive, credit prospects for Europe's food retail industry are stable. The incumbent mainstream retailers face significant competition from discounters in all the major European markets. European grocers with an investment-grade rating ('BBB-' or higher) are typically the largest among peers and hold a strong market position in their home markets, with advanced private-label propositions and geographical diversification.

We downgraded ELO (Auchan Holding), which operates hypermarkets and supermarkets in 11 countries and is the fifth-largest retailer in France, to 'BB+' in March 2024 and then to 'BB' in August 2024. ELO's core French retail operations are the main drag on its profitability and cash generation due to its significant exposure to the structurally challenged hypermarket store format. Meanwhile, we upgraded two food retailers: Co-operative Group Ltd., the U.K.'s largest consumer co-operative and the seventh-largest food retailer, to 'BB' on improved profitability and lower financial leverage through effective pricing investments and membership offerings; and France-based fresh food retailer ZF Invest, which owns and operates within traditional covered-market operator Grand Frais, to 'B' due to its differentiated business model translating into strong operating performance amid difficult market conditions.

We expect the grocery sector to grow its absolute EBITDA in 2025 from volume recovery driven mainly by higher price promotions and continued growth in private-label offerings. EBITDA margins for the sector dipped meaningfully in 2022. After some recovery, we expect them to gradually rise in 2025, but we do not expect them to reach their pre-pandemic levels due to higher labor costs. Because of declining input costs, there are opportunities for retailers with established private labels to increase and cement their market share by providing greater value to their consumers. Strong competition will continue to force smaller and mid-sized supermarkets such as Eroski in Spain and Esselunga in Italy to compete more aggressively on prices.

The rating upside is limited by thin operating margins and high investment requirements in store refurbishment, network expansion, IT infrastructure, and logistics. While FOCF generation remains relatively robust, deleveraging for many listed companies in the sector is constrained by shareholders' expectations of regular dividends and ongoing share buybacks. We do not anticipate market consolidation other than opportunistic acquisitions of pockets of stores given that, overall, our rated retailers, especially those that are well capitalized, already have substantial market shares.

Apparel retail: High competition and lukewarm consumer demand will constrain the growth plans of many European apparel retailers in 2025. We expect many rated companies will need to substantially increase promotions to boost volumes as unit prices remain elevated. While e-commerce and mobile commerce will remain the main engines of growth, we anticipate brick-and-mortar stores will see a resurgence in footfall as consumers seek a more immersive in-store experience. Retailers with a strong omnichannel presence and a robust marketplace offering such as Next PLC and Marks & Spencer PLC in the U.K. will continue to outperform their competition. We also expect Primark, with its low-cost model providing value-focused clothing and a unique store experience, will continue to experience strong demand in 2025.

On the other hand, H&M lost some global market share compared with competitors like Zara, Fast Retailing, and Primark, which all reported higher growth. To revamp and grow its core H&M brand, the group will increase marketing costs and capex to launch various initiatives to strengthen its brand. We expect an increase in both marketing costs and capex to launch various initiatives to strengthen branding including new advertising campaigns, larger flagship stores, improved digital experience including social media content and interactions, and large events in core cities. Hugo Boss is also hindered by a challenging economic environment, and the group is looking to expand its top line, supported by marketing campaigns driving up brand visibility and the ongoing and successful reshaping of its retail network, while increasing the in-store digital experience.

We consider the global mass-market apparel industry to be very competitive, extremely fragmented, and subject to fashion risk and continuous innovations. In this context, new niche brands, including pure online platforms, continuously threaten incumbent players. Fierce competition, together with exposure to weather and consumer cuts in discretionary spending, make the earnings and inventories of mass-market apparel retailers more volatile and unpredictable than those of less-discretionary retail sectors. Further initiatives to improve profitability are being constrained by geopolitical challenges, which weigh on cost structures, including higher freight costs due to prolonged disruptions in the Red Sea.

Specialty retailers: Operating prospects vary greatly across these nonfood retailers from a range of subsectors, such as value, travel, beauty, DIY and home improvement, and electrical retailers. Other than the value retail segment, most of the European rated retailers in this group have high exposure to discretionary spending. That said, specialty retailers in the jewelry segment such as Pandora A/S and Goldstory SAS, Italian cosmetic retailer Kiko Milano, and pet care retailers such as Fressnapf Holding SE and Agrifarma S.p.A. are benefiting from continued consumer demand despite strong prices and have been able to operate at attractive margins. We expect these retailers will continue to raise their profitability as they have comparatively smaller operating scale and room for accelerated growth thanks to strong brand appeal and broad assortment, but also inherently lower fixed costs for their specialty goods. We expect the European pet care market to continue to grow steadily, driven by a shift toward higher-value products, primarily due to secular changes in customers' attitude toward their pets and an increasing willingness to improve their living conditions.

The recovery in global travel retail and significant improvements in its scale, geographic diversification, and product mix following the successful merger between Autogrill and Dufry should enable Avolta, a leading travel retailer and operator in the food and beverages space, to continue to strengthen its credit metrics. Value retailers such as B&M European Value Retail S.A., Pepco Group N.V. Action Holding B.V. and the newly rated Bubbles Bidco S.p.a. (Acqua & Sapone), should see strong demand as they remain popular with price conscious consumers. They are responding by expanding their product assortment and store footprints. We expect these retailers to continue increasing their revenue while benefiting from robust EBITDA margins.

On the other hand, many rated retailers, particularly in the electrical, home goods, furniture, DIY, and home improvement segments have seen volume pressure following significant price inflation. Operating performance is typically highly dependent on key trading seasons especially in the second half such as the summer months, Black Friday, and the winter gift-giving season. Capex investments in technology and logistics will have to be prioritised in 2025 to ensure fulfilment and service capabilities remain comparable to competition, which include large and well invested global e-commerce leaders such as Amazon and eBay. These retailers need to maintain a continued focus on proactive cost and working capital management that are critical to protect profitability and FOCF from material deterioration.

Restaurants, pubs, and food service: We have moderated our expectations of the earnings growth and deleveraging prospects of the rated restaurants, pubs, and food service companies in Europe, owing to unfavourable demand fundamentals and intense competition. All the rated restaurants in EMEA are in the 'B' rating category and below, and, apart from PAX Midco (Areas), the No. 3 global player in the travel food and beverage concession catering industry, all have a business risk of weak. We believe the dine-in segment will continue facing difficult demand dynamics, thereby creating a challenging environment to turn around operations amid intense competition. Weak FOCF for many operators also constrains the financial flexibility for expansion or capex.

We lowered our rating on PizzaExpress, one of the largest pizza restaurant chain operators in the U.K., to 'CCC+' on persistently weak cash flow. The cost pressure from higher wages and sizable lease payments will largely offset benefits from the cost-control measures that several companies have already put in place. The U.K. based restaurants and pubs are particularly exposed given the rise in minimum wages and employers' national insurance contributions.

China

Big-box/grocery: Big-box retailers in China are gaining market share from supermarkets as consumers emphasize value. With even higher volume, big-box retailers are gaining incremental bargaining power against suppliers (consumer product makers) to tailor product specification and more favorable inventory terms.

Specialty department stores: Chinese department stores continue to face pressure from rival channels and category exposure (jewelry, luxury, mid- to high-end segments), with store traffic remaining soft. As such, department stores operators are focusing on growing core membership through more personalized experiences for shoppers, including tailored shopping services to hosting offline events at the malls.

Apparel retail: As a discretionary category, this channel is performing weaker than general merchandise. Returns and refunds have surged materially, which is adding fulfillment cost to retailers, resulting in a mild decline in margins.

Restaurants: Demand for high-end restaurants has tapered off and remains low, while demand for more affordable meal options has increased. Concurrently, consumers are opting for cheaper food options and increasing smaller meals (such as night-snack) and average spending per customer has been falling. Meanwhile, the delivery market that has been in late-stage growth will likely see high-single-digit percent growth into 2025, down from double-digit percent growth in 2024.

Japan

General merchandise stores (GMSs): We expect GMSs to increase revenue in the low-single-digit percent area over the next one to two years. Competition is intense with other channels such as specialty stores. Rising labor costs will continue to depress operating profits. Retailers are accelerating efforts to improve the efficiency of store operations to improve profitability. Some retailers including Ito Yokado, one of the largest GMS in Japan, is accelerating closing unprofitable stores.

Department stores: We expect department stores to increase revenue in the mid-single-digit percent area over the next one to two years. This category has posted 10%-20% same-store sales growth in the last 12 months. Domestic consumption among the wealthy has been solid. In addition, incremental consumption from increasing foreign tourists is supporting sales growth for stores in the larger cities in Japan. In contrast, rural area department stores will continue to close due to population declines.

Apparel retail: We expect apparel retailers in Japan to maintain solid revenue growth of 2%-3% over the next one to two years thanks to ongoing improvement in mobility for locals and higher tourism spending. Demand is shifting to lower-priced goods and casual and functional products.

Convenience stores: Operating performance of domestic convenience-store business is likely stable thanks to solid merchandising operations, with 1%-2% of same store sales. However, there could be market share shifts from top player Seven Eleven Japan to the other two giants, Family Mart and Lawson, given that consumers remain price conscious and seek value, which makes competition for market share even tougher.

Grocery: Price competition will pressure supermarkets' top lines. An increase in operational costs, including labor costs, pressures profits for the grocery retailers. Competition is fierce against discount stores. In response, retailers have increased private-label offerings, revamped stores. Some have made acquisitions to maintain competitiveness and increase scale in the mature market. Increasing investment burden amid weak profits could narrow creditworthiness headroom.

Australia and New Zealand

Grocery: Food retailers experienced easing inflation in categories such as shelf stable and fresh protein in 2024. We expect low- to mid-single-digit percent same-stores sales growth, driven by higher volumes. The largely nondiscretionary nature of supermarket spending should support earnings resilience. We believe retailers with established private labels are well positioned to benefit as budget-conscious consumers increasingly trade down and prioritize value for money. Ongoing regulatory scrutiny into the sector will continue to limit retailer pricing flexibility. We anticipate increased promotional activities and ongoing cost pressures will weigh on EBITDA margins for fiscal 2025. Nevertheless, most entities retain comfortable ratings headroom while executing on their growth strategies.

Brazil and Chile

Department stores: In 2024, department stores demonstrated good recovery following a challenging 2023. The most successful effectively integrated a robust e-commerce platform with an omnichannel strategy, responding to customer demands for greater flexibility. We anticipate consumption trends will maintain positive momentum in both Brazil and Chile through 2025. However, in Brazil leverage remains a concern due to ongoing high interest rates. In contrast, we expect the macroeconomic environment in Chile to continue improving, with stable credit availability.

Apparel retail: This is one of the fastest-growing areas in retail, particularly driven by casual and sports apparel. The performance of apparel retail was strong throughout 2024 and is expected to remain positive in 2025. Artificial intelligence (AI) is increasingly important for making preference-based recommendations, and companies are advancing in their use of data to identify trends and streamline the production of more targeted collections.

Grocery: This is generally a more resilient subsector in Brazil, less affected by rising interest rates. The performance in 2024 has been relatively good, particularly driven by the increasing popularity of the cash-and-carry model and higher food inflation, which has outpaced overall consumer inflation. Additionally, digital sales are rapidly gaining significance, a trend we expect to accelerate as consumers seek more practical and flexible shopping experiences for groceries.

Mexico

Department stores: We expect lower economic growth in 2025 will weigh on consumption of discretionary goods, resulting in revenue growth from department stores slightly above inflation level. Companies with more advanced omnichannel capabilities and improved customer experience will have a competitive edge over peers amid the surge of pure online retailers and the growth of private labels across several categories.

Convenience stores: We expect convenience stores will outpace overall consumption in the country in 2025, given the nondiscretionary nature of most of product offerings, along with initiatives to digitalize customers and improve omnichannel capabilities. We expect sales to grow 7%-10%, driven by both pricing strategies and store opening.

Credit metrics and financial policy

We expect issuers to adhere to prudent financial policies in 2025 with uncertain government policy changes that could spur higher costs. If inflation remains benign and interest rate cuts continue, we expect cash flow profiles and refinancing prospects for speculative-grade issuers to improve. We expect credit metrics to remain largely in line with 2024, with slight improvements to interest coverage and debt leverage ratios as EBITDA modestly improves with relatively flat demand and modest improvements in profitability.

M&A may increase if rates continue to decrease and a favorable regulatory environment in the U.S. spurs action. We believe dividend policies will remain consistent and share buybacks will be relatively modest. In Europe, we anticipate share buyback activity will be mainly limited to large food retailers with strong FOCF generation like Carrefour, Tesco, and Ahold-Delhaize. In our downside scenario, we see reduced rating headroom if companies return to expansive financial policies and shareholder-friendly activity before a sustainable recovery in credit metrics.

Key risks or opportunities around the baseline

1. Inflation.

Proposed tariffs could spur inflation, forcing companies to pass along cost increases to consumers, dampening demand and consumer spending. Rate cuts will likely be delayed, hurting the housing market.

2. Consumer spending and the labor market.

Consumer spending figures continue to surprise, remains relatively positive, and the unemployment rate remains low. Consumers could continue to show strength. Labor supply could fall sharply, leading to sustained higher wages in the market.

3. Leveraged credits default or enter liability management transactions.

We expect some credit deterioration for noninvestment grade issuers in 2025. Speculative-grade issuers with upcoming maturities could be forced to refinance at higher rates, continuing to constrain cash flows. They may default or seek alternative restructurings.

Inflation is reignited and rates stay higher for longer. The proposed tariffs under the Trump administration could spur inflation, forcing companies to pass along cost increases to consumers. This will dampen demand and further weaken consumer spending. With renewed inflation, rate cuts will likely be delayed, hurting the housing the market and consumers reliant on credit card debt. Shelter and labor costs remain high, and increased tariffs could keep prices and interest rates elevated. Further erosion of consumers' purchasing power will lead to lower confidence and spending.

Consumer spending and the labor market are stronger. Consumer spending figures continue to surprise, remaining relatively positive, and the unemployment rate remains low. Consumers could continue to show strength if they still have savings and wage growth continues. With potentially tighter immigration policies in the U.S., labor supply could fall sharply, leading to sustained higher wages in the market. Still, with sticky high prices, consumers could continue to reign in discretionary and big-ticket purchases.

Leveraged credits default or enter liability management transactions. We expect credit deterioration for non-investment-grade issuers in 2025. If rates stay higher for longer, speculative-grade issuers with upcoming maturities will be forced to refinance at higher rates, continuing to constrain cash flows. Those issuers who cannot improve performance or address their capital structures may default or seek alternative restructurings such as distressed exchange or liability management exercises that are becoming increasingly relevant.

Related Research

- China Retail 2025 Outlook, Jan. 7, 2025
- CreditWeek: How Festive Will The Holiday Season Be For Retailers In The U.S. And Europe?, Nov. 21, 2024
- Retail Brief: European Retailers Set Out Their Stalls For The Golden Quarter, Nov. 21, 2024
- U.S. Holiday 2024 Sales Outlook: Consumers Will Trim Trees And Spending This Season, Nov. 12, 2024
- Peer Comparison: Top European Food Retailers' Business Strength Benefits From Operating Resilience, Aug. 19, 2024

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Industry Forecasts: Retail and Restaurants

Chart 8

Revenue growth (local currency)

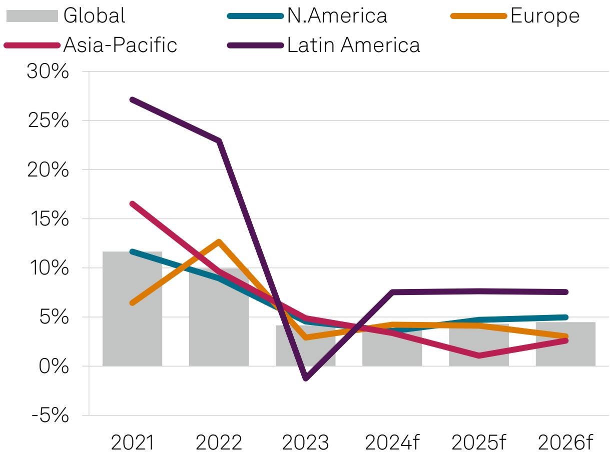


Chart 9

EBITDA margin (adjusted)

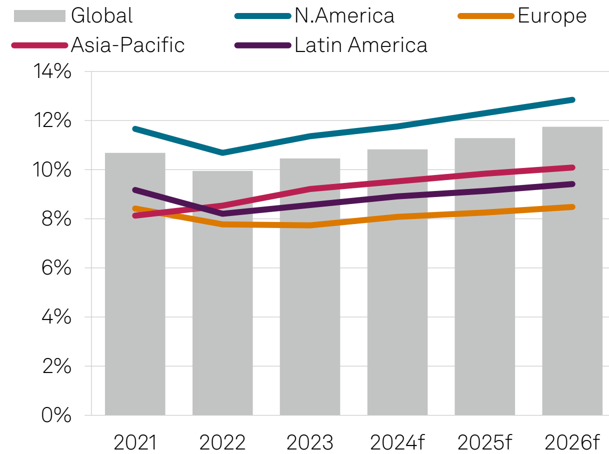


Chart 10

Debt / EBITDA (median, adjusted)

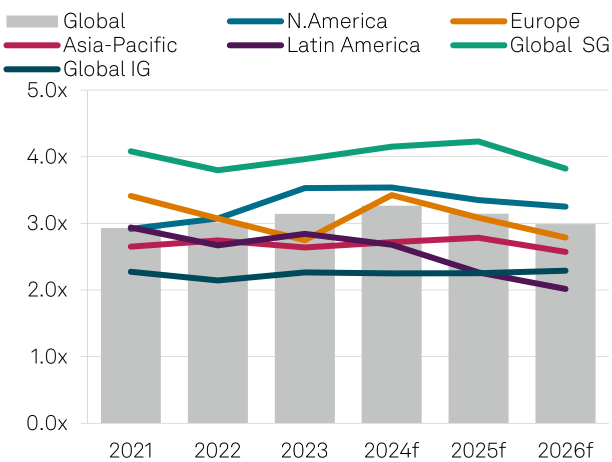
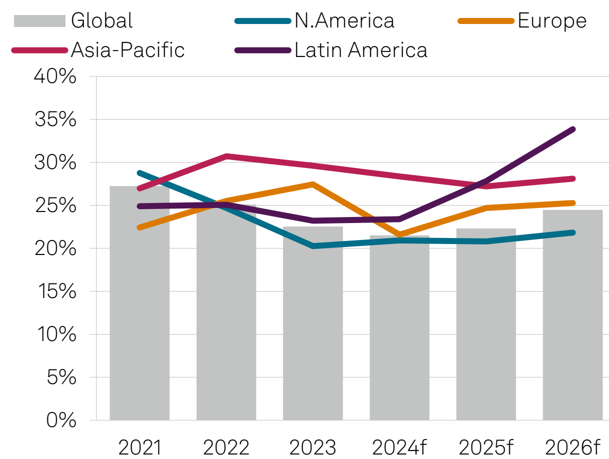


Chart 11

FFO / Debt (median, adjusted)



Source: S&P Global Ratings. f = Forecast.
Revenue growth shows local currency growth weighted by prior-year common-currency revenue share. All other figures are converted into U.S. dollars using historic exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO—Funds from operations.

Cash, Debt, And Returns: Retail and Restaurants

Chart 12

Cash flow and primary uses

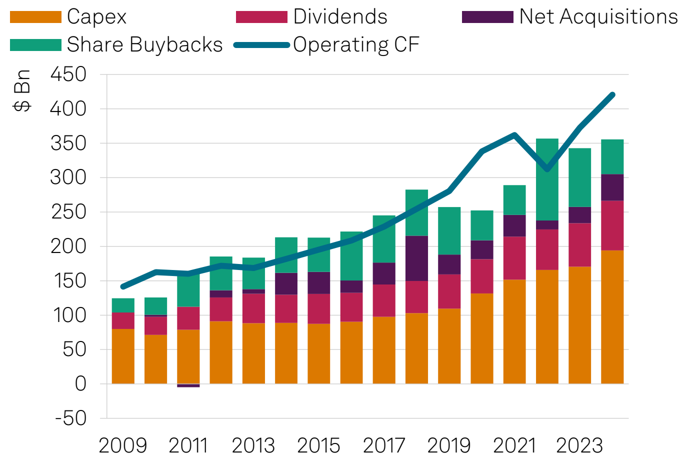


Chart 13

Return on capital employed

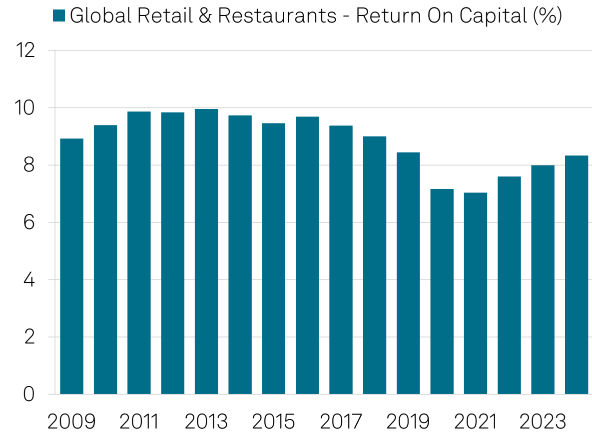


Chart 14

Fixed- versus variable-rate exposure

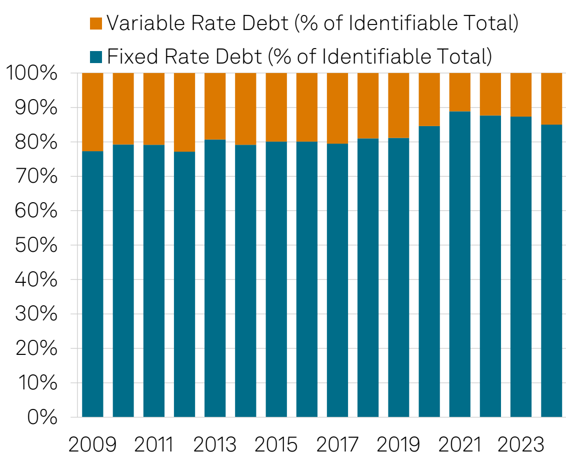


Chart 15

Long-term debt term structure

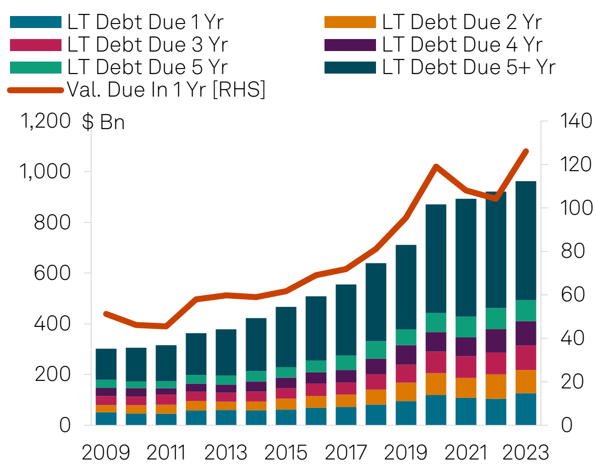


Chart 16

Cash and equivalents / Total assets

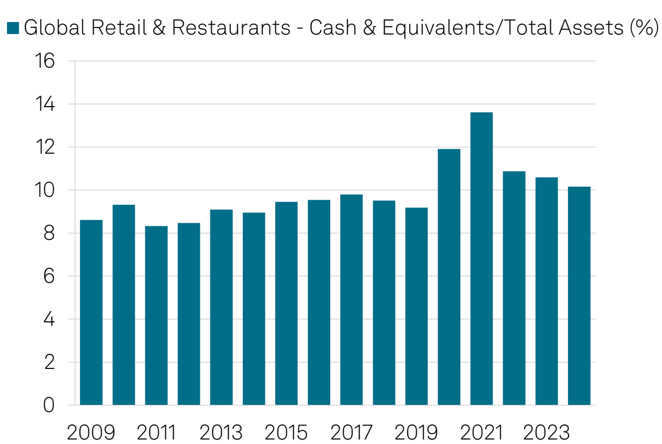
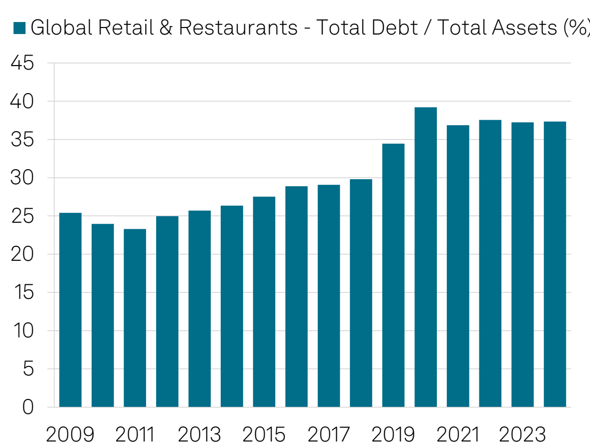


Chart 17

Total debt / Total assets



Source: S&P Capital IQ, S&P Global Ratings calculations. Most recent (2024) figures use the last 12 months' data.