JULY 6, 2020 5:55AM ET

What to Expect from a Covid-Disrupted Retail M&A Landscape

By Vicki M. Young

The retail sector's expected to see some changes ahead in a post-COVID-19 world. CREDIT: Shutterstock

The coronavirus pandemic has reshaped retail as we know it—and it's upending the retail mergers and acquisitions market, too.

On Wednesday, Macy's CEO Jeff Gennette told Wall Street analysts that the department store company has revamped its Polaris strategy to put off store investments, a signal that the more than $3 billion it lost in the first quarter is just a sign of things to come.

And it's not the only retailer taking a second look at its bottom line and reworking its M&A and investment strategy.

Bed Bath & Beyond, for one, is selling off businesses it purchased less than two years ago, MMG Advisors managing director Mary Ann Domuracki said during the "Retail in Turmoil: The M& Landscape in the Next Normal" webinar hosted by the Retail Marketing Society. The chain's plans to sell Christmas Tree Shops and Cost Plus World Market illustrate how some in the sector are divesting assets that are non-core to their main operations as they tighten up the purse strings.

Divestitures are a trend that could become more evident over the next six months as companies analyze their operations and make clear-eyed decisions on what should stay and what should go.

On the mergers and acquisitions side, Domuracki also foresees buyers thinking outside of the box in how they structure deals. This could mean retail sees fewer outright acquisitions and more synergistic mergers that mutually benefit both parties. Plus, a greater number of sellers might be "forced to come to market," she added, "as they need liquidity and realize that there are fewer retailers to sell to." The rash of stores that have already shut down as a result of pandemic disruption means retailers need less inventory to fill their remaining doors.

While bankruptcy has already claimed several high-profile retail chains, there's little certainty around which ones will manage to exit court proceedings intact, albeit in a new form. J. C. Penney is coming up against a July 14 deadline to forge a business plan with first-lien lenders, or else find a willing buyer or risk liquidation.

Leases could evolve in the near term, as bankrupt retailers and those that haven't filed seek to renegotiate their rental obligations with landlords. Andy Graiser, co-president at A & G Real Estate Advisors, predicts that lease terms will be shorter than they have been in the past but feature an option to extend. He also expects lease terms to offer a lower base rent plus a percentage of sales that could gradually kick in at a higher percentage next year if or when sales recover in earnest. Terms along these lines offer landlords some protection in addition to an upside when business improves. And the more modest base rent allows the landlord and tenant to equally share the covid pain.

The push toward experiential retail is likely to fade in the near term, too. New projects and redevelopments will probably feature fewer speed-racing tracks and trampoline parks, the kinds of attractions that were all the pre-covid rage in an attempt to reinvent the shopping mall, according to Graiser.

New projects will go back to basics with a focus on location, location and location. Good real estate is good real estate, Graiser said, which means store operators presented with an attractive rental opportunity will be smart to "lock it in for the long term." B and C malls on the lower rungs of the shopping-center totem pole could be ripe candidates for conversion to alternate uses. This could mean future developments focus more on residential and less on risky retail stores.

In the meantime, mall properties could see a rash a deals in which developers buy up their distressed tenants, much as Simon Property Group and Brookfield Capital did when they partnered with Authentic Brands Group to pluck fast-fashion chains Aéropostale and Forever 21 out of bankruptcy. The three are said to be kicking the tires in the J. C. Penney case. “Personally, I think this could only help the retail environment,” Graiser said.

Deal activity aside, retailers are struggling to figure out what it means to be Covid-19 compliant. It’s an issue “because there’s no consistent direction from the [federal] government,” said Stuart Kessler, founding partner and president of consultancy Clear Thinking Group. One of Kessler’s clients, which operates across 38 states, is putting together its own covid checklist since each state—and some local municipalities–has its own set of mandates. By doing the analysis at a micro level by state, companies can get a better picture of their overhead. “Four-wall profitability will be a different experience than in the past,” he said.

Companies will also review their store fleets and analyze different sets of cost strategies. “I don’t believe in the next 24 to 36 months that buy online pick up in [store] will be any less important,” Kessler predicted.

The off-price and dollar store segments are likely the ones that will see opportunities for growth over the next two to three years, Kessler added, as high unemployment rates breed a more cost-conscious consumer.