Post #1: Retail on the Ropes, But Punching Back

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With phrases like “shelter-in-place,” “social distancing” and “flattening the curve” becoming common vernacular, the U.S. and its economy have entered uncharted waters in response to the COVID-19 pandemic. While many industries are feeling the effects of this evolving crisis, retailers are taking decisive actions to sustain business operations. While some grocery and consumer staples retailers may be experiencing a slight uptick, most apparel, big box department stores and other specialty retailers are scrambling to deal with the need to respond to employee angst, preserve cash and quickly evaluate their balance sheets to adjust to the reality of store closures and depleted cash reserves.

With the second week of the pandemic behind us, leadership has become confronted with prolonged store closures and the reality of operations not returning “until further notice.” Retailers must now push business sustainability towards the forefront and make difficult organizational decisions to create financial flexibility while doors remain closed and many employees are unable to work.

Summarized below are topics we have been monitoring for our retail clients as we trudge deeper into the U.S. pandemic crisis.

- **Cash savings and liquidity have become the highest priority, and G&A is the focus:** Among the many drastic actions being taken by retailers to reduce cash requirements, we have noted the following as the most prevalent:

  — Store associate and corporate staff furloughs

  — Executive and outside director cash compensation reductions

  — Freezing merit and promotion increases for all employees

  — For dividend paying retailers, reevaluating or suspending dividend programs

  — Drawing down credit to create liquidity and financial flexibility

- **Hourly associates and corporate headquarter furloughs:** For those retailers that have communicated employee furloughs, the majority are dismissing a staggering 50% to 90% of their workforce. The hardest hit employee populations are the hourly full- and part-time store associates followed by “non-critical” corporate staff employees.

  — Non-critical staff has been generally defined as those employees who are not essential to the company’s e-commerce sales channel or are not involved in the business functions “critical to sustainable operations”

— We have also noticed a few retailers that have developed graduated salary reductions with higher salaried employee reductions in the range of 50% to 20% and lower salaried employees experiencing as much as a 10% salary reduction at the minimum

— The furloughs are generally effective April 1, but some retailers have disclosed compensating the furloughed employees with 1 additional week of pay (in addition to the approximate 1.5 - 2 week(s) of pay received during the initial store closure period)

— Furloughed employees are generally eligible for continued health and dental benefits throughout the furlough period

— Some retailers have discussed the terms of the furlough being ~6 weeks or longer, but the majority of retailers have committed to returning staffing levels on an as needed basis as the crisis winds down

- **Executive and outside director pay cuts:** Of retailers announcing executive pay cuts, the majority have reduced CEO base salary to zero while also reducing other executive and outside director compensation

— Management pay reductions have generally been extended to the VP/Director levels with base salary reductions being tiered based on level from ~50% to ~20%

— Outside directors' annual cash retainers have generally been reduced or eliminated. In some instances committee service fees have also been eliminated or reduced

As the crises continues and stores remained closed, Meridian is expecting more companies to communicate employee furloughs as well as executive and outside director pay reductions.

We expect retailers will continue to manage through additional issues with executive compensation during the current environment, including:

- How should recently approved 2020 annual incentive goals, that are now obsolete or unrealistic, be treated?
- Will compensation committees use more discretion when evaluating executive performance throughout the crisis and 2020 (effectively measuring how leadership responded to the difficulties presented by the crisis?
- What will be done with outstanding performance share grants which are underwater and/or unlikely to payout?
- How will compensation committees address the erosion in value of outstanding equity, even following grants awarded earlier this year?
- For those retailers who have not yet made their annual equity awards, how should programs and/or award values be adjusted to managed dilution and share availability?

We're hopeful that this will be a temporary setback for the retail industry, but we think that prudent actions will be well received by shareholders and other retail industry observers.