The Road Ahead For Rite Aid And Other Troubled Retailers

By **Talin Keshishian** (June 15, 2023)

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Corporate bankruptcies are at their highest levels since 2010 with many calling this era the retail apocalypse, and one thing has become very clear: No one is immune.[1]

With Bed Bath & Beyond Inc. filing in April in the U.S. Bankruptcy Court for the District of New Jersey, and Party City Corp. filing earlier this year in the U.S. Bankruptcy Court for the Southern District of Texas, more struggling retailers, many of which have been around for several decades, are barely hanging on.

They face the same looming fate, a bankruptcy filing that will likely impart the final chapter of their story.

The tale is not a new one, but it is one we will undoubtedly see more of in the foreseeable future as more companies that have simply run out of capital and resource avenues, while carrying heavy debt, are left with far fewer options and turning to the dreaded last resort, the inevitable plunge into bankruptcy.

Outlook

Halfway through 2023, troubled big retailers with unending internal shortcomings are braving their last battles with the current economic conditions consisting of rising inflation, interest rate hikes and tightened lending — none of which seem to be letting up.

While the outward cracks start to show with the shutdown of underperforming stores — Bed Bath & Beyond shut down 236 stores just before it filed for bankruptcy — internally, the trouble starts long before the doom.

It is fairly common knowledge that the last three years have been unsparing for many industries. With supply chain issues, emerging online competitors, a rise in prices — even with momentary halts in inflation — and tightened consumer spending, retailers that can't adjust fast enough are getting pushed out.

Familiar retail companies that have long paid close attention to margins and the bottom line have begun closing the doors to their stores while still scrambling to create operational changes and new models for the remaining storefronts.

In most cases, this has only prolonged the inevitable.

Who May Be Next

In a year that's seen so many high-profile corporate bankruptcies, we have taken note of a few patterns in metrics and behaviors tipping off potential insolvency issues.

And, if Rite Aid Corp.'s trajectory continues in its current direction, it may, unfortunately, fall to the same demise.

It's no secret that the pharmacy giant, which opened its doors in 1962, has been struggling for years. Just last year, it shuttered 145 stores and, in April, the company reported a net loss of $241.3 million adjusted net loss and a total adjusted earnings before interest, taxes, depreciation and amortization of $429.2 million for the fiscal year.

With a projected loss for 2024 at $466 million, the battling retailer's days might be numbered.[2] And if that wasn't enough, Rite Aid continues to get more bad news on the litigation front.

In March, the U.S. Department of Justice filed a lawsuit alleging violation of the False Claims Act, the act of submitting false subscription claims to Medicare and Medicaid and other government health programs.

The allegation is that Rite Aid filled hundreds of thousands of prescriptions that did not meet legal requirements for many controlled substances — i.e., opioid pills — which, according to the U.S. Attorney's Office, were "obvious red flags, and that Rite Aid intentionally deleted internal notes about suspicious prescribers."[3]

No stranger to publicized lawsuits, Rite Aid was just last year the subject of a class action in the U.S. District Court for the Eastern District of Pennsylvania that alleged that the company had made false or misleading statements to investors concerning Elixir, a pharmacy benefit management, or PBM, subsidiary and would-be golden child that Rite Aid had purchased in 2015 for nearly $2 billion.

While rivals like CVS Health Corp. rolled out its PBM CareMark in 2007 and have already reached success in the pharmacy services sector, Rite Aid, which was slower in the race, has not been as fortunate.

PBMs negotiate with drug manufacturers to create formularies, or lists of drugs insurers cover, and play a large part in setting drug prices, and it sounds like without a PBM, no modern big retail pharmacy can survive the future

The suit, triggered when Rite Aid acknowledged that the value of Elixir decreased by paying what is also known as goodwill impairment charge, alleges that Rite Aid inflated member numbers and made other omissions.

The complaint is significant because it sheds light on the fact that the PBM that Rite Aid touted as its knight in shining armor, which initially bolstered Rite Aids' standing, may not be living up to its expectations.

Despite the bad press, Rite Aid, confident it can mitigate its fiscal challenges, is continuing to put its focus on the bruised subsidiary that it hopes plays a large role in its turnaround program. Elixir announced in late May that it would release a new software platform improving customer service by using its interface tool.[4]

A look back shows that Rite Aid's trouble started years ago long before the lawsuits, but the COVID-19 pandemic temporarily sustained the pharmacy with the demand for medicine and the COVID-19 vaccines. Were it not for that, the deepening crack would have shown sooner.

Now, with the pandemic officially over, Rite Aid is unlikely to get another lifeline.

The company still has plenty of red flags. For one, Rite Aid's price to sales multiple is tiny in comparison to other national pharmacy chains like CVS and Walgreens Co. — .01 compared to .48 and .29, respectively.[5]

This is another not-so-great indicator that investors have low expectations for revenue growth going forward. Institutional investors including BlackRock Fund Advisors and The Vanguard Group Inc. control more than 51.76% of the outstanding shares of Rite Aid — greater than almost any other drugstore chain.[6]

While Rite Aid's downfall is that it just has not reduced its debt, with the quick departure of its CEO Heyward Donigan earlier this year, new interim CEO Elizabeth Burr has fetched Charles Schwab Corp., who at the end of March bought 2.6 million shares, signaling that the company seems determined to stay afloat.

The message now is that it's focused on its turnaround strategy of building a new model of product diversity and full pharmacy and health care services.

Takeover or Bankruptcy?

Just two years ago when the stock was still valued at just under $9, Rite Aid rebuffed Spear Point Capital Management's $815 million buyout offer maintaining that the chain had the assets — waging on Elixir — to compete in today's competitive market for prescriptions.

Will Rite Aid be lucky enough to get another buyout offer when its woes have since sunk deeper and its stock is now at $1.82?

Coupled with a large chunk of the debt maturity in 2025 and the rest in 2026,[7] what exactly is Rite Aid's debt management plan?

Help On the Bankruptcy Horizon?

Bankruptcy restructuring through a Chapter 11 filing may be a viable option, but can Rite Aid's many challenges be met upon filing? One thing bankruptcy initially gets you is time, a breather and a pause.

Big retailers know well the strategies and protections available to them through bankruptcy while they continue to operate and deal collectively with creditors, binding them to a reorganization plan and simultaneously getting rid of the liabilities that have paralyzed it, and rejecting the burdening leases and contracts.

The emergency nature of the filing may permit new or more favorable financing, giving lenders some perks and priority to extend financing to the debtor in possession while it still operates and pays the wages of over 47,000 employees.

A prepackaged Chapter 11 reorganization may already be in the works with key creditors who have a preapproved deal in place, keeping the primary focus on improving liquidity and capital.

But with Rite Aid's woes running deeper than capital restructuring, it may require far more time in the bankruptcy hospital to effectuate change in Rite Aid's bleak financial performance, solidify its turnaround program and make operational adaptations while implementing a sustainable industry redesign, and increasing its own brand pharmacy focus through scaling Elixir.

It remains to be seen if Rite Aid will in fact file bankruptcy, and, if so, whether it will be a quick, prepackaged plan or a traditional strategically planned one.

What will be the fate of Elixir, an integral part of Rite Aid's future? Will it stay on, or break off from its parent? Who will be the takers?

What we do know is that bankruptcy doesn't always spell a final death. Plenty of companies have successfully reorganized, emerged and lived to see another day with a transformed, likely scaled-down business model.

Time will tell how Rite Aid will fare and whether bankruptcy will be its doom and gloom — or its bloom and rebirth.

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Disclosure: BG Law represents a creditor in the Bed Bath & Beyond bankruptcy.

[1] Corporate Bankruptcies are Rising at a Concerning Rate, What to Do if your Company has Filed for Bankruptcy, Forbes, June 7, 2023, Senior Contributor, Jack Kelly).

[2] (Rite Aid Corporation Reports Fiscal 2023 Fourth Quarter and Full year Results and Provides Fiscal 2024 Outlook, Business News Wire, April 20, 2023.

[3] (Rite Aid Q4 results: Pharmacy causing pain, Supermarket News, Bill Wilson, April 20, 2023.

[4] Elixir announces the next wave of innovation for pharmacy benefits technology platform, Business Wire, May 23, 2023.

[5] 3 Red Flags For Rite Aid's Future, The Motley Fool, Alex Carchidi, April 25, 2022.

[6] Rite Aid:NYSE: RAD, Stock Price Forecast, Analyst Recommendations, CNN Business.

[7] Mounting Debt and Legal Risks Sink Rite Aid Into Distress, Bloomberg, Diana Li, April 11, 2023.