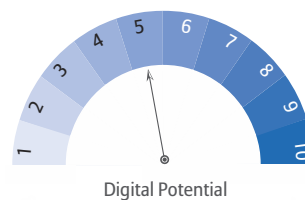
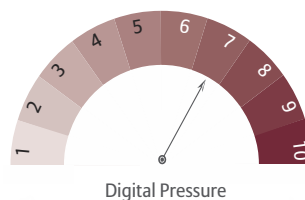
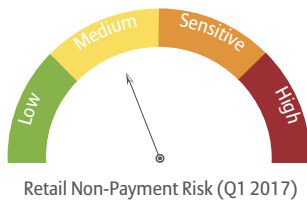




Retail in France

In search of lost innovation



- The slight pick-up of inflation (+1.1% expected in 2017) and acceleration of consumer spending (+2%) may offer retailers a one-time opportunity to boost pricing power eroded by three years of an intense price war.
- EBIT plunged in 2015 and 2016 to 3.7% and 2.6% respectively while net gearing soared to 95%. This hindered French companies' ability to adjust their offers to satisfy digital-ready consumers.
- Grocery, pure-players and organic segments are expected to resist better while the apparel segment might come under further strain.

Mired in stagnation

Although the penetration of the discounting format is less important in France (less than 10% market share) than in Germany (40%), price wars escalated four years ago. This was a desperate attempt to offset the threat of recession (+0.2% GDP growth in 2012). Since then, nominal sales have never exceeded a +1.5% growth rate y/y. The relative acceleration of real private consumption in 2016 (+1.8%) was countered by stagnating prices with inflation close to 0%. While macroeconomic drivers indicate brighter prospects for retailers (inflation above +1% and stronger private consumption), deeper changes will

be required to turn opportunities into earnings. The unfettered hunt for economies of scale and escalating price cuts has run its course. Big companies paid the price: seven French retailers with a turnover higher than EUR100mn went bankrupt in 2015 and one more was reported in 2016. French customers - 64% are e-shoppers - are open to new ways of shopping. Despite some success stories that cater to the needs of millennials – such as the private sales site *vente-privée.com*, booming local coops, and the online fashion brand *Sézane* - generally speaking, retailers fail to meet new shoppers' expectations.

Lost in customer relations

The mismatch between big box French strategy and shifting customers' expectations has resulted in a dramatic deterioration of the financial standing across the entire sector. EBIT plummeted in 2015 and 2016 to 3.7% and 2.6% respectively while net gearing soared to 95%. The economic adjustment in China and recessions in Brazil and Russia landed a blow on French grocers who invested massively in these regions. Euler Hermes assesses the risk of non-payment as Medium.

Added to the weakening financial standing, French retailers' perception of the sector's biggest challenges diverges from the global picture as portrayed by the Euler Hermes Digital Retail survey. Respondents felt

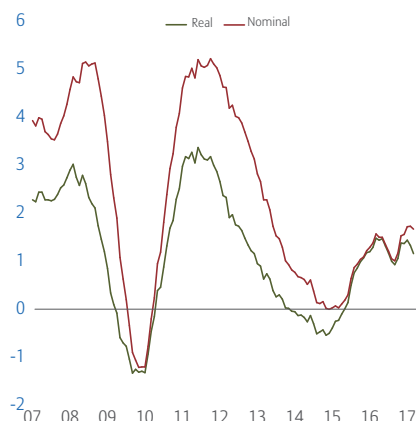
that local companies must first master omni-channeling, followed by the cost of online presence. Finally, French retailers should redefine market positioning. Indeed, the price war led to a blurred positioning as retailers manage e-commerce as a parallel channel. Only now do companies invest in differentiation in an effort to catch up with the digital race. What does seem to function properly are logistics: France is ranked 16th out of 160 in the World Bank LPI index. Still, international shipments and logistics quality and competence are relative underperformers.

Looking forward: What does it all mean for businesses?

Vertical integration - rather than horizontal concentrations - as well as offering unique organic products or limited collections, enabled some retailers to differentiate and survive the price battles. The discounts race has drained companies' ability to adapt to consumers' expectations. The rebound of the French economy can boost retailers with pricing power. This should be used to invest and innovate.

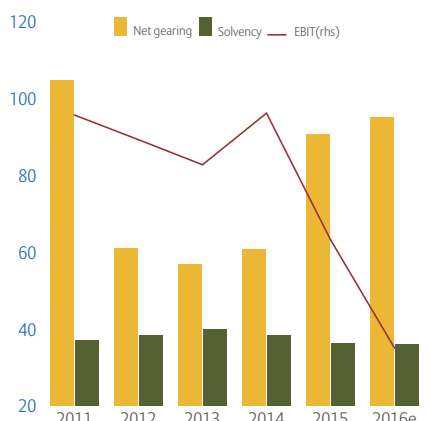
- ✓ Promising sub-sectors: Grocers, online pure players, organic segments
- ✓ Sensitive sub-sectors: Apparel and electronics retailers are most at risk, as they are affected by foreign online retailers. ■

Chart 1 Retail sales in France in %, 12m/12m, as of March 2017



Sources: IHS, Euler Hermes calculations

Chart 2 Financial performances of French listed retailers



Sources: Bloomberg, Euler Hermes calculations