



# Retail in Germany

## The march of the discount giants



- In 2017 and further on, the return of inflation and the slowing growth of real consumer spending suggest modest nominal retail sales growth in Germany.
- German retailers have suffered a dramatic decline in profitability: from 7% in 2011 to 2.9% in 2016. At the same time, indebtedness is down -6pp compared to the previous year, reaching a yet significant 95%.
- Discounters and online pure players are well placed to keep the growth momentum while the fashion and electronics sub-sectors face pressure.

### Mission almost impossible

Nominal retail sales growth in Germany has slightly regained momentum in Q1 2017. Yet it has not recovered to the pace observed at the end of 2015. This downturn results from the almost non-existent inflation (+0.5% in 2016) and stagnating households' disposable. Discounters' big hit overwhelmed the local market. The format accounts for more than 40% of the total grocery market. The top five European discounters are German. Crucially, these mega-players tend to expand their foreign activity very fast achieving a 10% market share in the UK and 2% in the US where the growth potential

is immense. Supermarket chain Lidl, for example, is gearing up to open stores in the US ahead of schedule in summer 2017. As a result, escaping the price war is almost Mission Impossible for German retailers. The return of inflation in 2017 (+1.8%, forecast) and 2018 (+2.1%) could hint at a relative improvement of German retailers' pricing power. One reason being is that German customers have by and large already adopted digitalization. 86% of the population uses the Internet and 27% of online retail is carried out on mobile devices. E-commerce, often more affordable than in-store purchases,

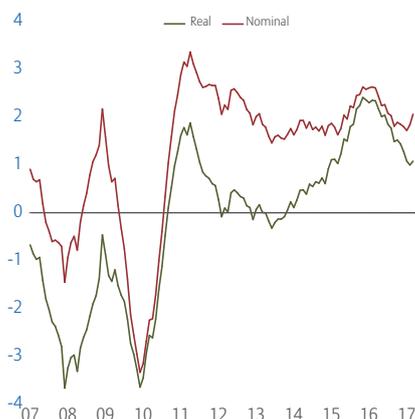
resonates well with price-savvy customers. Online sales represented 14% of retail sales in Germany in 2016 (compared to 9% in the World), up from 10% in 2010.

### Time to get going

In an almost-deflationary context, retail profitability dramatically plunged: EBIT declined to 2.9% in 2016, compared to nearly 7% in 2011. Food & drug and the apparel segments report the weakest profits at 2.2% and 2.3% respectively. However, the overall equity level remained steady while net gearing decreased to 95% in 2016), down from 102% in 2015. This is reflected in the limited number of major insolvencies (three companies with a turnover above EUR50mn in 2016). Euler Hermes non-payment

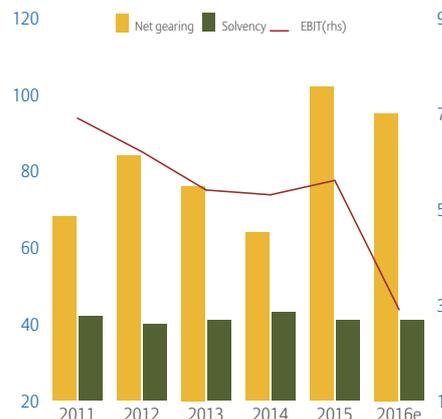
risk rating stands at 'Medium'. German retailers' perceptions of the sector's top priorities are well-aligned with local peculiarities. Respondents in the Euler Hermes Digital Retail survey feel that 'mitigating reputational risk' is a top priority, followed by the cost of online presence and the mobile customer journey. Companies find it difficult to address the German population's grave concerns about data privacy because of multiple data sources and flows. Add to that the complexity of legal frameworks in various countries. With no overall data strategy in place, this will remain a thorny issue. The other two priorities should be easier the tackle. The World Bank's international LPI ranks Germany first out of 160 on logistics. Rolling out mobile device journeys will require a fully-fledged data strategy, based on adequate infrastructures.

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



Sources: IHS, Euler Hermes calculations

**Chart 2** Financial performances of German listed retailers



Sources: Bloomberg, Euler Hermes calculations

### Looking forward: What does it all mean for businesses?

Clinging to price battles and outdated 'traditional' e-commerce is the single biggest threat to German retail. Upgrading the delivery and selling strategies will be key.

- ✓ Promising sub-sectors: Discounters and online pure players
- ✓ Sensitive sub-sectors: All segments, particularly fashion and electronics. ■