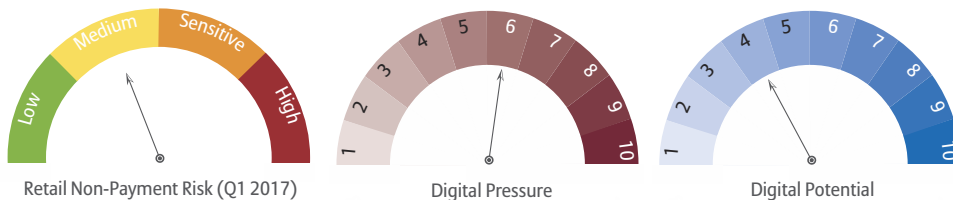


Retail in Japan

The upside-down pyramid



- Though still in negative territory, Japanese retail sales have been on an upward trend since October 2016. Yet the upside-down demographic and a rapidly aging population do not bode well for consumer spending growth.
- Japan's retail sector profits were down from 6% in 2013 to 5% in 2016 while net gearing has risen by +10pp to 75% over the same period.
- Convenience stores and online pure players are the least sensitive sub-sectors. General retail and home & office suffer from an unattractive positioning.

Moving up the aisle: New services and experience

Ever since September 2014 retail sales have suffered a continuous slide. The pace, however, slowed down after bottoming in March 2015 at -3.8% y/y. The stagnation if not the decline (-0.4% y/y in December 2016) in real wages is limiting real consumer spending, set to remain below +1% (+0.8% in 2017 and +0.9% in 2018). Deflationary pressures have undermined the market: the long-term CPI reached a mere +0.3% on a yearly average basis (2005-2015). The slight increase in producer prices

by +0.5% y/y in January 2017 could, however, lead to a slight recovery in retailers' pricing power. While being a mature market, Japanese consumers are quite digital-savvy: 55% shop online and in there were 125 mobile subscriptions per 100 inhabitants in 2015. However, population decline and aging negatively impact potential sales. The median age is much higher than the world figure - 46.5 and 30.1 years, respectively. To cope with the shrinking population (-1 million people in the past five years), some retailers - such as Seven & I and Aeon - have launched an interna-

tionalization strategy which seeks to expand business abroad in order to secure profits. In such an adverse environment, retailers have no choice but to focus on in-store experience, shopping convenience and added services. Optimizing delivery is one such example.

Senior citizens go digital

After three years of improving financial structure – both indebtedness and profit levels – Japanese retailers experienced deteriorations in 2016. Net gearing increased to 75% compared to 65% in 2013, while EBIT shrank from 6% to 5% over the same period. In this regard, Euler Hermes assesses retail in Japan to be in Moderate risk of non-payment.

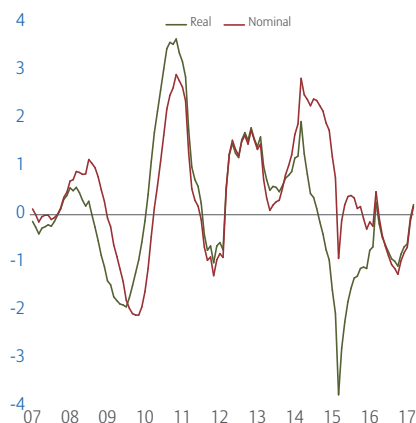
Demography explains why Japanese experts who participated in the Euler Hermes Digital Retail survey rank the top challenges for the local sector in the following way. Population decrease comes at the top, followed by mastering omni-channeling and tapping into big data. The efficient logistic system (ranked 12th out of 160 in the World Bank LPI benchmark) provides retailers with sound foundations. These can support the disruption of supply chains and the emergence of new delivery models that would be adapted to an aging population attracted to digital.

Looking forward: What does it all mean for businesses?

Offering services through apps and delivery flexibility are two major opportunities for retailers in Japan. However, as prices play an important part in purchase decisions, investment should be well calculated to avoid triggering price hikes.

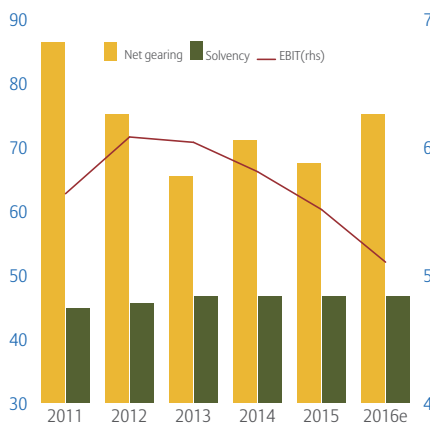
- ✓ Promising sub-sectors: Convenience stores and online pure players are well positioned to withstand pressures.
- ✓ Sensitive sub-sectors: General retail and home & office suffer from an unattractive positioning. ■

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



Sources: IHS, Euler Hermes calculations

Chart 2 Financial performances of Japanese listed retailers



Sources: Bloomberg, Euler Hermes calculations