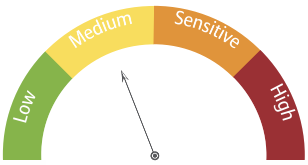
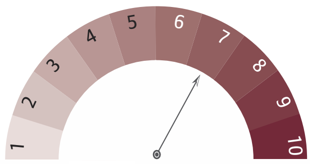
Retail in the US

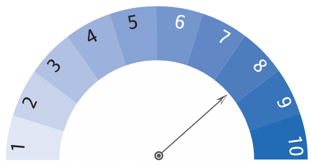
To thrive you must **first survive**



Retail Non-Payment Risk (Q1 2017)



Digital Pressure



Digital Potential

- **Nominal retail sales in the US bounced to +3% y/y end of 2016. They should accelerate in 2017-18 thanks to boosted household consumption and recovering retailers' pricing power. Yet a rise in import costs could offset the fiscal stimulus's benefits.**
- **Publicly listed retailers deleveraged in 2016. Net gearing was down to 95% (-15pp vs. 2015), while EBIT recovered at around 8%.**
- **The groceries segment has been so far spared by most of the disruptive impact, unlike Apparel and Electronics the main victims of restructuring and failures.**

No-frills is not enough

Nominal retail sales have bounced at the end of 2016 reaching +3.0% y/y in December, after stagnating at below +2.5% since end of 2015. This trend could be supported by the return of inflation. Euler Hermes's core scenario for the US forecasts an inflation rate of +2.5% in 2017 and 2018 (after a mere +1.4% in 2016) with three Fed hikes per year. The promised fiscal stimulus, corporate and personal income tax cuts, if implemented, should boost wages growth (+3.3% in 2017 and +4.1% in 2018) and household disposable income.

Renewed pricing power and increased consumer spending power should promise a bright future. Yet at the same time, if the new administration imposes tariffs and other non-tariff barriers, USD appreciation would not be enough to offset the rise in import costs. Retailers could pay a hefty price.

Therefore, American retailers must develop a differentiation strategy – other than no-frills – to increase margins and survive in an uncertain environment. Those who failed to do so in 2016 and early 2017 ended up failing themselves. American retailers are closing stores or failing at a record pace: Women's clothing retailer Bebe, Hancock Fabrics -one of the largest fabric sellers in the US-, Golfsmith, a golf-gear retailer… Past-dues activity has seen a steady increase since September 2016 with a knock-on effect along the supply chain on buyers in textiles, electronics, and manufacturing. In the meantime, US customers, of whom 70% are e-shoppers with Millennials leading the trend, have moved to the next level: they are eager to experience virtual and augmented reality in-store.

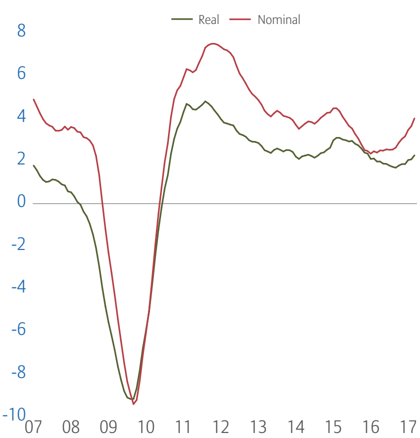
Ready for disruption

Retailers focused on deleveraging in 2016, pushing net gearing down to 95% (-15pp) and improving cost management allowing EBIT to recover up to around 8%. Euler Hermes estimates that non-payment risk in the sector stands at 'Medium' on average.

Moreover, American retailers are well aware of the long-run challenges. Interestingly, the top three challenges US participants named in our survey - mastering omni-channeling, mobile customer journey, and tapping into big data – accurately reflect the responses worldwide. In other words, as the US goes, so does the world.

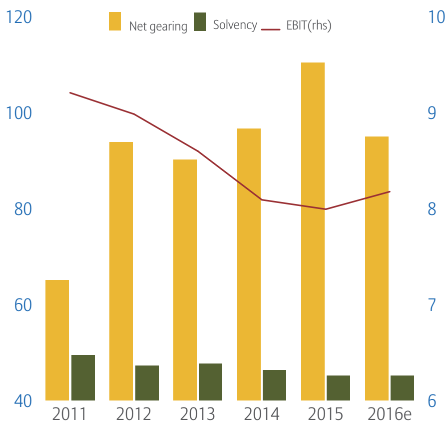
The country also benefits from efficient logistics. It is ranked 10th out of 160 in the World Banks' LPI index and excels in tracking and tracing of goods. Local companies are well positioned to embrace disruptive supply chain and delivery models.

Chart 1 Retail sales in the United States
in %, 12m/12m, as of March 2017



Sources: IHS, Euler Hermes calculations

Chart 2 Financial performances of American listed retailers



Sources: Bloomberg, Euler Hermes calculations

Looking forward: What does it all mean for businesses?

US retailers should focus on providing quality and innovative customer experiences and disruptive delivery formats.

✓ Promising sub-sectors: Grocers are relatively secure due to their critical size and the industry's must-have quality – food is always a necessity.

✓ Sensitive sub-sectors: Apparel and electronics will continue to experience the highest failure rates. ■