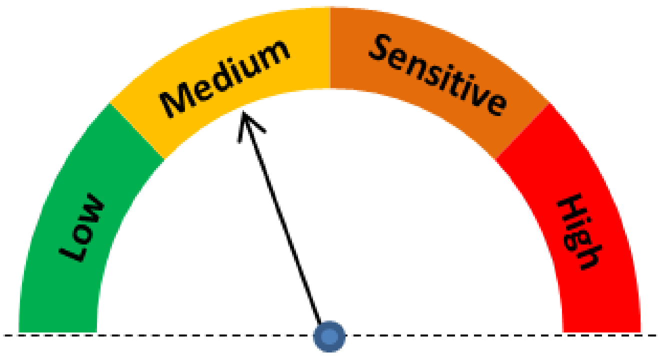
Euler Hermes Economic Research

Global Sector Report

RETAIL

Sector Risk Rating



What to Watch?

- Margin erosion despite rising volumes boosted by higher purchasing power (thanks to cheap oil)
- Inflation might pick-up beyond expectations for 2016 (USA +1.7%, China +1.8%) and put pressure on disposable incomes
- The tide of M&A activity will not abate in 2016 (after +7% deal count in 2015) triggering more group restructuring and business repositioning
- Possible arrival of yet more disruptive technologies / players

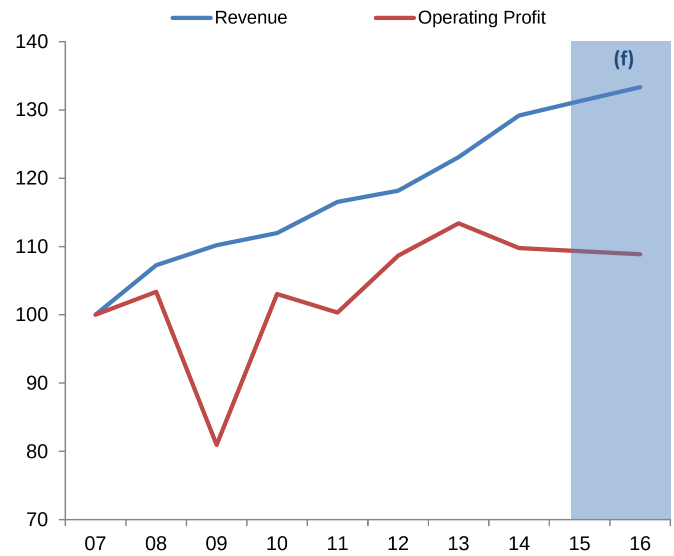
More restructuring as retailers rethink business models

Rising consumer spending, supported by ongoing low oil prices, hasn't saved retail from a slowdown in revenue growth - a mere +2% increase was recorded in 2015. The reason: a fierce battle for market supremacy between traditional and online players. If nothing else, companies protected their margins, and reported steady operating profits.

This may not prove feasible again in 2016. No surge in consumer spending is foreseen with +3% and +2% increases in the U.S. and EU respectively, and +8% in China. Economies such as Brazil – where retailers massively invested a decade ago – are struggling. As a result, Euler Hermes forecasts retailers' revenues to rise by only +1% in 2016 and profits to decline by -1%. The less-than-auspicious situation forces a business model reshuffle between physical stores and online sales, or omni-channeling.

When the current business environment hampers investment in new capabilities (knowledge or market share), retailers massively resort to mergers & acquisitions. The global number of deals increased by +7% in 2015 and should exceed USD200bn in value in 2016. However, it also implies a higher threat of restructuring and divestments for the sector, and along the supply chain.

Average Revenue and Profit for the Top 20 publicly traded Retailers (Index: 2007=100)



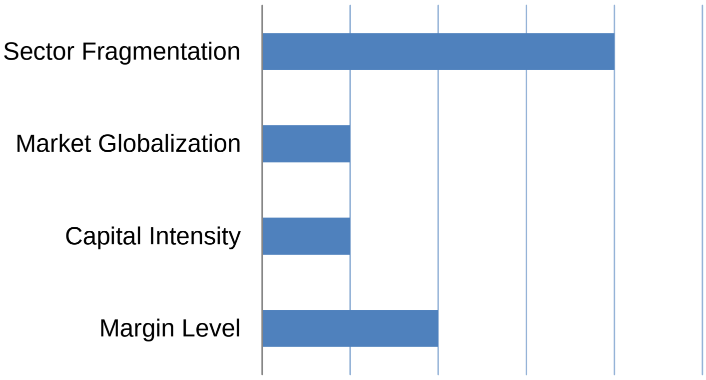
Sources: Bloomberg, Euler Hermes

Key Players

Country	Role	Sector Risk
United States	#1 exporter #1 importer #2 producer	
China	#2 importer #3 exporter	
Japan	#1 producer #3 importer	

ID Card

Sector Value:
7,294bn
USD



Strengths

- Well established players, with efficient pricing power relative to suppliers limiting financial default risk
- Brick and mortar still the preferred shopping format for purchasing of goods
- Long term growth in disposable incomes thanks to rising middle-class

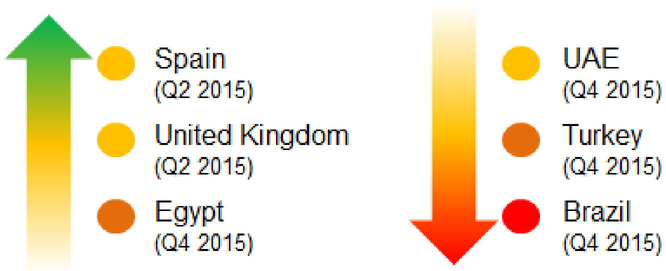
Weaknesses

- Race-for-volumes model reaching its limits with no clear alternative 'winning' strategy. Going fully on-line, for example, has its limitations
- High indebtedness stemming from massive development in emerging economies coupled with a slowdown in some important markets

Subsectors Insights

The boundary between **Grocery** (Food and Beverages, Home appliances) and **Non-grocery** retailers (furniture, sporting goods, office supply, etc.) has become increasingly blurred. It is the result of relentless product range diversification by groceries.
This trend stems from the race for revenues and is emphasized by the rise of **omni-channel** sales. The latter tends also to blur the usual distinction between **Grocers** and **Shops** that can compete online on an (almost) equal footing.

Recent Sector Risk Changes



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