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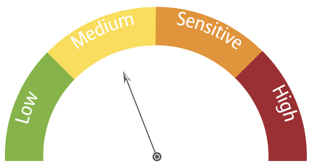
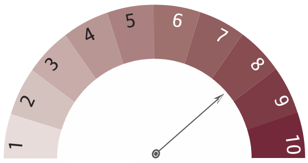
Retail in the UK

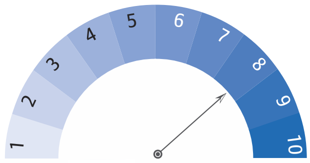
No room for complacency



Retail Non-Payment Risk (Q1 2017)



Digital Pressure



Digital Potential

- **In the context of Brexit, the macroeconomic outlook for 2017 and 2018 is uncertain as consumer spending is expected to slow down, weighing on retail sales.**
- **Intense competition, namely from online activities, is putting businesses at stress: EBIT was down -1.4pp to 5.6% and net gearing picked up in 2016 to 66%, from 55% the year before.**
- **Although it is not all bright major grocers and apparel e-players should remain on track in 2017, while department stores and high-street apparel retailers would keep suffering from consumption downturn.**

Uncertainty weighs on British retailers

Nominal retail sales have picked since end of 2016 (+3.0% y/y) after stagnating at about +1% since Q3 2015. Severe price pressures and low inflation (+0.7% in 2016), both played their part in the fierce price wars.

Yet, in a post-Brexit environment, we forecast inflation to rise by +2.5% in 2017 and +2.6% in 2018 on the back of depreciated sterling and National Minimum Wage has been revised up to GBP7.5/hour in April 2017 (from GBP7.2). A full-time worker stands to gain an extra GBP 1,400 a year. This could mean additional GBP4bn might be available for UK consumers.

A potential rise in inflation and income could foster retailers' pricing power, and compensate the likely deceleration in volumes. Indeed, real consumption growth is set to slow down (+1.9% in 2017 and +1.3% in 2018) and the rise in minimum wage offers only partial relief to low earners that are the most affected by higher food and fuel prices.

Another important factor is high concentration: only five grocers dominate the market. But threats abound: the discount format has made big gains, with up to 10% market share. At the same time, in 2016 a whopping 81% of customers were e-shoppers, a rate twice higher than the European average. This highly disruptive force sounded the death knell for many high-street retailers that failed to adapt. Two major failures were reported in the apparel segment in 2016. A Levy and Gajan Holdings could not withstand the competition from TM Lewin, Moss Bros, and the giant Marks & Spencer.

Well equipped for the ultimate de-compartmentalization

After several years of continuous improvement, British retailers' financial standing deteriorated in 2016. Net gearing ratio increased by +10pp to 66%, while EBIT slid -1.4pp to 5.6%. In the backdrop of worsening macroeconomic prospects, Euler Hermes estimates the UK retail sector faces a medium risk level for non-payment.

British retailers' top priorities are mostly aligned with our survey's overall digital challenges for the sector. The top three challenges experts chart include the mobile customer journey, the cost of online presence and mastering omni-channeling.

The UK enjoys an advantageous logistic environment, ranking 8th out of 160 on the World Bank's LPI. Retailers are well positioned to face the above-mentioned challenges, provided they succeed in stabilizing financials.

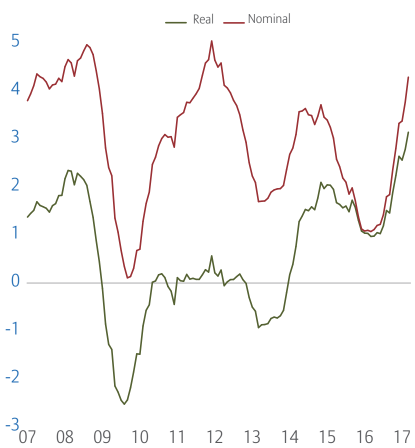
Looking forward: What does it all mean for businesses?

The ultimate de-compartmentalization of digital and in-store will be supported by leveraging IoT and cutting-edge payment methods. This should limit Brexit's expected negative impact on retail.

✓ Promising sub-sectors: Big grocers & discounters; fashion retailers with an online presence and overseas operations.

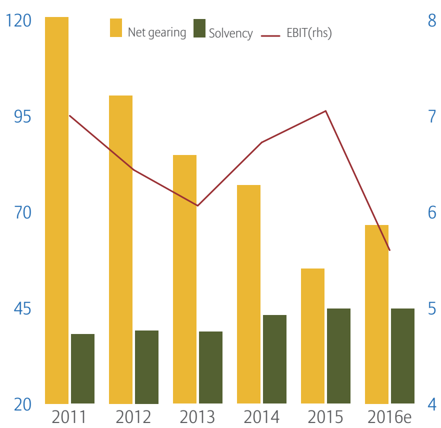
✓ Sensitive sub-sectors: Department stores and traditional fashion retail are the first to suffer from declining traffic. ■

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



Sources: IHS, Euler Hermes calculations

Chart 2 Financial performances of British listed retailers



Sources: Bloomberg, Euler Hermes calculations