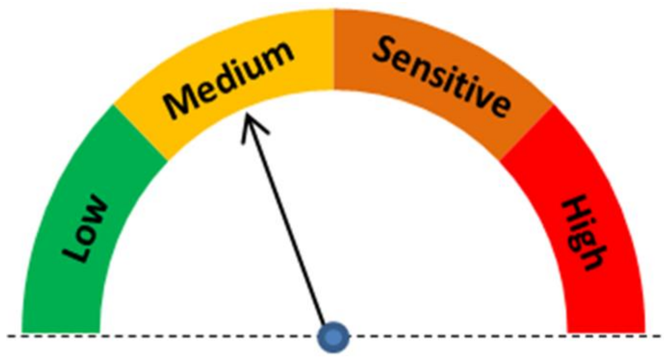
Euler Hermes Economic Research

Global Sector Report

RETAIL

Sector Risk Rating



What to Watch?

- Recovering prices should lead to better pricing power for retailers
- Data management and user experience (UX) become increasingly important parts of the business model
- M&A activity was estimated to be up +11% in 2016. Often it is directed at acquiring new technological capabilities. Restructuring should continue across the board in 2017
- Growing global, thinking local: the dominant theme propelling future growth

Growing pains: How to expand without worsening already-high indebtedness

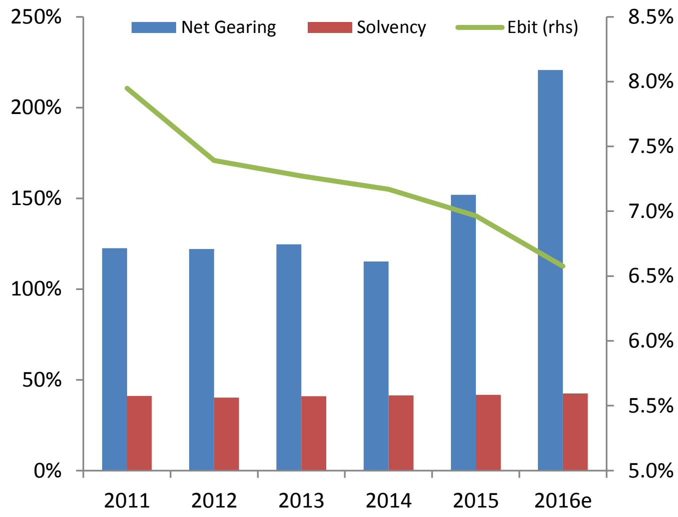
Despite a +2% increase in volume, nominal sales steadied against a backdrop of low commodity and consumer prices in 2016. This has a negative impact on retailers' pricing power.
As a result, the sector's profitability - as reflected by Earning Before Interests and Taxes (EBIT) - have reached the lowest level in six years at 6.6% (down -1.5pp over this period). In addition, indebtedness skyrocketed: the net gearing ratio now surpasses 200%. This deterioration is remarkable for Electronic retail where net debt exceeds equity by a factor of four.

The combination of weakening profits and rising debts will be a key concern as interest rates have already been raised in December 2016 in the US and as more Fed hikes are expected in 2017-18.

Yet, we forecast a contained reflation in 2017 with +2.2% in the US and +1.3% in Eurozone compared to +1.3% and 0.2% in 2016 respectively. Combined to recovering consumer spending, Retailers' margins should rise by +1.5% on average in 2017.

Yet, the ability to grow the business and profitability will much depend on the chosen distribution format. The rise of e-commerce is crucial: by 2020 it could represent 15% of worldwide retail sales.

Key financial ratios of publicly listed Retail firms (%)



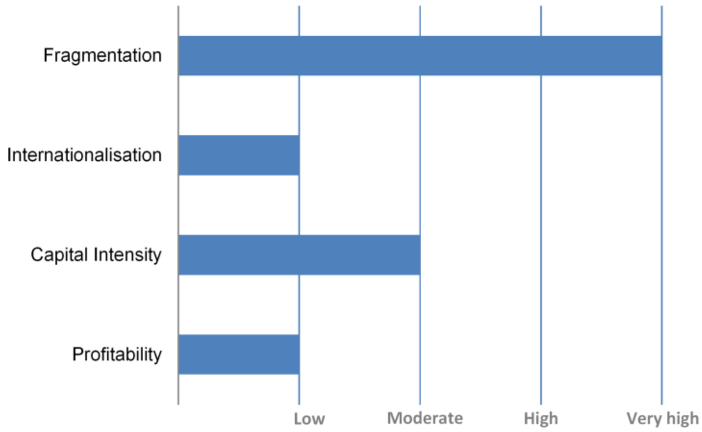
Sources: Bloomberg, Euler Hermes

Sector Value:
7,940bn
USD

Key Players

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

ID Card



Strengths

- Well established players, with efficient pricing power, compared to suppliers. This limits financial default risk
- Brick and mortar is 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 Insight

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 also blurs the traditional distinction between **Grocers** and **Shops** that can compete online on an (almost) equal footing.

Recent Sector Risk Changes

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