



Accessible Retail Conference 15th October, 2009

Green Shoots or Something Else

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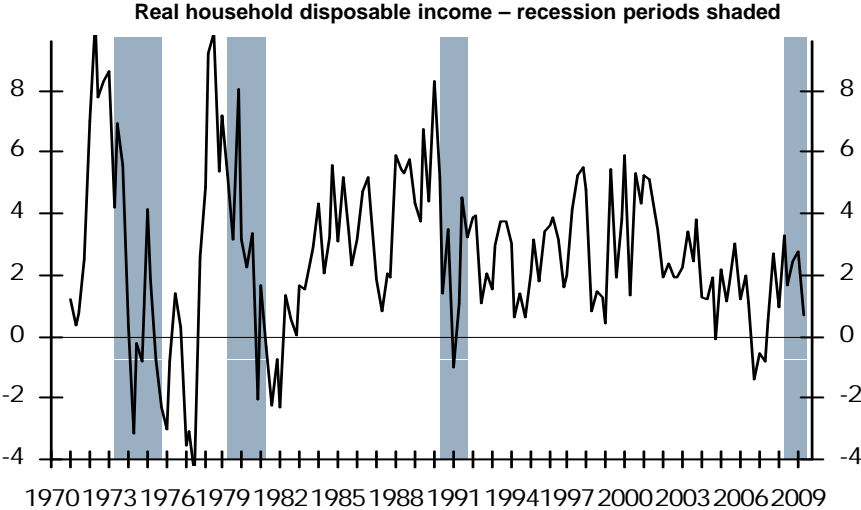
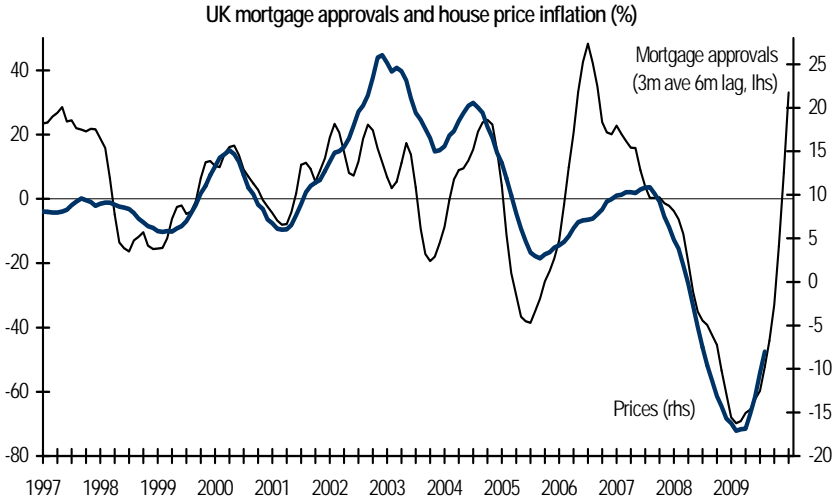
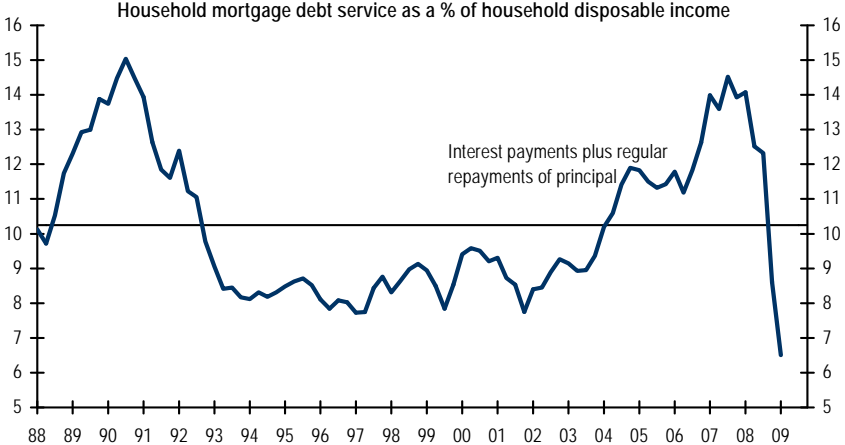
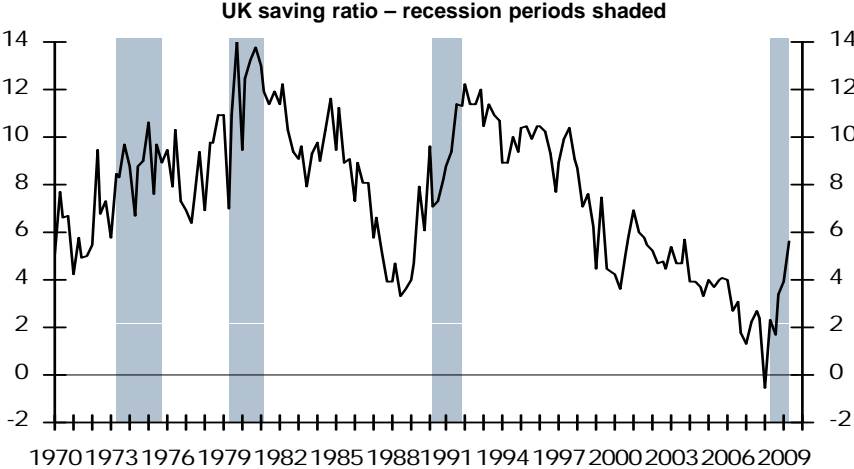
Agenda

- Understanding the Retail Cycle
- How the cycle plays out against broader structural movements in retail
- Is there anything different this time around?
- Retailers plans as relayed to market

The retail cycle

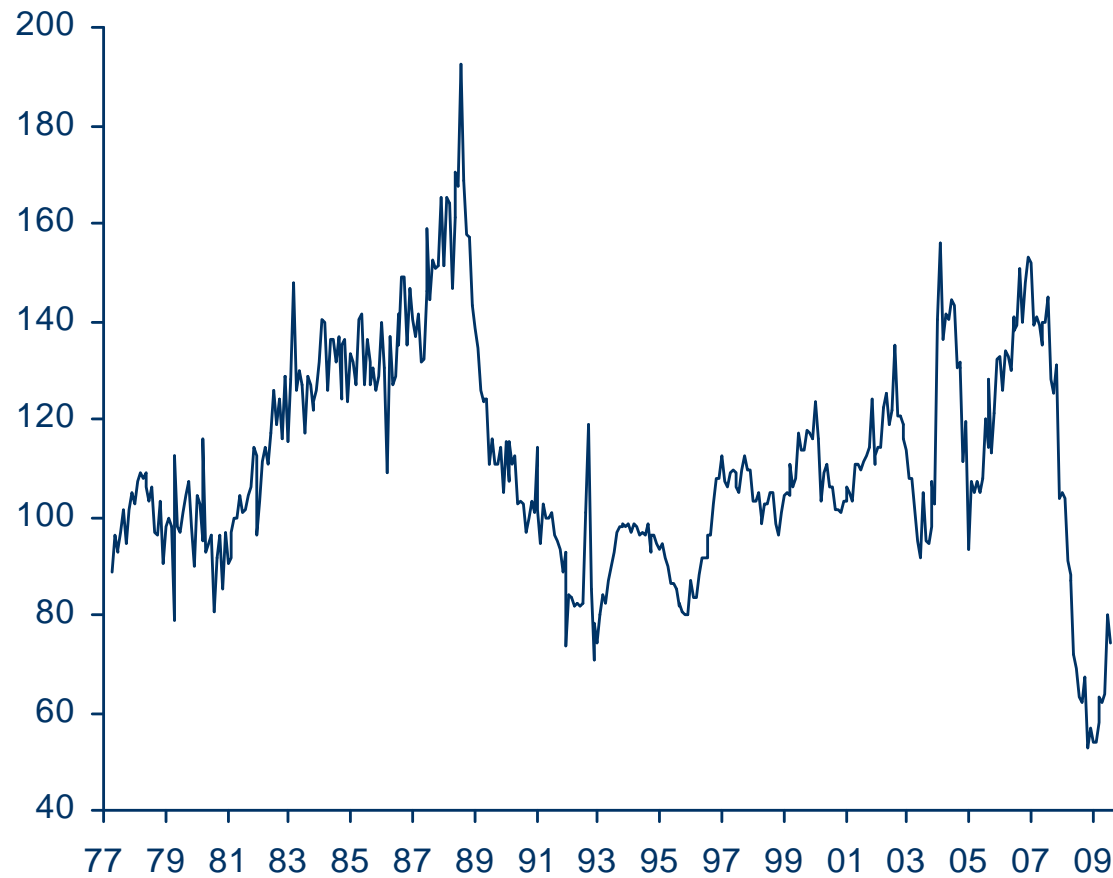
- The cycle of retail profitability reflects the demand cycle but is accentuated by the behaviour of the property industry
- Used to be that demand cycle followed electoral cycle but decoupling of responsibility for monetary policy from government and global easy money policies resulted in extended demand growth
- Typically retailers encouraged to over-expand by property availability and desire to be in the best locations (plus exit barriers)
- Historically space comes on stream as demand falters causing pain to both retailers (rent) and property developers (bust).
- REIT structures may have exacerbated

UK Economics:



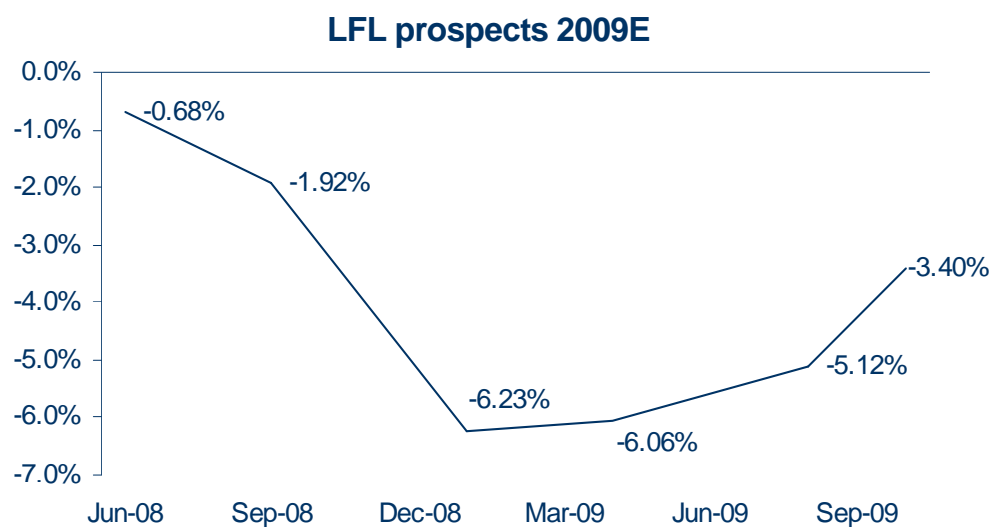
Source: Datastream

Housing transactions



Source: Datastream, Customs & Excise

2010 LFL prospects



Source: Credit Suisse estimates

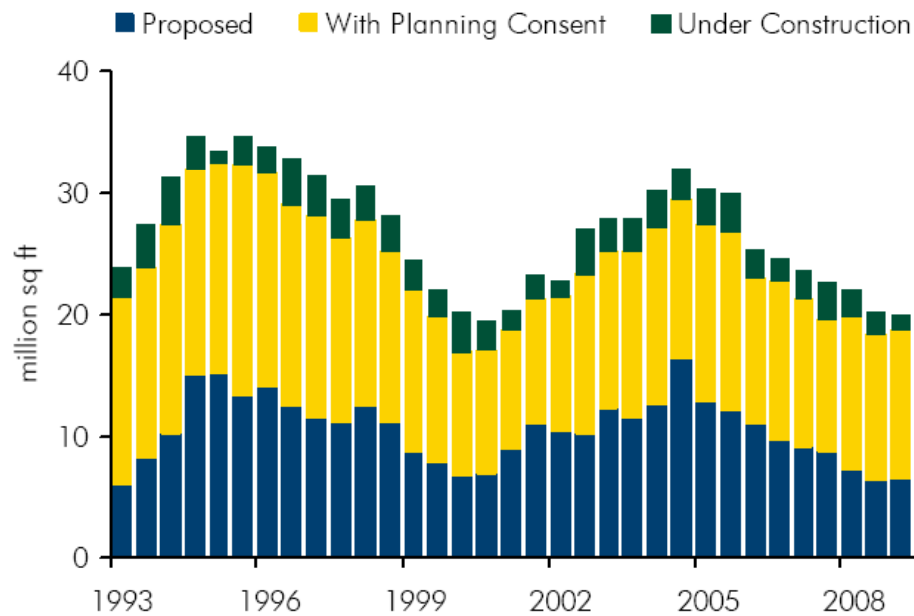
LFL growth - UK	01/10/09		
	2008E	2009E	2010E
Debenhams	-1.96%	-3.00%	-2.00%
DSGi	-6.92%	-9.41%	-1.96%
Halfords	-1.70%	-2.70%	0.74%
Home	-5.65%	-2.12%	0.94%
Kesa	-5.77%	-4.64%	-0.87%
Kingfisher	-5.92%	-2.20%	0.20%
Marks & Spencers	-5.04%	-1.86%	-1.06%
Next	-6.85%	-4.71%	-1.69%
WH Smith	-2.69%	-3.36%	-0.96%
Average - Weighted	-5.27%	-3.40%	-0.66%
Average - Simple	-4.72%	-3.78%	-0.74%

Out of Town Cycle

- OOT retailers have tended to sell predominantly hard goods – open use A1 consents relatively few.
- Hard goods markets have been in decline for much longer than the retail market as a whole – DIY has been in recession (until this year) since 2005.
- Housing market activity may stimulate and v short development lead time
- Some new formats – Next, John Lewis, Best Buy
- Existing formats not expanding – B&Q, DSGI, Comet
- Voids from failures – esp MFI
- Some expansion – Halfords, Argos, Wickes, Pets at Home, value sector

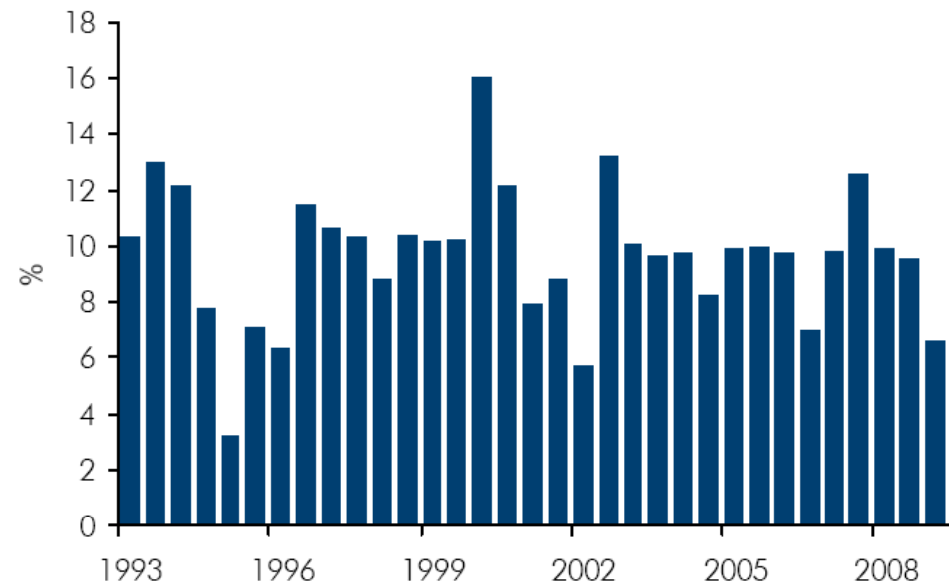
Out of Town construction

Retail Warehouse Parks in the Pipeline:



Source: CB Richard Ellis, PMA

Total Pipeline Under Construction (as a proportion of total pipeline)



Source: CB Richard Ellis, PMA

Structure

- Retail is an evolutionary process with businesses moving to the most cost efficient distribution over time.
 - Significant barriers to exit – institutional lease terms
 - OOT benefited from 1980s form de-regulation of consumer credit
 - Activity levels in recent years suggest that OOT development may already have peaked and be in more mature replacement phase
 - Some OOT markets being penetrated by online, less so by food retailers.
 - Big Box not the dominant force it was – B&Q, Carrefour
 - Structural changes happen most rapidly during periods of economic stress.
-

Evolutionary process in non food retail

Non-traditional

Non-food

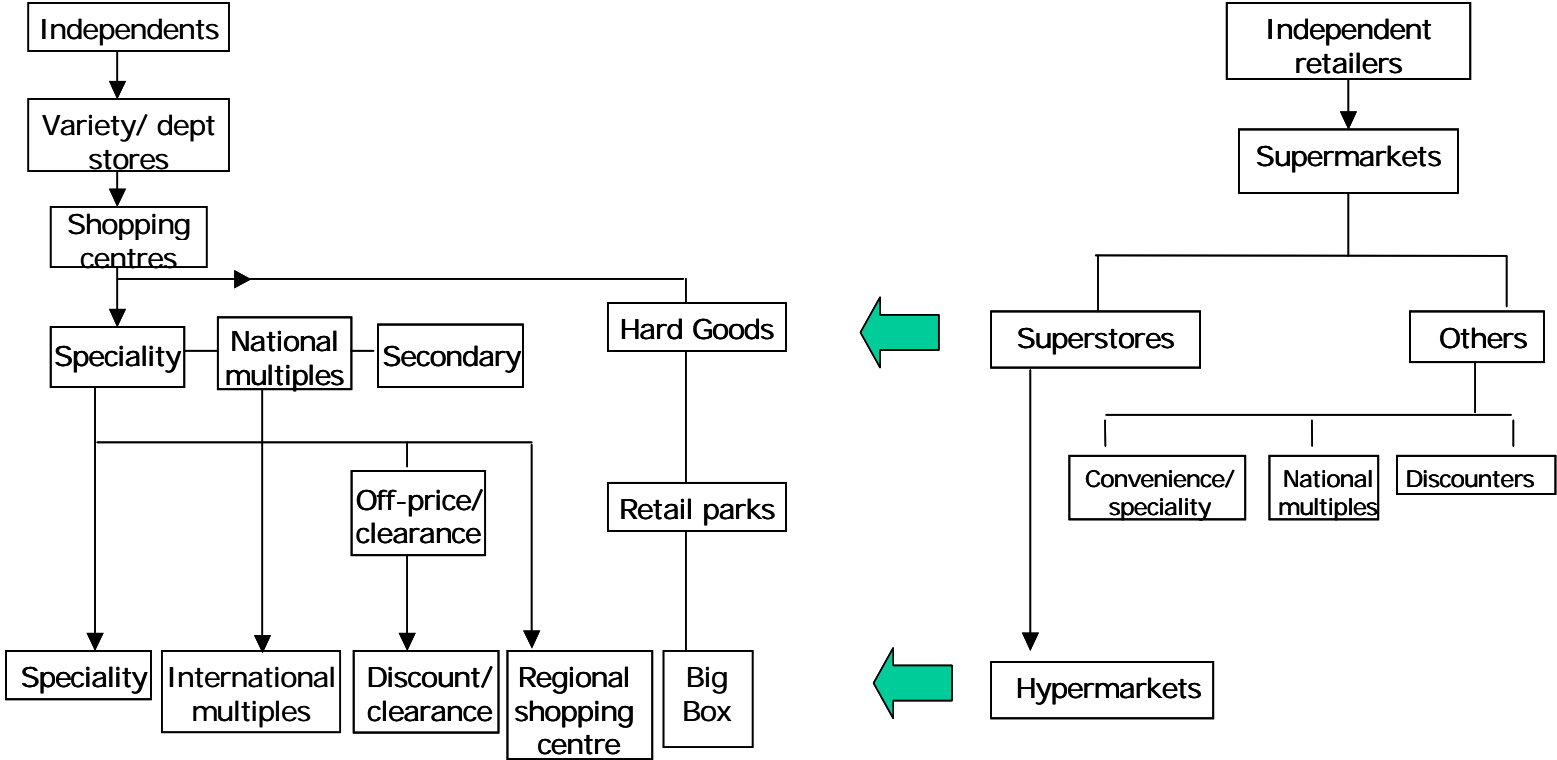
Food

In-town Edge-of-town Out-of-town

Mail order

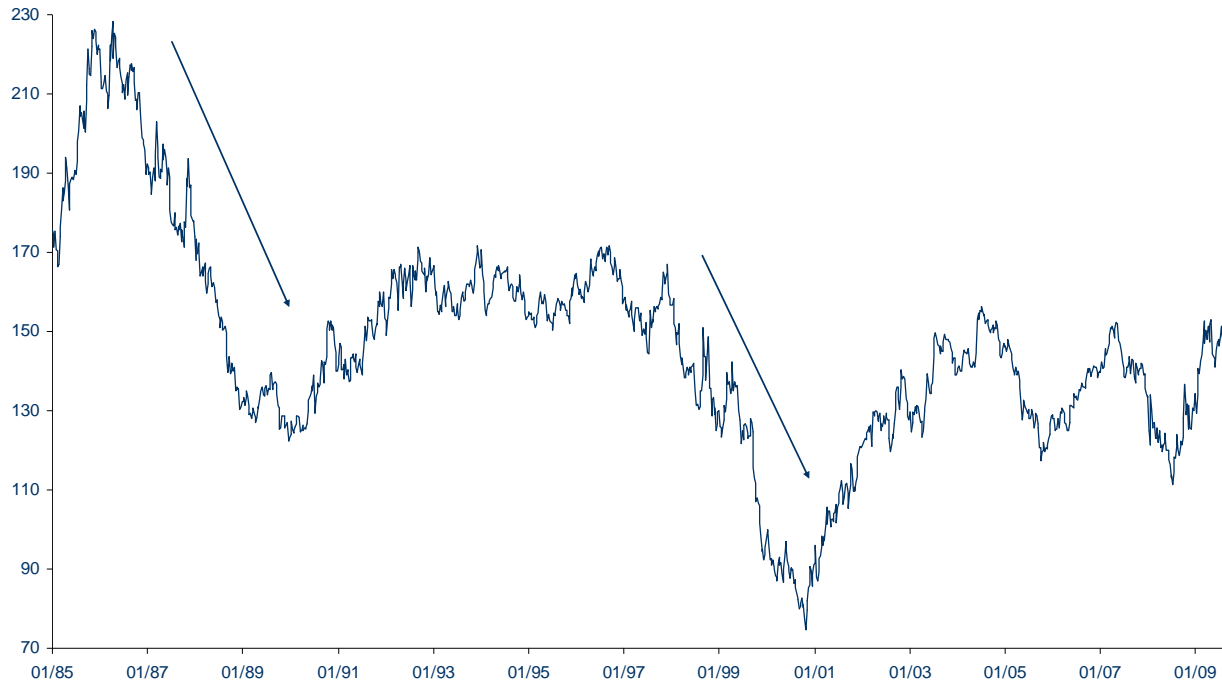
Off-price

Internet



Longer-term view

UK General Retail Sector vs FTSE All Share



Source: Datastream, Credit Suisse research

- Long down swings in retail profit cycle reflected by share prices – greater share to property.
- Rebound in early 2009 – is this saying recovery coming or short term adjustment to very negative post Lehman forecasts?

Risk appetite in the market overall has improved –



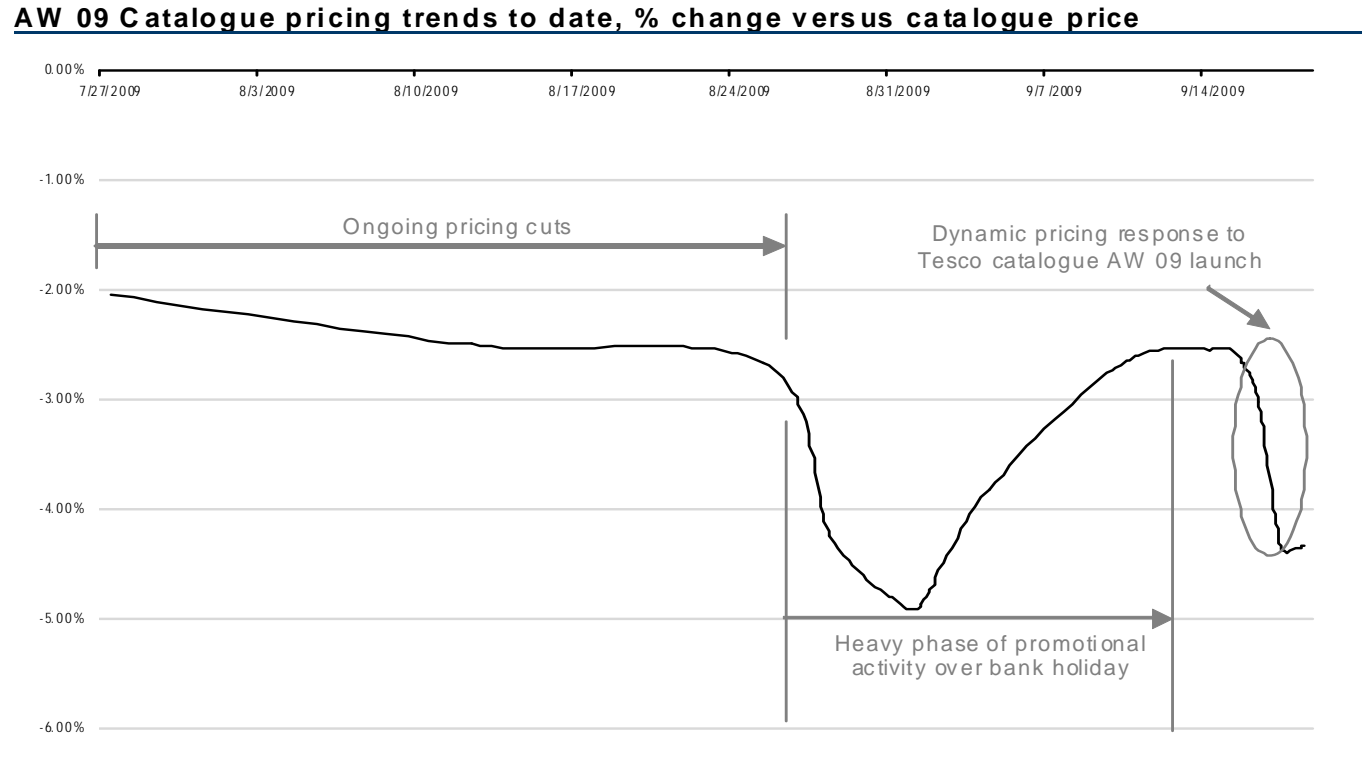
Source: Credit Suisse



Food retailer activity extends to catalogues – effect on Argos

- We have recently written on Home Retail discussing how it is becoming more vulnerable to price competition as it is forced to move more on-line itself.
- We have price-scraped the Argos website and show price movements within an Argos catalogue life.
- Big impact when Tesco launches its catalogue 6 weeks into Argos season
- Others moving into this space – Asda (similar demographics) also starting catalogue, Sainsbury up-scaling its non food.

Pricing – AW 09 to date

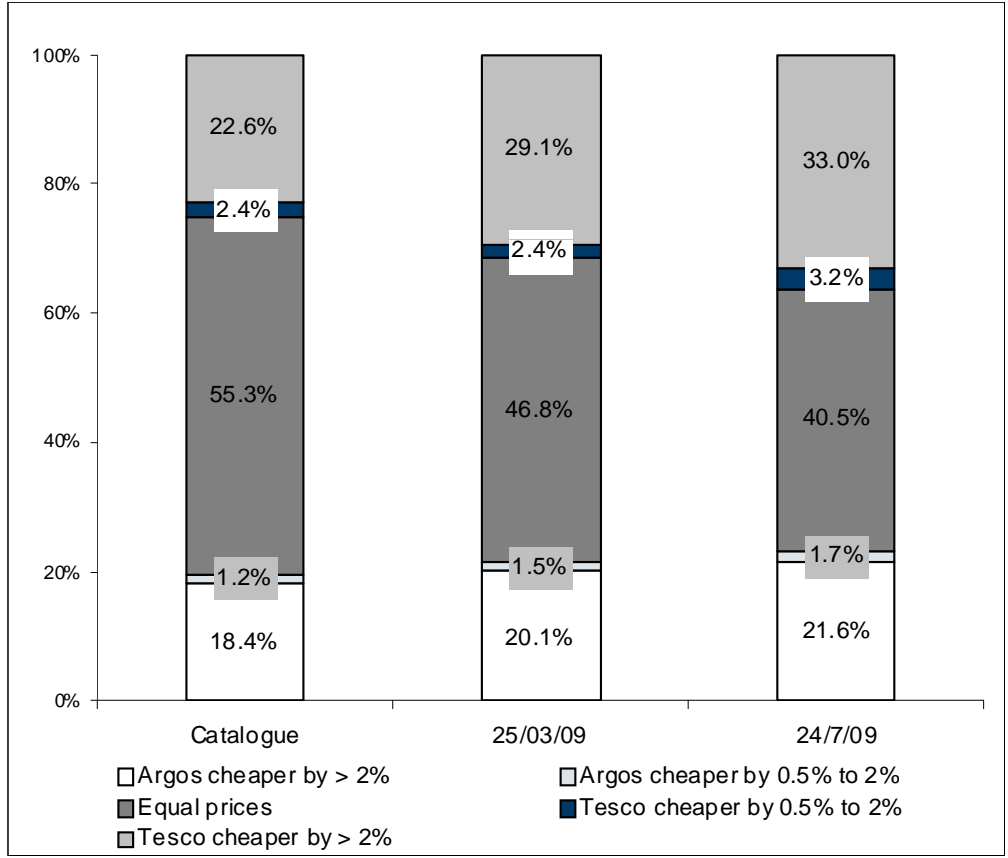


Source: Company data, Credit Suisse Estimates

- First 8 weeks of AW 09, analysis shows a price reduction of 4.4% (2.8% on a time weighted basis). Trend suggests further price reductions are likely, particularly given we are so early in the seasons' cycle. Note significant levels of reductions post Tesco AW 09 launch (12th September 2009)

Pricing – Tesco cheaper than Argos through SS 09

SS 09: Argos vs Tesco pricing evolution



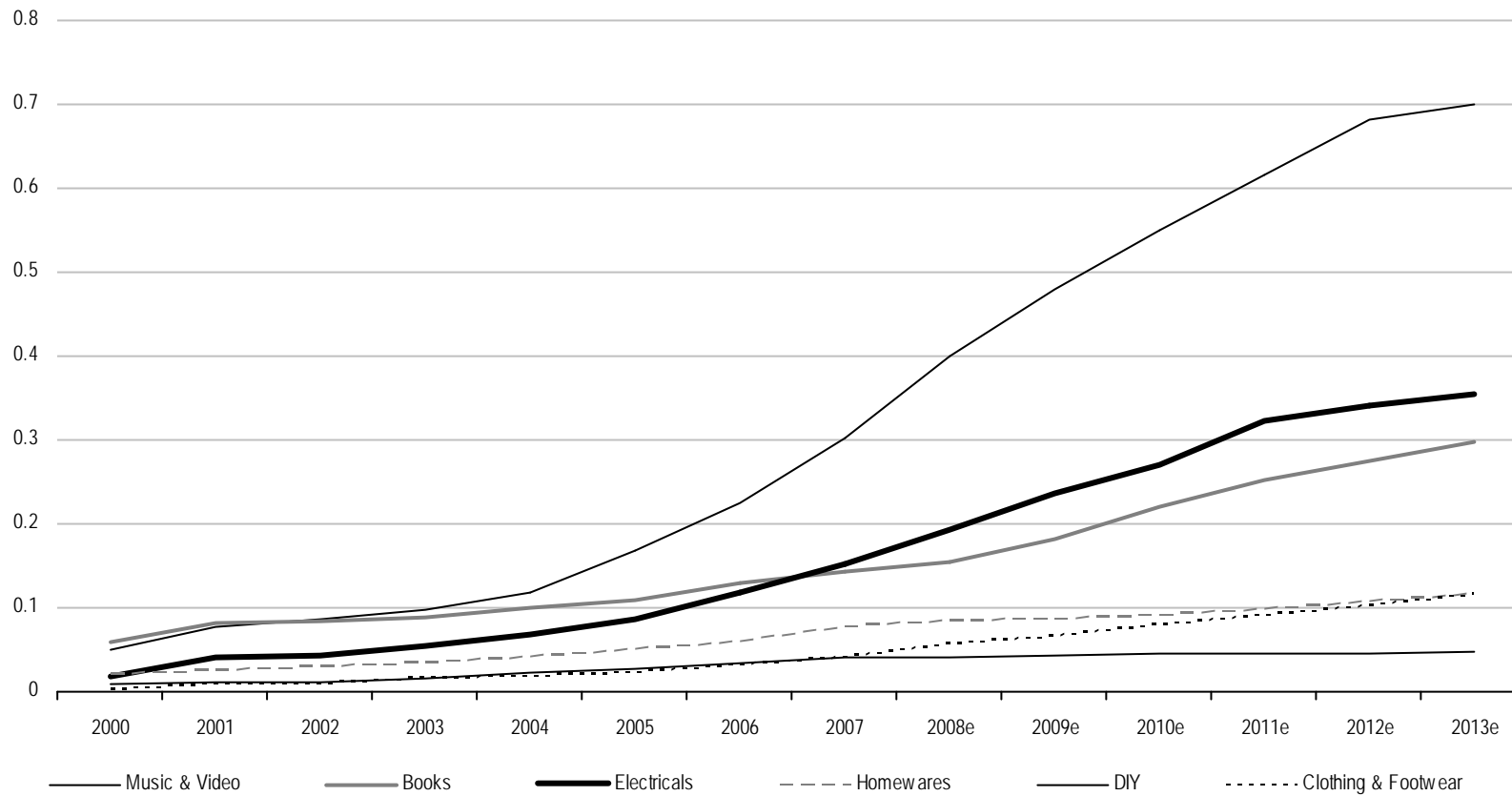
Source: Company data, Credit Suisse research

- Progressive deterioration in Argos’s pricing position relative to Tesco over SS 09
- Confirmed by monitoring Tesco’s more aggressive pricing policy
- Analysis suggests Tesco is becoming far more aggressive on price

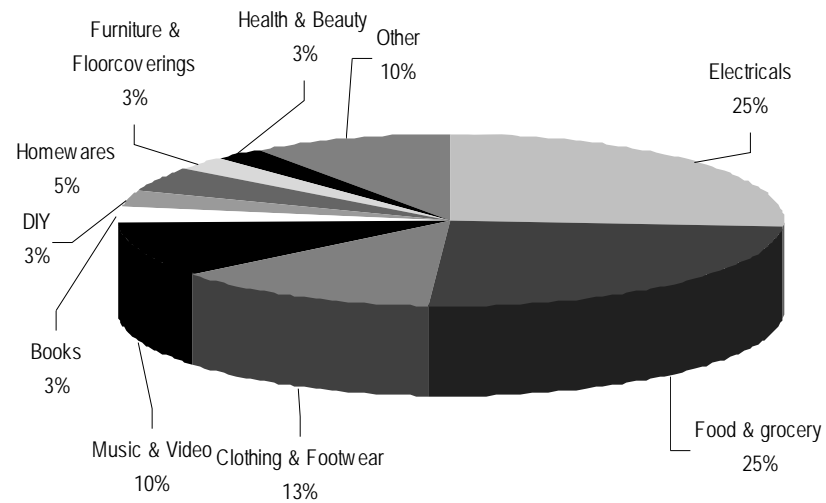
Online

- Online has grown rapidly in some sectors to the point where most of the future growth will go to the web.
- This is forcing re-appraisal and re-structuring in some sectors – the electrical sector is the OOT segment most obviously at risk
- DSGI is re-inventing its formats – will this lead to a down-sizing eventually?
- Home Entertainment – Borders/HMV

Online growth by product to 2013E

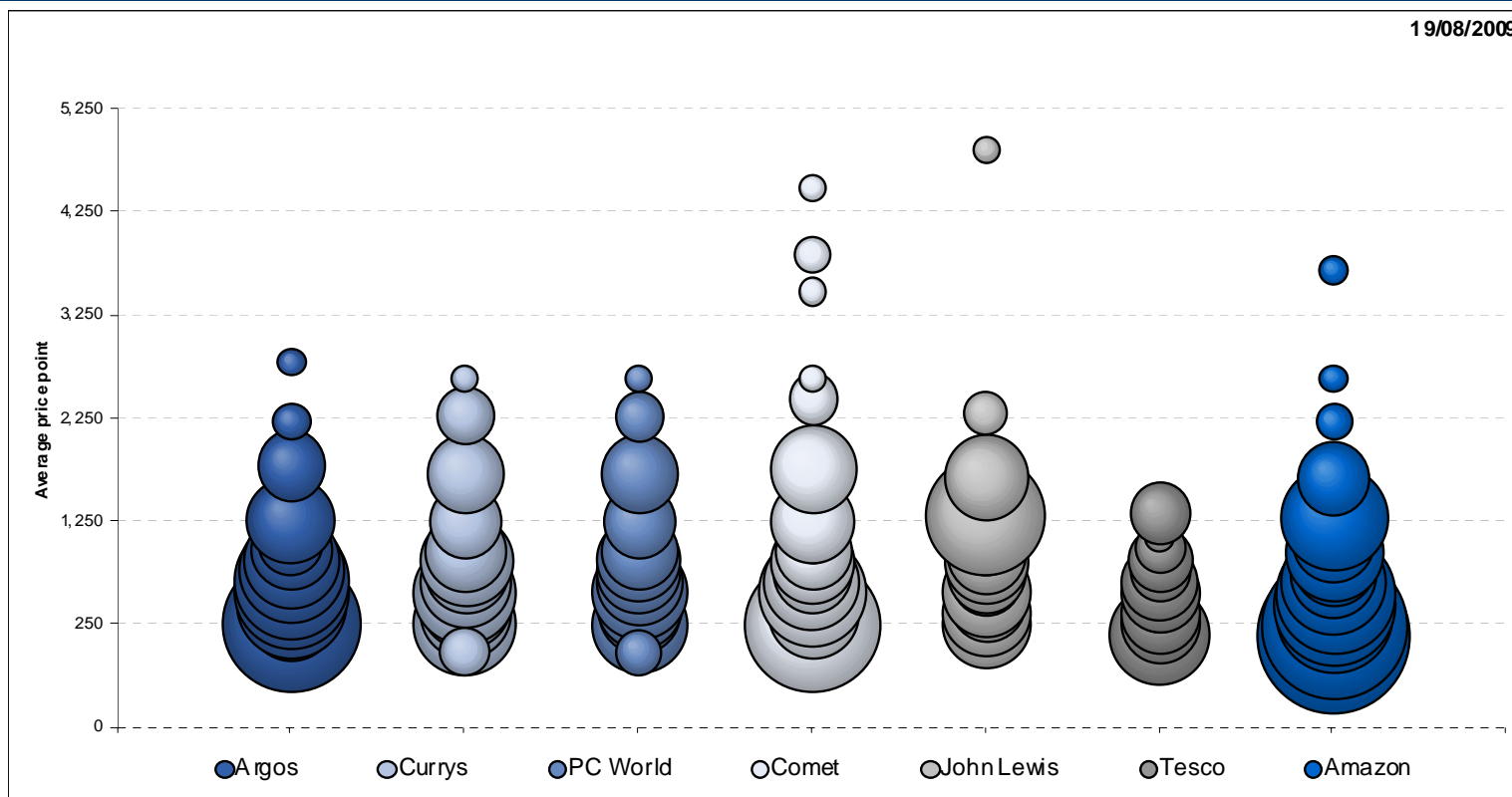


Online market – where we spend it



Electricals – Pricing architecture 1

Argos vs market : Flat-panel TV pricing architecture



Source: Company data, Credit Suisse research, TV prices as of 19/08/09

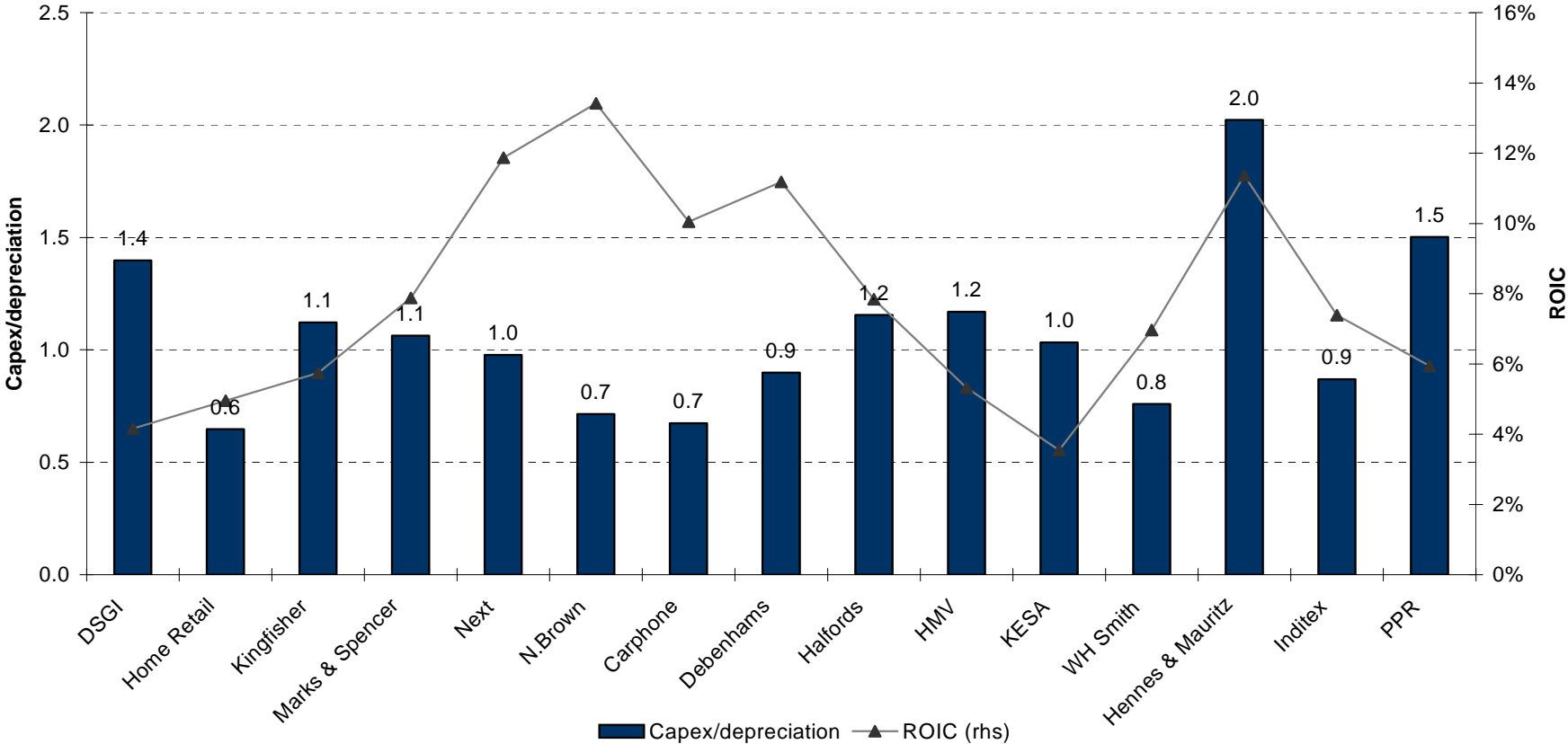
- Little differentiation in the market but Argos profile more similar to a pure play online retailer than High Street with a significant concentration of Entry Price Point TVs (EPP). Amazon now the cheapest.

Retailers

- Key issues – is it worth them investing – do they produce returns greater than the cost of investment?
- Can they afford to invest? What is their level of debt (lease adjusted)?
- Who is actually investing (capex/depr)?
- How much of the cut back in investment is cyclical?

Capex/depreciation v ROIC

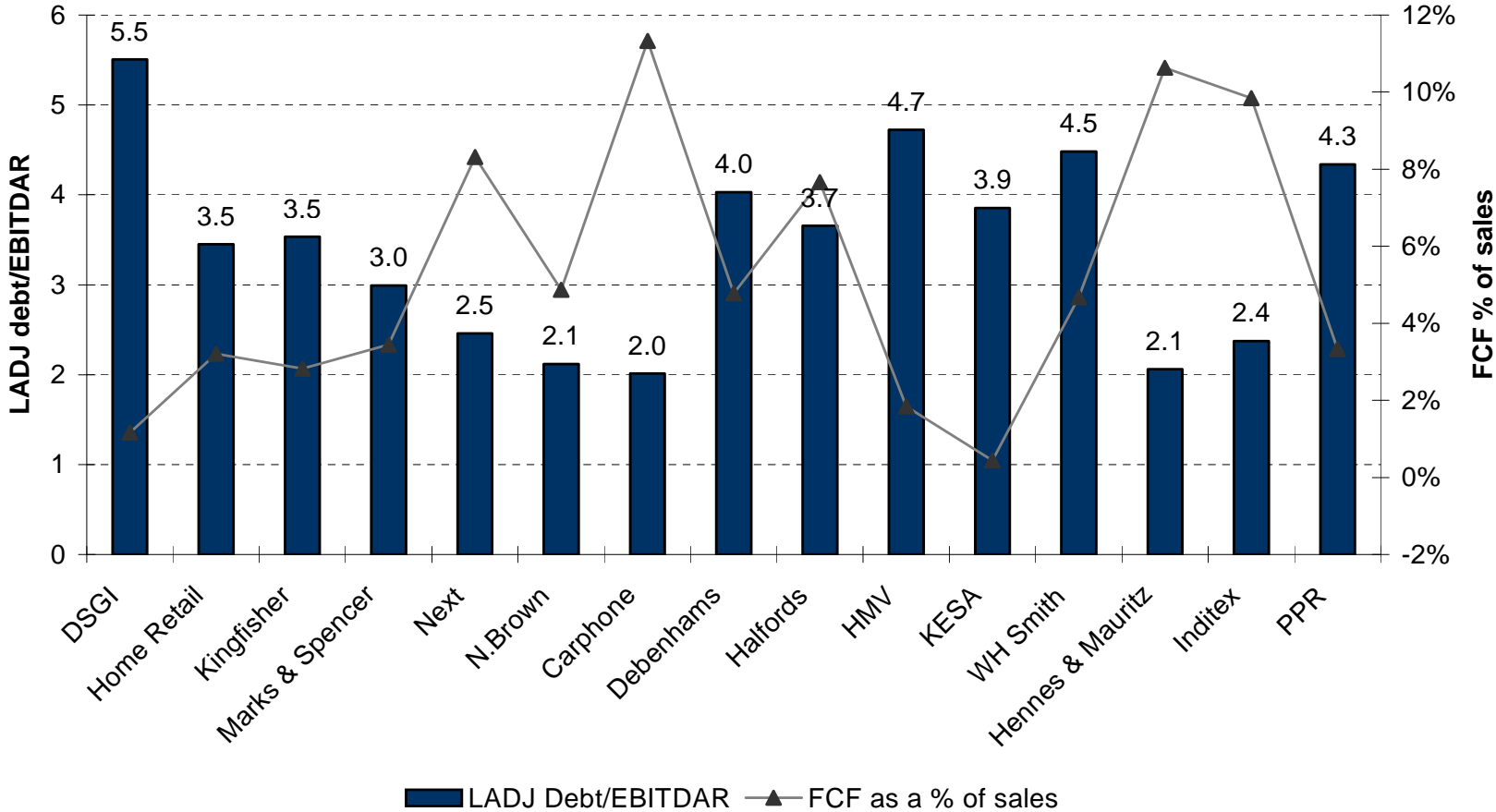
2010



Source: Credit Suisse estimates

LADJ Debt/EBITDAR v FCF as % of sales

2010



Source: Credit Suisse estimates

Retailer intentions

- Carphone Warehouse/Best Buy – 4BBs in 2010
- Debenhams – 6/7 yr to Aug 10 very few thereafter – pipeline issues
- DSGI – investing heavily in refits and larger stores
- Halfords 10-15 pa
- Home Retail – Argos +15 pa, Homebase static after Focus acquisitions
- HMV – v few
- Comet – handful/mezzs
- B&Q – refits/mezzs
- M&S - +1% ish?
- Next – stopped openings
- WH Smith – focus on airports, hospitals, railway stations.
- H&M/Inditex (Zara)/other international fashion multiples – grwth unabated
- Value retailers – strong growth but mainly in-town.

Conclusions

- We always seem to be miserable
- OOT development levels weak, demand outlook uncertain
- OOT has moved from penetration of overall market to having to defend from new channels
- Will be some recovery but longer term growth likely to be diluted by non traditional channel growth and re-structuring of existing players.



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Companies Mentioned (Price as of 01 Oct 09)

Brown (N) Group PLC (BWNG.L, p243.80, OUTPERFORM [V], TP p270.00, UNDERWEIGHT)
Carphone Warehouse (CPW.L, p191.70, OUTPERFORM [V], TP p207.00, UNDERWEIGHT)
Debenhams (DEB.L, p74.85, UNDERPERFORM [V], TP p62.00, UNDERWEIGHT)
DSG International (DSGI.L, p25.80, OUTPERFORM [V], TP p38.00, UNDERWEIGHT)
Halfords (HFD.L, p348.90, OUTPERFORM, TP p395.00, UNDERWEIGHT)
Hennes & Mauritz (HMb.ST, SKr385.00, NEUTRAL, TP SKr350.00, UNDERWEIGHT)
HMV Group (HMV.L, p102.60, UNDERPERFORM, TP p90.00, UNDERWEIGHT)
Home Retail Group (HOME.L, p279.20, UNDERPERFORM [V], TP p235.00, UNDERWEIGHT)
Inditex (ITX.MC, Eu38.57, UNDERPERFORM, TP Eu25.00, UNDERWEIGHT)
Kesa Electricals (KESA.L, p144.10, UNDERPERFORM [V], TP p85.00, UNDERWEIGHT)
Kingfisher (KGF.L, p209.20, OUTPERFORM [V], TP p220.00, UNDERWEIGHT)
Marks & Spencer (MKS.L, p356.80, UNDERPERFORM, TP p255.00, UNDERWEIGHT)
Next (NXT.L, p1788.00, OUTPERFORM [V], TP p2100.00, UNDERWEIGHT)
PPR (PRTP.PA, Eu86.60, NEUTRAL [V], TP Eu60.00, UNDERWEIGHT)
WH Smith (SMWH.L, p448.10, OUTPERFORM, TP p480.00, UNDERWEIGHT)

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