VERDICT in ASSOCIATION WITH SAS

UK RETAIL 2012 & BEYOND

EXTRACT

THE FOLLOWING SLIDES ARE AN EXTRACT FROM FORECAST REPORTS VERDICT PUBLISHED IN DECEMBER 2011.

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Introduction

Welcome to our forecast for UK retail in 2012 and beyond

UK retailers face yet another year of tough trading as the economy continues to suffer from the strains of the recession and global downturns. This whitepaper gives our forecast for the next year for total retail and the major sectors. It also explains some of the key issues and future developments that retailers will face over the next few years and what they need to do to survive and thrive.

About SAS

SAS is the leader in business analytics software and services, and the largest independent vendor in the business intelligence market.

About Verdict

Verdict Research is the leading authority on retailing. Its research and publications provide executives in a wide range of business sectors with unrivalled independent analysis of retail sectors & trends.

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Summary – key points

- **2012 retail growth 1.2% - third lowest growth rate in 40 years**
- **Non-food will shrink for fourth year out of five – down by £740m (-0.5%)**
- **Total sales lost by non-food categories since beginning of recession = £9.5bn (almost equivalent to combined sales of John Lewis, Next and all M&S non-food sales)**
- **Food will grow by 3.3%, but grocers adding c5.5% of new space so l-f-ls will be down**
- **Food winning at expense of restaurants and bars as we dine and entertain at home**
- **Tesco most challenged in food & grocery as competitors open more stores in its locations, offering shoppers greater choice**
- **Biggest losers are home related sectors – down £900m year on year**

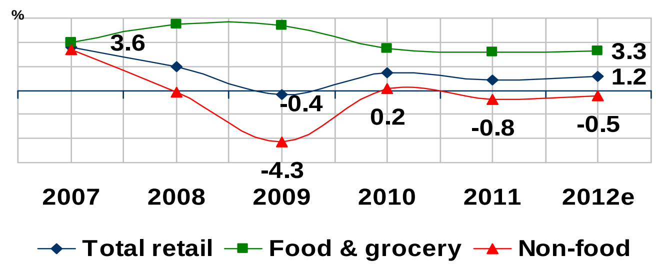
- **Diamond Jubilee and Olympics will improve consumer sentiment, but not confidence in Q2 & Q3**
- **Q1 will be the toughest – expect more casualties**
- **Consumer shopping style is changing – from extravagance to austerity**
- **Lower volumes will hit all, especially low price/high volume value retailers – expect consolidation**
- **Too much retail space – expect more store closures as retailers develop new location/online strategies**
- **Shift from youth to maturity as 16-24 year olds suffer economic woes and 65+s grow in numbers and work longer**
- **New technology fuels rise in m-commerce by all age groups and empowers voice of the consumer**
- **Retailers must invest to create a brand that will travel globally as well as survive in the UK**

2012 UK retail expenditure third lowest growth rate in 40yrs

Non-food spending contracts yet again

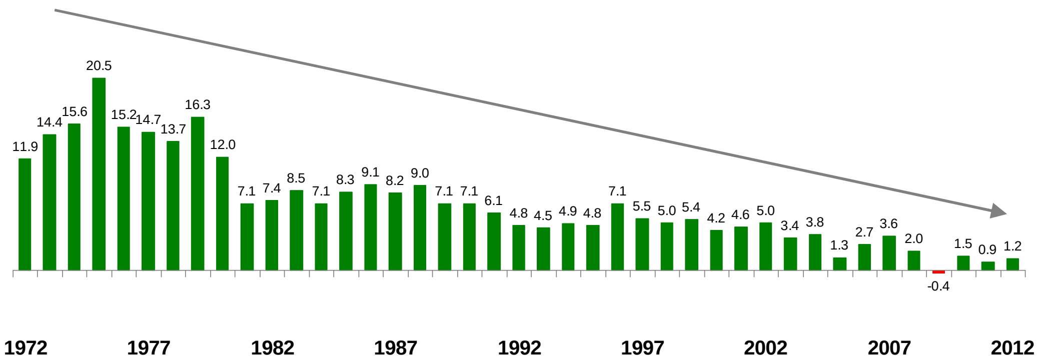
- At 1.2% we are forecasting retail expenditure growth in the UK in 2012 will be the third lowest rate in over 40 years – and each of these record years have been since the recession. Retail growth has been trending down every decade since the 1970s, but the recession has led to a virtual halt – average growth since 2008 will be 1.1% while in the previous five years (2002-07) it was 3.0%.
- Non-food is the biggest loser, shrinking by 0.5%, or £0.7bn. Between 2007, the year before the recession, and the end of 2012 non-food spending will have shrunk by £9.5bn. This is only a little under the total combined sales of John Lewis, Next and M&S' non-food sales.
- Food has been the driver of growth during the recession. It is an essential and regular purchase for everyone and despite price competition, inflation has led to us having to spend more for the same quantity.

UK retail expenditure growth year-on-year 2007-12e (%)



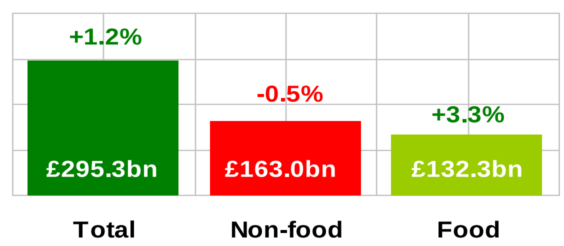
Source: Verdict Research

UK retail expenditure year-on-year growth (%) 1972-2012e



Source: Verdict Research

UK retail expenditure value (£bn) and year-on-year growth (%)



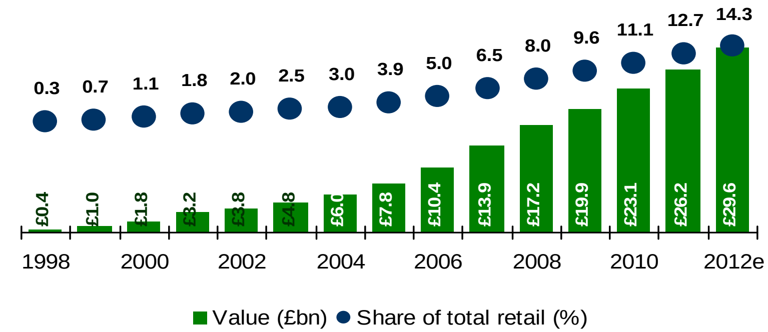
Source: Verdict Research

Low growth + internet = excess of space

Space contracts from oversupply

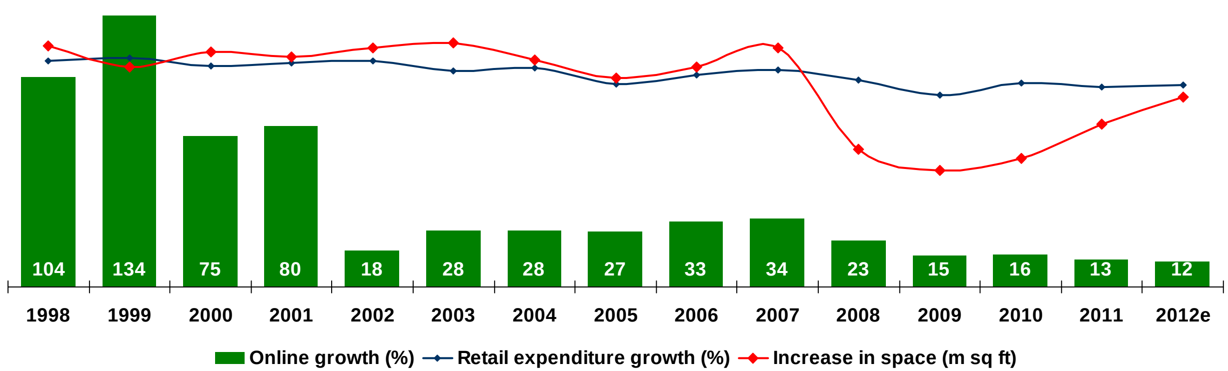
- Since the recession hit there has been a decline in space growth as secondary and tertiary locations have lost out to larger and new shopping locations. Casualties have released space too. The stores in good locations and with large enough space have been taken by competitors, but stores in irrelevant or poor performing locations have closed or moved out of retail entirely. This has hit the smaller store formats and independents particularly.
- Planned shopping centre projects have been put on hold but more will come through over the next five years, however new centres tend to pull from older surrounding ones so displacing demand rather than creating new demand.
- Meanwhile retailers are closing non-profitable stores, shifting to larger stores in better, more relevant locations which is increasing the average store size but reducing the number of stores.
- The main losers are small independents who cannot generate the footfall to cover their increasing costs, and secondary and tertiary centres.
- In addition the internet reduces the need for more stores and a new location model is emerging.

UK online retail expenditure (£bn) 1998 -2012e and share of total



Source: Verdict Research

UK online and retail expenditure growth and space growth 2002-12e (%)



Source: Verdict Research

New model emerging; flagships + outliers + online

Non-food: optimising stores and location strategy

- Non-food retailers are being forced to analyse their location strategies. In the face of falling sales and volumes, combined with rising operating costs, retailers can no longer afford to run unprofitable stores. When volumes were high and there was growth in the market, retailers' best performing stores would support underperforming ones and the latter would be supplying cash to boost the topline. Now however they are a drain on profits as margins tighten.
- With too much space retailers are reconfiguring their store portfolios, closing underperforming stores as leases expire or, in the worst case scenario entering into pre-pack administrations where they can reduce store numbers and eliminate debt before commencing trading again in a reduced format.
- The new model that is emerging is one of flagship stores with full ranges, in the largest, or most appropriate, locations for a retailer's target market, combined with smaller stores in satellite locations with online facilities (ordering kiosks with access to full range, sample ranges in stock for selection, click & collect facilities). This is complemented by transactional internet and mobile commerce sites that allow shoppers to access stores from any location at any time, and order goods.
- Some examples of this already happening are Debenhams with its smaller Desire stores, m-Commerce facilities and instore kiosks; House of Fraser's click & collect store in Aberdeen, M&S' trial boutique which has sample ranges of clothing with online videos and ordering facilities.
- The benefit of this model is it reduces costs of stores – rents, rates, staff, operating costs, delivery costs, and of cannibalising sales. Stock is in places where there is demand, and online also reveals where the demand is so that retailers can investigate the feasibility of opening new stores with less risk than in the past.

New location model 2012 onwards– flagships + satellites + online

Source: Verdict Research

- New model; large stores with full ranges in largest, or most appropriate location with smaller satellite stores carrying limited or sample stock, plus full online range, and click & collect facilities.
- Serviced by central distribution centre and outliers if necessary.
- Plus transactional online facilities and mobile commerce give consumers a wide variety of convenient options for buying.

The impact on retailers of changing environment

Power with the consumer not the retailer as they buy less and change shopping habits

Lower volumes

- Fewer opportunities to gain a share of a shopper's wallet as they are shopping less, visiting fewer stores and buying fewer items. If you are not number one on their list then you have little chance of getting a sale.

Fewer store visits

- More online shopping equates to lower store footfall and lower store revenues, while higher costs make stores unprofitable. Space, the great driver of retail growth over the past 40 years, no longer drives growth but instead dilutes profits.

High volume business under pressure

- Low price, high volume businesses will suffer as volumes but not costs fall. Furthermore retailers with low margins and high debt levels will be in peril, particularly if they have a narrow product range.

Technology is driving a leap in shopping style

- m-Commerce is growing fast and will become an integral part of shopping for all ages – retailers need mobile capability to engage with shoppers as well as sell to them.

Local shopping increases in importance

- High cost of transport, reduction in buying trips and an ageing population will reduce trips to out-of-town supermarkets, retail parks and shopping centres, hitting footfall and spend in those locations. Local, neighbourhood locations will offer more opportunities.

Shift from youth and family focus to mature consumers

- Young fashion retailers will no longer be immune as their target market is hit financially. Older generations will work longer and therefore retain higher incomes, but be on tight budgets as they face inflation in living expenses, so a large market on a tight budget.
- The new 55+ generation will be tech savvy and even the existing 80+s are finding latest developments in smartphones and tablets user friendly, so more opportunities to reach less mobile consumers.

Customer loyalty will define success

- As consumers look for the best offers, most relevant deals, best value and use the internet to inform their choices, they will be less loyal to specific retailers but retailers need that loyalty to capture spend.
- Social networking, blogs and website feedback give the customer rather than the retailer power.

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