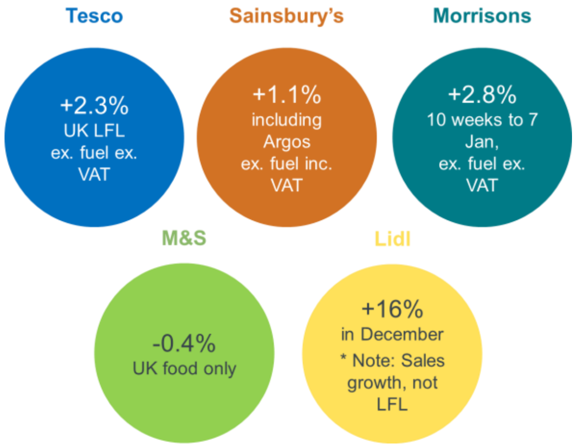
Talking turkey

RECENT PERFORMANCE OF UK GROCERY RETAILERS

As the curtain falls on 2017, grocery retailers are this week publishing their results over the all-important Christmas period.

The way the results are analysed is well-rehearsed. Kantar report absolute sales growth and market share changes based on its 30,000 strong shopper panel.[1] Media and industry commentators single out the 1-year underlying like-for-like sales growth figure ("LFLs") posted by all major grocery retailers, with those at the top end of the range hailed as the most successful.

Based on the latest set of results, most see Tesco, Morrisons and Sainsbury's as modest "winners" over the period after they posted LFL growth of 1-3%, despite some city analysts expecting more from Tesco. M&S was branded the "loser" amongst its main rivals, after seeing LFLs in its food business fall.[2] Although LFL growth is encouraging for the sector, we need to put these recent results in context. It has been a tough few years for UK grocery retailers. And to fully understand the current dynamics, we first need to know the history.



The highs and lows of grocery retail

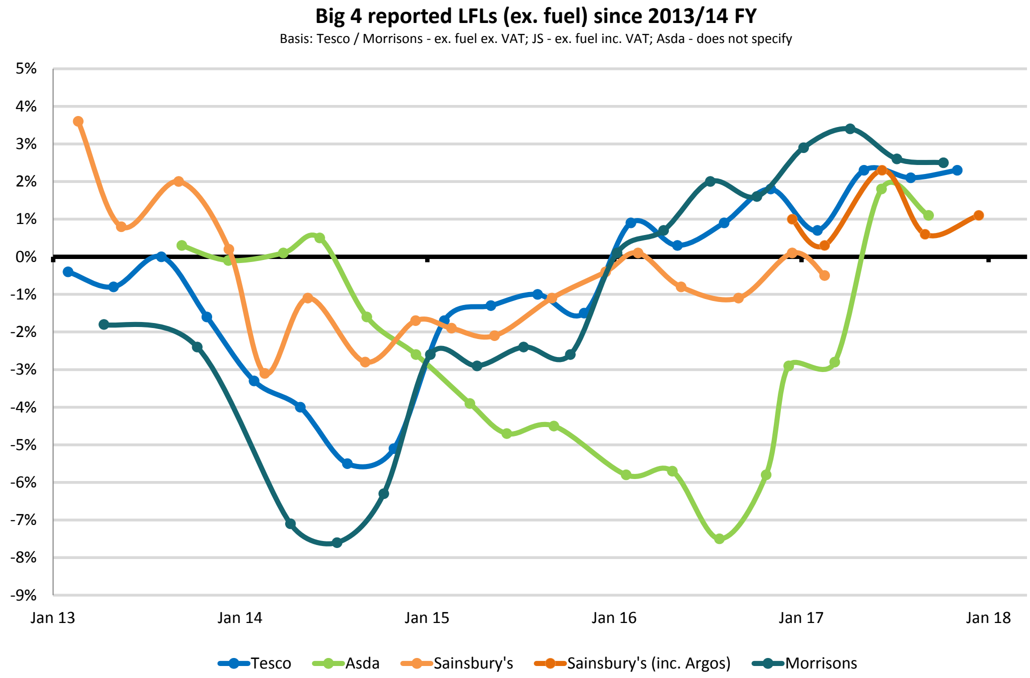
Reported LFLs for the major UK grocery retailers shows just how hard it has been over the last five years. A combination of continued shifts to online and convenience channels; the sustained growth and increased reach of discounters; and a deflationary environment for most of the period have hit retailers hard. And whilst consumers may have benefited, the effects have taken their toll on retailers.

- Morrisons and Tesco both saw 12 successive quarters of falling LFLs from 2013-2016, with sales falling by more than 5% in some quarters.
- Sainsbury's avoided these steep LFL declines, but its growth has been modest in 2017 despite food price inflation.
- Asda followed a slightly different pattern, resolutely holding sales flat in 2014, experiencing dramatic LFL falls from 2015-2017, and only recently returning to growth.

[1] https://uk.kantar.com/consumer/shoppers/2018/january-2018-grocery-market-share/

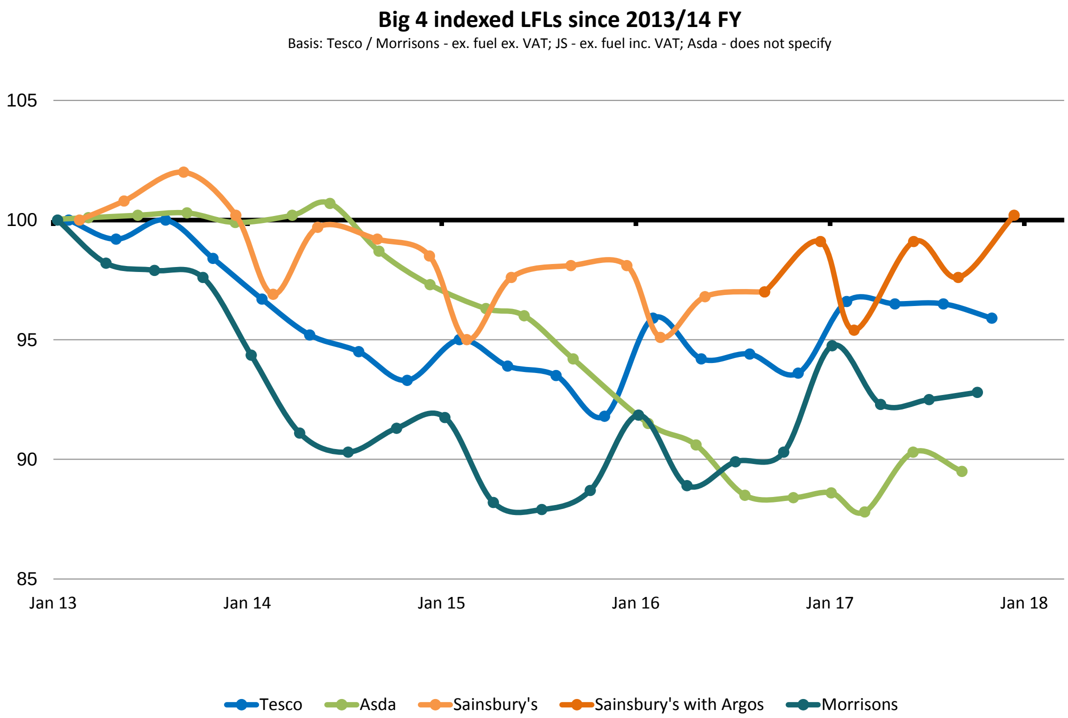
[2] https://www.theguardian.com/business/2018/jan/09/uk-christmas-retail-winners-profits

These LFL declines are significant. Grocery margins are slim, and are under pressure from rising rent, rates and the living wage. Add to that a 5% fall in LFLs, and the challenges are clear.



With all the highs and lows, the cumulative effect is not obvious. To address this, below we take a fixed starting point, and construct an index based on publicly reported LFLs from January 2013 onwards.

By combining LFLs in this way, the sustained pressure on retailers becomes more evident. It shows that no major grocery retailer is selling more on a LFL basis than it was in 2013. Asda's sales are 10% lower now than five years ago in comparable stores. And even for the best performers, sales have been flat.



So what?

It is only by recognising the sustained challenge faced by leading retailers that we can start to understand the current set of results and the future strategic priorities.

First, turnarounds are not yet complete. Dave Lewis (who joined Tesco in September 2014) and David Potts (who joined Morrisons in March 2015) can look at how the indices are moving, and be rightly proud of their efforts. However, when they assert to investors that the turnaround is no more than "firmly on track" (see Tesco Interim Results 2017/18) or "beginning to take shape" (see Morrisons Interim Results 2017/18), the chart confirms that they are right to remain cautious.

Second, it is no surprise that cost reduction measures remain an essential part of the turnaround. Cost control is a key strategic pillar for these retailers, even more so when sales are flat or falling in stores. Tesco is seeking to reduce operating costs by £1.5bn by the end of FY2019/20; Sainsbury's are on track to deliver £540m of cost savings over three years by the end of FY2017/18; and Morrisons have taken £1bn of cost out of the business, with a promise of more to come. The challenge is to do this with minimal damage to the customer experience.

Third, grocery retailers are moving beyond their traditional boundaries. Responding to the challenges in their traditional core business, grocery retailers have looked elsewhere for growth. Sainsbury's have bet on non-food retail with their acquisition of Argos. Morrisons and Tesco are exploring different wholesale models with their link-ups with Amazon, McColls and Booker. Asda has not yet shown its hand. It may be a couple of years behind its rivals – as LFLs dropped later and fell further than others. However, as it steadies the ship, it wouldn't be surprising to see Asda also opening up new channels for revenue growth in 2018.

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