Credit Benchmark®

UK General Retailers

Barbora Makova
Senior Research Analyst

March 2018

Recent UK sales data shows continued weakness. The surprising 1.4% drop in December was followed by growth of just 0.1% in January. Sales volume growth in 2017 was the lowest rate since 2013.

This is mainly due to sluggish real wage growth and the growing influence of online sales, as well as a spike in import costs following the EU referendum; although some of the price effects may reverse in 2018 if Sterling continues to recover.

Rising costs and weak demand has led some chains to consider closing stores (Debenhams, New Look) while others have fallen into administration (Toys R Us, Maplin).

Exhibit 1 shows credit risk trends and the credit distribution for 370 large UK companies in the General Retail sector.

Exhibit 1 Credit risk trends and distribution for UK General Retailers (UK General Retailers Index)

Exhibit 1.1 Credit risk trend

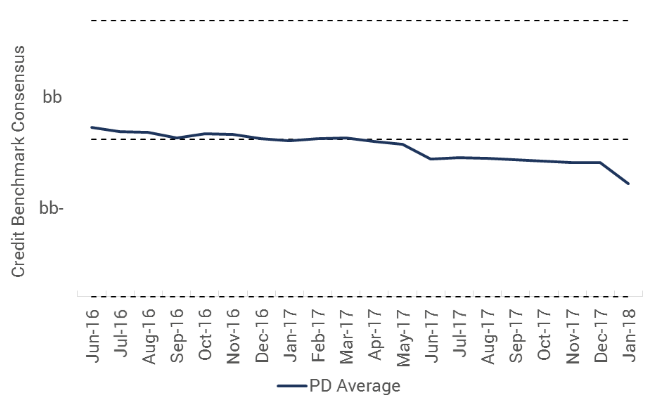
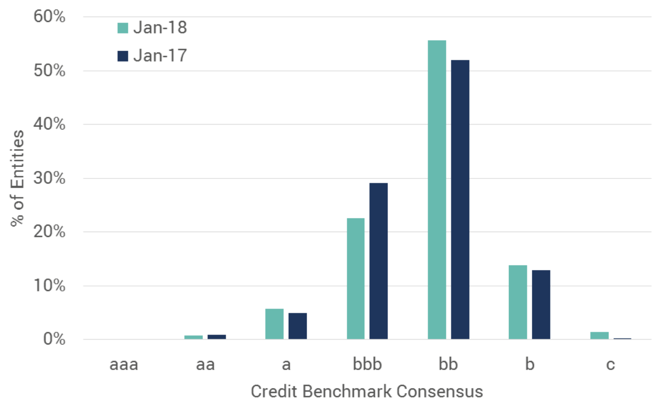


Exhibit 1.2 Credit risk distribution



This shows that the credit risk of UK General Retailers has been increasing over the last 20 months, and the sector was downgraded from **bb** to **bb-** in April 2017. The distribution shows that more than 70% of the UK General Retailers are viewed as non-investment grade in January 2018, an increase from 65% in January 2017.

The companies covered by the UK General Retailers Index can be divided into Specialty Retailers (60%), Specialized Consumer Services (19%), Broadline Retailers (10%) and Apparel and Home Improvement Retailers (11%). Exhibit 2 plots the trends and credit distribution for each of these subsectors.

Exhibit 2 Analysis of UK General Retailers subsectors

Exhibit 2.1 Credit risk distribution (January 2018)

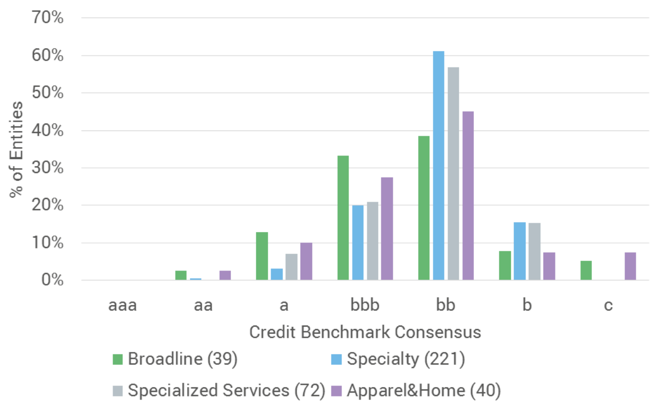


Exhibit 2.2 Credit risk trends

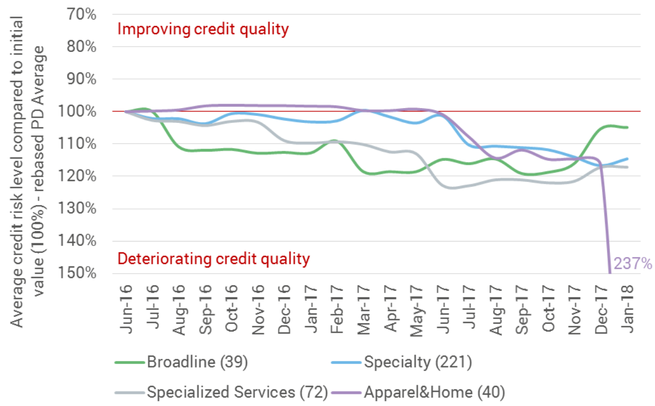


Exhibit 2.1 shows that Broadline Retailers have the highest credit quality, with 50% of entities in the investment grade category. In Apparel and Home Improvement Retailers, 40% of the entities are classified as investment grade; but this subsector also has more entities in the **c** category (8%) than any other subsector. The distributions for Specialty Retailers and Specialized Consumer Services are very similar, with a peak in the **bb** category; 75% of the entities are non-investment grade.

Exhibit 2.2 shows the credit trends for each subsector. Apparel and Home Improvement Retailers have been deteriorating since June 2017, with a significant drop in January 2018 due to a major downgrade. Broadline Retailers have improved in recent months and were stable throughout 2017. Specialty Retailers have been slowly but steadily deteriorating after a sharp drop in July 2017. Specialized Consumer Services have slightly improved since June 2017.

This note shows that current trends in the UK retail industry are well captured in banks' risk views. Most of the key subsectors have been demonstrating credit deterioration for some time. Interestingly, recent news on Toys R Us, Maplin, and New Look leads us to believe that the worst may not yet be over, and that this sector still has some way to go before its current issues are resolved.