Challenging the internet premium

It's a multi-channel future

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It’s a multi-channel future

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This report looks to challenge the superior rating that successful e-tailers currently stand on relative to multi-channel retailers. Within our selected universe, average benchmark valuations for e-tailers are 5.1-5.6x higher than multi-channel retailers for calendar year (CY) 2014 and 3.6-4.1x higher for CY15. Yet average forecast total shareholder return is just 3.1x higher for CY14 and 3.3x higher for CY15. With no dividends and earnings estimates already in mid-double digits, we query the scope for upside forecast surprise or a relative re-rating for the listed e-tailers.

Store-based retail is still growing in the UK

Chain-store operators have grown their UK store footprint by 33,000 units since 1998 (when Amazon entered the UK market). We believe the change in the UK high street is more a reflection of the continuation of two key longer-term trends – larger retailers have gained 21% share of total retail since 1986 and large grocery retailers specifically have gained 7.7% share – than the rise of the internet.

Internet retail sales growth has benefited from unsustainable influences

Most internet retail sales growth has been where goods and services can be transferred electronically, in selling big-ticket comparison goods and in moving from traditional non-store channels. Tangible retail has been harder for internet specialists to penetrate. This is shown by 66% of sales from non-store channels being internet based by 2012, compared to just 7.7% of predominantly non-food and 3.1% of predominantly food store-based channels.

Multi-channel gives store retailers a competitive advantage

With research showing that a multi-channel customer is worth 1.7x a store-only customer and 2.4x an internet-only customer, we believe a well-invested store base has, and will continue to have, a vital role in retail success or failure. In addition the apparent clear consumer preference for ‘click and collect’ also gives store-based retailers a strategic advantage over e-tailers, which we believe cannot be fully compensated for by using a broad density of collection points.

Brand identity remains central to retail success

A strong brand focus is central to successful retail strategies. Brand strength is likely to become more important with the emergence of omni-channel retailing and, aside from a few obvious exceptions (Amazon, eBay and ASOS), internet-only retailers have struggled to gain broad brand recognition relative to their ‘bricks’ competitors. For those that have managed it, the drivers of brand strength go well beyond the realms of e-commerce alone.

Querying the internet premium

While not disputing the strong performance of some of the listed e-tailers, looking into the future we query the size of their valuation premium over those that are pursuing a multi-channel model, or have a strong track record in investing behind their brand. We believe there is significantly more valuation upside on a relative basis to retailers pursuing these latter strategies.

Companies in this report

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ASOS
French Connection
Inditex
Marks and Spencer
Mothercare
Next
Ted Baker

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Store-based retail is still growing in the UK

Total UK retail sales grew 14.5% (£39.4bn) from 2007 to 2012, with 50% of this driven in store. Since 1998 (the year Amazon entered the UK market), chain-store operators have expanded their floor footprint by a net 33,000 outlets, or 2.9% CAGR, with retailers of tangible goods and services (rather than those that can be transferred electronically) growing by 37,000 outlets. At the same time, households with internet access have risen from 9% to 83%.

The UK high street has changed materially over the last decade. We believe the key reasons for this are the continuation of much more long-term trends, including:

- larger retailers gaining 21% share of total retail since 1986, growing at 3.7% CAGR since 1998; and
- large-format grocery channels gaining 7.7% market share since 1986, even accelerating its annual share gain since 2007.

The growth of internet retail has benefited from unsustainable influences

The internet generated £19.7bn incremental sales from 2007 to 2012, 48% of which was created by internet specialists. The internet has been a key beneficiary:

- where goods or services can be transferred electronically (eg, books, games, music, film), hence the demise of HMV, Blockbuster and Game Group;
- in selling big-ticket branded comparison goods, hence the demise of Comet and Jessops; and
- in moving from traditional non-store channels where logistics are broadly in place already.

Tangible retail has been harder to penetrate, in 2012 66% of non-store channel sales were internet based compared with just 7.7% in the predominantly non-food and 3.1% in the predominantly food channels. We believe internet retailing is starting to show some signs of maturity, including a slowdown in absolute and percentage growth year on year and an increased level of seasonality.

Multi-channel gives store retailers a competitive advantage over internet specialists

Multi-channel retailing puts the store back in the centre of a customer's interaction with a retail brand. So, investing behind the store experience with a bright, modern, easy-to-navigate layout, effective use of in-store technology and helpful, knowledgeable, friendly staff are key differentiators that traditional bricks and mortar retailers should be exploiting over their internet-only competitors. Research has shown that a multi-channel customer is worth 1.7x a store-only customer and 2.4x an internet-only customer.

Occupational and operational costs make stores expensive to run, especially in prime locations. But for non-store retailers, the high cost of consumer acquisition and marketing collateral in combination with the intrinsic inconvenience and the high cost of delivery should not be underestimated.

Going shopping appears to have become more of a leisure activity than mundane necessity, despite the decline in real disposal income in recent years. The growth of leisure and catering outlets suggests people are spending more of what they do have on leisure pursuits out of the home, giving store-based retailers the opportunity to engage with consumers while they are out and apparently willing to spend money.

‘Click and collect’ is shifting the balance of power towards store retailers

Home-delivery growth has stagnated relative to internet growth over the past six years, endorsing our view that much of the growth of internet sales to date has been cannibalised from existing non-store channels or from electronically transferable goods and services.

As one of the fastest-growing channels of retail, we believe ‘click and collect’ shifts the balance of power back towards store-based retailers. Although many online specialists have started to use a dense network of collection and drop-off points, in doing so they neither have the opportunity to re-enforce their brand identity nor gain an incremental sale.

The increasing importance of the brand

Retailers need to evolve from merchants to brand owners

An important differentiation needs to be made between retail merchants and retail brands. Merchants fulfil anticipated demand, while brands create more of it. The importance of brand equity is exemplified by Interbrand’s Best Global Brands index outperforming the S&P and MSCI by a factor of five from 2000 to 2013.

Retail brand winners and losers

Zara, eBay, Amazon, Next and IKEA scored most highly in our global retail brand ranking analysis, with M&S, John Lewis, Asda, Boots and Waitrose the top five UK retail names. On a global basis, we identify H&M, Tesco, Aldi, Carrefour and GAP as losing brand value momentum, and in the UK we highlight the lack of inclusion of historic retail stalwarts such as French Connection, Dixons, Homebase and WH Smith.

Of the internet-only retailers, only Amazon, eBay and ASOS receive a placing in the brand ranking tools we analysed. Not only do we believe this shows their success goes well beyond the realms of e-commerce alone, but the lack of other e-tailers reflects how difficult it is to gain traction without a physical presence. In contrast, our brand ranking analysis shows the continued strength of many retail names within the luxury sector, many of whom have no or very nascent online offerings, demonstrating the continued importance of overall brand experience over price or availability.

Omni-channel – putting the brand first

While many retailers are still grappling with the logistical complexities of multi-channel, the concept of omni-channel is emerging, which puts the brand in the middle of the relationship between the retailer and consumer, instead of the channel. Research published by BizReport has shown that omni-channel consumers spend 15-20% more than multi-channel and exhibit strong brand loyalty, often influencing others to patronise the brand. The requirement for more logistical development is significant, including the likely requirement for RFID (radio-frequency identification) technology. We feel it is likely the retailers that have been at the forefront of multi-channel retailing are most likely to remain at the forefront of omni-channel.

Valuation

For the purposes of this report we have selected a group of companies that we feel reflect a broad spectrum of retail characteristics and strategies:

- e-tailer – retailers that pursue a strategy of 100% online sales;
- multi-channel – retailers that have invested significantly behind their multi-channel capabilities;
- brand focused – retailers that have invested significantly behind their brand equity; and
- retail retrenchment – retailers that have reduced, and continue to reduce, their retail floor space.

Exhibit 1 below shows the relative valuation of these stocks. The consensus forecast for each stock has been adjusted to give a comparable calendarised valuation for 2014 and 2015 and three-year forecast earnings CAGR using CY13 as the base year. It also shows the potential total shareholder return for CY14 and CY15, which we calculate using annual percentage earnings growth plus the dividend yield.

Exhibit 1: Valuation

£m*	Retail characteristic	Market cap	Net debt/ (cash)	Three-year EPS CAGR**	CY 14 EV/EBITDA	CY15 EV/EBITDA	CY 14 P/E	CY 15 P/E	CY14 Yield	CY15 Yield	TSR 2014***	TSR 2015
AO World	E-tailer	993.8	(38.4)	50.9%	60.2	37.1	96.3	62.9	0.0%	0.0%	46.3%	53.1%
ASOS	E-tailer	3,586.2	(66.86)	32.9%	37.3	28.0	64.2	46.7	0.0%	0.0%	27.2%	37.5%
Next	Multi-channel	10,245.5	476.9	6.7%	11.7	11.1	15.8	14.6	4.3%	4.4%	12.3%	12.4%
M&S	Multi-channel	7,196.1	2637.7	10.7%	7.5	7.0	13.1	11.8	4.1%	4.4%	11.3%	15.1%
Inditex	Brand focused	66,350.3	(4808.6)	10.8%	14.4	12.9	25.5	22.6	2.4%	2.7%	11.8%	15.4%
Ted Baker	Brand focused	809.8	0.598	18.5%	13.8	12.1	23.0	19.6	2.1%	2.5%	21.5%	19.7%
Mothercare	Retail retrenchment	165.8	46.2	39.5%	5.5	4.6	18.0	11.2	0.0%	0.8%	48.9%	62.4%
French Connection	Retail retrenchment	84.4	27	N/A	68.5	N/A	N/A	N/A	0.0%	0.0%	N/A	N/A

Source: Bloomberg consensus forecasts and Edison Investment Research. Note: * All figures reported in £m excluding Inditex, which is €m. ** EPS CAGR calculated on calendarised earnings from a base of CY13. *** TSR combines earnings growth and dividend yield to calculate percentage annual return based on a stable relative valuation assumption. Priced at 2 May.

Our initial observation is to highlight how the broad retail characteristics we identify appear to have an impact on a stock's valuation relative to peer group. Interestingly, and contrary to our conclusions on the likely long-term retail winners, Exhibit 1 shows the two chosen multi-channel stocks trading at a discount to the peer group, with the more one-dimensional e-tailers trading at a significant premium.

Analysing the numbers in more detail, average e-tailer benchmark valuations are 5.1-5.6x higher than multi-channel retailers for CY14 and 3.6-4.1x higher for CY15, yet average forecast total shareholder return is only 3.1x higher for CY14 and 3.3x higher for CY15. This takes into account both the significantly higher forecast three-year earnings CAGR of the e-tailers and their lack of dividend, relative to the lower earnings growth forecast, but attractive forecast yield offered by the multi-channel retailers.

Aside from the obvious valuation discrimination between e-tailers and multi-channel retailers, we would make the following observations:

- The dividend contribution to the multi-channel retailers' TSR is not only likely to be significantly less volatile, but also rather more 'certain' than the purely earnings-driven TSR of the e-tailers.
- We feel the already high consensus earnings forecasts for the e-tailers provides less opportunity to surprise on the upside or a greater potential to disappoint. We also note that, while not totally apparent from the table above, earnings momentum at both ASOS and AO World has stalled somewhat for their respective FY14s, due to the need for additional investment to fund future growth. For both companies, consensus forecasts assume a return to nearer historic earnings momentum in FY15.
- With already extremely high valuation multiples, we would argue that the scope for a re-rating among the e-tailers is low and the scope for a de-rating is significantly higher.

- Conversely, with more conservative earnings expectations in conjunction with attractive yields and low relative benchmark valuations, we would argue that investing in the multi-channel retailers listed above offers the greatest scope for valuation upside.
- E-tailers on average trade at a 3.5x valuation premium to the brand-focused retailers in our analysis, although their TSR is only 2.2x higher – again pointing to greater potential upside for the brand focused retailers over the e-tailers. Interestingly, the valuation premium and TSR premium for brand focused over multi-channel retailers is similar at 1.5x and 1.3x respectively, pointing to similar risk/return profile for both strategies.
- Finally for the stocks undergoing retail retrenchment, while they apparently offer attractive TSR on a lower multiple, looking at the three-year earnings CAGR (where calculable), we believe these forecasts are optimistic, and currently not supported by a yield.

Retail strategy overview

Exhibit 2 below reflects the relative strength of each of the retailers over a range of more qualitative but important performance indicators. (We give more detail on the individual company rankings in the individual company profiles.)

Exhibit 2: A comparison of the qualitative drivers of retail success

	Retail characteristic	Store investment	Staff investment	Stock turn/ newness	Multi-channel	Logistics	Brand strength
AO World	E-tailer	N/A	***	***	*	***	*
ASOS	E-tailer	N/A	***	***	**	***	**
Next	Multi-channel	***	**	**	***	***	**
M&S	Multi-channel	**	**	**	***	**	***
Inditex	Brand focused	***	***	***	**	*	***
Ted Baker	Brand focused	***	***	**	**	*	**
Mothercare	Retail retrenchment	*	**	*	***	*	**
French Connection	Retail retrenchment	*	**	**	***	*	*

Source: Edison Investment Research. Note: Evaluation criteria: *below peer group/contracting; **in line with peer group; ***ahead of peer group/expansionary.

The key conclusions that can be drawn include:

- The two e-tailers scored well on staff investment, stock turn and logistics, all vital attributes and differentiators when competing with peers with ‘bricks’, suggesting their success goes well beyond the realms of e-commerce alone. Interestingly, both ranked poorly on multi-channel characteristics partly due to the lack of store portfolio, which we feel is an integral part of a multi-channel strategy. AO World also fell down on having no apps for mobile or tablet. While ASOS’s brand strength is starting to gain broader traction, AO World did not feature in any of the brand ranking tools we analysed. However, we believe that due to both its stock market listing and it introducing a fleet of distribution vehicles to act as moving billboards, its brand recognition scores are likely to improve significantly.
- Interestingly, the retailers we identify as embracing multi-channel (note that Next’s platform is significantly more mature than M&S’s) score in line with or above the peer group across our range of performance indicators, so we feel are among the best placed to exploit the multi-/omni-channel retail future.
- The brand-focused retailers score in line with or above the peer group in all areas except logistics, where neither yet has a next-day ‘click and collect’ service and where home delivery mostly comes at an extra cost. We also note that both were relatively late to introduce an internet offering at all, although this has not appeared to impact their brand strength, like-for-like sales, or share price performance over recent years.
- The retailers shrinking their core (UK) store portfolios score poorly over the range of performance indicators, with the exception of their multi-channel capabilities. First, in our view, this would point to the fact that the shrinking of their store portfolios was more a reflection of internal underperformance than the rise of the internet as a broader external influence. Second, it suggests a multi-channel offering in isolation has not driven a material revival to their overall performance to date.

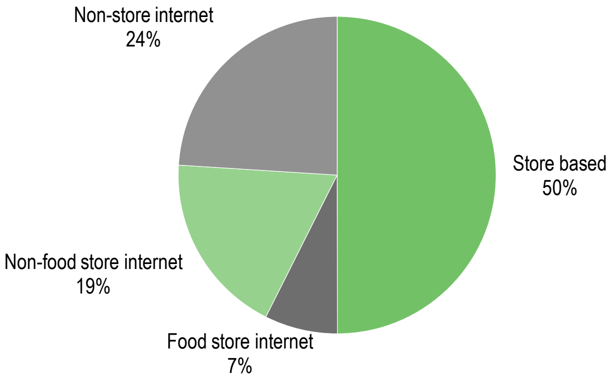
UK retailing: What is really happening?

Store-based retail is still growing

Total UK retail sales grew by 14.5% (£39.4bn) from 2007 to 2012 despite the poor economic backdrop (source: ONS). Of this, 65% has come from food retailers (including their non-food and internet offering), 16% from non-food retail (including their internet offering) and 19% from non-store retailing (including internet specialists and other traditional non-store channels).

Exhibit 3 below splits total retail growth from 2007 to 2012 by store and internet. The most striking feature of this is that 50% of retail growth has been from traditional store-based retail channels (not including their internet offering, which is separately identified below). This is despite the percentage of UK adults making purchases on the internet rising from 53% in 2008 to 83% in 2013 (source: ONS).

Exhibit 3: Contributors to total retail growth by sub-category 2007-12



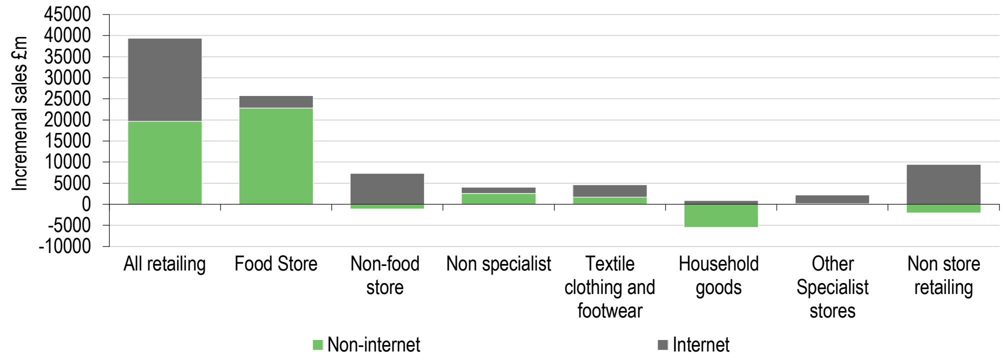
Source: ONS, Edison Investment Research

Exhibit 4 below breaks down retail growth by subcategory and total internet/store growth from 2007 to 2012. Clearly the main contributor to store growth has been food retail. And although non-food, non-internet retailing in total is slightly negative over this time, Exhibit 4 shows that this is largely the result of the sharp decline (£4.6m, -13.3%) in the purchase of household goods. As we discuss in more detail later, we can identify three reasons for this specific decline:

- the impact of the economic backdrop (by 2012 furniture and lighting sales had declined 6% from their peak in 2008);
- the inclusion of the electronically transferable goods within household goods sector (by 2012 audio, video and music had declined by 37% from the peak in 2007); and
- the inclusion of branded comparative goods (by 2012 electrical household appliances sales had declined 21.5% from their peak in 2007).

Importantly, however, non-specialist, textile, clothing & footwear, and other specialist stores have seen non-internet sales growth of 10.9%, 4.5% and 0.3% respectively over this time, meaning their total store-based sales have grown by £4.4bn since 2007. This was not only during a period of global economic uncertainty but also at a time when internet adoption and changes in consumer behaviour around technology and social media have arguably been at their most intense.

Exhibit 4: Internet/non-internet contribution to retail growth by subsector 2007-2012



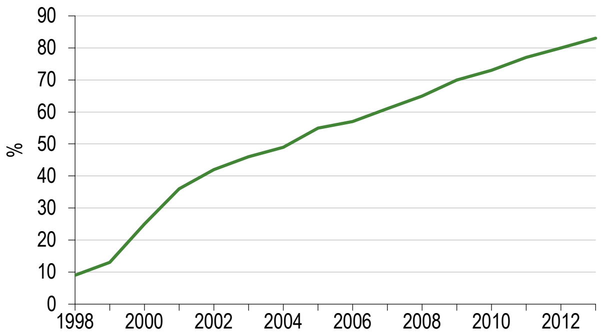
Note: All retailing is the composite of food, non-food and non-store retailing. Non-food store is the composite of non-Specialist, textile, clothing and footwear, household goods, and other specialist stores. Source: ONS data, Edison Investment Research

Excluding the household goods sector, 2009 was the only year that non-food store sales actually declined (-£3.7bn or 3.7%). Since then the non-specialist, textile clothing and footwear, and other specialist stores, have together generated £6.2bn of incremental store sales (to 2012).

The growth of internet retail is slowing

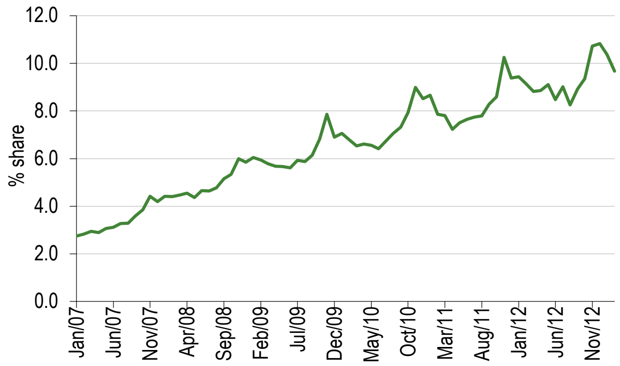
In 2013 83% of households had internet access and 83% of adults (aged over 16) used the internet at least once a week. However, in 2012 the internet still only represented 9.3% of total retail sales, as Exhibits 5 and 6 show.

Exhibit 5: UK Households with internet access 1998-2013



Source: ONS data

Exhibit 6: The rise of internet sales a percentage of total retail and its increasing seasonality



Source: ONS data

Exhibit 6 also shows that beyond 2009 internet sales show increased seasonality.

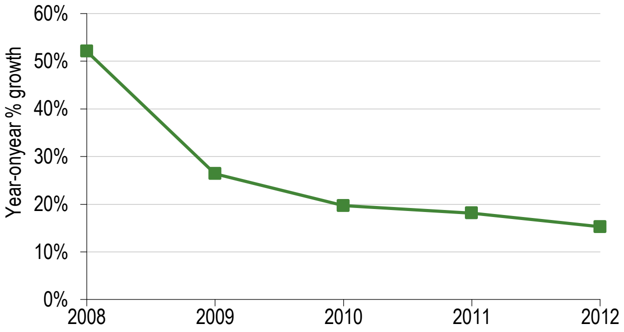
In our view, the seasonality reflects some of the key consumer motivations for internet shopping:

- poor weather;
- bulk purchasing (Christmas); and
- price sensitivity (sale shopping).

Increased seasonality can be interpreted as a reflection of increased maturity. This suggestion is reinforced by Exhibit 7, showing the sharp drop off in internet growth rates from 2009.

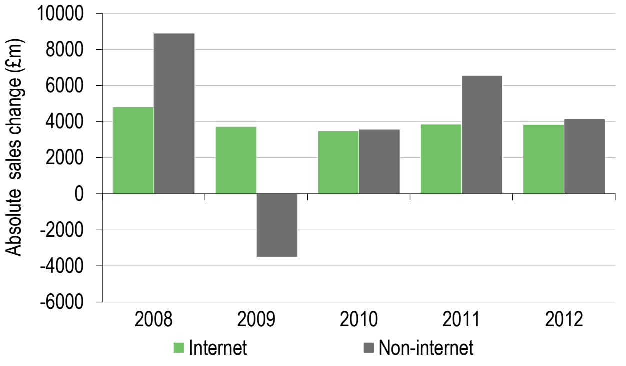
In addition to the percentage growth slowing, the absolute internet sales growth actually declined slightly from £3.86bn in 2011 to £3.83bn in 2012.

Exhibit 7: Slowdown in percentage internet sales growth since 2008



Source: ONS data, Edison Investment Research

Exhibit 8: Annual change in absolute sales by channel



Source: ONS data, Edison Investment Research

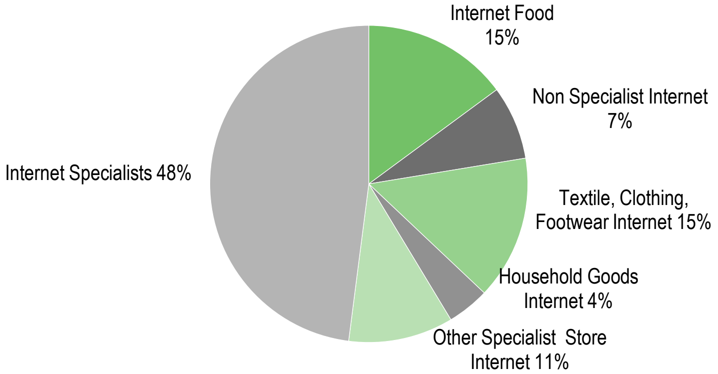
Exhibit 8 above shows that absolute growth in internet sales has stayed reasonably static at incremental £3-4bn sales per year 2009/12, a decline from an incremental £4.8bn in 2008. Exhibit 8 also shows that internet sales appear to be far less economically sensitive than non-internet sales. This could reflect our maturity argument: that the internet may be used more as a means of purchasing 'essential items', with larger, more discretionary purchases still being made within more traditional store based sales channels, but could equally reflect the internet's relative immaturity as a channel during the sharp retail downturn endured in 2009.

In conclusion, the data thus shows that despite regular gloomy headlines of another retailer going into administration, in total, store based retailing is still growing, and that despite very high adult usage levels (>80% in 2012), internet sales growth is slowing, both as a percentage and absolute. We therefore argue that there is a lot more going on in the retail space, than a simplistic transfer of sales from store to the internet, and that whilst the internet has been one factor in the decline of our high streets in recent years, as we discuss in more detail below, it is one of many.

Drivers of internet retail sales growth

Since 2007 internet specialists (the non-store internet retailers) have grown sales by €9.5bn. This accounts for 24% of total retail sector growth ex-fuel, or 48% of all internet growth, as Exhibit 9 shows. However, it also shows that 37% of internet growth (£7.3bn incremental sales) has been generated by the non-food store retailers.

Exhibit 9: Contributors to the growth of internet retail 2007-2012



Source: ONS data, Edison Investment Research

The growth of internet specialists: The easy gains are won

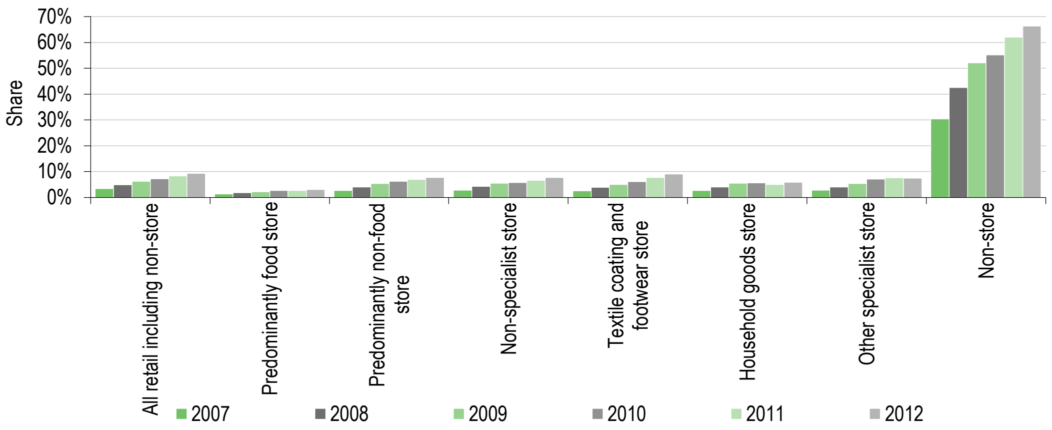
Of the incremental £9.5bn of sales generated by internet specialists, 22% could be attributed to a £2.1bn decline in traditional non-store channels such as mail order and telesales.

There is a clear logic to this direct cannibalisation, as the logistics of remote ordering and the delivery infrastructure were already broadly in place. However, given that the traditional non-store channels only reported £6.7bn of absolute retail sales in 2012, there is a limit to how much longer the growth rate of the internet specialists can continue to benefit.

In absolute terms, in 2012 the internet specialists accounted for 4.3% of total UK retail sales (ex-fuel); stripping out food retail, this rises to 8.1%. It could therefore be argued that the specialist internet sector is immature and there is still a huge amount of growth still to go for, but looked at another way, by 2012 the internet specialists had only achieved a 4.3% share of total retail, when household internet access and adult purchasing on the internet had reached 83%. Does this suggest there are some inherent limitations to the growth of the internet as a channel?

Exhibit 10 shows the percentage share of internet sales for each retail sub category. The 66% share achieved by the non-store category in 2012 clearly dwarfs that of both predominantly food stores at just 3.1%, and the aggregated non-food stores at 7.7%. We suggest that the majority of growth emanates from non-store sales transposition.

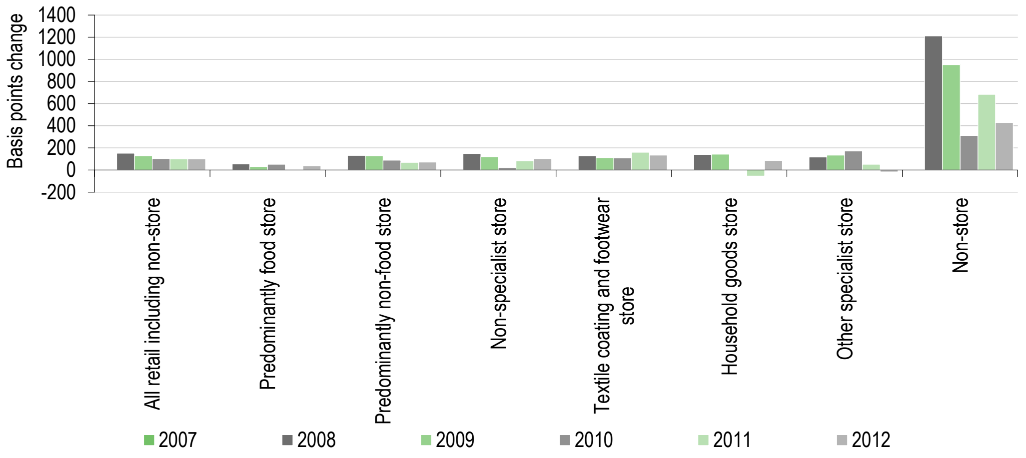
Exhibit 10: Percentage internet share by retail subcategory 2007-2012



Source: ONS data, Edison Investment Research

Looking at it from the point of view of the store retailers, it could be argued that if they get their internet offering and logistics right, growth in the internet channel could be hugely material. It could also mean that, given the choice of shopping for the same thing in store or online, consumers are still showing a clear preference for shopping in store.

Exhibit 11: Basis point change in internet share by retail subcategory 2007-2012



Source: ONS data, Edison Investment Research

Our argument above that internet growth could be maturing is supported by Exhibit 11, which shows the basis point share gain of internet sales across each retail subcategory. Internet channels are still gaining some share, but the incremental basis point gain across all retail channels is at best stable, and in reality slightly declining year on year.

A possible reason why internet retailing from store-based retailers is so much lower than non-store is that the logistics and distribution platforms for non-store retailers were broadly already in place, while for most store-based retailers they have had to be built, at significant cost to the retailer. As such, unless there is a significant technological advance, we believe logistics and delivery issues mean the slowing of the internet growth rate may continue, until more store-based retailers have developed multi-channel or even omni-channel sales platforms.

Internet advertising as a driver of internet growth

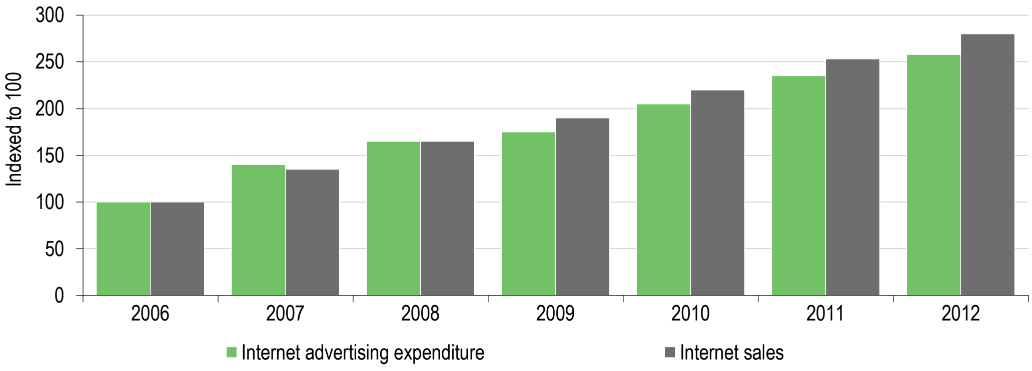
We would argue that internet specialists have benefited from an unsustainable rate of growth in online advertising spend over the past 10 years, which, when it inevitably slows, is likely to affect the growth rate of online sales.

The internet is dependent on advertising spend, as it is paid for by advertising and marketing. From nothing a decade ago, internet advertising has overtaken television as the largest channel of advertising in the UK, with more than £5bn spent in 2012 (source: WARC). However, the overall size of the advertising market has not grown materially, so most of the spend on internet advertising has been at the expense of traditional advertising medium channels, with the biggest losers being print newspapers and magazines.

Like the transfer of traditional non-store channel sales to the internet, the potential to continue cannibalising advertising spend from other media channels is inevitably slowing, and there are limits to the degree to which advertising expenditure will be allowed to rise as an overall cost to a business.

If the nature and penetration of online advertising spend corresponds to on-line sales growth as Exhibit 12 suggests, it follows that a slowdown in the rate of incremental spend on advertising growth is likely to correspond to a slowdown in the rate of pure-play internet sales growth.

Exhibit 12: The growth in online advertising spend versus online sales growth



Source: Verdict, WARC

Physical fascia and 'click and collect' could be the winner

Store-based retailers who are embracing multi- and omni-channels may yet have the upper hand relative to internet specialists. With online sales growth apparently much more dependent on continuous advertising spend, the physical presence of store fascias acts as constant advertising boards for the traditional store retailers and helps them remain in the front of consumer minds, especially where they have an online transactional website in combination with a 'click and collect' offering.

It is little surprise that some traditional and newer non-store retailers (for example, N. Brown and Moleskine) have broken into store channels and subsequently expanding them, against all perceived internet retail trends.

What has been happening on the UK high street?

We believe there are many interwoven and complex reasons for the increased number of high street vacancies. While the internet has grown strongly in the areas where goods or services are electronically transferable and where sales have been cannibalised from historic non-store channels, aside from the exceptions noted, tangible chain store retailers have grown space and sales. We feel they may even be in a stronger position than the internet specialists to continue to do so.

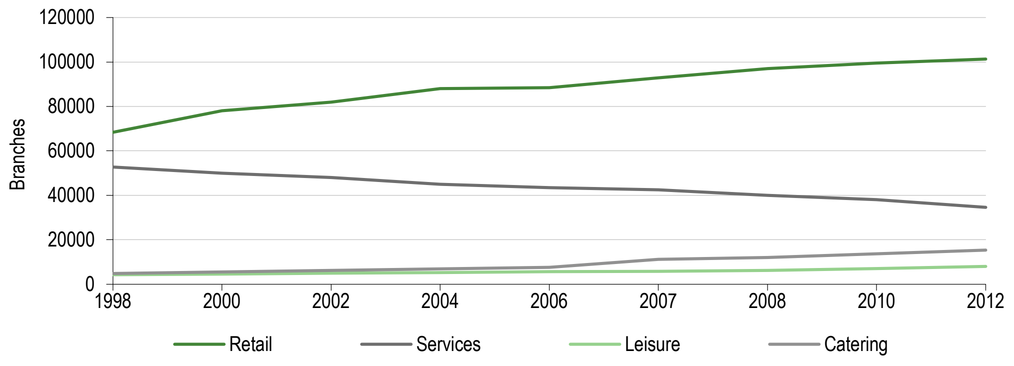
Demise of downloadable goods and services and branded comparison goods

Despite media reports of retail administrations and shop vacancies on traditional high streets, the reality, especially for the larger listed chain store groups, is not retail Armageddon.

A main casualty on the high street has been the service industry. Research from CRBE using data from Retail Locations, the leading industry database of UK chain shop operators, looks at chain branch counts rather than vacancy numbers. This means it measures whether chain branches are growing or shrinking nationally, (chain branch retailers account for 90% of total retail sales, and encompass all the listed store based retailers).

Exhibit 13 below shows chain branch change 1998/2012, and clearly shows the main casualty on the high street has been the service industry, with retail, leisure and catering outlets growing at 2.9%, 4.6% and 8.6% CAGR respectively over this time.

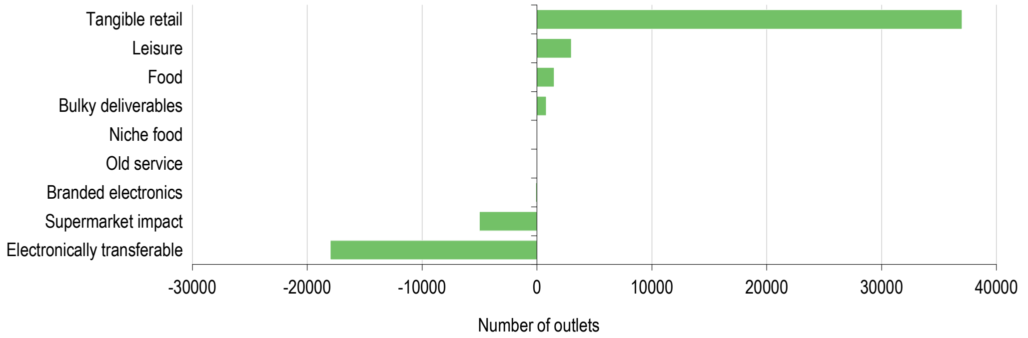
Exhibit 13: Chain branch change 1998/2012



Source: CBRE, Retail Locations

This endorses our suggestion that internet penetration has been very rapid where the infrastructure required is already broadly in place, in this case, where the transfer of a service can be done electronically, eg finance, travel, and utilities, as Exhibit 14 shows. Hence the closure of many historic high-street stalwarts such as banks, post offices, utility company showrooms and travel agents. Between 1998 and 2012 over 18,000 branches of service companies closed on our high streets.

Exhibit 14: Change in the number of outlets of electronically transferable goods vs tangible retail 1998/2012



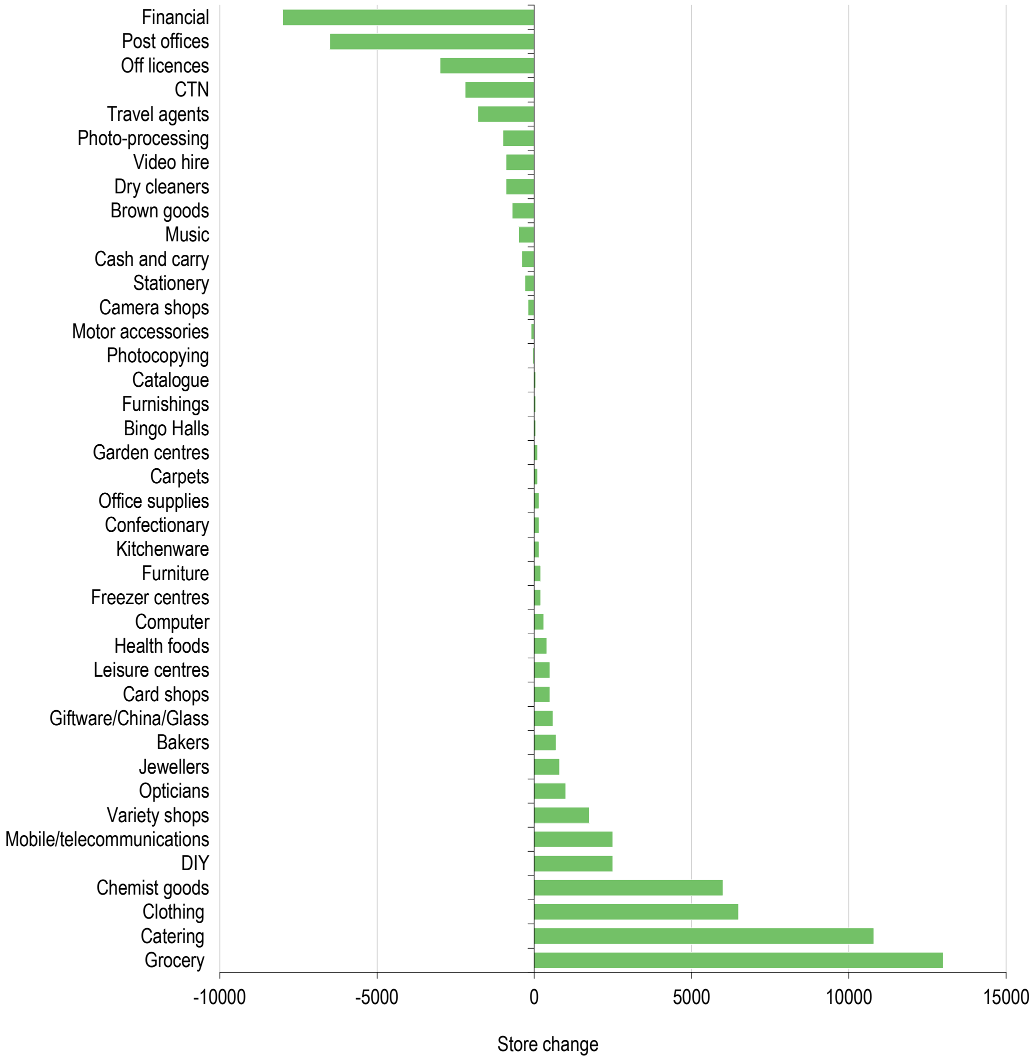
Source: CBRE, Retail Locations

The same argument can be made for goods that can be directly downloadable (books, music, films, computer games). ONS data show a sales decline of 37% in the audio, video and music subcategory 2007 to 2012 and hence recently failed retailers include HMV, Game Group and Blockbuster.

However, internet growth in the sale of tangible goods – goods that need to be physically transferred to the customer – has been much slower. Exhibit 14 above shows that in spite of the internet, the number of tangible retail chain outlets has grown materially between 1998 and 2011; this in itself is notable because 1998 was the year Amazon entered the UK market. We think the continued growth in tangible retail outlets is a reflection of the fact that with the purchase of a tangible products, the internet cannot fulfil all functions: it can serve as a till, but not necessarily as a direct retail channel.

Exhibit 15 below breaks down the tangible and non-tangible sub-categories further, showing in more detail that it has been downloadable goods and services have been the key drivers of store vacancies, and that most tangible retail outlets have gained space.

Exhibit 15: Detailed branch change 1998-Q112



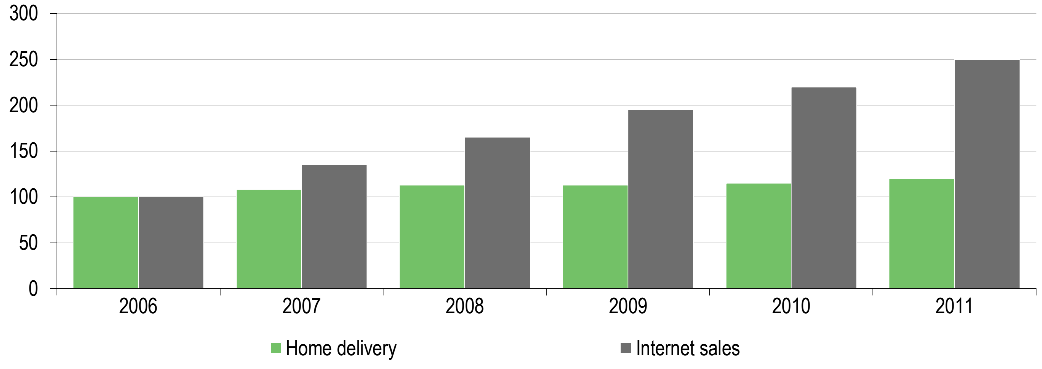
Source: CBRE and Retail Locations

A further casualty has been the sale of branded comparison goods. One exception has been in the sale of branded comparison goods, a sub-category of tangible retail. For the vendors of large ticket items such as grey and white goods, the recent economic downturn has been exacerbated by the ability of the internet to pose as platform for price comparison, especially for big ticket branded commodities, enabling consumers to shop around for the cheapest deals. These items were also traditionally home delivery, thus the inherent inconvenience of staying in for the consumer is no different. ONS data shows that electrical and household appliances grew by 5.5% CAGR 1986 to 1998 (including years of economic downturn), slowing to 1.6% CAGR 1998 to 2007, the early years of internet penetration, but have been in decline by an average of 4.7% per year since 2007. Short-term price comparison in large ticket commodity items can only be disrupted by store retailers bringing out own-label products, and / or varying warranty terms. Longer-term price alignment will slowly level the playing field between the internet specialist and storebased retailers, but only at considerable expense to margin, hence the demise of Comet and Jessops, and the rise of AO World.

Home delivery sales versus internet sales

The internet is primarily viewed as a home delivery channel; however, as Exhibit 16 below shows, while the internet has been growing rapidly, traditional home delivery has not. This reinforces our point that in the sale of tangible goods, the internet can serve as a till but not a delivery channel.

Exhibit 16: Growth in internet sales versus home delivery indexed to 100



Source: CBRE and Verdict Research

The sheer logistics and cost to the retailer of setting up an effective home delivery service mean margins are inevitably diluted. According to Verdict Research, over 60% of all online shoppers cite free delivery as important, with consumers equally unwilling to pick up goods selection costs.

A further problem with home delivery is the number of independent trips required by different home delivery vehicles to accomplish what could have been achieved by a consumer in an afternoon's comparison shopping in a regional shopping centre. In this case, the customer does all the work; they select their own items and pay for the cost of a single shopping journey. So there is no obvious benefit for a retail store operator to encourage deliveries from a store to a customer's home unless the customer would not purchase the item unless delivery was offered. Nothing from a store perspective is anywhere near as efficient as getting the customers to do (most of) the work, hence the obvious attraction to store retailers of 'click and collect' over home delivery. What is interesting, and good news for the store retailers, is that consumers appear to have a preference for this channel too. It is no real surprise that a consumer survey published by Which? magazine in 2012 found that over 60% of people shopping online had problems with delivery.

In our section about the future of store retailing below, we explore why we believe the 'click and collect' channel may even give store retailers strategic advantages over internet specialists. We also show that 'click and collect' also ties in with our idea of shopping as a leisure pursuit, with the advantage to the consumer of knowing they will be able to pick up exactly what they want when they want it. There is the advantage to the retailer of potentially making an incremental sale once the consumer is in store too, as well as re-enforcing brand identity.

Long-term retail trends

There have been other administrations in the tangible retail space, usually for reasons not associated with the internet: for example, Peacocks and Baugur, the Icelandic retailing empire, were the casualties of the credit crunch hitting highly over-leveraged balance sheets. Woolworths was partly due to its exposure to the electronically downloadable, audio, DVD and games subsector, but we believe more importantly was due to the loss of brand identity and relevance.

Small independent stores have also been a major cause of high street vacancies and are not picked up by Retail Locations data. Many independents have closed since the internet gained critical mass, leading to Experian GOAD reporting vacancy levels of c 14% overall in high street locations. We show below it is not just online retail that has been affecting the high street. Looking back further, we identify some longstanding trends that have had, and continue to have, a far more material impact on the state of UK high streets, including:

- the move from small to large format retail; and
- the expansion of the predominantly food channel into non-food.

This has more recently been exacerbated by:

- internet purchasing (especially as most small store retailers do not have transactional websites);
- overall consumer malaise; and
- the impact of the credit crunch on banks' willingness to lend to small businesses.

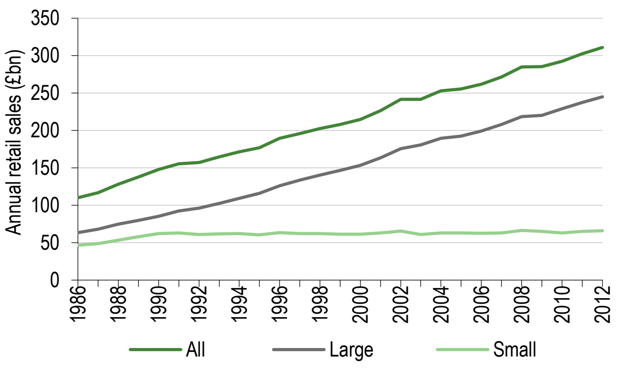
However, as most independents are by definition privately owned rather the publically listed, we argue the Retail Locations data is more relevant to the analysis of publically listed retailers.

The large are getting larger and the small are disappearing

Since 1986, when ONS retail data became available, a clear trend has been the disparity of performance between 'large' and 'small' retailers (see section on page 43 for ONS definition; however, listed retailers fit the 'large' definition).

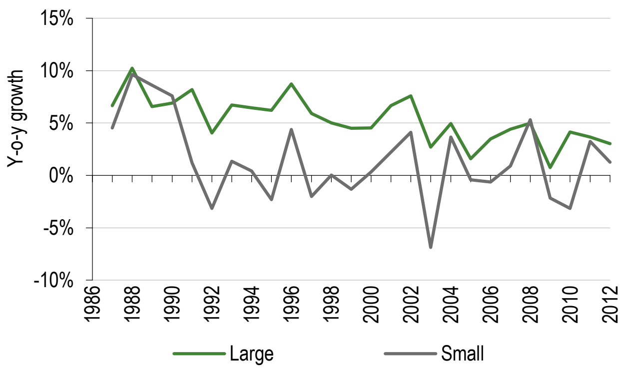
Exhibit 17 shows total retail sales growth (ex-fuel, but including internet and non-store retail) split by business size 1986 to 2012. Total retail sales (ex-fuel) have grown by 182% over that time period. However, as the chart shows there is a marked difference in performance between the large and small retailers, with large growing by 284% and small by just 42% absolute.

Exhibit 17: Aggregate retail sales (ex-fuel) split between large and small retailers 1986-2012



Source: ONS Data and Edison Investment Research

Exhibit 18: Year-on-year growth for total retail (ex-fuel) split between large and small retailers 1986-2012

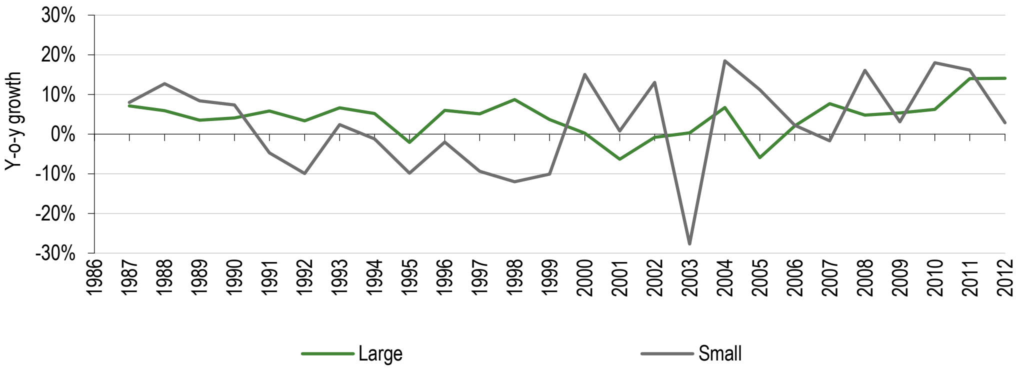


Source: ONS data and Edison Investment Research

As would be expected, Exhibit 18 shows the volatility of performance is much more marked from the smaller businesses, especially around the economic peaks and troughs of the past 26 years. Once lost, however, there is no evidence to show that in total small businesses regain any of the ceded share. Since 1986, large business retail has steadily gained 21% share of total retail sales, with its market share of total retail (ex-fuel) rising from 58% to 79%.

Exhibit 19 below splits out the evolution of non-store sales growth over the same time, and clearly shows the impact of the internet from 1998, (the year Amazon entered the UK and also representing a timeframe whereby household internet access has gone from 9% to 83%). In contrast to store retailing trends, since 1998 small business growth has exceeded large business growth, growing in aggregate by 91% since 1998 versus large business by 63%, and gaining 4% of share to reach 38%. This is perhaps not surprising given that since 1998 most internet specialist retailers will have at least initially come under the definition of 'small businesses'. However it could be interpreted as further evidence of the switch from traditional non-store retail channels to the internet.

Exhibit 19: Total non-store retail growth split by business size 1986-2012

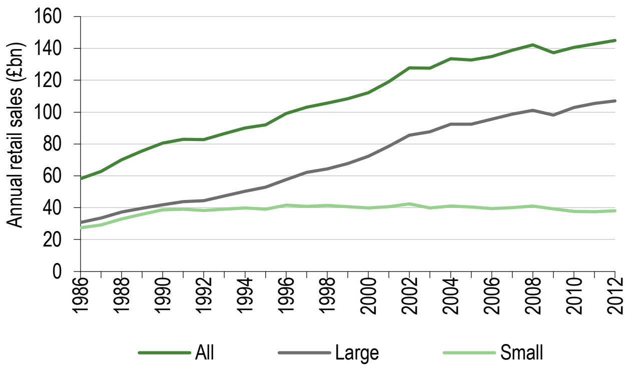


Source: ONS data and Edison Investment Research

What is also important to emphasise is despite non-store growth over the last 14 years being driven from ONS's definition of 'small' business; the overall impact of this on total retail (ex-fuel) for large businesses has been negligible (as shown in Exhibit 17). So it is possible to once again conclude that non-store retail propositions including internet specialists do not appear to be taking share from 'large' store-based retailers.

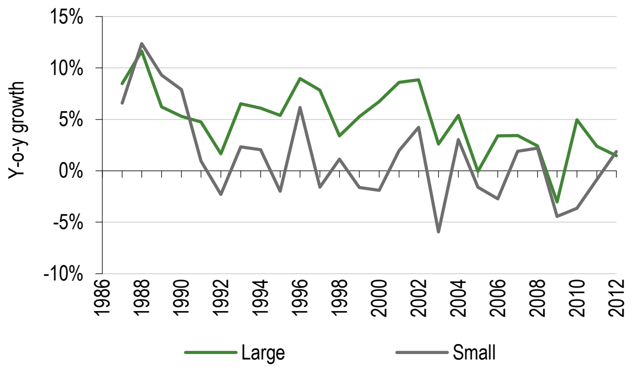
Exhibit 20 looks at predominantly non-food store retailers, where the trends are similar to that of total retail (ex-fuel), with large businesses very clearly taking share from small businesses, and little visible impact of the internet specialist on large business retailers.

Exhibit 20: Aggregate predominantly non-food retail split between large and small retailers 1986-2012



Source: ONS data and Edison Investment Research

Exhibit 21: Year-on-year growth for predominantly non-food split large and small retailers 1986-2012



Source: ONS data and Edison Investment Research

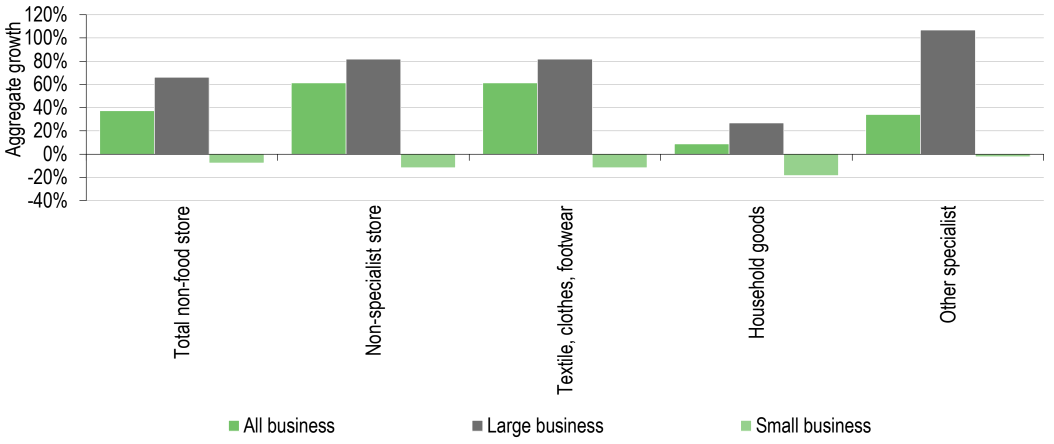
Total non-food retail sales (which excludes non-store channels) grew by 149% in total between 1986 and 2012; large business grew sales by 247%; and small business grew 39%. Large businesses gained 21% of market share, rising from 53% to 74%. Interestingly, the rate of share gain from small to large has not materially changed since 1998 with the start of more mainstream internet use. However, what the numbers show is an actual decline in sales in small business non-food retail of 7.8% since 1998, which could be put down to a number of factors:

- the continuation of share loss to large business retailers;
- the impact of the internet, as small retailers are unlikely to have their own transactional sites to compete with internet specialists or the internet sites of large stores; and
- the combined impact of the credit crunch materially effecting small business borrowing and the consumer recession since 2007.

As would be expected, Exhibit 21 shows that smaller non-food store retailers are also more susceptible to economic peaks and troughs. Although it also shows sales growth for small retailers picked up in 2012, which could be an early indicator that we are emerging out of our consumer malaise.

Exhibit 22 below looks at retail growth between 1998 and 2012 to analyse in closer detail the impact of the internet years on non-food store based channels. First, it shows that non-food retail has grown by 37% since 1998, within this large businesses have grown by 66%, (3.7% CAGR) and small business has gone backwards by 7.8% (0.6% CAGR). Excluding the underperformance of household goods, we calculate that non-specialist large business retail has grown by 60%, textile clothing and footwear large business retail by 82%, and specialist large business retail by 107% (or a healthy 3.4%, 4.4% and 5.3% CAGR respectively per year).

Exhibit 22: Aggregate growth of non-food store retail by subsector, split by large and small businesses 1998-2012



Source: ONS data and Edison Investment Research

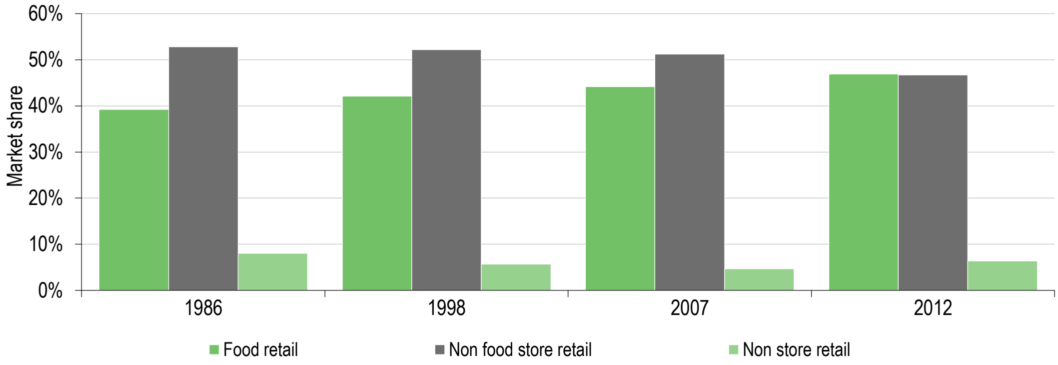
Grocery/non-grocery

Another much longer-term trend in British retail has been the switch of sales from non-food retailers to the major grocery chains as they have sought to continue sales growth by expanding into non-food categories.

Exhibit 23 below shows it has been the predominantly food channel that has been, and continues to be, the major game changer in the retail sector. Since 1986, when ONS retail records began, the predominantly food channel has gained 770bp of share of total retail (including non-store) from 39.2% to 46.9%, with non-food store retail losing -610bp share and non-store losing -160bp share.

What is interesting is that this share gain accelerated between 2007 and 2012 to an average of 54bp per year versus 24bp in the proceeding 21 years, with negligible difference in the rate of share gain before and after 1998 to 2007. The data also shows that 89% of food retail growth between 2007 and 2012 was store based. So the acceleration in share gain from 2007 is perhaps more reflective of the impact of the economic environment, with a greater proportion of consumer income having been channelled into essential food purchases rather than more discretionary non-food purchases. As a further reflection of this, since 2007 non-food channels have lost 450bp of total retail market share and, despite 2007-2012 being a time when the number of households with internet access and adult usage stats have been growing most quickly, the non-store channel only gained 170bp share.

Exhibit 23: Percentage market share of food, non-food and non-store retail 1986-2012



Source: ONS data and Edison Investment Research

The internet alone is not responsible for the demise or success of high street retail

Internet growth has benefited from unsustainable influences and we believe there have been many contributing factors to the demise of our high streets, with the rise of the internet being just one.

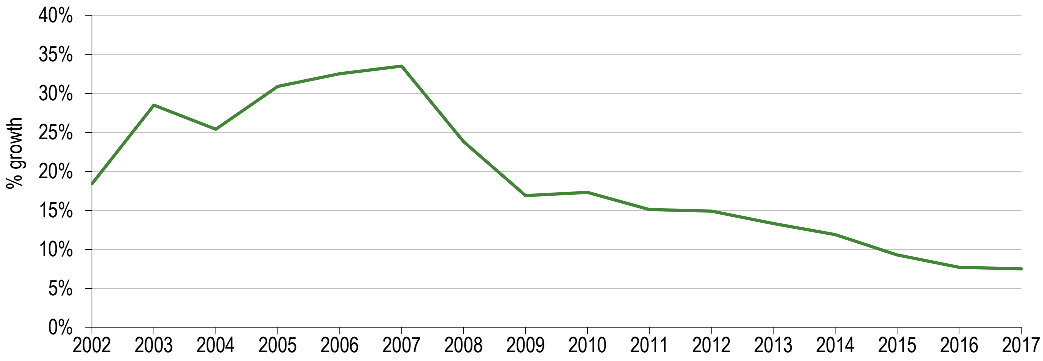
Additionally, looking at the performance of the legacy store retailers, there appears to be no relationship between the number of website hits and retail success. This is further evidence that while it certainly has an impact on modern retail; the internet alone is not responsible for its success or demise.

We argue that over the past 15 years internet growth has been driven by:

- the cannibalisation of traditional non-store sales channels;
- the growth of internet advertising; and
- by electronically transferable goods and services, and large ticket branded comparison goods.

With many of these easy wins close to fully realised, future internet growth will be increasingly dependent on diverting sales from the tangible goods space and, as such, we believe the growth rate of the internet is likely to slow, as a recent forecast from Verdict Research also reflects in Exhibit 24 below. Separate research from CBRE expects the internet to reach just 14-15% of total retail sales by 2020, less than half the level of the more optimistic predictions of recent years.

Exhibit 24: Historic and forecast internet sales growth



Source: CBRE and Verdict Research

Surprisingly low internet use for tangible retail

With adult usage statistics having risen materially from 1998 to 2013 as Exhibit 5 shows, and with 83% of all adults in the UK now using the internet at least once a week, what is the internet actually used for? Data from Alexa, the web information company (owned by Amazon), ranks companies in relation to the number of internet hits they receive both at a national and global level.

In the UK, Alexa's top five ranking sites are Google.co.uk, Google.com, Facebook.com, YouTube.com and BBC.co.uk, with only four retailers listed in the top 100 (see Exhibit 16 below). The remaining 96 sites are a combination of social networking sites, search engines, information channels, travel advisers, online betting and internet banking sites, in other words, goods and services that can be transferred electronically.

Exhibit 25 below shows a list of UK retailers and their ranking in terms of hits. While this is a fluid analysis, it shows how comparatively little the internet is used for tangible retail relative to other uses.

Exhibit 25: Ranking of UK retailers in order of internet 'hit-rate'

	UK rank
eBay.co.uk	6
Amazon.co.uk	8
Tesco.com	46
Argos.co.uk	57
ASOS.com	109
John Lewis.com	117
Marksandspencer.com	153
Asda.com	163
IKEA.com	164
Next.co.uk	170
Boots.com	195
Ebuyer.com	201
Debenhams.com	205
Sainsburys.co.uk	211
diy.com (B&Q)	212
play.com	253
houseoffraser.co.uk	327
homebase.co.uk	351
Waitrose.com	476
mandmdirect.com	908
ao.com	1044
Mothercare.com	1049
Simple Be	1137
Boden.com	1188
schuh.co.uk	1485
petsathome.com	1604
Kiddicare.com	2102
Jacamo	2339
Tedbaker.co.uk	2475
Jack Wills	2566
Frenchconnection.com	3245
Poundland.co.uk	4103
Fat Face	5295

Source: Alexa.com. Note: Data as of 25 February 2014.

Clearly it is no surprise that eBay and Amazon are ranked at the top of the retail peer group in terms of internet hits, but what is striking is how low down some of the other online only retailers feature, with only ASOS making it into the top 200, and some not featuring at all (BooHoo.com).

While it would be wrong to deny the extraordinary success of Amazon, eBay, and ASOS, we argue in more detail below that their success has been driven by significantly more factors than e-commerce alone.

In our opinion, Exhibit 25 shows that there appears to be no relationship between the number website hits and retail success. This could be interpreted as further evidence that while it certainly has an impact on modern retail; the internet alone is not responsible for either its success or demise.

What does the future hold for the store-based retail sector?

The rise of multi-channel

Research undertaken by Debenhams has shown that multi-channel customers are worth 1.7x a store-only customer and 2.4x an online only customer, worrying stats for 'one dimensional' online retailers.

In recent years, multi-channel has become the new buzz word in retail. While technology has facilitated its development, it is very much a consumer-led revolution. Multi-channel puts the consumer in control, increases availability and choice and enables consumers to shop in the way that best suits them, epitomised by M&S's marketing strap-line 'Shop my way'.

In many ways multi-channel has shifted the balance of power back towards store retailing, reinforcing the store as an integral part of a purchasing journey – it is a physical point of sale, a collection and returns point, a venue for 'in-store theatre' and interaction with a brand and is a halo for online channels. Effective multi-channel retailing, where digital and store channels are seamlessly joined up, is what most store retailers are grappling with. Those who have achieved it are not only enjoying the greatest retail success (John Lewis and Next are prime examples), but also have the potential to make many of the online only retailers look increasingly one dimensional. An example of the continuing importance of the store is a quote from the blogsphere "The only thing that could make ASOS even better (you know something other than its vast inventory, on-trend products, affordable prices, free shipping and returns) is a brick and mortar store we could visit on our lunch breaks".

Reinventing the store experience

The evolving role of a store has become an opportunity to use the physical experience to create value and is a vital differentiator for store retailers from internet specialists. An in-store purchase decision can be influenced as much by the store environment and the service received than the product itself. Stores are also increasingly serving as the embodiment of the brand to showcase and drive revenues across all channels.

At a time when many commentators were saying that, thanks to e-commerce, traditional retail was dead and stores would stop making sense, a handful of store-based retailers quickly realised it was largely impossible to compete with online retail on price. So rather than lower their prices and try to align cost bases to compete with their new online peer group, they made the decision to invest, not just behind an IT and logistics platforms to facilitate their own e-commerce offering but, almost more importantly, to invest behind their existing assets, stores and people.

Customers love a great experience as much as they love great products. Historically stores were there to drive sales by having the right product and stock physically in store, but now they are increasingly seen as entertainment destinations, engaging the consumer and serving as the embodiment of the brand to showcase and drive revenues across all channels. This means they should not be starved of investment or innovation.

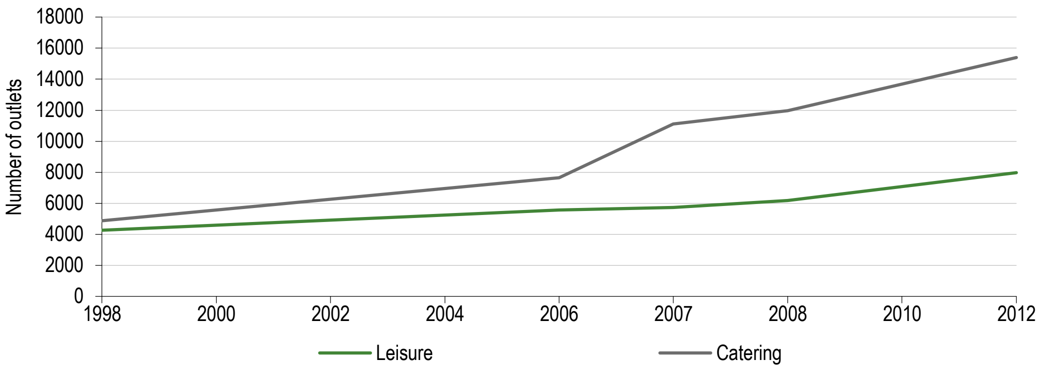
In-store technology has been a great facilitator in this transformation. It has a broad range of uses from practical efficiencies such as providing an in-store ordering system for product not physically displayed or mobile POS, to more experience-enhancing technologies, using video content and digital media on large screens and interactive displays. Not only can this attract customers in store, it also keeps the content fresh, relevant and continuously updated.

Using in-store Wi-Fi to enable a consumer to experience real-time interaction with a product or brand either directly with the retailer, or with friends and other influencers through social media has been a more contentious development. A common and quite logical fear among retailers is that introducing Wi-Fi technology in store would increase comparison goods shopping. However, this has been challenged by anecdotal research from Deloitte in North America, which shows that contrary to inherent logic, providing a Wi-Fi network in store actually increases the likelihood of purchasing. Similarly, research by WPP identified that approximately 50% of sales today are influenced by people researching online and then show-rooming in store, yet with still <10% retail sales occurring online, an engaging physical retail presence is surely still one of the most powerful tools at a retailer's disposal.

Another successful but non-technological strategy of store-based retailers to drive consumer traffic has been the offer of new services in store with complementary brands. This can be as simple as getting a coffee shop or restaurant concession, to trialling something totally different but with a corresponding socioeconomic consumer profile, for example, the introduction of Kuoni Travel concessions within John Lewis stores. This strategy has some advantages: shared ground rent and service costs; it is likely to attract more consumers in store; and it should keep customers in store for longer.

With our increasingly time-poor lifestyles, consumers are becoming much more discerning about how they spend their limited free time and money. Shopping therefore needs to evolve from a mundane necessity into a leisure pursuit. Evidence from CBRE and Retail Locations in Exhibit 26 below shows the growth of leisure and catering outlets since 1998 (an incremental >2000 and >7000 respectively). Contrary to the economic backdrop and consumer credit crunch, since 2006 catering outlets specifically have seen a marked step up in-store numbers, showing that consumers are still going out and spending money in retail centres. It is therefore up to the store retailers to engage consumers' interest while they are out apparently willing to spend their money.

Exhibit 26: Growth in leisure and catering chain outlets



Source: CBRE and Retail Locations

Investment in people

Investment in stores is not just about growing space and refurbishments, but its store staff and management strategy are central to a brand's communication with its customers.

The move to multi-channel retailing has created a more knowledgeable and demanding customer, so there is a need for store employees to be more knowledgeable about the merchandise, its availability and in some cases even information about origin or ethnicity. So rather than being viewed as employees at the bottom of the corporate hierarchy, we believe store staff should be seen as the first point of contact between a brand and a potential customer, and play a vital role in executing the brand image and overall retail experience.

This is where we believe many store retailers made a strategic mistake during the early 2000s – rather than investing in-store staff as a key differentiator against the threat of the 'faceless' internet, they sought to try to compete on cost by lowering store overheads and cutting staff numbers. Hindsight is a wonderful thing, but history shows that retailers who tried to compete with the internet by driving down costs have not been successful and they are now re-investing in the aesthetic and human side of their offering (eg, Home Retail Group, Tesco). Retailers that continued to invest in their people have continued to be successful at attracting new and maintaining their existing customer bases (eg, John Lewis, Ted Baker).

However, it is not just on the shop floor that the 'traditional' business model of retailing needs to be challenged and re-addressed, we suggest successful multi-channel retailing involves breaking down the 'silo cultures' of IT, marketing, sales and purchasing. Communication between these historically separate functions/departments needs to be made fluid, to ensure a seamless and consistent brand experience for the consumer. Once again, at the centre of it all is the consumer, as a clear and thorough understanding of who is your customer or target market is required to make appropriate decisions about channel integration and usability.

Looking forward, retailers need to re-evaluate their talent management strategy, with implications for training and pay-structures. For instance, is it fair that store staff are mostly still incentivised around the performance of their particular store, when their influence could have much greater repercussion around total brand performance? In this respect, by accident or design, John Lewis is once again ahead of the game; the share of profits allocated to its 84,700 partners, the Partnership bonus, is fixed every year by the partnership board and is distributed as the same percentage of gross annual pay to all partners.

Retail floor space

Occupational and operational costs make stores expensive to run, especially in prime locations. For non-store retailers, the high cost of consumer acquisition and marketing collateral combined with the intrinsic inconvenience and the high cost of delivery should not be underestimated, as the recent results presentation from ASOS clearly shows. We can conclude that when it comes to store portfolios, there is no 'one size fits all' or optimum store network. So what remains central to a retailer's success is not its store count or its percentage online sales, but the relevance of its retail proposition and the success of executing that proposition to best meet the ever-changing demands of the consumer.

Optimal store numbers have been the subject of increasing scrutiny over recent years, by companies and analysts alike. Recent research by Deloitte estimated that UK store portfolios need to shrink by as much as 30-40% over the next five years – clearly not possible given the long-term nature of most rental lease commitments.

The reduction in store estates to reduce fixed costs has been evident many times, with several high street retail names going into administration only to re-emerge with a smaller store network, eliminated debt and revived hopes of success. However, as we discuss in more detail later, this strategy is perhaps masking a more fundamental failure – the lack of relevance of the consumer proposition or a company's ability to effectively execute on it.

The risks of 'retrenchment retailing' for those retailers with a larger store footprint are threefold:

- There is an assumption that same percentage of the population can be served from a smaller footprint, but even closing an unprofitable store will almost certainly cede some easy share to competitors.
- The idea that the internet will pick up lost store sales, while in reality a profitable internet offering takes years of work and significant logistical investment. It also reduces any local halo effect that a store can have on internet sales.
- Reducing store numbers shrinks a retailer's 'click and collect' platform, reducing their exposure to the fastest growing channel of internet retail and the potential for impulse purchases while in store.

Looked at in more detail, it appears it is the retailers who have underperformed in recent years that are looking to shrink their store bases, while a number of more successful, mostly listed retailers are still looking to expand their retail selling space even in the UK, with Next, John Lewis, Primark, Ted Baker, Sports Direct and JD Sport all planning on expanding retail space as part of a multi-channel strategy.

A new trend that we see starting to evolve is that of non-store retailers entering the store channel. Having trialled six stores with its Simply Be and Jacamo brand in 2012/13, and opened a further two in 2013/14, N Brown most recently reported 35% like-for-like sales growth from its store portfolio, compared to 9.1% from its E-commerce sales. It has also identified a 3-7% halo impact on its non-store sales, within radius of a 45-minute drive from their stores. N Brown are now aiming to open a total over 25 stores, from which it estimates that it will cover 85% of the UK population. Moleskine, the Italian luxury stationery brand, is also opening its own direct owned stores (DOS), having historically focused on B2B sales and wholesale distribution. In the private sector, traditionally B2B or non-store specialist players such as Molton Brown, The White Company, and Hotel Chocolat have opened stores and subsequently expanded their footprint.

'Click and collect' – giving store-based retailers a competitive advantage

Over the last couple of years the fastest growth area of retailing has been 'click and collect'

While the concept is somewhat counter intuitive, click and collect means that you are not stuck at home, held hostage to the 'black box' scheduling of most home delivery services. And, as Exhibit 27 on page 30 shows, from a consumer perspective 'click and collect' is both cheaper (mostly free), and (mostly) quicker than home delivery.

The reason 'click and collect' works is that it solves the age-old problem of the 'final mile' of delivery. People simply do not like waiting in for a delivery, but most are happy to pick up purchases from a local high street, or even a regional shopping centre as part of a larger trip. Among the attractions of 'click and collect' is the certainty that the item you want will be there waiting for you. It puts the customer where they want to be – in control. It also lets the consumer see/touch/try the item in store and return it immediately if unsuitable. A weakness of even the most sophisticated e-tailers is the logistics and sometimes expense to the consumer of returning unwanted goods.

There are clear advantages to retailer of 'click and collect' versus home delivery. First, if executed efficiently, delivery in store should be cheaper than going 'the last mile' to a customer's own address. Second, with the consumer in store, there is an increased likelihood of an additional purchases being made. Finally, it gives the retailer the opportunity to reinforce brand identity and image with in-store theatre.

It is these three points that we believe give the store retailers at an advantage over the internet specialist, even with the development of delivery networks such as Collect+, (which store retailers can also use), or as Amazon is doing, and ASOS is trialling, installing lockers.

The concept of 'click and collect' has been around for a while, with store retailers such as Next, John Lewis and Argos leading the crowd. It is only in the last 12-24 months that it has become more mainstream among large chain store retailers. Although Verdict Research currently predicts that 'click and collect' will only reach 8% of online sales (1.2% total retail sales) by 2018, we feel early signs from the retailers that have developed the platform it may yet prove to be a far greater phenomenon than that (Next reported c 45% online sales were picked up in store in the year to January 2014 versus 30% in the previous year, and M&S reported at its full year results in May 2013 that 44% of its multi-channel sales are collected from stores).

The onset of omni-channel: Brand is central

Research published by BizReport has shown that omni-channel shoppers spend up to 15-30% more than multichannel shoppers and exhibit stronger brand loyalty, often influencing others to patronise the brand – a strong case for both logistical and brand investment.

While most retailers are still grappling with the logistical complexities of multi-channel, a new concept is emerging, that of omni-channel. Unlike multi-channel, omni-channel consumer communication is through the brand, rather than the channel. So while multi-channel puts the consumer in the driving seat in terms of how they want to shop, omni-channel makes the brand central to the relationship.

Omni-channel enables a retailer to develop marketing strategies around the individual consumer, and requires a consistent, seamless consumer experience through all available channels, rather than 'muddying the water' with differentiated channel offerings. While successful omni-channel retailing requires exacting standards of execution-only possible with the most advanced logistical investment and processes, it also reinforces the importance of the brand at the centre of the decision-making process, and the store as a physical place to reinforce it.

The importance of logistics

Superior IT and logistics have been an important driver of retail success

Technology is constantly changing consumers' interaction with retailers, from providing a simple price comparison tool and a channel for purchasing and downloading electronic goods and services, to enabling a till for tangible goods that can be ordered from a desktop or via a mobile platform for home delivery or click and collect, or a contactless payment system in store. Increasingly technology through social media serves as a channel for consumer brand and product endorsement, and data collected allows an opportunity for retailers to more accurately tailor their marketing approaches to the individual.

However, we feel IT and logistics still only form part of the complex and interconnected set of influences that are the building blocks and facilitators of successful brand communication.

The investment in infrastructure and logistics required from the retailers to execute effectively on this revolution in consumer behaviour is immense. Transforming from a traditional store retailer into an effective multi-channel retailer requires the development of complex logistics platforms to deliver a competitive service offering, in conjunction with a cost-efficient fulfilment operation.

There is no doubt that the move towards multi-channel and omni-channel has required, and will continue to, heavy IT and logistical investment in both time and money. At a recent retail conference in the US, a Senior VP of Logistics and Operations at Macy's said "You can't do omni-channel without accurate and fast data, and you can't do fast data without RFID".

RFID (radio frequency identification) is the wireless non-contact use of radio frequency electromagnetic fields to transfer data, enabling the automatic identification and tracking of microscopic tags attached to individual objects. It is not new technology but if introduced in retail, it would provide a vital link between the retailer and its suppliers. It would give retailers greater control over their product and brand and greatly enhance fulfilment expectations and capabilities with their end consumer.

Many of those who started off ahead of the game with legacy catalogue and delivery businesses (Next and John Lewis) have remained at the forefront of logistical and technological advances and outperformed their store-based peer group. However, that is not to say logistics have been the sole driver of retail success over past few years. Take Argos, for example – despite its legacy in catalogue retailing and home delivery and it being a pioneer of' click and collect', it struggled to 'connect' with the UK consumer until it re-defined its strategic positioning from a catalogue- to digitally-led retailer in summer 2012. Since this reconnection between brand identity and consumer expectation, it has reported consistently positive like-for-like growth.

Supply chain logistics for multi-channel retail are not only complex but also difficult to compare across different retailers. Ultimately what all retailers need to try to achieve with their IT and logistics is a consistency of delivery and speed of fulfilment that matches the ever more demanding expectations of the consumer.

We have therefore looked at the 'front end' consumer-facing platforms of various UK retailers to try to identify who is winning the logistics battle. Exhibit 27 shows the 'customer service' end of each retailer's logistic capabilities. While possible to form many individual conclusions from the data, on an over-riding basis, the retailers with the strongest front-end IT and logistic capability have been among the better performers, and conversely some of those with weaker front-end IT and logistic capabilities have been among the weaker performers.

Exhibit 27: Front-end logistic offerings of major retailers

	Transactional website	Mobile website	Mobile app	Tablet app	Click & collect	Next day*	Free	Home delivery	Cost	Wait time
AO World	✓	✓	x	x	x	x	x	✓	Free	2-3 days
									£9.99	Next day
									£29.99	Same day
Argos	✓	✓	✓	✓	✓	✓	✓	✓	£3.95	2 days
									Variable	Same day
Asda	✓	✓	✓	x	✓	✓	✓	✓	>£3.00	1 Day
ASOS	✓	✓	✓	✓	✓	✓	variable	✓	Free	6 days
									>£100 Free	Next day
									£5.95 <£100	Next day
Debenhams	✓	✓	✓	✓	✓	4 days	✓	✓	>£30 £3.00	4 day Std
									£4.99	Next day
French Connection	✓	✓	x	x	✓	3 days	✓	✓	£3.95	5-7 days
									£7	1 day
H&M*	✓	✓	✓	x	x	x	x	✓	£3.90	4-8 days
House of Fraser	✓	✓	✓	x	✓	✓	✓	✓	>£50 free <£50 £3	3-5 days
									£6	Next day
Jacamo	✓	✓	✓	✓	✓	3-5 days	✓	✓	£2.99	3-5 days
									£6.98	Next day
John Lewis	✓	✓	✓	✓	✓	✓	✓	✓	Free >£50	5 days
Majestic	✓	✓	x	x	✓	✓	✓	✓	free	1 day
M&S (GM)	✓	✓	✓	x	✓	✓	✓	✓	£3.95	3-5 days
									£4.95	1 day
									>£150 free	1 day
Mothercare	✓	✓	✓	x	✓	5	✓	✓	Free >£50 or £2.95	3-5 days
									£6.95	Next day
Next	✓	✓	✓	✓	✓	✓	✓	✓	£3.99	Next day
Primark	x	x	x	x	x	x	x	x	x	x
Sainsbury	✓	✓	x	x	✓	3-5 days	>£15	✓	£3.95	>2 days
									£5.95	Next day
Simple Be	✓	✓	x	x	✓	3-5 days	✓		2.99	3-5 days
									6.98	Next day
Ted Baker	✓	✓	x	x	✓	2-5 days	✓	✓	£4.50	2-3 days
									£5.00	Next day
Tesco	✓	✓	✓	✓	✓	✓	x	✓	>£3.50	Next day
Zara*	✓	✓	x	x	✓	3-5 days	✓	✓	>£50 free <£50 £3.95	3-5 days
									£9.95	1-2 days

Source: Edison Investment Research. Note: As at February 2014. Note: *If no next-day option is available, days for delivery given.

A total outlier to this thesis, however, is Primark, heralded as one of the great success stories of modern retail; it has no internet offering, with nearly 100% of its sales from its 269 stores. In its H1 trading statement covering the 16 weeks to 4 January, total sales were +14% and like-for-likes up mid-single digits, with particularly strong trading over Christmas.

It is also interesting that next-day 'click and collect' delivery is not available at some of the faster growing retailers such as Zara and Ted Baker, both of which reported store sales up in double-digits in their most recent trading periods. That said, retailers that have recently struggled (Debenhams and Mothercare), do not have next-day 'click and collect' service, where as some of the season's 'winners' (John Lewis, Next and House of Fraser) do.

What can be concluded therefore is that superior IT and logistics have certainly been an important driver of retail success and in our view their relative importance is only likely to increase, as consumer expectations continue to rise with the transition from multi-channel to omni-channel. Thus we feel those who were early adapters and pioneers of online and multi-channel retail are likely to continue to stay ahead of the technology curve in the future. However, as we also identify above, IT and logistics have not been the only driver of retail success, as a comparison between the performances of Argos (early adapter) and Primark (non-adapter) reflect.

Data: Collection, analysis and leverage

A differentiated loyalty scheme can add value to an overall consumer proposition, but again is just one of many influencing factors on both a customer's decision to purchase and their continuing loyalty. Early pioneers of loyalty schemes have certainly enjoyed great success, but now we believe there is a significant risk of alienating potential consumers through relentless blanket marketing approaches, particularly for smaller e-tailers. Being able to successfully manipulate 'big data' to provide a personalised marketing approach will differentiate value-enhancing versus value-destroying schemes**.**

Since 1995, when Tesco first employed Dunhumby to use the data from its club-card loyalty programme, retailers have been trying to entice consumers to shop with them using a variety of techniques. They range from account cards and credit cards linked to store-specific loyalty points, promotions and prizes, to earning and redeeming loyalty points across a wide range of providers of goods and services.

For the early pioneers loyalty schemes proved enormously successful, as shown by the rise of Tesco through the late 1990s to overtake Sainsbury's as the largest UK food retailer in 1996. But as with any industry defining revolution, the competition eventually caught up. With BP, Sainsbury's became the anchor brand to the Nectar points loyalty scheme launched in 2002 and, while it appeared to take Sainsbury's seven years to come up with an adequate response, Sainsbury's had aligned itself to a totally new concept – that of earning and spending loyalty points across a (now) broad range of retailers and service providers with similar customer profiles.

The value of loyalty schemes is not just about encouraging a repeat purchase. Increasingly, it has been about the data collection that enables a retailer to start to understand the key motivations of their consumer, what they are buying, when and why. This therefore gives them the opportunity to tailor individual communications with a consumer not only to drive an incremental sale, but more importantly to enhance brand loyalty. Consumers increasingly want to feel that a retailer's approach is bespoke, even if the product is mass.

Most loyalty schemes are still fairly blunt tools, offering blanket promotions that result in a consumer receiving an offer on a product that they have no interest in. Especially in the age of email, inboxes quickly become filled with communications and offers from retailers that hold no personalisation or interest, so instead serve as an irritation with negative implications for brand equity. This is especially a risk for e-tailers for whom email communication is a vital part of their brand awareness toolkit.

It is the retailers that can use and manage 'big data' to generate either a bespoke customer communication or a totally differentiated offering that are likely to succeed in this field. Some of the early pioneers are ahead of the game:

- Tesco offers targeted money-off vouchers and loyalty points on products it knows a consumer regularly purchases; and
- Nectar continually broadens the range of goods and service providers from which points are awarded and redeemed.

New entrants to the loyalty arena need to differentiate their offer again and, although not novices to the loyalty point/awards per se, the success of the My Waitrose and My John Lewis, where loyalty points have been replaced with free cups of coffee and a lottery style competition to win a month's or a year's worth of shopping vouchers, will be interesting to follow.

Those who try to launch undifferentiated 'copy-cat' concepts could end up putting potential customers off, rather than drawing them in. As with IT and logistics, data collection and consumer-facing loyalty programmes are two of the multiple interfaces a retail brand has with a (potential) customer. Once again, execution will prove to be key. In our view, no loyalty scheme is better than a poor loyalty scheme. We point to the success of Primark and Zara, with no loyalty schemes, relative to the recent performance of Mothercare, despite it having a number of ill-fated loyalty schemes across both its Mothercare and Early Learning Centre brands over several years.

The future of the high street as we see it

There is no doubt that the traditional high street is under pressure, especially in secondary and tertiary locations. Images of empty high streets and boarded up shops have been prevalent over the last six years and, in the main, the finger of blame has been pointed at the internet. Figures from Experian GOAD show that vacancy levels in high street trading locations are close to 14%. However, there is an assumption that these now ghostly high streets were once thriving areas of commercial activity when very often this was not the case. And as we have extensively discussed in this report, this is the result of multiple sometimes long-term trends, rather than just the impact of the internet.

Further evidence that there are other causes for the high street demise is that vacancy rates in prime (non high street) and good secondary locations are much lower, with many prime pitches at sub 4% vacancy as chain retailers move to these new high density, easily accessible shopping destinations. High productivity, large floorplate shopping space in prime shopping destinations and out-of-town shopping centres remain at a premium according to CBRE. If retailing of all goods and services were to be transferred online, it is unlikely this premium would exist.

So the demise of the traditional high street should not be interpreted as the decline of tangible retail. We have shown that in the main, large business retail (ie, listed retailers) is in good shape, especially those retailers who have been early to grasp the multi-channel format. And, even for those who have not, as long as their brand remains relevant within the tangible space, the internet alone is unlikely to derail success.

The traditional high street will need to reinvent itself. This could be through the growth of new types of business who are attracted to the space for its size, natural light, and brand advertising potential of a high street location (day nurseries, children's play-areas, yoga and Pilates practices, dance studios, doctors, dentists or veterinary practices). There would also be a rationale to resolve the much discussed chronic housing shortage, by changing the use for some long-term underperforming areas.

Thus even when the economic recovery takes hold, due to the number of factors that have affected these locations – of which the internet is just one – we believe it is unlikely many of these areas will be able to support a broad spectrum of sustainable retail.

It's all about the brand

We believe the key differentiator for success among retailers has been the relative strength and investment behind the brand, which with the advent of omni-channel is only likely to grow in importance. Since 2000 Interbrand's Best Global Brand (BGB) portfolio has consistently and significantly outperformed the S&P and MSCI. From a base at 100 in 2000, the valuation of S&P reached 117 by end 2013, the MSCI 118.2 and the BGB 192.

An interesting differentiation can be made between retail merchants that presume demand and accommodate it by being the means of supply, and retail brands, which generate demand in its own right, creating consumer value, going beyond the more directly comparative metrics of price and convenience. A good example of this comes from comparing the performance of Ted Baker with French Connection over the past six years.

On the face of it, they could be seen as similar propositions, a unisex fashion brand aimed at the young and fashion-conscious consumer. Arguably, given the economic backdrop, one would have thought Ted Baker with its higher price point would have fared worse. However, as Exhibit 28 shows, the opposite is the case.

Exhibit 28: Key performance metrics for French Connection and Ted Baker 2009 and 2014

	French Connection			Ted Baker		
Year to Jan	**2009**	**2014**	**Change**	**2009**	**2014**	**Change**
Revenues (£m)	248	189.4	(23.6%)	152.7	330.8	116.6%
Operating profit (£m)	(0.7)	(4.4)	n/a	17.1	40.7	138.0%
Store/Concession nos	144	147	2.1%	193	362	87.6%
Square ft*	330	300	(9.0%)	202.6	316.6	56.3%
Internet % sales		20%			7%	
Share price (£)	0.60	0.88	46.7%	0.11	18.53	16,693.7%
Market cap (£m)		84.4			809.8	
EV (£m)		111.4			810.4	

Source: Company data and Edison Investment Research. Note: *French Connection square foot does not include businesses held for sale or licensed/franchised space. Ted Baker square foot does not include partner stores. Priced as at 2 May 2014.

In the year to January 2009, Ted Baker had revenues of £152.7m versus French Connection of £248m. Ted Baker had an operating profit of £17.1m versus French Connection, already starting to show some stress with a loss of £0.7m. Ted Baker traded in 202.6k square foot of retail space, heavily biased towards concessions, and French Connection traded in 330k square foot (excluding businesses held for sale, licence and franchise space), heavily biased towards stores.

What is fascinating about the relative operational and share price performances is that Ted Baker has grown predominantly through a highly stylised and individualised network of concessions and stores, backed up by a powerful understanding of what the brand Ted Baker means to its consumers, and where it is capable of taking them. By contrast, , French Connection appears to have lost a degree of customer focus, with a steady evolution of strategies and management, seemingly leading to an internally focused organisation. It is also an example that the internet on its own cannot be held responsible for the failure of store retail. By FY14 only 7% of Ted Baker sales were online, 'underperforming' the average of the textile subsector at 9.1% while those of French Connection were at 20%. Additionally Ted Baker does not offer top of peer group 'click and collect' or home delivery logistics either.

What makes a strong brand?

There is no magic formula to making a strong brand and in the new digital world, they can be created and destroyed with alarming speed. Brand experience is more than time spent in a store, or searching a website, it is embodies every interaction that a potential and existing consumer has with a product or a brand that leads them to an initial purchase, and (hopefully) an ongoing loyalty.

Among the wide range of interconnecting qualities that define brand strength, we have selected a few that we believe represent some of the core qualities of a successful brand. These include:

- **Differentiation** – a 'unique selling proposition' that can take several different forms, from the product itself to its customer base, from service levels and the overall experience, to the brands messaging and the associations that this creates, and any other interactions the brand has with the consumer to encourage purchase.
- **Consistency** – across all touch points in terms of product, presentation, service and overall experience. **Execution** is key, as a brand is only as strong as its weakest link. However, consistency does not mean a static offering, a brand must have the agility to adapt to change, while maintaining its core messaging, and upholding the same consumer values and service.
- **Value** – a brand must represent good value, but this does not mean the cheapest. It can mean good quality at a fair price or exceptional quality that has earned it premium, ie luxury. Aspirational purchases embody a more total brand experience and reflect a desire to search for a better life, offering the promise of a brighter tomorrow.
- **Trust** – a strong brand needs to build a relationship with its consumer and all good relationships require trust. A brand needs to uphold values that are both meaningful and genuine to the consumer and, which communicate with them on a personal level; increasingly

consumers want to believe their interaction with a brand is bespoke, even if the merchandise is mass.

- **Customer understanding –** knowing your consumer is not just about setting out a defined target audience. It is about understanding their lifestyles and motivations and consistently delivering on their changing needs. Increasingly, brands need to be where their consumers are physically and digitally.

How can brands be measured?

So if brand strength is the key, with such a broad range of tangible and intangible attributes combining to characterise what needs to be a unique brand proposition, how can a brand be measured or compared? We have identified a number of brand ranking tools, with varying methods behind their analysis to try to find a common list of current brand 'winners' and 'losers'.

WPP's BrandZ

This is a valuation method that combines ongoing consumer research and rigorous financial analysis. Its claimed point of differentiation is the way it obtains consumer insights, by conducting ongoing, in-depth quantitative consumer research covering two million consumers in 30 countries, covering more than 10,000 brands. The end result is *BrandZ Top 100 Most Valuable Global Brands in 2013*.

Exhibit 29 below shows the retail and luxury names included within this list and extends to show the top 20 or 10 in each retail subsector that BrandZ separately discloses.

Of the top 100 consumer brands globally, 16 are retail and luxury names, the most valuable being Amazon ranked at 14. The technology sector steals the top three slots in the global ranking with Apple, Google and IBM respectively, McDonald's and Coca Cola ranked four and five, being the most valuable brands within the consumer sector.

Of the 40 retail and luxury brands listed below, 20 are European names and five UK. What we believe is more interesting than the ranking itself is the year-on-year change in brand value, the greatest percentage movers being Prada gaining 63% brand value on the previous year, Zara gaining 60%, Calvin Klein 52%, Gucci 48% and Home Depot 43%. The fact that there are three luxury names in the top five retail movers will have little to do with e-commerce or logistics (Gucci is the only one of the three with a mobile app, only launched last year). Instead they speak more about the importance of aspiration and overall experience in a consumer's purchasing decision, as well as an insight into what may be an improving consumer backdrop.

Clearly e-commerce cannot be ignored given the top five positions of Amazon and eBay within global retail, and their respective brand value and rank change. However, both companies have very strong and differentiated consumer propositions that go well beyond the scope of e-commerce alone. It is also of note that of the 40 brands listed across apparel retail and luxury below, they are the only e-commerce brands listed.

Exhibit 29: BrandZ – most valuable global retail and luxury brands 2013

Name	Top 100 brands	Apparel top 10	Retail top 20	Luxury top 10	Brand value ($bn)	Change (%)
Amazon	14		1		45,727	34.0
Walmart	18		2		36,220	5.0
LVMH	29			1	22,719	(12.0)
Zara	35	1			20,167	60.0
Hermés	40			2	19,129	0.0
The Home Depot	41		3		18,488	43.0
eBay	47		4		17,749	40.0
Tesco	55		5		16,303	(9.0)
Nike	56	2			15,817	(3.0)
Gucci	68			3	12,735	48.0
H&M	69	3			12,732	(6.0)
Ikea	74		6		12,040	31.0
Target	76		7		11,879	13.0
Woolworths	80		8		11,039	New
Prada	95			4	9,454	63.0
Aldi	99		9		8,885	(5.0)
Rolex				5	7,941	11.0
Lowes			10		7,559	26.0
Carrefour			11		7,372	(6.0)
Channel				6	7,075	6.0
Costco			12		6,789	33.0
Whole Foods			13		6,728	New
Cartier				7	6,377	32.0
Walgreens			14		5,925	New
CVS			15		5,620	New
Ralph Lauren		4			5,618	10.0
Falabella			16		5,611	7.0
Adidas		5			4,882	26.0
M&S			17		4,649	7.0
Uniqlo		6			4,627	25.0
Asda			18		4,617	19.0
Lidl			19		4,524	(2.0)
Coles			20		4,416	New
Burberry				8	4,194	3.0
Next		7			4,121	39.0
Lululemon		8			3,764	New
Fendi				9	3,636	New
Hugo Boss		9			3,524	8.0
Coach				10	3,276	New
Calvin Klein		10			1,801	52.0

Source: WPP, Milward Brown

Of the UK names, Tesco is the only brand to make it into the global top 100 at 55; however, its brand value was calculated at $16.3bn in 2013, down 9% on 2012, and down a material 37% since its peak in 2010, where it ranked as the 17th most valuable brand globally. M&S, Asda, Burberry and Next are the other four UK retailers to make the retail sector-specific list, with Next ranking seventh overall in brand appreciation year on year, up an impressive 39%, on top of a 16% rise in 2012.

Among the losers, Carrefour was the one retailer to ‘fall out’ of the top 100 in 2013, and has suffered year-on-year brand value and ranking decline from its peak in 2008, when it ranked 44th, to 98th in 2012, losing 48% of its brand value. Although still one of the most valuable brands globally Louis Vuitton’s brand value slipped in 2013, showing how difficult it can be for the luxury names to balance the exclusivity required to protect its desirability, and the inclusivity needed to attract new customers. Among the surprising losers of brand value in 2013 were both Aldi and Lidl, which contrasted with the overall strength of the luxury names (excluding Louis Vuitton) perhaps pointing to a shift away by consumers from the importance of ‘price’ to a broader appreciation of ‘value’.

Despite BrandZ favouring bigger brands and business, in our view it is the year-on-year change in value that provides a bigger clue to future retail success. And, as Exhibit 31 suggests, this is not necessarily a function of size.

Interbrand – Best Global Brand index

Since 2000, Interbrand has been calculating brand values based on three key components, which it measures through its own proprietorial valuation method:

- an analysis of a brands competitive strength;
- the role the brand plays in the purchase decision; and
- the financial performance of the brand.

Since 2000 Interbrand's Best Global Brand (BGB) portfolio has consistently and significantly outperformed the S&P and MSCI. From a base at 100 in 2000, the valuation of S&P reached 117 by end 2013, the MSCI 118.2, and the BGB 192. This could be interpreted as a reflection of the importance of brand strength to company success.

Looking at Interbrand's top global brands in Exhibit 30, 14 of the Best 100 brands globally are in the retail and luxury sector and include broadly the same names as BrandZ, although in a different order, and with some hugely different estimates of brand value (reflecting the subjectivity of calculating an absolute figure). We therefore look for common themes between the two lists and the year-on-year movement in value to try to identify relative brand strength winners and losers.

Exhibit 30: Retail and luxury brands included in Interbrand's 100 Best Global Brands analysis

	2013 ranking	2012 ranking	2013 value ($m)	2012 value ($m)	2013 change	2012 change
Louis Vuitton	17	17	24,893	23,577	6.0%	2.0%
Amazon	19	20	23,620	18,325	27.0%	46.0%
H&M	21	23	18,168	16,571	10.0%	1.0%
Nike	24	26	17,085	15,126	13.0%	4.0%
Ikea	26	28	13,818	12,808	8.0%	8.0%
eBay	28	36	13,162	10,947	20.0%	12.0%
Zara	36	37	10,821	9,488	14.0%	18.0%
Gucci	38	38	10,151	9,446	7.0%	8.0%
Hermés	54	63	7,610	6,182	23.0%	15.0%
Adidas	55	60	7,535	6,699	12.0%	9.0%
Prada	72	84	5,570	4,271	30.0%	New
Burberry	77	82	5,189	4,342	20.0%	16.0%
Ralph Lauren	88	91	4,584	4,038	14.0%	New
Gap	100	100	3,920	3,731	5.0%	-8.0%

Source: Interbrand

To put together a target list, we look for direction of movement in value and consistency of ranking. Exhibit 31 below shows the 13 retailers with a UK presence that have gained a position in both the BrandZ and Interbrand Global ranking surveys, ranked by value momentum.

Exhibit 31: Brand and momentum ranking

	BrandZ Global	% value move	Interbrand Global	Interbrand UK	% value move
Zara	35	↑↑↑↑↑↑	36		↑
eBay	47	↑↑↑↑	28		↑↑
Amazon	14	↑↑↑	19		↑↑
Next	>100	↑↑↑		5	↗
IKEA	74	↑↑↑	26		↗
Asda	>100	↑		4	↗
M&S	>100	↗		2	↗
Lidl	>100	↔			
H&M	69	↘	21		↑
Tesco	55	↘		1	↔
Aldi	99	↘			
Carrefour	>100	↘			
GAP			100		↘

Source: BrandZ, Interbrand and Edison Investment Research. Key: ↑ up multiple of 10%; ↓ down multiple of 10%; ↔ >-5% <+5%; ↗ +5% <10%; ↘ -5% >-10%.

While the actual rankings between the two lists vary, there is some commonality in momentum, both positive and negative, with Zara, eBay, Amazon, Next and IKEA enjoying the highest overall positive momentum and H&M, Tesco, Aldi, Carrefour and GAP the weakest. In the middle, the brand value momentum of Asda and M&S are marginally improving, while Lidl's is effectively static.

Other common themes between the two global lists include:

- A heavy weighting towards luxury and lifestyle brands Prada, Gucci and Hermés, which have also enjoyed some largest percentages in brand value appreciation over the last two years, again pointing to the importance of an overall brand experience, over price or online availability.
- Amazon and eBay enjoying a high ranking and some of the largest appreciations in brand value under both valuation methods. However, it is worth noting that they are the only two e-commerce retailers included in either list.
- Zara is one of the leading gainers in brand value in both lists, while H&M showed a decline in brand value according to BrandZ, and among the lowest scores in brand momentum using Interbrand's method over two years.
- While ranked highly on both lists, Louis Vuitton appears to be stalling in terms of brand value appreciation.

Key differences include:

- Nike stalling using BrandZ metrics, but still enjoying positive brand value momentum using Interbrand's analysis, whereas Adidas is included in Interbrand's Top 100 Global Brands, but is valued significantly below the top 100 level by BrandZ.
- Burberry also failed to achieve the necessary brand value to be included in the BrandZ top 100 list; however, it is included in Interbrand's, with value momentum in the Interbrand list also significantly above that reported in BrandZ's.
- While ranked and valued more highly using Interbrand's valuation approach, IKEA's brand value momentum is significantly higher using that of BrandZ.
- Notable absences from the Interbrand's ranking that made it into the BrandZ top 100 include Walmart, The Home Depot, Tesco, Target, Woolworths (Aus) and Aldi. However, Tesco and Aldi were two of just six brand names that suffered value decline in the BrandZ analysis, indicating perhaps a common theme of brand value erosion.

The publication of a top 100 global list by its nature clearly favours large global brands. However, Interbrand provides more granularity by publishing a list of the top UK retail brands, which we show in Exhibit 32 below.

Exhibit 32: UK top 15 retail names 2013 and top 10 2012						
2013	**2013 ranking**	**2012 ranking**	**2013 value ($m)**	**2012 value ($m)**	**2013 change**	**2012 change**
Tesco	1	1	10,810	11,011	-2%	9%
M&S	2	2	6,550	6,256	5%	3%
Boots	3	3	3,295	2,852	16%	15%
Asda	4	4	1,674	1,576	6%	13%
Next	5	5	1,370	1,319	4%	1%
Sainsbury	6	6	1,062	976	9%	15%
Argos	7	7	805	876	-8%	-4%
Morrison	8	8	451	438	3%	2%
Waitrose	9	9	429	382	12%	13%
ASOS	10		416		New	
B&Q	11		405		New	
John Lewis	12		314		New	
Debenhams	13	10	303	288	5%	1%
The Body Shop	14		299		New	
Primark	15		171		New	

Source: Interbrand

An initial observation is that in 2013, 14 out of the top 15 are store-based retailers, and in 2012 all 10 out of the top 10 were store based. Again, while the individual ranking are of some interest, year-on-year movement gives a better impression of the direction of future brand strength.

While maintaining most valuable retail brand position in 2013, some way ahead of peer group, (common to the BrandZ analysis), the year-on-year change in value of Tesco was one of the few to turn negative. Interestingly, despite a recent run of better results, Argos still appears to be losing brand value; while Debenhams has gained in value, it has slipped down the rankings, replaced by ASOS the top new entrant in the UK ranked at 10. On the positive side, Boots, Waitrose and Sainsbury's have gained the most value over two years.

The OC&C proposition index

With even the Interbrand UK retail index still favouring the larger retail names, looking at the OC&C retail proposition index (see Exhibit 33 below) size does not appear to be such an influencing factor, instead it measures 'attitudes' towards the world's leading retailers. The analysis captures 300,000 ratings from 30,000 consumers on nearly 600 retailers across nine countries. Consumers are asked to rate retailers on the strength of their overall proposition by scoring key elements of that proposition including:

- low prices
- value for money
- trust
- service
- product quality
- wide choice of products
- store/website look and feel
- fashionability

Exhibit 33 below shows the rankings of retailers with operations in the UK. While the position of the top six in the UK reflect similar conclusions to the brand ranking tools analysed above, the inclusion of Lakeland, Waterstones, Healthspan and Specsavers in the top 10 was surprising. In addition the (UK) rankings of Next at 60, Primark at 53, and ASOS at 34 were significant divergences from expectation, given the consistent strength of performance reported by all three retailers.

Exhibit 33: UK retail rankings within the OC&C Retail proposition index 2013

	Global	UK		Global	UK
Amazon	1	1	Austin Reed	233	46
John Lewis	8	2	B&M Bargins	234	47
M&S	23	3	TK Maxx	238	48
M&S Simply Food	26	4	Pets at Home	239	49
eBay	30	5	Ocado	240	50
IKEA	38	6	Wickes	249	51
Lakeland	42	7	99p store	252	52
Waterstones	50	8	Primark	253	53
Healthspan	53	9	Carphone Warehouse	254	54
Specsavers	57	10	Sports Direct	256	55
Waitrose	58	11	Harrods	257	56
Home Bargins	59	12	Morrison	259	57
Wilkinson	66	13	Mothercare	263	58
Aldi	73	14	Boots Opticians	284	59
Farm Foods	81	15	Next	285	60
Argos	83	16	House of Fraser	286	61
Greggs	89	17	Hobbycraft	290	62
Asda	105	18	Chainreactioncycles	293	63
Body shop	106	19	Cotwold Outdoors	295	64
Clarks	107	20	Holland and Barrett	296	65
Boots	110	21	Superdrug	297	66
Dobbies	111	22	Schuh	315	67
Richer Sounds	118	23	Space NK	317	68
Zara	120	24	Ted Baker	318	69
Hotter shoes	122	25	River Island	319	70
H&M	123	26	B&Q	320	71
Cath Kidston	126	27	Blacks	322	72
The Range	144	28	Game	329	73
Dunelm Mill	147	29	Superdry	333	74
Debenhams	149	30	Ernest Jones	338	75
M&M Direct	152	31	New Look	341	76
Tescos	153	32	Dorothy Perkins	342	77
Lidl	157	33	Lloyds Pharmacy	345	78
ASOS	162	34	Maplin	351	79
Toys R Us	164	35	Boden	354	80
Sainsbury's	167	36	Booths	355	81
Iceland	171	37	Wyevale	359	82
GAP	177	38	Fat Face	363	83
Play.com	186	39	Bargain Booze	364	84
Selfridges	214	40	Robert Dyas	381	85
Paperchase	216	41	TM Lewin	382	86
Ebuyer	217	42	Majestic Wine	384	87
Poundland	223	43	Karen Millen	387	88
Card Factory	225	44	Monsoon	391	89
Matalan	229	45	Timpsons	394	90

Source: OC&C Global Strategy Consulting

Exhibit 34 below shows more detail behind the overall index, identifying which retailers scored within the top 10 of each of the propositions above. It shows that the two highest ranking retailers in the UK (Amazon and John Lewis) achieve top 10 positions globally across a range of propositions. What it also shows is that while M&S only achieved a top 10 ranking for 'Quality' for its Simply Foods proposition, it must have score well (if outside the top 10) across a broad range of rankings to achieve the number three and four slot for the overall brand and Simply Food respectively, with the same argument for eBay.

Exhibit 34: Ranking by retail proposition

	UK rank	Price	Value for money	Trust	Service	Quality	Range	Appearance	Fashionability	Top 10 positions
Amazon	1		1	1	2		1	5		5
John Lewis	2			3	1	4		6		4
Waitrose	14				10	10				2
Poundland	43	3	10							2
Farm Foods	15	9	2							2
Card Factory	44	10	8							2
Aldi	14	6	3							2
Primark	53	1								1
99p	52	5								1
M&S Simply Food	4					1				1
eBay	5						2			1
ASOS	34								5	1
Zara	24								7	1
H&M	26								9	1

Source: OC&C Global Strategy Consulting

Given the extensiveness of the list, including of 90 retailers (out of a total list of 400) that operate in the UK, the absence of some names is also notable including Homebase, Co-op, Dixons and French Connection. Additionally, given the granularity of the list and number of 'smaller' retailers included, it is interesting to note that of the 90 UK retailers just nine are internet only, with the remaining being store based and increasingly multi-channel.

Lansons Communications' Most Trusted Company Index

Trust is a much-used word when trying to capture consumer loyalty to a brand. Lansons Communications published a list of the top 50 most trusted companies within the UK in 2013, which is shown in Exhibit 35.

Exhibit 35: Lanson Communications' Most Trusted Company Index 2013

Retail rank	Company	UK most trusted rank
1	M&S	1
2	John Lewis	2
3	Tesco	3
4	Boots	4
5	Amazon	7
6	Asda	8
7	Sainsbury	11
8	Waitrose	22
9	Morrison	23
10	Argos	24
11	B&Q	30
12	Next	37
13	Debenhams	42
14	eBay	42

Source: Lansons Communications

Once again, this evaluation tends to favour the larger names. However, it is interesting how all the grocery retail majors feature in the list, re-enforcing our view that a significant influence behind the demise of the high street over the last 25 years has been a shift of share from non-grocery to grocery, and if trust is connected to loyalty, it looks as though this shift is likely to continue. The only two internet players listed yet again are Amazon and eBay, perhaps indicating that consumers are still more willing to trust brands that they can physically interact with.

The Nunwood Centre for Consumer Excellent Experience

Finally, we have looked at the Nunwood Centre for Consumer Excellent Experience, which measures customer experiences around the UK's top companies. Nunwood has used its vast database of over 750,000 consumer evaluations to statistically validate the six most important factors that consumers talk about when it comes to great experience.

The six pillars identified by Nunwood are:

- Personalisation (24.2%)
- Integrity (17.9%)
- Valuing customers' time and effort (17.1%)
- Expectation (15.0%)
- Resolution (13.7%)
- Empathy (12.1%)

(The numbers in brackets record the statistically measured relative importance in driving loyalty and advocacy.)

Exhibit 36 below shows that 53 out of the top 100 UK consumer brands in 2013 were retailers, of which seven are non-store retailers. Once again, it shows an interesting mix of retailers, with some notable repeat performers and some absences.

Exhibit 36: Nunwood Centre for Consumer Experience Excellence 2013 ranking

	Rank		Rank
John Lewis	1	ASOS	45
QVC	2	Screwfix	46
Amazon	4	Play.com	47
M&S Simply Food	6	Tesco	47
Lush	7	Dunelm	47
Ocado	8	Matalan	50
M&S	9	Lidl	53
Waitrose	10	New Look	55
Sainsbury's	11	Mamas and Papas	57
Specsavers	12	Ikea	60
Asda	17	Superdrug	60
Laithwaite's Wine	18	ebuyer	62
Iceland	19	Fat face	62
Richer Sounds	20	Evans	62
Aldi	20	K&Co	71
Boots	22	Schuh	71
Argos	23	Littlewoods	74
Waterstones	25	Vision Express	78
Farm Foods	26	Selfridges	78
Morrison	29	Monsoon	78
Wilkinson	31	House of Fraser	82
Mothercare	34	JD Sport	83
Next	36	B&Q	83
Thorntons	36	BHS	87
Clarks	36	H Samuel	88
The Body Shop	41	Primark	97
Debenhams	41		

Source: Nunwood Centre for Consumer Experience Excellence

Edison total brand score

Brand evaluation is hugely subjective, due to the intangible nature of what makes a successful brand. However, we have managed to draw some common conclusions among the variety of chosen metrics.

Our key conclusion from this exercise is that if omni-channel is the future for retailing, then brand strength – however intangible it is to define or measure absolutely – will be of increasing importance and the direction of momentum could be used as an indication of future success.

Focusing on the UK-listed retailers, we have calculated a cumulative score for those retailers who feature in all four UK specific brand ranking approaches to come up with our own ranking, shown in Exhibit 37 below.

Exhibit 37: Edison total brand score

	Interbrand UK	OC&C UK	Lanson UK	Nunwood UK	Total score
M&S	2	3	1	9	15
John Lewis	12	2	2	1	17
Asda	4	18	8	17	47
Boots	3	21	4	22	50
Waitrose	9	11	22	10	52
Sainsbury	6	36	11	11	64
Argos	7	16	24	23	70
Tesco	1	32	3	47	83
Morrison	8	57	23	29	117
Debenhams	13	30	42	41	126
Next	5	60	37	36	138
B&Q	11	71	30	83	195

Source: Edison Investment Research

Interestingly, Marks & Spencer ranks highest among the UK retailers and appears in some of the global lists, with John Lewis scoring very well across the different metrics. Of the other retailers included in global valuation ranks, Asda maintains a good position across most metrics, and while Tesco ranks third most trusted UK brand, it slips down on Retail Proposition and Experience Excellence, with Next slipping down the rankings on Retail Proposition, Experience Excellence and Trust.

There are no online retailers ranked across all these criteria. While ASOS is included at number 10 in the Interbrand UK Retail Index, it is not ranked among the top 50 most trusted UK brands, is 34th in the UK in the Retail Proposition index and 45th in Experience Excellence. Primark is also not included in the Most Trusted index, and ranks 53rd and 97th in Retail Proposition and Experience Excellence respectively.

That said, this analysis again has tended to favour the larger retailers, so it is possible some credit is due to any of the smaller retailers who made it on to any of the lists in Exhibits 33 to 36 above.

Given the extensive nature of the brand evaluation tools above, and the seeming exhaustiveness of the lists, perhaps attention should also be drawn to those retailers who did not make any of the lists including listed players such as:

- French Connection
- Dixons
- WH Smith
- Homebase
- Carpetright
- Carphonewarehouse
- Lookers
- Appliances On-line / AO World
- BooHoo.com

Definitions (ONS)

Total retail ex-fuel: total UK retail sales, including all retail subcategories and channel ex fuel.

Predominately food stores: food retailers including their non-food sales, and internet sales

Predominately non-food stores: non-food store based retailers including their internet sales

Non store: retail sales from internet specialists, and traditional non-store non-internet channels

Large retailer: >100 employees, or 10-99 employees >£60m annual turnover.

Small retailer: 0-99 employees, or <£60m annual turnover).

Company profiles

EDISON

AO World

Consumer

12 May 2014

Ambitious outlook

In the first nine months of its financial year to March 2014, AO World reported 45% revenue growth, driven predominantly by the growth of its own website, ao.com (now 73% revenues). Gross margins were up 90bp year on year to 19.1%, driven by better product gross margin – due to heightened volumes – and delivery efficiencies. Marketing and advertising costs took a sharp step up, partly due to an increase in customer acquisition cost from 3.2% to 3.6% as the group moved its website to ao.com from ApplicancesOnline.com and launched its first national TV campaign. As a result, operating margin for the period was down 120bp at 2.2%, with reported EBIT falling 8% to £6.1m. Capex increased 3x versus the comparative period, due to the opening of eight 'outbases' in 2013 to complement its central warehouse in Crewe, which opened in 2012. With its current warehouse set up, AO World has the potential to expand to 5x its FY13 volume, enabling it to explore its expansion ambitions in the small domestic appliance and television subsectors and internationally.

Evaluation criteria

***Ahead of peer group/expansionary **In line with peer group *Below peer group/contracting

Criteria	Rating	Comment
Store investment	N/A	100% sales online
Staff investment/training	***	Excellent customer service is central to AO's strategy and employees are empowered to make individual decisions that best suit a customer's needs. Winner of 'Best Customer Service Initiatives' at Oracle Retail Week awards and ranked fourth in the Sunday Times Best Companies to work for in 2013.
Speed of stock turn	***	ao.com offers a market-leading proposition with 4,100 SKUs from 30 appliance brands and approximately 80% stock available for same day or next-day delivery.
Multi-channel capability	*	As a pure play e-tailer, AO World does not have a store portfolio as part of a multichannel strategy and ao.com does not have an app for mobile or tablet devices. However, it did receive several 'Best e-tailer' awards in 2013.
Speed/choice of delivery	***	The speed and flexibility of its home delivery offering is central to AO's business model. Free standard delivery is two to three days, next day is usually £9.99 (currently free), and same-day is available to 70% of UK postcodes (order before midday) at £29.99.
Brand strength	*	Given its 24% share of the online domestic appliance market and its core strategy of customer service excellence, it is surprising that AO does not feature in any of the brand ranking tools we identified, and ranked 1,044th in the Alexia hit rate analysis of most visited UK websites. We expect this to improve due to its stock market listing and new fleet of company-branded distribution vehicles.

Source: Company presentations, Edison Investment Research

Consensus estimates

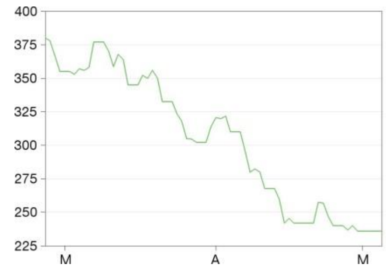
	Revenue (£m)	PBT (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)
03/13	275.0	8.7	1.6	N/A	147.5	N/A
03/14e	385.3	8.1	1.7	N/A	138.8	N/A
03/15e	481.3	13.9	2.7	N/A	87.4	N/A
03/16e	615.3	23.2	4.1	N/A	57.6	N/A

Source: Bloomberg

Price	**236.0p**
Market cap	**£994m**

Priced at 2 May 2014

Share price graph



Share details

Code	AO.
Listing	LSE
Shares in issue	421m

Business description

AO World is the leading online major domestic appliance (MDA) retailer in the UK, with a 24% share of the online market and an 8% of the total UK MDA market. 73% sales were from its website ao.com, 21% from third-party retail sales and 6% from logistics services.

Bull

- Strong customer service lead proposition.
- Market leading breadth of SKUs and consumer brands.
- Industry-leading distribution capability.

Bear

- Broader brand recognition remains low.
- Lack of stores makes it unable to compete in 'multi-channel world'.
- Very high valuation.

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ASOS

E-tail pioneer

In the six months ended February 2014, ASOS reported retail sales +34% and an increase in active customer base to 8.2 million (+36%). While retail gross margin was up 60bp due to an increase in operating costs, as a percentage of sales of 350bp operating profit was down 22% at H114 and EPS down 21%. The majority of the increase in operating costs reflects a decision to invest now for significant future growth, as ASOS refines and improves its offering and service in existing markets and explores new markets. However, the big step up in investment also highlights that capturing additional customers and revenues online does not come for free, and reflects the logistical difficulties of replicating the same instant consumer satisfaction of making a purchase in store for immediate wear.

Evaluation criteria

***Ahead of peer group/expansionary **In line with peer group *Below peer group/contracting

Criteria	Rating	Comment
Store investment	N/A	100% sales online
Staff investment/training	***	Payroll and staff costs increased by 47% in H114. ASOS was the winner of the Best Compensation and Benefits Scheme in the 2013 Payroll World Awards.
Speed of stock turn	***	ASOS lists >900 brands and >75,000 products, with 2.5-3,000 new products added per week. In addition, Marketplace has >145 individual listings.
Multi-channel capability	**	Industry-leading e-commerce interface in UK, which is being rolled out across major markets. Significant investment is continuously made in customer experience across websites and social media applications. Strong mobile and tablet capabilities through transitional websites, apps and social media. No store portfolio.
Speed/choice of delivery	***	Continuous investment in enhanced warehousing and delivery options result in a wide range of delivery choices offered within the UK, standard (free), next day, next evening, nominated workday (normally £5-£9), or 'click and collect' from a Collect+ network store (free >£100 order).
Brand strength	**	While not on any international lists, it was a new entrant on Interbrand's UK retail list in 2013, ranking 10th. It ranked 34th in OC&C's brand proposition and 45th in Nunwood's Centre for Consumer Excellence. It has an Alexia hit ranking of 109 in the UK.

Source: Company presentations, Edison Investment Research

Consensus estimates

	Revenue (£m)	PBT (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)
08/13	769.4	54.7	49.2	0.0	87.4	N/A
08/14e	1,012.0	65.4	59.5	0.0	72.2	N/A
08/15e	1,267.0	89.3	81.9	0.0	52.5	N/A
08/16e	1,562.0	120.1	112.4	0.0	38.3	N/A

Source: Bloomberg

Consumer

12 May 2014

Price	**4,300p**
Market cap	**£3.6bn**

Priced at 2 May 2014

Share price graph

Share details

Code	ASC
Listing	AIM
Shares in issue	83.43m

Business description

ASOS is a global fashion destination for 20-somethings, selling over 75,000 branded and own-brand products through localised mobile and web experiences. Its websites attract 71 million visits per month, and it has 8.2 million active customers; 38.5% of revenues are UK, 61.5% international.

Bull

- Industry leading e-commerce capabilities.
- Unique product breadth and range, continuously refreshed portfolio.
- Clear brand positioning and focus.

Bear

- Lack of a store base challenges future multi- or omni-channel participation.
- Ongoing cost of consumer acquisition.
- Ongoing cost of enhanced delivery requirement.

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French Connection

Consumer

12 May 2014

French re-connection

Revenue in the year to January 2014 was down 4% on a 7.7% reduction in floor space; however, like-for-like (l-f-l) H2 improved to +1.4%, with momentum continuing into FY15 with 11% l-f-l reported for Q1. E-commerce now represents 20% of group sales and grew 8% in FY14, with 27% of orders using 'click and collect' despite no next-day offering. Operating loss reduced from £7.2m in FY13 to £4.4m for FY14, with a profit of £1.7m in H214 versus a loss of £0.9m in H213. With the positive l-f-l in H2 and Q1 FY15, it may give some early signs that the turnaround strategy announced in H113 is starting to take hold. However, with 11 stores closing in FY14 and a further three to five scheduled to close in FY15, more cash flow is being used to shut stores (£1.7m in FY14; similar in FY15) than for investing, with FY14 capex just £0.7m. While some recent results look encouraging, in an increasingly brand-focused world we ask will French Connection be able to step up store and brand investment to continue to compete effectively?

Evaluation criteria

***Ahead of peer group/expansionary **In line with peer group *Below peer group/contracting

Criteria	Rating	Comment
Store investment	*	French Connection is reducing store numbers with the loss of 11 stores (7.7% floor space) in FY14, and a further three to five store closures in the coming year. With its objective of cash conservation, near-term store investment would appear unlikely.
Staff investment/training	**	The company has done extensive amounts of analysis on efficient staff rostering, increasing staff numbers at peak times, and reducing at numbers at quieter times While there is no quantitative feedback available to reflect an improvement in customer service, the recent acceleration in l-f-ls may be taken as indicative.
Speed of stock turn	**	There 2 main collections Spring/Summer and Autumn/Winter, with 4 mid-season 'drops' of new product
Multi-channel capability	***	E-commerce represents 20% of group sales and grew at 8% in the year to January 2014. Transactional websites are available on mobile and tablet accounts for 40% e-commerce sales.
Speed/choice of delivery	*	Free 'click and collect' in store currently offered with a three-day lead time. Alternatively it offers next-day home delivery at an additional cost of £6.98. A greater choice of options will be introduced from autumn 2014.
Brand strength	*	FCCN did not feature in any of consumer brand ranking tools that we analysed, although independent research undertaken on behalf of the company reflected 92% brand recognition. Until H2 FY14, we feel its operational and share price performance reflected strongly declining brand equity (see Exhibit 28); however, while it is early days, recent sales performance may suggest its fortunes are starting to change

Source: Company presentations, Edison Investment Research

Consensus estimates

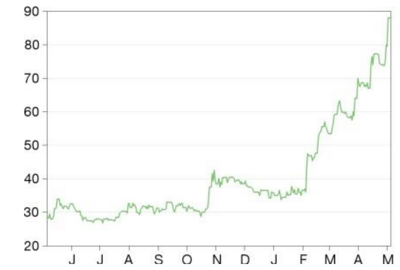
	Revenue (£m)	PBT (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)
01/14	189.4	(6.1)	(4.5)	0.0	N/A	0.0
01/15e	196.7	(0.8)	(0.8)	0.0	N/A	0.0
01/16e	202.0	1.2	1.2	0.0	73.3	0.0
01/17e	N/A	N/A	N/A	N/A	N/A	N/A

Source: Bloomberg

Price	**88p**
Market cap	**£84m**

Priced at 2 May 2014

Share price graph



Share details

Code	FCCN
Listing	LSE
Shares in issue	95.9m

Business description

French Connection designs, produces and distributes branded fashion. It operates retails stores, concessions and e-commerce in the UK, Europe and North America, and wholesales product in 30 countries. It has retail licensees in Asia-Pacific and the Middle East, with its licensed accessories.

Bull

- Positive like-for-like and operating profit in H214, and up 11% in Q115.
- 20% UK sales from e-commerce ahead of peer group average.
- Acknowledgement of the importance of staff training and investment.

Bear

- Underinvestment in stores, more cash flow being spent on store closures than refurbishments and openings.
- Below peer group execution e-commerce logistics.
- No brand recognition in Edison brand analysis.

Analyst

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EDISON

Inditex

Consumer

12 May 2014

Strong brand momentum

In the year ended 31 January 2014, Inditex reported 5% sales growth (8% in constant currency), driven by 3% l-f-l and 9% space growth. Operating profit and net income were -1% and +1% respectively, as Inditex continued to invest behind its global store and online roll-out. Inditex announced a 10% dividend increase to €2.42, representing a doubling of the absolute amount paid out to shareholders (€1.5bn) in five years. The company plans a continuation of its store roll-out with the gross addition of 450-500 stores, and the selective absorption of 80-100 smaller units. It expects to launch an online capability in two new markets (Mexico and South Korea) and anticipates a future progressive roll-out of its online strategy across all its concepts. Capex guidance for the year to January 2015 is 8% higher than 2014 expenditure at €1.35bn, with approximately 80% of the spend on new store openings, c 10% on refurbishment and maintenance and the remaining c 10% on IT and logistics, highlighting that the store portfolio remains central to the strategy.

Evaluation criteria

***Ahead of peer group/expansionary **In line with peer group *Below peer group/contracting

Criteria	Rating	Comment
Store investment	***	Space growth of 9% in 2013, and over 47% over the past four years. Gross 450-500 stores planned for 2014/15 absorbing 80-100 smaller units. Approx 80% annual capex (€1.35bn 2014) spent on store expansion, 10% on refurbishments and maintenance.
Staff investment/training	***	A policy of internal promotion results in strong company commitment. Potential store managers undertake an extensive training programme, and all store staff are partly remunerated on achieving revenue targets.
Speed of stock turn	***	Zara's unique product strategy offers customers 36,000 new designs per year with daily in-store feedback allowing constant modification to collections.
Multi-channel capability	**	Inditex lagged its peer group, only launching Zara online in September 2010 in its seven largest markets. It currently has online capabilities in 25 countries, with two more launches planned in 2014/15. A progressive roll-out across all concepts is planned.
Speed/choice of delivery	*	In the UK Zara offers three- to five-day 'click and collect' and free home delivery for purchases >£50 with a three- to five-day lead time.
Brand strength	***	Zara achieved some the highest brand value momentum scores in the international brand ranking tools we analyse. It also ranked seventh for fashionability in OC&C's global brand proposition index.

Source: Company presentations, Edison Investment Research

Consensus estimates

	Revenue (€bn)	PBT (€bn)	EPS (€)	DPS (c)	P/E (x)	Yield (%)
01/14	16.7	3.1	3.8	2.3	28.0	2.2
01/15e	18.1	3.4	4.2	2.6	25.3	2.4
01/16e	20.0	3.9	4.7	2.9	22.6	2.7
01/17e	21.9	4.2	5.2	3.3	20.4	3.1

Source: Bloomberg

Price	**€106.45**
Market cap	**€66.4bn**

Priced at 2 May 2014

Share price graph

Share details

Code	ITX
Listing	IBEX
Shares in issue	623.33m

Business description

Inditex is one of the world's largest fashion retailers. Its portfolio encompasses eight brands, with an aggregate of >6,300 stores in 87 different markets across the globe. 19.7% revenues are its domestic Spanish market, 45.9% Europe ex-Spain, 14% Americas, and 20.4% Asia/Rest of World.

Bull

- Investments in new flagship stores and the rolling refurbishment programme have resulted in an attractive in-store experience.
- Unique product strategy means on-trend products are consistently refreshed in store.
- Brand strength and momentum among highest in international brand recognition tools.

Bear

- Speed of 'click and collect' and home delivery order fulfilment slower than many of UK peer-group.
- Later entrant into e-commerce.
- Operating profit lagging revenue growth due to high investment requirement.

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Marks and Spencer

Consumer

12 May 2014

Poised for growth?

On 10 April M&S reported Q4 group revenue up 1.9% with total UK revenue up 1.5% and l-f-l down 0.2%. Within this, food was up 0.1% – a credible performance given Easter was in the prior-year comparator – and general merchandise (GM) down 0.6%. While on the face of it a continued negative performance in GM is disappointing, it reflects an improvement on Q3 (-2.1%) and the Easter comparative in the homeware division was unhelpful. In Q4 M&S successfully completed the migration of its internet platform, so online marketing activity was significantly reduced. Despite this, M&S.com reported 12.5% sales growth, in line with market growth in online channels but significantly below the >20% growth reported in the previous three quarters. New online promotional activity begins this month, so a reacceleration of growth in M&S.com and GM in the coming quarters is expected. M&S has spent c £2.3bn of capex 2012 to 2014, investing heavily behind its store portfolio, multi-channel and logistical capabilities.

Evaluation criteria

***Ahead of peer group/expansionary **In line with peer group *Below peer group/contracting

Criteria	Rating	Comment
Store investment	**	M&S is planning no new GM space but will continue to churn the portfolio to ensure it is operating from the best locations. 100% of the store portfolio should have been updated by March 2014. 150 Simply Food franchise stores are planned over three years.
Staff investment/training	**	M&S introduced the 'Fashion Camp' in 2013 to enhance in-store service; improving employee/customer communication, reducing till queues and using in-store technology to work with online channels.
Speed of stock turn	**	M&S is improving choice through its six distinct sub-brands. In addition it introduces seven phases of newness, two spring, two summer, two winter and a transition period.
Multi-channel capability	***	Having historically lagged its peer group, M&S has invested heavily in recent years behind multi-channel logistics, with M&S.com 13% of GM sales at March 2013. Its new web platform launches this spring in conjunction with the ramp up of its new e-commerce distribution centre and introduction of RFID tagging, a key facilitator of an omni-channel strategy.
Speed/choice of delivery	**	With its new web platform and ecommerce distribution centre (EDC), M&S hopes to improve availability and provide best-in-class delivery choices. Currently orders made before noon are available for next-day collection in store. At March 2013 44% of e-commerce sales were collected in store.
Brand strength	***	M&S is starting to show signs of positive momentum within global brand ranking tools. At a more granular UK level, it ranked first in our total brand score analysis, performing consistently well across a broad range of brand strength parameters.

Source: Company presentations, Edison Investment Research

Consensus estimates

	Revenue (£bn)	PBT (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)
03/13	10.0	564.3	32.7	17.0	13.5	3.9
03/14e	10.4	618.7	31.0	17.1	14.2	3.9
03/15e	10.7	701.8	34.6	18.3	12.7	4.2
03/16e	11.2	778.6	38.2	19.8	11.5	4.5

Source: Bloomberg

Price	440.8p
Market cap	£7.2bn

Priced at 2 May 2014

Share price graph

Share details

Code	MKS
Listing	LSE
Shares in issue	1.63bn

Business description

M&S is an international multichannel retailer. At September 2013 it operated from 766 stores in the UK and 455 stores in 53 international territories. 54% revenue is food and 46% general merchandise, including clothing and homeware. 88.7% of 2013 revenues were UK, 11.3% international.

Bull

- Investing behind multi-channel approach, improved store environments and staff training.
- Improved product segmentation and phasing of newness.
- Introduction of RFID a step towards effective omni-channel retailing.
- Strong brand recognition, showing positive momentum.

Bear

- General merchandise still losing share.
- Significant investment behind multi-channel has resulted in declining profits of 11.3% since 2010, despite sales growth of 21%.
- Lack of clear target consumer.

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Mothercare

Consumer

12 May 2014

Ageing stores not engaging young mothers

On 10 April Mothercare reported an improvement in Q4 underlying trading in both the UK and internationally after a very weak Q3. Q4 UK l-f-l sales were -0.3%, an improvement on -4.0% in Q3, giving -1.9% for FY14. International revenues were +9.8% on a constant-currency basis, a strong rebound from 3.3% in Q3, although still below 11.9% reported at H1. The international space grew by 13.1%, reflecting international franchisees continued confidence in the strength of the brand, while conversely the UK retail space shrank by 3.8%. 29% of UK revenues were reported to have been from its online platform, of which one-third of orders were 'click and collect'. In spite of this relatively high percentage exposure to internet sales, the Direct in-home business grew at just 1.8% in the quarter, giving 5.9% for FY14. At H1 capex was £7.4m; this compares to £10.3m of cash restructuring costs as the group tries to exit its underperforming UK store portfolio.

Evaluation criteria

***Ahead of peer group/expansionary **In line with peer group *Below peer group/contracting

Criteria	Rating	Comment
Store investment	*	While growing space rapidly through its international franchise model (15% space growth target), in the UK Mothercare and ELC store numbers have almost halved from 387 in 2010 to the current target of 200 by 2015. Major refurbishments have occurred in a few stores, but most of the portfolio remains underinvested.
Staff investment/training	**	There has been a major focus on staff training and service levels. Customer satisfaction scores were approaching 80% by H114, having been <70% the year before.
Speed of stock turn	*	In clothing two major ranges are launched annually in spring/ summer and autumn/winter, with some transitional lines introduced mid-season.
Multi-channel capability	***	Mothercare launched a new UK website last year and is rolling out local websites progressively through its international markets. Transactional websites are available on mobile and tablet and it boasts an i-Phone app, with the recent addition of an android app. No tablet app is available yet.
Speed/choice of delivery	*	Although the company claims next-day 'click and collect' in reality this still does not appear to be consistent across its store portfolio. Home delivery within three to five days is free for spends >£50.
Brand strength	**	In 2013 Mothercare ranked 58th in the UK in OC&C's retail proposition index and 34th in Nunwood's analysis of Consumer Excellence. Despite 80% of new mums visiting Mothercare in the UK, this is still not translating into market share gain or revenue growth.

Source: Company presentations, Edison Investment Research

Consensus estimates

	Revenue (£m)	PBT (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)
03/13	749.0	(21.5)	6.2	0.0	30.1	N/A
03/14e	736.2	8.4	7.2	0.0	25.9	N/A
03/15e	730.0	13.3	11.4	0.0	16.4	N/A
03/16e	752.6	21.9	18.5	2.07	10.1	1.1

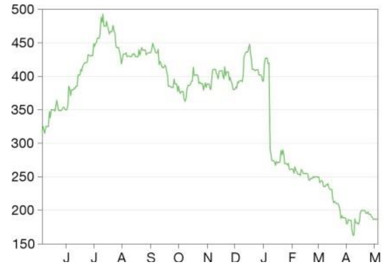
Source: Bloomberg

Price 186.8p

Market cap £166m

Priced at 2 May 2014

Share price graph



Share details

Code	MTC
Listing	LSE
Shares in issue	88.81m

Business description

The Mothercare and Early Learning Centre (ELC) brands are synonymous with children and parenting. The group operates through three distinct distribution channels: UK stores (45% revenues), UK direct (17.7% revenues) and international (36.6% revenues).

Bull

- Investment in a new transactional website and apps puts Mothercare's multi-channel capability towards the top end of its peer group.
- A focus on staff training has improved customer service levels.
- Continued strong growth in international franchise stores reflects the continued strength of brand equity for now.

Bear

- A near 50% reduction in store footprint gives the perception of a retail proposition that has lost relevance.
- The majority of the store portfolio is in need of refurbishment to enhance consumer experience.
- The logistics behind its multi-channel platform lags peer group.

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EDISON

Next

Consumer

12 May 2014

The Next steps ahead

In the year to January 2014, Next achieved 5.4% sales growth, translating to 11.8% growth in underlying PBT and 23% underlying EPS growth. It also returned £461m to shareholders through a combination of share buybacks and dividends. In its Q1 trading update in April, Next reported revenue growth in its store-based portfolio, Next Retail (+8.8%), and Next Directory (+13.7%), underpinning the importance of its store base and emphasising how the two businesses are complementary and support each other. The company plans to add another 15.7% retail space over the next three years and in the year to January 2015 invest a further £43m in new systems, warehousing, HQ costs and refurbishments to support its growth plans.

Evaluation criteria

***Ahead of peer group/expansionary **In line with peer group *Below peer group/contracting

Criteria	Rating	Comment
Store investment	***	4% expansion in retail trading space in 2013/14, with further 15.7% planned over next three years in large format stores. In 2014 55% of floor space was described as excellent to good, with the aim to increase this to 73% in two years.
Staff investment/training	**	With service levels currently viewed as generally good but not exceptional, Next has introduced a new operational objective for improved service to customers from Next staff in stores and call centres.
Speed of stock turn	**	Next aims to move away from a two-season buying cycle to a four-season cycle and two to three collections within each season, with the aim of driving more weather-appropriate stock and more change and newness within its collections.
Multi-channel capability	***	Next is an industry leader in multi-channel retail partly due to its legacy mail-order business, with Next Directory now representing 37.6% of sales. It emphasises that the businesses are complementary and support each other effectively and efficiently.
Speed/choice of delivery	***	Next is best in class. Next-day delivery for customers who ordered before 10pm was available in 74% stores (by retail turnover); the objective is to reach 99% by year end.
Brand strength	**	Very well recognised by international brand valuation tools, Next falls down on more granular UK-specific retail recognition metrics, something its objective of improved service levels will hope to change.

Source: Company presentations, Edison Investment Research

Consensus estimates

	Revenue (£bn)	PBT (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)
01/14	3.74	695.2	366.0	154	18.0	2.3
01/15e	3.98	768.2	388.7	293	17.0	4.4
01/16e	4.18	818.3	420.5	288	15.7	4.4
01/17e	4.40	876.1	454.0	314	14.6	4.8

Source: Bloomberg

Price	**6,610p**
Market cap	**£10.2bn**

Priced at 2 May 2014

Share price graph

Share details

Code	NXT
Listing	LSE
Shares in issue	155.03m

Business description

Next is a UK-based fashion and accessories retailer that also offers full range of homewares. It operates through three main channels: a network of >500 stores in the UK and Eire; a directory business (catalogue and website) with >4m active customers; and a network of c 200 international franchise stores.

Bull

- Continuing to expand space and invest in stores in the UK.
- Industry-leading multi-channel capability and execution.
- Strong international brand recognition.

Bear

- Scope to improve customer service proposition.
- Currently less frequent Collection updating than some more fashion lead peer group, although looking to improve.
- Lower UK brand recognition scores for retail proposition, experience excellence and trust.

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Ted Baker

Consumer

12 May 2014

Style focus

In the year to January 2014, Ted Baker reported a 26.5% increase in revenue, a 26.7% increase in pre-exceptional PBT and a 22.3% increase in pre-exceptional EPS. It has also announced a 26.7% increase in its dividend to 33.7p, which is a yield of 1.8%. It achieved a 24.6% increase in global retail sales; within this e-commerce sales were up 55.7%, accounting for 9% of total retail sales. The company plans to add 31 stores and concessions internationally in the year to January 2015 (+8.6%), with capex expected to be higher at £25m (versus £19.8m in the year to January 2014). This is partly due to the continued store expansion, but also to refurbishments, e-commerce, brand investment and the roll-out of a new IT platform.

Evaluation criteria

***Ahead of peer group/expansionary **In line with peer group *Below peer group/contracting

Criteria	Rating	Comment
Store investment	***	Total space increased by 10.7% to January 2014 (mostly international) with a further 31 stores and concessions planned to January 2015 (+8.6%). Central to Ted Baker's success, in our view, is the individual highly stylised nature of its store fit-outs, reinforcing the brand message and creating a unique and fun retail experience.
Staff investment/training	***	Ted Baker recognises that its people are central to the success of the brand. Performance is reviewed bi-annually, with a wide range of training initiatives on offer to further career development. Bonus schemes are linked to individual and corporate performance.
Speed of stock turn	**	Ted Baker has six collections for both women's and menswear, with its main collections in spring/summer and autumn/winter, then high summer, Christmas and SS and AW transition periods.
Multi-channel capability	**	Having been behind the curve, a new e-commerce platform was launched in the UK in November 2013, and is perceived as a key part of the future growth strategy. A transactional website is available on mobile and tablet, but no app is available on either.
Speed/choice of delivery	*	Ted Baker only offers free 'click and collect' in store with two- to five-day lead time. Next-day home delivery for orders placed before 4pm is available for £5; free standard delivery takes two to three days.
Brand strength	**	While only gaining one mention from our brand analysis, it could be argued that Ted Baker is too niche to gain broader popular recognition. As a greater reflection of the momentum of its brand equity, we highlight its five-year performance and share price progression in Exhibit 28.

Source: Company presentations, Edison Investment Research

Consensus estimates

	Revenue (£m)	PBT (£m)	EPS (p)	DPS (p)	P/E (x)	Yield (%)
01/14	321.9	38.9	69.0	33.7	26.8	1.8
01/15e	367.4	46.8	81.7	40.3	22.7	2.2
01/16e	409.4	54.4	95.6	46.8	19.4	2.5
01/17e	493.0	66.0	113.8	N/A	16.3	N/A

Source: Bloomberg

Price	1,853p
Market cap	£810m

Priced at 2 May 2014

Share price graph

Share details

Code	TED
Listing	LSE
Shares in issue	43.7m

Business description

Ted Baker is a leading global lifestyle brand distributing across five continents through its three main distribution channels: retail (including e-commerce 9%) 78.3% revenues, wholesale 19% revenues, and licensing 2.7% revenues. The UK and Europe account for 77.8% revenues, US and Canada 19.2% and Asia 3%.

Bull

- Strong store investment programme, both in new store roll-out and refurbishment.
- Significant recent investment in multi-channel capability.
- Strong brand identity.

Bear

- A relative laggard in e-commerce, although it is investing behind this channel.
- Below peer group fulfilment on 'click and collect' and home delivery options.
- Limited brand recognition across international and UK specific brand recognition analysis.

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