Australian retail 2015:
Welcome to the Hunger Games!

Ferrier Hodgson’s annual retail industry report
February 2015
Contents

Welcome 3
Australian economic snapshot 4
What is impacting retail spending? 6
An eye to the future 9
About Us 12
Key contacts 13
2015 is likely to shape up as one of the most competitive retail markets on record. Notwithstanding a rapidly declining AUD, online remains strong and global international retailers continue to enter our market, taking market share from domestic players. Welcome to retail’s version of the Hunger Games!

In economic terms, the environment is hardly conducive to significant retail growth. The challenge for Aussie retailers is not just an online demon or a market full of fresh global competitors; it is the confronting reflection of their own retail brands being forced to change at a pace that is often beyond their control.

As global retail boundaries fall, the Australian consumer has become more sophisticated and more demanding, armed with a level of mobile gadgetry we would not have dreamed of 10 years ago.

With the next wave of digital disruptions already on its way, the greatest challenge facing domestic retailers is not whether they need to adapt - but how do they manage the process of metamorphosis in a market where everyone is stealing share from each other.

While we believe there are good reasons to be optimistic about the opportunities created in a changing market, the pace of change continues to increase and in 2015 the market will remain as competitive as ever.

James Stewart
At the end of a mining boom and in the middle of a housing boom, Australian consumers are struggling to spend.

Interest rates remain low
House prices are high
The stock market remains volatile
The construction industry is yet to fill the gap left by the slowing resource cycle
GDP growth remains modest
Household savings rates remain high
Unemployment levels are slowly rising
Appetite for credit remains tight
AUD is in rapid decline putting pressure on margins

The net effect of these see-sawing factors is that consumer confidence remains low as the two speed economy, driven off the back of a resources boom, morphs into a one speed economy reliant on consumer spending which is stuck in third gear.

Source: ABS, RBA November 2014
Australian retail 2015: Welcome to the Hunger Games!

Australian economic snapshot

Consumer Confidence
The data shows that confidence has fallen considerably from 2013. The results cap off a ten month run of negative (i.e. below 100) confidence.

Exchange rates
The Australian dollar fell below US$0.80 late in 2014 and has continued its downward trend. Some analysts are predicting the dollar to fall further over the next 12 months.

Housing market
The local housing market has been a source of strength for the past twelve to eighteen months. However, the market appears to be driven primarily by investors (often from offshore) rather than homeowners. With interest rates expected to reduce even further, the housing market is likely to remain strong for the foreseeable future.

Unemployment
Unemployment reached historical highs on the back of the slowing resource sector and sits at c.6.2%. Interestingly, September marked the first time since before the GFC that our unemployment rate was higher than that of the US, impacting consumer confidence.

Source: www.tradingeconomics.com
Source: www.oanda.com
Source: ABS, November 2014
Source: ABS, November 2014
What is impacting retail spending?

Since our last report, retail spending and consumer confidence has been impacted by government policy, a subdued lending environment and the continued growth of online retail (both domestic and international) as well as the steady wave of international retailers arriving on Australian shores.

Government policy
The election of the new Coalition Government in August 2013 came with:

- The much heralded end to the ‘age of entitlement’ reflecting a more stringent approach to financial support of certain industries. For example, following the withdrawal of government subsidies, within 6 months Ford, Holden and Toyota had all announced the closure of Australian manufacturing operations; and

- A renewed focus on federal debt reduction to combat the national deficit leading to the prospect of significant tax increases and deep cuts to family benefits.

A subdued lending environment
The banking sector has also been subject to capital adequacy reforms which have been designed to protect the industry from unexpected shocks by promoting greater stability. As capital adequacy ratios have risen however, many players in the lending sector have focused on driving their deposit books. As a result, on the one hand lenders want to lend, however, the perception of many in the market is that lending practices have also become constrained, impacting commercial growth and consumer credit.
Online retail

Online retail spending growth in Australia continues to outpace total retail sales growth, albeit at a slower rate to last year. According to data from NAB, domestic online retailers, who have benefited from the falling Australian dollar, are now capturing around 75% of total online spending.

Sales results are mixed on a category basis, with groceries recording the strongest annual growth, followed by department stores and homewares.

_The key to increasing online sales is making the transaction as effortless for the customer as possible._

US consumer surveys show that, relative to clothing, nearly all other retail categories require less effort or ‘friction’. Therefore online sales penetration will continue to increase in these categories.

Finally, the increased adoption of smart devices will further increase online sales penetration.

### NAB Online Retail Index

<table>
<thead>
<tr>
<th></th>
<th>YOY growth %</th>
<th>MOM growth %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>May-14</td>
<td>Jun-14</td>
</tr>
<tr>
<td>Total online index</td>
<td>5.5%</td>
<td>9.6%</td>
</tr>
<tr>
<td>Domestic</td>
<td>7.0%</td>
<td>10.8%</td>
</tr>
<tr>
<td>International</td>
<td>1.2%</td>
<td>6.0%</td>
</tr>
</tbody>
</table>

Source: NAB

### Growth of online spending by category

12 months to July 2014

![Chart showing growth of online spending by category](source: Morgan Stanley)

### User penetration and perceived friction of eCommerce

![Chart showing user penetration and perceived friction](source: Morgan Stanley)
What is impacting retail spending?

**International retailers**

Until 2005, Australian retailers were thought to be immune to the impact of any foreign retailers due to our economy’s geographic isolation, and their bullish views of their own local brand strength.

**However, the historical lack of interest from foreign retailers to invest in Australia has now all but disappeared.**

Our economy was not as severely affected by the GFC in comparison to European and USA markets resulting in Australia becoming an appealing market for many international retailers.

In the last three years Australia has been infiltrated by a growing number of international retailers. We have seen GAP, Topshop, Zara, Hollister, Uniqlo, H&M and Costco enter the market, challenging Australian retailers for market share and best practice principals. Anecdotal evidence suggests that the retail spend figures have been significantly bolstered by sales from international retailers as they typically offer a superior in-store experience, competitive pricing and a quality product offering.

International retailers are leveraging their economies of scale, solid online platforms, innovative in-store experience and vertically integrated business models to disrupt the Australian retail market.

---

Timeline of international retailers entering the Australian market

- **Aldi** 2001
- **GAP** 2009
- **ZARA** 2010
- **Hollister** 2011
- **Uniqlo** 2012
- **Forever 21** 2013
- **Costco Wholesale** 2014
- **Topshop** 2015*
- **MUJI** 2016*
- **H&M**
- **Pottery Barn**
- **LiDL**

*expected
Smart devices

Smartphone adoption across the globe is increasing at a rapid pace. Recent reports suggest that by June 2014 there were 4 billion mobile phone users across the globe, of which one quarter are smartphone users. This year, more than half the world’s 4 billion mobile phone users will have smartphones and the total number of mobile phones will outnumber the people on earth.

For retailers with a solid online platform, this presents a significant opportunity for growth, with over 25% of consumers engaged in online shopping using their phones. This number is increasing rapidly.

In 2015, mobile shopping via smartphones will account for USD$163 billion of sales worldwide, and according to Mintel reports, by 2019 half of today’s smartphone users will be using smartphone mobile wallets as their preferred method of payment.

Wearable is wonderful

The wearable technology space has been gaining momentum over the past 12-24 months, with a variety of smart watches including the Apple Watch increasing consumer awareness.

At the 2015 Consumer Electronics show in the US, wearable technologies were at the pointy end of the wedge. Tech pioneers are continually experimenting with ideas, incorporating technologies into wearable products such as computerised glasses, smart watches, smart rings, bulletproof suits, smart headphones and health and fitness tracking devices - the list is endless.

A Juniper Research study conducted late last year expects the wearable tech industry to reach a worldwide spend of $19 billion by 2018.
An eye to the future

Drone on

While drones were once regarded as purely military and surveillance tools, they are now being used in more practical and commercial settings.

The real game changer with this technology is parcel delivery. A number of retail companies, such as Amazon, Domino’s Pizza and Deutsche Post, are trialling the use of drones to deliver their products directly to consumers’ homes.

These companies are investing in the technology because they see the potential for fast, efficient delivery and huge cost savings.

Cost of drone delivery versus traditional post

*same day delivery via regular post

Source: Flirtey

3D printing

3D printing is a natural evolution of the manufacturing and printing industries.

While it may seem like something out of a science fiction movie, the reality is it is already in use. Only recently the technology was used by Dutch designer Iris van Herpen at the Paris Fashion Week to print a series of dresses 24 hours before her runway show.

Worldwide demand for the technology is tipped to hit $5 billion by 2017.

Source: http://www.dezeen.com/
Omni-channel

Omni channel retailing is more relevant now than ever before. Combining digital strategies with brick and mortar operations is becoming increasingly important for retail success, as smartphone adoption rises and online sales increase.

33 per cent of retailers recently surveyed say that omni channel retailing was their number one priority for 2015 - up from 22 per cent last year (source: Deloitte).

People now live their lives with embedded technology and best practise retailers are embracing this change. In order to thrive in the current retail landscape, retailers need to focus on an integrated brand experience. Customers want to be made to feel good about buying a particular product or brand. A dynamic in-store experience, innovative visual merchandising, exceptional customer service and a strong online presence that excites and engages customers is the new benchmark for retailers.

More retail trends

In-store tech
From digital signage to self-serve kiosks and online product directories on interactive screens, rapid technology advancements are providing new opportunities to engage customers in-store.

Apps
Many retailers are incorporating apps into their omni-channel strategy. In the US, 49% of shoppers would rather purchase products via apps than a browser.

Payment systems
Along with systems being developed by the major banks, Apple and Paypal are targeting the mobile payments space with their own digital wallets.

Data analytics
Some of Australia’s biggest retailers have been crunching the numbers and have recognised the competitive advantage that analytics can deliver to drive sales and growth.
Ferrier Hodgson is regarded as a market leader in retail advisory and restructuring services in Australia and is a trusted industry advisor to operators, lenders and financiers to the retail sector.

We can add significant value to your retail business through our:

- Deep knowledge of retail and the issues affecting the sector;
- Extensive hands-on experience managing major retail chains;
- Ability to quickly identify operational issues within retail businesses and implement practical solutions;
- Experience and expertise in identifying and implementing business change through evidence-based customer insights; and
- Ability to identify and implement improvements to business processes.

Through our network we are able to offer a dedicated team of experienced professionals with a deep understanding of retail in the Australasian market.

Azurium, a wholly-owned subsidiary of Ferrier Hodgson, provides specialist business performance improvement consulting and advisory services to clients across Australia, New Zealand and Asia.

With more than 70 years of combined experience, our team comprises true retail specialists, each with an extended network of experts who can be leveraged as required. The team can add value across all aspects of your business, providing practical, implementable advice in the areas of:

- Strategy
- Business transformation and change management
- Customer intelligence
- People excellence
- Enterprise risk management
- Analytics
Ferrier Hodgson

James Stewart
Retail Practice Leader
T: 03 9604 5642
E: james.stewart@fh.com.au

John Melluish
Partner, Sydney
T: 02 9286 9820
E: john.melluish@fh.com.au

Martin Jones
Partner, Perth
T: 08 9214 1444
E: martin.jones@fh.com.au

Martin Lewis
Partner, Adelaide
T: 08 8100 7657
E: martin.lewis@fh.com.au

Tim Michael
Partner, Brisbane
T: 07 3831 4833
E: tim.michael@fh.com.au

Craig Hunter
Principal
T: 03 9604 5108
E: craig.hunter@fh.com.au

Luci Palaghia
Director
T: 03 9604 5132
E: luci.palaghia@fh.com.au

Scott McKinnon
Senior Manager
T: 03 9604 5152
E: scott.mckinnon@fh.com.au

Christos Kyriakides
Manager
T: 03 9604 5119
E: christos.kyriakides@fh.com.au

Mark Tippet
Senior Analyst
T: 03 9604 5185
E: mark.tippet@fh.com.au

Azurium

Andrew Whittaker
Partner
T: 03 9604 5659
E: andrew.whittaker@azurium.com.au

Dr Ian Tho
Executive Director
T: 03 9604 5189
E: ian.tho@azurium.com.au

Neeraj Sharma
Partner
T: 03 9604 5687
E: neeraj.sharma@azurium.com.au

Richard Officer
Retail Transformation Consultant
T: 03 9600 4922
E: richard.officer@azurium.com.au

Denis Carruthers
Retail Property Specialist
T: 03 9600 4922
E: denis.carruthers@azurium.com.au

Kevin Winterburn
Retail Specialist
T: 03 9600 4922
E: kevin.winterburn@azurium.com.au

Australian retail 2015: Welcome to the Hunger Games!