frontier economics

Reasons for cheer?

UK GROCERY CHRISTMAS RESULTS

Last week saw industry analysts pore over sales results for the UK's largest retailers in what has become an annual ritual. The headlines focus on "like-for-like" (LFL) sales growth and who is up or down on the same period last year. History is quickly forgotten; but stitch together results from a few years in a row and the true pressure on UK grocery retail (and who has been winning long term) becomes clearer.

For UK grocers, this year's Christmas results are a mixed bag. Tesco tops most commentators' lists as the winner, and with LFL growth of 2.2% were some way ahead of their rivals. Morrisons and Waitrose at least managed a small rise in LFL sales, although strip out the growth from wholesale sales at Morrisons and their retail LFL growth of 0.6% was more modest (down on H1 2018 results).

Sainsbury's and M&S didn't even manage that and both saw sales fall. For Sainsbury's, small gains in grocery sales were undone by a drop in general merchandise and clothing, while M&S saw food sales slip 2.1%. Even at Aldi, where the headlines said 10% year-on-year growth, much of their outperformance relies on a new store opening programme. Many of their existing stores are probably not much better off this year than last.

Grocery is a mature sector and no-one expects stellar growth rates. But the flat sales revenues have to pay for many costs that rise year on year:

- for property – business rates are on an automatic upward track;
- for staff costs – another living wage increase is due later this year;
- for cost of goods sold – commodity prices and food inflation are still flowing through, even before Brexit.

Meanwhile, consumers continue to shift slowly but steadily towards higher service (and higher cost) convenience and online channels.

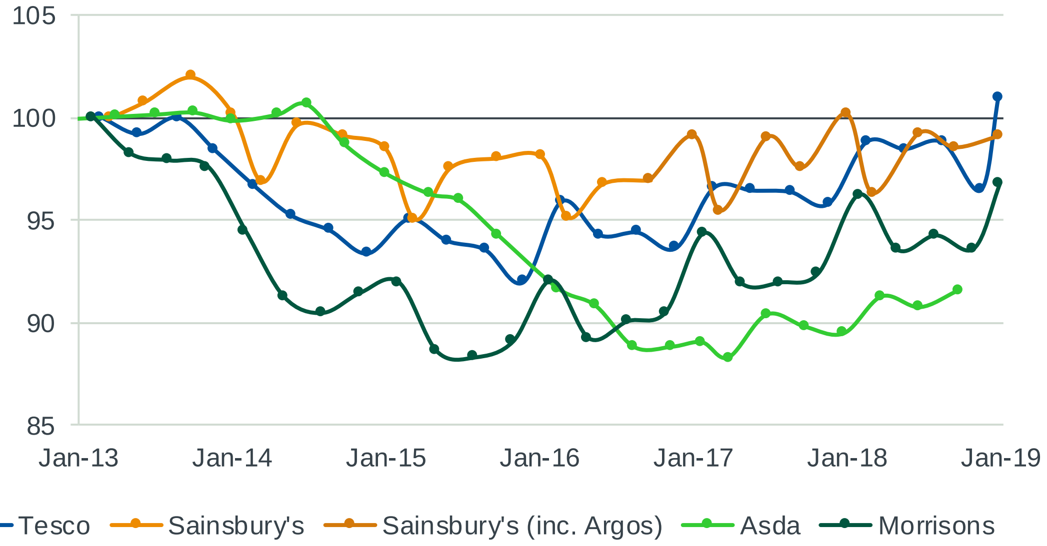
The long road to recovery

Look at the history and the pressure is even clearer. In many ways, this was a decent Christmas for UK grocers. Tesco's sales performance was widely reported to be its best at Christmas since 2009. Bring together several years' worth of performance and you can see why.

The chart below builds a sales index for each major retailer using published LFL figures. It takes 2013 as a start point and then builds out cumulative LFL changes in later years. This shows that most retailers are yet to reverse the prolonged fall in LFL sales the big grocers saw between 2013 and 2016.

At the top of the pack, Tesco and Sainsburys have broadly clawed their way back to where they were in 2013 after substantial falls in earlier years. Tesco may even have nudged slightly ahead of 2013 for the first time. However, that just means that *nominal* sales are broadly back to where they were 5 years ago. Each grocer has had 5 years of cost price inflation to withstand since then, showing the extent of the challenge and change they have faced to retain and rebuild profitability. At Asda, the challenge is even more extreme. Based on reported LFLs, by last year a typical Asda store had probably lost over 10% of its sales revenues relative to 2013, a hole that they are only now starting to fill.

2019 will see more change as: Morrisons and Tesco's continue their growth in wholesale; Sainsbury's and Asda try to progress their merger; and the convenience sector consolidates further. And all against a backdrop of Brexit, consumer and supply chain changes. What won't change is the pressure on the sector of limited sales and rising costs – and the winners will be the grocers that can reinvent themselves quickly enough to generate and share value with customers next year.



Note: Tesco / Morrisons - ex. fuel ex. VAT; JS - ex. fuel inc. VAT; Asda - does not specify. Morrisons and Tesco figures exclude contributions from wholesale channels.

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