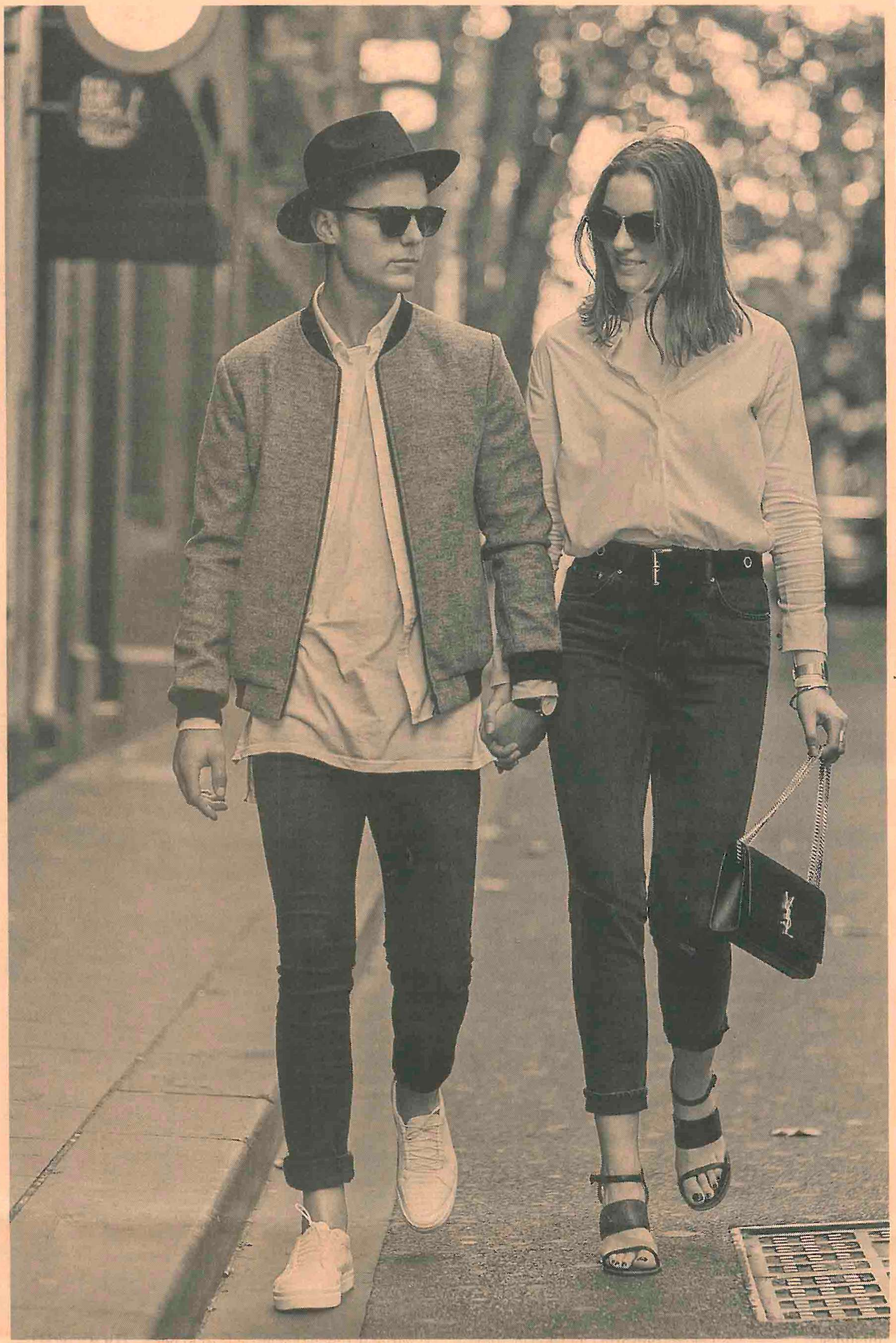
COMPANIES

Topshop fails to wear well in the retail heat of Australia

Competition and economic slowdown are hitting high street sales in country



Topshop was part of a wave of foreign chains looking to cash in down under — Christian Vierig/Getty Images

JAMIE SMYTH — SYDNEY

When Topshop opened its first store in Australia in 2011, hundreds of customers queued overnight to snap up the retailer's "Cool Britannia" brand of fast fashion. It was part of a wave of foreign chains — including Zara, Miss Selfridge and Hollister — aiming to cash in on a market that had been relatively sheltered from foreign rivals and had escaped the ravages of the global financial crisis.

But things have not gone to plan. Last month Topshop's local franchise partner, Austradia Pty Ltd, slipped into administration, with net losses of A$3m in the six months to January 28 2017. Retail tycoon Sir Philip Green, whose Arcadia Group owns Topshop, is in talks with administrator Ferrier Hodgson about a rescue bid.

"Topshop was very successful in its first few years but there was an issue with the franchise model," says James Stewart at Ferrier Hodgson.

Rescuing Topshop is not going to be easy in Australia, which is experiencing an influx of foreign competitors and an economic slowdown that is hitting high street sales. Over the past year almost a dozen big retailers, including Herringbone, Rhodes & Beckett, Marcs, David Lawrence, Pumpkin Patch, Laura Ashley and Payless Shoes, have gone into administration in the country.

The competitive threat is about to intensify, as Amazon prepares to launch a full sales offering in Australia.

The move by the US group is expected to hit the entire Australian retail sector — from clothing to grocery and electronic goods. It prompted US bank JPMorgan to downgrade its profit forecasts for a host of retailers last month, including department store Myer, electronics groups Harvey Norman and JB-Hi-Fi and Super Retail group.

"The outlook for the Australian consumer is deteriorating, in our view, while the pending entry of Amazon is a negative for multiples and earnings per share forecasts," says JPMorgan in its report.

Already the Australian clothing trade was suffering from weak retail conditions, high wage and rent costs, and fierce competition from emerging online operators, according to Ibisworld, a research group.

"Weak consumer sentiment has encouraged bargain hunting, leading to price becoming an increasingly important aspect of competition," says Lauren Magner, analyst at Ibisworld.

Retail sales momentum has slowed since late 2014 due to a soft economy and wary households, which are struggling due to a debt to disposable income ratio of 189 per cent — one of the highest in the developed world. Retail sales fell 0.1 per cent in March and 0.2 per cent in February, prompting Citi to warn in a note last month that the sector was "verging on recession". In April retail sales bounced back 1 per cent, according to figures released last week, providing some hope of better times ahead.

"Households are scrimping and saving a bit more while focusing on paying down mortgage debt. Subdued wage growth is also hitting consumption," says Tapas Strickland, economist at National Australia Bank.

"Retailers are responding by discounting — so retail sales volumes aren't so bad but values are weak."

Some of the larger foreign clothing retailers are faring better in Australia.

Spanish group Zara, which has 18 stores, increased sales by 15.5 per cent to A$256.4m in the year to January 2017.

> 'Households are scrimping and saving a bit more while focusing on paying down mortgage debt'

But operating margins at its Australian operation fell 4.4 percentage points to 6.2 per cent, compared with the prior year — a result analysts at Macquarie attributed to a weakening Australian dollar and a trickier trading environment. At a group level Zara reported an operating profit margin of 12.4 per cent.

The Australian arms of Swedish retailer H&M, Japanese chain Uniqlo and Zara generated combined sales of A$684m in the last 12 month period reported in their annual reports.

NAB expects Myer, which owns 20 per cent of Topshop, to be hardest hit by Amazon's arrival and has slashed its profits forecast for the group by 15 per cent in 2018 and 30 per cent in 2019. The department store's shares have fallen a third since January 1.

Analysts say traditional retailers will have to improve their own online offering to insulate themselves from Amazon and other foreign online competitors. Just 7.1 per cent of Australia's total retail sales are online, compared with 11.3 per cent in the US, according to NAB data.

"When Amazon arrives in a country it drives more people towards online retailing — it is likely to change the mindset of Australians," says Ruslan Kogan, founder of Kogan.com, one of the largest local online retailers listed in Australia, which plans to sell its own private label products on Amazon's marketplace.

Food fight

Supermarkets feel bite of increasing competition

Even Australia's concentrated supermarkets sector, where Wesfarmers' Coles and Woolworths retain almost 70 per cent of the market, is feeling the impact of increasing competition. German discounter Aldi built its market share to 13 per cent in the year to March and speculation is mounting about the launch of AmazonFresh, a grocery service from the US online retailer. Pressure is building on Coles' and Woolworths' profit margins, which were roughly double those of the UK's Tesco in 2016, according to research by Citi.

"Australian supermarkets enjoy higher profit margins than their UK and US peers as the market is more consolidated, planning laws are more restricted and population growth is higher," says Craig Woolford, a Citi analyst. "But we are seeing that gap narrow as competition intensifies."

Mr Woolford says the launch of AmazonFresh may not prove too disruptive in the early years as it will take time for the US group to build its supplier base and logistics operation. Amazon will have more of an impact initially on the consumer electronics sector, he says.

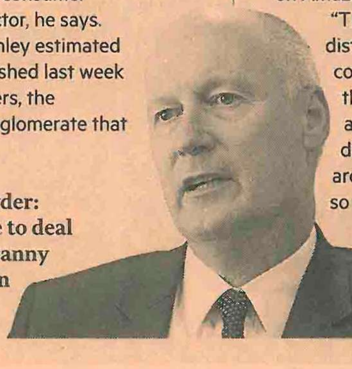
Morgan Stanley estimated in a note published last week that Wesfarmers, the Australian conglomerate that owns Coles, Target, Bunnings and Kmart, could lose about 4 per cent of annual sales and A$400m in earnings before interest and tax to Amazon by 2026.

However, Richard Goyder, managing director of Wesfarmers, says the conglomerate is in reasonable shape to take on new entrants.

"I think there has been an over-focus on Amazon's entry," he says.

"There is the tyranny of distance in Australia to contend with and all the costs that go with that. Wage rates are high and there is a different tax system. These are factors we deal with now so there are clearly more challenges and costs to contend with for competitors."

Jamie Smyth



Richard Goyder: grocers have to deal with 'the tyranny of distance in Australia'