

ANALYSIS

House of cards?

Weak trading and a request for rent reductions point to trouble at House of Fraser. **Becky Waller-Davies** looks at what's going on behind the scenes

Not so long ago, department stores were synonymous with Christmas as their cavernous halls played host to festive grottos and harried last-minute outings.

But as the January updates roll in, you'll be more likely to read of poor trading than glad tidings. Debenhams set the tone by triggering a profit warning, while House of Fraser's online sales plunged over the festive period.

Britain's department stores, having suffered as a result of the rise of Amazon, specialist retail rivals, value players and the decline of shopping as a day-long pastime, now look weaker than ever.

As Debenhams resorts to heavy discounting and market-leader John Lewis continues to reinvent itself, some industry observers feel that House of Fraser looks particularly vulnerable, especially given its recent plea to landlords to slash rents.

Dogged by poor trading – like-for-likes slumped 5.2%, online sales dropped 9.8% and EBITDA losses widened from £900,000 to £8.6m in the six months to July 29 – House of Fraser suffered the latest in a series of blows just before Christmas when agency Moody's downgraded its credit rating.

House of Fraser was formerly rated B3, meaning it was considered "speculative" and carried a high credit risk. Its new Caa rating sees it judged to be of "poor standing" and subject to a very high credit risk.

"Absent an unexpected general uptick in consumer demand, a recovery in HoF's profitability is dependent upon either an improvement in the company's product offering or in cost savings initiatives, which each

involve execution risks," Moody's lead retail analyst David Beadle said.

"The negative outlook reflects the risk that if profitability does not return towards the level recorded in previous fiscal years, the current capital structure may prove unsustainable."

The downgrade ratcheted up the pressure on House of Fraser – it has already been the subject of intense speculation among peers and financiers.

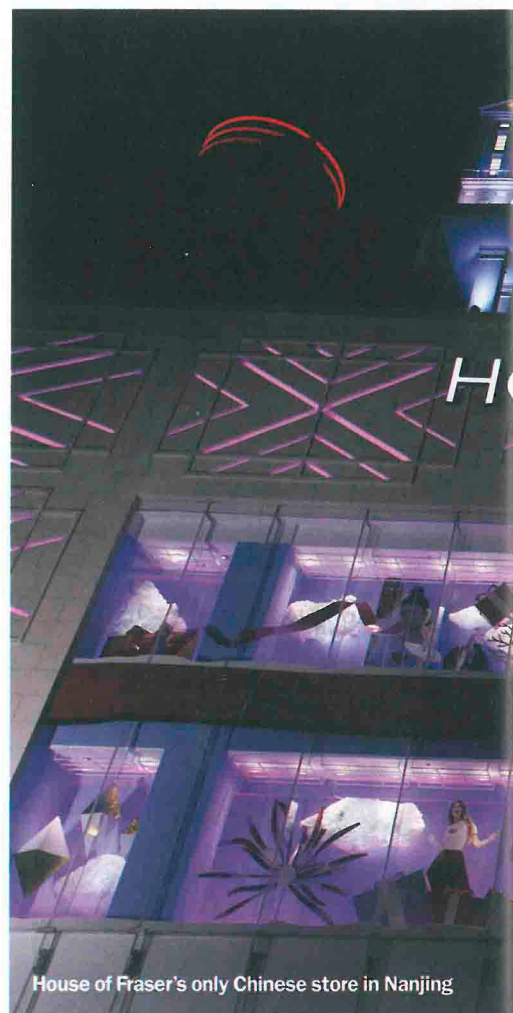
Saviour fails to deliver

When tycoon Yuan Yafei, chairman of Chinese giant Sanpower, bought House of Fraser in 2014, many expected a treasure chest of Chinese money to be made available to the department store, which had been under-invested. This has not materialised.

Instead, House of Fraser has suffered a stream of management changes and, until very recently, a severe lack of investment from billionaire Yuan.

The fall-out began shortly after the ink dried on Sanpower's deal to buy the department store business.

A reported promise of £75m in new funding went unfulfilled and the mooted opening of 50



House of Fraser stores in China has also failed to come to pass.

So far, just one store, located near Sanpower's HQ in Nanjing, has been launched.

House of Fraser has strenuously denied that a £75m golden handshake was ever pledged.

Such mixed messages set the tone for Sanpower's ownership from 2014 onwards, creating a situation where different parties seem to operate under different assurances and impressions.

Unusual allegations have continued to surface. For instance, former House of Fraser executives say they felt they constantly had to look over their shoulder during their time at the retailer, in an atmosphere of hands-on interest that created a mood of insecurity.

Tight headroom

House of Fraser's continued poor trading has prompted fears among several sources with links to the retailer about its ability to meet covenants – fears exemplified by the Moody's downgrade.

A £15m working capital sum was injected into the business by shareholders in September.

The investment was made into the UK holding company,



House of Fraser's Frank Slevin and Alex Williamson

Read the latest news and
analysis on House of Fraser
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If like-for-like sales are down 5%... then a big rent call could undo things – it will be tough after Christmas

Former House of Fraser senior staff member

Chairman Frank Slevin – a former Hong Kong banker, who has remained a little-known figure within the UK retail industry despite being at the head of one of the biggest businesses within it – is characterised by one person as “detail-orientated and driven”, but calculating.

Another critic claims: “All Frank cares about is Frank.”

New boss Alex Williamson, fresh from the tracks of Goodwood estate, divides opinion.

Many say that much of head office has warmed to him and that he has shown “real leadership”. But others charge him with being “a tactician rather than a strategist” who is fiddling while Rome burns.

Strategy-less

It is understood that Williamson is purposely running House of Fraser on a list of action points rather than a strategy, reasoning that the market changes too quickly to conceive and implement a full strategy.

The market’s fast-changing nature makes a by-the-seat-of-your-pants management style understandable, but it’s easy to theorise that it could also be a good way to deal with an unpredictable owner.

That unpredictable owner could be House of Fraser’s saviour yet, however.

Yuan’s wealth means that, even while some question whether House of Fraser can sustain its presence on the UK high street, Sanpower could ride to the rescue time and time again.

And among management, as is the case across much of the department store sector, the spectre of BHS looms as a reminder of the price of irrelevance.

Such a fate is something nobody wants, but some observers believe that the business in its current form needs radical action.

“There is a lot of concern over keeping people’s jobs going,” one insider says. “HoF has 60 stores – 20 of them are capable of comprising a good business. The best thing would be for private equity to come in, cut the fat and save 3,000 of 9,000 jobs.”

While it’s hardly going to boost morale, this poor trading update won’t ultimately determine whether the business has a sustainable future. Only Yuan Yafei holds that power. **rw**

which then paid the sum to the trading company in the form of licence fee payments – including those relating to the use of its name and intellectual property in China – and loan repayments.

The cash was gratefully received. “That money went into keeping the business running,” said one person with knowledge of the situation. “Cash flow was that tight.”

In its downgrade, Moody’s asserted that covenant headroom was “tight” due to erratic trading and hailed the arrival of the fresh funds as good news. This highlights the need for continued investment in the beleaguered department store.

If profitability does not return towards the level recorded in previous fiscal years, the current capital structure may prove unsustainable
David Beadle, Moody’s

A former senior member of staff says: “We needed the investment promised by Sanpower because HoF has always been fairly close to the edge where debt is concerned.

“If like-for-like sales are down 5% as they were in the first half, then a big rent call could undo things – it will be tough after Christmas.”

House of Fraser is currently attempting to cut its cost base. The recent discussions with landlords were the latest in a series of attempts to slash overheads.

Last summer, executives were charged with shaving 10% from the head office wage bill in a move that insiders insist was purely a cost-cutting measure. Teams including digital, buying and merchandising were among those affected.

Deemed “one of the worst things that could have happened” by one source, the lost talent has contributed to head office not being “a happy place”.

And while the retailer has been in conversations with landlords in an attempt to cut rents at over 30% of its portfolio, Retail Week understands it has not provided a plan to improve those stores in return.

The rent reduction plan and redundancies come against a backdrop of constant churn among the leadership team and different ambitions for the business.

