

Deborah: Good afternoon, everyone and thanks so much for joining us for our conversation on Primark with John Mercer, who is our research head in London. We are going to look at Primark as we look around the globe in retail research and we're gonna have John Mercer give a quick background on himself and then we'll start off with some Q&A. John, I'll turn it over to you.

John Mercer: Hello, I'm John Mercer, an analyst at Fung Business Intelligence Center, and I'm going to talk through some of our key findings and key thoughts on Primark. We're going to run through three areas. First off, we're going to look at the fundamentals of Primark, what is its proposition, how does it make the low price model that it operates work, and who are its shoppers.

So first off, some basics on Primark. It's a 5.35 billion pound company, in terms of turnover in fiscal year 2015, that's up 13 percent year over year. Its comps in fiscal 2015 were up 1 percent. Its gross net comps have been slowing year over year. It operates 293 stores across ten countries. And it's best known for price; its ultra-low prices are really what it's known for. It's very much a selling point. And its fashion is generally seen as semi-disposal fashion, primarily because of its ultra-low pricing.

So as you can see on the screen, its product offer spans fashion, casual wear and basics, as well as formal wear, shoes, accessories, a relatively limited selection of homewares and some beauty, costume jewelry and luggage. Based on store visits, we estimate that womenswear dominates; we think it takes up about 60 percent of in-store space. Menswear takes up maybe a quarter and the rest split between children's wear and homewares and luggage.

And how does its pricing compare to its major rivals in the states? Well, we did a pricing survey a couple of months ago and we found that basic and key competitors, Walmart was pretty much its closest competitor on price, but even Walmart was 17 percent more expensive. If we look at H&M, which is kind of in the same more fashionable bucket as Primark, it's about double on price, we think. So the difference we found was 102 percent. And then you get department stores, such as JC Penney, which we think tends to be about 50 percent more expensive based on our basket.

But it isn't all about price. Okay, Primark is known for its ultra-low prices but it offers much more than that. Firstly, its store environments are very high quality, particularly in its new flagship stores. It goes for big, glossy stores. And they deliver an image that Primark is not just a budget retailer selling low-priced clothing, it's

more than that.

And this dovetails with its kind of second USP, which is it offers fast fashion, effectively. It has a rapid stock turn, it brings in new ranges often. It's kind of fast fashion but an ultra-low price. So it's to really fair to compare Primark directly with some other budget retailers such as supercenters because it's much more about on-trend products catering to younger shoppers.

How does it achieve such low prices? It's all really about high volumes and low margin. As you can see on the screen, its UK gross margin is about 19 percent and this is considerably lower than most of its rivals in the UK markets. And it makes it up on volumes; it's high volume, low margin.

So who shops there? Well, we've got some data on its UK shoppers, and its age peak in the UK is among 16 to 24-year-olds, so a very young shopper base. Its penetration peaks amongst that age group but also amongst that age group survey data has found that Primark is by quite a long distance the most popular clothing retailer in the UK. And as I mentioned earlier, that age bias really differentiates Primark from some other budget retailers, whether that's supermarkets in the UK or supercenters, such as Walmart, in the U.S., who tend to be more positioned towards family life stage shopper.

UK consumer data also shows that Primark over-indexes amongst female customers. In the UK, by shopper numbers, it's the number one clothing retailer for womenswear, it's the number two clothing retailer for children's wear, and it's the number three clothing retailer for menswear. So it's more popular among women than it is among men.

So when we've gone now to the story of Primark entering the U.S., which is the big story for Primark this year. So who will lose out, will its U.S. rivals have to cut prices and how big will it get in the states? So some basics. Primark opened its first American store in September and it's announced plans to open up to ten stores with eight locations confirmed so far. And this is what George Weston, the CEO of Association of British Foods, said recently, he said that they weren't scared by what they saw at the value end of American retail, and this reiterates our view that Primark is very much differentiated from a lot of players at the budget end of retail.

So who will lose out to Primark in the U.S.? I think this is very much related to who Primark's core shopper is, as we just saw is

very young. We think this will skew the losses towards mono-brand apparel specialists, particularly those who have a bias towards young shoppers and those who have a low or midmarket or budget positioning. We think department stores or mass merchandisers with a less fashion positioning or with a more midmarket or family life stage shopper look less at risk of losing customer to Primark. We think, broadly speaking, that most of the losses will be from younger positioned apparel specialists.

So these are our ballpark estimates of where Primark USA sales may come from in terms of competitors. We think the majority, as I said, will come from budget and low or midmarket clothing specialists. Low or midmarket department stores may contribute some, mass merchandisers and superstores may also contribute a little, particularly in the core ranges that Primark stocks. I mean it stocks fast fashion but it also stocks kind of core ranges of staples and we could see some switching there from channels such as department stores and mass merchandisers.

So how big will it get? We think within four years of entering the U.S. markets, Primark could be seeing \$1 billion in annual sales. This is a ballpark estimate and it's based on we think pretty conservative store opening estimates. Our projections assume that Primark in the U.S. opens seven and a half stores per year on average. This is pretty much in the same ballpark as it's announced store openings in the U.S., and it's also the total of the average store openings per year in Germany and Spain, which have been two successful markets for Primark.

It's arguable a conservative estimate but so far we don't have any information from the company on how many U.S. stores they're planning. If it does open seven and a half stores per year, as I said, we think it will get to around a billion dollar sales per year in fiscal year 2019.

So beyond the U.S., where else has Primark moved and has it been successful? What is its strategy for internationalizing, and also will it start offering ecommerce which it currently doesn't offer? So Primark has seen success in a number of new markets. It began trading in France, for instance, in December 2013, and it recently said that it saw very high sales densities in its latest fiscal year. Spain has been a strong market. Recession-hit shoppers have flocked to the budget retailer. Portugal has also been a strong market for Primark.

Italy is its next European market. It's due to open there in Summer

2016. We think Italy could be one of its tougher European markets. Italian shoppers are known for being willing to spend on fashion and also being willing to spend conspicuously on fashion, so we think a budget private label retailer, such as Primark, is probably the toughest market for Primark, but if it can crack Italy we think it can probably crack any market.

So there's the rundown of store numbers. And as you can see from the market entry data, Primark's internationalization really took off in 2006. It's entered nine countries since then if we include the Canary Islands within Spain, and obviously, as I said, the U.S. was its most recent and Italy is next year.

So its strategy for internationalizing has been to open flagship international stores. These are big, multi-floor spaces, they're glossy, prestigious flagships, and as a consequence to that, we estimate the average Primark store is now just over 37,000 square foot, up from just under 32,000 square foot at the year-end 2010. And in the U.S., where Primark has bought a suite of stores from Sears, we estimated that those will average just under 57,000 square foot of store. The biggest is set to open at King of Prussia Mall, where it will open 75,000 square foot of net selling space.

And these bigger flagship stores have been bolstering performance. Primark has noted that some of its newest locations are now amongst its top 20 stores, and this isn't, we think, just because these stores are bigger, flashier, we think it's because Primark has been bringing its brand to customers who haven't had access to it before.

So this has been the effect in terms of average sales per store and sales per square foot. So, the bigger flagship stores have helped bolster average annual sales per store. Sales per square foot has also been trending upwards, until fiscal year 2015, when it disappointed a little, that was in part due to currency effects. Constant exchange rates, sales per square foot will continue to rise in fiscal year 2015.

So elsewhere in the world how have competitors reacted? Well, we've seen a little evidence that big clothing retail rivals have lowered prices to compete with Primark. This is in part because its rise in markets such as the UK have been pretty steady, and also because elsewhere in Europe market conditions have made it tough to separate other retailers' reactions to Primark from generally catering to such huge consumer demand. And complicating it further is the fact that our clothing is often in a deflationary

category in any case. So in terms of the market, it's difficult to see any kind of Primark effects.

In countries such as the UK, we think that Primark has chipped away at a number of midmarket and low-midmarket retailers rather than steal share from any one particular retailer. Some analysts have speculated that H&M in the U.S. will be forced to lower prices when Primark expands in the market. We don't agree, we think firstly, because H&M and Primark already compete in a number of European markets, they compete alongside each other apparently quite comfortably. And secondly, because we think consumers understand the difference between them. We don't think consumers really view them as interchangeable. We think they understand that they are pitched at slightly different levels.

So moving on to multichannel retailing, Primark stands apart from any retailers. It remains a mono-channel retailer; it refuses to sell online. This is largely because its ultra-low price points would make it very difficult to make it profitable. We also think that the impulse buys that we see in store, where shoppers pile their baskets high, would be very difficult to replicate online. You see shoppers browsing the aisles in Primark and when they see the prices they add more to their basket. We think that will be a tough call to do that online.

It did try selling through ASOS in the UK in 2013; it was a short-lived experiment of a few months and it's not done anything since. And it's also part of a booming mono-channel budget retailing. We've seen the expansion of grocery discounters such as Aldi and Lidl. In the UK we see pound stores such as Poundland. In the U.S., some of the dollar stores, such as Family Dollar and also Internet-only retailers in fashion, such as ASOS and Boohoo.com. They're all mono-channel retailers and they're all growing very fast. So that kind of cements our view that there's no urgency for Primark to become a multichannel retailer.

So the company's focus is very much on building its international presence through major flagship stores, and it's a growth story that's obviously worked well so far. We expect to see Primark put down more glossy international flagships, and we think that's a strategy that will work well in the medium-term, and we don't see ecommerce as a particular medium-term strategy. We expect to see more of what Primark has already been doing.

Deborah:

Great, John. Thanks so much for all the news. I have a few questions and then we'll turn it over to the audience. So can you

talk – I've certainly been in a lot of their stores, but can you talk about what differentiates their in-store experience versus the competition, and as they continue to grow and they're not online and multichannel/omnichannel is so important these days, what do you think will keep the customer coming back?

John Mercer:

Okay. I think the stores are different from a lot of rivals, certainly the new stores differ by their scale. I mean they're big, multi-floor stores. And they look terrific. The merchandising, the finish in stores, they – you know, they look like the flagship stores of a really kind of fashionable midmarket retailer. What keeps shoppers coming back? I think there are two elements. Firstly, they don't sell online, so you have to go into the stores to see what they're offering that week, and that couples with the kind of rapid stock turn they have. So really, the only way, as a shopper you can find out what they're stocking is to go in and have a look, and once you go in the prices are so cheap, as I've mentioned, impulse buys are high and it's very difficult to leave emptyhanded, I think.

Deborah:

Great, thanks. And then in terms of the Sears locations where, you know, obviously these boxes are all fairly unique, what challenges do you think might arise as Primark is building out their U.S. presence?

John Mercer:

I mean brand awareness is obviously one potential problem for Primark. I presume that it's scouted out good quality mall locations. I mean, as I've mentioned, in a lot of countries they've been building flagship stores, you know, in some cases they've been refitting prestigious stores or locations. The first were in Boston, for instance, was a kind of a flagship store at Downtown Crossing. So I mean I guess if all the Sears stores have kind of been in mall locations that's a possible risk. But I mean generally we're quite bullish on Primark in the U.S.

You know, it's very distinctive, really. There are a lot of players and I think there are more players in the U.S. than here in the UK offering budget fashion, but I think there are very few who offer that combination of fast fashion, really low prices and kind of a good in-store experience. And I think the mistake that some make is to put all kind of lower priced fashion into one bucket, whether that's Walmart offering fashion in supercenters, whether that is H&M offering relatively low priced fashion, I think consumers perceive the difference, and I think in a lot of cases they are different consumers.

The crossover between Primark and the likes of Walmart I think is

relatively low. There may be some crossover between H&M and Primark but as I'm mentioned, they already compete in other markets. So think it's a really distinctive proposition, and I think the likes of Sears and I think some other operators have also mentioned this, they are likely to hope that Primark ultimately proves a footfall driver in the malls that they're in.

Deborah: Great. And we do have a question from the audience. Is there a sustainability point of view that can affect Primark's image?

John Mercer: I think, to be honest, they've already been through that and come out the other side. In terms of sustainability, in terms of kind of worker conditions, there was obviously the Bangladesh tragedy a few years ago and Primark was – it was kind of pretty much targeted by campaigners after that. But some – they've done two things – well, they've done three things, actually. They've paid a lot of compensation, they've been – they have appeared to kind of – have strong audit process – yeah, strong audit process. And also if you go on their website, they're pretty open about, you know, ethical credentials.

It's very easy to kind of characterize them as – because they're ultra-low priced that they're going to be cutting corners kind of on stores and on ethics. In terms of kind of worker treatment, I don't think that stacks up and I don't think that at Primark that stacks up. In terms of kind of the ethics of kind of disposable fashion, I mean I guess that's a different issue, but yeah, that's an issue that some retailers have begun addressing, H&M, for instance, it encourages clothes recycling. But I mean I don't think it's an issue that would hit Primark, certainly not.

Deborah: Okay. We have another question that came in from the audience. How many potential markets/doors in the U.S.?

John Mercer: Okay. Well, as I mentioned, we did some projections. I'll just go back through the slides, and as I said, we think they're pretty conservative projections. So where are we? Let me just find the slide. So our projections, on the basis of a conservative seven and a half stores per year gets them to just over 30 stores by fiscal year 2019. That's based, as I said, on their original opening plans, you know, so how many they've opened in European markets.

In a number of markets, they've opened and they've been quite cautious about opening stores. They seem to have really gone for this strategy of opening big stores in major cities. So I don't see that that would change in the U.S. So I mean I guess we would see,

if Primark finds it's a market that's successful for it, I guess you would see Primark opening big stores in kind of all the major urban centers over the medium-term.

Deborah: Okay. We have another question, what are the plans for Canada?

John Mercer: I'm not aware of any plans for Canada, and I guess they would want to see, first of all, how the U.S. went. I guess they had their hands pretty full for that.

Deborah: Okay. Another question from the audience. Rent and prime locations in the U.S. are not cheap, rather they are expensive. With their low margins, how can they sustain their profitability? What is their initial gross margin on goods? Do they take markdowns?

John Mercer: So their initial – their gross margin as reported for their UK accounts, which is really the only indicator we have because they're part of a conglomerate, ABF, is about 19 percent. So it's a much lower gross margin than a lot of their competitors. How – I mean how they pay for such prestigious and such kind of flagship locations is through the volume. The whole thing is about low margin, high volume. Sorry, Deborah, what was the second part of that question?

Deborah: What is their initial gross margin on goods and do they take markdowns.

John Mercer: In terms of markdowns, it's relatively rare to see markdowns in Primark, despite their rapid stock turn. They are an everyday, low-price operator. They're not a high level operator. So it is kind of a standard low price. As I said, it's rare to go into Primark and see markdowns. They presumably just sell through the products at full price, in most cases.

Deborah: Okay. We're gonna take one more question from the audience and then we'll – actually, I guess two more just came in. Are they going to participate in key shopping holidays in the U.S. in the future? So I'll let you –.

John Mercer: Okay. Well, one thing that was notable is that they took part in Black Friday this year in the U.S., whereas they don't take part in Black Friday in the UK. In the UK it's very much a new event, Black Friday. It took off, or it's taken off in the last few years. They didn't take part in the UK, but they did in the U.S. this year. So they are compromising their kind of everyday low price position a little bit in the U.S. I don't know what the scale of the

discounts were in the U.S. So I think we will expect to see more of that kind of adjusting to what the local market expects in the U.S.

Deborah: Okay. And two more questions. Do you think Primark can thrive in the long run without ecommerce?

John Mercer: In the long run it may eventually have to do ecommerce. In the medium-term, I think it can thrive without ecommerce, absolutely. As I noted, it's one of a number of budget positioned retailers who are really kind of powering ahead, the grocery discounters, the nonfood discounters, and they're all doing it without ecommerce. And it's also – I mean you can also make parallel to Internet-only retailers, who are powering ahead without stores, the likes of Boohoo and ASOS, which are both relatively value positions; they're mono-channel retailers. So I think in this kind of budget segment you really can make headway without having a kind of multichannel strategy, certainly in the medium-term. Longer-term, who knows, maybe they will need to adopt ecommerce in the longer-term, but I certainly don't think they will do it in the next few years.

Deborah: Okay. And then the last question, I promise. So just as they are continuing to grow in the U.S., and, as you mentioned, you know, the brand name is not necessarily strong yet throughout the country, how do they basically help the consumer understand their kind of price-value relationship?

John Mercer: I think from the Boston store opening we saw kind of – they must have generated a lot of kind of PR and press coverage, and I think that the thing to do is get shoppers into the stores. Once shoppers get into the stores and see the prices and see the products, I think they get wowed. You don't really need to do advertising. It's one thing Primark hasn't done so far is advertising, you just need to get shoppers curious, get them into stores and they use word of mouth a lot and they use social media a lot to get their message out. And I think once consumers see the products and see the prices, they become ambassadors for Primark, really. Yeah, so it really is getting that footfall in stores.

Deborah: Okay. One last question. So anecdotally, major retailers have said that omnichannel shoppers spend three to four times more than those shopping only in one channel and that shoppers online opting to pick up in-stores will spend 30 percent more on impulse when they pick up in the store. Given these points, isn't Primark leaving sales on the table?

John Mercer:

No, because I think the costs for it to sell online will be greater than the benefit. I mean we already see a lot of impulse buying in Primarks, you don't need that kind of click and collect buyer to come in and to kind of upsell them. And also, the stuff that gets thrown around that multichannel retailers – that multichannel customers spend more than mono-channel customers, I mean you could argue that multichannel retailers – multichannel customers, sorry, are those that are most loyal in the first place. If you're shopping across channels you're likely to be a relatively loyal shopper, which is why you spend more in the first place. So it's – you know, that whole thing about multichannel customers spending more, there's something slightly cyclical about that because they're likely to be more loyal in the first place.

But I really don't think Primark needs that to kind of boost average basket size. It's – you know, it already gets impulse buys and it gets, by unit volumes, I think its basket size has allowed it to be bigger than most of its rivals.

Deborah:

Okay, great. Well, everyone, John, thank you so much, and thank you for entertaining all these questions, we really appreciate it. Everyone, we'll make John's contact information available and make the deck available. There'll be a transcript. If anyone needs anything, we'll make sure you can get in touch with John. And thanks, John, for putting everything together for us. This was fantastic. And everyone Happy Holidays, and we'll get you all the details for our upcoming calls. Thank you.

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