




WHAT'S NEXT FOR **UK POUND** SHOPS?



-  Major UK pound shop chains have seen **revenues surge** in the post-recession years.
-  The economic slump and the Woolworths failure paved the way for this segment's **rapid expansion** of stores.
-  With further expansion expected, we think the **segment is looking increasingly crowded**.
-  Some players are now eying **international markets** in their bid for growth.

WHAT'S NEXT FOR UK POUND SHOPS?

THE POUND SHOP BOOM

Variety-store retailers have proliferated rapidly in the UK, mirroring the store-expansion boom of discount grocery chains (notably Aldi and Lidl), as the low-price, no-frills formula has found particular resonance in Britain's era of sluggish economic growth.

This retail segment encompasses chains like Poundland, 99p Stores and Poundworld, which sell all of their products at fixed price points. Similar to the dollar chains Dollar General and Family Dollar in the US, everything in the pound stores sells for £1 (or 99p) and the goods are bought cheaply in bulk. The group also includes chains with more flexible pricing schemes. Those include B&M Bargains, Home Bargains and Poundstretcher. For both types of stores, the offerings are heavy on beauty and personal care, household fast-moving consumer goods (FMCGs) and food and beverages (particularly confectionery). Other categories typically include do-it-yourself (DIY) and automotive accessories, pet products and seasonal goods. It is a low-margin business, where volumes drive profits. For simplicity's sake, we refer to these retailers as "pound shops," given that they tend to be viewed as one group.

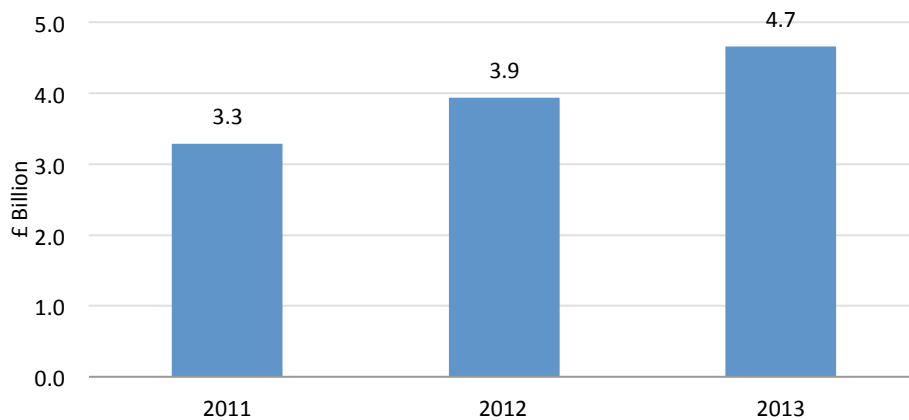
Pound shops' profitability benefits from the ability to 1) buy excess stock from grocers (customers can sometimes find leftover branded holiday stock, for example); 2) getting major brands to manufacture slightly smaller packs especially for them; 3) private labels (under a multitude of own brands); and, in some cases, 4) grey-market sourcing, such as buying branded stock from overseas.

General merchandiser Wilkinson is often classified in this segment, but it has larger stores and a bigger assortment of higher-value categories, such as DIY, so we do not include it with the pound shops.

RAPID GROWTH SET THE STAGE FOR 2014 IPOS

This is a fast-growing segment. The six-biggest pound shops grew their combined revenues by nearly 42%—or £1.4 billion—between the companies' 2011 and 2013 financial years.

Figure 1. Total Net Sales of the Top-Six Pound Shop Chains*



**The sum of Home Bargains/TJ Morris, B&M European Value Retail SA, Poundland, Poundstretcher, 99p Stores and Poundworld
Source: Company reports*

- B&M Bargains has been the fastest growing of the pound stores, and it is on the cusp of stealing first position in the segment from Home Bargains.
- Two of the big chains launched initial public offerings on the back of this growth last year: Poundland debuted on the London Stock Exchange on March, 12 2014, to be followed by B&M on June 12, 2014. The remainder are privately owned.
- Poundstretcher has been a longtime player in the segment, but this means its scope for store expansion is more limited. Coupled with a product mix that is less focused on FMCGs and food and beverages, this has resulted in less dramatic revenue growth.

We don't include Wilkinson within this segment, although for comparison purposes we include it at the bottom of the following tables.

Figure 2. Top Pound Shops: Net Revenues

	2011 £ Mil.	2012 £ Mil.	2013 £ Mil.	% Change 2011–2013
Home Bargains/TJ Morris	914.8	1,058.4	1,277.3	39.6
B&M European Value Retail SA*	764.2	992.9	1,272.0	66.5
Poundland	780.1	880.5	997.8	27.9
Poundstretcher	348.4	368.0	395.4	13.5
99p Stores	270.2	341.5	370.4	37.1
Poundworld	206.5	293.8	345.3	67.2
Wilkinson	1,565.4	1,529.7	1,460.0	-6.7

*Excludes Jawoll, acquired April 2014

Source: Company reports

WHAT'S DRIVING GROWTH?

Aggressive Expansion

The sluggish economy, as well as the demise of mixed-goods giant Woolworths in late 2008, helped pave the way for the rapid expansion of the major pound shop chains over the past several years. Indeed, many of these retailers now occupy former Woolworths sites.

Figure 3. Top Pound Shops: Year-End Store Count

	2011	2012	2013	Change 2011–2013
B&M European Value Retail SA	274	331	373	99
Poundland	389	458	528	139
Poundstretcher	397	400	405	8
99p Stores	180	217	239	59
Poundworld	180 (e)	210	242	62
Wilkinson	366	372	375	9

Note: We do not have robust time-series data for Home Bargains/TJ Morris; approximately 370 stores at January 2015

Source: Company reports

An Improved Product Offering

A strong, branded, FMCGs offering has been key. Health and beauty and household FMCGs sit alongside packaged food and drink at the core of the pound shop's offering.

Fixed-price stores Poundland, 99p Stores and Poundworld enable shoppers to buy branded FMCGs at compelling price points. Meanwhile, B&M Bargains uses its more flexible pricing strategy to sell alcoholic beverages, while Home Bargains has developed a strong fragrance offer.

The segment's growth has almost certainly hit FMCG sales at the major grocers. Giving a hint of the seriousness with which grocers view them, in May 2014, grocery market leader Tesco announced plans to roll out "pound zones" to 300 of its stores.

Such is the clout of these value merchandisers that we now commonly see major food and FMCG manufacturers offering their goods in sizes designed to meet the price points of these stores. This builds a virtuous cycle for attracting shoppers, which then gives the retailers more bargaining power with owners of big brands.



THE ONLY WAY IS UP?

But there are hints of softening growth:

- Poundland's comps fell 1.7% in 2012 as a result of "a significantly higher than usual number of stores opened by competitors," though this improved to +1.4% for 2013 and its latest half-year results (H1 2014) showed much-improved gains of +4.7%.
- B&M reported a slowing in its comps to 4.5% in its latest trading update, which covered the holiday period 2014, saying that "market conditions are competitive."

This is perhaps not surprising as comparisons get tougher and rivals' store numbers grow. The top six pound shops now have nearly 2,200 stores, well ahead of the 807 stores Woolworths was operating when it closed its doors six years ago. In our view, the segment looks to be getting crowded.

Even so, major players are still in full expansion mode:

- Poundland has said it sees opportunities for a total of 1,000 UK stores.
- Poundworld plans to open another 200 stores over the next five years, under a rollout program of around 40 stores a year.
- TJ Morris (trading as Home Bargains) plans to have 400 stores by June 2015, with the target of 700 total stores within the next five years.

In our view, the greatest threat to these plans is the reviving UK economy. As British consumers begin to feel better off, will they want to continue splitting their shopping between the supermarket and these deep-discount stores? One-stop shopping is far more convenient and the default choice in the UK market. We think that many shoppers may once again opt for this path of least resistance.

Consequently, we expect segment growth to slow, and wouldn't be surprised to see a shakeout of the weaker players in the medium term. The retailers that continue to thrive will be those that can encourage shoppers to make an extra trip to the pound shop, alongside their regular grocery shop. A strong branded presence and complementary non-grocery products should help with this.

LOOKING FOR GROWTH ELSEWHERE

That does not mean these retailers have to accept a low-growth future. Perhaps anticipating pressures to justify hefty valuations, the newly public retailers are at the forefront of international expansion.

- Poundland expanded into Ireland under the Dealz fascia in 2011, with 31 Irish stores established by the time of its IPO. It ramped up international growth by extending the fascia into Spain in February 2014, with plans to open 10 Spanish stores over a two-year period.
- Poundland has clearly focused on recession-hit countries, albeit ones that are now on a recovery path. But it's not just about targeting hard-hit shoppers. In markets like Spain there is scope to consolidate a fragmented discount segment.
- Last year, B&M acquired Jawoll, a value-positioned German retailer. German retailing is traditionally very price-led, which means there will be limited scope for B&M to establish a competitive advantage through a low-price positioning, but there will likely be benefits in sourcing.

These actions suggest international opportunities for others in the sector. Expansion elsewhere in Europe offers further options to build scale, and, as we note above, some European markets will be ripe for consolidation, with savvy chains able to gain share from independent retailers.

For some of the pound shops, these opportunities could mitigate any potential future weakness in their home market.



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