COUNTRY SECTOR SUMMARY - March 2019

RETAIL: TURKEY

RISK ASSESSMENT: VERY HIGH

HIGHLIGHTS AND OUTLOOK

Coface's sector risk assessment on retail in Turkey is currently at 'High Risk'. Coface downgraded its risk assessment of Turkey's retail sector from "High"' to "Very High" in the second quarter of 2018, and has not upgraded it since.

The main threat for Turkish retailers comes from exchange rate volatility and slower domestic consumption. The Turkish lira hit an all-time low of 7.21 versus the US dollar in mid-August 2018, and lost nearly 40% of its value against the greenback over the year, pushing up inflationary pressures and input costs for companies.

In order to contain the negative impacts of the lira's depreciation on sale prices, many retailers fixed prices for some time in May. Nevertheless, the currency shock in August and its upward impact on prices – annual producer prices jumped by a record 46% in September 2018, while consumer prices jumped 25% in October – resulted in a sharp deceleration in domestic demand. The central bank's rate hike of 625 basis points in September to curb inflationary pressures increased the borrowing costs of households significantly, adding to the downward pressures on demand for retail products. As a result, retail sales started to decline as of the beginning of September 2018 on an annual basis. In 2018, retail sales inched up only by 1.3% year-on-year compared with an increase of 5.7% a year earlier. Between August and December 2018 when the economy was hit by the currency shock, retail sales plunged 5.2% on average compared with the same period of a year earlier.

Total consumer spending is expected to slow further in the months ahead as stubbornly high inflation, rising unemployment, and increased borrowing costs erode both purchasing power and consumer confidence.

Strengths

- Large, young and dynamic population representing a large domestic market
- Geographic proximity to Europe attracting European tourists
- Efforts of modernisation and improvement in overall products offered to consumers?

Weaknesses

- Sharp depreciation of the lira and rising borrowing costs
- Low profit margins decline in the future
- Strong competition that weighs on pricing

Key Players

- **BIM:** Budget supermarket chains. By the end of 2017 it reached 6074 stores in Turkey. It also has stores in Morocco and Egypt. In the first nine months of 2018, its net sales rose 28.2% to 23.2 billion lira (around USD 4.4 billion) from a year earlier.
- **Koctas:** a 50/50 joint venture between Kingfisher and Koc Group (mainly furniture, homeware, garden equipment sales) . Their net profit rose to 20 million lira (nearly USD 3.8 mn) in 2018 from 17 million lira in 2017.
- *Source: BMI, companies web sites*

Regional Risk Assessments: Construction

ASIA	MEDIUM
CENTRAL & EAST. EUROPE	MEDIUM
LATIN AMERICA	MEDIUM
M. EAST & TURKEY	HIGH
NORTH AMERICA	HIGH
WESTERN EUROPE	MEDIUM

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SECTOR ECONOMIC INSIGHTS

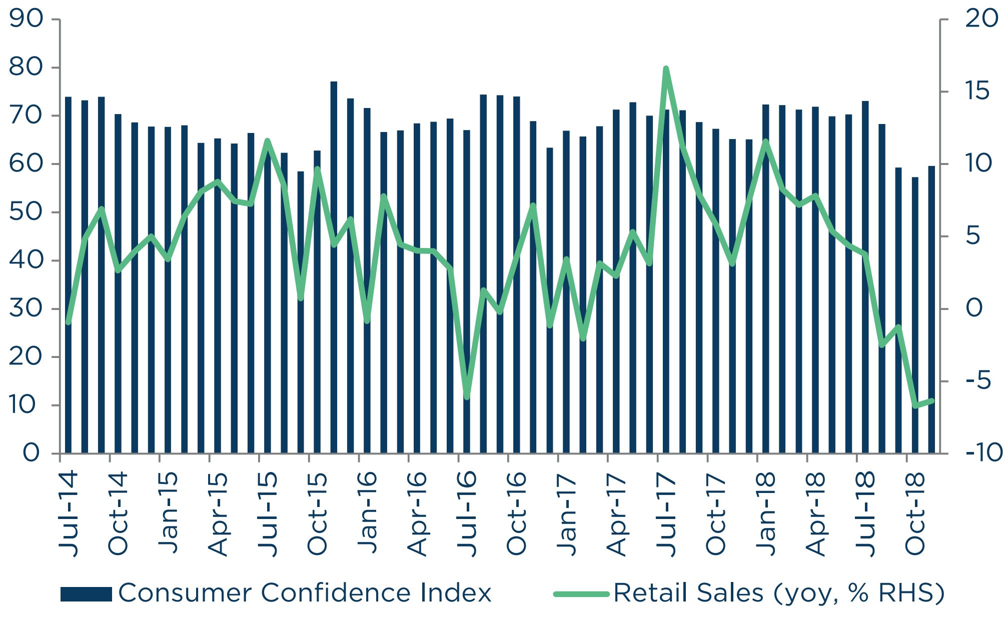
Lower spending is expected to impact mostly non-essential goods, such as clothing and footwear, and household goods. The annual increase of clothing spending (in lira terms) is estimated to have slowed to 9.5% in 2018 (to 44 billion lira) before rising again by 15% in 2019. Annual household goods spending is estimated to have grown by 9.5% (to 87 billion lira) in 2018 and is expected to increase by 16% in 2019. Yet demand side discrepancies are not the only problems in the retail sector: low levels of profitability will continue to be the main challenge for retailers as they suffer from high level of operational costs, a structurally weak return on equity, high indebtedness, tough competition and lower perspectives of sales. These problems have resulted in a deterioration of cash flow and higher costs.

The sector's profitability has been adversely impacted over the years. Although the retail sector has achieved high growth rates over the years, it was not the same for its profitability. Many retailers struggle with financial difficulties and pressures on profitability. Between 2014 and 2016, the cost of merchandise rose from 72% of net sales to 77%. At that time, the ratio of return on equity fell from 26% to 23%. This pushes most of the retailers to rely on banking loans to finance their businesses. In an environment of higher interest rates, this situation significantly reduces their profits.

The sector recorded a foreign exchange loss of 2% of the net sales in 2016 compared with 0.9% in 2014. The lira weakened versus the US dollar by 24% in 2015 and another 21% in 2016. At that time financial expenses rose to 2.5% of net sales from 1.8%. As a result net profit fell to 0.6% of net sales in 2016 from 1.1% in 2014. Tough competition is reducing profit margins despite a slight recovery in 2016. Retail discounts stood at 6% of net sales in 2016, edging down from 6.8% in 2015.

A positive development for retailers may come from the improvement of international tourists flows to Turkey. International arrivals to Turkey in the first nine months of 2019 rose by 20% to 36 million people. This growth should be a supportive factor for all the subcategories of the retail sector during 2019. Recent developments in the retail sector confidence index indicate that retailers' expectations of business activity for the next three months have started to recover from the bottom they hit in October 2018. The macroeconomic environment, particularly the trend in lira and inflation will be determinant of the strength of this fragile recovery.

TURKEY CONSUMER CONFIDENCE AND RETAIL SALES



Sources: TSI, Coface calculations

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