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THE SECRETS OF RETAIL'S REPEAT TOP PERFORMERS

By Ketil Gjerstad and Greg Papp

During the past decade, the global retail industry established a solid record of very strong value creation. For the five years from 2011 through 2015, the industry's performance declined somewhat in both absolute and relative terms. Still, it continues to deliver better value than most other industries. An examination of the industry's repeat top performers over the past decade reveals clear patterns. The best value creators over time are those that are insulated from e-commerce, capitalize on the growth of emerging markets, and continually evolve their business model.

In 2016, The Boston Consulting Group conducted its annual study of total shareholder return (TSR) of nearly 1,620 publicly traded companies in 28 industries.[1] Ninety-four of the companies were in the retail industry. (See *Creating Value Through Active Portfolio Management,* the 2016 BCG Value Creators report, October 2016.) Overall, from 2011 through 2015, the retail companies in our sample returned an annualized TSR of 16% (down from 21% for the five-year period ending in 2014). The industry ranked eighth overall and fourth among the five consumer industries studied. Travel and tourism, consumer durables, consumer nondurables, and fashion and luxury were the other four.

Although the US economy grew faster than that of other countries from 2011 through 2015, five of the top ten performers in the retail industry are based outside the US. (See Exhibit 1.) The top performer overall was Rite Aid, which delivered an annual TSR of 55% from 2011 through 2015. Much of that contribution (37%) came from the reduction of debt. After a difficult stretch of several years, Rite Aid launched a restructuring initiative, including retiring significant debt, which concluded in 2015. Rite Aid also created value through improved margins and higher valuation multiples. (Walgreens and Rite Aid recently announced plans to merge. The deal is scheduled to close in 2017.)

Multiples Lead to Greatest Value Creation

The restructuring program makes Rite Aid an outlier, yet there are several key themes

Exhibit 1 | The Retail Top Ten, 2011–2015

					TSR Disaggregation[1]					
					❶ Profit growth		❷ Valuation	❸ Cash flow contribution		
	Company	Location[2]	Market value[3] ($billions)	Average annual TSR (%) =	Sales growth +	Margin change +	Multiple change[4] +	Dividend yield +	Share change[5] +	Net debt change
1	Rite Aid	US	8.2	54.8	3	10	8	0	–3	37
2	Ryohin Keikaku	Japan	5.4	51.9	12	8	32	3	1	–4
3	Domino's Pizza	US	6.1	50.9	7	4	20	3	2	15
4	Dollarama	Canada	7.2	41.8	13	6	17	1	3	2
5	Ulta Salon, Cosmetics & Fragrance	US	11.8	40.6	22	9	11	0	–2	1
6	Hotai Motor	Taiwan	6.3	38.3	8	5	17	5	0	4
7	Alimentation Couche-Tard	Canada	25.0	37.9	14	9	15	1	0	–1
8	Woolworths Holdings	South Africa	6.2	35.9	20	9	10	6	–5	–5
9	The Home Depot	US	167.7	33.4	5	7	12	3	5	1
10	O'Reilly Automotive	US	25.0	33.2	8	6	12	0	7	0

Sources: S&P Global Market Intelligence; annual reports; BCG analysis.
Note: n = 94 global companies with a market valuation greater than $4.5 billion as of December 31, 2015.
[1]The contribution of each factor to the average annual TSR is shown in percentage points. Because of rounding, the numbers may not add up to the TSR figure shown.
[2]Location of corporate headquarters.
[3]As of December 31, 2015.
[4]Change in EBITDA multiple.
[5]Share change refers to the change in the number of shares outstanding, not to the change in share price.

that are common among the rest of the top ten, and they are consistent with last year's analysis of the industry. The largest factor in value creation continues to be an increase in the valuation multiple. Nine of the top ten players posted double-digit contributions to TSR from improved multiples over this period. (Rite Aid was the only exception, with an 8% contribution from valuation multiples.) The capital markets have favored defensive industries such as retail, bidding up the share prices of these stocks.

In addition, revenue growth remained an important contributor, with five of the ten companies achieving double-digit improvements. That feat is all the more impressive given the relatively sluggish GDP expansion in most markets over the past five years. As we have highlighted in past reports, over the long term, revenue growth is the largest contributor to TSR for top performers.

The third factor is margin improvement. The best-performing companies are creating value by streamlining operations, reducing overhead, and getting more efficient to generate gains that fall to the bottom line.

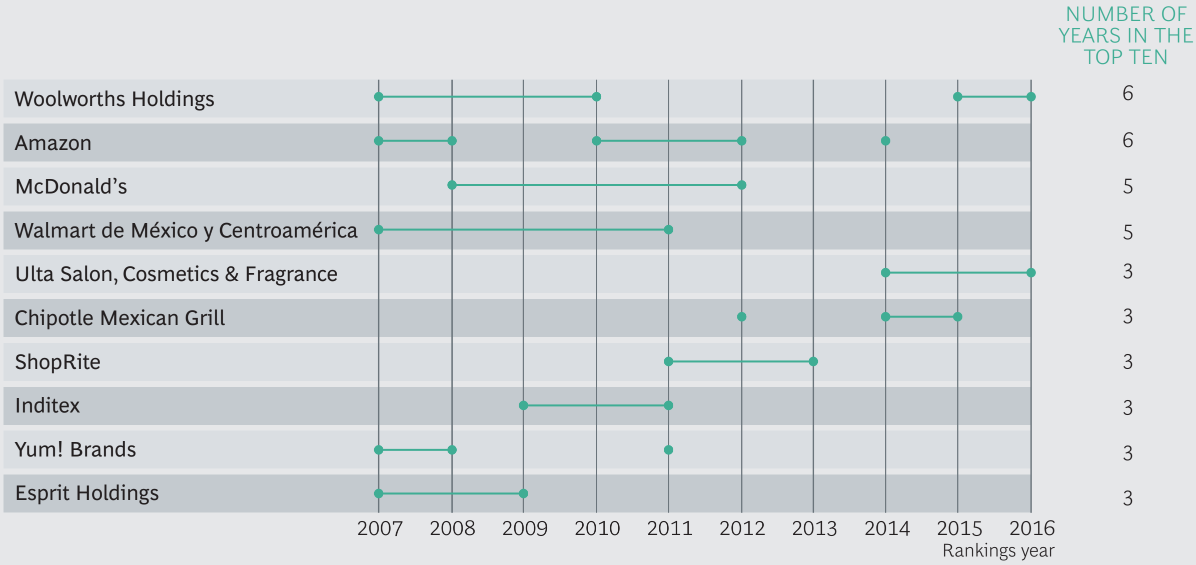
Overall, despite their continued strong absolute-value creation, the top ten, as a group, underperformed compared with last year's top ten: annual TSR fell from 50% to 42%. Similarly, even though valuation multiples were the biggest contributing factor to value creation, their contribution was lower than that of last year's top ten—16% compared with 22%.

How to Be a Repeat Performer

Following up on a theme from BCG's broader Value Creators report, we looked at what it takes to generate consistently strong TSR performance. Five of the top value creators from this year's list are repeaters from last year: Domino's Pizza (third this year); Ulta Salon, Cosmetics & Fragrance (fifth); Hotai Motor (sixth); Alimentation Couche-Tard (seventh); and Woolworths Holdings (eighth). Notably, for most of these companies, the primary driver of value creation remained consistent. This year, all of these repeat top-ten performers relied heavily on multiple expansion, and four of the five relied on revenue growth.

In addition, ten retail companies have appeared on the top-ten list at least three

Exhibit 2 | Repeat Performers Among the Retail Top Ten Since 2007



Sources: BCG Value Creators reports; BCG analysis.

times since 2007. (See Exhibit 2.) As noted in the overall Value Creators report, maintaining a spot among the top performers requires finding a way to "beat the fade," meaning the regression from superb value creation to merely average returns. On the basis of our analysis of repeat top performers, we have identified several ways that companies can beat this fade and deliver sustained strong performance.

The first is to be insulated from the threat of e-commerce. For example, companies in the restaurant and service industries—including Chipotle Mexican Grill, McDonald's, and Yum! Brands—have created strong and lasting value over the past decade. The second approach is to tap into the growth potential in emerging markets. Walmart de México y Centroamérica, ShopRite, and Yum! Brands have benefited from such growth. The third is to continually evolve a winning business model. Amazon, relentless in opening new revenue streams and developing new business models, has, for example, built Amazon Web Services into a predictable profit stream that complements its more volatile e-commerce business.

Finally, one notable aspect of the repeat top performers is their diversity across categories, including grocers, e-commerce players, restaurant chains, mass retailers, and health and beauty companies. The clear implication is that although the particular segment a company operates in is important, it's possible to perform well—and sustain strong performance over time—in all retail segments.

In all, the retail industry is still performing well compared with other industries, despite the decline in absolute returns. Revenue growth is slowing as retailers face digital competition, and the capital markets are correspondingly and carefully scaling back their expectations. In this environment, delivering sustained high TSR performance has proved difficult, but some retailers have managed it effectively. They have succeeded by developing business models that meet their customers' needs—both today's and anticipated—and making their internal operations as efficient as possible. That is a winning formula for strong value creation regardless of what the future holds.

Note

1. TSR is a metric that encompasses all sources of value that accrue to shareholders. It includes changes in sales, margins, and valuation multiples, along with all sources of free cash flow to investors and debt holders, such as changes in dividends, net debt, and the number of shares outstanding.

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