COURSE OF THE EXCHANGE

Death of retail

Many have talked of 'the death of retail' pointing to companies like Amazon inc. without giving consideration to what 'retail' is and what a 'retailer' does. A 'retailer' is someone selling goods that someone else has made. Their main preoccupation is not *anything* apart from in *inventory management*. Of course, different retailers have different 'business models,' some hiding plain usury. Defunct British company 'Rumbelows' used to over-price their electronic goods for sale to make their rental arm look more attractive to those on 'lower incomes.' It is true that 'retail' is dying… but in a way that will take all 'retailers' with it – Amazon included.

Differences between a supermarket and futures market

Before we delve into current 'retail' trends, let's compare a supermarket – the idea of which much of the public are familiar with and a futures market – of which the same cannot be said. Many take for granted being able to walk into a supermarket to purchase produce at will. The idea of a supermarket or 'retail consumption at leasiure' is comparatively new (past 60 years) and has accompanied exponential growth in fiat, whereas futures markets have a history stretching back into pre-history.

	Supermarket	Futures market
Purchases and sales	Manager buys in by weight and sells by 'tale' or 'number.' Public access for sales only.	Market maker quotes bids and offers by weight. Public access after vetting.
Swaps	No more difficult than placing good *A* 'back on the shelf from the basket' for good *B*.	Wanting good *B* instead of good *A* would mean having to take the bid for good *A* and offer for good *B*.
Settlement	After good is placed in basket, payment of 100% of price is completed at 'checkout.'	Delivery might be months away; 10% of contracted price is deposited with market maker upfront and remaining 90% settled on delivery.

For the general lack of awareness of how futures markets work amongst the public, supermarkets get to take advantage of that, 'profiting' from them.

'Footfall' across city centres worldwide is falling and with that, fewer sales on the 'high street.' The 'owners' of a supermarket only care about its 'operating profit margin' calculated as 'gross profit minus staff costs, depreciation and interest.' As soon as the 'operating profit margin' starts falling, the gormless 'executives' managing supermarkets, who've never put anything on to a shelf themselves, try to cut staff costs to protect this margin. Without going into some (pointless) MBA-style thesis of how this leads to failure, gormless 'executives' will end up having to run the entire supermarket operation themselves… including 'shelf-stacking.'

'Operating profit margin' for the futures market maker could be considered as 'the difference' between their offers and bids. However, developing this means eschewing the nonsense of 'metric spaces,' as 'the difference' between bids and offers – which themselves are changing – is subtle and beyond the ability of most to handle.

<u>Tesco, Apple and Amazon</u>

Tesco is not only a 'traditional supermarket' but also a bank. To February this year, sales were £57bn, for the year. This is broadly flat over a 9-year period! Its 'operating margin' has fallen from 5.4% to 3.2% since 2010. Furthermore, 'profit arising from the sale of property' typically accounts for 10% of this 'operating profit.' Tesco's inventory turn has increased from 20.9X to 25.4X since 2010 but with 'lower operating margins' they are still 'not selling goods quickly enough' to compensate for this. Since 2010, Tesco's 'free cash flow' has fallen from £3bn to £1.4bn. 'Dividends' to shareholders have fallen from £1bn to 0 over the same period.

Let's take a look at Tesco's 'bank' balance sheet implied from their total balance sheet.

TESCO BANK' implied

£'m	2018	2017	2016	2015	2014	2013	2012	2011	2010
Financial assets									
L/T loans to customers	6,885	5,795	4,723	3,906	3,215	2,465	1,901	2,127	1,844
S/T loans to customers	4,637	4,166	3,819	3,814	3,705	3,094	2,502	2,514	2,268
Loans to banks etc	-	-			-	-	-	404	144
Short term investments	1,029	2,727	3,463	593	1,016	522	1,243	1,022	1,314
Cash	4,059	3,821	3,082	2,165	2,506	2,512	2,305	1,870	2,819
Financial liabilities									
S/T borrowing	1,479	2,560	2,826	2,008	1,910	766	1,838	1,386	1,529
Customer deposits	7,812	6,687	7,479	7,020	6,858	6,015	5,465	5,074	4,357
Deposits by banks	-	-			-	-	-	36	30
L/T borrowing	7,142	9,433	10,711	10,651	9,303	10,068	9,911	9,689	11,744
Assets	16,610	16,509	15,087	10,478	10,442	8,593	7,951	7,937	8,389
Liabilities	16,433	18,680	21,016	19,679	18,071	16,849	17,214	16,185	17,660
Net operating company debt	177	- 2,171	- 5,929	- 9,201	- 7,629	- 8,256	- 9,263	- 8,248	- 9,271

Since 2010, loans to customers have soared from £4.1bn to £11.5bn. Furthermore, the way that funding has been sourced viz long v. short term funding has got substantially worse since 2010. Back then, short dated funding accounted for 37% of assets but this has rocketed to 62%. Implicit net debt attached to the retail company has fallen from £9.2bn in 2010 to a *cash* position of £177m as of Feb 2018.

Tesco have used their retail operations for usury, whilst their retail operations have suffered the consequences! Selling poorer quality goods more quickly isn't working. Of course, this is outside of the concept of Tesco being a mutual or partnership – which will be the only way for 'the company of Tesco' to survive. Never mind about issues to do with 'buying by weight' and 'selling by number' as highlighted earlier. Perhaps this situation is unique to Tesco? This isn't the case, as Morrison's, with sales of £17.2bn for the year up to February, has similar trends.

What about retailers without a bank hidden in their balance sheet, such as Apple or Amazon? Amazon can be considered a pure 'profiteer' – 'buying in goods,' without using their own balance sheet for working capital purposes, then 'turning them.' Since the end of 2015, Amazon's sales have compounded at over 25% per year but even mighty Amazon's operating margin has fallen from 3.1% achieved in 2016 to 2.3% as of end 2017. Amazon's inventory turn is also down from 8.3X to 7.4X. As more people who market and sell their products online do it from their own dedicated websites, Amazon's business model looks more and more dubious. As soon as Mr. Bezos, 'CEO of Amazon' finds his bottom line in trouble, he'll start 'letting people go' – and with that 'his company' will go too.

Even 'upstream,' 'higher-end' retailers like Apple aren't immune to fiat retail disappearing. For the nine months up to September 2018, receivables decreased by $3.7bn on the year, meaning cash to Apple from product sales of $3.7bn. Sounds good? Payables over that same increased by $10.3bn, i.e. cash out from Apple, as the company prepares to make what nobody will want to buy!

In summary:

> *Regardless of 'stock market' trends – internal operating metrics at retailers are collapsing across the board; from Apple to Morrison's. Differences between a supermarket and a futures market should be contemplated upon as the basis for this. For those holding shares in retailers, exchanging them, whilst they still sparkle from a 'bull market,' might be very wise.*

20th September, 2018.