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Argos Proves Loser in U.K. as Wal-Mart Gains With Amazon: Retail  
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By Sarah Shannon

Jan. 10 (Bloomberg) -- Terry Duddy has described the U.K. retail market as "challenging" in every results statement since he led the separation of Home Retail Group Plc from former parent GUS Plc in 2006.

With the shares losing four-fifths of their value since then, analysts like Credit Suisse's Assad Malic in London say it's time for a change of plan.

The owner of the Argos catalog retailer and Homebase chain has the "most vulnerable business model" in European retailing this year, Malic said. "Management need to present a more credible strategy this year, which looks to address some of the structural problems around Argos's positioning."

U.K. retailers from Tesco Plc to Marks & Spencer Group Plc turned to discounting to drive holiday sales amid weak consumer demand. Home Retail, which employs more than 53,000 people, may say this week that Argos's same-store sales fell for an eighth straight quarter, according to estimates compiled by Bloomberg.

Argos has been hurt by dwindling household incomes and competition from supermarkets including Tesco and Web retailers such as Amazon.com Inc. Duddy may need to consider closing some of the chain's 750 stores, according to Chris Walker, a retail analyst at Nomura.

Home Retail's market capitalization has dropped to 720 million pounds (\$1.1 billion) from about 3.7 billion pounds since the spinoff. That's led to media speculation that the company may be a takeover target. Net income in the year ending Feb. 28 will probably fall 58 percent to 74 million pounds, based on estimates from 16 analysts surveyed by Bloomberg.

#### Falling Sales

At Argos stores, shoppers choose from a catalog listing more than 22,000 products, including budget televisions, video games and furniture, and have items brought out from a storeroom or delivered. Customers can also order by phone or online, with more than 35,000 items available on the website.

"Fundamentally, it's not moved with the times," Richard Black, who oversees the U.K. equity income fund at Legal & General in London, said in a phone interview. "For us to own it, we would need at the very minimum a strategy to improve the sales performance, and protect and grow the margin. With management, we've found it very difficult to get an idea what their strategy is to reverse that decline."

Same-store sales at Argos probably fell 9 percent in the third quarter, according to the median estimate of 15 analysts surveyed by Bloomberg News. That would likely be the worst performance of the larger listed U.K. retailers outside of Kesa Electricals Plc's Comet chain.

#### Lowest Recommendations

Home Retail shares ended 2011 as the third-worst performing stock in the U.K. FTSE 350 General Retailers Index, falling 56 percent compared with the index's 12 percent decline. The Milton Keynes, England-based retailer has the lowest consensus analyst recommendation and price-to-earnings

ratio of 18 U.K. retailers with market capitalizations of more than 500 million pounds, according to data compiled by Bloomberg.

Chris Wermann, director of corporate affairs for Home Retail, declined to comment for this story.

"The performance is disappointing, obviously," said Cato Stonex, a partner at fund manager Taube Hodson Stonex Partners, which owns 5.14 percent of the stock, Bloomberg data show. "We believe the groundwork has been laid for improved performance once the cycle turns and consumers feel slightly more confident."

Sixteen out of 26 analysts monitored by Bloomberg rate the stock a "sell," compared with five analysts who have it as a "buy," and five "hold" recommendations.

#### Homebase Performance

Home Retail is due to report sales for the 18 weeks through Dec. 31 on Jan 12. Same-store sales at the Homebase home-improvement unit probably fell 1 percent, the estimates show.

After Next Plc and John Lewis Partnership Plc reported stronger holiday sales last week, statements due from other retailers this week may not be as positive, said Richard Cathcart, retail analyst at Espirito Santo in London.

Marks & Spencer, the U.K.'s largest clothing retailer, today reported a 1.8 percent decline in U.K. same-store revenue at its general merchandise unit, missing the median estimate for a 0.5 percent drop. Debenhams Plc, Britain's second-largest department-store chain, said same-store sales were unchanged.

Tesco, the U.K.'s biggest retailer, is due to issue an update on Jan. 12 and may report a 0.6 percent drop in same-store sales, excluding fuel and value-added tax, for the six weeks through the first week of January, analyst estimates show.

Home Retail's Duddy has headed the business since 1998, when it was part of GUS. Prior to that, he held various positions at Dixons Group Plc, the biggest U.K. electronics retailer, including managing director of the PC World chain. He owns about 0.3 percent of Home Retail shares.

#### Asda Campaign

In addition to his responsibilities as CEO, Duddy is also overseeing Argos after Managing Director Sara Weller left the chain last year for personal reasons.

"Most people want someone with a bit of online or multichannel experience and someone who can look at the cost base and reposition the business," said Nomura's Walker, who has had a "reduce" recommendation on Home Retail since 2010.

Argos was targeted by Wal-Mart Stores Inc.'s Asda supermarket chain in a holiday advertising campaign that compared prices on toys. In response, Argos, the biggest toy retailer in the U.K., offered 50 percent discounts on 1,000 items, which analysts said may hurt profitability.

"That is now the big risk given how promotional Christmas was," said Simon Irwin, an analyst at Liberum Capital. He estimates margins may narrow as much as 1.5 percentage points.

"Of the big ones, Home Retail is definitely going to be the most dire," Irwin said. "The real issue is the lack of plan. Home seems to be the rabbit in the headlights."

#### 'Big Cost Base'

According to Legal & General's Black, Argos's "very large" liabilities on store leases are also a concern. The operating lease charge was 366 million pounds in the last year, according to a first-half statement in October.

Nomura's Walker said Duddy should consider scaling back the number of outlets to contain costs.

“It’s a big cost base; you should be looking to reduce that store portfolio over time,” he said. “Management still think each store is contributing and profitable,” which isn’t a “cash positive” decision, he said.

Home Retail had net cash of 200.5 million pounds at the end of the first half ended Aug. 27, and isn’t indebted like retailers such as HMV Group Plc.

Adding more branded items that shoppers recognize at Argos may help improve its fortunes, according to John Guy, an analyst at Royal Bank of Scotland Group Plc. The chain sells 1,500 own-brand items such as Chad Valley toys, Alba consumer electronics, Bush televisions, and Hygena and Schreiber furniture.

“Argos needs to shift the product mix; people don’t buy electronics that are own-brand as much these days,” Guy said.

“The emphasis continues to shift in favor of branded goods with more males than females making the final purchase decisions.

Own-labels aren’t selling as well as they used to.”

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