

ANALYSIS

Sainsbury's interest in Home Retail surprised the industry. Nicola Harrison, Luke Tugby and James Wilmore look at the key issues raised

As Sainsbury's circles Home Retail...

The key questions answered

Why is Sainsbury's interested in acquiring the Argos and Homebase owner?

Sainsbury's has outlined several reasons for its interest in Home Retail. Pretty much of all of them centred on Argos – rather than Homebase – and predominantly its multi-channel capabilities.

"The grocery giant argued that combining with Home Retail would "bring together multichannel capabilities and delivery networks for fast, flexible and reliable delivery to store or to home across a wide range of food and non-food products".

The enlarged group would "optimise the use of combined retail space. The combined entity would have attractively located stores across the UK, with an enhanced supply and delivery network and a strong presence across food and grocery, clothing, homewares, toys, stationery, electricals, furniture and other general merchandise".

Argos has developed an impressive clicks-and-bricks strategy as it seeks to leverage its 800-store estate.

Last year it rolled out a hub-and-spoke distribution model that involves the larger store in a particular area fulfilling smaller branches around it, thereby improving stock availability, largely for click-and-collect orders.

As a result of the hub-and-spoke strategy it was able last year to launch a same-day delivery service costing shoppers just £3.95. Customers can order as late as 6pm and get their order by 10pm the same evening.

However, not everyone is convinced that Argos' multichannel capabilities are good enough to warrant a takeover by Sainsbury's. "On omnichannel we are surprised that Sainsbury's would consider that it does not have

the expertise in this area already," said Haitong analyst Tony Shiret.

"Also the complexity of omnichannel would be far greater in non-food than food so it would be acquiring a big step-up in complexity for relatively marginal benefits within its own offer."

Another reason Sainsbury's gave for the approach was to reap "revenue synergy potential", meaning the retailers could sell their products in each other's stores.

The tie-up could potentially enable Sainsbury's to sell its Tu fashion range through Argos. Likewise it could conceivably even mean food being available in Argos shops.

The grocer has already been piloting Argos concessions in some stores since last year. But Shiret was incredulous that Sainsbury's cited this as a motive for a deal.

"It is a little surprising that Sainsbury would be confident enough to want to acquire Home Retail on the basis of such a limited period of shared experience in so few stores, without even the benefit of knowing how they traded in the peak season," he said.

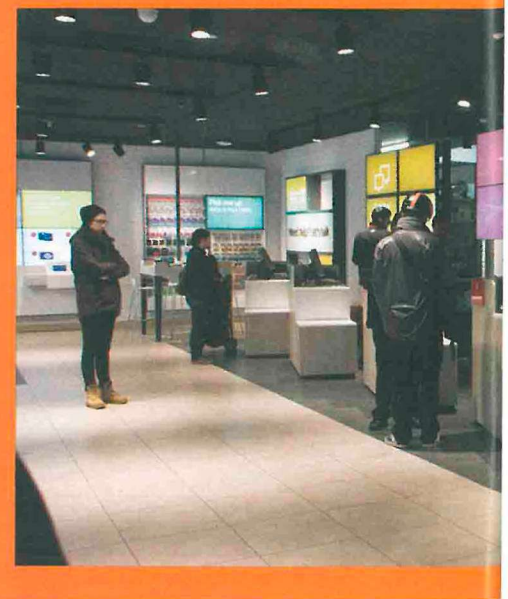
Shiret thought the proposed deal was an odd move by Sainsbury's. "It makes no strategic business sense," he said.

Why was Sainsbury's initial approach rejected?

Home Retail said that Sainsbury's approach undervalued the business and its long-term prospects.

Reports have suggested that Sainsbury's cash and shares offer valued Home Retail at about £1bn, but Investec analyst Alistair Davies believed the business could be worth closer to £1.45bn.

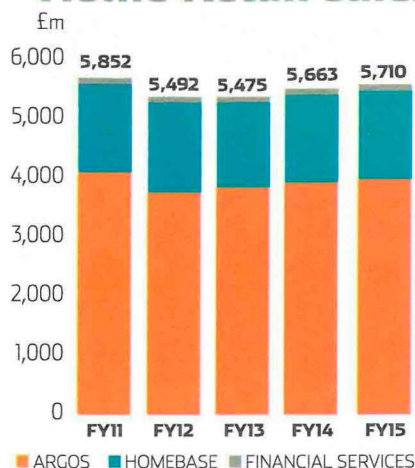
If such a disparity in valuation was the reason behind Sainsbury's November failure it will need



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Home Retail sales



to significantly improve its offer if it wants to seal a deal.

Sources close to the situation told *Retail Week* that Sainsbury's had been eyeing Home Retail "for a long time", an interest that could even date back prior to the grocer inking a concession partnership with Argos a year ago.

One knockback is therefore unlikely to spell the end of Sainsbury's interest in the business.

However, sources insisted that while an acquisition of Home Retail would help to "accelerate" Sainsbury's boss Mike Coupe's strategy, there is a sense inside the grocer that it "does not need" to purchase the general merchandise group in order to achieve his aims.

The grocer already outperforming its big four rivals in the sales stakes, so Home Retail is apparently being categorised as a 'would like' rather than a 'must have' addition.

What would a deal mean for Sainsbury's rivals?

Three of the main problems Sainsbury's hopes to address by striking a deal are also being faced by its closest grocery rivals.

Like Sainsbury's, market leader Tesco and Walmart-owned Asda are both in the process of tackling issues such as excess store space, trying to give shoppers more reasons to visit their stores and improving the depth and credibility of their general merchandise offers.

TCC global insights director Bryan Roberts believes the duo will be following developments with interest because an acquisition of Home Retail would allow Sainsbury's to "put that process on steroids".

"What people often forget is Argos and Home Retail more broadly has a very credible set of brands lurking within it like Habitat, the electronics brands, Chad Valley, which Sainsbury's could use in their general merchandise offer," Roberts explained.

"There is lots of scope and it's not all about stores or concessions. A lot of it will be about brands and procurement."

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Roberts thought Sainsbury's would learn lessons from Tesco, which operates its Dobbies garden centres, Harris + Hoole coffee shop chain and Giraffe restaurants as separate businesses, rather than being "transformational" and combining different elements of the businesses.

He said Sainsbury's would likely seek to be "more subtle" by exploiting Home Retail's brand and sourcing capabilities.

But he envisaged cost-cutting, either by closing underperforming Argos stores or converting them into Sainsbury's Locals – something that would further ramp up the pressure on grocery rivals.

Roberts said a deal would not lead to a "knee-jerk buying spree of random non-food retail businesses" by Tesco and Asda, but it could spark more concession partnerships.

"It would be interesting to see what Sainsbury's does with it, but there could be opportunities to replicate aspects with other retailers and that wouldn't necessarily require a change of ownership.

"There are lots of impressive general merchandise retailers out there like Pets at Home, Halfords, Maplin, Paperchase – the list is almost endless as to who would be credible partners to tick the two main boxes of using excess space and giving shoppers more reason to visit."

Does Sainsbury's want the Homebase DIY business?

Probably not. The DIY retailer did not get a mention in Sainsbury's statement listing the advantages of any deal with Home Retail.

That may be because there are none, which is how it felt back in 2000 when it sold Homebase for £969m. For those who have forgotten, Sainsbury's used to own Homebase in the 1990s, and it seems unlikely the grocer would want to revisit the past having decided to move on.

If Sainsbury's acquired the whole of Home Retail, the best bet must be that it would sell Homebase.