

# 3. Ocado Within the Marketplace

## Market

### The UK Grocery Market

- Grocery is the largest of all retail segments, representing over 50% of retail sales globally.
- The size of the UK grocery market is substantial, estimated to be worth £179 billion in 2016 and forecast to increase to £211 billion by 2021 (IGD).
- The grocery industry is characterised by high volumes but low margins.

### Price and Cost Dynamics

- The continued growth of hard-discount stores and enhanced competition from new entrants to food distribution has put pressure on supermarkets, stimulating price deflation and competition across the industry, resulting in margin pressure.
- The industry is experiencing input cost inflation driven from both the introduction of the national living wage and the fall in the value of sterling following the EU referendum, making product imports more expensive.
- The combination of price deflation and cost inflation has led to compounded pressure at this time of intense competition.
- Over the year there has also been a dramatic decline and by the end of the period a partial recovery of oil prices, which has impacted the UK economy as a whole.

### The Changing Shape of UK Grocery

- Recent industry dynamics have seen retail growth shifting away from the “space race” model, whereby market share is captured by opening additional real estate, towards alternative store formats including hard discounters and convenience stores, which differentiate on price and consumer convenience to capture market growth.
- One of the most material structural changes in the UK has been the shift away from physical stores to online, particularly mobile, driven both by shoppers’ increasing appetite for convenience and digital connectivity, and service enhancements in online operations.
- It is estimated by IGD that by 2021 this channel will be worth £17.6 billion, a 68% increase from 2016.
- Aside from incumbents’ online offerings we are also seeing new entrants in the UK market. This includes the launch of Amazon Fresh, as well as the convenience market being further supplemented by alternative online options, such as meal kit providers and delivery services for prepared food.

### The Global Grocery Market

- Global grocery retail has historically been slower to adopt the online channel than in the UK but is building momentum.
- Kantar Worldpanel forecasts that global grocery e-commerce will grow to 9% of the market and be worth \$150 billion by 2025.
- As illustrated by the UK market, as competition increases and technology develops to enhance the online experience, global demand for online grocery is expected to accelerate.

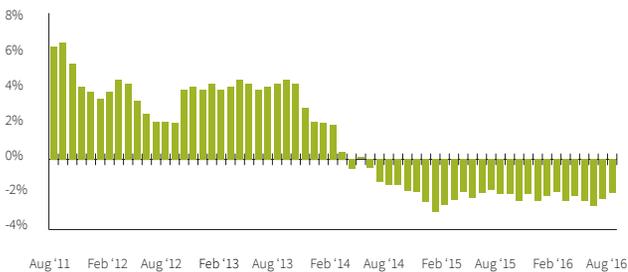
## Trends

### Grocery Market Size

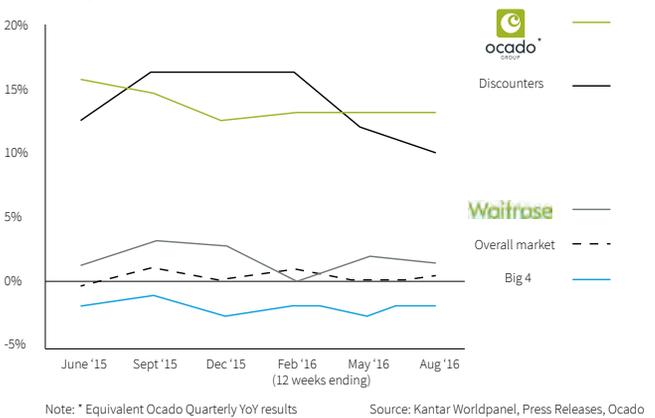


### Price Deflation

CPI - 01 Food & non-alcoholic beverage YoY %



### % YoY 12 week growth



### Grocery Retail Sales (US\$ bn)

Region	2016	2021
Asia	3,011	4,084
Europe	2,178	2,591
Africa and Middle East	902	1,457
North America	1,196	1,424
Latin America	912	1,220
Oceania	110	141

Source: IGD

Impact on Retailers	What This Means for Ocado
<ul style="list-style-type: none"> <li>The immense size of the grocery market results in significant opportunities for retailers.</li> <li>Despite the market size, British supermarkets have faced another tough year, with challenging market conditions.</li> <li>Given the low margins in the industry, exacerbated by price deflation, it is important for retailers to be cost efficient.</li> </ul>	<ul style="list-style-type: none"> <li>We seek to gain share in this largest retail segment.</li> <li>Our core focus is to take actions to drive growth and increase scale, while striving to improve efficiencies to lower operating costs.</li> </ul>
<ul style="list-style-type: none"> <li>Many retailers, including Ocado, adopt a price matching approach which has the effect of broad industry prices falling in a deflationary environment.</li> <li>Traditionally, rising product costs are reflected by higher consumer prices but because of the intense price competition prevalent within the industry, retailers have been more reluctant to respond quickly, exacerbating the price deflation-cost inflation gap.</li> <li>While supermarkets have been one of the main beneficiaries of the declining oil price through the reduction of food input prices, transportation and energy costs, this may to some extent reverse in the future.</li> </ul>	<ul style="list-style-type: none"> <li>A number of factors have however helped us in navigating these challenging conditions: <ul style="list-style-type: none"> <li>We have continued to grow, enabling operating leverage and natural margin expansion with better purchasing power.</li> <li>The vast majority of our employees were already at or above the new National Living Wage levels when introduced, limiting the short-term impact.</li> <li>The operational efficiency of our model means energy costs are a comparatively small part of our costs.</li> </ul> </li> </ul>
<ul style="list-style-type: none"> <li>The shift to online creates a challenge to incumbent players in the low margin grocery industry.</li> <li>Online involves retailers providing more services for customers at greater cost but the same price.</li> <li>As the online channel expands, driven by more competitive propositions, technology and services, this encourages UK consumers to shift more of their grocery spend online, accelerating the pace of the channel shift further.</li> </ul>	<ul style="list-style-type: none"> <li>We are well placed to benefit from the fastest growing channel in UK grocery and, unlike traditional bricks and mortar players, we are not restricted by capital intensive stores.</li> <li>We continue to build momentum in the online grocery market and as the segment expands we have the opportunity to capture market share through our superior customer offering.</li> <li>The pace of the channel shift and the opportunities to capture this advancing market share are key drivers for our growth.</li> <li>Our growth enables further investment into improving our proposition through our industry leading technology and software developments.</li> </ul>
<ul style="list-style-type: none"> <li>The size of the global grocery market presents a huge opportunity, but also a challenge, for retailers globally, as consumers choose to shop more online.</li> <li>The pace of the channel shift will depend on a retailer's appetite to embrace and invest in online capabilities to gain first mover advantage within their territory.</li> <li>Today, outside of a few markets, online grocery is still too small a segment to be disruptive. However, as more retailers invest in this space they may act as catalysts, pushing others to seriously consider their online offerings.</li> <li>Retailers adopt different strategies reflecting either a defensive approach, where they develop in line with the market in order to retain market share, or an offensive strategy, where they proactively seize the opportunity to grow ahead of the market by enhancing their proposition.</li> </ul>	<ul style="list-style-type: none"> <li>We believe that we will be able to leverage our IP through Ocado Smart Platform which will position us well for this channel shift on a global level.</li> <li>The enhanced propositions within the online arena increase customer awareness and adoption, which in turn grows the market and accelerates the channel shift – we believe we are well positioned to capitalise on these growing global trends.</li> </ul>