

RETAIL MARKET

The increase in retail sales has continued – the retail market benefits from the favourable consumer situation and the increase in retail spending in Czech households.

The “quantitative” stage of retail network development is over; we can see the emphasis on the improvement of quality and the modernisation of business premises.

There is an intensive convergence of traditional “brick and mortar shops” and the online world.

In 2017 there was an exceptionally high number of transactions in the retail market, and most investments, particularly from strategic investors, were directed towards the retail segment. The yield rate is gradually decreasing.

THE CZECH RETAIL MARKET IS GROWING.

The ongoing growth of the Czech economy and favourable situation for consumers have a positive impact on the volume of retail spending in Czech households. The turnover trend that started in late 2013 and early 2014 therefore also continued in 2017. Consumer confidence has reached values we were used to before the deterioration after 2010 came.

The positive development of the retail sector is also confirmed by the index of the development of the number of Czech shopping centres visitors. According to the data of the International Council of Shopping Centers (ICSC), the number of visitors annually decreased in 2012 and 2013. Since 2014, the increase in the numbers of visitors has been recorded. In 2017, shopping centres had about 2.6% more visitors than in the previous year according to estimates. The turnover in the shopping centres increased by up to 7% in the last year according to estimates, which exceeds the rate of growth of the whole Czech retail market.

It is very positive that the increase in the turnover in 2017 according to the results of the measurement of the representative Household

Panel of GfK was not primarily driven by an inflation or the increase in trade volume, but by “up-trading”, i.e. the fact that customers started to prefer goods of higher quality and therefore of higher price.

The increasing demands and customer sophistication is characteristic for the current period, and this trend will accelerate in the future. Customers will get increasingly demanding with regard to shopping, quality, services and customer service, the speed of the purchase or delivery of goods, and also with regard to information – not only information related to goods.

They take many things for granted – what was previously an added value is now a standard. They want to make favourable purchases but not compromise with regard to quality, so it will get even more difficult to satisfy them. The generation of millennials is particularly characterised by considerable impatience. They usually want to satisfy their shopping needs immediately, “here and now”.

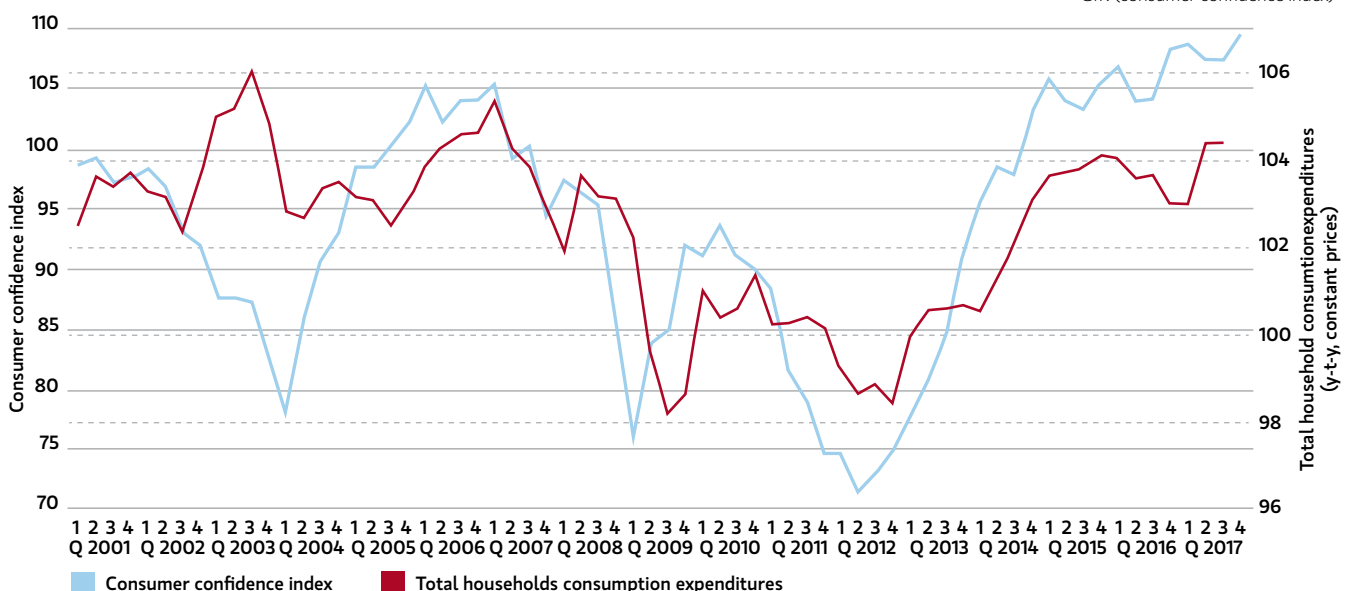
The importance of a shopping experience, the time devoted to shopping and a simple and trouble-free process grows. This will be

“I expect a stronger emphasis on collecting data about clients.”

Tomáš Oesterreicher, Arcona Capital

GRAPH the development of retail spending and a consumer confidence index

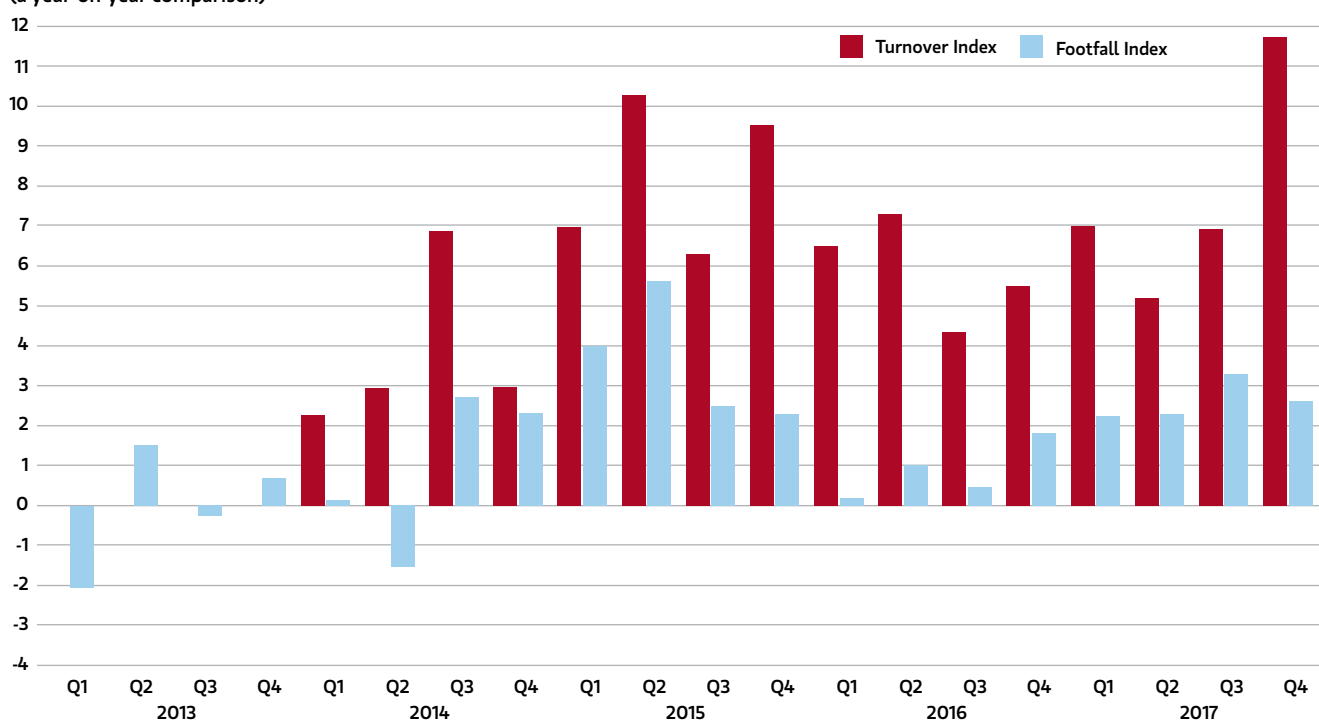
Source: Czech Statistical Office (retail revenue), GfK (consumer confidence index)





GRAPH The development of shopping centre visitors and the development of the turnover in the Czech Republic (a year-on-year comparison)

Source: ICSC



noticeable in the use of technology in the commercial area (and in other places as well), and in customers being less willing to travel for shopping. This is significantly influenced by the point of sale – the preferred store formats and further development of shopping environment and technology.

At the same time, the differentiation (both for shops and customers) between “a fast pragmatic purchase” and “an experiential purchase” will deepen. Digitisation and offer personalisation, and its adjustment for a specific customer, will become important topics.

THE DEVELOPMENT OF MARKET AND STORE FORMATS

Trade concentration in the Czech Republic is still lower than we are used to in Western or Northern Europe. Ten biggest chains with fast-moving goods currently control 75% of the market. Kaufland Česká republika and Lidl Česká republika experienced the fastest growth in their turnovers in the last measured period. By the way, both of these chains are very different with regard to the extent of sold items (more than 10 times more in Kaufland), but both of them originally based their market success on low prices, and both of them have been focusing increasingly on improving the quality of the offered products and the shopping experience in recent years.

Only networks that primarily operate stores with fast-moving goods are among ten biggest commercial chains in the Czech Republic. The key point of sale of non-food goods are specialized stores (IKEA, Hornbach and OBI have the biggest turnovers) and shopping centres. A separate part of this chapter is devoted to shopping centres.

The Czech Republic has already experienced major growth. Thanks to investments in modernisation and steps that arose from the requirements of the demand, the retail network has been undergoing a gradual transformation. The current definitions of formats cease to be true – particularly supermarkets and discount stores will get closer to one another.

Even in the next period, the growth of business formats will be primarily driven by productivity rather than expansion. The spaces of hypermarkets will get smaller and smaller (especially those that are not able to ensure sufficient space efficiency), and convenience concepts will be used more in the market.

“Business network concentration will still continue, but purchasing power and easy accessibility will always be a major condition.”

Pavel Berger, Komerční banka

TABLE The largest commercial chains in the Czech Republic (with a turnover of over 20 billion CZK – revenues according to the closing of accounts for 2016 and 2017)

Source: GfK, Commercial Register



Company	Number of own stores	Turnover in CZK bn (excl. VAT)
Kaufland Česká republika	128	58.4
Ahold Czech Republic	329	48.3
Tesco Stores ČR	195	44.4
Lidl Česká republika	236	38.4
Geco (prodejny Geco tabák-tisk)	264	33.0
Penny Market	374	32.0
Makro Cash & Carry ČR	15	29.9
Globus ČR	15	22.8
Billa	259	22.8

Quality specialist stores/sellers have a bright future ahead of them. On-line retail will grow across the segments. Primarily non-food categories will benefit from the economic growth (if it continues until the end of this decade). Also hybrid formats, including stores + gastronomy or services and so on, will expand.

The combination of stores and services will be one of the key trends. It can be seen in the variety of services provided by traders in the business area and elsewhere and in the development of technologies. The "social function" of stores will also become more important – stores will become important places for meeting people: from shopping centres, small stores in villages or gas stations.

On-line retail grew by a two-digit number in 2017, too. The integration of on-line/off-line will get more sophisticated, and it will become necessary for traders. The growth of e-commerce across sectors will be driven by the improvement of shopping convenience and time savings. We expect the growth of on-line sales even outside large cities.

Customers will require even greater integration of sales channels and a smooth transition between them. New media will significantly help familiarize people with this omni-channel. An even faster growth of on-line retail is limited by the functional and efficient security of the logistics stage.

SHOPPING CENTRES

The most popular place for buying non-food products in the Czech Republic are still shopping centres, which deepened their dominance even more in 2017. There are more than four hundred shopping centres of various types and sizes: shopping galleries, retail parks, hypermarkets with small shopping malls with over 5,000 m², specialized centres, etc. In total, their rentable area exceeds 4.5 million m².

Ninety shopping centres can be placed in the category of large or medium-size shopping centres according to the categorisation of ICSC, and their total commercial area is 2.4 million m² of GLA. Almost a quarter of these centres (and a third of the commercial area) is in Prague. The threshold of a hundred trade units was exceeded by more than twenty Czech shopping centres.

The number of shopping centres calculated for 1,000 citizens is slightly below the EU average. With the recalculation of the real purchasing power, the Czech Republic suddenly belongs to the group of countries with an above-average capacity of business spaces.

A generous investment by Unibail-Rodamco in the enlargement and modernisation of Centrum Chodov in Prague contributed the most to the growth of commercial areas in 2017. 39 thousand m² of new rentable area was added here in November 2017, which caused made whole capacity of the centre exceed 100 thousand m², and the total number of trade units is now over three hundred – this is an incredible 50% more than in the second largest centre in the Czech Republic. A new shopping centre called Central (13.6 thousand m²) was opened in Jablonec, and IGY shopping centre in České Budějovice was also extended at the end of the year.

"I believe in the return of smaller street shops and gastronomy into the streets in attractive (often traditional) urban locations."

Leoš Anderle, Sekyra Group

Members of the ARTN expert panel expect only small additions to commercial areas now. They see more opportunities for expansion in retail parks than in shopping centres, mainly in district towns. Most investments are now primarily directed towards redevelopment – the modernization or extension of existing buildings – more than in new construction.

2018 should also see the long-postponed opening of outlet centre Prague The Style Outlets. After various changes, the project was now overtaken by the second most important operator of outlet centres in Europe, Neinver, which is developed in cooperation with The Prague Outlet company. A centre called Outlet Arena Morava (TK Development) and Gěčko (Reflecta Development) should be opened in Ostrava.

Other interesting projects are being prepared for the coming years, especially after 2019. For example, some of them include the expansion of Avion Shopping Park and Královo Pole shopping centres in Brno, OC Letná will be opened in Prague, and a multi-purpose project Savarin in the centre of the city; other business projects will be completed in the centres of Plzeň and Zlín. Dynamic development, which involves other larger additions to commercial areas, can be expected in Průhonice-Čestlice zone. In the long run, Prague can look forward to other large development projects concerning areas around railway stations such as Smíchov, Bubny or Žižkov.

INVESTORS AND TENANTS

The period between 2015 and 2017 was characterised by the extremely high interest of investors in retail. 2017 even broke the record of 2015 in the volume of investments – more than 1.5 billion EUR were directed towards retail real estate¹.

TABLE Largest shopping centres in the Czech Republic (according to the number of tenants)

Source: GfK, public sources, the current data as of 1 January 2018

Shopping Center	City	No. of units	Total GLA in sq m	Owner
Centrum Chodov	Prague	302	102,000	Unibail-Rodamco
Galerie Šantovka	Olomouc	200	46,000	SMC Development
Forum Nová Karolina	Ostrava	193	58,000	Meyer Bergman
Olympia Brno	Brno-Modřice	186	102,000	Deutsche Euroshop
Palladium	Prague	180	40,000	Union Institutional Investment
Galerie Harfa	Prague	179	45,000	WOOD & Company
NC Letňany	Prague	176	120,000	Union Institutional Investment
Nový Smíchov	Prague	170	58,000	Klepierre
Centrum Černý Most	Prague	169	77,000	Unibail-Rodamco
Avion Shopping Park Ostrava	Ostrava	165	85,100	Inter IKEA Centre

TABLE Selected transactions in retail in 2017

Source: BW

Property	City	Vendor	Purchaser	Price est. (EUR million)
Olympia Brno	Modřice	ECE/ Rockspring	Deutsche EuroShop	384
OC Letňany	Prague	Tesco	CBRE GI	225
Fahrenheit Porrtfolio (mixed)	více lokalit / various	CBRE GI	CPI	x
Metropole Zličín 50% share	Prague	Commerz Real	Unibail-Rodamco	x
Avion Shopping Park	Prague	Ikea	Pradera	x
Futurum Ostrava	Ostrava	Bainbridge	Star Capital	x
OC Královo Pole	Brno	Aerium/Bainbridge	CPI	60
Central Most	Most	Mint Investments	EPG	x
OC Haná Olomouc	Olomouc	Pradera	Star Capital	x
OD Tesco Brno	Brno	Tesco Stores	Crestyl	x
OD Tesco Plzeň	Plzeň	Tesco Stores	Amádeus Real	x
CTP (CT Retail) portfolio	various	CTP	DMO Invest	40
Arkáda Prostějov	Prostějov	CPI Group	x	x
Van Graaf	Prague	MTK Developments	BMO Real Estate Partners	x
City Palais	Prague	private investors	Redevco	>40
OC Karviná	Karviná	CBRE GI	Bluehouse Capital	x

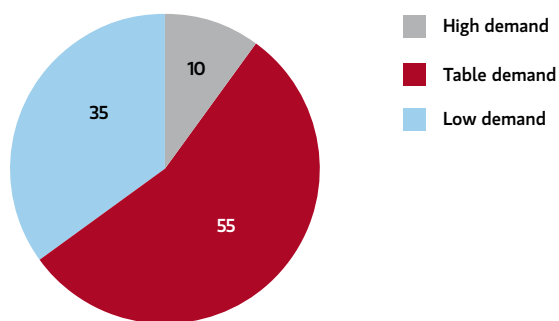
The purchase of Olympia shopping centre in Brno by Deutsche EuroShop, the acquisition of a wider portfolio of commercial complexes by CPI group, and the purchase of OC Letňany in Prague by CBRE Global Investors, must be mentioned as some of the biggest investments from the previous period. The most significant investment in retail was the acquisition of the half share in the shopping centre in Prague called Metropole Zličín by Unibail-Rodamco at the turn of the year. This company strengthened its dominant position in the Prague market of the largest shopping centres thanks to the joint venture with present owner Commerz Real. Another important

acquisition of 2017 is also located in Zličín – Avion Shopping Park, which was acquired by investment fund Pradera from Ikea Centres (except the building of IKEA itself).

The ARTN expert panel expects a stable interest in investments in the retail segment. Nevertheless, the number of potential acquisition targets is decreasing. Contrary to the past when various financial groups invested a lot in shopping centres and they did not plan to own this type of real estate for the long term, the current situation is better. The number of speculative investments has decreased con-

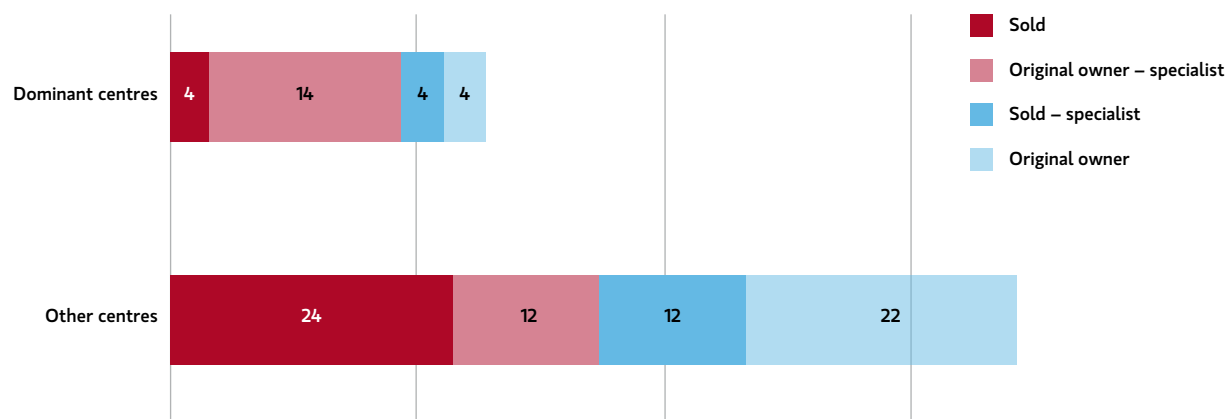
GRAPH Will retail premises be more attractive for investors in 2018–2019?

Source: ARTN survey



GRAPH The ownership structure of shopping centres in the Czech Republic after new transactions were made

Source: Cushman & Wakefield

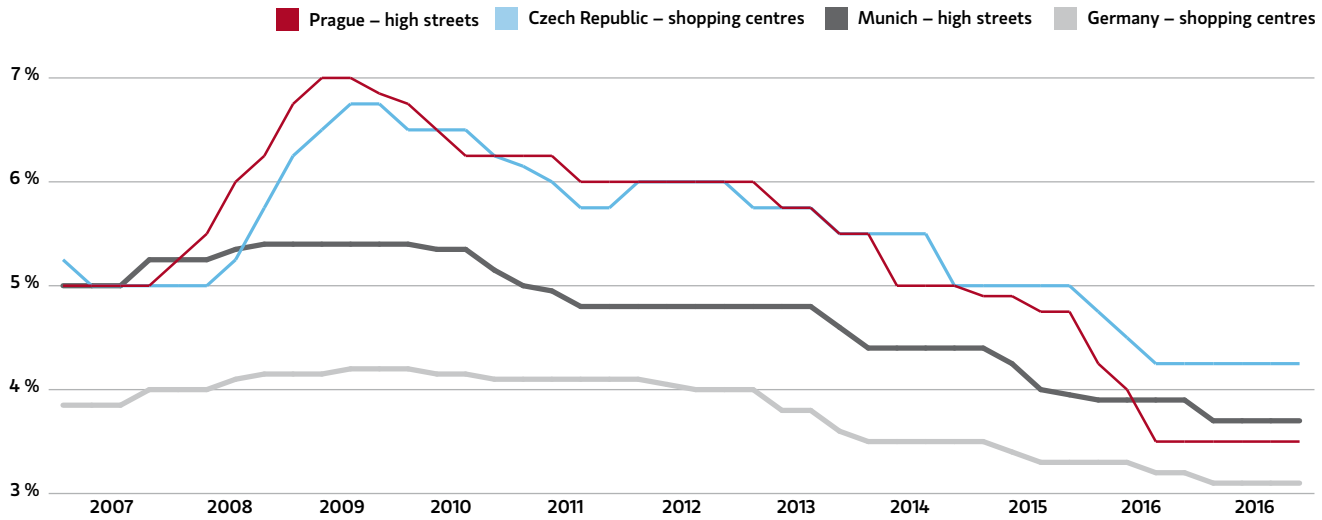


¹ You can find more information on page ...



GRAPH The development of yields of shopping centres and high streets in the Czech Republic

Source: Cushman & Wakefield (Excel will be provided)



siderably; crucial investments are from strategic investors who are prepared to cultivate and develop their portfolio for a longer period of time. These important players focused on large and high-quality shopping centres in the previous period.

The yield rate of retail area has been gradually decreasing since 2009. Even though it has not reached the low values as in the neighbouring Germany, it is getting closer to them. The average yield of shopping centres has fallen below 4.5%, and even to 3.5% for the most lucrative areas on high streets. But the next period will most likely bring further compression in both options.

Buyers naturally expect that their investment will pay off in the form of sufficiently high rents. Most experts approached by ARTN expect that the rents will probably stay approximately the same or there will only be a slight increase. To talk about the average rent is too simplified – the differences between rents in successful and less successful centres are becoming greater and greater.

While some successful centres in exposed locations increased rents for smaller areas even to hundreds of EUR/m²/month, the value in centres, which have been losing visitors and tenants, has fallen to the level of around EUR 10/m²/month; the lower limit for retail parks in regions is around EUR 5–6/m²/month.

With the increasing influence of on-line platforms, it is becoming problematic for some tenants to differentiate the turnover gained in a particular store. The turnover rent is now reached in the segments of meals or convenience, the essential thing is therefore the base rent for most tenants.

The phenomenon of increasing diversification of the level of rents according to the power of tenant is becoming more and more distinctive. In short, the stronger the brand, the more difficult the negotiations of the developer or owner are, and the more favourable offers for tenants. There are certain brands in the market that are necessary for an attractive and well-arranged mix of tenants. On the contrary, strong shopping centres can choose between dozens of candidates, and they fully use this opportunity. A new tenancy relationship means a higher income from the rent or a more reputable brand, and both in a perfect case.

By the way, a prosperous economy has attracted some new tenants to the Czech Republic, so brands such as Vapiano, Zara Home, Oysho, Tezyo, Denon, Palmers, Boux, Kazar, Thomas Sabo and many others appeared in Prague for the first time.

FURTHER DEVELOPMENT PERSPECTIVES

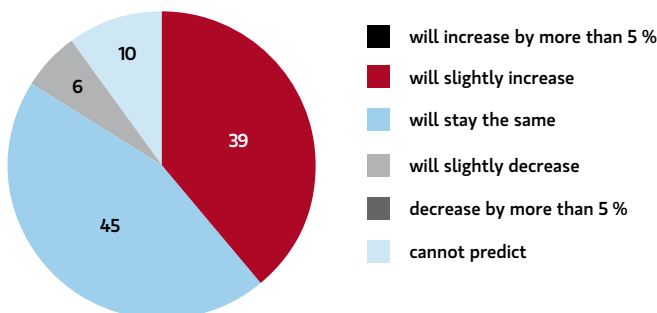
The development of retail and business in general will be naturally influenced by the development of the Czech economy. The important thing is whether the current positive development of spending in Czech households will also maintain the trend of higher investment in the quality of retail network and shopping experience.

The total consolidation of the whole segment with an emphasis on operation efficiency will continue. The limit for retail development will primarily be the shortage of quality staff on all levels. Therefore, it will not be easy to meet the expectations of increasingly demanding customers. Where transport makes it possible, the return of shopping centres to inner cities will continue, which may lead to lo-



GRAPH How will rents in retail develop in the future?

Source: ARTN survey



wer numbers of visitors to some shopping centres on the peripheries without further specialization or quality improvement.

"One of the major trends will be significant increase of the Food & Beverage and entertainment share."

Petr Brabec, CPI

There will be an intensive convergence of traditional "brick and mortar shops" and the online world. The phenomenon of digitisation will no longer be an interesting opportunity for traders and centres. The differences between successful and unsuccessful traders and shopping centres will deepen, both in the number of visitors and turnovers and in rents.

Quality management and continuous modernisation of shopping centres and making them more attractive will be the preconditions

for success. Customers and retailers will primarily look for centres that are being improved and provide more than in the past. Free-time offer and services will be concentrated in shopping centres, which will be the stimuli for local community meetings. The main type of goods in shopping centres will still be fashion, the greater share in the offer will be covered by services, gastronomy and entertainment, and there will also be more pick-up shops of on-line traders. Shopping centres will also build their clear profile and position as a brand with greater attention. Owners and property managers will also look for new sources of income, be it parking, additional income from pop-up shops or rents for stalls, the sale and distribution of electricity, or various marketing events.

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