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THE PCS ALERT
The latest in DB Pensions

PENSION CAPITAL STRATEGIES
Innovative Alternatives

THE GLOBAL FINANCIAL CRISIS - THE FALL OUT FOR PENSIONS. WE FOCUS ON THE RETAIL SECTOR.

Dear Sid

The last few months have seen unprecedented turbulence in financial markets. The global economy is in recession and there is doom and gloom on the high street. But what does it mean for pensions?

The retail sector is often a bellwether for the UK economy. In the good times we are all happy to spend more and more, and fuel a retail boom. In the bad times, spending is immediately cut back and shoppers demand savage price cuts before they will part with precious cash. Retail companies typically run on relatively tight margins. Reductions in spending can therefore have a significant impact on bottom-line results.

So how is the retail sector faring? Not well, is the answer. Christmas trading figures and analyst comment all suggest one of the toughest times on record for the high street. We have already seen a number of companies call in the administrators, including household names such as Woolworths. Even Marks & Spencer has had to announce job cuts and store closures as a result of falling sales, pointing towards some very hard times ahead.

But where do pensions fit in? Well, increasingly, the luxury of a generous defined benefit pension scheme is something retailers can ill afford. Marks & Spencer has only just announced significant cut backs in its pension provision. Moreover, the legacy of a large defined benefit pension scheme is more and more seen as a millstone around the necks of company boards and a drain on precious cash flow. When margins are tight, those companies that have not managed to deal with the burden of their DB pensions are finding themselves at a competitive disadvantage.

PCS Market Analysis
We have analysed the numbers from twenty major high street companies to see how they are affected by their pension schemes. There are no easy comparators that can be simplistically applied across all companies to assess the relative impact of their pension schemes. We have therefore chosen two yardsticks for our analysis:

a) What is a 30% increase in accrued pension liabilities expressed as a percentage of gross cash flow from operations?
Changing legislation and increasing longevity have served to add significantly to accrued pension liabilities, hence increasing demands for cash funding from trustees. But can companies afford more demands for cash at the present time? There are two other important considerations here. Firstly, corporate bond spreads are at levels not seen since the Great Depression of the 1930s. This means that due to the perverse accounting rules, pension liabilities are at artificially low levels. A return to more normal levels would see pension liabilities in company accounts increase by 30% or even more. Secondly, if a company does get into difficulties, it is not the accounting liabilities that the trustees will be looking at, but the full wind-up liabilities, which since 2003 are a statutory debt on the company. These are typically 30%-40% greater than the accounting liabilities.

b) What would be the impact on profit before tax of ceasing to provide DB pensions for all employees?
Of course, a replacement benefit would have to be provided, but it would typically be considerably cheaper.

The results of our analysis are shown below:

Most affected		
	(a)	**(b)**
Jessops	(525%)*	(1%)**
Beales	330%	(44%)**
WH Smith	179%	0%
Thorntons	116%	9%
Sainsbury	111%	16%
Marks & Spencer	110%	8%
Mothercare	92%	84%
Morrisons	80%	7%
Kingfisher	77%	7%
DSG	75%	(5%)**

Least affected		
	(a)	**(b)**
Alexon	69%	5%
Debenhams	53%	0%
Kesa Electricals	51%	7%
Tesco	36%	16%
Brown (N.)	34%	3%
Greggs	32%	5%
Home Retail	30%	6%
Signet Jewelers	26%	2%
HMV	22%	7%
Next	20%	2%

* indicates a gross cash outflow
** indicates a reduction in losses before tax

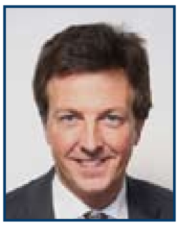
All figures are in £m	Market Capitalisa-tion at 31 Dec 2008	Revenue	Gross cash from operations	Pre-tax Profit	Total Employment Costs	DB Pension Assets	DB Pension Liabilities	DB Surplus / (Deficit)	DB Service Cost	DB Cash Funding
Tesco	28,305	47,298	4,099	2,803	5,293	4,089	4,927	(838)	461	340
Morrisons	7,370	12,969	756	612	1,505	1,939	2,007	(68)	44	193
Sainsbury	5,744	17,837	998	479	1,957	4,171	3,676	495	76	82
Marks & Spencer	3,386	9,022	1,236	1,129	1,151	5,046	4,544	502	94	99
Kingfisher	3,187	9,364	546	395	1,270	1,472	1,395	77	29	103
Next	2,131	3,329	637	498	663	383	428	(46)	10	9
Home Retail	1,856	5,985	564	426	768	647	563	84	27	14
WH Smith	562	1,352	111	76	194	793	662	131	0	10
Brown (N.)	557	611	51	78	80	51	57	(6)	2	17
Signet Jewelers	495	1,833	147	167	351	126	129	(3)	3	4
Kesa Electricals	467	5,357	186	165	707	241	317	(77)	12	16
HMV	436	1,875	143	57	233	86	103	(16)	4	3
Greggs	349	586	75	51	234	78	78	(1)	3	2
DSG	301	8,546	295	(193)	801	690	741	(51)	9	13
Mothercare	291	677	55	5	86	181	167	14	4	4
Debenhams	214	1,839	286	106	308	526	501	25	0	8
Thorntons	68	208	14	8	61	38	54	(16)	1	3
Beales	8	59	3	(1)	15	33	35	(2)	1	2
Alexon	6	262	19	12	58	43	44	(1)	1	3
Jessops	1	325	(2)	(70)	41	22	30	(8)	1	2

Conclusion

In the current economic environment it is vitally important that companies address the problems presented by their DB pension schemes. Increasingly these are damaging competitiveness and even threatening the very survival of the company. We believe that over the next five years the large majority of private sector companies will close their DB pension schemes to all future benefit accrual. Indeed a recent survey of pensions in smaller firms from the Association of Consulting Actuaries found that in those firms with DB schemes, nearly half of all such schemes are closed to future accrual. Those that move first (and some already have, e.g. Debenhams and WH Smith) will gain competitive advantage. We also believe that companies need a clear big picture end-game strategy for managing a reduction in their accrued pension liabilities, which ultimately leads to their complete removal.

PCS offers a comprehensive analysis and advice service (including detailed sector analysis) which helps companies set their long-term strategy and gives them a route map for managing ongoing benefits, dealing with (and managing down) historic pension liabilities, through to planning for the arrival of Personal Accounts in 2012 (which present another likely hike in pension costs). Times are tough and companies can no longer afford to shirk the difficult decisions which their pension schemes present.

Yours sincerely,



For further information on the services PCS can offer you, please email us at solutions@pensionstrategies.co.uk or visit our website at www.pensionstrategies.co.uk to register your interest. Alternatively call Charles Cowling on 0161 242 5388 or Rob Dales on 0113 203 5883.

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