# Power bills will be passed on through retail prices

Be afraid, consumers. Be very afraid. Yesterday's announcement that Eskom can raise electricity tariffs by an average of 25% in each of three successive years from April will saddle retailers with cost rises they have no choice but to pass on.

By Michael Bleby 25 Feb 2010

The effective doubling of electricity prices over three years — as the increases compound — will cut profit margins.

“Shoprite said electricity costs were equal to 1% of sales,” says Nedbank Securities analyst Syd Vianello.

“If that goes to 2% of sales from 1%, you've just taken one (percentage point) out of your 5% operating margin. If you're Pick n Pay and working on a 3% margin, it's taken even more out of the profit.”

## Raising prices and absorption

Retailers will have little option but to pass the increases on, Vianello says. “It means prices are going up.”

In the aftermath of yesterday's announcement by the National Energy Regulator of SA, retailers played down the effect of the hikes on consumers.

“Pick n Pay will do everything possible to absorb this forecast increased cost, which is likely to be in the vicinity of R100m for the first year at this rate. We really are scrupulously looking at every possible way to absorb this cost,” Pick n Pay CE Nick Badminton said.

Higher power prices would raise costs across the whole food chain, from farm to shelf, Shoprite marketing director Brian Weyers said.

“Shoprite's portion of this cost will be relatively small and will make a small percentage difference to food prices, which the supermarket group will endeavour to absorb for as long as possible,” he said.

But Vianello is sceptical about how much the retailers will absorb. “I've heard that before: They will absorb as much as possible. What does ‘as much as possible' mean? That they will absorb 1% and pass the other 99% on?”

## The naked truth

Others are blunt about it.

“These higher input costs are going to be seriously inflationary,” Woolworths CEO Simon Susman said last week.

Spar CEO Wayne Hook says the increase will hit smaller stores, for which electricity costs already equal 1.4% of turnove

“That proportion could go from 1.4% to 2.3%,” Hook says. “Retail margins are pretty tight. It's hard to swallow another one (percentage point) in costs.”

## 'Raging' inflation unlikely

The increases come after a period of lower increases food prices. Shoprite CEO Whitey Basson said on Tuesday interna food price inflation fell to 1.7% in December from November, but picked up last month to 2.5%.

Hook says inflation at his company's distribution centres is running at 2.1% a month.

The power price hikes are unlikely, however, to push food inflation back to the “raging” levels seen in 2008, Hook says.

## Across-the-board increases

While higher prices will spur businesses everywhere to cut costs, the increases will be felt across the board.

“It's going to knock us,” says Andy Turner, technical manager at Eastgate Shopping Centre in Bedfordview, Johannesburg

Tenant stores at Eastgate pay their own power costs. On top of those, however, are the extra costs the centre managemen pays for communal services such as lights and air-conditioning.

“Our average electricity bill is R1,6m to R1,7m a month,” Turner says. A further 25% “has to be billed somewhere”, he say

## Slowing recovery

That “somewhere” will be consumers and this is where risks lie for the wider economy. Consumer spending makes up mor than 60% of SA's gross domestic product. If consumers have less to spend, any recovery is slower.

“The concern I have with consumers being deprived of disposable income is that you're not going to see sustainable grow says Tendani Mantshimuli, a consumer economist at Liberty Life. She estimates this year's electricity increase will add 0.4 percentage points to annual consumer price inflation.

## Poor to feel it most

The “electricity effect” on spending will not be uniform, however. It will cut to the heart of the positioning of the different retailers. Woolworths, which targets wealthier shoppers, says it will be less affected.

“Our customer does have more disposable income,” Susman said last week. “Our customers will be affected, but less than our competitors.”

By contrast, the 61% of consumers who cite Shoprite as their supermarket of choice will be harder hit.

“We deal with a much poorer population,” Basson says.

*Source: Business Day*