

Nearly time to buy shares

Massmart's chief executive Grant Pattison has long cautioned against expecting short-term wonders from the SA retailer's acquisition by Walmart. The reality of his warning kicked in with a vengeance in June, sending Massmart's share price diving by a third.



"I always said 2013 would be a tough year for us," says Pattison. "Costs incurred in our expansion have come in hard this year." Over the past five years Massmart spent R5bn on expansion, including its entry into food retail and a makeover of its supply chain.

The impact of higher costs and tough trading conditions are reflected in the retailer's 9,3% fall in headline earnings per share (HEPS) in the 26 weeks to June. This brought the fall in HEPS over the past five years to 21%.

Pattison does not promise a rebound in the second half of the year, but leaves little doubt the period of sliding earnings is near an end. "The integration with Walmart is over, our food retail base is built and our supply chain development is complete," says Pattison. "I am feeling far more confident about 2014."

So, too, is Richard Middleton, manager of the Investec Growth Fund. "We are seeing more an opportunity to buy Massmart than to sell it," says Middleton. "You must take a two- to three-year view. You will want to own Massmart in 2014 and 2015."

Pattison looks to rising trading margins from 2014 and enhanced product offerings as key drivers of Massmart's profit growth revival. Also playing a big role will be food retail, driven by Masscash's 44 Cambridge stores and Foodcos in Massdiscounters' Game stores.

Pattison is upbeat on food. "In the first half of 2013 food sales grew 20% [to R5,7bn]. We expect sales of over R11,5bn in the full year," he says.

Concerns over Foodco

Concerns that marketing of Foodco has not been up to scratch are dismissed by Pattison. "Only a quarter [27] of Game stores have a Foodco offering. We will only be able to market effectively when there are Foodcos in all Game stores."



Pattison also stresses the introduction of Foodco into Game is not the reason for the halving of Massdiscounters' profit over the past two years. "Game stores with Foodcos are doing well. It is the ones without Foodcos that have performed badly," he says.

Dragging profit down has been weak merchandise sales, says Pattison, a problem not unique to Game. But he concedes: "We did not do a good job in Game."

The solution to Game's woes, he says, lies in a management shake-up in which Massmart veteran Robin Wright was appointed as Massdiscounters chief executive in January.

"It will take him [Wright] 12 months to achieve a turnaround," says Pattison. Wright replaced Jan Potgieter, who resigned as chief executive in January.

Middleton believes Walmart's influence will also begin to be seen in Massmart. "When Walmart acquires a company, costs tend to rise initially, as we saw when it bought Asda in the UK," says Middleton. "Once the Walmart processes kicked in, Asda's margins and profits began to rise."

Playing a key role in Massmart's share price prospects are foreign investors who, excluding Walmart's 53% stake, own a third of Massmart's shares.

"The shares are tightly held," says Middleton. "I don't think foreigners will sell." Middleton says foreign investors are also attracted by Massmart's strategy in Africa, where it has 29 stores in 11 countries generating annual sales of R5bn.

Massmart will soon open stores in three additional countries: Angola, Kenya and Nigeria.

A big test of investor confidence in Massmart will be at around R140/share, about R10 below its current price. Massmart should find strong support at R140, says 36One Asset Management analyst Daniel Isaacs Middleton agrees. "I can't see it falling much lower than R140," he says. If they are correct, buying time could be close at hand.

Source: Financial Mail via I-Net Bridge

For more, visit: <https://www.bizcommunity.com>