

## Retail: Finding the sweet spot

The general retail index has been flat since March, but that doesn't mean there are not investment opportunities.

By [Zeenat Mborad and Evan Pickworth](#) 15 Jun 2010

In light of a watchful South African consumer after the pain of the recession, the key for investors will be to look for those stocks that have paid down their debt, are not overly reliant on exceptional sales and have strong cash flows on their balance sheets.

Stocks that meet these criteria include Shoprite Checkers (SHP) and Foschini (FOS), while stocks not meeting these standards include Massmart (MSM).

### Pressures

One analyst feels retailers will have difficulty increasing their top line over the next 12 months, given challenges in the consumer environment.

And economist from Standard Bank Goolam Ballim feels the economy is likely to take somewhat longer to return to trend growth than what markets are currently factoring in.

He says household spending growth is likely to be more moderate than initially envisaged, owing to limited credit growth and relatively weak labour absorption, maintaining the unemployment rate at around 25% in the short-to-medium term.

But another retail analyst says while there is pressure on disposable income and unemployment will remain high, there has been modest growth in the retail sector.

### 'Worst is over'

"It is difficult to picture the retail sector returning to 2007 levels, but the worst is over," he says. He adds that while the index has been flat since March, that doesn't mean consumers are not spending. His sense is that they are just being cautious on what they buy.

Gabriel Davel from the National Credit Regulator also notes that consumers are becoming more active in looking for better prices and thus shopping around more. He feels this is a very positive trend in light of high debt levels that were built up in the past.

The latest NCR stats show a levelling off in the increases of those going into debt counselling.

The second retail analyst above also mentioned that consumers are buying more World Cup related goodies at the moment - another indicator that there is a growing willingness to tap into disposable income.

### Retail index

SA's general retailers index struck 25 329 on 26 January 2010, and proceeded northwards to hit 32 051 on 11 March.

By 14 June, however, it had hardly changed from March levels - and it is effectively mimicking the action of the broader consumer services index. That is indicative of the general consumer trend of cautiousness.

The trend also indicates a hefty dose of caution by analysts and investors on where the sector will head to next and when those consumers will dip deeper into their pockets.

### **Individual sectoral stocks**

When looking at the individual sectoral stocks based on the prospect of slower sales going forward, especially after World Cup spending is out of the way, Shoprite Checkers is looking the strongest of the lot with lower debt service levels, costs under control and strong cash flows. Another stock meeting some stringent criteria is Foschini.

Massmart, however, has a serviced debt to shareholders' funds ratio of 49.5%, versus just 9.80% for Shoprite. Return on equity - a good measure of whether shareholders are getting value for their investment shows Massmart dropping to 82.40% from 96% a year ago, whereas Shoprite has managed to grow its ROE to 41.5% from 33.70%.

While these are not clear buy signals, the stocks meeting these types of criteria could be overweight or accumulated within portfolios going forward.

The retail sector story is not a simple one to understand at the moment and the next broad move may not shoot the lights out, but there are opportunities, even after World Cup fever abates.

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