Value investors pounce

The fall in retail shares has been overdone and valuations are now more attractive.

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A slump in the share prices of almost all big-name retailers has brought their valuations back to earth with a thump. It has also sparked the first notable buying of SA retail shares by domestic asset managers in at least two years.

"We have started buying," says Evan Walker, a fund manager at 36One Asset Management "I do not belie we are seeing the start of another bull run in retail shares, but valuations are looking attractive. We are now up to a 5% exposure to retailers. This is still well below the exposure of about 20% we had at one stage."

Raising eyebrows is Coronation Asset Management's change in strategy towards retailers. Having ended first quarter with retail exposure limited to a holding in Clicks, Coronation has turned aggressive buyer, scooping up a 10% stake in Spar worth about R2bn and a 10,2% stake in The Foschini Group (TFG) wortl about R2,3bn.

Foord Asset Management has also been a retail share buyer of late, lifting its stakes in TFG and Truworths to just over 5% each. However, this does not mark a sudden change in strategy, says Foord fund manage Dane Schrauwen "We have long been outliers in the [asset management] industry in liking retailers for the long-term consumer income growth story," he says. "Going over 5% in the two shares was a non-event."

Another motivation for buying retail shares is the attraction that their valuations could hold for a foreign retailer, says Walker. Using TFG as an example, he says: "An 11 p:e could be a very attractive buying leve for a foreign retailer aiming to get a 1000-store footprint in SA."

More so at R10/US, he continues. Though TFG is off its low seen in late June, its price is still 30% down from its January high and 40% down in US dollar terms.

Some share prices hit hard

Share prices of credit retailers such as TFG and Truworths were the hardest hit in the retail sell-off and the fall was worsened by African Bank's (Abil) revelation in May that its bad debts had soared. "We have been unfairly tarred with the same brush," says TFG CE Doug Murray.

Expressing a view shared by all credit retailers, Murray says: "Banks are new to the [unsecured lending] sector. We have huge experience and knowledge in the consumer credit market. Many years ago we were already extending credit to consumers whom banks then considered unbankable."

Counting heavily against TFG in the minds of investors running scared of unsecured lending is its persona loan and private-label credit card business, RCS. TFG has a 55% stake in RCS and Standard Bank a 45% stake.

Murray dismisses concerns about RCS, recently the subject of an abortive acquisition offer. "Only 26% of RCS's [R4,2bn] debtor book is in unsecured loans," says Murray. RCS's provisioning against nonperformi loans stands at 121%, which is very conservative, he adds. Abil's comparable level of provisioning is 59% and Capitec's 113%.

RCS has been a good business for TFG. "It has outperformed retail for three years," says Murray. But one concern has prompted TFG to seek a buyer for RCS. Though RCS is a separate entity, as a 55% subsidia it is consolidated on TFG's balance sheet. "It pushes our [TFG] net gearing to over 50% [of equity] while in reality our net gearing is only 13%."

TFG has two options. "We can cut our stake in RCS to under 50% and not consolidate it," says Murray. "B as a minority we would still need an exit strategy." The alternative is to sell RCS, a choice Murray concede should have been made earlier.

"We are in no rush to sell RCS. We want fair value plus a premium," says Murray. "Something will happen due course."

Cheap shares

Based on a consensus forecast of TFG's results to March 2014 by 12 analysts polled by I-Net, it is on a 10,5 p:e, or more than 20% below its 10-year mean. Swiss bank UBS puts TFG's forward p:e at an even lower 9,8. "I don't call our share price but I think it is fair to say it is cheap," says Murray.

The same applies to Truworths, says independent retail analyst Syd Vianello "Truworths is the cheapest it has been in a long while. It has a strong, ungeared balance sheet and has increased its earnings in good a bad times for over a decade."

Though Truworths' share price has lifted off its June low, it is still down 25% from January. Based on a consensus forecast from I-Net of the retailer's results to June it is on a 14,7 p:e, its lowest in 40 months a in line with its 10-year mean.

But whatever domestic investors may think, holding sway are foreign investors, who have been the big buyers of SA retailers over the past several years. Their positive view appears to have been unshaken by the recent slump in retail share prices. What foreign selling there has been this year has been primarily by short-term traders and hedge funds, says Schrauwen.

The highest level of activity this year by foreigners has been in TFG. Foreign ownership of TFG increased from 41% at the start of 2013 to 46% in March, falling back to 41% at the end of May. Truworths has seen foreign ownership vary from about 63% to 65%, with its long-time top shareholder, Aberdeen Asset Managers, holding just over 25%.

Among other retailers widely held by foreigners, Clicks has seen foreign holdings fall slightly this year, fro about 63% to 60%. Massmart has experienced no change in foreign holdings, which stand at 83%, includi Walmart's 53% stake. Foreign holdings in Shoprite have held steady at around 50%.

Strong niche positions

"Foreign investors are attracted by SA retailers' First-World management in an emerging market," says Ab Capital analyst Christopher Gilmour He believes the companies standing out as likely to weather the curre

tough economic environment best are Shoprite, Woolworths and Mr Price

"They all have strong niche positions," says Gilmour. "Shoprite has a leadership position in Africa, Woolworths is attracting the aspiring black middle class and Mr Price appeals to consumers looking for fashion at a low price."

The ratings of SA retailers are not out of line with those in other emerging markets and are arguably even o the low side. For example, putting Shoprite's estimated 26 p:e to June into perspective, India's largest list food and fashion retailer, Tata subsidiary Trent, is on a 53 p:e.

Turkey's largest retailer, supermarket group Migros Ticare, is on a 57 p:e while the country's overall retail sector is on an average 23 p:e. Russia's largest food retailer, Magnit, is on a 27 p:e and Brazil's largest fo retailer, CBD, is on a 23 p:e.

SA retailers are not alone in facing headwinds. India's formal retail sector recorded sales growth of 10% ir the year to February, reports the Indian daily Business Standard Adjusted for inflation, real growth was abo 3%.

In Turkey, retail sales in the first quarter of 2013 reflected the first year-on-year decline in four years. Russian real retail sales growth is running at 4%/year and in Brazil real retail sales in April were up only 1,6 on a year earlier.

The picture is similar in SA, where real retail sales in the three months to April were up 2,8% compared wi the same period in 2012, reports Stats SA. At current prices, sales were up 7,2%.

However, there was a wide variance between sectors. Continuing a longstanding trend of putting fashion first, consumers drove real clothing sales growth by a healthy 7,3%. Real food retail sales growth was low 1,2% but at current prices was boosted by inflation to 6%. The big loser was the furniture sector, where re sales fell 4,7%.

Opinions among economists differ on prospects for SA retail sales growth. Investec economist Annabel Bishop believes second-quarter retail sales growth will reflect a declining trend.

Taking a more optimistic view is independent economist Mike Schüssler "It is not a great time for retail but is not all doom and gloom," he says. "The economy is not as bad as most people think."

He bases his view on the BankservAfrica economic transaction index. Compiled from electronic interbank fund transfers, it has a 99,7% correlation with GDP growth, he says. "The index points to second-quarter GDP growth being far better than first-quarter growth," says Schüssler. GDP growth, he believes, will be a least 3%, up from first-quarter growth of only 0,9%.

If Schussler's prediction is correct, consumer confidence stands to receive a solid boost. It would be goo news for retailers and for investors now buying their shares.

Source: Financial Mail, via I-Net Bridge

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