Retail's stellar climb runs out of steam in 2013

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After a stellar run over the past few years, appetite for South Africa's retail stocks cooled this year as profit growth slowed on strained consumer spending.

(Image: Wikimedia Commons)

Independent analyst Ian Cruickshanks says South Africa as an investment arena is no longer a favoured destination.

"Finally, investors are taking note of overall retail spending ... the fact that it's hardly growing. What we are seeing is that there is finally a reaction in share prices, I think they have come off a little bit. From January to October there was a total of an R60bn inflow for bonds and equities from foreigners ... they lost half because they sold R30bn in November, what does that tell us?" he said.

JSE-listed retailers became the flavour of the month for foreign players in search of higher yields, after the fallout experienced by commodity shares after the 2008 recession. Boosted by the hype about the rest of Africa's growth prospects, foreigners ploughed into shares, driving valuations up.

Although there have been pockets of value to be found in the retail sector, the price:earnings ratios of retail companies have been unsustainably high, with retail counters not pricing in the risk of slowing spending.

Investec Asset Management equity analyst Diane Laas says year-to-date retail share price movements tell a story.

"The share prices of Truworths and Foschini, generally considered credit retailers are down between 25% and 30% year-to-date. Retailers that have been exposed to any sort of credit have sold off really aggressively, it is probably justified, because the topline sales growth has slowed along with it.

"There is another story playing out in the market. Cash-based Mr Price apparel's topline growth came in around 15% and upper-income player Woolworths in clothing was 11.5%. Mr Price is definitely a value-focused retailer and Woolies targets a higher-income consumer," she says.

High unemployment and slow income growth in South Africa have checked household expenditure, already crimped by soaring utility costs and rising debt. The slowdown in rampant unsecured lending, which gave retail sales a boost, is expected to be one of the major contributors to the slump in consumer spending.

"If you look at Shoprite, their share price is down 15% this year that is a low-income consumer story. In their most recent sales numbers for the period July, August and September the volume growth was negative. Food volumes are very seldom negative so it speaks to a struggling consumer," Laas says.

The effect of consumer spending and subsequent moderation in retail spending has been noted by foreign investors, signalling the end of the retail rush.

"The sector doesn't have the popularity it used to have. Foreigners also look at the uncertain political setup - the anxiety between unions and the African National Congress (ANC), so we have an early dose of pre-election jitters regarding foreign investment in South Africa as a whole," Cruickshanks says.

"Retail stocks are still looked on as expensive, but what we have seen in the last year is reasonable results from some of the retailers which have grown into pretty high price:earnings ratios, and that has made them look slightly better valued ... but they are still high," he added.

Shoprite at the moment trades on a price:earnings ratio just above 24. Mr Price on 25.5, Woolworths about 22.77 and Truworths at 11.29. Foschini Group's shares are trading on a price:earnings ratio of 11.20 times.

Looking ahead, Cruickshanks says the stocks that would remain popular and in investors shopping baskets were Shoprite, Woolworths and Mr Price. He adds that there was still "a question mark" on Pick n Pay, which is undergoing a turnaround.

"They have a new CEO, but it will take time (for him) to prove himself, they are still on a ridiculous price:earnings ratio, so I don't like the look of that. I do not see a lot of mileage from the others, especially the credit retailers - Foschini and Truworths. Shoprite, with its Checkers brand is trying to compete with where Pick n Pay used to be and doing it helluva well.

"Woolworths has made a corner in their higher LSMs and is doing well in providing value, fashion and catering to the new middle class, the so-called black diamonds. They are both seen as fair value. As is Mr Price because it maintains a reasonable fashion standard, getting the right fashion styles at the right time, pleasing customers that are buying down, retaining and gaining other customers," he says.

Consumer spending is likely to remain in the doldrums next year.

"With high debt and inflation, the cost of living is mounting. It is hard for the average person, especially for the poor, there is uncertainly with the elections, all this is having a slowing effect and I would not look for a big recovery next year. People are not going to rush out and buy furniture, especially not on credit. They are going to stick to necessities," Cruickshanks says.

Professional services firm PwC says South Africa has the biggest retail market in sub-Saharan Africa, and the 20th-largest in the world.

Cruickshanks adds that foreign investors ware probably going to look next year for greater diversity in the financial and industrial sectors.