The Woolworths Chronicles - Part 1: Not going hungry

By Zeenat Moorad

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It is conceivable that juicing is a fad too far and that kale isn't as saintly as it seems. However, for the fervent who cleanse, reset and detox but might be averse to slicing, chopping and dicing, it has never been easier to get in five-a-day, thanks to Woolworths.

Woolworths CE Ian Moir.

Photographer: Trevor Samson

One might argue that its precut juice mixes pander to the lazy, but the retailer is more inclined to call the prepped offerings and shortcuts it sells "solutions."

"Customers come in [to our stores] and want to be inspired about what to make for their meals. They want us to help them, to make it easy for them. Even if it’s just allowing them to put sprinkles on a salad — they feel less guilty," says Woolworths CEO Zyda Rylands. "Customers also don’t have to get to a big mall — we have small stores and some big ones. It’s just convenient to get to us. We are very well positioned."

The group has made fat profits from catering to the time poor and cash rich, and in doing so it has altered retailing in SA to build a R25bn food business.

Five years ago, when SA's weekly food shoppers became Woolworth s' target through its supermarket-slash-grocery strategy, Pick n Pay was in the throes of its descent and Shoprite was gung-ho on Africa.

Woolworths dug in and stole market share. And it's been doing so ever since. Customarily frequented for "jocks and socks", fancy jam and biscuits, its aisles began to brim with more mundane items like loo roll and tomato paste.

And though Woolworths essentially became a different animal as its basket shoppers became trolley shoppers, its position as a niche player has endured.

Sasha Naryshkine, a director at asset management company Vestact, which holds a "buy" rating on Woolworths, says the "Woolies" client is still happy to pay for quality.

"What is key is that they [Woolworths] are differentiating themselves from their competitors in their food offering, making sure that they appeal to higher-income groups that are not price sensitive," says Naryshkine. "There's this whole idea that the rich remain rich and are less likely to worry about price over the superior quality. Food is less risky [and] premium (not too premium) is pretty sticky, provided that they keep the quality and maintain the brand, relative to their peers ... management are masters at this."

Despite the broader economic malaise, Woolworths' full-year numbers largely came in above expectations, unlike most of its peers. Food delivered strong numbers: total sales were up 11.9% and 5.7% on a comparable basis. Transformation initiatives at its Australian outfit, David Jones (DJs), are seemingly on track — it posted its strongest earnings since 2011. And while Clothing & GM didn't exactly shoot the lights out due to what group CEO Ian Moir called "a horrible, nonexistent winter" (sales were up 8.2% or 4.4% comparably), the only real lemon was Country Road, of which there will be more in next week's Financial Mail.

Naryshkine reckons that at a historic price:earnings ratio of 19, and forward closer to 16.5, the stock presents a great buying opportunity. Plus investors are getting paid more than 3% yield as a bonus.

Woolworths is cheaper than it has been in a while. The counter is down nearly 17% this year, mostly on profit taking and the lingering risk of higher income tax on wealthier consumers. There has also been some fret over the quantum of change going on at its Australian business — the head office move from Sydney to Melbourne, a food roll-out at DJs, a big fix-up at Country Road and a revamp of its Elizabeth Street store.

Still, analysts remain captivated by Moir's growth story, with 10 "buy" ratings on the stock, alongside five "holds" and two "sells".

On average, these analysts expect the share price to hit R94.45 within a year. It's not too far off already, and bobbed at about R81/share at the time this magazine went to print.

In SA, the plan for food — other than finding ever-greater numbers of cultivars to spiralise and sell — is to invest in price.

Just how aggressively this will play out at Woolworths remains to be seen.

With a trading margin above 7% — which is dizzying and perhaps a wee bit unsustainable for a food retailer — its drive to keep and grow market share might spell some pressure down the line.

As far as clothing goes, Woolworths, as a predominantly cash-based player, has been less vulnerable than rivals Truworths and the Foschini Group (TFG) to changes to the National Credit Act.

Moir says the intent of the new regulations was right: "Government [was] trying to do the right thing ... [it was] trying to control credit, which was in danger of getting out of control. But there were some unintended consequences of the act that hopefully the regulator will think about again, and I'm thinking particularly about the credit limit increases in stores, which now require three months’ worth of bank statements.

"That is going to affect all businesses."

At Truworths, the implementation of the national credit regulator’s (NCR) new affordability assessments resulted in a loss of between R200m and R250m in credit sales. The group, along with Mr Price and TFG, has initiated legal action against the NCR and the Department of Trade and Industry.

As onerous as the new rules are, blame for the tapering off of credit sales cannot be laid solely at the NCR’s door.

With a rising unemployment rate and high household debt, consumer confidence is severely depressed, particularly in the middle to lower segment of the market. Never before has the environment been so tough for so long.

Alec Abraham, Sasfin’s senior retail analyst, says that in terms of defensive exposure, investors would probably want to stick with food rather than apparel retailers.

"At the moment, given the way things are going — and that is extreme pressure on consumers’ spending — people with tighter budgets who were initially just moving away from buying furniture and appliances are now not spending that much on clothing," he says.

Moir, like his less-polished counterpart at Shoprite is unapologetically blunt about domestic headwinds.

"We are not expecting any growth in SA. Everyone is facing a tough time. It’s not going to get easy soon — we’ve seen some positivity coming through with the local elections, some improvement in the rand and the end of the drought.

"But we still see political turmoil," he says.

Retailers, as some of the largest private-sector employers in SA, pay billions in direct taxes to the fiscus.

On government’s role in tackling the economy’s structural problems, Moir says: "I don’t see how at 0% growth forecast you can argue that they are [doing enough]. I think government really needs to do more. But we all do, don’t we? We all want SA Inc to be successful and we are all prepared to do our part. Woolworths does a lot to develop small businesses to create more wealth and jobs in the economy and we employ a lot of people. Government, being the government [of this country] needs to do more and to do a better job of governing."

As high flying as its food business is, Woolworths only makes a quarter of its profits from selling food — the DJs acquisition effectively reduced the food contribution to the group, making its business profile somewhat riskier.

Yet, noting that its current price was the cheapest entry point in years, Woolworths was upgraded to overweight from neutral by JPMorgan on 1 September.

In a note, analysts said that after a steady de-rating over the past year, valuation no longer appeared to be a concern and now looked cheap in the light of history.

"We ... continue to like the David Jones story, even though we believe the profit inflection in this business is now delayed to FY19. Woolworths is one of the few SA consumer names that has clear long-term vectors [DJs, SA food], which we believe is attractive to long-term investors," they said.

Woolworths two years ago paid R23.3bn for department chain DJs. It also paid retail tycoon and long-time nemesis Solomon Lew about R2bn for his minority stake in Country Road.

Every great city is said to have an iconic department store — Paris has Le Bon Marché, New York has Bergdorf Goodman and London has Liberty. With DJs in Sydney, Moir is setting out to build the most "beautiful store in the southern hemisphere".

Source: Financial Mail