Dis-Chem and Clicks remain attractive

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While the general retailers' index has sunk 27% from its April 2015 peak, two shares in the sector appear to be proving the so-called "lipstick theory".

Clicks's shares closed at R145, a whisker from their record of R145.64, taking gains since the start of the year to 23%.

Dis-Chem ended the session at R28.10, just below its 14 June record close of R28.94. Dis-Chem stock has gained 26% year to date even as consumer confidence, according to the latest data from the Bureau for Economic Research, suffers its worst run since 1982.

The lipstick effect was coined by Leonard Lauder, chairman of cosmetics empire Estee Lauder, who found that during times of economic stress, sales of his lipsticks rose. The premise is that consumers who aren't able, or confident enough, to splash out on a big ticket item will comfort themselves with smaller luxuries.

But there may be a deeper reason behind it, too.

A 2015 Psychology Today report cited a series of experiments that found "while tougher economic times decrease desire for most items, they increase women's yearning for products that boost their attractiveness". Humans, apparently, are genetically predisposed to compete "ferociously" for mates when times are difficult in order to pass on their genes.

Local analysts may take a dim view of curious psychological studies, however. Of the 13 surveyed by Bloomberg, only two have "Buy" calls on Clicks - Arqaam Capital and Barclays. Six analysts rate it a "Hold" and five think investors should sell.

They are similarly split over Dis-Chem, with three 'Buy" calls, three "Holds" and two "Sells".

Sentio Capital says Clicks's major shareholders are mostly international, and generally more optimistic. "In SA as a whole, only 26% of pharmacies are corporate owned," said Sentio portfolio manager Imtiaz Suliman. "It's 50% in the US and UK, and just on that basis, foreigners think there's huge potential for growth."

One analyst, who wants to remain anonymous, says "Personal care and beauty products only account for 27% and 34% of Dis-chem and Clicks's retail revenues respectively and are not the only drivers behind the earnings growth in these businesses. Both companies benefited from store roll-outs and gaining share in fragmented markets."

Sentio is not adding to its 1.15% stake in Dis-Chem, citing the company's forward price to earnings ratio (PE) of 30. Clicks's is similarly lofty, trading on a forward PE of 28.8. In comparison, Shoprite's forward PE is less than 20, while the Woolworths PE is now 14.2.

One analyst says, "It is more difficult for Clicks and Dis-Chem to beat already high consensus expectations in an environment like this, but if they can " the shares could rally."

Suliman cites both companies' high levels of return on equity as a major draw. "Clicks has been consistently buying back shares which has aided them - doing more with less equity. If you look at Dis-Chem's growth, it's not going to be funded by rights issues, it's a virtuous cycle - they can invest more in the business and be more competitive in pricing."

For the six months ended February, Clicks's return on investment stood at 47%. Headline earnings grew 13.5% and the company expects full-year headline earnings growth of between 11% and 16%.

Dis-Chem's full-year results to the end of February showed a 22.5% increase in headline earnings per share and the group has maintained its ambition to double its store base over the next five years, from 106 at its listing in November 2016.

Suliman describes Dis-Chem as a "category killer" - able to stock its shelves with 30 types of soap, for example, that consumers are not able to purchase elsewhere. Surv says, "Ironically, poor macro-economic conditions should speed up consolidation as the independents will struggle more."

Source: Business Day