

Shoprite competition closes in

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"Shoprite has taken advantage of the strong rand to invest in a lot of real estate in Africa by opening 16 additional stores in Nigeria this year and planning three new stores in Ghana," says Shoprite CEO Whitey Basson.

Investors who put their confidence in Basson and his team have reason to smile. Defying the odds, the food retail giant romped home in the six months to December 2010, lifting sales by 9,4% to R36,26bn compared with the first half of 2009/2010, headline EPS by 13,6% and its interim dividend by 10%.

This is a solid showing in a consumer market yet to recover from recession and in which intense competition contributed to Shoprite experiencing internal price deflation of 1,2% in the six months to December.

The key factor in Shoprite's ability to buck the trend was higher customer numbers and market share, says Basson. At an analysts' presentation he indicated that of combined sales of the big-four food retailers, Shoprite has a share of about 35%, Pick n Pay (PnP) about 30%, Spar between 25% and 26% and Woolworths between 8% and 9%.

Notably, Shoprite's results were in sharp contrast to those of PnP, from which Coronation Asset Management analyst Quinton Ivan says it has taken market share over the past three years.

In the six months to August 2010, PnP recorded a 7,2% fall in headline EPS compared with the same period in 2009/2010, and sliced its interim dividend by 6,9%.

Another of Shoprite's notable achievements in the six months to December was the lifting of its trading margin from 5% to 5,11%. The increase continued a decade-long improvement during which its trading margin increased from around 1,75% in 2000.

Playing a big role in Shoprite's ability to lift trading margins was its early adoption of a centralised distribution model, says Ivan. PnP, which reported a trading margin of 2,85% in its 2010/2011 interim results, is a latecomer to the model, having just launched it, initially in inland regions. PnP will complete its move to centralised distribution only in 2014, says Ivan.

Centralised distribution, he adds, has placed Shoprite at a big advantage over PnP, especially in the supply of small convenience stores demanded by consumers. "With centralised distribution you need very few deliveries each day compared with dozens under a supplier-serviced model," he explains.

Sanlam Investment Management analyst Mario Scholtz argues that when it comes to margins, things are about as good as

they can get for Shoprite.

"All the big competitors have set up, or are in the process of setting up, central distribution centres in an attempt to catch up with Shoprite," says Scholtz.

"These developments should increase competition in its primary markets and start putting pressure on its margins."

Head of retail research at Nedbank Capital, Syd Vianello, disagrees. "I believe Shoprite's margin is sustainable but it's unlikely to go higher," says Vianello.

Another aspect to investment in Shoprite and other food retailers is the end of what, for consumers, has been the happy situation of low food price inflation. In 2010 it was a mere 1,4%.

In January food inflation doubled to 2,8% and will, predicts Ivan, rise by between 5% and 7% in 2011.

"My view is that food price inflation could go to 10%," says Vianello.

Whatever the outcome, Ivan and Vianello agree that it is a positive factor for food retailers. "Food retailers prefer rising prices over rising volumes," says Ivan. "Even if volumes fall, higher prices will offset this."

Food retailers, always a defensive play, could attract even more interest in an environment of rising inflation.

Scholtz argues that for all Shoprite's business attractions, from a value investor's perspective it is expensive. "We believe the counter is pricing in too much blue sky for us to remain invested," he says.

Specifically, Shoprite is trading on a 19,8 p:e, well above its 10-year average 16 p:e and its five-year average 18 p:e. Seemingly discounting better times ahead, PnP is trading on a 23,6 p:e which compares with its 10-year average p:e of 18 and five-year average of 20. Spar is trading on an 18,6 p:e, compared with its 10-year average p:e of 17 and five-year average of 18.

While none of the big food retailers can be termed cheap, given Shoprite's record it would be hard to argue that it is overvalued compared with its peers.

Vianello also has doubts about PnP's ability to launch a major competitive offensive at present.

"There is so much internal restructuring at Pick n Pay that they could take their eye off the ball. It's very worrying," he says.

PnP also faces a challenge in Australia, where sale of its loss-making unit Franklins for R1,55bn has been blocked by the competition authority and now depends on a court decision.

On Spar, Vianello says: "It is a good, solid business but it won't grow as fast as Shoprite."

Much of Shoprite's growth potential lies outside SA. Giving it a big firstmover advantage over other SA food retailers, Shoprite began a drive into Africa over a decade ago and today one in seven of its 1505 stores are in 15 countries outside SA.

Basson says Shoprite has taken advantage of the strong rand to invest "in a lot of real estate" in Africa. In addition to expanding into three new African countries, he says Shoprite will open 16 additional stores in Nigeria this year and is planning a further eight to nine. Three new stores are planned in Ghana.

Basson is also upbeat on prospects in SA. "The current cycle will pass," he stresses. He adds that government's

jobcreation strategy also favours Shoprite. "The first port of call for those finding jobs is always our stores," he says.

But a big dampener on prospects is US retail giant Walmart gaining control of Massmart.

Vianello says Walmart "will transform retailing in SA" and will set its sights on becoming a big force in food retailing. Walmart is the US's largest food retailer.

Basson says Shoprite is not sitting back and waiting.

He explains that Shoprite has increased its own global sourcing capacity significantly, taking heed that a key element of Walmart's model is global sourcing at the lowest prices.

The Walmart factor makes investment in retailers a tough call in general. But for investors confident in Basson and his team's ability to meet the challenge, Shoprite ranks as the blue-chip among SA food retailers.

Source: Financial Mail

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