

## SA Retail Sector – Drivers and Trends in a COVID-19 world

The South African economy and consumer have been under pressure for some time, then COVID-19 hit! In this article we unpack the drivers of the SA Food and Apparel Retail Sector, imminent policy decisions required to unlock SA's GDP growth potential and the current trends which will provide opportunities to savvy retailers and investors.



**Nick  
Rogers**

The SA retail sector, by nature, relies predominantly on the movement of consumers to physical shops. Consequently, there was a dramatic decline in both sales and share prices in March when SA went into hard lockdown. The ability of management to adapt so quickly is testament to years of long-term strategic planning that have seen our retailers diversify earning by geography, income levels and

sectors. There are many layers that drive consumer sentiment which will be covered; however, the medium-term outlook is positive driven by global change in sentiment following the US elections and announcements on vaccines which will ultimately see shoppers behavior normalise in time.

To begin with, let's look at the main drivers of the sector for both retailers and consumers. There are many positives over the medium-term.

- Interest rates. Investing in a house, car, education and/or business often requires a large loan. The ratio of household debt to disposable income is sitting above 85% whilst the TransUnion SA Consumer Credit Index remained at 44 in Q3 (a level above 50 implies a positive environment) illustrating the deteriorating consumer credit health. SA's repo rate, at 3.5%, has never been lower! This materially reduces monthly repayments providing much needed extra cash at the margin to spend on essential goods. Furthermore, global central banks and the SARB are in no rush to increase interest rates, given the surging "second wave." This is positive for retailers and it eases the pressure on credit books.
- The exchange rate. Put simply, a strong Rand is positive for consumers and retailers alike since most big-ticket items - from TVs, fridges, laptops and cellphones down to clothing - are imported. Consequently, a stronger USD/ZAR exchange rate makes these goods relatively "cheaper". Over the past 3 months, the Rand has been

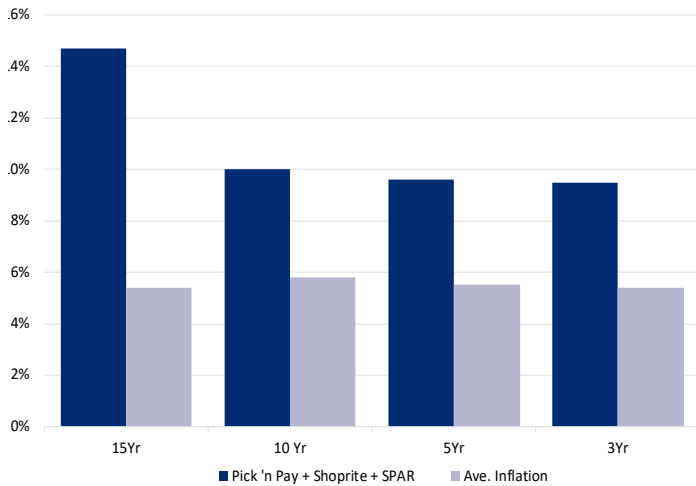
### SPEED READ

- The COVID-19 2nd wave will dampen the consumer recovery but a Biden win, coupled with the global rollout of a vaccine will provide a tailwind for emerging markets (EM).
- The Rand is the best performing EM currency over the past 3 months, a positive for retailers.
- COVID-19 has accelerated e-commerce adoption by 3 - 5 years.

- the world's best performing Emerging Market (EM) currency, having appreciated by 36% vs the US Dollar.
- Oil Price. SA's largest import reached historic lows in 2020 due to a collapse in demand as global travel ground to a halt and speculative oil derivative trading sending WTI oil futures to minus \$37 USD/bbl. OPEC have kept production unchanged this month. Despite a gradual recovery to above \$50/bbl, the 2nd wave lockdowns and a cautious OPEC will keep a lid on the price with most analysts expecting the price to remain below \$60 for 2021 or until demand accelerates meaningfully. Petrol prices are a large monthly cost for both the consumer (commuting via cars/taxis) and the retailer (delivering nationwide via freight) thus the current environment is net positive for the sector despite the recent 40 c/l rise at the pumps.
- Food Inflation. SA may potentially produce the 2nd largest maize crop on record this season, yet prices have soared to R3,000/ton due to record global demand. Excess supply and the stronger Rand should temper the price of one of the main drivers of SA food inflation. Food retailers, unlike consumers, benefit from passing on food price inflation to customers. One just has to look at the 7,500-odd products at Shoprite which have not risen in price over the past year to see that the consumer, not the retailer, should continue to benefit over '21 as food inflation stabilizes at about 4%.

Despite our rate of GDP growth grinding ever lower post "NeneGate", at the start of 2020 few expected that year's growth rate to plunge to -8%! With unemployment spiking

## EARNINGS GROWTH REL TO FOOD INFLATION



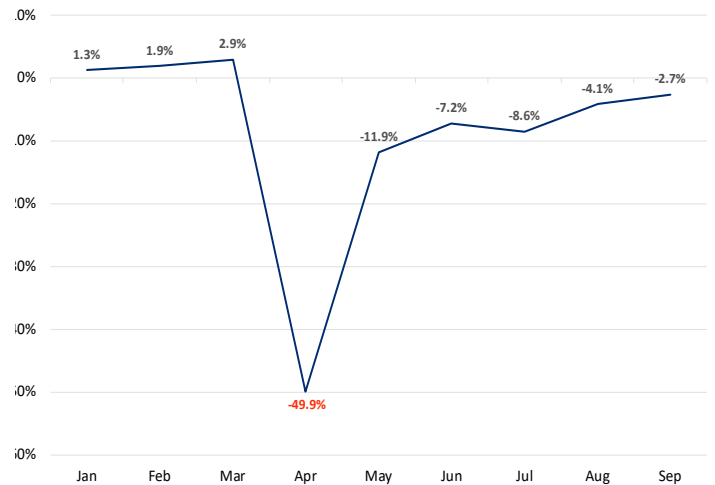
*Food retailers consistently grow their profits at a higher rate than food inflation.*

to record high levels, there is a growing reliance on social grants to feed and clothe the nation which is not sustainable. Consumer spending underpins the retail sector, however, it is directly correlated to consumer/business confidence which fell to the lowest level on record during 2020. Government thus needs to urgently implement policy to a) kick-start GDP growth & b) increase employment. These policies include:

1. Restructuring of the electricity sector, including Eskom's debt levels, the unbundling of Eskom into different business units, and further renewable generation. Despite our general scepticism, there was progress on these issues during 2020, and we are confident that some of this progress will become increasingly evident as the year progresses.
2. Maintaining their discipline with regard to the public sector wage bill.
3. The auctioning of new spectrum, expected by 31st March, to reduce data costs. Affordable and fast internet accessibility is positively correlated to GDP growth.
4. Infrastructure projects to boost employment and domestic demand.
5. Tourist visa policy changes to boost jobs and foreign earnings.
6. Public / private partnerships for investment initiatives (which now importantly, include the procurement of COVID vaccines.)
7. Further momentum on criminal prosecutions for past crimes.

Although we have repeated many of the above issues over the past two years, we are cautiously optimistic that most will gather momentum during the course of 2021 and underpin a renewed uptick in SA business sentiment which

## SA RETAIL SALES GROWTH



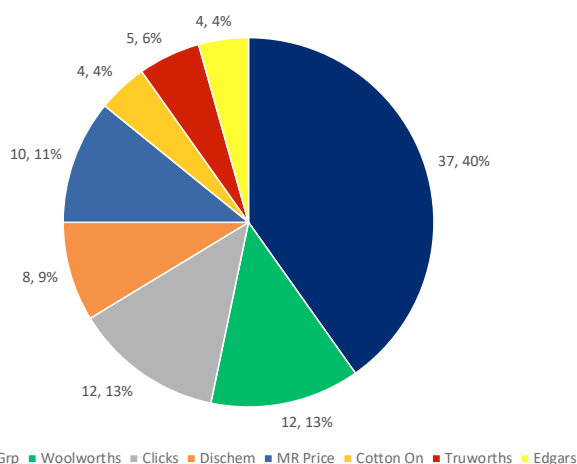
*Retail sales have recovered well after the lockdown-induced collapse.*

will in turn jump-start consumer confidence.

The old saying "adapt or die" rings true when looking at the sudden and dramatic changes that took place within the sector under the restricted conditions that prevailed for much of 2020. Whilst some of these will slow when COVID recedes, many changes are structural and here to stay.

1. The rise of e-commerce. Amazon has a product range of 350 million different products, all sold online, versus a range of about 250,000 for a typical large mall. COVID-19 accelerated the adoption of e-commerce by between 3-5 years and the trend looks permanent. Foschini Africa, Mr Price and Woolworths Fashion experienced increases in online sales of +152%, +72% and +35% respectively over the latest reporting period yet growth of only 5%, 2.6% and 2% respectively in total sales. Consequently, although online sales are starting from a low base, there is plenty of room for further growth. That said, fashion specifically is often about the experience. Consumers prefer to look and feel, and try clothes for size before buying, whilst returns can also put consumers off. Foschini (37% of online traffic) is the dominant fashion player followed by Woolworths (12%) and Clicks (12%). Takealot dominates the durable and general goods markets, well ahead of Makro and others. Online sales for food retailers remain small – about 1% - 1.5% of total sales. The problem is that the average order size is about R200, well below the cost of delivery. This will change in time, but the UK example shows that online sales need to reach about 20% of total sales before economies of scale really start to generate material profits. SA has some way to go.

## APPAREL RETAILERS SHARE OF ONLINE TRAFFIC



*The Foschini Group has the largest share of online sales amongst the listed retailers, followed by Woolworths and Clicks.*

- Are food retailers more defensive? The superior margins of the food retailers over the last reporting period illustrate the advantage of being classified as an ‘essential service’ e.g., SPAR Gross margins +11.9% whilst Shoprite’s record sales numbers are partly a result of being allowed to remain open for the full period relative to other retailers. With discretionary spend under pressure, this trend is set to continue as consumers prioritise food purchases. Higher margin fresh food has been a boon for retailers as more people cook meals at home at the expense of eating out, and the structural move to healthier lifestyles is taking hold globally. Any further stringent lockdown measure will again see food retailers outperform apparel.
- Working from Home (WFH). A recent survey by Willis Towers Watson found that 66 SA companies expect 33% of their staff to WFH in 3 years’ time. Time will tell whether this materializes, but sales of athleisure clothing have soared at the expense of formalwear, both for women and men.
- DIY. The WFH trend has seen a surge in demand for home improvements both locally and globally as people upgrade their homes and working environments. The likes of SPAR-owned Build-It, Shoprite’s OK Furniture and Mr Price’s Sheet Street and MRP Home all experienced double-digit growth in sales. This trend may well fade as the flurry of initial activity dies down.
- Local procurement. Long lead times for fashion, bottlenecks at ports and the weak Rand over lockdowns have forced SA retailers to reassess their reliance on China. Leading the charge is Foschini, who now sources 34% of its product locally, whilst Mr Price is aiming to spend R5.5 billion locally by 2025. This is a structural (and most welcome) shift and one that will

boost much needed employment.

- Local shopping. As the dreaded “second wave” gathers momentum across SA, retailers with a neighborhood presence stand to benefit further as people prefer to avoid congested malls, are constrained to a certain area during lockdowns and the WFH trend sees more people move to the suburbs. Regional malls are under pressure to find innovative ways to support footfall, including ideas such as local dentist/doctor’s offices and nurseries. Furthermore, the family outing to the mall over weekends is off the cards – at least for now – but we believe this is just temporary.
- Acquisitions. As always, tough times throw up opportunities. Foschini has snapped up JET from an ailing Edcon for just R333 million, reporting an immediate provisional gain on the bargain purchase of R694 million. Mr Price has added Power Fashion to its portfolio, giving both companies immediate exposure to the vast lower LSM income groups, beneficiaries of the COVID-19 and social grants.
- Survival of the fittest balance sheet. When a black-swan event like COVID-19 occurs, the strength of the balance sheet will determine who survives and who falls by the wayside. Edcon being forced into business rescue and to sell JET for a ‘steal’ is a good example of this. Fortunately, our preferred holdings - Mr Price (debt free), The Foschini Group (successfully raised capital via a rights issue in mid-2020), SPAR (strong cash flow and balance sheet) and Shoprite (management were already addressing their debt prior to March) - have all weathered the storm.

Unfortunately, the “second wave surge” over the New Year and the potential for more stringent lockdowns will see retailers come under renewed pressure, no doubt. However, there are sufficient levers available for Government to pull which could see a recovery in consumer confidence once talk turns to action. There will be a definite shift away from food to apparel spend once people start to travel, socialise outdoors, return to restaurants and entertainment venues but discretionary spend will only rise meaningfully when unemployment falls. In a persistently low interest rate environment, our formal retailers are well placed to whether another tough period, and to take advantage of the opportunities that will certainly come their way. This could be buoyed by renewed interest in SA equities should the positive mood towards emerging markets continue.



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**Topic:** N/A

#### **Natal Midlands**

**Date:** N/A

**Venue:** Fernhill Hotel  
Midmar / Tweedie Road  
(almost opposite entrance to Midmar)

**Morning Time:** 10am for 10.30am

**Evening Time:** 5.30pm for 6pm

#### **Johannesburg**

**Date:** N/A

**Venue:** Rosebank Union Church, Cnr  
William Nichol and St Andrews  
Road, Hurlingham

**Time:** 7am for 7.30am

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