Foschini: better with a Jet engine

Founded in 1924 and listed on the JSE in 1941, The Foschini Group (TFG) is one of SA's oldest listed companies and a leading fashion and lifestyle retailer. The company continues to achieve SA sales growth ahead of peers by differentiating itself as a specialist across numerous sub-categories and income levels. CEO Anthony Thunström and his team must be commended on the execution of their strategy - to become Africa's leading omnichannel retailer - in a fast-paced world where the traditional bricks and mortar retailers are having to adapt to a world dominated by e-commerce giants.

Nick Rogers

From humble beginnings as a single chain, TFG has grown into a giant of the local retail industry. Merchandise categories span its traditional ladieswear categories, but now include the high growth areas of menswear, athleisure and value aimed at low-income consumers. Its products can be found in 32 countries via 4,300 outlets, offering over 31 brands. Africa accounts for 69% of turnover, Australia, 18% and the UK 13%, giving the company Rand-hedge qualities. Well-known local brands include Foschini, Markham, AmericanSwiss, @Home, Fabiani, Jet, Total Sports and Sportscene.

The latest reporting period bore the full brunt of the Covid-19 pandemic. Despite experiencing store closures during every month of their financial year that ended in March, it was a year of two halves. In the first half, the lack of demand for smart/formalwear hurt sales as offices closed and 'going out' was curbed by lockdowns and strict social distancing rules. In addition, job losses and pay cuts saw many consumers trading down to the more affordable value segment where TFG was under-exposed. However, in H2, the group was significantly less impacted by lockdowns. Management adapted quickly by increasing the leisurewear/athleisure offering to capitalize on the accelerating trends of working from home and wellness. Furthermore, the Jet deal dramatically increased exposure to the value segment. The net result was a 63% increase in turnover when one compares the 2nd with the 1st half. Let's now examine the main drivers of this turnaround.

Firstly, the immediate action to deal with the hard lockdowns was to focus on cash preservation and 'batten down the hatches' by 1) extending payment terms with suppliers; 2) seeking rental relief from landlords in shopping centres; 3) putting over 60% of expansionary capex under review; 4) tightening their credit granting criteria (less than one in 10 credit accounts were approved), and 5) cancelling or delaying merchandise orders. As a result, TFG managed to generate a remarkable R9.4 billion worth of cash despite a once-off R2.7 billion impairment in the UK and other restructuring costs.

SPEED READ

- **Seizing the opportunity: Jet, bought from Edcon for R385 million, turned profitable within six months and recorded a gain on the purchase price, of R709 million.**
- **Covid positive - TFG's online sales grew 132% in SA and 58% in Australia, and now comprise 12% of total group sales.**
- **Shares purchased in the rights offer last year at R41.90 have returned +250%.**

Secondly, the Group embarked on a R3.95 billion rights issue (raising new capital) to shore up the balance sheet and provide flexibility to pursue any opportunities. Shareholders had the option to buy 40 new shares for every 100 held at a price of R41.90 - a 40.8% discount to the prevailing share price. Our decision to back TFG's quality management and follow the rights issue for clients has been handsomely rewarded, given that TFG shares are currently trading above R150 per share. Despite not declaring a dividend in 2021, management has indicated that they would look at resuming dividends in FY2022 thanks to their strong cash position. For now, it is a total return story. The gains in the share price have more than compensated for the lack of a dividend.

In tough times, the last thing one wants is excessive debt that is onerous to service. Combined, the above measures reduced net debt by R7 billion to R1.3 billion (a fall of 83%) which set the Group up perfectly for an opportunity of a lifetime. Having initially denied they were in talks with ailing retailer Edcon, TFG suddenly surprised the market by announcing that they had bought Jet from it for an opportunistic R309 million, which included roughly R800 million worth of stock! The company realised a gain of R709 million on that transaction and should enjoy a boost to turnover of R6 billion in the year ahead. Through that deal, Foschini acquired 425 hand-picked stores and are looking to comfortably add 100 more. The market cheered the news of the re-launch of JET Home which will be rolled out within 345 Jet stores. In one fell swoop, TFG had increased its market share to 18% in the highly competitive but lucrative lower LSM value market, lining up Mr. Price and Pepkor in its sights at a crucial time and further diversifying its earnings base across all levels.

It was in late 2017, on a site visit of TFG's very impressive Quick Response Manufacturing (QRM) operation in Caledon, where I saw first-hand the intense focus that TFG was placing on local manufacturing to optimise its supply chain. With the Rand capable of swinging violently in both directions, ordering merchandise from China has always posed a huge foreign exchange risk. Furthermore, the long lead times of over 5 months where one's ability to predict fashion correctly and order the right quantity across every size is crucial and often a gamble. This is a problem all SA retailers have faced over the years, and it has been exacerbated by Covid and the disruption to global supply chains. Owing to their strategic focus on QRM capability and the establishment of two manufacturing hubs in the W. Cape and KZN, lead times have now been slashed to just 42 days! Put simply, this competitive advantage enables TFG to generally give their customers what they want before their competitors can. Getting fashion wrong can cause material losses – think of all those "end-of-season" sales, but thanks to TFG's market-leading QRM ability, markdowns to clear excess stock have reduced from 16% to 7% and consequently, gross profit margins have risen from 36.8% to 48.8%, over the past four years.

It is well known that the pandemic has accelerated the shift from shopping in physical stores to shopping online. Last year, online retail turnover in TFG Africa and TFG Australia exceeded management's expectations, accelerating by 132% and 58% respectively whilst the London TFG brands managed just 9%. Excluding Jet, online sales now account for a very respectable 13% of group sales versus 8.4% in the prior year. There is further to go. Management is targeting online sales to comprise 25-30% of total sales in the medium term – significant when compared to an average of 3% online penetration for the SA retail sector. Importantly, all geographies are profitable which is not the case for many of TFG's peers. What is driving their success? Online sales success is directly correlated to social media following and brand strength. TFG's social media following is outpacing the rest of SA retail. For example, it has the largest Facebook and Instagram following. Total social media followers reached 13.9 million (+11% yoy) and there were 152 million unique website visits. Interestingly, 2.6 million orders were placed consisting of 5.7 million items indicating that online consumers were compelled to add extra higher-margin products to their basket - a bit like impulse snack purchases made whilst standing in the Woolies queue.

Globally, consumers are demanding easy-to-use technology that allows them to buy what they want, how, when and where they want it, especially through mobile devices. It is now more important than ever to have an omnichannel presence to maximise profits. What is the difference between single-channel and omnichannel? Single-channel commerce means you're selling your product via one sales channel only. Examples include a brick-and-mortar store, your own website or via a third party such as Takealot. The main differentiator is that omnichannel commerce should provide a seamless, user-friendly and completely connected/engaged consumer across all channels. Over the past few years, TFG has become the market leader amongst listed retailers in offering customers an "always-on" one-stop shop. TFG's impressive and popular in-house and third-party brand offering, local QRM capability and vast store network puts them closer to customers and has laid the foundations for its strategic aim to become the largest, most reliable and most profitable e-commerce destination on the continent.

In conclusion, TFG's management has adapted rapidly and successfully to mitigate the pandemic's threat. It has the potential to release over R1 billion in provisions, grow credit sales off a low base and resume the dividend. Furthermore, it stands to benefit over the long term thanks to its strategic investment in its supply chain and e-commerce platforms, which are ahead of its peers. The company is thus well positioned and committed to generating steady long-term returns for shareholders and despite having rallied hard after results, we are happy to hold TFG and add on any weakness as consumer confidence and employment turn more positive.

Please note, due to the concerns over the 3rd wave of Covid, Harvard House has decided to cancel our Insight presentations until further notice.

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Topic: n/a

Natal Midlands

Date:	TBC
Venue:	Fernhill Hotel Midmar / Tweedie Road Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg

Date:	TBC
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

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