# Mr Price: still our preferred retail apparel stock.

*According to StatsSA, sales growth for the Textile, Clothing and Footwear segment of the retail sector has been far better and more resilient over the past year than the rest of the retail industry. This bodes well for my favorite retail apparel group, Mr Price, which recently released their results for the financial year ending March 2024. Although there were numerous headwinds during the previous financial period, and the continuation of macro-economic pressures during this current year, investor sentiment has turned positive and the future looks more promising than the past.*

**SPEED READ**

- **The 2023 annual financial results for Mr Price Group (MRP) were disappointing. The share price reflected the deterioration in investor sentiment.**
- **A year later, both of their recent acquisitions, Power Fashion and Studio 88, recorded double-digit revenue growth, which pushed the Group's total revenue growth into double digits.**
- **One of the most attractive features of MRP is their strong balance sheet and steady cash flows. After their annual capital expenditure, they still have health free cash flows.**
- **MRP remains a leader amongst local apparel retailers in terms of operating profit margins. This, combined with their strong balance sheet, allows them to pay regular dividends to shareholders – very much in line with our income-focused philosophy.**

Jana
van Rooyen

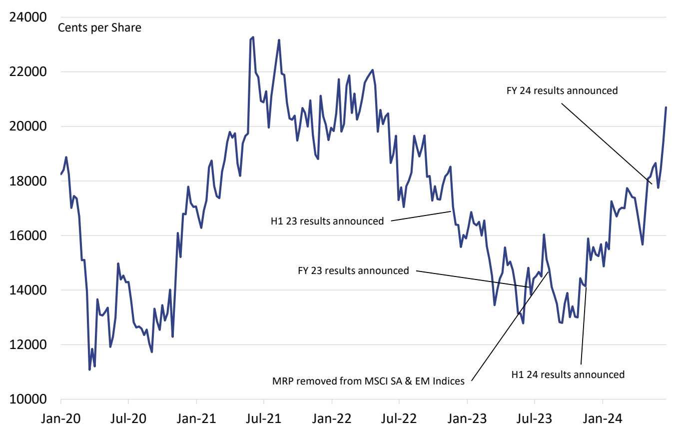
My favorite retail apparel company recently announced their 2024 financial results. I am sure Mr Price Group (MRP) is well-known to most of our clients. It is the second-largest apparel retailer (behind Woolworths) based on market cap and is included in the FTSE/JSE Top 40 index. Founded in 1985, MRP predominantly operates from South Africa with the bulk of its revenue generated from fashion-value offerings to its customers. This article provides an annual update of the Group and reaffirms why I am so biased towards it.

Let me start with a quick recap. Another year has come and gone, and MRP has posted their 2024 financial results. In 2023, there was a noticeable impact from loadshedding, given that MRP were caught napping. They were not prepared for the level of loadshedding that we endured from October 2022 through to June 2023, resulting in significant lost sales as stores were unable to trade and consumers focused their spending on alternative power solutions rather than new clothes.  Furthermore, weak sales meant that stock levels were too high, which resulted in margin erosion as they had to discount prices to clear the shelves.

Like all companies, at some stage one needs to upgrade IT systems. Whilst the benefits over time can be substantial, the implementation phase seldom goes smoothly. Corporate SA is littered with examples of costly IT upgrades gone wrong. During their 2023 financial year, MRP replaced their Merchandise Resource Planning system, which caused disruption in the supply chain and merchant activities, materially impacting margins. Stock levels were not correct, which forced the Group to mark down items, which in turn saw a decline in gross margins. Nonetheless, compared to other general retailers that went through similar upgrades, MRP was much quicker to recover.

Investors' disappointment with these results was clear with the share price descending steadily, as seen in the chart below. This period of weakness meant that during the quarterly review of indices by Morgan Stanley Capital International ("MSCI"), MRP was deleted from its SA Index. That prompted a further selloff. A year later, and not only is the sentiment towards SA more positive after our elections, but MRP's results were solid. Given the issues in the base from 2023, MRP was set for a better financial year. Fortunately, they exceeded expectations.

## MRP SHARE PRICE




*MRP share price declined by 19% between the results presentation for the 2023 interim results held in November 2022 and the year end results for 2023. Although the interim results for 2024 showed a tough period, investors started to anticipate better times ahead. The positive election result has been the cherry on top.*

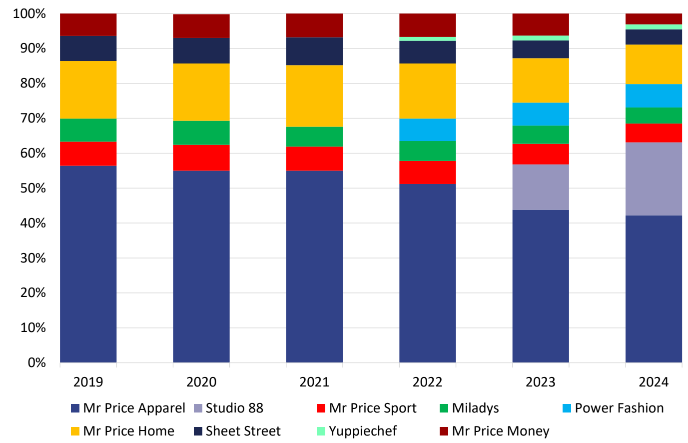
For many years MRP grew organically rather than through acquisitions. In fact, MRP's last acquisition was Sheet Street, way back in 1996. However, since 2020, MRP has made three key acquisitions, taking advantage of its strong cash position and the turmoil created by the Pandemic and weak economy, to pounce! These acquisitions were Power Fashion (further cementing their role in the value sector), Yuppiechef and Studio 88.

Over the past year, both Power Fashion and Studio 88 recorded double-digit growth, which in turn pushed the Group's total revenue growth into double digits. Encouragingly, Power Fashion has had 26 consecutive months of market share gains according to the Retailers' Liaison Committee. Unfortunately, not all segments were sunshine and roses, as their Home segment same-store sales deteriorated by almost 4%. Here, the Foschini Group has been a formidable competitor following their acquisition of Tapestry, and Pepkor has also entered the homewares market. Nonetheless, MRP still maintains a 30% market share collectively over its three Home brands and saw an uptick in revenue growth in the latter part of the 2024 financial year.

> "Encouragingly, Power Fashion has had 26 consecutive months of market share gains according to the Retailers' Liaison Committee."

MRP's revenue has always been predominantly cash based. As our macro environment deteriorated, with consumers facing rapidly rising inflation and interest rates, many consumers turned to credit to supplement their discretionary spending. MRP saw an uptick in their credit growth in the prior year of more than 8%. However, this financial year, with the cost to service debt even higher, MRP was more prudent with their approvals and credit sales only increased by less than 2%. This might have dented revenue growth in the near term, but it's better than having a large bad debt charge in the years to come from consumers who over-extended themselves.

## MRP DIVISIONAL SALES CONTRIBUTION




*The chart above shows the contribution of each division to sales over the past few years. We can see that the contribution of Studio 88 and Power Fashion has increased year on year, while Yuppiechef makes a far smaller contribution.*

One of the most attractive features of MRP is their strong balance sheet and steady cash flows. MRP debt largely consists of lease liabilities – rental due to landlords across their store network. With a strong cash balance, the net debt position is negligible so, unlike other companies with large debt positions, MRP does not undermine its earnings and profits with large interest payments. Equally encouraging was the improvement in cashflow as the trading performance improved and working capital efficiencies took place. Capital expenditure was focused on allocating cash to opportunities that provide the highest return. As a shareholder, you want to know that a business is thinking of the next steps to ensure future growth.

The acquisitions of Power Fashion and Studio 88 have come at the expense of margins – both operations tend to have lower margins given their target markets – so the Group's margin has declined slightly. That is not to say that they are unprofitable – just a little less profitable than before. Nonetheless, they still grew operating profits, and

MRP remains a leader in the SA apparel sector in terms of its operating margin. So, they have room to be flexible to achieve growth.

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At the end of the day, all this adds up to a cash positive business with a strong balance sheet and no debt, and hence the ability to reward shareholders. MRP's dividend policy is to pay 63% of its headline earnings to shareholders as a dividend – a ratio that has been constant for the past fifteen years, except for FY20 which was the Covid year. That consistency is reassuring and speaks to the quality of the underlying operations.

Looking ahead, we expect earnings (and therefore dividends) to rise over the next three years, based on:

1. Modest rollout of new stores. MRP is planning to spend R1 billion over the next year on capital expenditure which is an increase of 9% over the prior year. This includes around 200 new stores, the equivalent of 5% growth in new space. In the previous financial year, investments were made to ensure all stores have sufficient back-up power. In the year ahead more of the investment focus can be on growth and not just protecting the current revenue stream.
2. There have already been some green shoots for the start of FY25. At the time of writing, SA has enjoyed almost 100 consecutive days of no loadshedding. We know that costs will reduce as a consequence.
3. As MRP revenue is largely generated in South Africa, it is sensitive to Rand fluctuations, especially since they still import a large proportion of their stock. The Rand has strengthened against the US Dollar as sentiment towards SA has improved. This will alleviate margin pressure if sustained.
4. MRP is well positioned to benefit from a consumer recovery over the next year, thanks to its value offering. We still anticipate that the Reserve Bank will cut interest rates by September or October, alleviating the current consumer pressure. That, together with anticipated higher growth following the elections, would be a significant tailwind for the retail sector. MRP will be leading the charge.
5. Finally, the introduction of the two-pot retirement system in September may lead to an uptick in discretionary spending. We know that South Africans are not good savers. We believe many will dip into their retirement pots to fund current expenditure – bad news for their retirement, but good news for retailers.

Unfortunately, it is not all plain sailing. I am sure everyone is enjoying the warmer winter weather – which is good news for those who feel the cold, but bad news for retailers with full shelves of winter woolies. Luckily, the cold snap in June has offered some reprieve and I am sure that we will have more cold snaps before winter is over. In addition, much has been written about our ports. Whilst the worst appears to be behind us, delays and inefficiencies remain, which push up logistics costs. MRP is mitigating this by increasing their lead times, but that also raises fashion risk – lots of stock in items that are not selling well.

In conclusion, and thanks to a very capable management team, MRP was able to deliver better results and shareholders were rewarded with a total dividend of 810c per share, the highest in the Group's history. Investor sentiment has also improved, and although MRP trades at a higher PE ratio than it did a year ago, its valuation is still 12% lower than the average valuation over the past ten years. If MRP price can deliver growth as currently forecast, then there is still plenty of upside potential.

## BUY THE SHARE


*In my Intuition article in September last year, I wrote about the 2023 financial year end for MRP. At that time, the share price was around R135. As mentioned at that time, the weakness provided a perfect opportunity to invest at an attractive entry point given a P/E Ratio of 11x. That price was less than what a T-shirt would have cost you. There is a good chance the shirt would not be as trendy now, but if you opted for the share instead, you would have had a capital gain of 48%.*

Our next seminar will be held in September. The topic will be advertised in due course.

**Topic:** TBC

| Natal Midlands | |
|---|---|
| Date: | 12 September, 2024 |
| Venue: | Christ Church Howick, 23 Mare Street, Howick |
| Morning Time: | 10am for 10.30am |
| Evening Time: | 5.30pm for 6pm |

| Johannesburg | |
|---|---|
| Date: | 10 September, 2024 |
| Venue: | Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham |
| Time: | 7am for 7.30am |

| Cape Town | |
|---|---|
| Date: | n/a |
| Venue: | SSISA Conference Centre, Boundary Road, Newlands, Classroom 1, 3rd Floor |
| Time: | 7.30am |
| Venue: | ABRU Motor Studio, Lourensford Wine Estate, Somerset West |
| Time: | 5.30pm for 6pm |

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