Pick n Pay's performance still poor

A year ago Pick n Pay chairman Gareth Ackerman spoke of the "green shoots [of recovery] getting stronger". His enthusiasm was more than a little premature.

Far from being on a recovery track, Pick n Pay's headline earnings per share in the 52 weeks to March slumped 30,8%. It was the worst in three years of consecutive declines that have more than halved earnings and dividends.

"They [management] were a bit optimistic about progress," says a diplomatic Richard Brasher, the troubled retailer's new chief executive who was appointed in February. Brasher brings with him 26 years of experience at Tesco UK, from which he resigned as chief executive in March last year.

He will need all his experience at Pick n Pay, which has been trying to fast-track the reinvention of its business model, severely damaged by a decade of under-investment.

Complacency manifested itself throughout Pick n Pay, not least in its failure to follow Shoprite, Spar and Woolworths in adopting central distribution. This limited Pick n Pay's ability to serve a growing demand for more convenient shopping, entailing large numbers of smaller stores. These can only be served efficiently through a central distribution system.

"Pick n Pay was not able to take the advantage of scale its competitors did," says Brasher. "Competitors," he adds, "were able to position 60% of their stores where customers wanted them while Pick n Pay has achieved this with only 15% of its stores," he says.

Compounding Pick n Pay's problems was its acquisition of Australian retailer Franklins in 2001. A big drain on capital and management time, the unprofitable company was sold in 2011 for R1,3bn.

The results of the strategic blunders speak for themselves. Once SA's largest food retailer, Pick n Pay finds itself trailing the pack, which took full advantage of its self-inflicted plight. Shoprite, which overtook Pick n Pay in sales terms in 1998, reported sales of R46,7bn in its six months to December, almost 80% of Pick n Pay's latest annual sales of R59,3bn. Spar has also opened up a solid lead on Pick n Pay, reporting retail sales of R66,2bn in its year to September 2012.

Pick n Pay has invested billions to address its problems. The consolidation of five regional buying operations into one central unit in 2012 and replacing its old technology platform with a top-notch SAP system was costly.

"We must now convert capital expenditure into profit," says Brasher. He has also put the brakes on what he believes has been change at too fast a pace. "The team's focus must be on making what we have work, not doing new things," he said.

Brasher also leaves no doubt he is not entirely satisfied with Pick n Pay's leadership team's showing. "Better performance is required. It must become a high-performance team, not a loose coalition," he stresses.

Retail sector specialist Syd Vianello believes Brasher is signalling big changes ahead in Pick n Pay's top management. "Brasher will want to work with people he is happy with," says Vianello. "There will have to be changes in leadership. It is time to bring in new blood from outside the company."

It appears to be already underway with the poaching last week of two Shoprite executives: merchandising director Gerhard Ackermann and Gustave Möller, head of expansion at U-Save.

Amid the gloom of Pick n Pay's latest results, Brasher talks up some positives. "There were some things to be pleased about. We served more customers than ever and opened 107 stores, the highest number ever for Pick n Pay."

The retailers reported a 4,3% rise in the customer count in its latest financial period. But this did not yield commensurate sales volume growth. Sales growth of 7,1%, when adjusted for price inflation, came in at only 0,4%. More telling, sales on a same-store basis were up only 3%, indicating a 2,9% fall in volume per store.

Shoprite, in its six months to December, reported a 3,2% rise in SA customers and a 4,8% rise including African operations. Shoprite's sales grew 13,8%, or by 9,5% when adjusted for product inflation.

Spar also outshone Pick n Pay, increasing retail sales through 868 food stores by 11,5% in its year to September. Adjusted for inflation, volume grew 5,4%. Woolworths, which has been eroding Pick n Pay's market share in the higher income sectors, reported food sales growth of 11,1% in the 26 weeks to December. Adjusted for inflation, volume was up 3,7%.

Brasher is undaunted. "No competitor is invincible," he says. "I have played against most of the best [retail] teams there are. You must trust your own game and get on with the job."

His confidence is backed by his record at Tesco UK as part of what he terms "a strong team" that grew market share from 15% to 30% in one of the world's toughest retail markets. Brasher is credited with having created Tesco's international sourcing operation and its entire supply base, key elements in its success and critical areas in Pick n Pay's recovery.

Evan Walker, a fund manager at 36One Asset Management, is not convinced. "Brasher needs capital to expand and fix stores but he does not have the balance sheet to do it," he says.

Pick n Pay has an ambitious capital expenditure programme calling for investment of R1,767bn in the 12 months to February 2014. This is R462m (36%) more than in the previous 12 months and includes R803m for new stores and R232m for store upgrades.

It comes at a time when the retailer's debt is rising steeply. I-Net Bridge data shows serviced debt at the end of the latest reporting period at 122% of shareholders' funds, up from 70% the previous year. Cash flow in the latest reporting period was also poor, coming in, after tax ,at R312m and dividends paid at R583m and R230m, down from R1,23bn the previous year.

While a rights issue appears to be needed, such an issue would depend on the Ackerman family's willingness to follow its rights. An alternative could be a substantial preference share issue.

But even backed by the required capital, Walker believes Pick n Pay is entering the race for space too late. "Another 600 food stores will be opened in the next two years in a market that is near saturation," he says. "Pick n Pay's expansion will worsen the situation."

Shoprite's chief executive Whitey Basson is clear on his strategy. "We are defending our turf aggressively," he says. "We have the infrastructure to open as many stores as we want to without significant investment."

Brasher is staying mum on a timeframe for his strategy for reviving Pick n Pay. "It will not be a one-year event and neither will it be a 10-year one," he says.

"I am confident he [Brasher] can fix Pick n Pay but it is likely to take many years," says Absa Capital analyst Christopher Gilmour

Walker's view is harsher. "Pick n Pay's results will improve, if only through increased efficiency. But even if they double it is still too expensive." The retailer's 38 price: earning ratio is almost double the average 20 ratio over 10 and 20 years.

Investment in Pick n Pay is an act of faith in Brasher's ability. But even if he pulls it off and Pick n Pay's headline earnings per share rebound, its share price appears to be discounting a big part of any recovery.

Source: Financial Mail via I-Net Bridge