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Retail innocents abroad

Better to travel in hope than arrive for retailers seeking new fortunes

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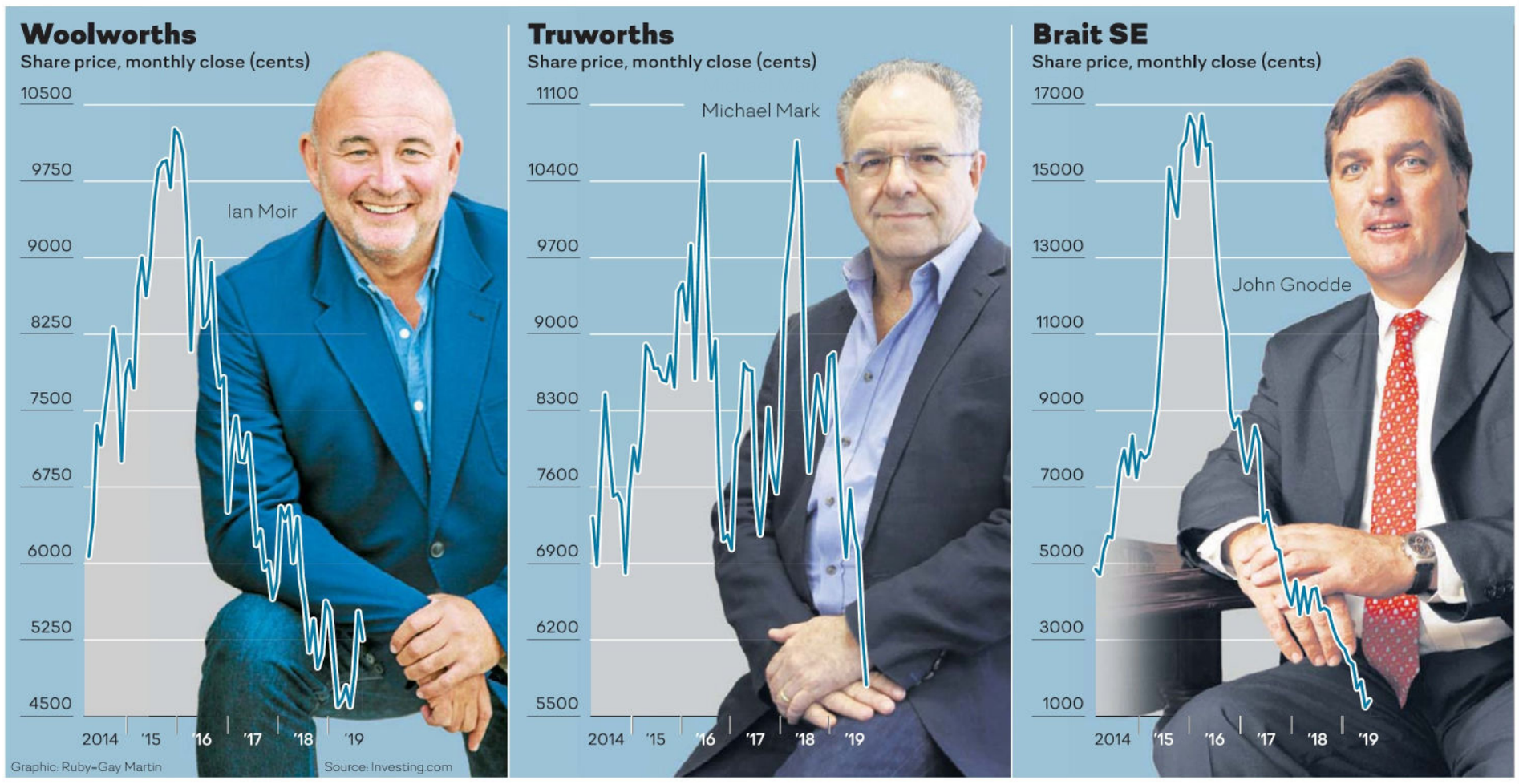

● The slew of write-downs from locally listed retailers that bought overseas companies show these purchases have not only failed to meet expectations, they continue to lose shareholders billions of rands.

Big South African retailers have enjoyed strong domestic growth over the past 20 years. There aren't many possible acquisitions left locally that can boost earnings, and local growth is stagnant. So, caught between a rock and a hard place, they've bought overseas.

But analysts and fund managers question why they bought businesses that needed to be fixed, and in sectors in decline or with balance sheets that were stretched too far.

Truworths bought Office, and Brait acquired New Look in the UK, and both have had to deal with curve balls such as Brexit fuelling consumer uncertainty, a depressed market and the acceleration of the migration to online shopping.

Woolworths' plan to create a "leading southern hemisphere retailer" and "one of the top 10 global department store operators" by buying David Jones has so far failed. Instead it has written off about R12bn, more than half the purchase price of R21.4bn.

When Woolworths bought the Australian company, some were concerned it had not only overpaid, but was exposing itself to a dwindling retail model.

When the deal was completed in 2014, Woolworths' share price was about R105. Since then about R53bn has been slashed from its market capitalisation and the shares are now trading at about R52.

On top of this, Woolworths has replaced three sets of management at David Jones in a short period.

What went wrong for Woolworths? A tough economy for sure, but more pertinent is that department stores have fallen out of favour with consumers, who want specialised stores. Now Woolworths is hoping its A$400m (R4.1bn) investment in sprucing up its flagship store in Sydney will lure customers.

Earlier this month, Truworths International shares hit a nine-year low after it cut the value of its UK business by more than a third. Again, Brexit turmoil and online shopping took their toll.

After earnings in the UK fell by up to two-thirds in the year ended June, Truworths wrote down the value of its Office business, which it bought for £256m in 2015, by £97m (R1.79bn). It has been in talks with lenders to restructure the shoe chain's debt.

Anthony Thunstrom, CEO of , says the UK market is "as tough as hell". He says that at the end the day it's an acknowledgement upfront that we're not going to go and run retail or businesses overseas from SA. "You cannot do that. And almost every example that you've seen go wrong one way or another links back to someone over here trying to run a business over there.

"So for us it's all about finding the right management team, and chemistry to find a management team you can work with. It's the same team that has delivered success of the brand and then being prepared to stay on for a substantial period of time through incentives.

"That fundamentally is our belief."

He adds that "every single case of the businesses TFG has bought has come through a personal referral and not via investment banks".

Less than four years after buying a 90% stake in UK fashion chain New Look for more than R14bn in 2015, Brait said in January this year that a restructuring and a bailout will leave it owning no more than 18% to 30% of the company. The news saw Brait's share price collapse to R25, its weakest level since 2012. It hit R167 in 2016.

New Look is now returning to its broad-appeal product and has seen improvements in year-on-year profitability across key womenswear categories.

Sasfin Wealth senior equity analyst Alec Abraham questions whether the retailers pursued particular targets, or if these were brought to the retailers by deal-seeking corporate financiers.

Abraham says local companies that have focused mainly on the domestic market have outperformed their peers. It's all about poor allocation of capital and the strategic decisions of business decisionmakers, he says.

Analysts say a company such as Clicks, which does not operate overseas (it exited Australia about 15 years ago) and is focused on the domestic market, is the highest-rated retailer based on price-earnings ratios.

> **'None have bought strong operating businesses to start with'**

But for some foreign retailers that have expanded into SA the South African market has not yielded returns. This week Botswana-based retailer Choppies Enterprises said it planned to sell its South African stores.

South African retailers that expanded offshore in many cases bought companies that needed to be fixed.

Evan Walker, a portfolio manager at 36One Asset Management, says South African retailers have gone offshore predominantly to fix businesses that need it.

"None bought strong operating businesses to start with. Everyone's ventured abroad looking for turnaround stories in markets that are already tough and where domestic competitors didn't want them," he says.

Walker says Woolworths bought David Jones when department stores were already slumping, and Truworths bought brick-and-mortar retailer Office "when you could see the internet coming fast and furious".

He says it's a hard call as to whether South African companies are seeing more write-downs from international expansion than their overseas counterparts.

As for local executives, "they're taking the capital offshore and the opportunity cost has been billions, and worse, it's seriously impeded their balance sheet", says Walker.

It seems TFG bought slightly better-quality businesses "but it's still early days and we are still waiting to see", he says. "It does look like they have made an economic return on the business, and they've been happy to let management continue running it."

Daniel Masvosvere, an equity analyst at Sanlam Investments, says the "ground has shifted underneath retailers".

"South African retail is over-spaced. We're fast running out of growth runway so if you're going to grow, you're going to take market share from someone else. There's not enough growth to go around for everyone. You'd naturally look for other places to allocate capital for growth and good returns.

"It's timing, it's picking the right asset, and right or wrong is not always apparent at the outset of doing the deal. It comes down to finding the right opportunity, paying as little as you can and executing on it once you've done the deal, all the while hoping the environment remains supportive, " he says.

> **'It's timing, it's picking the right asset and right or wrong is not always apparent'**

"A key aspect is not putting too much capital at risk."

Masvosvere says TFG's menswear group RAG in Australia, which it bought for R3bn in May 2017, has performed well and continues to do so.

Thunstrom said others "have a very negative view of Australia and it's a view we don't share. They haven't been in a recession since 1990 and they continue to grow. They're sitting at around 5% unemployment. We really don't see Australia as a difficult place to trade."

Last year, TFG said its London business would be likely to incur some bad debt write-offs as a result of the collapse of House of Fraser, through which it has concessions.

Yet in March this year, TFG said it was seeking to secure more than 9,000m² of retail space across its UK fashion brands over the next year. TFG entered the UK in January 2015 through the £140m purchase of women's fashion retailer Phase Eight, and added Whistles a year later.

This week, Truworths said in its 2018 interim report that key initiatives to drive growth in its UK operations include the "Store of the Future" concepts in Office in Oxford Street and in Offspring in Selfridges, and new developments in e-commerce, which now contribute 33% of Office sales.