Pick n Pay: Time to turn the retail tide

By Stafford Thomas

4 Nov 2016

"Retailing is not complicated - it's just hard to do well."

Pick n Pay in Benmore Gardens.

Picture: Freddy Mavunda

These were the words of Pick n Pay boss Richard Brasher when he took the helm of the then-beleaguered chain three years ago.

Pick n Pay, it would seem, is getting on top of things — seven consecutive reporting periods of strong headline EPS (HEPS) growth leave little doubt of that.

However, the retailer has a long way to go.

"We are in the process of modernising every facet of the company," Brasher says in an interview with the Financial Mail.

A key aspect is enhancing customer experience —Retail 101 that Pick n Pay neglected, to its detriment, for many years.

Playing catch-up fast, the retailer plans to pump R1.55bn into new stores and store revamps in the year to February 2017, up from just R816m two years earlier.

The capex focus since July 2015 has been on rolling out "next-generation" Pick n Pay and Boxer stores. The decidedly fresher and more modern-looking stores bring with them faster checkouts and a broader product offering, including store-in-store clothing, wine and personal-care offerings.

Though Brasher says such refurbishments are disruptive, "the results justify [them]". Reflecting this, the company has reported double-digit sales growth from its next-generation stores in the latest half-year to August.

One big positive of the new-generation stores is far better utilisation of store space, made possible by centralised distribution.

"In the past, about 40% of a store was used for storage," says Alec Abraham of Sasfin Securities. "Now only 5%-10% is needed, with the remainder put to work generating sales."

Though Pick n Pay has made strides with centralised distribution in Gauteng and the Western Cape over the past nine years, a big gap exists in KwaZulu Natal. The chief obstacle is difficulty in finding a suitable site.

However, this could change soon. "We are homing in on a site," says Brasher.

The group’s rivals have been building back-end capability for more than two decades. But Pick n Pay’s modernisation brings with it increased efficiency and, very importantly, the ability to contain costs. This, in turn, leads to the ability to lift operating profit margin.

It takes only small, incremental operating margin improvements to leverage big improvements in profit. In the latest six months a 7.2% rise in revenue, combined with an increase in operating margin from 1.3% to 1.5%, lifted operating profit 19.7%.

Another biggie for Pick n Pay in its latest six months was the dismantling of its archaic pyramid structure, which has long drawn the ire of shareholders activists like Theo Botha, through the unbundling of Pick n Pay Holdings.

The founding Ackerman family, which had control of the company for almost 50 years, introduced the pyramid structure in 1981 to prevent a hostile takeover.

"It was complicated to unwind but is no game changer," says Brasher. Indeed, the Ackerman family retains its 52.8% control of Pick n Pay through the issue of new, unlisted B voting shares. What it does do, says Brasher, is "tidy up" the corporate structure. "It eliminates having to have two boards and two sets of shareholders."

Another aspect of Brasher’s strategy to extract value from Pick n Pay’s R75bn annual revenue is a drive to increase the importance of margin-enhancing, private-label products. He has gone about it aggressively, introducing 700 new private-label products in the latest six months, bringing the total to 1,600. "At this level our private-label products are becoming noticeable in our stores," says Brasher, who mastered the private-label art during his 26 years with Tesco.

Private labels, also known as house or store brands, are often perceived as being a no-frills, lower-cost alternative in SA.

Now sporting what Brasher terms "modern and bright packaging", Pick n Pay’s lineup covers its basic no-name-brand range, as well as the upmarket Finest and Organic ranges.

"We may have another one up our sleeves," says Brasher.

Abraham sees Brasher working his retail magic for many years to come. "I expect HEPS to grow at above 20% annually for at least the next two years," he says. Looking to even bigger things, he sees operating margin at 4%-5%.

It makes Pick n Pay a share worth riding for the long term.

12-month target price: R69,25
Price on November 1: R66,17
Analysts' consensus: BUY/HOLD/SELL

Source: Financial Mail