Woolworths comparing their worth

By Stafford Thomas

4 Mar 2011

Since Woolworths and Truworths parted company in 1998, 17 years after an ill-conceived merger, Truworths has been the share to back, rising 700% compared with its former stablemate's modest 260% advance. Now the odds could be swinging in Woolworths' favour.

Both companies did investors proud in the six months to December 2010, Truworths delivering a 19.4% rise in headline EPS and Woolworths an even more impressive 25.8% rise.

Woolworths' results indicate that the problems that plagued it for years are over, says Absa Asset Management analyst Chris Gilmour "It is almost firing on all cylinders again."

Tasked with fine-tuning Woolworths is Ian Moir, CEO since November 2010. Moir comes with the reputation of being the man who put Woolworths' problem Australian unit, clothing retailer Country Road, back on the road to health.

Can it get better than this?

There is certainly nothing wrong with Truworths' health. Indeed, Gilmour questions whether there is scope for it to get much better. Pointing to the retailer's 28.7% trading margin, he says: "This is as good as you get anywhere in the world; how do you improve on it?"

Truworths is in a way a victim of its own success, reflected in cash flow that is growing its already excessive R1,8bn cash pile by R500m or more every year.

Though CEO Michael Mark dangles potential acquisitions in front of investors, the question is: what's there to buy?

Actually, there are no clothing retailers of any significance to be bought, says Investec Asset Management analyst Diane Laas Gilmour agrees, saying any acquisitions are likely to be minor in the context of its overall business.

Gilmour is not condemning Truworths to "ex-growth" status. But without an effective avenue to deploy its cash - other than a big special dividend - its return on equity (RoE) looks set to continue falling. Truworths' RoE fell from 49.6% to 41.5% between 2008/2009 and 2009/2010.

By contrast, Woolworths' RoE, after falling from 31.5% in 2006/2007 to 26.3% in 2008/2009, lifted to 39.7% in 2009/2010, its highest level since its unbundling in 1998.

Preparing for the fall

And while Truworths is preparing investors for a fall in sales growth, it is full steam ahead at Woolworths.

At an analysts' presentation, Truworths noted that sales in the first eight weeks of 2011 were up 9.8% compared with the same period in 2010, when growth was at 11%. The slowdown is not surprising, given the consumer euphoria in the run up to the soccer World Cup in mid-2010, says Laas. "Sales are growing off a high base; I expect sales growth in 2011 will fall further."

By contrast, Woolworths' financial director, Norman Thompson, told analysts at a presentation that sales growth in the second half of 2010/2011 was expected to be in line with first-half growth.

Looking at the medium term, Moir expects Woolworths will lift the profitability of clothing sales by 20% and of food by two-thirds. If the retailer can achieve these goals, it offers potential.

Woolworths' focus on high-income groups also suggests it will be left relatively untouched by Walmart, which is expected to target lower-income groups.

Growth forecast

Based on I-Net analysts' forecasts, between 2010/2011 and 2012/2013, Truworths' EPS are expected to grow at an average of 17.5% and Woolworths' EPS by an average of 15.3%.

Analysts' optimism over Truworths appears stretched, while their forecast for Woolworths appears to underplay its potential.

Source: Financial Mail