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EMERGING COMPANIES

Lights on the till

Some smaller retailers are beating the industry downturn by good management and by not falling into the discounting trap.

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There seems to be bad news everywhere for retailers. April was one of the worst months for retail sales growth in years, according to the Australian Bureau of Statistics, and indications are that May and June were no better. Department stores, hit particularly hard by unseasonably warm autumn weather and weaker consumer confidence, reported a fall in sales of 11.3% in April compared with March. They reacted by starting their sales earlier than usual. To make matters worse, a string of profit downgrades by small listed retailers have sent share prices falling across the sector.

ALAN KINDL: Have to fight for every dollar. Image: Louise Kennerley

But amid the gloom there are a handful of small retailers that are bucking the trend, either by being in the right subsector or because of good management, or a combination of both. Many of the retailers that are struggling the most have slashed prices in an attempt to recover, but in doing so they risk falling further into the mire. Companies that have refused to drop prices, but continue to provide differentiated service or quality to consumers, appear to be doing better.

An example of a company that slashed prices in an attempt to recover is the audio equipment and mobile-phone retailer Strathfield Group. On June 2, Strathfield told the market: "Following signs of a slight pick-up in March that was not sustained, the retail environment again slowed in April and May." Lumbered with excess and superseded stock and facing declining sales, Strathfield sold $1 million of equipment at prices that were break-even at best, and loss-making at worst. Strathfield now expects a loss of between $2 million and $4 million for 2004-05, compared with a net profit of $2.9 million in the half-year ending January 2, 2005.

In response, Strathfield shares were savaged; they fell to less than 5¢ in the second week of June, down from a 52-week high of 24.5¢, reached in December. Later in June, Strathfield announced a $12.15-million capital injection and the imminent resignation of three non-executive directors.

One retailing company that is attempting to survive the downturn without widespread discounting is Retail Cube. It sells paint, knives and sports shoes under three separate brands (Amazing Paints, King of Knives and The Athlete's Foot). In May, the company said retailing conditions "have undoubtedly weakened further" since it warned the market of slowing sales in October 2004.

Although Retail Cube's paint business is only expected to break even in the first half of 2005, and sales

of knives are below last year's level, the company says that The Athlete's Foot continues to trade well in an extremely tough retail climate. The chief executive of Retail Cube, Robert Estcourt, says he is beginning to shift the business model of the two struggling divisions to mirror the successful franchise model of The Athlete's Foot.

Estcourt says The Athlete's Foot has succeeded because it "has a very clear view of what its market is and how to access that market, and sticks to it with great discipline". He says the business refuses to compete on price alone, even as other retailers fall into the trap of discounting to stimulate sales. "Obviously we have to have a competitive price, but we compete on the overall service and shopping experience. If you compete on price alone, you will always be at the mercy of your suppliers and/or the large stores who can blast the hell out of you. You have to differentiate yourself on more than just price."

The managing director of The Athlete's Foot business unit, Michael Cooper, says franchised retailers may be better placed to do well in a downturn than retailers that own their outlets directly. "Franchisees tend to be more committed to their business than employees. In any period of downturn, those that are committed and determined are more likely to be successful."

Other well-known retail brands have been affected by slower sales growth and discounting. Clothing retailers have been among the hardest hit. Rebel Sport says its net profit for 2004-05 will be 15% below that for the previous year, partly blaming discounting that was done to overcome slow sales during the warm autumn. The big apparel retailer Just Group says sales in May, usually one of the biggest months for the company, were disappointing and that its earnings before interest, tax and amortisation (Ebita) for 2004-05 will be between $67 million and $73 million. This is down from an earlier forecast that the company would achieve Ebita of more than $80 million.

Miller's Retail, which owns chains such as Katies and Crazy Clark's, is taking drastic action to stem the effects of the retail slowdown. In early June it announced it would start a programme of aggressive sales and stock markdowns to cut its inventory levels, as well as closing 80 of its 1050 stores and writing down the value of its discount variety operations from $31.1 million to zero. Overall, the costs of its efforts to turn the business around will be as much as $55 million in 2005. Miller's Retail now expects to post a net loss this year, but its chairman, Geoff Levy, says the changes will free up working capital and give the company a platform for growth in 2006.

Not rocket science

A handful of retailers are defying the downward trend and have forecast growth in sales and profits. Retailers in the automotive sector, including Adtrans Group, AP Eagers and ARB Corporation, have all said they expect good results in the six months to June 30, thanks to continued strength in new car sales.

One of the best-performing small listed retailers this year is Noni B, a women's clothing retailer with about 180 stores. It reported 10% sales growth in the six months to December 31 and says that growth is continuing in the second half of the financial year. In late May, it announced a stunning upgrade to its forecasts, flagging an expected 35-40% profit increase this half-year.

Alan Kindl is Noni B's managing director and a substantial shareholder in the company (the Kindl family owns more than 45% of Noni B). He says: "We do not accept that there is a slowdown [in retail]. Retail is not that bad. It has not been easy, but retailing hasn't been easy for 20 years since we started. You have to fight for every dollar. But if you have got the right products and you exceed customers' expectations as far as service is concerned, people will always come back to your stores."

Kindl's approach to retailing provides a useful model for other retailers that are struggling. "We are not rocket scientists - there is nothing magical about it. We keep our eye on the ball, we are hands-on managers. We work very close to the market and spend a lot of time in stores, to find out what is happening out there. The answers are not in head office - the answers are out in the stores."

Noni B also avoids the discounting that other retailers, including Myer and David Jones, have brought forward to move winter stock and boost revenue. "We are always last to go into sale mode," Kindl says. "It is about control. Why do people go on sale early? Because they are not in control of their inventory."

Stockmarket investors have baulked at small retailers since the downgrades began. A fund manager at the Pengana Capital emerging companies fund, Steve Black, is cautious about the retail sector at the moment. But he says specialty retailers can grow despite the downturn. "If you have got the right format and you can manage that growth, then rolling out new stores can be pretty prosperous."

This is the strategy being followed by JB Hi-Fi, the discount home-entertainment and electronics retailer. JB Hi-Fi continues to make positive sounds, including affirming its forecast profit growth of 45% to 60% in 2004-05. Its chief executive, Richard Uechtritz, says sales slowed between January and April, mainly on "large-ticket" items such as consumer electronics and whitegoods. But he says the addition of new stores and better sourcing of goods means gross margins are improving, boosting net profit.

Retail therapy

What successful smaller retailers are doing to combat slower consumer spending:

- Some are discounting prices to reduce excess inventory and free up working capital, which can be reinvested in profitable growth.
- Others are differentiating on service and quality, not price, and avoiding cutting profits to boost sales. In a price war, bigger retailers will beat smaller ones.
- One listed retailer is applying a franchise model for expansion. Some retailers say franchised stores do better than company-owned stores, particularly in a downturn, because they are more committed and less likely to blame external factors for their woes.
- Some specialty retailers are opening new stores in an attempt to grow by increasing market share as overall retail spending slows.

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