Kathmandu can-do

Growth justifies takeover rebuff, says Simonet

PETRINA BERRY
RETAIL

THE head of outdoor clothing retailer Kathmandu says strong profit growth vindicates the group's decision to reject a takeover offer last year.

Speaking yesterday as the group posted its results for the year to July, Xavier Simonet said the buyout attempt was misguided. "The business model is not broken and that was the assumption of the takeover bid," he said.

New Zealand retailer Briscoe lobbed a takeover bid for Kathmandu just a day after Mr Simonet stepped into the chief executive role in June last year.

The takeover offer coincided with a slide in Kathmandu's share price after the retailer had aggressively discounted stock, downgraded profit forecasts and struggled with sluggish sales growth.

A year after rejecting the takeover offer, Mr Simonet unveiled a full-year net profit that had "exceeded expectations."

Kathmandu's net profit rose 64 per cent to $NZ33.5 million ($32.4 million), and sales rose 4 per cent to $NZ425.6 million.

The previous year, the group — which is based in New Zealand and listed on the Australian Securities Exchange — had suffered a 51 per cent slump in profit to $NZ20.4 million.

Mr Simonet said Kathmandu was holding less inventory and had moved away from aggressive discounting and towards new and distinctive products with higher prices.

The value of the group's total inventory was reduced by 15.8 per cent, or $NZ17.9 million, over the year.

Kathmandu's like-for-like sales, which strips out the impact of shops that have opened or closed, rose 2.6 per cent in Australia but slipped 0.1 per cent in New Zealand.

Total sales grew 7.4 per cent in Australia and 1.9 per cent in New Zealand, helped by the opening of five new stores.

But the group's British sales declined 10.5 per cent due to the closure of three stores.

Kathmandu, which had only four UK stores, decided a year ago to close its UK stores and abandon plans to expand into Europe. Instead, the retailer wants to grow its overseas brand through online sales and digital marketing.

"We have seen a huge increase in the number of younger customers getting excited about the brand and visiting our website," Mr Simonet said.

Online sales grew about 15 per cent, amounting to about 7 per cent of total sales.

Kathmandu declared a final dividend of NZ8c a share, up from NZ5c a year ago.

AAP

MERGER JUST THE MEDICINE FOR SALES

DEALS

PHARMACY group Terry White has lifted its full-year earnings by half after merging with Chemplus, and is looking for more mergers to fuel further growth.

The group yesterday posted a net profit of $1.84 million for the year to June — up from $1.22 million the previous year — following the buyout of Chemplus pharmacies in July last year. Its sales jumped 47 per cent to $70.6 million.

Terry White last month announced it was merging with Chemmart to form one of Australia's biggest retail pharmacy networks, with about 500 pharmacies and a turnover of $2 billion.

The group is now considering a float in the wake of the Chemmart deal.

Chief executive Anthony White said the company was well positioned to pursue another merger with a smaller pharmacy group with 20 to 40 stores in Australia.

"The main thing is to get a group that's fairly like-minded and really focused on healthcare and frontline health services and really making the pharmacist the centre of all things we do," he said.

Mr White said health services differentiated Terry White pharmacies from its main competitors.

"We train and develop the pharmacists to be upfront and accessible to the customer, whereas you go into a Priceline store or a Chemist Warehouse store, (and) they're really hidden — they're secondary to the product on sale," he said.

Terry White had about 430 shareholders, including co-founders Terry and Rhonda White, and was looking at a public offering in the next year to two years, Mr White said.

"We've definitely got the base to do it now and maybe if we can do another acquisition in the next 12 months or so that would be a great base to go forward with," he said.

"This transaction with Chemmart has been very rewarding for the shareholder base, and hopefully we bring it through to an IPO and it'll be even more successful for them."

The Terry White group prides itself on the accessibility of its pharmacists, according to its chief. Picture: ANNETTE DEW

Coles HQ slice added to Charter

PROPERTY

CHARTER Hall has bought half of the building that houses the headquarters of supermarket heavyweight Coles.

The listed property company revealed yesterday that it paid $140.5 million to Investa Office Fund for the stake.

It noted the Wesfarmers-owned grocer had a lease tying itself to the Melbourne property, called the Coles Headquarters, until 2030.

The other half of the building — on Toorak Rd in Hawthorn East — was owned by a private group, Charter Hall said.

Opened in the 1980s, the site had been affectionately dubbed Battlestar Galactica by Melburnians because of its foreboding exterior of black glass and concrete, ahead of a refurbishment in recent years.

It was originally the home of the Coles Myer retail empire before that business was split up last decade.

Shares in Charter Hall closed up 2.9 per cent yesterday at $5.38.

When low fees can only guarantee you low returns

THE SHORT CUT
with ANDREW MACKEN

FOR years now, there has been an almost structural increase in the amount of capital allocated to passive equity index funds — and a corresponding decrease in the amount allocated to active equity funds.

The rationale has been simple: passive funds are typically much lower cost and their returns have outperformed most active funds over recent years.

What's not to like?

The value proposition of equity index funds is that they are basically certain to receive the average market return, less the cost of the fund which is typically minimal.

Actively managed equity funds come with the prospect of generating returns higher than the market though are typically accompanied by higher fees. And the market outperformance is far from guaranteed.

In recent years, investors in many actively managed funds have been frustrated by the ugly combination of higher fees and returns of less than the market average.

For many, this situation has made it easy to make the switch to passive equity index funds.

A question worth asking, however, is the following: does the above calculus change in a structurally lower-returning world?

There is a strong case to be made that the future of long-run average equity returns may not look as attractive as in the past. The reason is that a number of the major drivers of equity returns are likely to present headwinds in the future, instead of tailwinds.

First of all, consider interest rates. Over the past 30 years, interest rates have fallen to zero (and, in some cases, are now negative).

Lower interest rates make the relative earnings yield of an equity security appear more attractive. The result is an expanded valuation multiple and higher stock price. Should interest rates increase, on the other hand, the reverse becomes true.

Second, corporate profit margins are near all-time highs driven by a period of cost reduction following the global financial crisis, as well as by reduced interest costs.

Costs cannot be cut forever and at some point margins should start to revert to the mean via price competition. Compressing margins result in slower earnings growth and relatively weaker stock prices, all else being equal.

Third, demographics in many parts of the world, including North America, China, Europe and Australia, are deteriorating. By this we mean that the dependency ratio between retirees and workers is increasing at an accelerating rate.

Slower growth in the working-age population results in slower GDP growth, while higher growth in retirees likely strains public budgets that fund healthcare and pensions.

These three headwinds alone result in a high probability that future long-run average equity returns won't be as attractive as over the past 30 years.

But for a passive equity investor, the return is precisely this average long-run equity return. Nothing more, nothing less (except for the management fee).

A high-quality active manager, on the other hand, retains the opportunity to outperform the market, despite a typically higher fee structure. And in a low-return environment, any outperformance — even small — becomes a relatively higher share of the overall total return.

And over the long term, this outperformance results in serious value accretion due to the power of compounding.

Proponents of passive equity index funds argue that it is better to lock in the market index return rather than risk missing it with an active manager.

But in a new low-returning world, how sensible is it to lock in this market index return?

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