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## Winners and losers in the COVID retail rollercoaster

*Written for **Money Magazine**, September 2021 Edition, by Forager Funds Senior Analyst of the Forager Australian Shares Fund, Alex Shevelev. Article titled "Winners and losers in the COVID retail rollercoaster"*

Who is the most important person in Australian retail at the moment? That's right: the local postie getting all those online goodies delivered to your door.

Retail stocks fell into two buckets as the COVID pandemic developed. The early winners were mostly e-commerce players, benefitting from the closure of physical retail outlets. The later winners benefited from buoyant consumer confidence, government support (such as JobKeeper) and fewer things for consumers to spend their money on.

Almost every retailer was a winner. But as we roll into the new financial year, both groups face some headwinds.

Share prices of the early winners rose markedly as the pandemic took hold. Despite initial predictions for lower consumer spending, the closure of physical retail meant more dollars for online shopping. Valuations expanded to all time highs.

As the economy reopened and vaccine rollouts showed success overseas, businesses like online electronics retailer **Kogan** (KGN) and **Redbubble** (RBL), an online marketplace for artists, have seen substantial falls in share prices. Lockdowns in Sydney and Melbourne, which will hopefully be brief, have done little to support share prices so far. While these businesses, and others like them, have good long term revenue growth prospects, in most cases that revenue growth is already reflected in their highly-valued share prices.

### **An early winner with a rosy outlook**

One early winner we have pulled the trigger on is online beauty company **Adore Beauty** (ABY). Adore's share price was down substantially since its well-timed initial public offering (IPO) in October 2020. The main seller was local private equity powerhouse Quadrant and the IPO was promoted by big-name brokers Morgan Stanley and UBS. Two days after trading for the first time, investors were nursing a 14% loss. Things didn't get better as a confusing trading update in April appeared to show growth slowing dramatically (it did slow, but not as dramatically as feared). Seven months after the IPO, Adore's share price had halved.

That is a good lesson for investors buying businesses off private equity: they are experts at timing their exits.

Still, despite the recent slowing growth, Adore remains a leader in its niche. Sales of beauty and personal care products online look to be growing at over 20% a year for the next half-decade. And Adore will be increasing its share of this growing pie.

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Years of outstanding customer service (and hundreds of thousands of free Tim Tams, one for every order over \$5) mean the business has built up outstanding goodwill with its customers. A management team which has more than \$100m invested in the company is incentivised to drive great long-term outcomes. The next 12 months might disappoint relative to a lockdown fuelled 2021, but the longer-term outlook is as rosy as Adore's Pixi Rose Tonic face creams.

On the topic of beauty, shaver and hair dryer retailer **Shaver Shop** (SSG) is a business the market is still pricing as a dying old-world physical retailer. It isn't.

After listing in mid-2016, the Shaver Shop struggled to keep costs under control. Margins fell despite a steady increase in sales. Profits flatlined. Then came COVID and threw the business into turmoil. In the first few weeks of the pandemic sales fell 11%. Shaver Shop battened down the hatches, cut spending, cancelled a pending dividend and prepared for a tough retailing environment.

Two months later the environment had shifted completely.

In the 6 weeks to mid-May 2020, fuelled by a quintupling of online sales, overall sales rose 32% from the prior year. With higher sales came fewer promotions and improved margins. Operating costs didn't rise much, positioning the business for net profit growth of 86% in the half year to December 2020. The company bought some franchisees and stockpiled cash.

Sure, it doesn't have the growth opportunity of Adore. And much like Adore, Shaver Shop may have to experience some muted growth as more people head back to a physical barber in 2022. But the company now has a well planted foot in the online world: online sales have risen to 30% of overall sales. As more spending shifts online, Shaver Shop will be there to capture it.

### **Structural winners in the offline world**

Delayed winners started winning when consumers started feeling confident.

No overseas trips. More time spent at home. Some useful government support.

A perfect combination to drive consumers to purchase those big ticket items they would have otherwise held off on.

New car sales soared, as did sales of new couches and TVs.

Large listed electronics and furniture retailers **Harvey Norman** (HVN) and **Nick Scali** (NCK) are trading substantially above pre-COVID highs. So is auto dealer **Eagers Automotive** (APE).

While these businesses are still enjoying strong trading conditions, they remain cyclical. Big ticket items are not frequent repeat purchases. And when the cycle peaks, there is only one way to go.

In May spending on household goods fell 6% from last year according to the Australian Bureau of Statistics. This is the first decline in almost two years. Furniture and homewares managed to grow 5% but growth rates slowed from 35% over the last three months. Sales of electronics were down 8%.

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## What happens when support falters?

As the Reserve Bank of Australia starts withdrawing the extraordinary monetary stimulus support that has kept interest rates low, the federal government rolls back COVID support packages, and international borders eventually open up, big ticket retailers are going to start facing headwinds. Australian banks have already increased their fixed mortgage rates to reflect higher market interest rates. The moves were a modest 0.2% to 0.3%, but if interest rate increases continue the average mortgage borrower will need to think twice about their new car or couch.

Despite these risks, there are still opportunities among these delayed winners.

**Motorcycle Holdings** (MTO) owns motorbike dealerships and is a retailer and wholesaler of motorbike accessories. Sales had been growing despite years of declines in industry-wide motorbike sales. Then the company got a welcome boost from COVID. Restrictions lifted quicker than many feared, while the government's JobKeeper support kept more people employed and spending. It also meant Motorcycle's salespeople had a portion of their wages subsidised.

With travel off the calendar and access to \$20,000 of superannuation Australians turned, like Steve McQueen in *The Great Escape*, to motorcycles. And with public transport suddenly less appealing, motorcycles present a cheap and exciting way to get around.

High pre-pandemic debt levels are gone, replaced with a balance sheet flush with cash. Recently acquired dealerships are contributing strongly. And new initiatives are boosting the range of motorcycles and other products in-store. All told, net profits are guided to be up about 70% for the 2021 financial year.

Investor fears of a big reversal in profitability are likely to be unfounded. This small, founder-led business has been making shrewd acquisitions and increasing its market share while times were tough. It should come out of COVID stronger than it went in, and be stronger again in five years' time.

Retailing, offline or online, is rarely smooth sailing. Despite calamitous initial expectations, COVID has proven a boom for most retailers with profits and valuations inflated for many of the large listed retailers. But, from sellers of face creams to shavers and leather jackets, a handful of smaller listed retailers are trading on cheap valuations and continue to grow.