DIVIDENDS

The Warehouse cautious on growth

JENNY RUTH

ONE OF the strongest messages coming out of The Warehouse Group's dismal annual results was that management now regards it as a low-growth, high yielding investment story.

The company changed its dividend policy and will now pay out 90% of earnings – up from 75% previously.

Chief executive Ian Morrice said this is a formalisation of what The Warehouse has effectively been doing over the past couple of years with the special dividends it has been paying.

Ian Morrice says The Warehouse has formalised the special dividends the company has paid out over past years. Photo: Michael Bradley

While the company last year paid ordinary dividends of 21 cents a share, special dividends raised the payout to 31c a share. This year's dividends totalled 30.5c a share.

"There is still growth available to us but it's modest growth. We've made no bones about that," Morrice said.

Formalising the policy came as a result of the firm deciding suitable acquisitions are unlikely in the near term. "The dividend policy is clearly illustrating it's going to become a yield play," said Rickey Ward at Tyndall Investment Management.

Most in the market are underwhelmed by the company. Guy Hallwright at Forsyth Barr rates it a "hold" and Sarndra Urlich at First NZ Capital is "neutral" while Buffy Gill at Goldman Sachs JB Were doesn't like the stock and rates it a "sell." Stephen Bennie at New Zealand Funds Management is an exception, celebrating the fact The Warehouse is now the second biggest yielding cyclical stock in the market behind only fellow retailer Hallenstein Glasson Holdings.

"It has a gross dividend yield nudging 10%. That's a very good cash return from any investment," Bennie said.

The company has been through some very difficult years since Morrice joined in August 2004, including the exit from its disastrous and expensive Australian adventure and then hitting the worst recession in decades, he said.

"I think we're getting to the stage when the ducks are starting to line up for them again."

One would expect The Warehouse's fortunes to improve as the economy does but that isn't happening yet.

Its "Red Sheds" results got worse as the year went on. From flat sales in its fourth quarter last year, the sales decline became worse every quarter, culminating in a 3.4% decline in the latest fourth quarter, according to analysis by Hallwright at Forsyth Barr.

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> – Ian Morrice, CEO of The Warehouse.

"We're quite honest about the fact that the second half was particularly tough for us," Morrice said.

Particularly tough categories were apparel and homewares. Morrice said poor weather and its specialty store competitors recovering from a poor period last year combined to hurt its sales and account for some of them achieving much better results than The Warehouse. High levels of discounting in the final quarter was driven by the need to clear excess stock.

The declining CD and DVD market didn't help the result. While The Warehouse claims rising market share, the shrinking market and declining average prices cost it $13 million off its sales line, the results showed.

Chief financial officer Luke Bunt's comments to analysts when the results were released weren't very comforting.

"The view we hold is that [full-year] 2011 could quite easily be as promotionally driven as 2010. I don't think we're seeing sufficient stability in retail consumption to argue for stable gross margins at this stage," Bunt said.

To the outside observer, The Warehouse's strategy over the last few years has been to move more upmarket with higher value stock and store upgrades. A number of observers have thought this was the wrong strategy and the company's results suggest that.

Morrice said while the company has indeed been upgrading stores and offering better quality stock, it has been following what customers want.

"What we believe . . . is that customers are changing. The days of conspicuous consumption and people buying lots of stuff whether they needed it or not, I think those days are gone," he said. "Ten years ago, there was lots of volume to be made in very, very cheap product. I don't think people are consuming as much of that particular type of product these days."

But The Warehouse hasn't given up its position of being the cheapest in the market and still has such "entry level" offerings in every category and intends to continue doing so, he said.

Bennie certainly believes Morrice has a much better grasp on what will and won't work at The Warehouse.

Bennie said he wasn't sure when Morrice started that he had a good feel for what The Warehouse was.

"He had a few shonky ideas about product lines. Six years on, he's obviously now got a much better idea of what The Warehouse is and the type of products they can sell successfully and the changes they can make to the stores."

■ **Jenny Ruth is a freelance journalist.**