EQUITY MANAGEMENT (SOUTH AFRICA)

EQUITY INSIGHTS

Pick n Pay: Five years into a successful turnaround, and the outlook is promising

Issue date: 16 October 2018

COMPANY OVERVIEW

Pick n Pay is a multi-faceted food retailing group with annual sales of R83 billion and 17% of the market share in South Africa. The Group has 1,628 stores, covering 2.4 million square meters of floor space of which 60% is owned and the remainder franchised. Pick n Pay branded supermarkets, hypermarkets and express convenience stores target middle to upper income customers countrywide. Boxer supermarket stores target lower end customers primarily in KwaZulu Natal and the Eastern Cape. 6% of revenue is generated from profitable operations in other SADC countries. Liquor, clothing and pharmacy stores now accompany the food offering while mobile and online are key growth focus areas. Value added services are being introduced through in-store kiosks, including money transfers, credit purchases and withdrawals.

Between 2008 and 2013, profits reduced by 43%, as margins came under pressure in the face of intense price competition by Shoprite who led in supply chain centralisation. In 2013, previous Tesco's Chief Richard Brasher joined as CEO, where he spearheaded a turnaround strategy to stabilise the business and recover a competitive operating position. Five years on, earnings have recovered 135%.

ATTRACTIVE CASH FLOWS

The business model at Pick n Pay is made highly attractive by their lean and predictable inventory and cash management. This enables them to convert a return on assets of 7% into a return on equity of 33% with moderate debt on the balance sheet. Operating cash flows produced are more than twice earnings, enabling the business to invest in growth and maintenance while consistently paying out 65% of earnings and providing strong stock option incentives to management.

GOOD STEWARDSHIP UNDER CEO RICHARD BRASHER

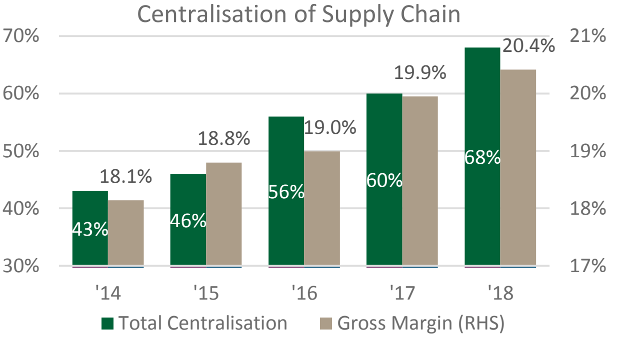
The bottom line result of the turnaround has been a doubling in the profit margin from 0.9% in 2013 to 1.8% in 2018. Strategic initiatives have been implemented across the business and include;

- Centralisation of the supply chain up to 72% in H1 2019, enabling cost efficiencies and gross margin improvement
- Investment in attractive pricing points by passing through gross margin and supply cost gains to customers
- Better stock planning, supplier collaboration and stock availability.
- Retail MD and turnaround specialist Pedro Da Silva has implemented a targeted efficiency enhancement program across the business
- Next generation store layouts have improved the customer experience and created a platform for value added services
- Improved quality and value of fresh produce and meat offering
- Loyalty program enhancements targeting personalised discounts
- PnP Express convenience store partnership with BP
- Clothing and liquor retailing introduced as a key growth driver
- Assortment review, and private label expansion to 21% of stock
- Operating efficiency gains through voluntary severance programme

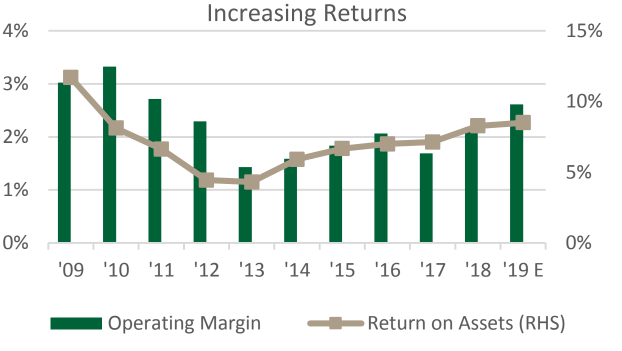
Along with five years of strong earnings per share growth, market share gains have now been reported over the past 12 months. Combined with a business in increasingly good shape, this raises the prospect of expanding returns and strong sustainable earnings growth.

	PIK
Market Cap	R 32bn
Current Share Price	R 64.39
52w High-Low Range	R 57.26 - R 82.09
Forward PE	17.3x
Forward DY	3.78%
Financial Year End	25 February 2018

Sources: FactSet, Oct 2018



Sources: FactSet, Oct 2018



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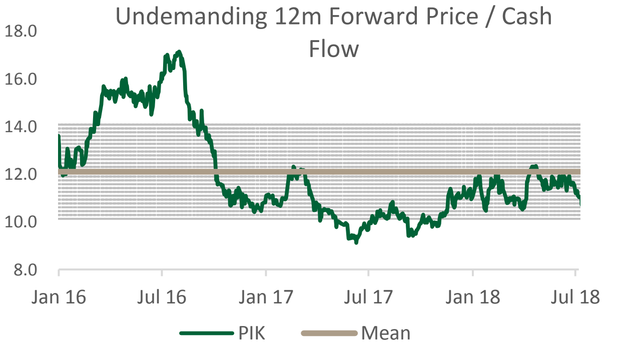

Sources: FactSet, Oct 2018

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