



Pepkor tilts the scales

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In South Africa's robust retail market, Pepkor stands out from competitors as the pre-eminent discounters. Armed with a strategic scale advantage and expansive operations, the group is positioned as a market leader in apparel, with considerable roots in other markets with growth opportunities. We delve into the key elements of Pepkor's success, its scale advantage, the iconic PEP and Ackermans formats and the significant cellular business.

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The Pepkor empire comprises over 5 700 stores across various market segments (*charted below*) in South Africa and neighbouring countries - the most extensive of any local retailer. The Foschini Group (TFG) has the second largest South African store presence with 3 644 stores.

Virtuous cycle of discounting

Pepkor enjoys unrivalled sourcing power as the largest South African garment buyer and therefore procures items at significantly lower input prices than competitors - passing most of these savings on to customers, resulting in higher volumes sold. This virtuous cycle of low markups and high-volume sales has solidified Pepkor's position as the leading discounter in South Africa.

PEP talk

The benefit of Pepkor's scale advantage is most apparent in the flagship PEP chain. Stocking everyday replenishment items at very low prices allows PEP to cater to price-sensitive customers, mainly residing in townships and rural areas, where PEP is often the only formal apparel retailer available. PEP is the price leader in 95% of their products on offer, with a comparable competitor price gap of 25%. PEP sells in excess of 690 million products annually across their 2 590-plus stores.

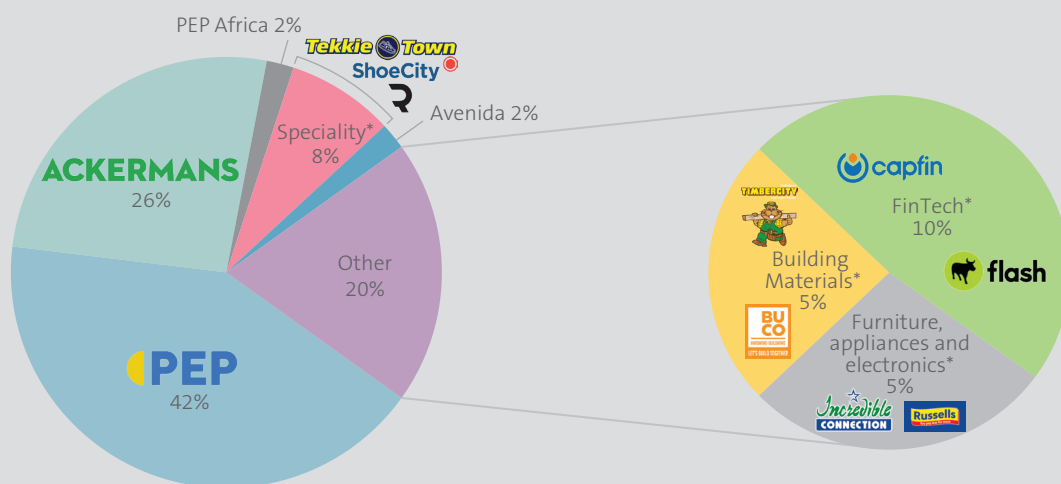
PEP's 'no frills' approach is characterised by simple store formats that allow for a straightforward shopping experience, with the emphasis on affordability. Stores are mainly located in close proximity to their core customer base or public transport hubs, supporting the concept of affordability as customers save on travel costs. These locations have low store rentals in line with PEP's low-cost operating model, boosting profitability for the group.

As illustrated on the next page, PEP has the biggest skew towards entry-level price points compared to competitors - 98% of their products are priced under R200, with an average price point of just R48. Loyalty for the PEP brand has enabled extensions into new formats such as PEP Home and PEP Cell, that have enjoyed quick and significant success and offer future growth potential.

Many of PEP's customers are government employees, who have strong job security and have seen above average wage increases over the last decade. It is estimated that half of PEP's customers earn less than R5 000 per month, with 40-50% of their customer base being social grant recipients, who similarly have reasonable income security, although at a very low level. PEP also has high exposure to informal economy participants, who are adaptable and resourceful in a tough economic climate.

While their customer base is reasonably resilient and PEP's product range of basic items at entry-level price points offers

Pepkor group operating profit split by business (2023)



*Speciality: Tekkie Town, Dunns, Refinery, Shoe City, CODE, SPCC | *FinTech: Financial services (Tenacity, Connect, Abacus, Capfin), Informal Markets (Flash) | *Building Materials: BUCO, Timbercity, Tileteria, Floors Direct, MacNeil, Cachet, B-One, Buchel, W&B Hardware, Buildware, Citiwood, Brands 4 Africa | *Furniture, appliances and electronics: JD Home (Russells, Bradlows, Rochester, Sleepmasters), JD Tech (Incredible Connection, HiFi Corp)
Note: Ackermans and PEP figures are estimates
Source: Company data, Camissa Asset Management estimates

customers some relief in tough economic times, the reality is that the lower-end consumer remains severely financially challenged at present due to high food and transport costs. We have seen the impact of this manifesting in lower-than-normal sales growth in recent PEP results, but we remain sanguine about the prospects for this highly cash-generative business as the consumer cycle begins to turn. Additionally, PEP benefits from consumers trading down when real incomes are squeezed.

The people's champ

As a group, Pepkor dominates the schoolwear market in South Africa, with 75% market share. A local PEP factory manufactures 11 million school garments annually and, consequently, a complete school uniform for a grade 1 child can be purchased at PEP for as little as R120. While schoolwear is a low margin business for PEP, the offering builds a loyal customer base and promotes store footfall with cross-product shopping opportunities. High sales volumes optimise revenues relative to its overhead costs (store rentals and employee costs) and enable PEP to benefit from holding stock only for short periods.

Unparalleled customer reach

Pepkor's extensive countrywide store footprint enables them to reach customer nodes that are inaccessible to other retailers. Coupled with a highly efficient distribution network,

this has opened other opportunities for the group. PAXI, PEP's parcel delivery service (started in 2015), is an example of this. It offers the lowest courier fees in South Africa for consumers and small businesses and there are currently over 2 800 PAXI points located in all PEP, Tekkie Town and Shoe City stores across the country. This service uses the existing infrastructure of the group and therefore comes with little incremental costs to Pepkor.

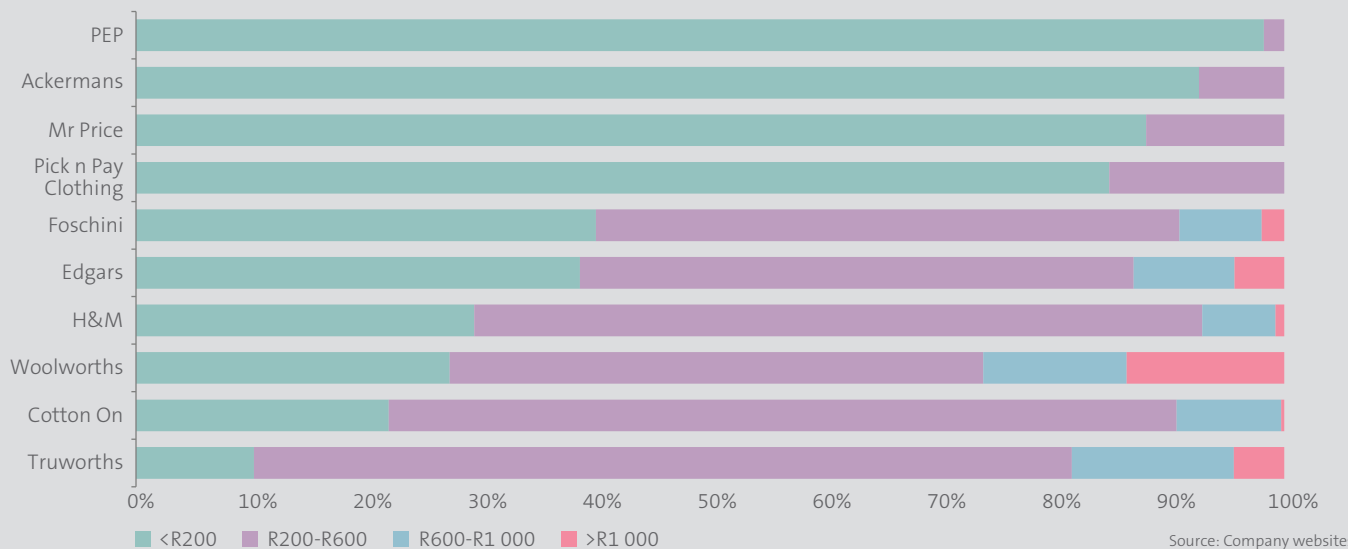
PAXI's growth since inception has been steady and, in 2023, it completed just under five million deliveries, with 24 000 businesses making use of the services. While this is a relatively small contributor to group profit at present, it is proving advantageous by boosting store footfall and strengthening overall customer brand loyalty.

Cellular sales soar

Notably, Pepkor is the largest distributor of cellular phones in South Africa, selling an average of one million prepaid handsets per month alongside a staggering 50 million SIM cards per year. This line of business accounts for approximately 20% of group earnings. Currently, Pepkor sells the equivalent of 70% of all prepaid handsets in the country, 57% of which are now smartphones.

Pepkor's far-reaching store footprint enables network providers to effectively reach the market for cellular phones and SIM cards,

Pricing profile of apparel retailers (January 2024)



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making Pepkor an obvious partner of choice. Each handset is sold with an associated SIM card on behalf of a network provider. While the handsets generate a relatively low margin, most of the income derived from this arrangement is through recurring revenue. For each SIM card that Pepkor registers on behalf of the network providers, they earn a percentage of the airtime loaded throughout the active life of the SIM card, irrespective of where the airtime purchase is made. In future, we see Pepkor benefiting from the ongoing migration to smartphones and the associated increase in data spend that this brings.

Ackermans - beyond basics

Together with PEP, the Ackermans chain forms the heart of the Pepkor stable. These brands sell one in every two kidswear garments purchased in South Africa and two out of every three baby garments. Maintaining a strong commitment to value, Ackermans attracts and caters to a slightly more affluent customer base than PEP, with their stores mainly located in malls.

In the period since 2007, the Edcon group (mainly Edgars and Jet) - then the largest local retailer - performed very poorly and shed significant market share to its competitors. The weakened competition allowed Ackermans to gain meaningful market share (*shown below* from 2010) from Edcon's chain of Jet stores where they competed head-on in key categories including kidswear.

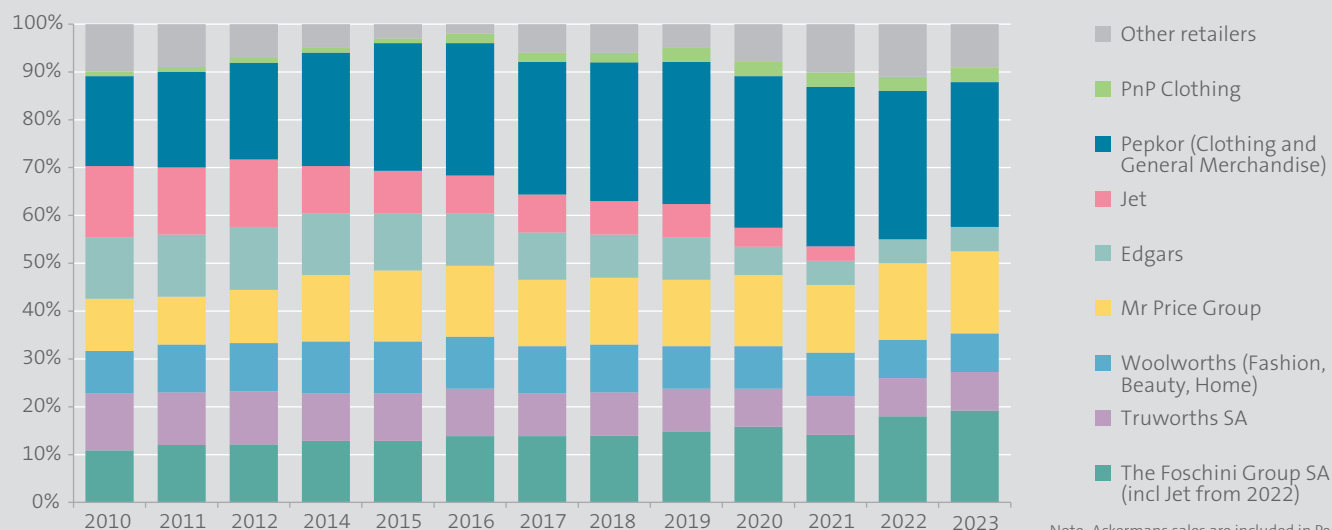
Edcon's constrained access to capital under private equity ownership enabled Ackermans to secure prime retail locations and make strategic expansions with reduced competitive pressure. Today, Ackermans is the leading kidswear retailer in the country, with more than 900 stores.

With Jet falling under The Foschini Group umbrella since 2020, access to capital has no longer been a concern and they have returned as a far stronger competitor to Ackermans despite their smaller store base of 450. While we certainly acknowledge the heightened competition facing Ackermans, we remain positive about their growth prospects and they continue to be the dominant retailer in kidswear and infant clothing, with a strong store presence and brand affiliation as a leading value player in the market.

Discounted discounter

Pepkor's core offering is relatively defensive and benefits hugely from their unrivalled customer reach and scale. We anticipate growth from the newer segments within the group and a consumer that benefits from lower expected inflation. Additionally, Pepkor's recent Avenida acquisition in Brazil is still small but is growing rapidly and offers interesting and potentially material optionality. All this is not adequately represented in Pepkor's share price and our clients are therefore exposed to this upside potential. **UP**

Apparel retailers market share



Note: Ackermans sales are included in Pepkor
Source: Company data, RMB Morgan Stanley research



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