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Spar: playing catch up

In 1932, Dutchman Adriaan van Well founded SPAR International, based on the belief that independent wholesalers and retailers could achieve far more by working together than working alone – how right he was! In 1963, South Africa became the first country outside of Europe to join the organisation. Known as The SPAR Group Ltd (SPAR), it is a wholesaler and distributor of goods and services to SPAR, SUPERSPAR, TOPS, SaveMor, Build It, S. Buys & Pharmacy in South Africa (63% of Turnover), the BWG Group in Ireland and SW England (24%), SPAR Switzerland (11%) and SPAR Poland (2%). Despite bumper sales figures last year, full year results for 2021 were underwhelming as they lost market share to SA peers, resulting in share-price weakness. This article will look at the causes of the current weakness and why we still see the company as a core holding in portfolios, despite SA retailers and consumers facing an imminent 4th wave during the busiest period of the year.

Nick Rogers

SPAR

SPAR's local convenience format worked especially well during the various lockdowns. Firstly, many consumers chose to avoid large regional malls where anchor tenants such as Checkers and Pick 'n Pay experienced reduced footfall and instead shopped more locally where SPAR stores dominate. Secondly, as panic set in, there was excessive pantry loading which boosted turnover. In contrast, 2021 has seen various external and internal factors create headwinds, which we examine in more detail:

- Liquor bans resulted in one-third of trading days being lost at TOPS. SPAR's wholesale turnover remains 6.4% or R500 million lower than that achieved in 2019. The CEO stressed a double-whammy to sales since liquor trade over the weekend is generally very lucrative for the adjacent SPAR grocery stores. This partly explains market share losses over the period due to an over-reliance on liquor versus peers.
- A weak online presence was bought to the surface by the pandemic which created a surge in online shopping globally. Competitors, Checkers with its "sixty60" app and Pick 'n Pay's "asap!" were well-positioned versus SPAR's c150 stores with a limited online offering. To mitigate this, management has just announced the December launch of SPAR2U which will be rolled out across 100 stores over the next year. Unlike its SA peers who rely on local IT skills, SPAR International is backing the app which has global IT specialists on hand to assist. Goods will be delivered mostly by using electric bikes and due to the local franchisee's ability to adapt quickly, products on offer will be tailored to each local community which differentiates it from competitors. Fortunately, the structural change to convenience shopping, bought on by lockdown restrictions, 'staycations' and working from home

"Liquor bans resulted in one-third of trading days being lost at TOPS."

SPEED READ

- **In December, SPAR SA will launch a mobile app called SPAR2U relying mainly on electric bikes to deliver purchases.**
- **SPAR TOPS lost a third of its trading days due to stringent lockdown restrictions.**
- **Build It performed exceptionally well. Wholesale turnover grew by 24% thanks to working from home trends.**

(WFH) plays into SPAR's neighbourhood business model. With the announcement of the new omicron variant and fears of a 4th wave, "there's a friendly SPAR wherever you are" remains as relevant as ever.

- Riots & Looting hit profits with 180 stores affected and an estimated lost wholesale turnover of R639 million (almost 1% of group turnover) across their core grocery, liquor and Build It businesses. On the plus side, Spar has helped facilitate the payout of R572 million to its affected independent retailers so far via the SA Special Risks Insurance Association (SASRIA). SPAR's higher-margin private label sales dropped by 0.4% to R10.5 billion with 5 suppliers severely impacted during the July unrest. However, due to the growing acceptance of trading-down to cheaper private-label foodstuffs, where quality is not compromised, sales should bounce back as struggling consumers look to save where they can. Unfortunately, not only have insurance premiums risen but SPAR was forced to improve security at shops and Distribution Centres to meet those insurance requirements. These unexpected consequences have unfortunately meant that the cost of doing business has increased, hitting margins at a time when food inflation is on the rise and the ability to pass on costs easily has decreased. Competitors will no doubt be facing similar pressures.
- Weak results from the newly acquired Polish business, Piotr i Pawel (rebranded SPAR Poland) disappointed the expectant market. The negative reaction was mainly in response to the possibility of a further R2 billion in funding requirements and the breakeven date being pushed out a year, to the end of 2022. To refresh memories, Spar finalised this acquisition in early 2020. Lockdowns have meant that they have been unable to visit Poland in person to implement their growth plans. Fortunately, the new CEO has just managed to enter the country for the first time and made great strides by rationalising their network of distribution centres and re-signing new contracts with all independent retailers to ensure that their loyalty (measured by the % of goods purchased from SPAR), rises from 27% to the minimum required 40%. Evidence in the numbers matter most in the short term, however, the long term prospects are exciting as SPAR is only just starting to tap a huge formalisation opportunity in this high growth economy.

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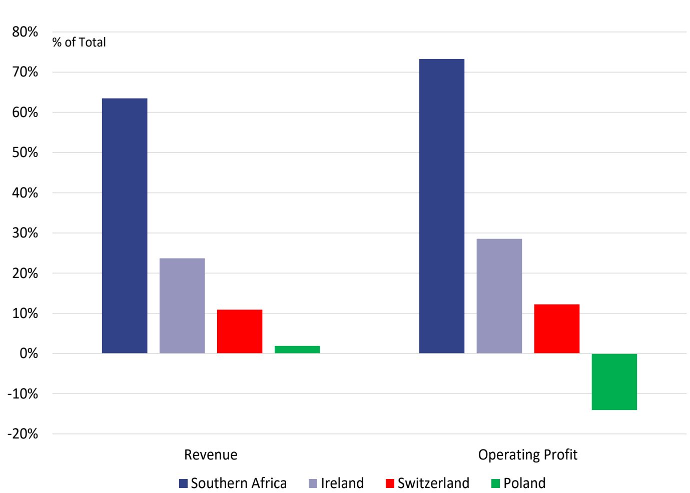
SPAR's South African journey began in1963 and it has been growing ever since.

SPAR REVENUE & PROFIT SPLIT



37% of Spar's revenues are derived from outside of SA, but this falls to only 27% of operating profit given that its newly-acquired Polish operation is presently loss-making. That should change over the next two years.

This brings us to the good news where the established international operations delivered. Switzerland held onto lockdowns gains and grew revenues in Swiss Francs by 5.6%. There was a drop in the number of Swiss consumers heading across the border to shop at cheaper value retailers in Germany and Austria having experienced and being impressed by what SPAR has to offer. The successful integration of 60 higher-margin petro-forecourt convenience stores acquired from Store Service AG bodes well too. BWG Foods in Ireland saw solid growth in turnover of 3.5% in Euros. This was an impressive feat given the BREXIT supply-chain and labour challenges e.g. shortage of drivers. The foodservice division is well placed to bounce back as hospitality picks up.

Renowned asset manager, Jean-Pierre Verster made a great point recently - "Spar management team has done really well to recognise that their big growth in South Africa was going to be muted going forward. They wanted to expand internationally but they saw what happened to the likes of Woolies – and the pain they went through with the David Jones acquisition in Australia – and they wanted to do it in a low-risk way. So, through the Spar head office in the

Netherlands, they got in touch with Spar guilds in other countries. They know the model, it's not a different brand. They know these businesses well." Unlike Shoprite's 90% Rand earnings, SPAR's hard currency earnings now total 37% of Group turnover – well-diversified relative to peers.

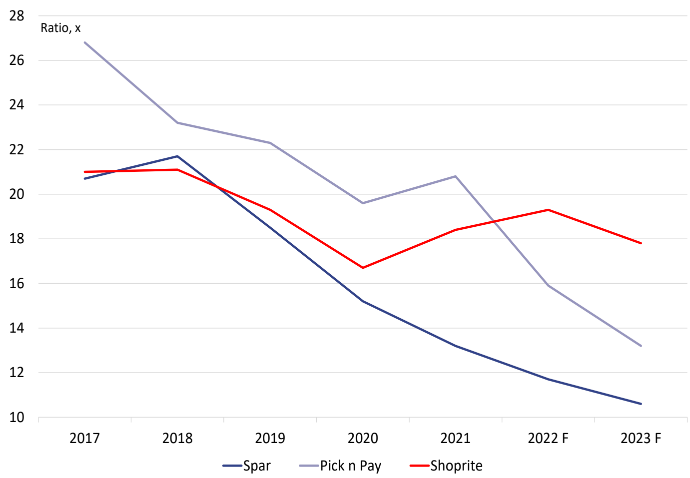
"SPAR is very well placed to continue benefitting from its convenience shopping format"

The rising trend to work from home (WFH) and the consequent increase in home improvement spending saw sterling results from Build IT, with wholesale turnover growth of 23.5%. BuildIT has strategically placed outlets in far-flung rural areas, highlighting management's vision and strategy to diversify the income streams and also cater for the vast informal sector, where continued rural home improvement is underpinned by social grants, making it very defensive.

To future-proof the business, SPAR is investing R1.8 billion over the next two years on a cutting-edge SAP IT system. This will be a phased approach, DC by DC and region by region, to avoid supply-chain issues. In the short term, the rollout of e-commerce will incur further costs. However, the data mining opportunities and increased revenue from online will result in SPAR gradually catching up to its peers. The move to shopping via mobile devices is still in its infancy in SA at c3% but these initiatives will result in market share gains in time.

In conclusion, despite the near-term headwinds, SPAR is very well placed to continue benefitting from its convenience shopping format. The franchisee stores, owned by entrepreneurs who are living within the very communities that they serve, can adapt to changes on the ground immediately which has proved vital during the pandemic. Last but certainly not least, SPAR remains the cheapest grocer amongst its peers. It trades on a forward P/E ratio of 12x and an attractive dividend yield of 5%. Diversified both by product and geography, SPAR is looking very attractive at current levels for those willing to see through the near-term challenges.

SA FOOD RETAIL VALUATIONS



Spar is the cheapest of the three major SA supermarket chains. Based on current consensus estimates, its P/E ratio is expected to fall to just 10x over the next 24 months.

The valuation of SPAR looks attractive as management invest in new IT systems, Polish expansion and a push into home delivery here in the South African market..

Our seminar schedule for 2022 will be published in the new year. Watch this space

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Topic: **To be confirmed**

Natal Midlands	
Date:	TBC
Venue:	Oasis Conference Centre, 72 Main Road, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg	
Date:	TBC
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

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