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**Dedicated to Value**

# **South African Antipodes**

**Two Markets, Worlds Apart**

**Presentation to Deutsche Bank Consumer Conference - March 2005**

## *Format*

- Strategy
- Results to date
- What's changed?
  - Food Wholesaling
  - General Merchandise Discounting
  - Home Improvement
- Prospects
- Risks

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## Strategy

“Competition in an industry is rooted in its underlying economic structure and goes well beyond the behaviour of current competitors”

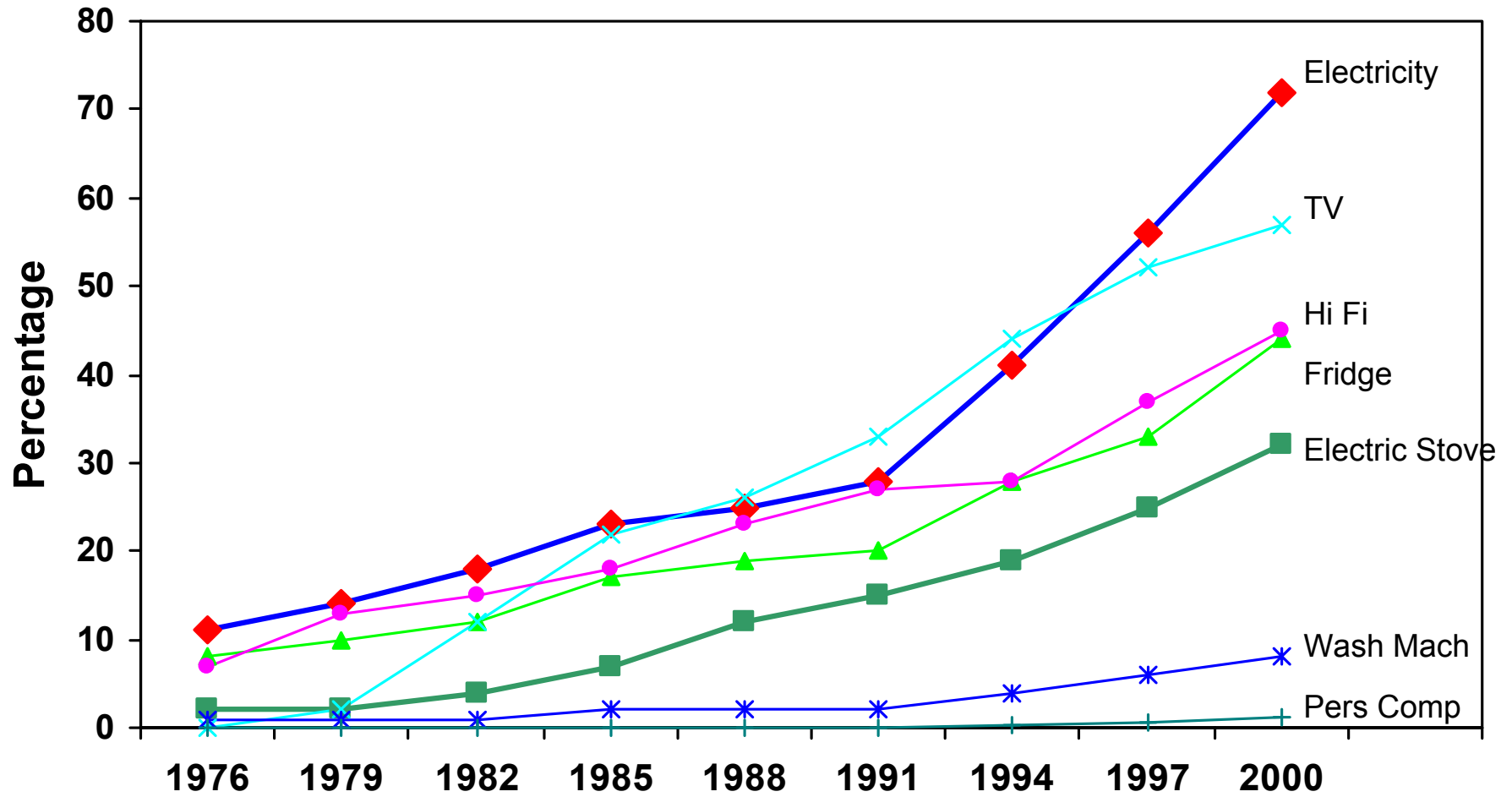
Michael E. Porter

# *The starting Environment*

- Mid eighties 4 major socio-economic trends clear:
  - apartheid not sustainable
  - increasing share of PCE from black consumers
  - demographics an increasingly unreliable basis for marketing
  - composition & behaviour of consumer markets was in flux
- Marketers would have to adapt to the changing needs & aspirations of a different, more complex market

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# Black Ownership Trends



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Source: SA to Z

# *The starting Environment*

- Mid eighties 4 major socio-economic trends clear:
  - apartheid not sustainable
  - increasing share of PCE from black consumers
  - demographics an increasingly unreliable basis for marketing
  - composition & behaviour of consumer markets was in flux
- Marketers would have to adapt to the changing needs & aspirations of a different, more complex market
- **Manufacturing sector largely inefficient**
  - too much low wage labour & old technology
  - too little international competition
  - too many inefficient factories

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## *The starting Environment (cont.)*

- Wholesale/retail structure highly inefficient
  - too much (poor) retail space
  - too many undifferentiated retail companies & brands
  - redundancy of business models & support infrastructure
  - high reliance on credit
- By the late 80's it was clear that the mass markets need for value would drive:
  - more efficient manufacturers & suppliers
  - more efficient retail & wholesale distribution
  - the rationalisation of assets & formats
  - **rapid broad based consolidation**

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## *The starting Asset (1988)*

- Makro
  - R350m warehouse club 6 old, poorly located, under performing stores
  - high volume, low margin distributor of branded food, liquor & general merchandise
- Competitors
  - Food – Metro. Liquor – Independents. General merchandise – Pick 'n Pay & Hyperama.
- Scale & operational excellence required to compete
  - Scale – Procurement/amortise costs
  - Operational excellence – Sustain low cost base > price

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## *Strategy development*

- Research showed potential for only 12-14 Makro stores. Makro alone could not achieve the requisite critical mass and market prominence.
- Acquisitive growth essential
  - Reluctant to add to the excess industry space
  - Saw new brand building as expensive
  - Did not envisage any dramatically new business models
  - Active protagonist in industry consolidation
  - Quicker
  - Cheaper

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# *Strategy development*

- Recognised pros & cons of acquisitive growth
  - Pro > broader, deeper market penetration than single retail/wholesale brand
  - Cons > duplicate costs / acquisition risk
- Focus:
  - Geographic market – Southern Africa mass market
  - Distribution type – Wholesale & retail
  - Distribution model – High volume, low margin, low cost
  - Merchandise – Build on existing category expertise
  - Payment – Mainly cash (no reliance on finance charges)

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# *Massmart's Competitive Growth Strategy*

- Build portfolio through acquisitive & organic growth, based on category expertise
- Mitigate portfolio costs through internal collaboration & joint initiatives (not centralised)
  - Procurement
  - Coordinated retailing (Location, Positioning, Pricing & Promotion)
  - Cost reduction (Shared information & services)
  - Human capital development & motivation
- Incentivise for alignment

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## *Mission (Part 1)*

Our definition of purpose - the assets and competencies used to realise our vision

Massmart is a **South African** based **international, management group,**

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## International

(Expanding regional presence)

- South Africa
  - Exceptional national footprint
  - Under represented (10%) in Western Province (19%)
- Lesotho
- Swaziland
- Botswana
- Namibia
- Zimbabwe
- Zambia
- Mauritius
- Uganda
- Mozambique
- ***Tanzania***
- ***Ghana***
- ***Nigeria***

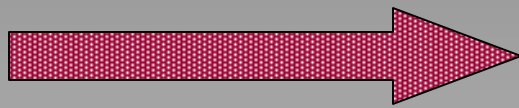
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## *Mission (Part 1)*

Our definition of purpose - the assets and competencies used to realise our vision

Massmart is a South African based international, management group, **invested** in a portfolio of **differentiated, complementary, focused wholesale and retail formats,**

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## Portfolio

(Differentiated focused retail/wholesale formats)



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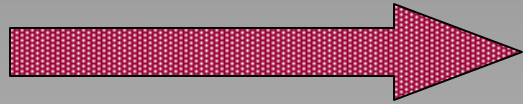
## *Mission (Part 1)*

Our definition of purpose - the assets and competencies used to realise our vision

Massmart is a South African based international, management group, invested in a portfolio of differentiated, complementary, focused wholesale and retail formats, each reliant on **high volumes**

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## High volumes

(Exceptional productivity)

- Average sales per store R137m
  - 8 stores with sales >R500m
  - 16% of JSE listed retail & wholesale sales with only 3% of outlets
- Average sales per square meter R34k
- Average sales per employee R1.35m
- Average EBITA per store R5.9m
- Average EBITA per employee R53k
- Expenses as % sales fallen for four years

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## *Mission (Part 1)*

Our definition of purpose - the assets and competencies used to realise our vision

Massmart is a South African based international, management group, invested in a portfolio of differentiated, complementary, focused wholesale and retail formats, each reliant on high volumes and **operational excellence**

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## *Mission (Part 1)*

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Massmart is a South African based international, management group, invested in a portfolio of differentiated, complementary, focused wholesale and retail formats, each reliant on high volumes and operational excellence as the foundation of price leadership,

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## *Mission (Part 1)*

Our definition of purpose - the assets and competencies used to realise our vision

Massmart is a South African based international, management group, invested in a portfolio of differentiated, complementary, focused wholesale and retail formats, each reliant on high volumes and operational excellence as the foundation of price leadership, in the distribution of mainly **branded consumer goods**

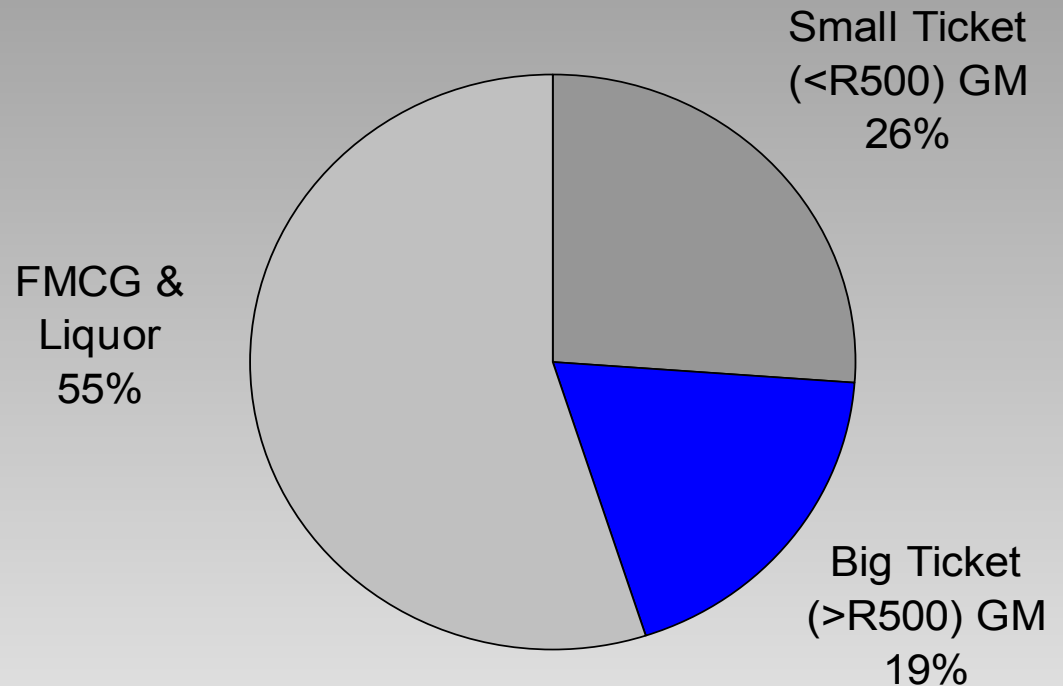
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# Branded consumer goods

(Major stockists of leading brands in 7 product categories)

- Wholesale FMCG
- Home improvement
- Appliances
- Hi Tech
- Liquor
- Sports & Outdoor
- Multimedia & Office



Categories > R1.5b in 2004

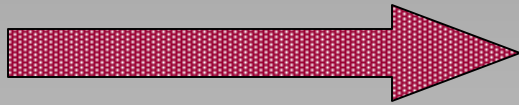
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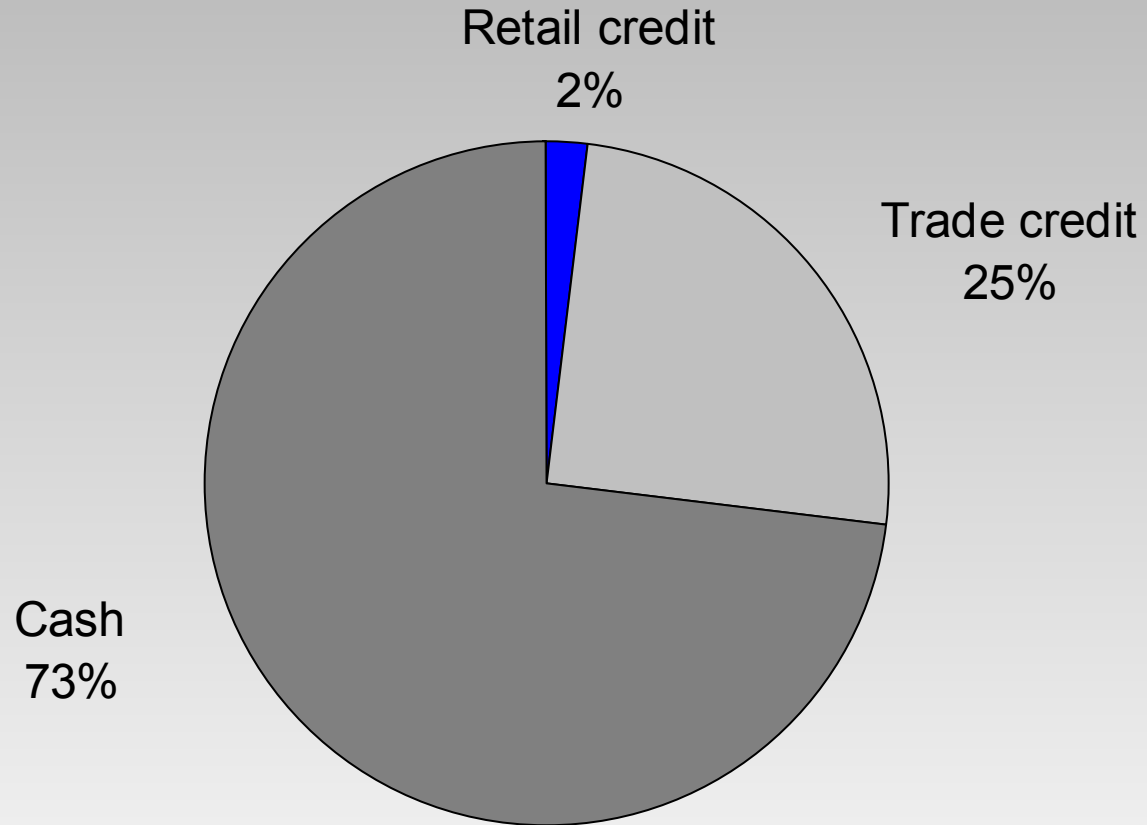
Massmart is a South African based international, management group, invested in a portfolio of differentiated, complementary, focused wholesale and retail formats, each reliant on high volumes and operational excellence as the foundation of price leadership, in the distribution of mainly branded consumer goods for cash.

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Cash

(High cash sales & flow)



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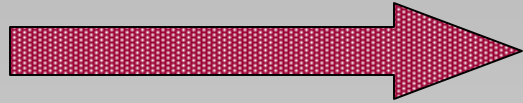
## *Mission (Part 2)*

Our definition of purpose - the assets and competencies used to realise our vision

The group actively seeks the continual improvement of performance in the portfolio and its parts, through **strategic and structural clarity, high market shares, excellent management and leadership, cost effective technology and the sharing or agglomeration of capabilities, knowledge, resources, influence and information.**

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## Leadership

### Young / diverse

- Top 58: young (43), educated (70 degrees), retail/wholesale experience (15 yrs.)
- Excellent mix of business experience, retail skills and academic qualifications
- Determination to bring science to retail/ wholesale

### Entrepreneurial

- Empowered to trade
- Encouraged to innovate
- Incentivised to perform
- “We act like owners because we are” (12% if all options exercised)

### Aligning demographically

- 13% executive directors, 15% top mgmt, 27% senior mgmt, 43% professionally qualified middle mgmt, 50% academically qualified junior & supervisory mgmt, from previously disadvantaged groups

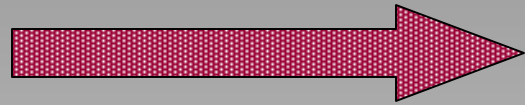
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## *Mission (Part 3)*

Our definition of purpose - the assets and competencies used to realise our vision

To this end thought leadership, individual and collective performance, and collaboration throughout the group are **highly rewarded**, with executive management **incentivised predominantly on group performance.**

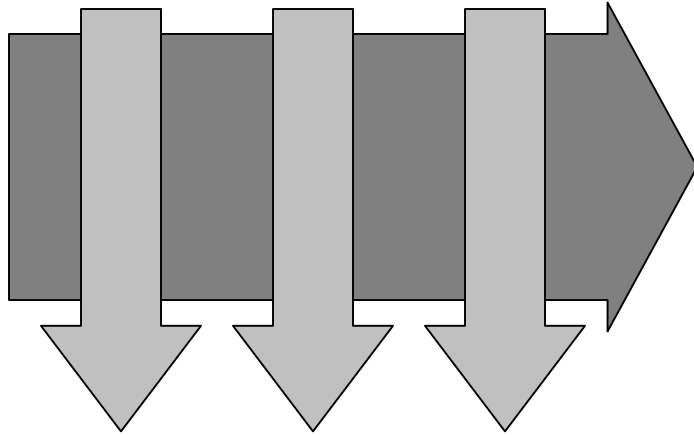
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## Incentivisation

- Shareholding
  - 12% management (if all options exercised)
  - 30% international institutions
  - 58% local institutions
- Incentives
  - 60% of senior executive remuneration variable
  - 45% of executive remuneration variable
  - 30% of senior management remuneration
  - Lowest level workers receive performance bonuses
  - 22% of total remuneration variable

# Business Model



## Channel collaboration

- Procurement (Forums)
- Coordinated retailing (Positioning, Pricing & Promotion)

## Shared services

- Non differentiating services rendered at lower cost to Divisions
- Human Capital management

## Divisional growth

- Differentiated competitive offerings
- Dominant in complementary product categories
- Multiple target markets & regional reach
- Favorable cash characteristics
- Sound organic growth
- Strict acquisition criteria

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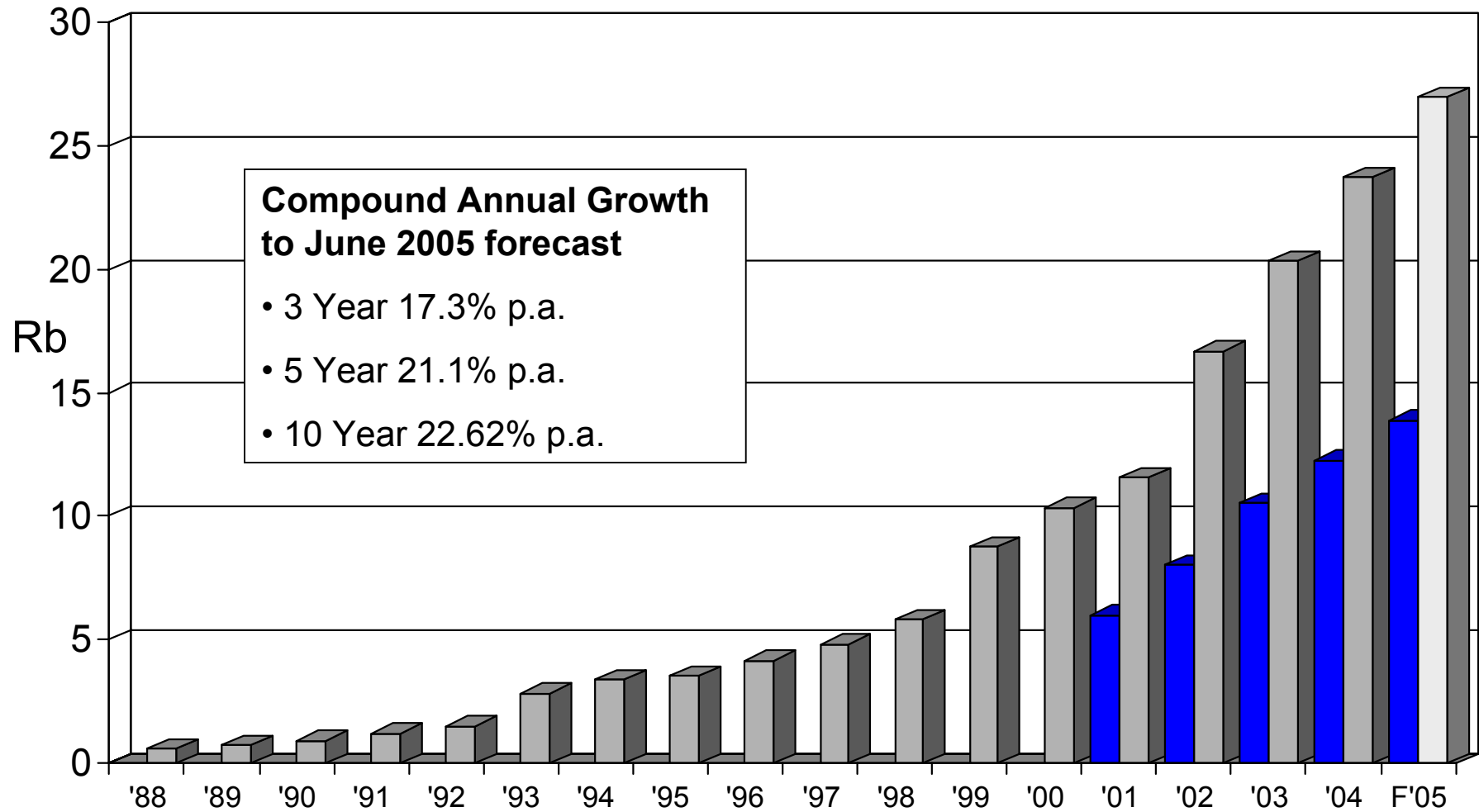
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## Results to date

“Words are words, explanations are explanations, promises are promises, but only performance is reality”

Harold S. Geneen

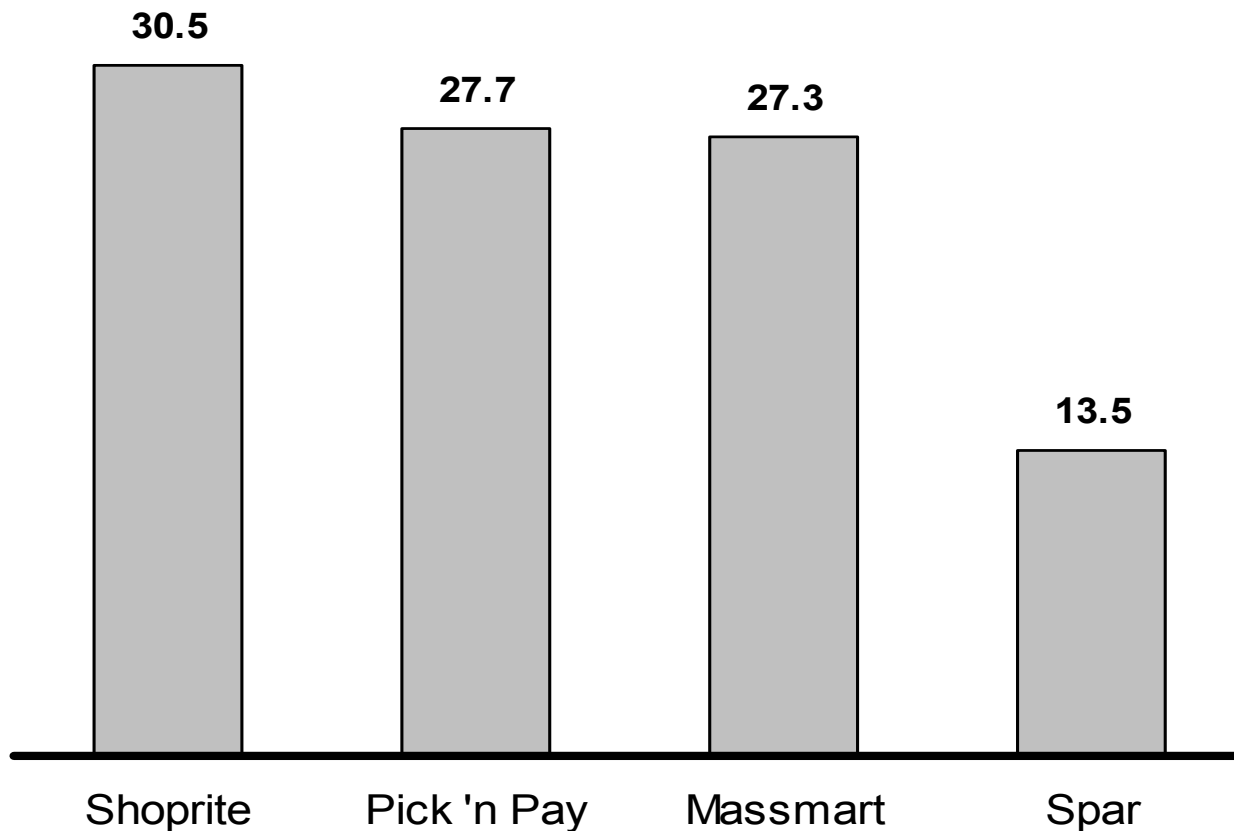
# Sales growth



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# *Major regional mass marketer*

(2004/05 African turnover, Rb)



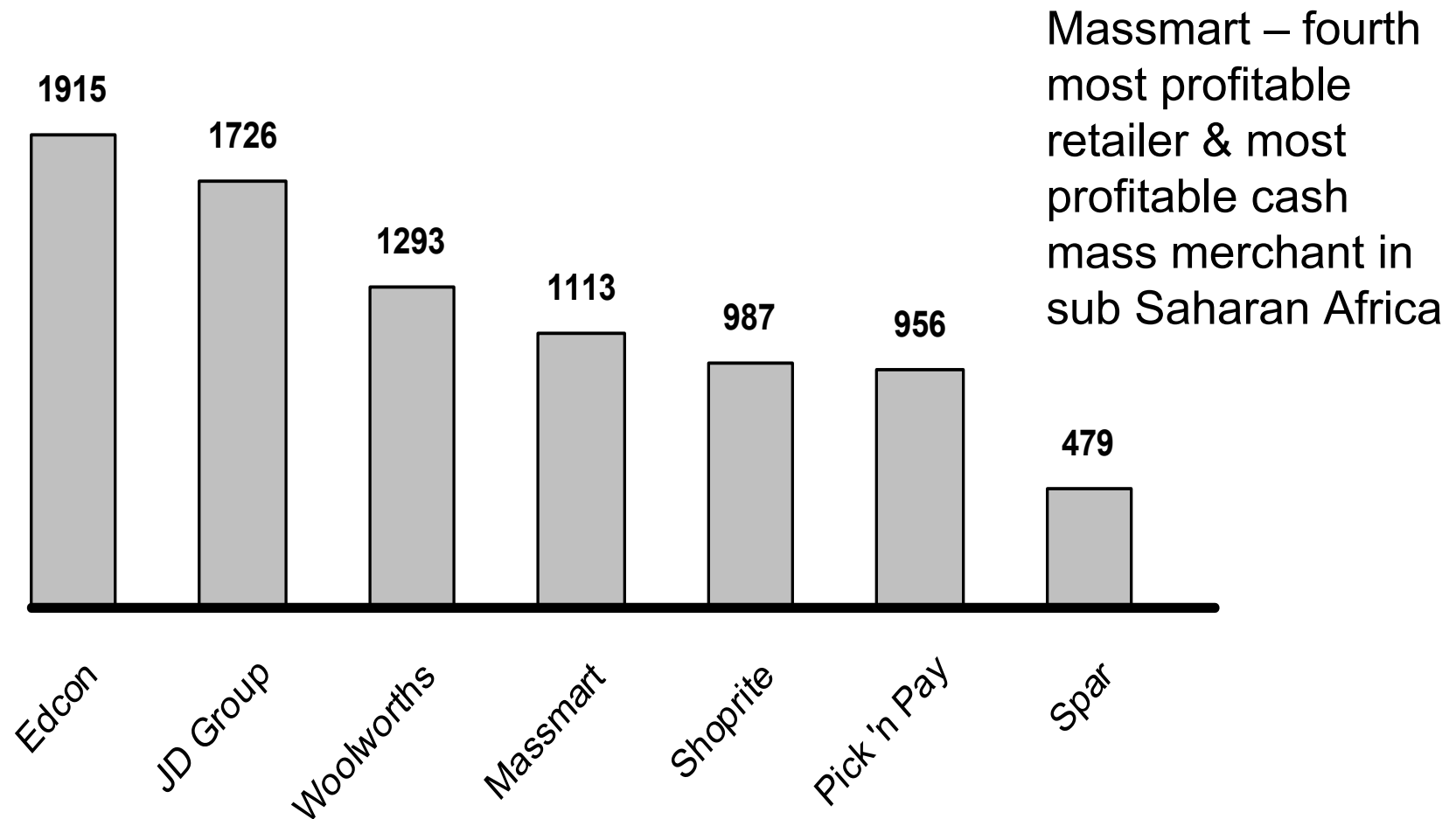
- Massmart in Africa:
- Ranks 3<sup>rd</sup> in total sales
  - Ranks 1<sup>st</sup> in Gen. Merchandise, Liquor & Wholesale food
  - Ranks 4<sup>th</sup> in food

Source: Deutsche Bank

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# *Regional profitability*

(2004/05 EBITA, Rm)



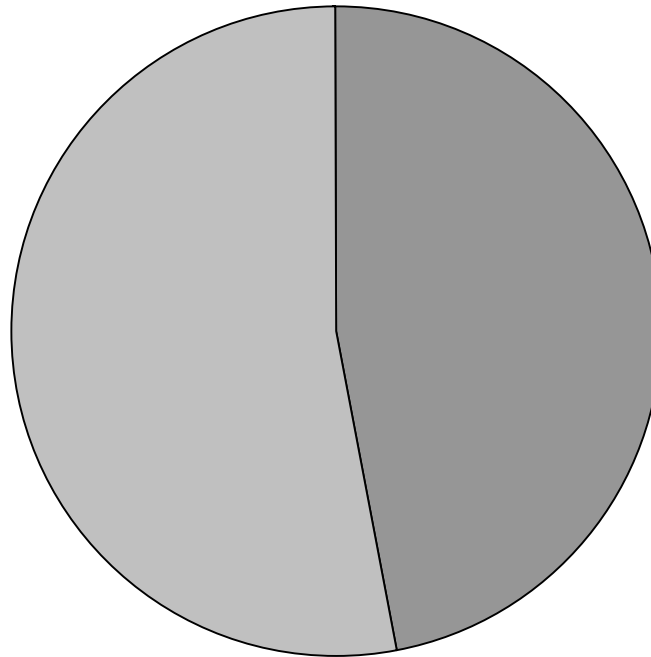
Source: Deutsche Bank

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## *Sales contribution*








54% Wholesale  
(mainly FMCG) to  
retailers who  
supply consumers  
in the  
LSM 2 - 6 groups



46% Retail  
(mainly general  
merchandise)  
to end users  
in the  
LSM 6 -10 groups

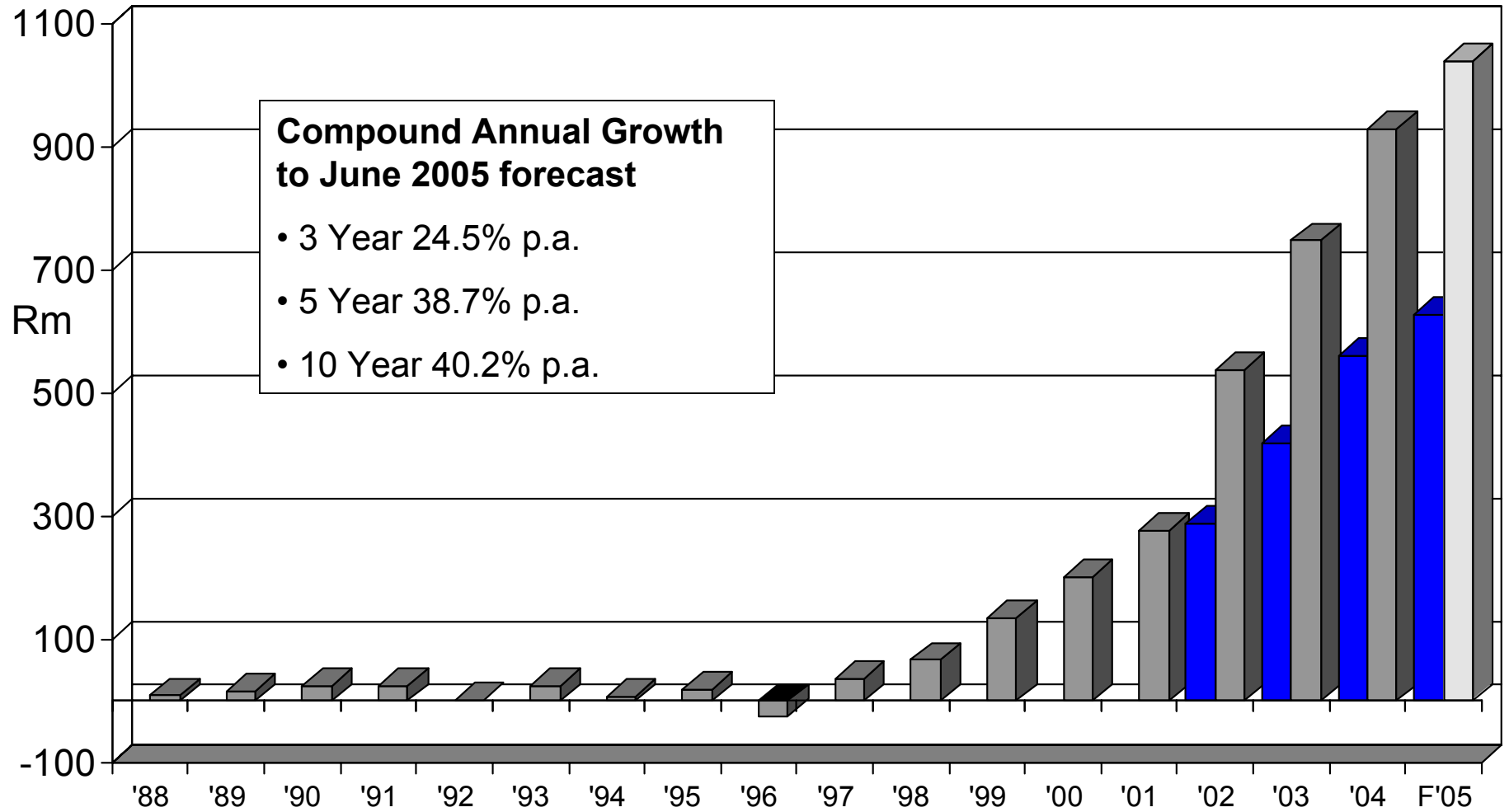
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# Market penetration

% of total sales	1998	1999	2000	2001	2002	2003	2004	2005
Shoprite 	31%	31%	29%	29%	27%	26%	24%	23%
Pick 'n pay 	23%	22%	22%	22%	21%	22%	22%	21%
<b>Massmart</b> 	<b>12%</b>	<b>16%</b>	<b>17%</b>	<b>17%</b>	<b>21%</b>	<b>21%</b>	<b>21%</b>	<b>21%</b>
Spar 	8%	9%	10%	10%	10%	10%	11%	10%
Edcon 	12%	11%	10%	10%	8%	9%	9%	10%
Woolworths 	10%	9%	9%	9%	9%	9%	9%	8%
JD Group 	4%	3%	4%	3%	3%	4%	4%	7%

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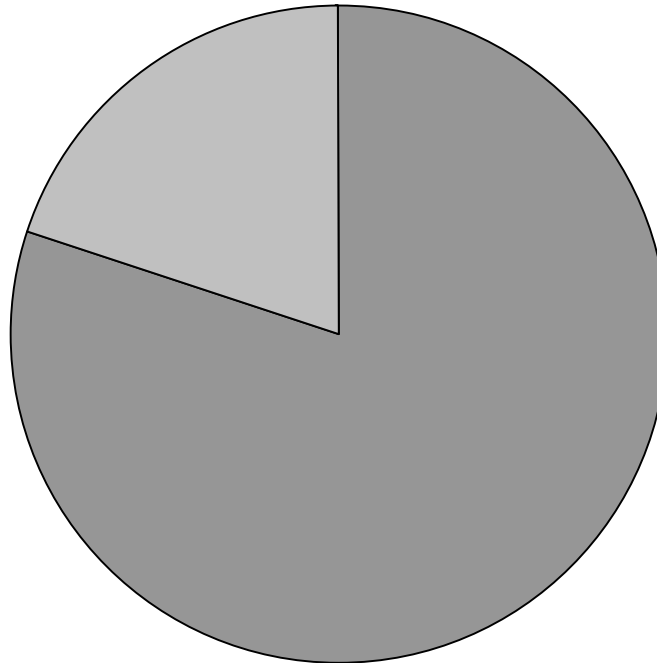
# EBITA growth



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## *Profit contribution*

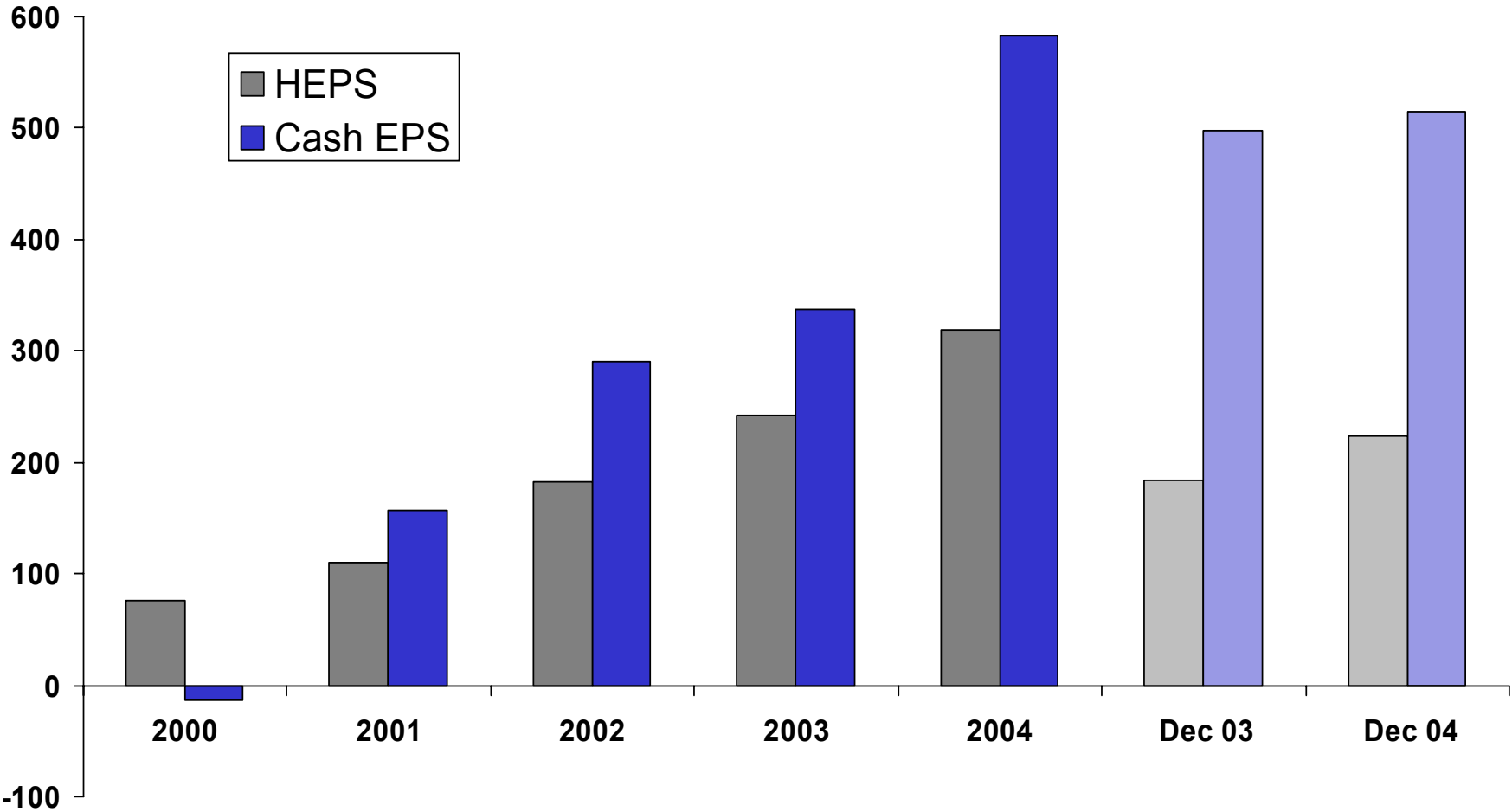
23% Wholesale  
(mainly FMCG) to  
retailers who  
supply consumers  
in the  
LSM 2 - 6 groups



77% Retail  
(mainly general  
merchandise)  
to end users  
in the  
LSM 6 -10 groups

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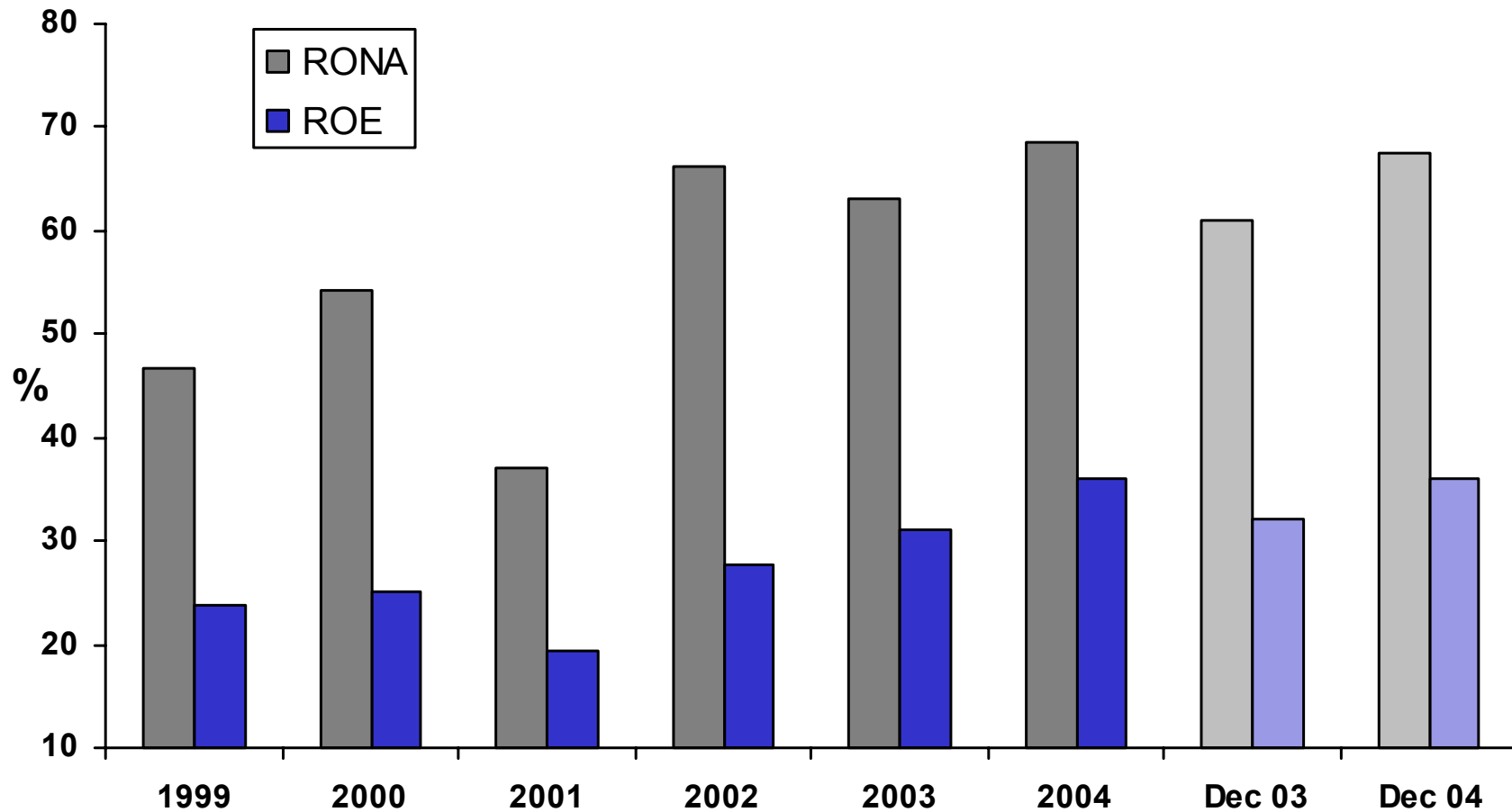
# Cash Earnings



HEPS – Headline Earnings per Share (cents)  
Cash EPS – Cash from Operating Activities, before dividends paid



# Returns



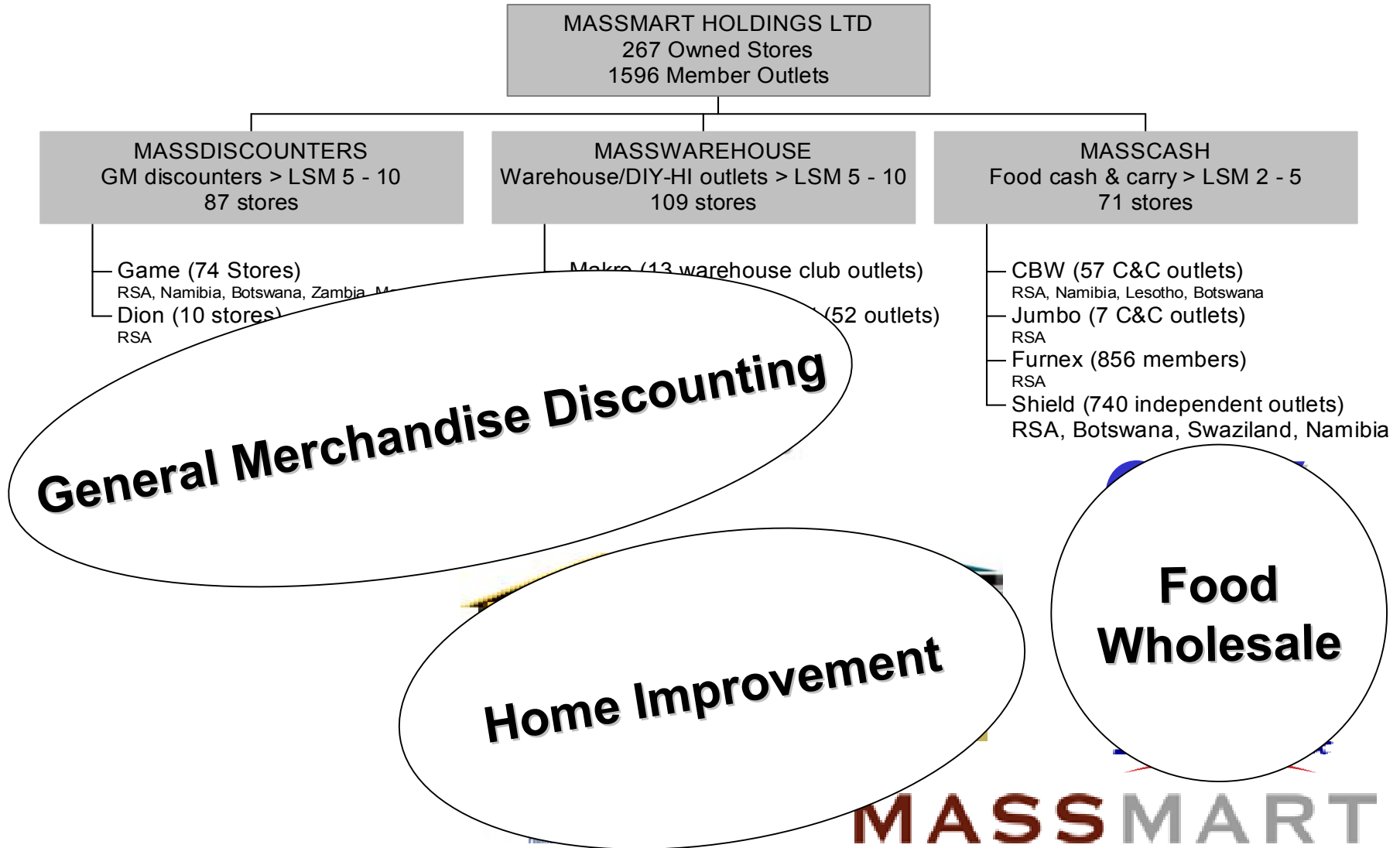
RONA - EBITA / Average Net Assets

ROE - Headline Earnings / Average Shareholders Equity (ignoring previous goodwill & trademark write-offs)

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# Massmart today

(Leadership in 3 consumer segments)



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## What's changed?

“Organisations fail because their theory of business is outdated. The assumptions on which the organisation has been run no longer fit reality. Among the key assumptions are those on markets, customers, mission, competitors, core competencies, and technology”

- Peter Drucker



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**Food Wholesaling**

# RSA Food Market

\*Food = edible groceries, non-edible groceries, commodities, confectionery, tobacco, perishables, cosmetics, bakery, red meat, fruit & veg, cigarettes at ACV (Actual cost to consumer)  
 \*Excludes food services R23b – R25b.  
 \*Verification – BMR estimates market at R155bn excluding all “personal care” at R21b

**Independent C&C = R38 bn**

**Direct from suppliers R25,8bn**

**Independent Retailers + some Wholesalers (Direct) – R84.4bn**

**Independent C & C – R38bn**

**ICC / IBC = R13.0bn**

**UMS / Shield share of members direct purchases (i.e. 80%) = R10bn**

**RSA Food market R171.4bn**

**Metcash divisional:**  
 Metro /Trador – R4,8bn  
 Trade Centre – R1,7bn  
 UMS – R1,5bn  
 IGA /Friendly – R1,2bn

**Metcash RSA – R9,2bn**

**Massmart division:**  
 Makro – R?bn  
 CBW – R?bn  
 Jumbo – R?bn  
 Shield – R?bn

**Massmart – R11,4bn**

**Forecourt Stores – R3bn**

**Pick n Pay – R21bn**  
 Boxer / Score

**Shoprite – R22bn**  
 Checkers / Usave / OK / Sentra

**Spar Retail– R16.9bn**  
 (Spar Wholesale: R 11.9 bn)

**Woolworths – R5bn**

**Formal C&C R20.6bn**

**Other majors – R19.1bn??**  
 (Clicks, Game, Franchise Direct)

**MA**

**Majors & Branded Superettes R87bn**

## *Wholesale Food Market*

- Mainly independents serving LSM 2 - 4
  - 65,367 (94%) of 69,771 outlets
  - account for R63.4b (37%) sales
  - key distributors (stores <R1.6m p.a.) of commodities to low income consumers in peri-urban & rural areas
- Majors struggling to define profitable format in slow growth, lower income market
  - low gross margin FMCG commodities constitute 40% - 60% of mix relative to <5% in middle/upmarket outlets
  - store costs & corporate burden (growth / tax / overheads / governance) much higher than independent
  - major food producers diversifying dependence on majors by supporting independent trade

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# *What's changed? (Wholesale food)*

- Inflation
  - low single digit cost price inflation & significant deflation in some categories (i.e. maize) for first time in 25 years
  - inflation likely to remain low but not negative in medium term
- Consequences
  - sales & R's gross margins decline
  - market responds by lowering prices to maintain sales
  - little volume sensitivity to promotions as the potential of lower prices forces traders to hold low inventories
  - with gross margins < 10% any volume increases fail to compensate for gross margin sacrificed
  - expense growth > cost price inflation creates net margin squeeze

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## *What's changed? (Wholesale food)*

- Expected sequential industry response
  - attempt to increase volumes
  - reduce expenses
  - increase gross profit margins
  - align cost price inflation & expense growth over time
- Sustained low inflation will
  - accelerate industry trends away from marginal business
  - accelerate rationalisation & consolidation
  - create an opportunity for a low capital intensity, low expense, low price retail model (i.e. Aldi, Netto), in pursuit of which someone will erode shareholder value

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## *Competitive stance*

- Manage CBW & Jumbo to generate ROE >30% & cash profits with cautious new store growth
- Participate in consolidation of wholesale trade by buying selected stores at close to NAV
- Avoid acquisition of small, unbranded, founder managed, overpriced businesses. (i.e. difficult to integrate & grow, low return on effort)
- Exit high volume, low margin, high risk sales/customers in Shield to achieve acceptable returns on debtors book
- Maintain measured trading aggression until gross margins rise & cost price inflation & expense inflation align

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**General Merchandise  
Discounting**

# *General Merchandise Market*

- From niched specialists to mass discounters serving LSM 5 – 10+
- General merchandise
  - non furniture durables (appliances, hi tech, sports & outdoor, multimedia & office, housewares)
  - mass market discounting is the most complex retailing
- Fragmented but consolidating
- Very few successful “Category Killers”
- Hypermarkets biggest single competitor
- Credit furniture retailers hold large share of appliance & home electronics market

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## *What's changed? (GM discounting)*

- Expanding consumer market (structural)
  - education & employability
  - employment equity & BEE
- High consumer confidence (cyclical)
  - interest, exchange & inflation rates
  - national psyche
  - international benchmarks
- R/\$ driven lower cost price inflation/deflation
- Shifting shopping nodes
- Product innovation
- Exceptional product value

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## *What's changed? (GM discounting)*

- Changed view of working capital management
- Further opportunities for large Game outlets in South Africa
- New opportunities for small Game outlets
- Requirement for more upscale positioning of Dion
- Opportunities for Dion expansion
- Opportunities for three new Makro outlets
- Medium term profit opportunity in relocation of two Makro outlets

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## *Competitive stance*

- Creative procurement (local/international/private label)
- Maintain merchandise & marketing innovation
- Refine working capital management (logistics)
- New store development
  - Game Africa
  - Large Game outlets RSA
  - Small Game outlets RSA
  - Makro RSA
  - Grow repositioned Dion cautiously

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**Home Improvement**

## *Home Improvement Market*

- Three segments in or serving LSM 5 – 10+: home improvement enthusiast, DIY specialist, small to medium building contractor
- Conservatively estimated R18b to R20b market
- Very fragmented
- Many small independent businesses ranging from “yards” selling building supplies to specialists selling upscale imported taps
- Very few chains
- No national chain (i.e. Home Depot, B&Q) aimed at the middle to upper income consumer

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## *What's changed (Home Improvement)*

- Expanding consumer market (structural)
  - education & employability
  - employment equity & BEE
- High consumer confidence (cyclical)
  - interest, exchange & inflation rates
  - national psyche
  - international benchmarks
- Housing shortage (structural)
- Rerating of domestic property prices
- Start of consolidation of very fragmented industry
- Strong comparable store growth from BW & TW

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## *Recent acquisitions*

- De La Rey, Federated Timbers & Servistar for a phased cash consideration of R660m to R750m dependent on performance
- Estimated additional sales of R2.0b to June 2006
- PBT margins > 6%
- All three to be housed in Masswarehouse
- Furthers strategic objective to become major participant in DIY/HI distribution
- Provides national footprint and exceptional procurement opportunities

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## *De La Rey*

- Subject to regulatory authorities approval
- Very similar to Builders Warehouse
- 3 stores (expanding) in Western Cape
- Mainly cash retail customers with lesser participation by small building contractors
- Excellent management

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## *Federated Timbers*

- Subject to regulatory authorities approval
- Mirror image of Builders Warehouse
- 34 stores in 9 provinces
- Mainly small building contractors with lesser participation by cash retail customers
- Excellent management

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## *Servistar*

- Subject to regulatory authorities approval
- Smaller version of Builders Warehouse
- 14 stores in 3 provinces
- Mainly cash retail customers with very little participation by small building contractors
- Excellent management

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## *Competitive stance*

- Build market leadership & reputation on price, range & service to three target markets
- Continue to explore ranging opportunities
- Refine ambience & layout of BW & TW formats
- Review merchandise/market opportunities in light of acquisitions
- Determine new store, format & product gaps in enlarged portfolio
- Clarify brand/format positioning
- Leverage group procurement capability
- Leverage private label programme

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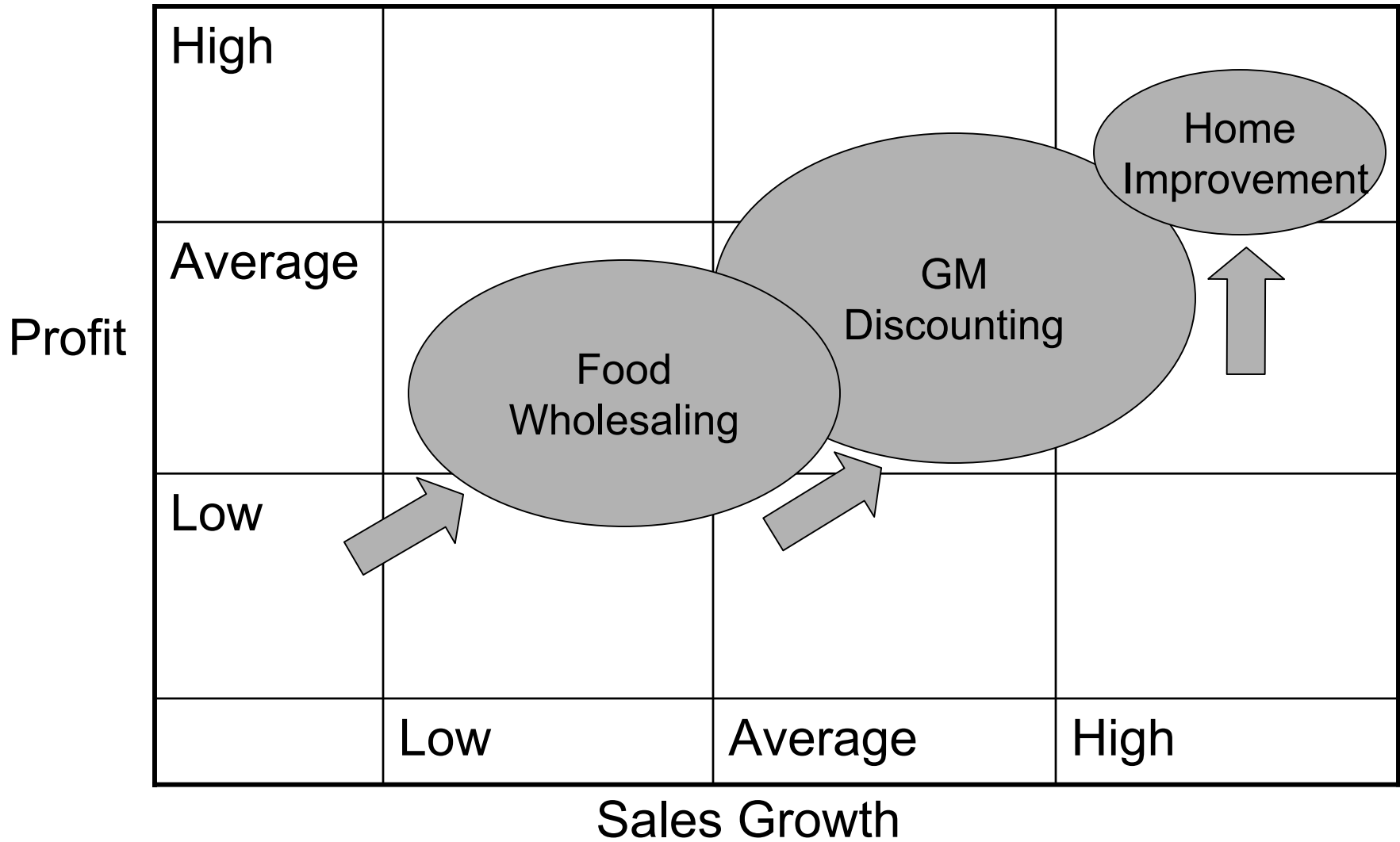
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## Prospects

"The reward for work well done is the opportunity to do more"

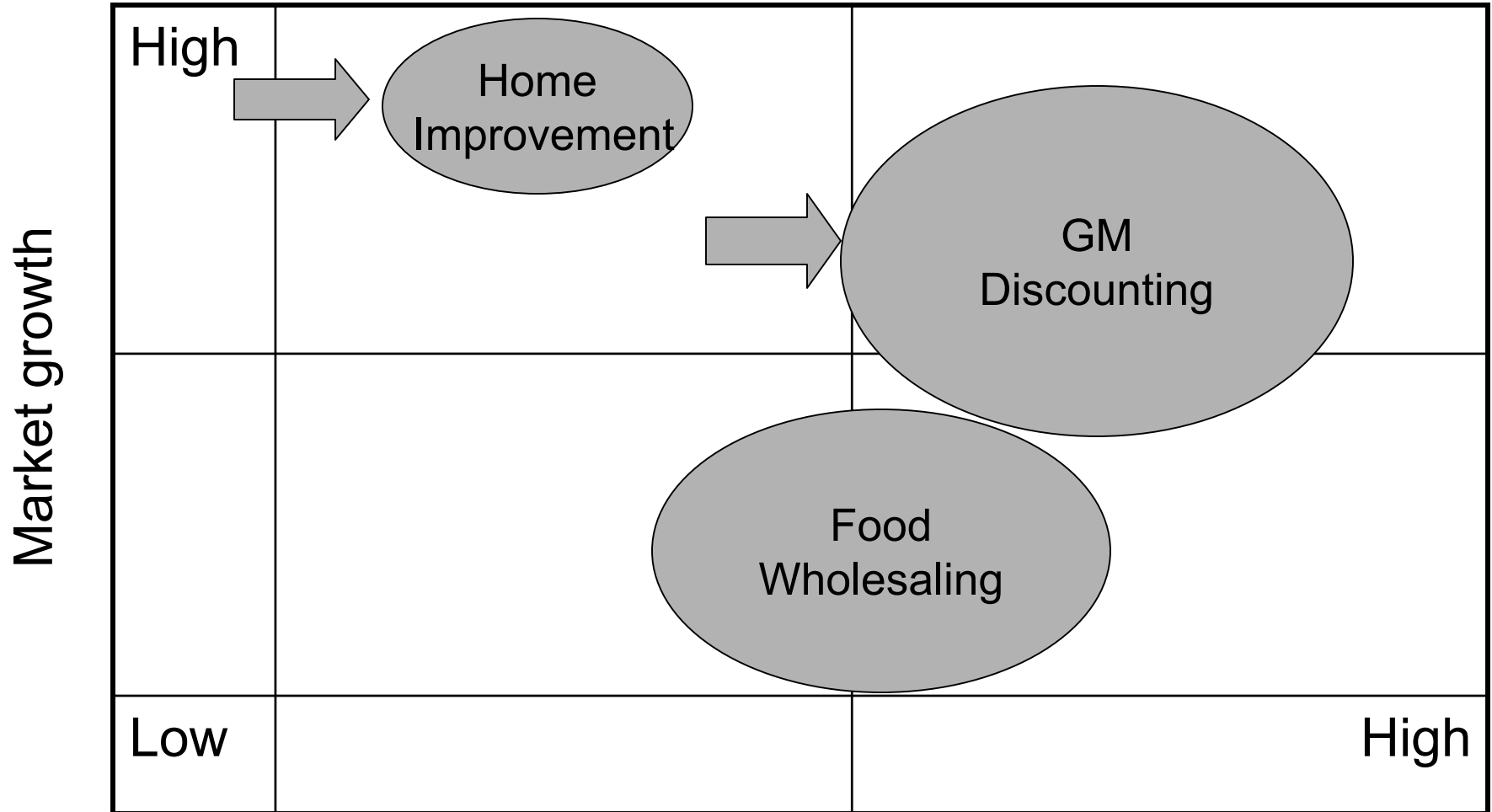
Marcel Proust

# *Growth/profitability*



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# Growth/Share



Market share

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# Targeted PBT ROS

	<i>Med. term full year target</i>	<i>Dec '04</i>	<i>Jun '04</i>	<i>Dec '03</i>	<i>Jun '03</i>	<i>Dec '02</i>	<i>Jun '02</i>	<i>Dec '01</i>	<i>Jun '01</i>	<i>Dec '00</i>
Massdiscounters	<b>6.0</b>	7.82	<b>4.77</b>	5.83	<b>3.64</b>	5.40	<b>3.36</b>		<b>2.02</b>	3.2
Masswarehouse	<b>5.0</b>	5.00	<b>4.30</b>	4.64	<b>3.03</b>	3.29	<b>2.91</b>	3.9	<b>2.52</b>	3.3
Masscash	<b>3.0</b>	1.75	<b>3.00</b>	3.08	<b>4.08</b>	3.46	<b>3.92</b>	3.1	<b>3.52</b>	3.0
Group	<b>*4.47</b>	4.48	<b>3.97</b>	4.47	<b>3.49</b>	3.80	<b>3.29</b>		<b>2.48</b>	

\* Proforma using actual sales mix and target margins

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## 2007 Vision for Growth

	3 Yr effect	Rb	Progress
June '04 sales base		23.8	
Inflation (6.5% pa) (4%)	20.8%	4.9	-R1.9b
Real comparable growth (4% pa)	12.5%	2.9	
50 new/acq.stores @ R100m ps 22 CBW/Jumbo, 21 BW & 7 Game		5.0	14 in yr.1
Opportunities under research		0.3	
Acquisitions		?	R2.0b '06
Sales to June 2007		36.9	
Targeted PBT margin 5.0%		1.83	
Targeted EPS		>600c	

\*Based on UBS '04 sales & PBT forecasts

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# *Prospects*

- Confident of strategy, portfolio, unique approach to high volume low cost distribution & leadership
- Manifest in capex & investment programme
- Excited by new store opportunities & acquisitions
- Lower operating income growth in H2'05 than H1
  - Exceptional working capital improvements in H2'04
  - Under performance of wholesale food (Masscash)
- H2 EPS growth depressed by STC (not applicable in '04)

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## Risks

“Education is when you read the fine print, experience is what you get when you don't“

Henry R. Luce

# *Risks*

- External
  - Economic growth / Consumer confidence
  - Lower or falling inflation
  - R/\$ volatility
  - Labour costs
  - Legislation of industry structure or pricing
- Internal
  - Maintaining strategic & structural focus
  - Maintaining control of a large, complex, trading business
  - Weaker Rand impact on direct or indirect imports (30% purchases)
  - Attracting, developing & retaining competent experienced leaders & managers

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## *Merchandise innovation*

“In retail, you are either operations driven - where your main thrust is towards reducing expenses and improving efficiency - or you are merchandise driven. If you are going to show the kind of double-digit comparable store sales increases that we show every year, and grow a company the way we've grown ours, you have to be merchandise driven. Retailers that are operations driven tend to level off and deteriorate.”

David Glass – Chairman Executive Committee Walmart

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**Dedicated to Value**

**Thank You**

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