

EQUITY INSIGHTS

Dis-Chem Pharmacies: Uniquely Positioned To Create Value for Shareholders

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A BACKGROUND TO DIS-CHEM'S BUSINESS

Dis-Chem was co-founded by Ivan and Lynette Saltzman in 1978 when they opened their first retail pharmacy store. Today, Dis-Chem generates R22.4 billion in revenue from 208,000 square meters of space across 149 retail stores, the majority of which are 'big-box' format, over 1,000 sqm.

With a dispensary in all of its stores, contributing 37% of revenue and housing 280 wellness clinics, Dis-Chem fills over 2 million scripts monthly. The business uses discounted dispensing fees to drive footfall into its large front shop which retails personal care and beauty, healthcare and nutrition, and baby care products. Positioned as a discount retailer, Dis-Chem offers superior prices and brand assortment. The 'pharmacy first' and discounted front shop approach has accrued a 23% market share in dispensary and overall retail sales of R19 billion, both roughly equal to rival Clicks, which operates with a third more retail space.

The pharmacy retail sector in South Africa is the fastest growing retail sub-sector, well above nominal GDP. The sector has been consolidating for years, with Dis-Chem and Clicks gaining share. With independents still occupying 50% of the market, this is expected to continue for the foreseeable future. The key to Dis-Chem's success in gaining dispensing market share is its designated service provider status within certain medical aid schemes, offering clients a lower drug dispensing fee than through independent pharmacies. Unlike Dis-Chem, independents rely on the dispensary for 80% of revenues and have limited ability to negotiate dispensing fees or form collective drug purchasing agreements. This has established a durable regulatory and scale advantage for Dis-Chem which generates the majority of its revenue and profit in the front-shop.

ATTRACTIVE STORE ECONOMICS LEADING TO RAPID GROWTH

The economics of a Dis-Chem store are highly attractive with break-even in their first year and a four-year road to maturity, by which time trading density averages over R100,000 per sqm with excellent profitability. Over five years, the group earned a 49% average return on equity, despite an average store maturity of 60%. Dis-Chem grew their footprint by 80% over this period, with revenues more than doubling. The value proposition is compelling, evidenced by consistent market share gains across categories.

Given the tough economic environment and low inflation in both dispensary and front shop, the rapid 12.5% annual space growth has diluted the very high returns, although they continued to be well above cost of capital. This impact is likely to continue in the short to medium run, with profitability and returns improving as space growth slows and stores mature. The additional space will accrue greater long term market share gains to the group, and retailing is a business that greatly advantages those with scale and market share with business done increasingly on their terms. We expect Dis-Chem to continue to benefit from improved supplier payment days, rebates, fees, and supplier-funded promotions.

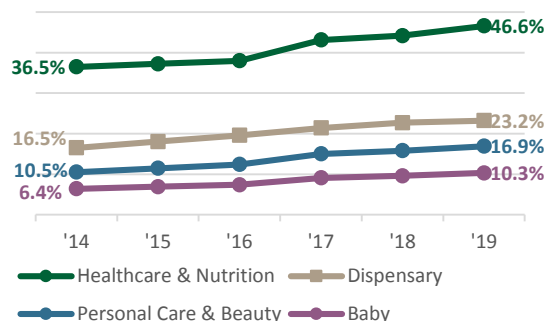
CONCLUSION – ESTABLISHING A POSITION AT CURRENT VALUATIONS

We anticipate durable free cash flow growth, with strengthening fundamentals post the period of elevated space growth. After the euphoria of the listing, the current valuation is more attractive and Dis-Chem is expected to generate strong returns for shareholders.

Dis-Chem Pharmacies Limited	
Market Cap	R 19bn
Current Share Price	R 21.90
Forward PCF	16.4x
Forward DY	2.06%
Financial Year End	28 February 2019

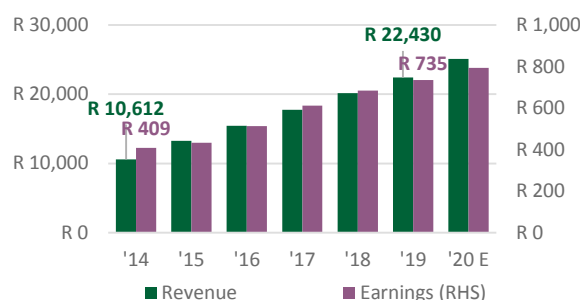
Sources: FactSet, July 2019

Dis-Chem Market Share per Segment



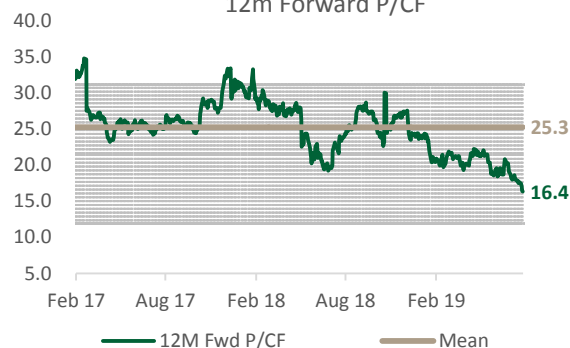
Sources: Company Filings, July 2019

Revenue and Earnings in R millions



Sources: FactSet, July 2019

12m Forward P/CF



Sources: FactSet, July 2019

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