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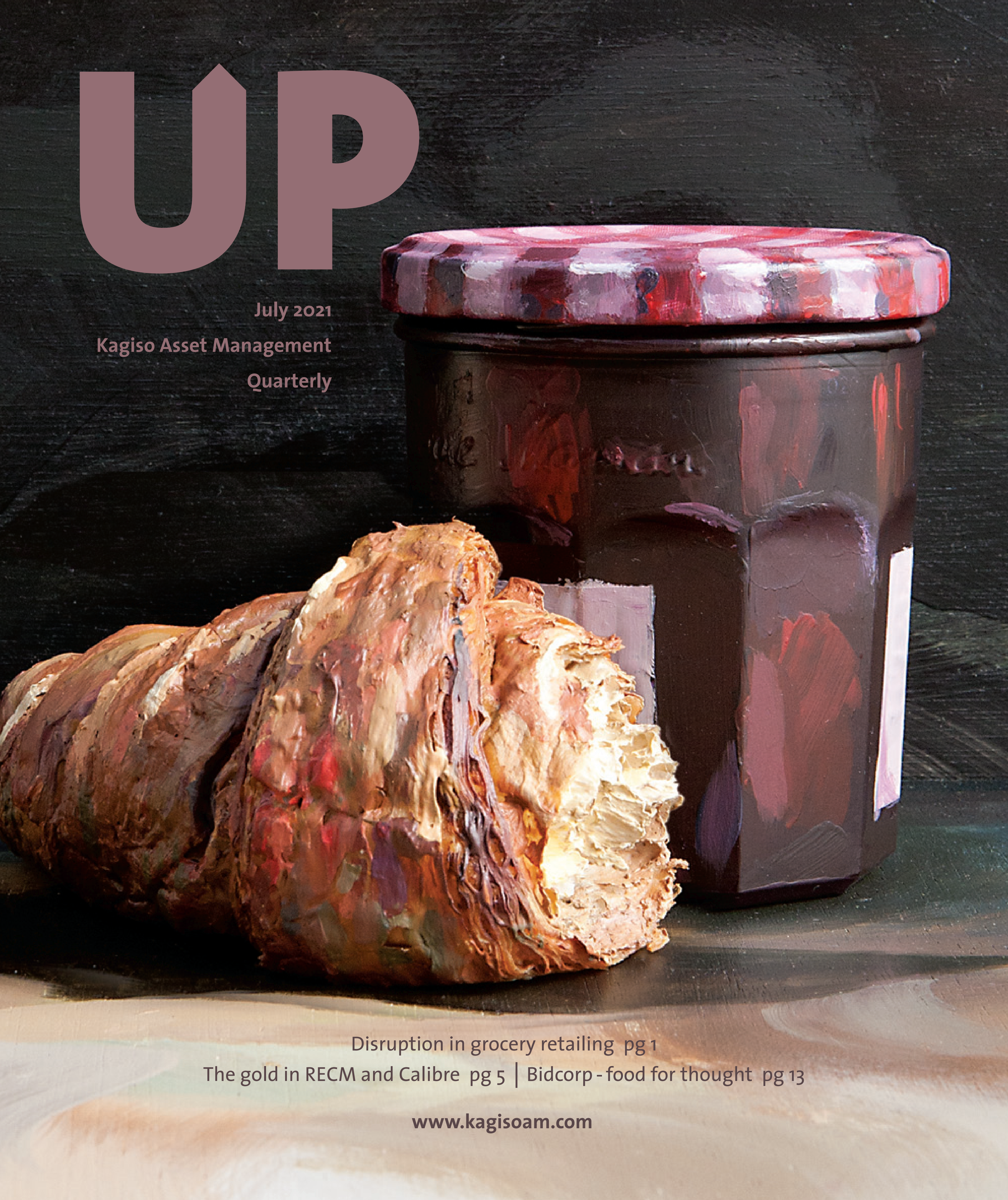

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Disruption in grocery retailing

Sarah le Roux - Investment Analyst

A forgotten item on the shopping list used to mean another trip to your local store. Covid-19 has accelerated the development of online grocery apps to the point where three of the country's four largest grocery retailers offer on-demand delivery. We explore how the online grocery environment has developed in South Africa over the past 18 months and the likely implications going forward.

Disruption in grocery retailing

A competitive landscape

Pick n Pay and Woolworths have offered online delivery from their websites and shopping applications for several years. Shoprite, on the other hand, only launched online delivery for the first time in November 2019. SPAR operates a franchise model that allows individual retailers some flexibility in selecting their own product assortment and price, making it difficult to launch a groupwide online delivery app. Therefore, although some SPAR retailers do have their own websites with online delivery capabilities, the group remains well behind their listed competitors in this arena.

As Covid-19 constrained our mobility, many online businesses began to thrive. Delivery services offered by traditional retailers were overwhelmed and 'click and collect' options were introduced. Disruptive online operators gained market share as consumers searched for alternatives to eating out or physically going into stores. The *table below* summarises the types of online food retail currently available in South Africa with examples for each (including comparative examples of similar businesses in the US).

Over the past year, Uber Eats and Mr Delivery have rapidly expanded their food offering. Multiple independent convenience stores and speciality food retailers that lack the scale to develop their own delivery network have opted to join one or both platforms. The selection has grown wide enough that each of these apps now have a separate category devoted to convenience grocery. Woolworths, on the other hand, has been trialling a separate website for their meal kits, called FUUDI.

Innovation has not been limited to businesses targeting the higher income segments. Yebo Fresh delivers primarily to townships in the Western Cape, using bulk deals and combination packs to price competitively, with the aim of making online delivery accessible to lower income consumers. In the height of lockdown, the business partnered with NGOs and Community Action Networks to deliver food parcels to those in need.

Nobody's free lunch

In the US, traditional grocery retailers were slow to adapt their offering to online, allowing the likes of Amazon Fresh to gain a foothold. This is not the case for some of the local retailers, who have instead chosen to be at the forefront of disruption. Shoprite was the first of the large South African grocery retailers to introduce same day delivery with Checkers Sixty60. Beginning with nine supermarkets and five liquor stores offering a limited selection of products, they set a target delivery window of 60 minutes. In under two years, they have rapidly scaled the operations to the point where, as at the end

Comparison of online food retailers

	Omnichannel	Online only	Aggregator	Meal kits	Ready-made	Food delivery
Description	Traditional grocery retailers that offer online delivery and click and collect	Online grocery retailers with little to no physical store base	Third party applications that allow customers to shop across multiple retailers in a single order	Weekly boxes of ingredients for specific recipes	Boxes of ready-made meals, fresh, or frozen, heat and eat	Predominantly meals prepped to order by restaurants/ dark kitchens
South Africa	Woolworths, Shoprite, Pick n Pay, SPAR	Yebo Fresh, farmfresh, GreenFish	OneCart, Zulzi	UCOOK, FUUDI, Daily Dish	DinnerBox, Umatie	Uber Eats, Mr D
US	Walmart+, Whole Foods Market, Target	amazon fresh, freshdirect	instacart, Shipt	Hello Fresh, Blue Apron	Real Eats, freshly	Uber Eats, GrubHub

Source: Kagiso Asset Management research of June 2021, they operate out of over 200 stores with more than 15 000 products to choose from.

The popularity of Sixty60 forced competitors to respond. Pick n Pay had already been partnering with Bottles since 2018 in offering on-demand alcohol delivery. Following the introduction of the first alcohol ban, the Bottle's business model pivoted from alcohol to grocery. In October 2020, Pick n Pay bought Bottles, thereby ensuring exclusivity and allowing for greater integration into the existing Pick n Pay ecosystem. In December 2020, Woolworths began trialling their own on-demand grocery app - Woolies Dash. *Tabled below* is a summary of the key differences between the three apps and their stage of development as of June 2021, with Woolies Dash still in phase 1 testing[1] at the time.

Picking from stores

Each of these three retailers use their existing store base to fulfil on-demand orders. This allows them to be close to the customer, limiting delivery time and reducing the cost of delivery. Both Checkers Sixty60 and Bottles are profitable on an incremental store cost basis. However, the additional costs involved in servicing online customers imply that on-demand will never be as profitable as in-store sales. Therefore, where in-store sales are substituted for online sales, the overall impact on profitability is negative.

Online sales do increase overall profitability where the introduction of on-demand increases the total sales that a store is able to generate. An example of this was when Shoprite introduced Checkers Sixty60 in more affluent Cape Town areas, like those around their Rondebosch, Kloof Street and Atlantic Seaboard stores, where they were previously not well-represented. They found that roughly a third of the customers on Checkers Sixty60 had not previously shopped in one of their stores. As this segment of the market is already well penetrated by both Pick n Pay and Woolworths, it seems unlikely that these two would benefit to the same extent.

Challenges arise where picking from stores results in a negative experience for in-store customers. Stockouts can occur where stores underestimate the additional demand from online orders, forcing customers to compete with in-store pickers[2] for that last packet of lettuce on the shelf. Furthermore, customers may find the overall shopping experience less enjoyable when witnessing multiple in-store pickers rushing about at a frenzied pace.

Stockouts can have an even greater impact on the on-demand shopping experience. Customer dissatisfaction is likely to be

[1] During phase 1 testing, Woolies Dash is operating as a standalone application, offering free delivery for orders over R75 to areas surrounding a select number of stores. The next phase of rollout will see Woolies Dash integrated into the Woolworths app.
[2] Store staff that act as shoppers for online orders, physically selecting the items off the shelves.

Comparison of on-demand applications owned by the traditional grocery retailers

Retailer	Shoprite	Pick n Pay	Woolworths
App name	Checkers Sixty 60	bottles by Pick n Pay	Woolies Dash
Launch date	November 2019	June 2020	December 2020
Delivery fee	R35	R35	Free*
Number of stores on the platform**	125	105	18
Average delivery time (minutes)	60	60-90	Timeslot dependent
Number of products	15 000	10 000	Full store catalogue
Development	In-house	Acquired	Outsourced
Loyalty points awarded?	No	Yes	No

* There is a R50 delivery fee for orders under R75.
**Pick n Pay counts each supermarket and related bottle store as a single location and does not disclose the number of liquor stores separately. Therefore, for comparative purposes, the store count for Shoprite only includes supermarkets and excludes the stand-alone liquor stores.

Source: company websites and investor relations, Kagiso Asset Management estimates high where an 'out of stock' item is only identified after an order has been finalised, particularly if that item happened to be the main reason behind placing the order in the first place. To combat this, each of these apps offers customers an opportunity to substitute. Recent investments in technology around supply chain and inventory management have also assisted in reducing the number of 'out of stocks' that occur on these orders.

Likewise, customers may become wary when a particular shopping app develops a reputation for sending goods that are typically close to expiry. Stores have an incentive to get rid of older stock to limit wastage, however, this needs to be carefully balanced against the customers' desire for produce that stays fresh long enough for them to use it.

Market size limitations

In South Africa, although population density in urban areas appears favourable for online delivery, other challenges limit the total addressable market. Less than 7% of the population (roughly four million people) earn over R70 000 per year and less than 1.2 million of those individuals (the top 1%) earn over R500 000 a year[3]. Given these dynamics, only a small proportion of the population can afford to regularly pay a R35 delivery fee. In addition, about a fifth of the population is unbanked, limiting payment options available to them. A lack of street addresses in informal settlements can also complicate the delivery process, particularly when combined with the time sensitivity of an on-demand offering. Click and collect mitigates these issues, however it is less of a threat to the convenience store as these customers are still required to travel.

Shoprite management has indicated that based on their calculations, when the Checkers Sixty60 app reaches 250 stores (relative to a total store base of 1 901[4]), they will have penetrated around 80% of the current addressable e-commerce market. SPAR management have similarly commented that only a small proportion of their store locations (around 200) would benefit from an online presence.

Looking ahead

While on-demand grocery delivery poses a threat to traditional convenience formats, the impact is likely to be limited to stores primarily servicing mid to upper income consumers and, therefore, to a relatively small proportion of the total South African population. Furthermore, the extent to which these apps can continue to grow or even defend their market share as conditions normalise, remains to be seen. As people return to work and once again find themselves commuting on a regular basis, the frequency of online shopping will likely reduce. Consequently, although it forms an important element of the overall customer proposition, we do not view on-demand delivery as a source of significant earnings growth for the listed grocery retailers over the medium term. UP

3 South African Revenue Service 2020 Tax Statistics release (figures relate to the 2019 tax year).
4 The total number of Shoprite, Checkers, Checkers Hyper, Usave and Liquorshop stores in South Africa at the end of the 2020 financial year.

The gold in RECM and Calibre

Dirk van Vlaanderen - Portfolio Manager

"South Africa's large, traditional casinos are rapidly losing market share to alternative forms of gambling - a trend that looks set to continue. We consider the changes underway in the local gambling market, highlighting RECM and Calibre's Goldrush business as ideally positioned to benefit from these market trends."

The gold in RECM and Calibre

Shifts in gambling activity

In 1996, the National Gaming Act legally formalised casinos in South Africa (currently 39 in operation) - each enjoying a geographic monopoly. This curtailed competition and ensured that a decent return could be earned on the significant capital required to build and maintain these establishments. For many years since, the rollout of new casinos and increasing household incomes guaranteed good growth in total casino gross gaming revenue (GGR[1]), as indicated in the *left chart below*. More recently, however, casino GGR growth has struggled to beat inflation, averaging just 1.4% in the last five years.

The same is not true though for alternative forms of gambling in South Africa, all growing above 10% per annum on average over the past five years (*below left*) and benefitting from the rollout of new licenses and a consumer that is enjoying the novelty, location, affordability and convenience of new modes of gambling.

Unlike casinos, alternative forms of gambling [limited payout machine (LPM) gambling, Bingo and sports betting] are not restricted to a few large venues and can reach a much greater market by operating in smaller towns, shopping centres and online (in the case of betting). The enhanced proximity to customers and the convenience of these forms of gambling is a key enduring competitive advantage over casinos.

For many years, large casino operators opposed the expansion of gambling licenses for LPM, Bingo and sports betting operators in an attempt to defend their casino monopolies. This dynamic has changed materially in the last five years, with all the large casino operators now having their own alternative gambling businesses. Today, the industry as a whole is supportive of the growth and success of these previously considered "outcast" gambling formats.

Limited payout machines - unlimited potential

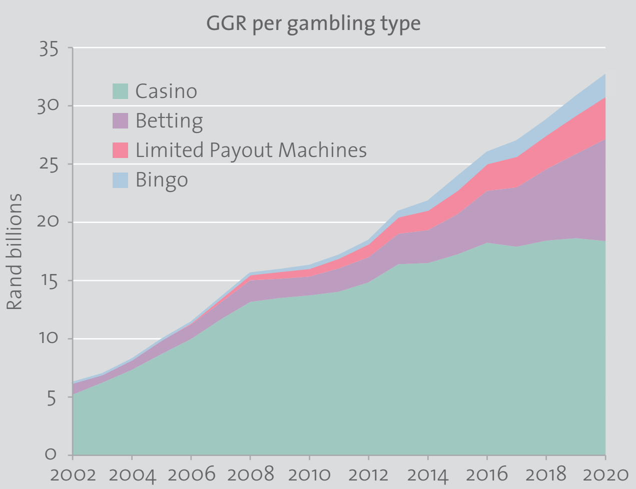
LPMs offer gambling convenience as they are commonly found in easily accessible bars or restaurants. There is usually a limit of five machines per site with a stipulated maximum bet size and prize per spin (R5 and R500 respectively).

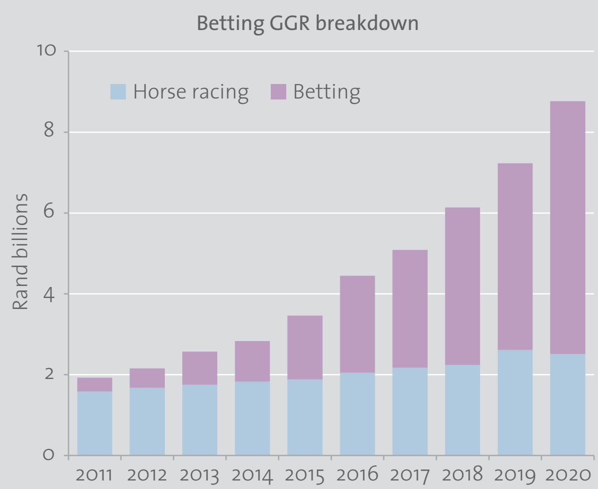
LPMs enable a lucrative business model. The route operator (owner/machine operator) installs the machine and splits the net gaming wins 60/40 with the site operator (the bar/restaurant owner). The machines are all monitored centrally by the route operator, with cash collected weekly and the option to switch a machine off remotely if payment is not received.

The biggest challenge for route operators, since LPMS were first introduced in 2003, is the availability of suitable sites. This is the reason why the rollout of LPMs has been much slower than expected, with only 13 989 active machines in 2020 from initial expectations of 50 000. To expedite machine roll-out,

[1] The revenue of an operator derived from gambling, less winnings paid out to players.

Total South African GGR per gambling type





Source: National Gambling Board

provincial gambling boards have now agreed to the rollout of "Type B" LPM licenses, allowing for up to 40 machines per venue. Another massive potential boost to revenues for LPMs is the likely increase of the minimum bet size that has remained at the R5 level for over 15 years.

Following much industry consolidation over the past 10 years, the LPM market is now essentially a three-horse race between Sun Slots (owned by Sun International and Grand Parade Investments), Vukani Gaming (owned by Tsogo Sun Gaming) and Goldrush. The relative size and profitability of these businesses are set out *below*.

Burgeoning Bingo

Traditional Bingo (where players need to match random numbers to pre-printed cards) has advanced through technology to include electronic Bingo terminals (EBTs). These look, sound and play in a very similar manner to slot machines and link players to one another. Electronic Bingo has largely replaced its traditional counterpart in South Africa.

The significant growth seen locally in recent years is due to new machine and license rollouts. There are currently 9 427 licensed Bingo positions - Gauteng has the largest exposure, followed by the Eastern Cape and then KZN. There are no Bingo licenses in the Western Cape, Northern Cape and Free State at present. EBT operations have essentially created mini casinos (usually situated in shopping centres), offering gamblers a more convenient alternative to travelling to traditional casinos. In addition to the significant growth we expect from further license rollouts and the maturation of existing sites, we see significant opportunity in electronic Bingo should the gaming boards look to issue licenses in the unlicensed provinces.

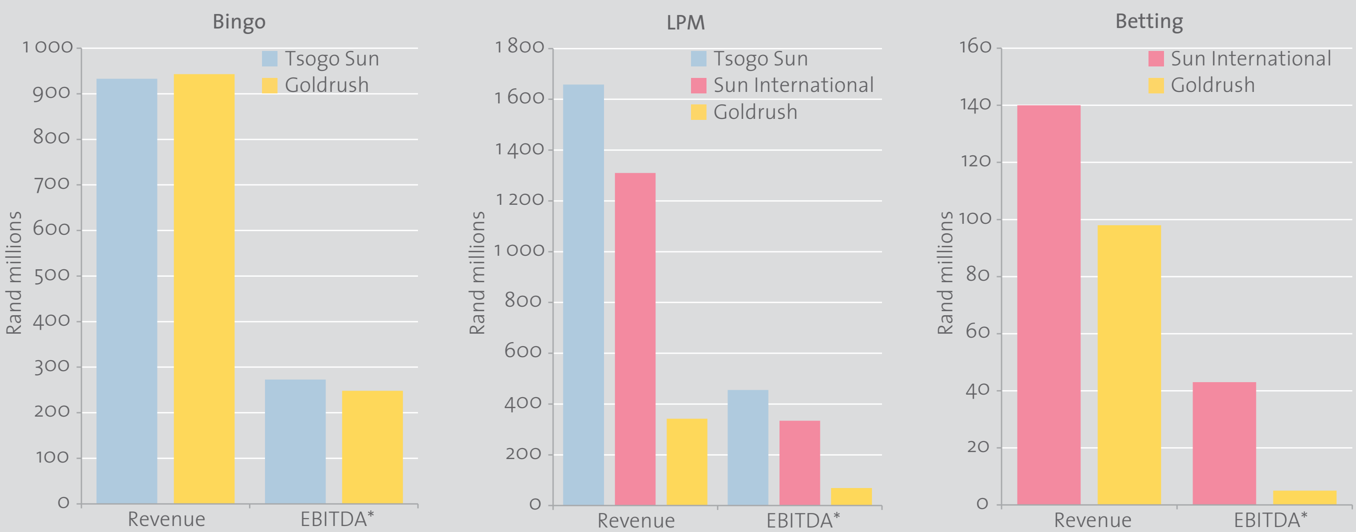
Industry consolidation over the past 10 years has resulted in Galaxy Bingo (owned by Tsogo Sun Gaming) and Goldrush being the dominant Bingo license operators in South Africa, both similar in size (*charted below*).

Big on betting

Betting on horse racing has traditionally dominated the betting scene in South Africa, but the rise of sports and other betting options has rapidly outpaced the stagnant horse racing scene. Today, sports betting is three times the size of betting on horse racing (*right chart on previous page*). Bets can either be placed in person at physical retail outlets or via several online platforms, and gamblers can bet on the outcome of many sports fixtures, on a number of games (such as local and international Lottos) and on casino-style live play (eg betting on the outcome of live roulette or other games).

While online gambling is still illegal in South Africa, online betting is permitted. The barriers to entry for online betting are

Key financial metrics for alternative gaming businesses of JSE-listed gambling companies



*Earnings before interest, taxes, depreciation and amortisation
Financial metrics for the following year ends: Sun International - 31 December 2019, Tsogo Sun Gaming - 30 September 2019, Goldrush - 31 March 2020
Source: company data, Kagiso Asset Management estimates

The gold in RECM and Calibre

relatively low as a provincial betting licence (comparatively easy to obtain versus a casino, LPM or Bingo license) is all that is required in order to operate and a betting business costs relatively little to set up.

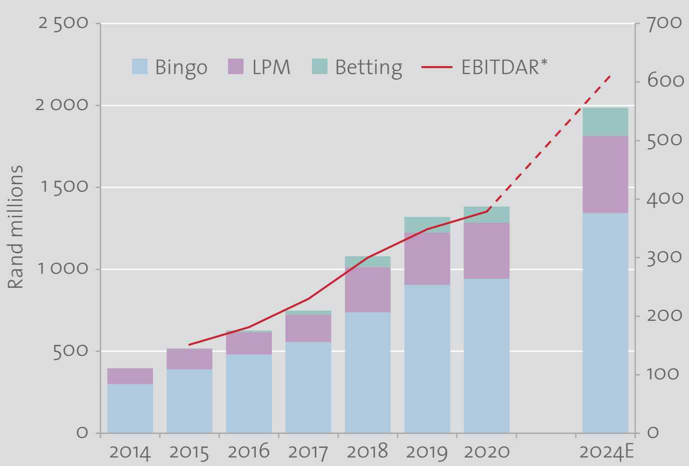
Locally, the industry is dominated by private companies, with the largest being Hollywoodbets and Betway. The listed casino groups have been late to participate in the betting industry and are now investing to catch up: Sun International with its Sunbet brand, Goldrush operating as Gbets and Tsogo Sun Gaming with a majority stake in Bet.co.za. As the *chart below* indicates, betting is currently a small contributor to revenue and profit for Goldrush.

RECM and Calibre is well positioned in alternative gambling

RECM and Calibre is a JSE-listed investment holding company that has historically managed a diversified portfolio of predominantly unlisted investments. Following a portfolio reorganisation earlier this year, the company is now solely focused on the alternative gaming sector through its 58% holding in Goldrush.

Goldrush has spent the past 10 years consolidating LPM and Bingo licenses around the country and is now one of the leading players in the alternative gambling industry in South Africa. Bingo is by far the largest contributor to group revenue and profit, but a hefty LPM business and nascent betting business are also exciting growth vectors for the group. Goldrush, unlike

Goldrush revenue and EBITDAR*



*Earnings before interest, tax, depreciation and rental
Source: company data, Kagiso Asset Management estimates

its listed competitors Sun International and Tsogo Gaming (who only generate between 15% and 20% of revenue from alternative gambling), is solely focused on this high-growth segment of the local gambling market.

With the rollout of Bingo licenses having required significant investment (new machines and the fit-out of suitable sites), we expect strong growth in earnings over the next few years as these sites mature. With the investment phase completed and once the devastating Covid-impacted period is behind them, we expect Goldrush to generate cash flow well ahead of profit, resulting in a large and growing dividend stream for shareholders.

Regulatory clouds on the horizon

The gambling industry is not without its regulatory risks, such as the potential for a smoking ban in casinos and Bingo sites, which could possibly deter some gamblers from these venues (a large proportion of gamblers are smokers). All gaming taxes are levied provincially, but the National Gaming Board is mulling over imposing a national gaming tax. This would negatively affect the margins across all forms of gambling and the industry is, therefore, currently opposing these proposals.

Some eccentricities at RECM and Calibre

An unusual feature of RECM and Calibre is its share structure, whereby two different share classes exist - namely the unlisted ordinary shares and the JSE-listed preference shares. The share classes have identical economic interests, but the listed preference shares do not have any voting rights. Consequently, the ordinary shareholders and founders of RECM and Calibre control the business. While control structures are not unusual on the JSE, it is important to understand that investors are beholden to management with very few of the usual shareholder protections. Mitigating this somewhat, is the fact that management (ordinary shareholders) are very economically aligned with preference shareholders as they are large owners of the business.

Following the 'Goldrush'

The gambling landscape is evolving rapidly in South Africa and we believe the next 10 years will see significant growth in alternative forms of gambling. Furthermore, it is our view that RECM and Calibre's current share price does not fully appreciate the future cash flow prospects of the business. UP

Enhancing Quilter's asset gathering ability

Meyrick Barker - Investment Analyst

"Quilter is a vertically integrated wealth manager operating in the UK, the world's fifth largest wealth market. The business comprises two main segments - one provides trusted financial advice, wealth and asset management, and the other is a multi-channel fund platform (the second largest in the UK) that provides access to a broad range of investment products. We outline how Quilter has modernised and streamlined the business to capitalise on the strong demand for financial advice within the UK."

Enhancing Quilter's asset gathering ability

Reasserting the brand

The launch of Quilter's new fund platform concluded the final stage of their rebrand following unbundling from Old Mutual in 2018 and listing on the Johannesburg and London stock exchanges. The business, however, has a long pedigree. Its earliest incarnation - William Morris and Sons - can be traced back to 1771, where it consisted of a partnership of stockbrokers formed shortly before the opening of the London Stock Exchange in 1773.

Quilter was formed through a sequence of mergers and acquisitions including the Skandia (European wealth and insurance business) transaction in 2005, that incorporated what became Quilter's original fund platform. Through a sequence of recent divestments and acquisitions, the business model has been refined. Today they are a fund platform, an advice network and an asset manager combined, with their focus being on gathering investment assets (predominantly from UK-domiciled citizens) to administer, advise and manage.

Multiple client touch points from which to generate revenues

In that they offer both asset and wealth management, Quilter's vertically integrated service offering affords them the opportunity to earn platform, advice and asset management fees.

Each of these services are charged for independently and investors interact with Quilter via two main distribution channels: Quilter employed advisers (tied) who generate an advice fee or independent financial advisers (IFAs or non-tied). Advisers direct client assets either into Quilter managed investment products (generating an asset management fee) or into third party products and funds. The assets are typically invested into financial products through an investment platform - either Quilter's (generating a platform fee) or that of a third party.

Encouraging more adviser flows

While the platform fee is the smallest of the abovementioned charges and standalone platform businesses are typically not significant profit contributors, Quilter's platform is strategically important in creating a valuable asset gathering ecosystem, supporting the broader business. In addition to acting as an access point for an array of investment products, platforms enable the efficient management of an adviser's clients' assets - easing the adviser's administrative burden. A reliable and robust investment platform with broad, efficient functionality can create a loyal adviser base, provided that:

- it has an easily navigable user interface and is integrated with the adviser's back-office;
- it offers transparent, competitive pricing;
- it delivers quality service and technical support to its user base; and
- it hosts a comprehensive investment product offering.

Assets held on UK investment platforms have grown by a compound annual growth of 21% in the 10 years ending 2019. Despite some recent consolidation of UK investment platforms, the industry remains highly competitive, with approximately 30 investment platforms available (several are dated and ripe for disruption).

Quilter's asset-based fee model supports their goal to grow and increase the productivity of their tied agent force, and to encourage more independent advisers to invest a larger proportion of their advised assets on the Quilter platform (ideally within Quilter managed products). It also results in their profits being linked to the general level of financial markets.

In February 2021, Quilter completed an upgrade of their investment platform (which took more than five years and cost about £500 million) to a highly configurable, market-leading software solution provided by FNZ[1]. The upgrade positions them well for the continued digitalisation of the wealth management industry and includes certain middle and back-office operations being outsourced to FNZ, thereby reducing operational costs. Prior to this, Quilter's platform (originally acquired as part of the Skandia acquisition) had a somewhat constrained product range and lacked some required functionality - a factor that impeded asset growth.

In the period leading up to Quilter's platform migration, advisers may have been somewhat concerned that the pending upgrade might lead to disruptions and this may have adversely impacted client flows. The *chart on the next page* indicates

[1] A global company providing software solutions for the wealth management industry and to which a wide range of administrative asset and wealth management related functions can be outsourced. In 2020, FNZ acquired South African third-party administration firm Silica from Ninety One.

this, demonstrating that non-tied agents (who have a choice of alternative platforms) gradually contributed a smaller proportion of total gross inflows. The chart also disaggregates the £63 billion of assets on Quilter's platform at the end of 2020, between agent type and whether assets are managed internally.

The upgrade addressed significant shortcomings in terms of the breadth of investment solutions[2] available on the platform. It also enhanced the reporting functionality available, making it easier to meet client needs. Furthermore, the enhanced self-service functionality reduces the number of support interactions required with the adviser base and improves Quilter's productivity - in turn delivering cost savings.

Quilter charges a competitive fee for the use of the platform and delivers highly regarded support to their adviser base.

The holy grail: directing more asset flows in-house

For integrated wealth managers such as Quilter, the wealth management arm can deliver a valuable source of new money flows into its asset management business and thereby an additional revenue stream. IFAs typically direct about 20% of their flows into Quilter solutions, whereas tied agents direct threefold the proportion into Quilter products (Quilter may not incentivise advisers to make use of Quilter-managed products). Through effective product development, good performance track records and ongoing engagement with the adviser force, a larger portion of asset flows can be captured in-house.

Enduring demand for advice

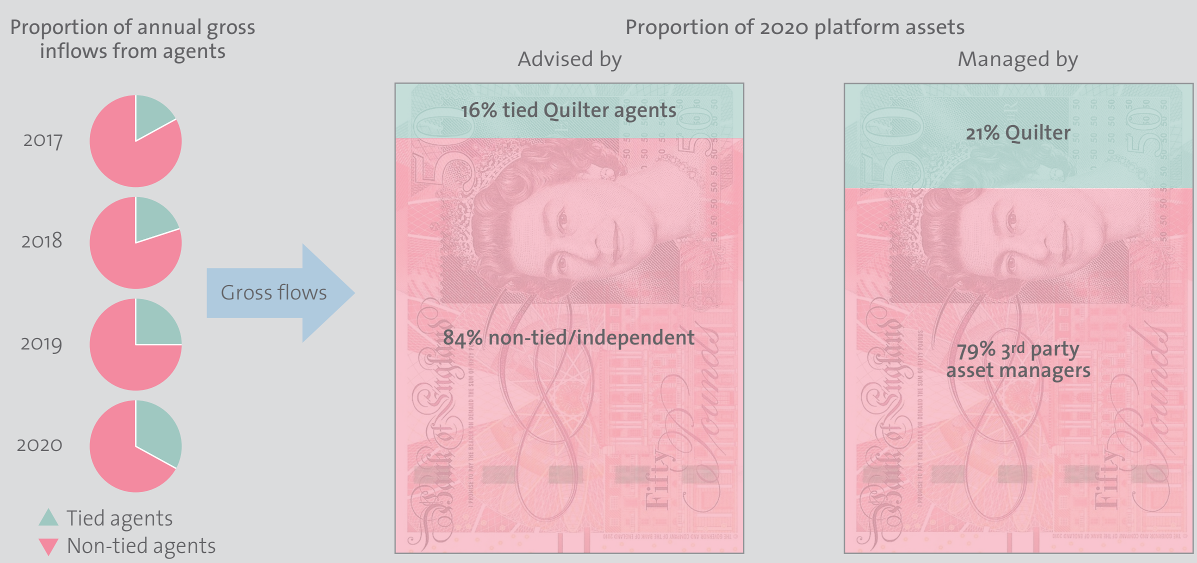
A variety of advisory models exist, ranging from very low-cost, self-service investment propositions to more costly, comprehensive wealth planning services. Compared with asset management, the longevity of wealth management assets is superior and advisers in the UK often earn higher fees than asset managers (who have been subject to acute fee pressure).

Significant resources are currently being directed towards the development of low-cost, simple advised propositions - providing a valuable service to part of the investment community. JP Morgan's recent acquisition of Nutmeg in the UK is a move in this direction. Despite the headwind to adviser margins that these propositions present, the fundamental service of wealth planning and advice is difficult to cannibalise by technological innovation.

An automated solution will struggle to match the breadth of service and tailored solutions provided by wealth managers and lacks the highly-valued human touch element. Complex tax and pension rules, the shift of financial risk to households,

[2] Although Quilter's platform has the functionality to allow for investment in individual shares, this service is not currently offered. Exchange Traded Funds can be purchased.

Split of Quilter's platform assets



Source: Quilter

Enhancing Quilter's asset gathering ability

the removal of mandatory annuitisation and the need to mitigate adverse behavioural tendencies, has resulted in a sustained demand for appropriate, timely and personalised financial advice.

Nurturing the adviser channel

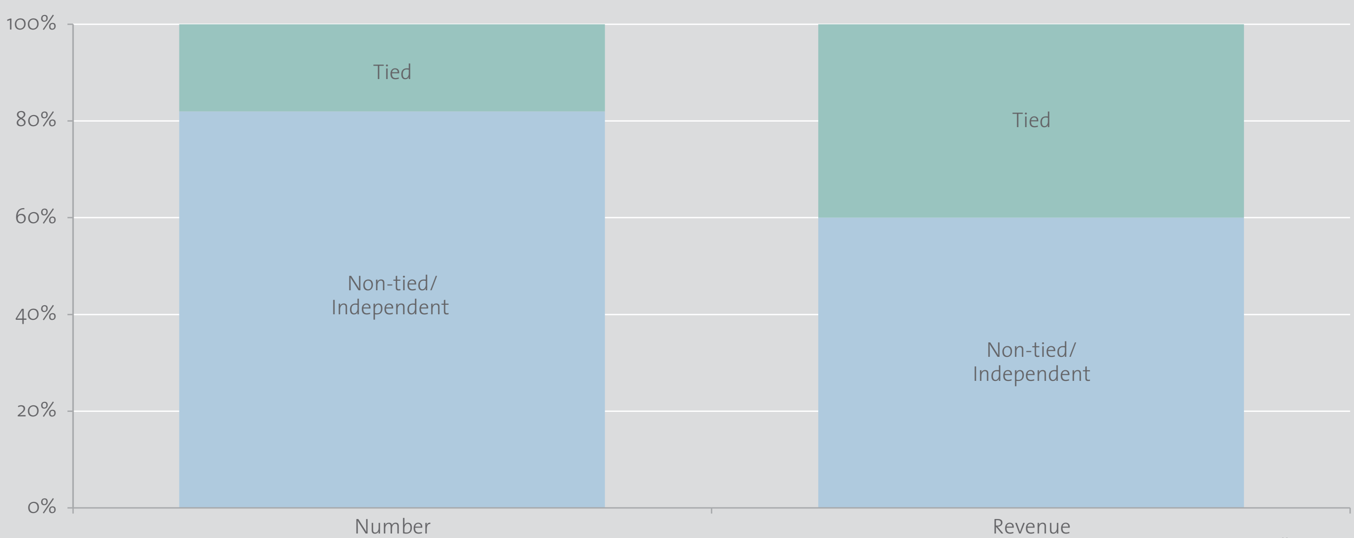
Despite this, the number of financial advisers continues to decline (approximately 35 000 advisors currently operate in the UK market, with which Quilter has relationships with 8 000). There are 11 million people with between £50 000 and £5 million of investible wealth - many with financial affairs sufficiently complex to require advice. The *chart below* demonstrates the split in UK advisers between tied and non-tied by number and revenue generation.

The cost pressures resulting from increased regulatory demands make it difficult for smaller independent financial advisers to survive. While not the primary focus, Quilter's business model allows for productive IFAs to become tied agents. In addition, Quilter has an adviser training academy to develop quality tied agents. This delivers a pipeline for future asset growth and ensures continuity of advice and retention of assets as older agents retire. It is also a lower risk strategy than buying advisers and integrating them into an established corporate culture. In response to Covid-19, Quilter has developed digital training strategies to assist their adviser force in remotely servicing their clients. They have one of the largest adviser forces in the UK with approximately 1 800 tied agents. This comprehensive national distribution footprint is a competitive advantage that enhances the business's asset gathering capabilities.

Growing returns to shareholders

Despite revenue headwinds, wealth management remains a resilient business model and one of the more profitable businesses in finance. The recent enhancements to Quilter's fund platform provides for a more compelling adviser proposition. The ability to manage and source client financial assets, accommodate tied and non-tied advisers, and provide access to a leading, secure fund platform allows Quilter to own all elements of the client investment proposition. It also enables their adviser force to deliver sound client outcomes over the long term. Quilter's continued initiatives to support and grow their adviser force means the business is well positioned to deliver growing cash returns to shareholders. UP

Split in UK financial advisers by number and revenue



Source: Redburn, FCA

Bidcorp - food for thought

Mohamed Mitha - Investment Analyst

"Bidcorp's ambitious growth strategy has seen it develop from humble beginnings in 1989 as a South African foodservice business, to the JSE-listed broadline foodservice group it is today - with a presence in more than 35 countries across five continents. We unpack Bidcorp's journey to becoming one of the most profitable global foodservice companies and assess their prospects in this 3.5 trillion-dollar per annum industry."

Bidcorp - food for thought

Fulfilling a central role

"Foodservice" is an umbrella term for the wide range of products, services and businesses involved in the preparation and service of food outside the home. Bidcorp operates as a wholesale and contract distributor within the broader foodservice industry, essentially functioning as an intermediary between a range of local and specialty food producers and other business customers - the scope of which is indicated in the *right chart below*.

Across the group, Bidcorp warehouses an extensive range of over 350 000 products sourced from more than 24 000 suppliers. This includes shelf-stable items (eg sugar), refrigerated food (eg meats) and frozen products (eg ice-cream), along with non-food items such as napkins and sanitizers. The company's multi-temperature delivery vehicle fleets transport products to a global customer base of more than 280 000 businesses and institutions. The *left chart below* illustrates Bidcorp's geographical exposure, reflecting a well-balanced mix across the different territories.

Dining out dishes up potential

Covid-19 pandemic impact aside, the broader foodservice industry has enjoyed robust growth over time as dining habits have increasingly shifted in favour of the convenience of the Food-Away-From-Home (FAFH) market. The ever-improving value proposition of quick-service restaurants together with better standards of living have aided this trend, and distributors like Bidcorp have benefitted through supplying the businesses that cater to FAFH.

By 2010, FAFH expenditure had overtaken Food-At-Home expenditure in the US and it accounted for an estimated 53% of total food spend by 2019. Yet, in the UK and Australia - two key markets for Bidcorp - a deceleration in the growth rate for FAFH spending has been noted, indicating that this theme is reaching maturity in these markets (*charted on the next page*). Bidcorp have subsequently sought a different approach for growth and profitability across these markets, through solutions-based innovation and service excellence.

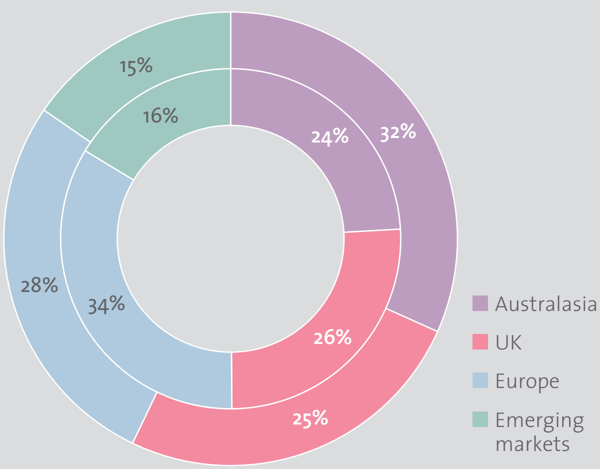
Standing out from the crowd

Foodservice distribution is typically characterised by a high level of commoditisation among the products on offer. Pricing competition is fierce and, similarly to food retailers, distributors price their products as a basket of goods with some items being loss-leaders and others earning higher margins. Clients can change suppliers with relative ease and, while there are benefits to having scale, the barriers to entry for new competitors remains low for these reasons.

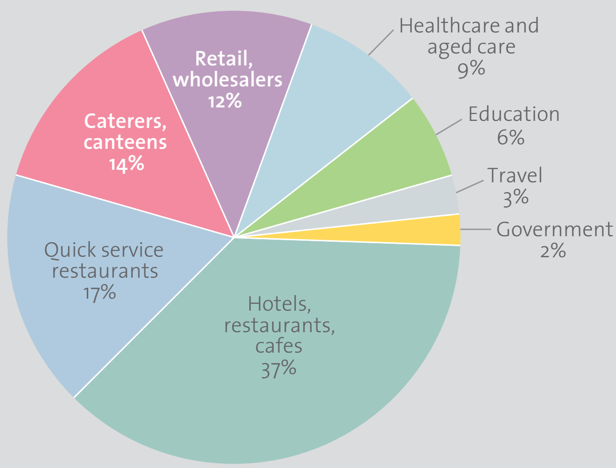
To combat this, Bidcorp has focused on increasing their client offering. The company owns and operates processing facilities

Bidcorp's geographical exposure

Revenue (inner) and trading profit (outer) split*



Revenue split* by customer mix



*2019 split used to avoid COVID-19 distortions
Source: company data

which are used to make value-add products including, for example, ready-to-fry potato chips, pre-cut vegetables and frozen ready-made meals. Not only does this present a greater range and save customers preparation time, these value-add products earn a higher profit margin for the group.

Additionally, Bidcorp has sought to further differentiate themselves from competitors through building client loyalty by offering bespoke menu development, recipe costing and operational guidance to their client base. They run "Customer Experience Centers" in certain countries, where clients can learn about new products and how best to use them via tutorials given by professional chefs. Their sophisticated online ordering platform also enables clients to access real-time stock levels, prices and scheduled arrival times for deliveries.

Strategically building profitability

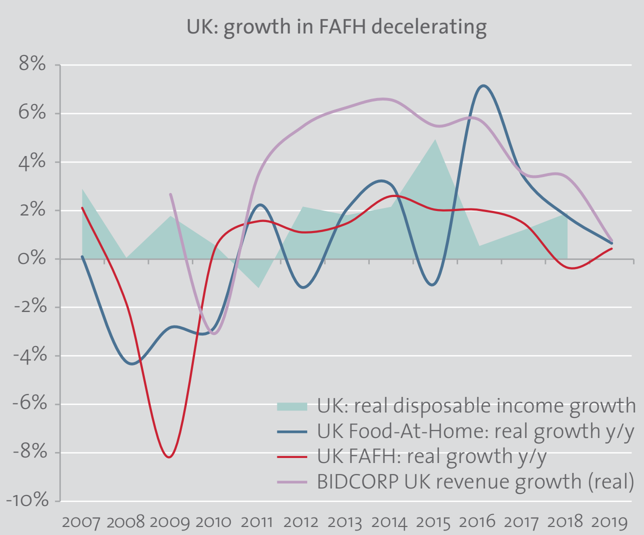
Bidcorp's most notable achievement has not necessarily been growing the group's revenue base, but rather transforming the profitability of the business - the evolution of their trading profit margin shows successful strategic execution. This is evidenced by the Australasian business, which (upon reaching scale) opted to refine their customer mix, tailor the business to cater to high-margin (low volume) independent restauranteurs and rationalise their low-margin (high volume) clients (ie large national chain restaurants).

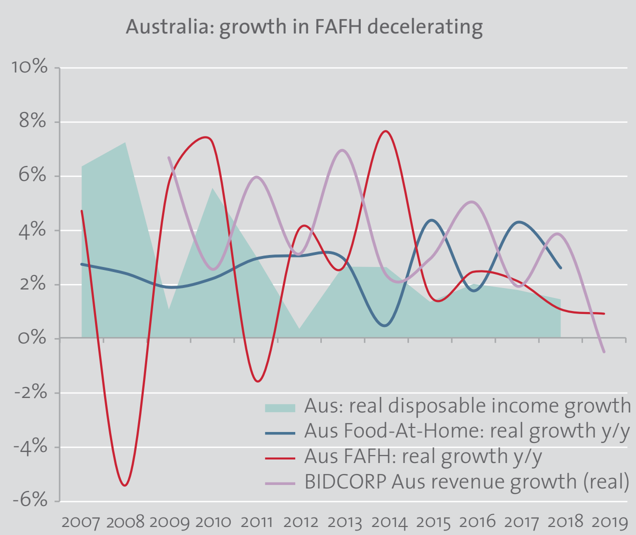
Independent customers typically do not have the same bargaining power as national chains and therefore pay up to 20% more for items. However, focusing on independent restauranteurs comes with an increased level of complexity as the need to cater for many different clients - each with potentially different requirements - demands a high level of service and attention to detail. Consequently, Bidcorp rolled out a network of decentralised depots across key transport nodes to position themselves closer to their clients. The high capital outlay and greater associated costs of doing business has been more than offset by the increased financial rewards, with the depots offering a competitive advantage over other distributors in the region.

Pre-Covid-19, this strategy led to Bidcorp delivering a trading profit margin of 6.9% in Australasia (see *chart on next page*) - notably the highest within the group.

This success has led to Bidcorp signaling an intention to emulate a similar strategy in other regions. While we see merit in this, we believe it is unlikely that other regions will reach the same levels of profitability as Australasia. Each market has its own culture and hospitality-related nuances, with the Australasian market characterised by a strong mix of cafes and independent restaurants relative to national chains - compared to the profile

Structural growth reaching maturity in UK and Australian markets





Source: company data, USB estimates, ONS, ABS

Bidcorp - food for thought

of most other markets in which they operate. There will therefore likely be challenges in fully replicating this strategy elsewhere with the same expectations.

However, we do see further opportunities for Bidcorp to increase profitability by downscaling or disposing of underperforming business units within the group - as they did with their loss-making UK Logistics division in 2017.

An interesting market exposure mix

Bidcorp have built up a meaningful presence in China - the world's largest foodservice market - and have established a foothold in regions across South America and other Asian markets including Hong Kong, Malaysia, Singapore and Vietnam. Unlike the UK and Australasia, many of these foodservice markets are still in the early stages of maturity, where the rise in more formal dining out (FAFH) is a more recent development.

There is a clear and positive correlation between individuals dining out more as income levels increase. With Asia estimated to be home to 90% of the next billion middle-class consumers, the long-term opportunity is particularly evident for Bidcorp.

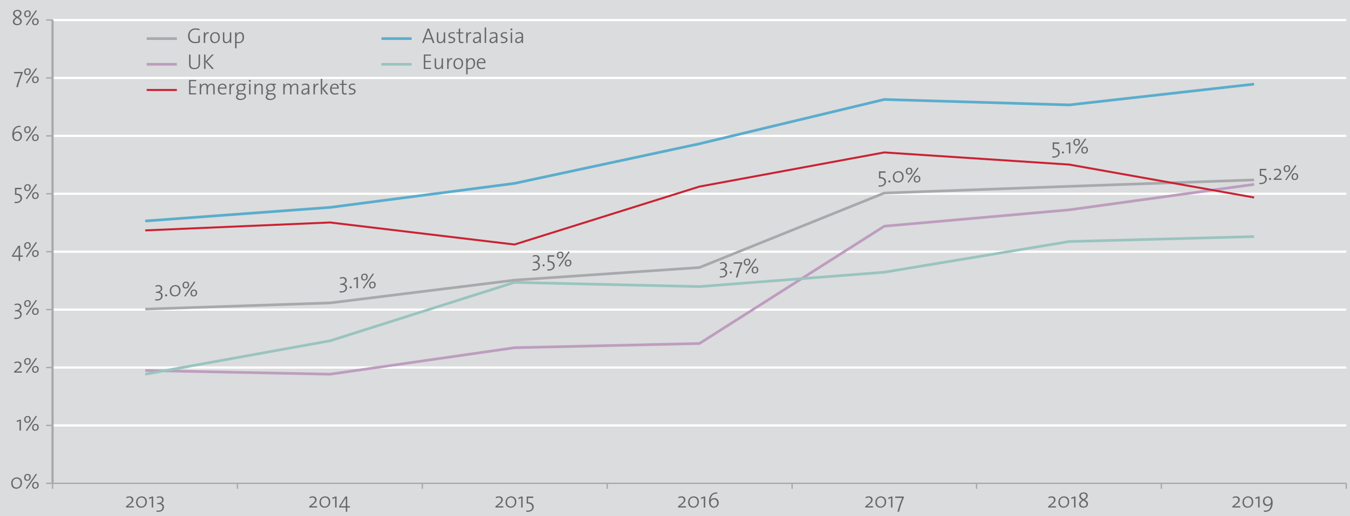
Notably, emerging markets have proven themselves as challenging and often volatile territories in which to do business. While we see potential in Bidcorp's growing exposure to these territories, we are cognisant of the fact that strong execution will be required for these opportunities to be fully realised.

Eat or be eaten

The complexity and size of the industry and low barriers to entry have led to a high level of fragmentation among foodservice distributors. Consequently, opportunities to achieve growth through acquisitions has been a long-standing theme within the industry, with larger players like Bidcorp regularly acquiring smaller distributors. Bidcorp have indicated that they intend to continue acting as a consolidator in the sector, buoyed by a strong balance sheet and robust cash generation. Given the scale of their operations in key regions, the business serves as a solid platform to integrate bolt-on acquisitions. Done right, most of the target's revenue can be retained while cutting out the majority of their cost base - adding value to the acquirer relatively quickly. Bidcorp have had reasonable success with this strategy to date.

We view Bidcorp as a world-class, well-managed company that has consistently delivered returns exceeding its cost of capital. While we find the share price high relative to its prospects at present, we remain alert to opportunities to add this quality company to client portfolios. UP

Bidcorp trading profit margin by geography



Source: company data
(2020 omitted due to COVID-19 distortions)

Kagiso Asset Management Funds

Performance to 30 June 2021	1 year	3 years[1]	5 years[1]	10 years[1]	Since launch[1]	Launch	TER[2]	TC[3]
Unit trust funds[4]								
Equity Alpha Fund	40.0%	13.2%	10.2%	10.5%	16.0%	Apr-04	2.01%	0.51%
SA Equity General funds mean	25.3%	5.5%	4.6%	8.1%	12.0%			
Outperformance	14.7%	7.7%	5.6%	2.4%	4.0%			
Global Equity Feeder Fund#	19.8%	-	-	-	10.7%	Nov-19	2.86%	0.35%
FTSE World Index[8]	15.9%				17.4%			
Outperformance	3.9%				-6.7%			
Balanced Fund	27.6%	10.5%	8.9%	9.7%	9.4%	May-11	1.61%	0.43%
SA Multi Asset High Equity funds mean	17.2%	6.7%	5.8%	8.6%	8.3%			
Outperformance	10.4%	3.8%	3.1%	1.1%	1.1%			
Protector Fund	25.7%	10.3%	9.3%	7.9%	9.9%	Dec-02	1.60%	0.35%
CPI + 4%	8.8%	7.8%	8.6%	9.6%	10.2%			
Outperformance	16.9%	2.5%	0.7%	-1.7%	-0.3%			
Stable Fund	24.5%	9.2%	8.0%	8.6%	8.3%	May-11	1.53%	0.46%
CPI + 2%	6.9%	5.8%	6.2%	5.8%	5.8%			
Outperformance	17.6%	3.4%	1.8%	2.8%	2.5%			
Institutional funds[5]								
Managed Equity Fund*	39.5%	13.1%	9.3%	10.2%	11.6%	Sep-06		
FTSE/JSE Capped SWIX Index	27.6%	4.8%	5.2%	10.3%	10.8%			
Outperformance	11.9%	8.3%	4.1%	-0.1%	0.8%			
Domestic Balanced Fund[6]	32.7%	12.8%	9.6%	9.1%	9.0%	May-07		
Peer median	22.5%	5.5%	6.0%	9.0%	8.8%			
Outperformance	10.2%	7.3%	3.6%	0.1%	0.2%			
Global Balanced Fund[7]	29.0%	12.1%	10.6%	-	10.3%	Jul-13		
Peer median	18.4%	7.4%	7.2%		9.1%			
Outperformance	10.6%	4.7%	3.4%		1.2%			
Bond Fund	16.9%	9.8%	10.0%	-	9.3%	Aug-15		
BESA All Bond Index	13.7%	9.2%	9.2%		8.4%			
Outperformance	3.2%	0.6%	0.8%		0.9%			
Money Market Fund	5.2%	7.3%	7.8%	7.1%	7.7%	Jan-04		
Alexander Forbes STeFI Composite Index	4.0%	6.1%	6.6%	6.3%	7.1%			
Outperformance	1.2%	1.2%	1.2%	0.8%	0.6%			
Sharia unit trust funds[4]								
Islamic Equity Fund	36.4%	10.3%	10.4%	9.3%	11.4%	Jul-09	1.55%	0.22%
SA Equity General funds mean	25.3%	5.5%	4.6%	8.1%	10.0%			
Outperformance	11.1%	4.8%	5.8%	1.2%	1.4%			
Islamic Global Equity Feeder Fund#	9.9%	-	-	-	12.5%	Jan-19	2.42%	0.18%
Global Equity General funds mean	14.3%				21.2%			
Outperformance	-4.4%				-8.7%			
Islamic Balanced Fund	27.1%	9.9%	9.0%	8.3%	7.9%	May-11	1.55%	0.15%
SA Multi Asset High Equity funds mean	17.2%	6.7%	5.8%	8.6%	8.3%			
Outperformance	9.9%	3.2%	3.2%	-0.3%	-0.4%			
Islamic High Yield Fund#	10.5%	-	-	-	7.3%	Mar-19	0.57%	0.03%
Short-term Fixed Interest Index (STeFI)	4.0%				5.7%			
Outperformance	6.5%				1.6%			

Highest and lowest monthly fund performance	Highest	Lowest	Highest	Lowest	Highest	Lowest	Highest	Lowest	Highest	Lowest
Equity Alpha Fund	10.9%	-2.8%	12.6%	-21.6%	12.6%	-21.6%	12.6%	-21.6%	12.6%	-21.6%
Global Equity Feeder Fund	15.4%	-6.6%	-	-	-	-	-	-	18.1%	-15.6%
Balanced Fund	9.1%	-1.0%	9.1%	-15.7%	9.1%	-15.7%	9.1%	-15.7%	9.1%	-15.7%
Protector Fund	7.4%	-0.4%	7.4%	-13.9%	7.4%	-13.9%	7.4%	-13.9%	9.5%	-13.9%
Stable Fund	6.1%	-1.7%	6.1%	-11.4%	6.1%	-11.4%	6.1%	-11.4%	6.1%	-11.4%
Islamic Equity Fund	9.6%	-1.4%	9.6%	-14.3%	9.6%	-14.3%	9.6%	-14.3%	9.6%	-14.3%
Islamic Global Equity Feeder Fund	7.9%	-4.9%	-	-	-	-	-	-	14.6%	-8.4%
Islamic Balanced Fund	8.0%	-1.1%	8.0%	-9.3%	8.0%	-9.3%	8.2%	-9.3%	8.2%	-9.3%
Islamic High Yield Fund	2.7%	0.1%	-	-	-	-	-	-	2.7%	-2.4%

Footnotes and disclaimer follow overleaf.

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Footnote: [1] Annualised (ie the average annual return over the given time period); [2] TER (total expense ratio) = % of average NAV of portfolio incurred as charges, levies and fees in the management of the portfolio for the rolling three-year period to 30 June 2021; [3] Transaction costs (TC) are unavoidable costs incurred in administering the financial products offered by Kagiso Collective Investments and impact financial product returns. It should not be considered in isolation as returns may be impacted by many other factors over time including market returns, the type of financial product, the investment decisions of the investment manager and the TER. This is also calculated on the rolling three-year period to 30 June 2021; # over 12 months to 30 June 2021. [4] Source: Morningstar; net of all costs incurred within the fund and measured using NAV prices with income distributions reinvested; [5] Source: Kagiso Asset Management; gross of management fees; [6] Median return of Alexander Forbes SA Manager Watch: BIV Survey; [7] Median return of Alexander Forbes Global Large Manager Watch; [8] Benchmark changed with effect from 1 January 2021 from "Average performance in Global Equity unit trust universe".

* Our two Managed Equity composites have been amalgamated with immediate effect. The history of Managed Equity (SWIX) has been maintained and the benchmark changed to Capped SWIX with effect from 1 July 2019. In future, therefore, we have just one Managed Equity composite with a Capped SWIX benchmark. This change has been implemented after consultation with our GIPS auditors, and therefore our composites will continue to be GIPS verified going forward.