How and why Dis-Chem is cannibalising itself

In Sandton, this strategy will help double turnover in just two years

Dis-Chem is even using the great natural resource of time to its advantage, with three stores in a single area closing at different times – 6pm, 7pm and 8pm – in line with the number of customers they are likely to attract at those hours.

This article was written by Hilton Tarrant and appeared first on Moneyweb on June 18, 2019

Pharmacy giant Dis-Chem Group has given some insight into how it deliberately cannibalises its own stores in an area in order to grow the top- and bottom-line from the node overall.

In the year to the end of February 2019 it added 20 new stores, one fewer than the previous year. At that point, its footprint totalled 149, of which 123 were its traditional 'big box' format stores, with 21 newer smaller format outlets (the remainder were TLC and other stores).

As saturation is reached – with outlets in all major urban nodes across the country – and with the shopping mall boom being all but over, growth will increasingly see it add stores in nodes it already serves.

Rival Clicks has followed this strategy for years, adding stores (with pharmacies) in hundreds of convenience and suburban centres to complement its larger flagship 'destination' outlets in super-regional and regional malls. Out of its 680 stores, 496 (or nearly three-quarters) are the convenience format. It has almost certainly cannibalised existing stores in nodes where it adds new stores.

In a presentation accompanying its results, the Dis-Chem Group details how it considers store expansion. For its euphemistically-named 'white space' model, it uses five inputs – catchment area, penetration, site suitability, competition and existing network.

Once this analysis is complete, it then asks three questions:

- Is there an opportunity for additional Dis-Chem presence (and incremental performance)?
- Where in the areas should a new store be established? Will we build or acquire, and what format will be deployed?
- How can fixed costs be managed to optimise store-level Ebitda (earnings before interest, taxes, depreciation, and amortisation) given top-line implications on existing locations?

In the presentation, it shares how it approached the situation in three different catchment areas. This is possibly the first time a major retailer has provided the market with this sort of insight.

Sandton

In Sandton, where it already had a store at Benmore Gardens, a site in Sandton City became available (part of the space vacated by Stuttafords). Additionally, a medical centre opened in Morningside. It opened stores at both locations. The appeal of the former is fairly obvious, while at the latter it says it will "benefit from the convenient medical centre environment". It describes the node as "extremely attractive" and "significantly underpenetrated' from a pharmacy point of view (there are only eight competitor pharmacies in Sandton).

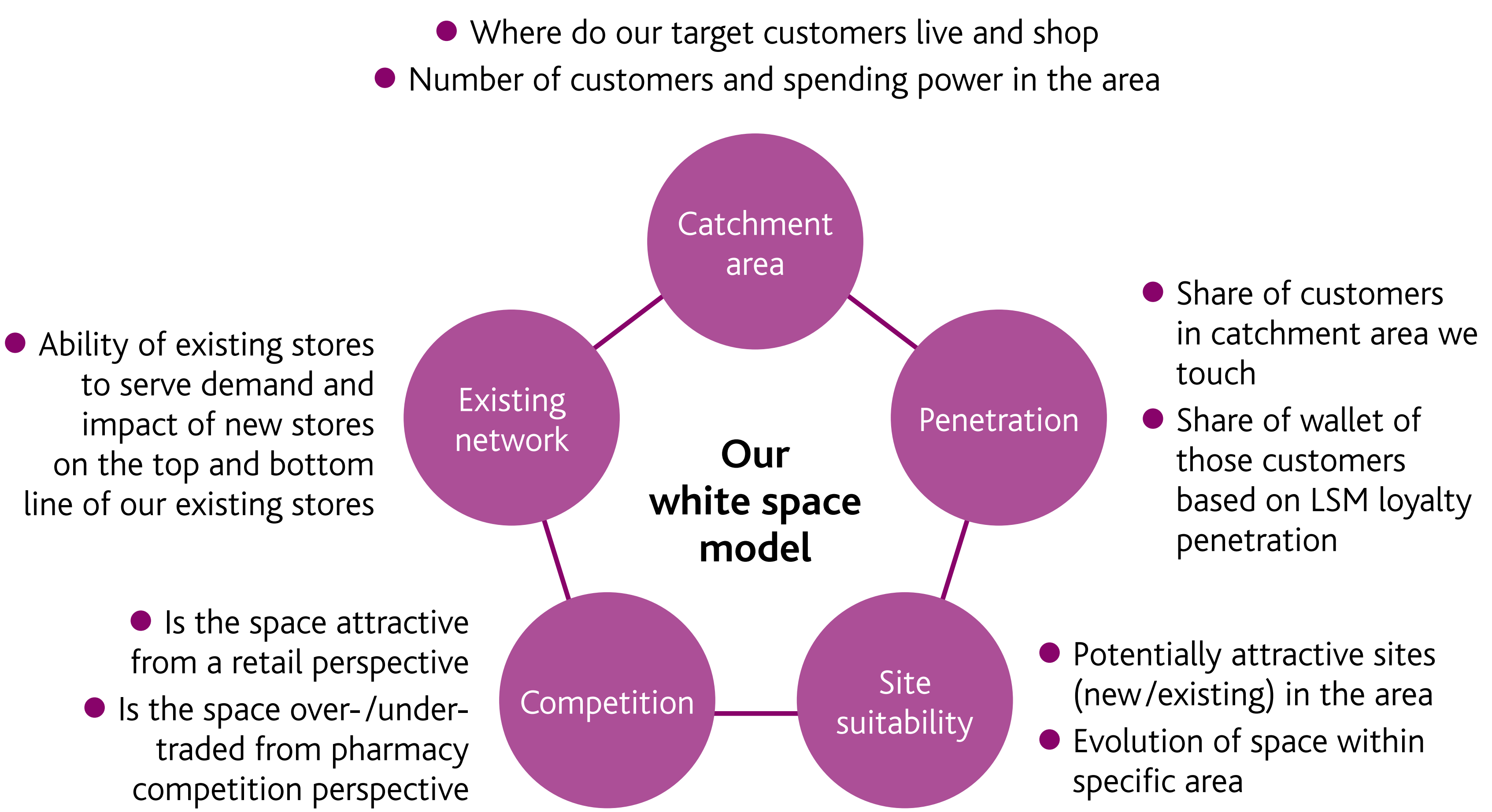
From a market that had been pretty flat since 2016 (with at most less than 5% top line growth at Benmore), it has nearly doubled revenue across the node to R416 million a year from the R211 million from just Benmore in its 2017 financial year. By next year, revenue will be close to R500 million across the three stores. This hasn't come at tremendous top line cost to the Benmore store, with revenue in that outlet retreating to roughly the FY2014 level.

> "This means the nearly R200 million in revenue it added in the year came at a 'sacrifice' of just R40 million at the original store in the node"

The alternative, of course, was to keep trading from one store, with other competitors potentially stepping in.

It says it is "managing costs across the node by redeploying staff across the three stores." This helps explain why the Ebitda margin across the node is heading back towards recent highs (9%/10%). Trading density will catch up as the two new stores mature.

We identify white space using five key inputs



Greenstone

The dynamics in the area around Greenstone (off Modderfontein Road, east of Johannesburg) are very different. Here, there has been significant residential development in recent years. This led Dis-Chem to reduce the importance of its store at Greenstone Shopping Centre as a 'daily shopping destination'. In the last three years, it opened two new stores at convenience centres in the area, while "proactively managing staffing levels and operating hours across the node".

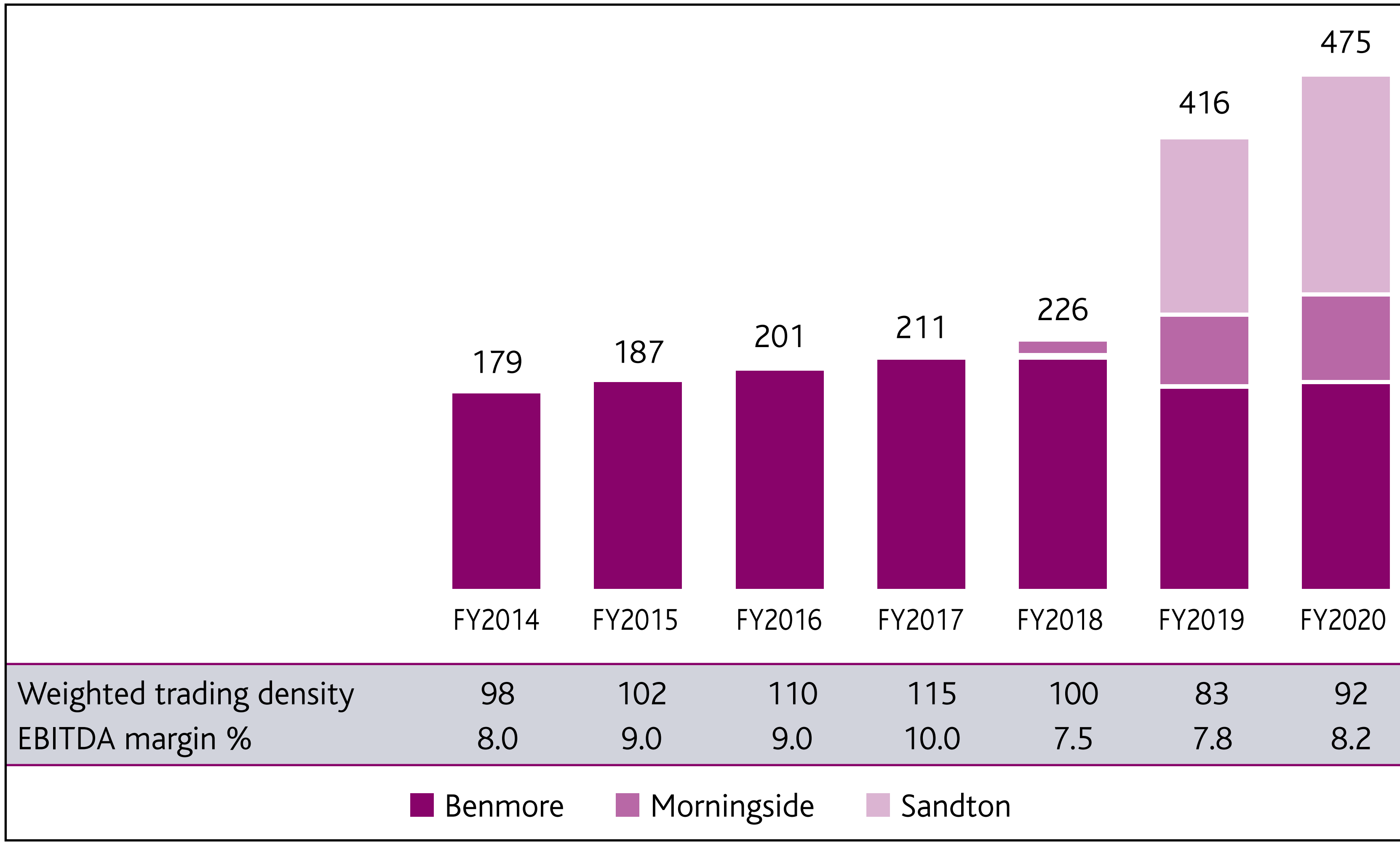
The original (Greenstone) store closes at 6pm, the newest (Flamingo Shopping Centre, nearer the Modderfontein Nature Reserve) closes at 7pm, and the store at a convenience centre on Greenstone Hill closes at 8pm on weekdays. In this node, it will have grown revenue from R224 million in FY2016 when it had the single store to R368 million this year, again without sacrificing too much on the top line from the original Greenstone Shopping Centre store.

While there are 15 competitor pharmacies operating in the area, it contends it remains 'extremely attractive'.

George

What the group has done in George is different still. It describes this market as "over-traded on [the] pharmacy side with strong independent pharmacies with good locations and comparable dispensary pricing." While these 23 competitor pharmacies are clearly giving Dis-Chem a real fight, it still describes the retail market as 'attractive'.

Total node revenue (R'm)



	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020
Weighted trading density	98	102	110	115	100	83	92
EBITDA margin %	8.0	9.0	9.0	10.0	7.5	7.8	8.2

Source: Dis-Chem Group

Its decision to purchase an independent pharmacy "to secure [a] dispensary base" and increase its "penetration within the area" is arguably the least aggressive move from the three case studies shared. The group likely had no other option.

The move will help it grow revenue in that market by an estimated 22% in the current year, a significant improvement on the sub-10% growth it has booked in recent years.

Dis-Chem Group will add 22 stores in the 2020 financial year (to end-February 2020). **SR**