M&G Investments

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Boxer being unboxed

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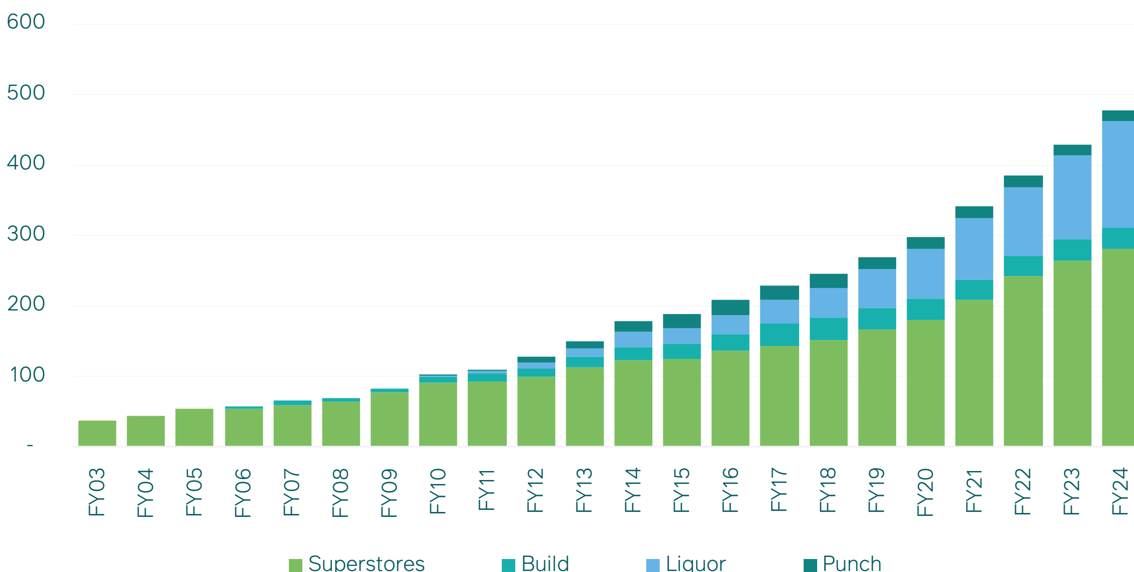
Boxer's background

Boxer started out as Kwazulu Cash & Carry in 1977, when the first store opened in Kwazulu-Natal (KZN). It rebranded to Boxer Cash & Carry in 1991 and then rebranded again in 2012 to Boxer, as it had redefined its offering in the core supermarket division and launched two other formats: Boxer Build in 2004 and Boxer Liquors in 2009.

Boxer's growth has been rapid since the business' formation, as depicted in chart 1. Store numbers have grown at a compound annual growth rate of 14% since the first store opened in 1977. Currently, there are 281 Boxer Superstores, 150 Boxer Liquors, 31 Boxer Build stores and 15 Boxer Punch stores as at 28 February 2024 (Pick 'n Pay Stores Limited 2024 financial year end).

In 2002, Pick 'n Pay Stores Limited acquired Boxer Superstores for R185 million, to extend their reach into the rural/peri-urban areas, specifically of KZN and the Eastern Cape, where the Pick 'n Pay brand was underrepresented. This complemented the footprint of Pick 'n Pay's other mass-market brand, Score, but raised questions as to why Pick 'n Pay needed two brands serving the low to middle income market. Following over five years of losses at Score, Pick 'n Pay decided to close the business in 2010 and converted the stores to Pick 'n Pay franchises, leaving Boxer as its only brand serving the low to middle income market.

Graph 1: Split of Boxer stores by format



Source: Morgan Stanley

Business model

Boxer aims to be "Africa's favourite discount supermarket" which caters to the growing low to middle income consumer market, which makes up the largest portion of the South African population.

A discount supermarket typically offers consumers lower prices than traditional supermarkets, through taking a lower gross profit margin and utilizing a high percentage of private label products. Efficient operations and lean business models allow them to offer lower prices while maintaining profitability.

The most well-known discount supermarkets globally are the two German retailers, Aldi & Lidl. Both businesses have taken substantial market share in the countries they operate in, as their offering appealed to cost-conscious consumers. Aldi & Lidl entered the UK market in the early 1990's and are currently the fifth and seventh biggest supermarket chains, with 8% & 6% market share, respectively.

The supermarket format, Boxer Superstore, has multiple similarities to these global discounters. It offers a limited range of products at attractive prices, with a substantial and growing private label portfolio and a highly efficient supply chain. Where Boxer differs from the hard discounter model of Aldi and Lidl is that its stores are around 50% bigger, typically 1900m2 and have multiple full-service departments (i.e. fresh produce, bakery, butchery and a hot food delicatessen).

Boxer only offers 3000 stock keeping units (SKUs), a very focused range relative to Pick 'n Pay's 18000 and Shoprite's 11000. Selling substantial volumes of a limited range puts Boxer in a strong position to negotiate good prices from suppliers, which can then be passed on to customers. The core of the offer is basic commodities, such as maize meal, rice and cooking oil. This type of product has a long shelf-life and are stored at ambient temperatures enabling a relatively simple and low-cost supply chain, as the distribution centres do not require as much refrigeration as competitors. Interestingly, all procurement is managed by only ten commercial buyers. The simplicity of the model allows for this very lean structure. This lower operating cost enables Boxer to be profitable, while competing on price with much larger rivals like the USave and Shoprite banners of the Shoprite Group.

The value proposition is further enhanced through a high proportion of private label products. While not quite at the 90% plus levels of Aldi and Lidl, private label accounts for approximately 35% of sales in key categories for Boxer. Private label has two significant advantages for a retailer. Firstly, it creates differentiation, as customers can only buy these products from your store. Secondly, the gross margin on private label is 20-25%, more than double the high single digit margin achieved on branded products. This margin differential enhances the profitability of the retailer, whilst also providing an option to invest in price to offer even better value to customers and hence drive higher volumes of sales. Boxer is continually developing private label products, under their various labels. "Golden Ray", a tribute to Pick 'n Pay founder Raymond Ackerman, has become a trusted brand throughout the basic commodity categories. While the confined labels (brands exclusive to Boxer) often out-sell branded goods, for example Boxer sells more "Best Cook" baked beans than Koo baked beans (Koo is known to be the number one brand in the canned vegetable category).

As stated earlier, Boxer has grown their footprint of stores rapidly and have guided that they are aiming to add 50 new stores per year. With 281 Supermarkets and 150 Liquor stores, relative to Shoprite's 628 Supermarkets and 461 LiquorShops, Boxer still has a long runway of store growth in South Africa. Boxer's current footprint is however concentrated in KZN and the Eastern Cape, resulting in the brand being well-known and greatly enhancing the probability of success when rolling out new stores. What is unknown is whether Boxer will have as much success as it shifts its focus to rolling out stores in the other provinces, where some competitors have much stronger footholds (e.g. Shoprite in the Western Cape).

From a financial perspective, the narrow range of products and high stock turnover results in very efficient inventory management, reducing the amount of capital tied up in stock and shortens the cash conversion cycle. Given the 'no frills' nature of the stores and the low-cost distribution system, Boxer should be a low capital intensity and highly cash generative business. Given Pick 'n Pay's historical poor disclosure, we can only surmise these insights of the actual cashflow and return dynamics of Boxer. We will get clarity towards the end of 2024, when the Boxer pre-listing document is published.

Boxer's listing on the JSE

Pick 'n Pay's woes are well known. To summarise the issues, the core Pick 'n Pay supermarkets have been losing market share for over five years. The implied declining volumes, combined with cost growth exceeding sales growth has created negative operating leverage, resulting in the Pick 'n Pay portion of the group delivering an operating loss of R1.5 billion at the end of their 2024 financial year. The Pick 'n Pay segment in the group's results include PnP Clothing, PnP Liquor and the Pick 'n Pay Franchise stores, which are all profitable divisions as far as we know. This implies the corporate-owned Pick 'n Pay supermarkets delivered a loss well in excess of the reported loss. As stated earlier, disclosure is poor, so these insights require some assumptions based on how peers trade and comments made by management over time. This poor operational performance, while spending significant capex on the failed Ekuseni strategy caused debt to build rapidly. Pick n Pay Group went from having a net debt of R378million in the 2022 financial year to R6.1 billion at the 2024 financial year-end (after selling R1 billion of assets deemed unnecessary), and hence breached covenants. This has forced the Pick 'n Pay Board and management to address the problems within the group.

In February, the Pick 'n Pay Board announced their two-step recapitalization plan for the group to raise an estimated R10–12 billion required to fix the group. This comprises of a rights issue of R4 billion (being implemented currently), and secondly, listing Boxer on the JSE towards the end of the year. Pick 'n Pay Group will retain a majority of Boxer and have indicated they will raise R6-8 billion from the initial public offering (IPO). We estimate Boxer to be worth approximately R20 billion, which implies the group will sell down between 30%-40% of their shareholding.

In our view, listing Boxer separately will be positive. The robust competitive offering, growth prospects from further store rollout, low capital intensity and expected strong free cashflow generation should deliver good returns for shareholders over time. However, we see two key risks to be aware of before investing in Boxer. Firstly, the balance sheet structure is not yet known. How much debt Pick 'n Pay Group chooses to put on to the Boxer balance sheet at IPO could change the prospects of the investment case. Secondly, the dividend policy is not yet known. Whilst Pick 'n Pay is raising R10-12 billion of capital, we are uncertain whether it is enough to fix the challenges within the Pick 'n Pay division. Pick 'n Pay's planned controlling stake in Boxer provides the ability to implement a generous dividend policy, sending cash back to the Group to invest in Pick 'n Pay. This would either restrict Boxer's ability to roll out more stores or force them to take on debt. Neither are as beneficial as allowing Boxer to use its cash to fund its own growth.

We look forward assessing the detail in the Pre-Listing Statement due to be released later this year and the potential of having another high-quality retailer listed on the JSE, in which we can invest our clients' funds.

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