CEO's report

The Group approached the end of our financial year in February 2020 amid growing concerns about the rapid spread of the coronavirus and its potential impact. Since then, the world has been turned upside down by this pandemic and its devastating economic, health and social consequences.

Ivan Leon Saltzman

The past financial year can be characterised by the continued weak macroeconomic environment in South Africa that has severely constrained consumer spending, and which has been evident in the declining basket size and spend.

I am very pleased, however, that our focus on Return on Invested Capital (ROIC), cost control, operational adaptability and strategic agility has provided some benefit in this extremely tough trading environment. These factors have all, ultimately, resulted in Dis-Chem reporting positive results with improved market share across all our core categories.

Group performance

The Group continues to report revenue growth ahead of market growth. Overall revenue was 12% higher at R24 billion, which was on the back of a 10% increase in revenue growth in the previous financial year. Retail revenue rose 11% to R21.8 billion with like-for-like retail sales growing 4.0%, which is commendable considering selling price inflation of 2.2%. Retail gross margins improved, with dispensary margins under pressure in a competitive market.

The external revenue growth of 14% in the wholesale environment is mainly due to the successful acquisition and integration of Quenets – the Western Cape wholesaler acquired in the latter half of the previous financial year – and an increase in TLC franchise stores from 91 to 104. TLC's revenue grew by 29.8%, which reemphasises the feasibility and success of this business model. We have also made a strategic decision to embark on a corporate TLC model, which allows us to purchase smaller stores that would not normally be suitable for a Dis-Chem store format. Independent customers grew by 4.3%, as independent pharmacies continue to consolidate.

Cost efficiencies remained a core focus throughout the period, with expense growth influenced by a number of once-off expenses, including higher bonus pay-outs as a result of a change in our bonus policy as well as residual strike-related costs. Retail expenses grew by 13% to R4.7 billion as we invested in new stores while contending with increased store rental and electricity costs. Within wholesale, expenditure grew by 5.2%, to R1.4 billion, excluding one-off items. Wholesale's costs were well contained, largely as a result of the earlier investments in technology, as well as other productivity and performance enhancements.

The ROIC focus in particular has been on enhancing margins, specifically in terms of the in-store retail environment, improving trade terms with suppliers, and better stock days following the rationalisation of stock and improved buying efficiencies, while also taking advantage of an extension in creditors days. This resulted in the necessary inventory reductions and rationalisation across the wholesale space. Pleasingly, this was achieved without compromising revenue, or any impact on our customers' access to our products and services, and ultimately was one of the leading levers that led to our enhanced ROIC.

The effect of the ROIC focus is also evident in the net working capital days that reduced to 33, as well as the year's vastly improved free cash generation, which increased by a significant 115%, or R671 million, year on year. At year-end, the Group's cash and cash equivalents had turned around by a remarkable R782 million, from an outflow of R481 million last year to a positive inflow of R300 million. This is after taking into consideration the improved working capital movement, dividend payments, growth capex, acquisition costs, finance costs, taxation and other payments.

Overall expansion and maintenance capex reduced by 8% to R363 million. We opened 18 new stores over the last year and acquired three new pharmacies resulting in a total of 170 stores as at 29 February 2020.

While we improved market share across all core categories, our earnings in the current period were impacted by one-off items such as the adoption of the new accounting standard IFRS 16, and the low growth in purchases from suppliers, which resulted in the total income margin declining.

The majority of the inventory rationalisation occurred in the first half of the year and this period's earnings decreased by 37.4% compared to the corresponding period. However, as purchases increased in the second half of the year, this was convincingly reversed, with earnings increasing by 16.7%.

The Group's total earnings, excluding one-off items, decreased by 5.9% over the corresponding period, while earnings attributable to shareholders and headline earnings both declined by 16.8%. Earnings per share and headline earnings per share were both 69.6 cents, a decrease of 16.7%.

Through our pharmacy focus, reward-driven campaigns and availability of choice for our customers we continued to drive strong footfall into our stores, while also growing our Dis-Chem loyalty membership base to over 5.5 million, which is up from 4.7 million in the previous year – that is nearly one million additional people welcomed to the Dis-Chem family since last year. The increase was primarily driven by the exponential membership growth in our FOR YOUTH Programme and as well as our Baby programme, which has seen numbers doubling.

Digital future

Overall, the COVID-19 lockdown period has seen a revolution in terms of Dis-Chem's e-commerce programmes. There was sales growth of 375% on these platforms during March; sales increased 262% month-on-month in April, while the first two weeks of May saw another exponential surge of 490%.

Although this phenomenal growth has originated on the back of the situation presented by COVID-19, we were already leveraging our e-commerce strategy and innovation, which is led by our overall purpose of winning and retaining patients and customers. Our intent remains on increasing our store footprint, while driving secondary retail opportunities through innovation. We are, for example, enhancing customer convenience through our courier pharmacy Dis-Chem Direct and our 325 in-store, corporate and travel clinics. We also have Click and Collect in every store and we intend to continue investing in ongoing enhancements to our e-commerce platform.

Our HealthWindow platform has delivered good growth in additional sales and services, which we estimate to be valued in the region of some R150 million. It has also been given a significant boost from the lockdown situation.

COVID-19 impact

Post year-end, the effect of the coronavirus pandemic has damaged the entire nation. The economic impact on the South African consumer is expected to be long-lasting and severe. As management, we have placed an extraordinary amount of focus and attention on mitigating the impact on our people, and our business. Our priority has remained the care and wellbeing of our employees, customers, suppliers and so many others who are part of the Dis-Chem community.

From the outset, Dis-Chem has played a critical role in the provision of essential goods and services to protect consumers against COVID-19. This has meant keeping our stores open throughout the lockdown, with stringent measures in place to protect our employees and customers.

We have introduced a number of very strict in-store protocols and will continue to update these as any new risk is identified or in accordance with regulatory changes.

We must acknowledge President Cyril Ramaphosa and Health Minister Zweli Mkhize who have displayed outstanding leadership in the fight to contain and combat the enormous threat to our country and our society. As a Group, we have supported this intent in different ways; we donated an initial R2 million to the independent Solidarity Fund set up by the President as a platform for the public and private sector to fund various COVID-19 initiatives. We are proud that so many of our loyalty programme members have joined us in contributing to the Fund. The Dis-Chem Foundation is also more active in alleviating hunger during these times.

As a result of the urgent need to speed up COVID-19 testing, we introduced drive-through testing stations at a number of stores across the country, with thousands of tests conducted during April and May alone.

As was to be expected, March 2020 saw a massive 45.6% growth in sales as consumers stocked up before the lockdown began. Sales declined by 21% in April as the full effect of the lockdown was felt but started recovering in the first two weeks of May with some 3% growth in sales materialising. The net effect has been sales growth of 6% over the 11 weeks since 1 March 2020, with Group revenue rising 9.6%. The Covid-19 period has resulted in additional expenses as we have aligned ourselves with the regulatory environment and landscape.

The ultimate impact on trade in the 2021 financial year is currently unknown and will depend heavily on the duration of the lockdown levels and the normalisation of retail trade. The Group is continuing to adapt quickly to the current environment, with a focus on mitigating the near-term impact whilst positioning itself for success in the future. We have, for example, taken several steps to strengthen our financial position and maintain financial liquidity.

Operating and regulatory environment

COVID-19 has also highlighted the inequalities in our healthcare system. While the NHI will only come into effect in 2026, the urgent need for affordable access to healthcare is expected to lead to reform in the delivery and consumption of care in the private space once the pandemic is under control.

As Dis-Chem, we are well placed to be part of the solution. We have the largest and most consistent clinic offering and we are expanding the service scope of our Clinic sisters as well as investing in Telemedicine technology across all our clinics to increase the reach and reduce the costs of specialist services for patients. I am excited about the fruition of our vision for Dis-Chem, to play a significant role in bringing affordable healthcare to the many South Africans that are in need.

Strategic progress

After year-end, we announced our intention to acquire 100% of the well-known baby care products retailer Baby City from its founder shareholder, the Aronoff family, for R430 million, which is payable on transaction closure. Baby City is a specialist destination baby retailer and operates a network of 33 stores across South Africa, selling a comprehensive range of branded baby products at reasonable "Everyday Low Prices". For the 12 months to February 2020, Baby City generated revenue of R855 million.

We greatly admire what Michel Aronoff, who conceptualised and strategised Baby City's direction, has achieved with this brand. We are extremely pleased that he has agreed to continue serving as managing director of Baby City and that their current staff will all be retained. This is an exciting acquisition which has interested us for many years; our businesses were built with similar philosophies, there is a good cultural fit and both teams recognise the significant synergies that can be extracted from this transaction, which will ultimately be of benefit to all stakeholders.

Cash preservation

With much uncertainty about the duration and impact of the pandemic, and how quickly South Africa will recover, there has been an intensive focus on preserving cash. The dividend payment will therefore be deferred until the next dividend cycle, once the Group better understands normalised trading conditions and after it considers the funding sources for the Baby City transaction.

We have reduced our capex programme and will take a cautious approach to new IT investments over this period. Operating cost reductions are also being driven by a focus on reducing unnecessary variable cost spend, suspending direct marketing expenditure and postponing the dividend payment, among other initiatives.

There has been a lot said about our rental payment intentions during this COVID-19 period. It must be made clear that Dis-Chem, in line with the market trend and essential services trade, paid 83% of April rentals, and 100% of all utility amounts. May rentals were paid in full, in line with the return to normal trade.

We have strongly rejected allegations by the Competition Commission that we engaged in excessive pricing of surgical masks during February and March 2020. The Group has presented a legal response and as of 26 June 2020 the matter is still under review. As such, neither the outcome nor the costs of the legal proceedings can be determined.

Looking ahead

Despite the devastating impact that will be felt in most sectors of the economy for the coming year, with consumers under more pressure than ever before, we will continue our store footprint growth strategy with 21 new retail stores planned for the 2021 financial year.

While the ultimate impact on trade in the 2021 financial year is unknown, our continued focus on ROIC, our existing cash and expected cash generation ability, our iconic brand, focused management team and dedicated employees provides great comfort that we will adapt quickly to a new normal, however, that transpires in the years ahead.

We remain extremely confident about our offering and will continue our investment in our distribution centres and retail stores, enabling us to deliver high quality products, superior customer service and an ever-improving shopper experience. An important element of this success remains our supplier base. Our Supplier Profitability Model has therefore been refocused to deliver better efficiencies and ensure an increased stock turn and logistic fees, the conversion to cross-docking or flow-through model from warehousing, while removing non-profitable suppliers from the distribution environment.

Appreciation and conclusion

Our mission is to be a caring team that strives to provide consistent value, low prices and service excellence for our customers' health and beauty needs while caring for the communities and environments in which we operate. Despite an extremely difficult trading environment, the Dis-Chem family rose to the challenge to help deliver on all aspects of our mission with commitment and care.

I am extremely grateful to all our people for their contribution to making Dis-Chem the destination outlet of choice for millions of loyal customers, as is evident in our revenue growth and increased market share.

My sincere gratitude is also directed toward my fellow board members for their unstinting contributions and dedication during this challenging time. Our many strategic advantages will ensure that we transition through this period as a united team and emerge even stronger than before COVID-19.

Ivan Saltzman
CEO