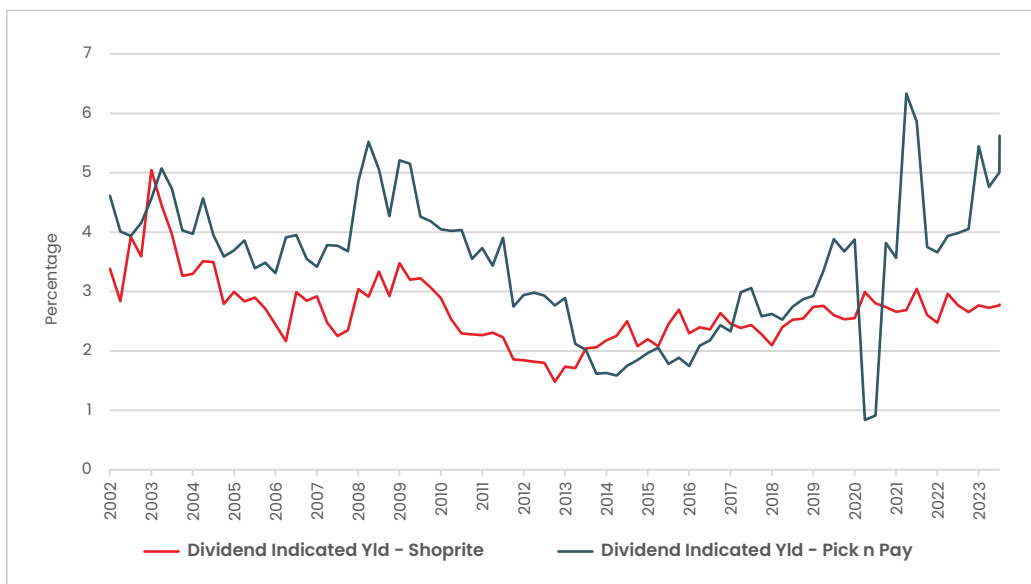




The cost of cashing in **CALVES**

Proponents of classic value investing will advocate buying shares cheaper than what they are worth. Value could be measured as low price-to-earnings ratios or high dividend yields (a company’s annual dividend payment expressed as a percentage of the share price).

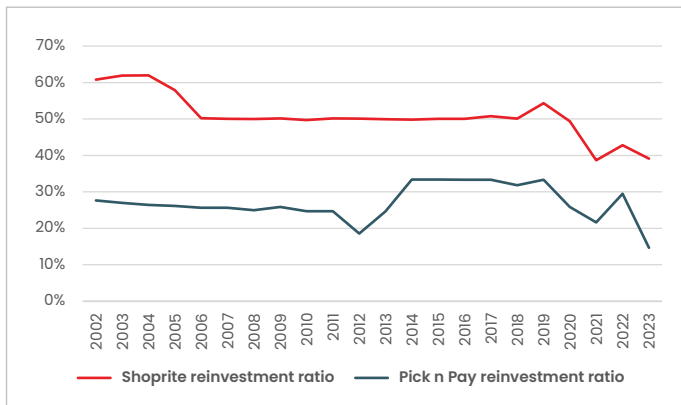
The chart below plots the dividend yields of Pick n Pay and Shoprite over the last 21 years. Pick n Pay has almost always offered a more attractive yield. In the classic value sense this would suggest that Pick n Pay gives you more bang for your buck. This is especially true given that the two businesses operate in the same industry and should therefore have similar underlying profit drivers. On this basis, Pick n Pay would be deemed the better investment opportunity.



**Figure 1: Shoprite vs Pick n Pay
Dividend Yields**
Source: Bloomberg

Now let us consider the profits that the two companies reinvested into their business in each of the last 21 years. This is the portion of profits that was not distributed to shareholders as a dividend. As shown below, Shoprite consistently reinvested a higher – and generally much higher – portion of profits. This was at the expense of a more attractive dividend. In cattle farming terms: rather than shipping most of its calves to the market for cash, Shoprite held back about half to continuously build the herd.

Figure 2: Shoprite Reinvestment Ratio



Source: Company reports

What was the *reward* for greater reinvestment?

Over the period above, Shoprite's profit per share compounded at 15.1% per year, while Pick n Pay delivered only 6.6% per year. If you bought Pick n Pay at the end of September 2002, you would have enjoyed an annualised return of 8.9%. Shoprite rewarded shareholders with an annualised return of 22.2%. Expressed differently, R100 invested in Pick n Pay in 2002 would be worth R550 today. The same amount invested over the same period in Shoprite would be worth R5500.

Why does Shoprite fit in the Granate portfolios?

Regular readers of our publications will know that we regard a company's governance structure, balance sheet, management team and competitive advantage as critical considerations before making an investment. Shoprite fares well on all these measures. The reinvestment of profits enabled the Shoprite management team to expand their competitive advantage by building a platform with immense buying power and cross-selling potential. Shoprite has a stronger balance sheet, enabling it to successfully test new offerings, reinvest in lower prices and do bolt-on acquisitions. Shoprite and Pick n Pay faced



a similar opportunity set but Shoprite made smarter decisions. The result? Shoprite has gradually been taking market share from Pick n Pay.

Shoprite is run by capable individuals specifically incentivised for long-term outcomes. The board has established an incentive structure that rewards wise capital allocation. We believe that this is part of good governance. The long-term incentive structure that determined 2022 awards, was a result of return on invested capital, growth in diluted headline earnings per share and employment equity.

How do we *value* something that's this special?

While we don't approach valuation in the way classic value investing may suggest, we are certainly not willing to pay more than something is worth. But we consider far more than Shoprite's relative price-earnings-ratio and dividend yield. We place a value on the business that does not yet exist; the business that is being built by reinvestment. Currently, more than half of our valuation is attributable to the value we expect Shoprite to create from reinvestment.

We are proud shareholders of Shoprite and very happy customers. We believe that Shoprite will continue to take market share and that the arrival of summer is unlikely to turn Pick n Pay's fortunes.



Granate is a people business.

We are committed to creating a rich and rewarding culture through our shared values. Granate is configured thoughtfully and intentionally so that our team can thrive for the benefit of our clients. We care about the same things you do and are *relentlessly* committed to protect and grow your savings.

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