Investment Research Note

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External communication

NEDBANK PRIVATE WEALTH

Research Note: The opportunity presented by the township economy

According to geospatial services provider Afriscope, South Africa has more than 500 major townships where an estimated 19 million adults – close to a third of SA's population – reside. These often-underserviced communities are home to thousands of businesses ranging from spazas, fast food outlets, hair salons, mechanics and builders that represent the so-called informal economy. This hive of activity, which is also underpinned by SA's large population of social grant recipients, represents a significant source of consumer demand and disposable income. Estimates of the size of SA's informal economy vary; retail research hub Trade Intelligence estimates that it is worth R184bn annually, while township economy expert GG Alcock believes its worth as much as R750bn per annum. This represents an opportunity for FMCG businesses, landlords and retailers to formalise this market.

Opportunities and challenges

The township retail property market is still in its infancy compared to more traditional urban markets that have been burdened by oversupply for some time. Landlords with a township presence have benefitted from the under-penetration of formalised retail, and this is most evident in their low vacancies and positive rental reversions. More importantly, their rental growth is supported by strong trading metrics from their underlying tenants. Tenant affordability metrics remain strong, namely low rent-to-turnover (<6%) and occupancy cost ratios. Even with its relatively strong fundamentals, the township market has attracted minimal capital compared to other urban markets. Exemplar and Safari are two of only a handful of listed landlords with pure-play township retail strategies. Those with notable exposure to this underserviced market as part of their overall strategy include Vukile, Resilient, Fortress, Dipula and Fairvest. Some of the barriers to entry into this market include insufficient market intelligence, lack of access to developable land, poor municipal service delivery and a higher cost of doing business (security, corporate social responsibility etc). The benefits of operating in these markets outweigh the challenges, in our view, for those players that have invested the time and resources to provide workable solutions. Some of these innovations are listed below.

Typical Township Retail Centre Formats:

- Are smaller centres that do not flood the market with space;
- Are designed to have lower operating costs e.g., less reliant on lifts and air conditioners;
- Have a higher weighting towards tenants that offer essential goods and services to weather tougher economic climates;
- Play a 'convenience' role in the community, therefore eliminating transport costs for consumers;
- Incorporate local entrepreneurs and informal traders in the tenant mix to get buy-in from the various community stakeholders, and
- Limit reliance on municipal services where necessary e.g., installed solar PVs and boreholes.

Alex Mall, Johannesburg (Exemplar)

Source: Company website

Refining strategies to service this opportunity

Amongst the retailers there are those, in our view, who recognised this opportunity early on and have positioned their businesses accordingly. The Shoprite Group is an example, with its clearly defined segmentation strategy across three supermarket brands – Checkers, Shoprite and Usave – catering to three distinct consumer segments. Each of these brands appeals to its target market through assortment, store layout and location. The group's "low cost, no frills, limited assortment discounter" Usave caters to the low-income segment of the market with stores largely located in underserved communities. To increase its penetration in these areas, the group introduced a container-store format branded Usave eKasi. These small and flexible-format stores require only five or six shipping containers and overcome some of the challenges faced by retailers and landlords in developing a presence in township locations. Pepkor is another retailer that is well positioned for this opportunity via its flagship PEP brand and Flash business, which provides payment devices to informal traders.

Source: Company website

For a few retailers, strategies have had to be refined in recent years to be able to participate in this pocket of growth. Long-time food retail laggard Pick n Pay introduced the Ekuseni strategy (a new dawn) under its then new (and now replaced) CEO. A key aspect of the strategy was the launch of a new brand, Pick n Pay QualiSave, aimed at the mass-middle market and distinct from the struggling Pick n Pay supermarket banner. The group's outperforming but sub-scale discount format Boxer was identified as a growth engine with a doubling of its store base and sales envisioned, over a five-year period. While the Ekuseni strategy is currently under review, given the change in leadership, Boxer is expected to continue to be a strong underpin to the group's growth prospects. Mr Price, considered ex-growth by some investors until recently, acquired Durban based low-priced fashion retailer Power Fashion (170 stores) in 2021. Power Fashion gives the Mr Price Group access to the low-income consumer segment and the potential for significant growth. New stores have been rapidly rolled out since acquisition – target of 500 stores by FY26 – with Power Fashion now present in the major townships including Alexandra, Soweto and Tembisa. Woolworths' newly launched WEdit is a smaller limited range format that allows for the opening of stores where the group's traditional department stores are not viable. Woolworths' first Cape Town based WEdit store opened in Gugulethu in May 2023.

In the pursuit of the township economy opportunity, retail strategies also require an understanding of the unique role played by informal traders. Informal traders maintain their relevance in the communities they serve by offering customised packaging, operating for extended hours, being close to where consumers live and, in some cases, offering credit. With low overhead costs and by making use of buying groups they are also able to be competitive on prices. The retailers who can innovate to meet the specific needs of this market are likely to be the winners in this space.

Investment views

In our House-view equity model we hold our retail exposure via Mr Price and Shoprite, where we are overweight relative to our benchmark. We consider both to be best in class in their respective categories and well positioned to capture the township retail opportunity. While Mr Price has faced various challenges over the past year, the group remains well positioned in the value segment of the apparel market with sector leading return metrics and a disciplined management team. Shoprite has been the standout performer amongst the food retailers as the group continues to flawlessly execute on its clearly defined strategy and gain market share.

In the House-view Property model we have exposure to the township retail theme through our holdings in Resilient and Vukile. Both counters were early adopters of a township retail strategy as part of their overall offering, and this has served them well as they have consistently delivered positive rental reversions and low vacancies even in the tougher economic climate post Covid-19. The investable universe of pureplay township retail landlords remains small given the barriers to entry, we are however optimistic that it will expand in time. We look forward to more meaningful exposure to this segment of the market.

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