REPUBLIC OF SOUTH AFRICA
COMPETITION COMMISSION

Competition Act, 89 of 1998

MEETING WITH WOOLWORTHS

DATE: 2017-11-02

VENUE: CSIR PRETORIA

CHAIRPERSON: Ms L Mtanga

COMMISSION MEMBERS

Ms S Grimbeek : Principal Economist
Mr T Khumalo : Senior Legal Counsel
Prof Halton Cheadle : Apology - Absent

ON BEHALF OF WOOLWORTHS

Mr Spencer Sonn - Managing Director
Mr Maurice de Villiers - Divisional Director – Real Estate
Ms Antonia Gail - Legal Counsel, Woolworths
Mr Wilson – On behalf of Webber Wentzel for Woolworths

LEPELLE SCRIBES

P O Box 73090 Lynwood Ridge 0040
Free State (051) 430 1052 431 8205
Limpopo (015) 291 5522 230 0030
Fax: (086) 512 9211
Cell: (082) 866 9707
Email: info@lepellescribes.co.za

TRANSCRIBER'S CERTIFICATE

I, the undersigned, hereby certify that insofar as it is audible, the aforegoing is a true and correct verbatim transcription of the proceedings recorded by means of a digital recorder.

In the hearing of

COMPETITION COMMISSION AND WOOLWORTHS

Reference number	
Date of Hearing	2017-11-02
Stenographer	Lepelle Scribes
Account Ref	Not Provided
Sound System	MP3 Audio Files
Date of Completion	2017-11-02
Total Number of Pages	

TRANSCRIBER'S NOTES:

1. Transcript is typed verbatim.
2. Names not spelt out for the record are transcribed phonetically.
3. Indistinct words and or phrases are indicated with sound system timestamps

Transcribers: S de Jager. D Jacobs. H van Rhyn. M Prinsloo. K Nicholson. A van Staden.

Signed off by: H van Rhyn Date: 2017-11-03

Sworn Transcriber

LEPELLE SCRIBES

PO Box 73090 Lynwood Ridge 0040

FREE STATE: (051) 430 1052 431 8205 LIMPOPO: (015) 291 5522 230 0030

Cell: 082 866 9707 Fax: (086) 512 9211

Email: info@lepellescribes.co.za

PROCEEDINGS ON 2 NOVEMBER 2017

CHAIRPERSON: Ladies and gentlemen, good afternoon and welcome to Woolworths making their submission to the commission. Inquiry in a public hearing. I am just introducing myself to those who may not know who I am. I am Lulama Mtanga, I am a panellist in this inquiry.

We have been explaining throughout the week that the chairperson of the inquiry has not been able to attend, due to circumstances beyond his control, or the commission’s control, and I will be chairing the hearings that are running up until Monday.

I am assisted by the two colleagues, whom I will ask to introduce themselves. Thereafter I will ask the Woolworths delegation to also place themselves on the record, especially those people who will be talking. But I am happy for everyone to introduce themselves, even if they will not be talking. Thank you.

MS GRIMBEECK: Good afternoon, my name is Sunel Grimbeek. I am a principal economist at the commission and I am leading the technical team that is working on the grocery retail inquiry.

MR KHUMALO: Good afternoon. My name is Thabo Khumalo, I am the senior legal counsel, working on the inquiry.

MR SONN: Good afternoon, I am Spencer Sonn I am the managing director for the Woolworths Food division.

MR DE VILLIERS: Morning, I am Maurice De Villiers, divisional director for real estate, at Woolworths.

MS GAIL: Hello I am Antonia Gail and I am the legal counsel for Woolworths.

MR WILSON: And Robert Wilson from Webber Wentzel, representing Woolworths.

CHAIRPERSON: Thank you. Different stakeholders, especially the retailers to whom the inquiry is written to, had different ways of presenting and others had introductory remarks. I do not know how you intend to proceed. We are in your hands or maybe if you want us to just going to just ask by you are asking you questions? I do not know how you want to proceed?

MR WILSON: Thank you Chair, my clients will make a presentation to the panel. We have prepared a short PowerPoint presentation just by way of talking points, which is presented. I do have some extra copies that I could possibly hand up and it might guide, if you want to make notes on it, but I will ask Mr Sonn and Mr De Villiers to take you through the presentation.

CHAIRPERSON: You may proceed. Mr Wilson, when you are ready?

MR SONN: Okay thanks very much to the commission for allowing us the opportunity again to make the submission. Really the structure of our presentation is to give everybody just an overview of the business and we start to delve quite deeply into our foods division, but I think it is important to understand the context of our broader organisation, how Foods fits into that and then some of the sort of key aspects of our business, with specific reference to the kinds of topics that I think the inquiry is focused on.

Let us see if technology plays a role. It is the last one, just got to press it harder. It is the last one. You know what I think? This is the last slide, let me just go back.

Okay. Right. So that really is the structure of the presentation. We will cover the group into Foods, our distribution and cold chain, and talk about our stores, store openings and leases.

From a group perspective, so the Woolworth Holdings Group is a Southern hemisphere retail group. It is comprised of three operating divisions. Woolworths South Africa, which is the head office in Cape Town and specifically trades within South Africa and other parts of Africa. It is just under 60% of the group turnover and just over 65% of the group profit. Within that because it is relevant to our Foods business, Foods is about 67% of the Woolworths South African business from a turnover perspective.

The second divisions is David Jones, which is the head office in Sydney currently and trades in Australia New Zeeland. And then Country Road which is based in Melbourne and trades in Australia New Zeeland and has some stand-alone stores in South Africa, as well as has a footprint within our stores in South Africa.

Of note is, as a group, it is our group vision to be one of the most responsible retailers in the world. We have eight key sustainability focuses in that regard.

We employ across the group about 44 500 employees. We have a 1500 stores across the 14 countries within which we trade, and we serve about 15-million customers across the Southern hemisphere.

So drilling down into Foods, our main target market is in old speed, the LSMA210[?] and now SCL22. So we very focused and have been consistently for many years within the food division on the, sort of upper middle to upper end of the market.

Our main competitors, being Checkers, Pick ‘n Pay, Spar. 90% of the products we sell, so just to be clear about what that slide says, not 90% of our catalogue but 90% of the products we sell are Woolworths branded, if you look at our sales and we have a very diverse supplier base. So it is comprised with large and small. We have a number of branded multi-nationals that is supplying to our business as well. And then we have a number of private and some family owned, independent businesses that supply us, and we will talk more about our suppliers as we go through.

Just by way of our evolution as a business. The business was founded in 1931. We were a general retailer. Foods was a very small part of that business and ironically, we only exclusively sold branded items back then, always offering more premium quality innovative products. In the 60’s we started to see a fundamental change in the retail landscape, larger retailers, the likes of Pick’ n Pay, the light of O K Bazaars started to, with real scale, introduce far more competitive pricing on branded products, which we struggled to compete with and consequently lost market share.

It was also strategically quite a tipping point for our business and a tipping point for the direction that our business was then to take, which has continued to this day which was to really embarked on the strategy of differentiation. We could not compete with the bigger players at that time and so sought to find our niche within the market through differentiating ourselves.

And we set about differentiating ourselves through our product and that fundamentally gave birth to our private label or Woolworths brand strategy. It is a strategy we have remained true to, to this day and it meant in about 1963 a deviation from a predominantly branded environment. In fact we moved all brands out of our store, started to build our own private brands.

Our focus was on fresh food in particular, and our focus was on delivering consistently high quality to the more upper-end of the market, and whilst I call our fresh food the notion of quality and consistently delivering the best quality, permeates right throughout our business, not only on our fresh food side, it permeates into the ambient side of our business and permeates through the way we serve up the people we have. It is a real philosophy within our business.

That strategic change started to show itself in us, starting to gain back market share. To support that, in the 80's we invested in the centralised distribution and that was really to ensure product integrity all the way through our chain, from our supplier base and manufactures into the stores, right through to the customers.

It obviously allowed us to be more efficient and it started to shape the way we built our stores and you will hear more about that as we go through, requiring us to have less backup area through this model, that allowed us to get goods to stores just in time and replenish them frequently and more efficiently.

It is also important to say that at that time we saw the opportunity to roll out more conveniently located stores, so it is bullet point slightly lower down on the slide, but from a chronological point of view was around the same time, where we went into slightly smaller locations in residential areas, and we have over the years developed the capability to run them fairly profitability.

They are obviously expensive to set up and can be expensive to run. You over index in fresh, in those environments which was our strength and it was where we wanted to differentiate ourselves.

So our supply chain, our systems both forecasting and replenishment, our store processes, all needed to be honed in order for us to manage those environments well and profitably.

I think it helped us deliver this high ground in fresh, convenient, high quality, food. In 2000 we started to think about expanding our offer. At that time customers still cherry-picked picked us for their favourite Woollies items and we were not seen as a one-stop shop, and we never wanted to be seen as one-stop shop for the mass-market, but we did want to be more appealing and have a higher penetration for our target customer, who was becoming more time starved, once we offer them the convenience of being able to find everything that they wanted in our larger stores, and that resulted in us starting to bring more non-branded Woolworths products into our store again, but be very choice full about which products we brought in, given the fact that the vast majority of our stores, by relative terms to our competitors, are still fairly small, given the fact that we wanted to over index on our private label.

We are very selective about which branded or non Woolworths items we bringing to our stores in order to complement that overall proposition, obviously being guided by what our customers want.

Throughout we have continued to invest significantly in our cold chain. And equally whilst it is not a direct investment of our own, cold chain does not only start at the door of our distribution centre, it starts all the way back into our manufacturing facilities and so the investment into this cold chain, real competitive value, that we have in our business, starts all the way back there.

So that is just to give you a sense of the evolution, some of the barriers we faced, coming into the market. How we needed to course direct them.

I think quite importantly how, some of what happened back in the 60's really started to solidify our strategy and our point of difference today.

So, you know, the Woollies difference is encapsulated many things. The difference is our strap line and we just try to, you know, call out the key things, that it is all about our quality. Woollies is renowned and loved for innovation. Customers trust us for safety. Over the years we have been able to offer customers choice.

We like to think that we are able to deliver that consistently, certainly not perfectly. And the overall proposition we want to give the customers -because there is no doubt, we are not the cheapest retailer in the market place is value, and when you stack up everything that we offer, the one element we have not necessarily referenced there, but which is very core to our capability, is the notation of convenience, would all be wrapped up in that difference.

We seek to deliver this through the Woolworths brand. Ultimately that is what differentiates us and it is compelling as long as we are able to deliver it, and deliver it consistently.

Now the manner, I guess fundamentally that we are able to deliver that is through the product. We can have, you know, the best stores, the best service, but those elements really come to bear when the customer evaluates our product, and so it highlights the real importance of those folk that make our products, which is our manufacturing base, our suppliers, because that is where the product comes from.

And our success in being able to deliver the difference, is totally reliant on that supplier base. That helps us to deliver that and so, over many, many years, we have build partnerships with our suppliers, and we believe that within our supplier base, we have some of the highest quality producers.

Not necessarily always the biggest, but some of the highest quality producers and growers in the market place, and together we have built businesses, some from really, really small.

Many, many years ago they would have been backyard or garage operations into formidable businesses.

Today we have tried to play our part by providing the market by remaining committed to those suppliers so that they could invest into their businesses.

We have imparted skills, particularly on the product development side and technical side into those suppliers. We have also been able to provide accessing to international manufacturers, what international plants look like and what some of the processes are in those facilities, and our suppliers have been able to invest in the best technology and people.

And today we have partnerships that span, you know 30 to 50 years long. We even have a few suppliers that have crossed the 60 years journey, multi-generational suppliers that have been with us still built on exactly the same values that we started with.

In trying to give you a very snap shot view of operationally how our trading groups are structured, the key pillars of our business are centred around these sort of core areas.

So there is a buying capability that sits within our structure. You know this is not going to be too unfamiliar from other businesses, but where we would over index or under index would be quite unique to us.

So in any retail business you have got to have buying and they look after the commercial aspects of your business. Planning, which looks after the really allocation of goods, forecasting, stock management, replenishment flows, stock into stores, cataloguing, which are the right products for the right stores.

New product developers. This would be an areas where Woolworths would over index in terms of the in-house capability that we have.

So we have a team of product developers who are pretty much all you know skilled and educated, some with a shipping background, others with culinary school background, others home grown talent within our business, making up the third component of our operating team and then technologists, all of which are food scientists, would have a food science technical diploma, degree or qualification, and they really look after the quality and safety of our business.

And a lot of our success lies in the integration of this team and how they work together. There is a healthy tension that exists because whilst they work together really well as the team, each has a specific agenda that they are driving and our function is to be able to harness that so that it delivers the best product outcome.

This would be, broadly speaking, what comprises each of our trading divisions. When I talk trading divisions that rolls itself all the way down into the departments. So the dairy department or the poultry department would have a buyer, planner, product development technologist.

Sometimes when the departments are slightly smaller, you would have some of those roles shared, but generally all of those functions would come to bear within a department in driving that business forward.

Within the food division, from a central point of view, they would also, these trading teams would be supported by centres of excellence. So you would have a technical centre of excellence and a new product centre of excellence which supports the trading group.

They would generally have a far broader and far further horizon. They would look at, you know global trends and best practice, refine processes and provide planning and up-skilling that then finds its way into the trading groups which is more focused on the sort of day to day operational running of the business and has sort of a 18 month horizon.

So we just wanted to give you a flavour of the makeup of what goes on in sort of the head office team. A lot of the interaction with Woollies would obviously be in our stores. So that is the team that sits behind.

And I am really honing in here on the food division. Obviously we are supported by many other divisions, supplier chain, IT, our real estate division et cetera.

The business journey is something we are really proud of. It is in its 10th year this year. We have been blessed to win a number of awards. Thrice we have won the most responsible retailer in the world award.

We monitor multiple things you know, the control of our trucks, our electricity, water, all of the things we call out there. We are focused on sustainable farming. We focus on sustainable sourcing. Our farming for the future programme, which is highlighted in our stores and in our marketing activity, will be familiar to many of you.

Within the sustainable sourcing, a good example is sourcing of sustainable palm oil. We have an aspiration for example in 2020 to only use responsibly sourced palm oil in the manufacture of any of our private label products. That is just an example of the kind of targets we have set ourselves in the space of sustainable sourcing.

And then we also sponsor the entry of new suppliers. We currently have 48 enterprise development suppliers working with Woolworths. In the past three years their accumulated spend would be just on about a billion Rand of our turnover or of the cost of turnover into us.

We have dispersed just on about R26 000 000 worth of funding to those suppliers. It is a big focus for us. Even more energised, we are looking for smaller more artisanal suppliers. We are looking for more Black suppliers.

We have set ourselves a target of improving, increasing our percentage of Black spend from where it is today to a quite bold target for 2020. So it is something we want to get after quite aggressively, and it is something we are good at because throughout our journey as Woollies we have grown suppliers from being very small to now being formidable businesses.

We have, you know we own our own distribution centres. We have 3 of them, the Midrand BC, up here, Cape Town distribution Centre and then a smaller distribution centre in Durban.

There are a number of advantages to this centralised distribution model. Many retailers are following that model now. We have been doing it, as I said, since the 80's. It gives our suppliers one or three access points to deliver to.

It helps us control our quality better, rather than suppliers delivering to the back of every single store every single day, it allows them to make one delivery and you know we carry the cost then of on-trunking those. It does also allow us to have less storage space within our stores and therefore we can give more of the space to the trading environment.

And then just culture, and it is worth calling out, this really is the pride of our business. Both infacturally in the way that we have geared ourselves to maintain our temperatures in the fresh part of our business right throughout our chain, and as I made reference to earlier, even back into our supplier base, the temperatures within which are factories operate, and then all the way into our stores.

So certainly culture infra-structurally is really embedded into our business, but it is also embedded culturally. It is something which we developed over many years. In our stores, staff are very clear.

Our distribution staff are very clear about the parameters within which they need to operate in order to make sure that we are safeguarding and looking after that culture and throughout our business.

And *ja,* ultimately it is about ensuring that we maintain, not only safe products, but that we deliver the product to the customer in the most delicious, highest level of quality state that we possibly can, and culture is a massive, massive enabler to unlock that. But obviously it looks after the safety of the product as well and thereby products our customers.

Can I hand over the Maurice now? I am just thrown with the last couple of slides.

<u>MR DE VILLIERS</u>: Thank you Spencer. I just want to take you, a few slides, through some background information on the makeup of the real estate space within Woolworths.

As the business strategy is *analism* 8 to 10, our location of our stores is very much a LSM 8 to 10 location. It need to be a premium destination and then to be an attractive destination.

We currently trade on 234 000 square metres, both across in South Africa and the rest of Africa, which is made up of about 330 markets, and if you split those markets further, there is about a 46% of those markets trade with clothing. Meaning they are located, or just short of half of them, are located in medium to large shopping centres that trades with clothing.

If you compare it to our competitors, I think we estimate that we are approximately one tenth the size of the trading footprint of what a Pick ‘n Pay and a Checkers is. We are probably about one fifth the size of what Spar is in terms of their space.

We look we our spaces are located. 84% of all our trading space is located in the four Metropol, meaning Johannesburg, Pretoria, Cape Town and Durban. So only 16% of the space is actually located in the country towns, in the smaller towns which include Port Elizabeth, East London and Bloemfontein.

So we are primary the major city trader, and if you unpack it then further as we spoke last, we are very much located in the high end suburbs, meaning the east of Pretoria, north of Johannesburg, a bit in the south, the wealthiest suburbs, the north of Durban.

Okay thanks. If we look at where we open stores and where do we find opportunities, I think the first question is where can we trade profitably and where is the demographic makeup that matches our target of LSM primary 9 to 10.

And then one tries to determine the size of that trading opportunity. How much of that market can we capture in terms of the market share calculation. Normally we already have a lot of stores in these markets, and then the key question for us is about capitalisation. How much is new sales and how much is existing sales? Meaning whether we are just moving deckchairs or not.

And I think if one understand that market, one can then get into the issues around the centre and where it is located and how convenient is it, what does the centre do to compete with other centres, is this the most attractive centre relative to the others, what is the tenant mix, and et cetera. I mean, that is normally the sequence in terms of how we would analyse a particular opportunity going forward.

If we look at our leases, I think you know, our view is that we have no exclusivities in our leases. We have a fair amount of clauses that deal with to capture the intent of the centre that is presented to us.

So at the time of when we make the decision to go into a centre, the picture that is presented to us, the makeup of the tenants that is presented to us, and the purpose of the centre that is presented to us, we try to capture.

So if it is a convenient centre, and we are investing in a convenient centre, we would like that back purpose of that centre remain as that, that it does not change its colours halfway through its life and try to compete with a super regional, meaning bringing a lot of national fashion and they change the nature of it because I think all shopping centres fulfil a specific purpose, whether it is convenience and whether it is pure destination in the sense of a Sandton or a Mall of Africa.

And I think the rest of the ... there is a fair amount of clauses about crime and grime kind of issues about cleanliness, issues about refuge yards not ... were being in certain distances to our front door, and it is primary to control the environment that we trade in and that it is of a high standard for our customers, and that it is complimentary to the kind of customer that we are trying to attract to that particular trading opportunity.

I think there was a fair amount of question in the last discussions on return on investment, and what is that period? We have done a fair amount of work on that, but there are some many parameters around what makes an investment pay off in a certain particular period.

You know whether do the size of the market, the wealth in the market, the frequency of shop, whether the landlord charges for parking or not, or how many stores we have in terms of cannibalisation or competing schemes coming up and cannibalised that will all impact on the growth.

The quantum of capital that we invest in there, the kind of rental deal that we do, et cetera, all has a function in terms of whether that payback period is medium or long term or can drift out or you can enter into an economic environment as we have at the moment where the growth rates are fair softer and then that payback period will ultimately just move further, further out.

And I think that is really the key highlights that we wanted to deal with in the upfront presentation. Thank you very much.

CHAIRPERSON: Thank you very much. You have indicated that 90% of your goods or items are branded items and the 10% will come from…

MR SONN: Yes, so 90% is of private label and the 10% would be the… of our sales is in branded items, so the branded.. the national branded items that we stock.

CHAIRPERSON: Basically those being products that you will find at Pick n Pay, Spar and the like.

MR SONN: That is correct, Chair.

CHAIRPERSON: Okay.

MR SONN: That is correct.

CHAIRPERSON: Okay. And then, is there a difference in terms of how you source that 10% and the 90% from the suppliers?

MR SONN: Fundamentally not. In many of the private label products particularly on the fresh side of our business but I think it applies in the ambient side of our business as well, over the years the development of the products would have been done collaboratively with our suppliers so that would be one of the differences.

But in terms of our relationships with those suppliers versus the relationships we have with the branded multi nationals who supply is, there is the same level of our partnership that exists there and many of the branded multi nationals are equally strategic partners within our supply base.

So perhaps the development of the product there might have been some differences, there certainly would have been but outside of that, not many.

CHAIRPERSON: Would you have any specifications for example on the product, on that 10% as to how it must be developed for Woolworths purposes?

MR SONN: No, so the brand is… You can… The brand…

[Intervened]

CHAIRPERSON: Still the same, it is the same product.

MR SONN: Yes.

CHAIRPERSON: Okay and then we also with regards to your trading terms and your trading agreements, the trading terms that you enter into with your suppliers are both in the 90% and in the 10%.

MR SONN: Yes.

CHAIRPERSON: Are all those trading terms contained in your trading agreements, everything…?

MR SONN: We would… they would all be contained in those. Those are negotiated on an annual basis. Yes, they would all reside there.

CHAIRPERSON: Okay and then we… can you speak through… I do not know if you want to… If you want me to go through each question on the allowances that we wanted to deal with just to understand what are the basic… do you charge a basic rebate and how is that done in relation?

MR SONN: Yes.

CHAIRPERSON: I do not know if that will differ to the 90% and…

MR SONN: Yes.

CHAIRPERSON: Ja, can you speak to that?

MR SONN: It is quite varied.

CHAIRPERSON: Yes.

MR SONN: So generally we have a basic menu of trading terms and they are comprised of, I am sure you would have heard it through the week, so the standard discounts allowances *et cetera*. Very few are fixed and there is lots of variability in terms of how we apply them.

So you had a question in the submission around which are sort of variable and which are fixed and perhaps that would be one way to get to the question. So we would have… there really are three thereof that are fixed.

The settlement discount would be agreed with the supplier and again within the settlement discount there is a menu of settlement discounts. So between the supplier and ourselves we would discuss which would be the best payment terms and what is the associated discount with that.

CHAIRPERSON: Just going back on the settlement discount. When you say menu, do you have an... in relation to periods... [Intervened]

MR SONN: It is right.

CHAIRPERSON: Do you have a minimum and a maximum?

MR SONN: We do. So we would have a... ja, we would have anything from zero all the way through to probably 4.5% depending on how soon the supplier gets paid.

CHAIRPERSON: In that period applicable?

MR SONN: So also varied, so anything from seven days from statement to 30 to 45 days of statement.

CHAIRPERSON: Up to?

MR SONN: 45 days is the... our preferred menu is 2.5% on 30 days.

CHAIRPERSON: Just to warn you Mr Sonn, if you do not want, we really do not want the percentages *per se*.

MR SONN: Fine.

CHAIRPERSON: Because some of that may be confidential.

MR SONN: Yes.

CHAIRPERSON: So we are comfortable if you do not want to mention. However if you are talking in general and you are comfortable to have those on record, we will allow you to.

MR SONN: Fine.

CHAIRPERSON: In the questions that I am asking you, we will try and avoid anything that goes into the actual figures and amounts.

MR SONN: I would... ja, we would certainly prefer that I guess.

Well we are trying to be transparent as possible.

CHAIRPERSON: Okay sure.

MR SONN: So then I appreciate that. So yes, the settlement discounts would be a menu of options. Those will be negotiated between our buying teams and the suppliers. The percentage of discount would apply relative to the payment period.

Our payment periods are not exhaustive, are not extensive. So settlement discount would be one, and even within that based on where there suppliers at, based on how important cash flow is *et cetera* we would apply discretion there. The second is marketing allowance... [Intervened]

CHAIRPERSON: Just to go back again to the settlement discount. It is a question I tried to understand even with the queue retailer that have appeared before us. Just to understand, we understand that there is a settlement fee that is charged on the supplier by the retailer. Does Woolworths charge a fee, is there something called a settlement fee that you will deduct from the payment that you will be making to your supplier?

MR SONN: So as we... so depending on the days that the supplier wishes to be paid.

CHAIRPERSON: Yes.

MR SONN: Based on the time value of money, there is an agreed settlement... [Intervened]

CHAIRPERSON: Fee.

MR SONN: Discount which the supplier pays to Woolworths.

CHAIRPERSON: Okay. A discount to Woolworths. Okay and this discount, I tried to ask for example just to understand the rational of it, you have given us the period of, you said the period itself ranges from anything from seven days to 45 days.

MR SONN: Yes.

CHAIRPERSON: And just focusing on the maximum, let us say if you have agreed with the supplier that you will pay in 45 days, would there still be a settlement fee or discount payable to Woolworths for you meeting that 45 day payment or a fifth day payment?

MR SONN: Yes.

CHAIRPERSON: Why is that? What is the rational for…?

MR SONN: So the supplier is getting paid within a reasonable period of time and for that there is a benefit to the supplier getting paid 45 days after statement is a reasonable period, so that would be the rational.

CHAIRPERSON: As opposed to what? What would be the unreasonable period of time when the 45 days is actually the maximum available period in your menu?

MR SONN: So we do not have it in our menu but if you start getting to sort of you know, 60 days, 120 days, you know that stock is being… has been… has turned and been paid for and so as a retailer we would be benefiting from having sold that stock whilst the supplier still has not been paid so it is not a… beyond a certain period we do not think that is reasonable.

CHAIRPERSON: Okay. I guess what I am trying to understand is when you agree on the settlement period, is it a settlement period that is favourable in all cases where the settlement discount is applicable?

MR SONN: We believe so.

CHAIRPERSON: Is it favourable to the supplier?

MR SONN: We absolutely believe so.

CHAIRPERSON: Okay.

MR SONN: And the supplier would be able to compare that with, particularly if they are supplying others, they would be able to make that comparison and we believe it is reasonable, yes.

CHAIRPERSON: Okay and then you also mentioned that you… can you speak extensively or just maybe for the record and you may have given this to us previously but we just want to understand how does Woolworths work with its suppliers? Do you have a confined list of suppliers that are only Woolworths suppliers outside of that 10%? So I am talking about that 90% now of the branded Woolworths products. How does Woolworths work with those if that is not confidential?

MR SONN: I do not think it is, I am actually quite happy to share with you that we have within our supplier base about 450 to 500 suppliers across the spectrum and you know, those will go from very small one line suppliers to quite big branded multi-national suppliers who supplies a basket of goods. But I think the point I would like to make is it is not a small dedicated list of suppliers. There is quite a wide variety of suppliers and very diverse in their make up.

CHAIRPERSON: Okay. You have also mentioned that some of these, I am not sure if I can say a number of them, are suppliers that you... that have been with you... [Intervened]

MR SONN: Over the years.

CHAIRPERSON: Over the years and you even mentioned that up to 60 years with some of them.

MR SONN: Yes.

CHAIRPERSON: Some of them having been backyard suppliers.

MR SONN: It is right.

CHAIRPERSON: Can you just explain how you would have initiated, how would Woolworths start working with a supplier? Do you have specifications that are Woolworths specific? And we just need to understand how different you operate to other suppliers.

MR SONN: Yes.

CHAIRPERSON: Because in most instances we understand that there would be a supplier in the open market, let us say Spar, Pick n Pay, Shoprite. Mr Khumalo would produce his products and approach Spar, Pick n Pay or Shoprite to have his products on their shelve.

MR SONN: Yes.

CHAIRPERSON: So in your case how would that process work?

MR SONN: Fine. Good question. So the vast majority of the products that are... [Intervened]

CHAIRPERSON: In the 90%...

MR SONN: In the 90% would be... the vast majority of them would be products that we have worked with the supplier on products we have identified as opposed to... we are not a retailer that is approached often by suppliers to say we have got this product for you and... not saying that that does not happen.

So that certainly has happened and there are certainly suppliers who have been successful in that space. But classically we look for an artisanal chocolate supplier, we would read the trends, we would understand that that is an opportunity for us to differentiate ourselves in the market and then we would look to... [Intervened]

CHAIRPERSON: What do you mean an artisan chocolate supplier exactly?

MR SONN: So a chocolate supplier that is not a mass producer of chocolate that you know, in some instances will go all the way from the cocoa bean to the actual slab which really works for us because we can guarantee the integrity of the product all the way through and it offers us a point of difference and it fits in to our customer segment. So we would, we would look to find suppliers like that. And the opportunities are far less now than they would have been in the past. In the past we would have you know, travelled the world, seen where some of these innovations are and then come back home and look to find those suppliers locally. There were far more opportunities then as you can imagine but those opportunities still exist today, just not as many of them.

We would then look at that supplier, assess their manufacturing capability, processing facility *et cetera* and then work with them to be able to bring that product to market, more often that not, in fact probably 99% of the time in our private label but you could find that there is a artisanal brand that is well loved out in the marketplace that would be relevant.

So it is not only about the national brands, the fast moving consumer brands, it could be a brand that is local, locally inspired, that would complement our offer.

CHAIRPERSON: So when a supplier supplies a Woolworths branded product, would they be only supplying that and nothing else and therefore not supplying the rest of the market?

MR SONN: In some cases yes, in some cases no.

CHAIRPERSON: Okay.

MR SONN: So in some cases we have got, and over the evolution of time it also changes. So let us go back to my chocolate example again, this is a chocolate supplier who is now quite a mainstream supplier of ours, started out being very small.

As they built their facility and have needed to see more volume put through their factories, they have gone and supplied others.

We have always generally works with them on that and tried to make sure that there is a degree of differentiation between what we have and what others have, that is going to be important to us.

But, and in some cases if I take our prepared food for example, we are very protective of those being exclusive, exclusive suppliers to us.

So and that would be a category for category based on where we believe we want to hold the high ground and we would be very, very protective of that.

CHAIRPERSON: Would I be correct then to deduce from what you have just said that you do not place any limitations on who the supplier can supply, however you would place some limitation on the specification of the products that they may be supplying to Woolworths that that product does not become available necessarily to your competitors?

MR SONN: We will do the latter.

CHAIRPERSON: Yes.

MR SONN: We will also be very circumspect by whether the supplier supplies others.

CHAIRPERSON: Yes.

MR SONN: Depending on what the product is and depending on strategically how important it is and also the degree to which we have had involvement in developing the IP of the product. So we will in certain instances, will get to a point with a supplier where fortunately most cases, neither of us want that the supplier supplies anybody else but if the supplier did want to that, that does end up being an energetic conversation.

CHAIRPERSON: Okay.

MR SONN: About that particular items but broadly speaking, you know we will be able to resolve that.

CHAIRPERSON: And does Woolworths have any damaged goods allowances and how does that, how is that implemented?

MR SONN: So damaged ... [intervened].

CHAIRPERSON: Between you and the supplier.

MR SONN: So damaged goods, as in goods that get damaged in our system?

CHAIRPERSON: Yes and you have to return them or whatever - how does that process work.

MR SONN: Yes. So it is, there are various parts of it. It is quite a refined process within our business. So for starters, I think the identification of where the damaged occurs, is really important. So that you can place liability where it should be. And that is often a grey area in a broad chain. We try our best to be able to get to identify at least broadly where that is. Most of our suppliers, if not all of our suppliers, the goods that they supply us, we will hold retention samples of the batches that they send us.

So the goods will come into our stores and they hold retention samples. If we find the product to be defective, we will go back to the retention samples. If they find it to be defective, clearly something happened in the factory. We also have, I guess various critical control points. We do temperature checks at our distribution centre.

We do temperature checks in our stores. Sometimes if a product still gets through all of that and it is a little bit grey about, you know where the liability sits, we have to apply some logic and judgment and we apply some broad principles.

If a product is finding to be defective in nearly a 100% of our stores, it is quite plausible to determine that the product was problematic from the source.

If it is in a few stores, it is very plausible that actually the fault started with in the Woolworths store because once we take it in from the distribution centre, we take responsibility for it. I would also say that in … [intervened].

CHAIRPERSON: Sorry.

MR SONN: Yes?

CHAIRPERSON: Just on that. Can you link that where you take the risk and then where the supplier takes the risk?

MR SONN: Yes.

CHAIRPERSON: With regard to these allowances, is it a fix amount that is just charge at any point or as agreed upon in advance?

MR SONN: So we do not necessarily agree with… We do not agree… We do not have an allowance as a general principal across. In some suppliers where we, particularly where we warehouse the goods, there is an allowance that might or might not be applied.

CHAIRPERSON: Yes.

MR SONN: It is also not standard. On the fresh side of our business, there would not be any allowance. So a product will be delivered to us and if it is defective, we would classically action a, what we call a return to vendor. If the product has been and we can determine that it is the supplier liability and we … [intervened].

CHAIRPERSON: So you basically are back on this exercise of determining.

MR SONN: Yes.

CHAIRPERSON: Where this could have occurred.

MR SONN: Yes.

CHAIRPERSON: Okay.

MR SONN: And then for all of the rest, so we do not have a sale or return policy.

CHAIRPERSON: Yes.

MR SONN: Any product that is not defective that comes into our chain, runs through our chain and does not sell within shelf live, we absorbed the cost of that. So we take ownership, once it hits the distribution centre.

CHAIRPERSON: Okay and with regards to the damaged goods or the goods that you have to return to the supplier, how does that work? Do they… Would you charge them an allowance for the damage or is it charge to the point where you have to return? How or what is the mechanics of that? How does it exactly work?

MR SONN: *Ja.* It is, we have … [intervened].

CHAIRPERSON: I am thinking about this because I know you have got a very strict process.

MR SONN: Yes.

CHAIRPERSON: For your customers.

MR SONN: Yes.

CHAIRPERSON: If what you say, if they are not happy?

MR SONN: Bring it back.

CHAIRPERSON: Then bring it back, we will not charge you for it.

MR SONN: Yes.

CHAIRPERSON: And I am trying to understand who then does the

… [intervened].

MR SONN: The cost.

CHAIRPERSON: The cost of that product?

MR SONN: Yes.

CHAIRPERSON: When you do that. Is it your cost, at your cost or at the cost of the supplier?

MR SONN: Right. So if, you know if there is just gross negligence, the product is found to be defective, our suppliers also have insurance against that.

CHAIRPERSON: Yes.

MR SONN: And it will vary. So the degree of the loss is borne by the supplier through them not recouping what they have. So they audit the manufacturing costing. We return it. There is no penalty associated with that. It is really the goods get returned. They do not make the sale and they incur the loss of the production of the product.

CHAIRPERSON: Okay.

MR SONN: We bear the loss through, because we do not have a wide repertoire of choice. You know if our poultry supplier delivered off chicken in Gauteng, there is really two - commercial chicken supplier and the free range supplier. If it is the commercial chicken and we have to return all the chicken our supplier would sit with a loss of that. We will sit with loss sales because we do not have an alternative to put on the counter. So, whilst they bear the direct lost, we would bear the indirect loss of that as well.

CHAIRPERSON: You have mentioned that you have got three distributions centre.

MR SONN: Yes.

CHAIRPERSON: Do you charge allowances on your suppliers or is there any distribution fee?

MR SONN: So the … [intervened].

CHAIRPERSON: For warehousing allowance?

MR SONN: So as I say, in some of the instances with a long life, with longer shelf life suppliers, there would be a warehouse allowance that can be applied, might be applied. It is not strictly speaking applied. That would be part of the negotiations.

CHAIRPERSON: So there is no blanket approach?

MR SONN: No blanket approach but it would be one of, you made reference to our trading terms.

CHAIRPERSON: Yes.

MR SONN: If supplier Khumalo did have that, it would be contained on their trading terms.

CHAIRPERSON: Okay.

MR SONN: But supplier X might not have it.

CHAIRPERSON: Okay and on your, do you have anything called redistribution allowance?

MR SONN: No.

CHAIRPERSON: It is something we have heard of.

MR SONN: No.

CHAIRPERSON: Drop shipment allowances?

MR SONN: No.

CHAIRPERSON: You do not have those and category management allowances?

MR SONN: We do not have that either.

CHAIRPERSON: Okay. Central office allowance?

MR SONN: No.

CHAIRPERSON: You do not and then advertising allowance, you were about to say that. If you can speak on that.

MR SONN: Yes. So, we have a standard marketing allowance which all suppliers would pay a percentage of, a very low percentage of. Really to help us drive the growth of the category, either through advertising or through promotion.

CHAIRPERSON: Yes.

MR SONN: It is negotiated annually and it is part of this… It would also be contained in the terms and that would be, so that would be one of the, what we would phrase it as the marketing allowance, which sits as a standard part of our terms. In addition to that, there might be and will be in certain categories, a promotional allowance.

CHAIRPERSON: Yes.

MR SONN: Certain categories which predominately see quite high uplifts or promotion, would together with the retailer invest in making sure that we have an allowance that allows us to promote those products at sort of frequent levels. Whether it is month end or every quarter and that is more of an ad hoc spend, which again would be negotiated with the supplier up front.

If we are going to have twelve promotions across the year, how would we together fund that? We obviously take a cost price deduction. The supplier would look to help to support that. So that we can offer a discount and it does not totally erode our profitability, collectively.

CHAIRPERSON: Okay and do you charge any, when you open a new store? Is there a new store allowance that you charge?

MR SONN: Absolutely not, no.

CHAIRPERSON: You do not charge that?

MR SONN: Not to the suppliers, no.

CHAIRPERSON: Okay and for refurbishments, do you charge any?

MR SONN: No.

CHAIRPERSON: None. We also understand that you are one of the stores that will charge for example that you will ask your developer to put up fittings for you. Is that something… is that a blanket approach or is it something that you will do in certain instances?

MR SONN: You… [Intervened].

CHAIRPERSON: The fact… sorry.

MR DE VILLIERS: The norm is generally that the developer would ask specifications for us.

CHAIRPERSON: Okay.

MR DE VILLIERS: *Ja,* it is similar to the other retailers as well. The other food retailers.

CHAIRPERSON: You say it is similar to?

MR DE VILLIERS: It is similar to the other food retailers. So what we call grey box or, you know, grey box meaning that it is a bare concrete with nothing in it.

CHAIRPERSON: Yes.

MR DE VILLIERS: And the tenant arrives and then put ceilings, flooring, lighting, electricity, DB boards and everything. If that is not the case.

CHAIRPERSON: Yes.

MR DE VILLIERS: It only happens mostly outside the borders of South Africa. In the borders of South Africa, for food stores, by and large and nearly all the sites that we do go in, there is a specification that the owner of the board, the developer of the centre is putting in for us.

So he would put in the ceilings, the sprinklers, air conditioning and dark labellers and what else you need in the back, offices et cetera.

CHAIRPERSON: Okay and refrigeration and stuff like that. Do you put yourselves in?

MR DE VILLIERS: No. The refrigeration, the plant normally we would install ourselves but in cold rooms they might build the cold rooms but we will do the on floor refrigeration. There is sometimes a split between the two.

CHAIRPERSON: Oh okay. So whatever they put in, would that be owned by them?

MR DE VILLIERS: Yes.

CHAIRPERSON: In terms of your ... [intervened].

MR DE VILLIERS: Yes, it is owned by them and when we, when the lease comes to an end and we decide to move on or close the store that reverts back to them.

CHAIRPERSON: Okay sure.

MR DE VILLIERS: We have responsibility to maintain that plant.

CHAIRPERSON: Ja.

MR DE VILLIERS: For example, if we trade there for many, many years, the lift at some point might not work anymore.

CHAIRPERSON: Yes.

MR DE VILLIERS: Then we need to prove or the air conditioning that we had maintain and service that as the specifications.

CHAIRPERSON: Okay.

MR DE VILLIERS: And then they will do the capital replacement thereof.

CHAIRPERSON: Okay.

MR KHUMALO: So Mr de Villiers, where you have a, you have been running say the Woollies Clothing store and you wanted to add a food, a Woollies Food within next door, you do not require a developer to contribute to that, you know, to that work of putting in the Woollies Food?

MR DE VILLIERS: It very seldom happens. So normally if we would have a clothing only and we extend the store, the developer would still put the infrastructure in.

Sometimes we execute the work and he might give as a contribution to do the work but in cases where we can ward it of and it is behind the scenes in the lone store, next door, he would fit out in most of the cases.

In some cases where we have taken it on board, it is purely because the developer might not have the skill set to do it himself but we prefer not to build as far as possible and take on the construction risk. It is something we are trying to eliminate.

CHAIRPERSON: I just want to go back on your presentation. You or just focusing on the food side of your business. What would be the minimum of your food size, size of your food stores and the maximum you can have, without pains?

MR SONN: I suppose the minimum and Maurice must just help me here, the minimum size of our food. Are you talking about product range or size of store?

CHAIRPERSON: Size of the store in square metres.

MR SONN: Okay. Ja we do…

MR DE VILLIERS: The minimum size is maybe an Engen in the forecourt where we would operate in conjunction with Engen.

CHAIRPERSON: *Ja.*

MR DE VILLIERS: Probably it would have about 36 square metres of trading space, floor space.

CHAIRPERSON: Within that?

MR DE VILLIERS: Within the Engen forecourt.

CHAIRPERSON: Yes.

MR DE VILLIERS: Then when it comes to our small local stores, they tend to, we tend to trade on 350, 300. So it is a shell of about 500 square metres, or 450 to 500.

CHAIRPERSON: Yes.

MR DE VILLIERS: And from there it starts stepping up to our biggest stand alone food stores is about 3000 square metres. And if you look at a total store with food and clothing combined, those store sizes can go up to about 14 000 square metres.

CHAIRPERSON: Okay. You also mentioned that you significantly invest in cold chain. Can you just explain what that means? It is a subject for us to understand of or maybe for the record.

MR SONN: So it is really insuring that we have got the maintenance of the temperatures we set for our products to service them optimally to our customers, right through the chain.

So what it means is that our distributions centre, which is where the product is received from the supplier and if you ignore perhaps for the conversation, for the point of this question then, the plea that the truck in which the product was delivered, is running at the same temperature.

CHAIRPERSON: *Ja.*

MR SONN: The factory in which it was produced, et cetera. So within our distribution centres we have got cold rooms and the facility where the goods are picked need to run at a certain temperature, so we have to invest into that, the refrigeration within our trucks that transport the goods from the distribution centre to our stores, our stores need to be fitted with refrigeration to hold the goods, our refrigeration within stores, so that is the stock rooms or the back areas, our refrigeration within stores.

There is also investment into the technology, to be able to monitor that all the way through so that we can see that the maintenance of the temperature has been kept.

We have got items, like temperature loggers, we have got things like those goods in stores were we are able to do temperature probes, so that is what I was trying to make reference to, is the infrastructural investment into the maintenance of cold chain, it runs right across the supply chain.

CHAIRPERSON: Okay, sure. Okay, you also mentioned that, I just want to understand now with regards to your suppliers again for the 90%, can we understand this to mean the bulk of those suppliers are suppliers that Woolworths would have approached, because you kind of know what you are looking for and you approach the suppliers with your specifications, am I correct, are we correct to understand that, that seems to be the case?

MR SONN: Many of them we would have approached, and remembering that we have partnerships that span 20 to 30 years, back then we would have approached our suppliers. It is also, I think, important to note that some of the branded multi-national suppliers that we have also supply us in our private labels, so they do not only supply the brands, and so in those instances those products might have existed or existed in the marketplace, and the supplier in discussion with ourselves produces a private label version of those products for us to our specification agreed with the supplier.

CHAIRPERSON: Okay, do you charge a listing fee?

MR SONN: We do not charge a listing fee as a standard practice, it is not a policy of ours. It is something which if offered is something we would considered, and there would have been instances where, but as a standard practice it is not a condition of doing business or something that we would necessarily put on the table.

CHAIRPERSON: So you do not have anything that looks like a listing fee in the Woolworths…? [Intervened]

MR SONN: The area where listing fees would more likely find themselves, and probably exclusively find themselves, is in the branded, so the 10% of sale space, where it is more of a common practice.

It is not something in the fresh part of our business we have any interest in necessarily exploring.

CHAIRPERSON: That is why I was asking this questions, because if in most instances you approach your suppliers, it would not make sense to then charge them a listing fee.

MR SONN: That is right.

CHAIRPERSON: Because it is not like they approached you.

MR SONN: That is right.

CHAIRPERSON: Okay, fine. And you also spoke about your sponsor entry program… sorry. Okay, my colleague just wants…

MR KHUMALO: I am not sure whether you have completed, you have answered all the questions around trading terms. I just wanted to avoid us going to something else before, and then taking you back to trading terms, but you had initially said when you were discussing the settlement terms, you have said it was one of the three figs.

MR SONN: That is right.

CHAIRPERSON: I am not sure if the others that you have discussed now are part of those, and if you can just...? [Intervened]

MR SONN: Close that one up.

CHAIRPERSON: Ja.

MR SONN: Yes. So the marketing allowance was the other one and the third one was a brand integrity allowance that is a standard part of us being able to assess and audit our suppliers in terms of, it is exactly that, the integrity of our brand, that it is being managed from a quality, hygiene and ethics point of view, and then there is an additional one, but it is not a standard, because in some instances it does not exist, and that is the base rebate, which is a rebate which we would have with a supplier as a percentage of the business that we do with that supplier, but it is not an absolute precursor to be able to supply us that exists. In the vast majority of products there would be a base rebate, but there are certainly some areas where that is forfeited, there is no rebate.

MR KHUMALO: Okay, and then other than those, I assume those are the fixed ones, what are the ones that are not fixed?

MR SONN: So the non-fixed ones would be sort of a promotional fund which might exist with certain suppliers and not with others. The warehouse allowance might exist with some and not with others. Those would be the types of discretionary funds or discretionary allowances that we would have.

MR KHUMALO: And how does that work, I mean, how do you decide which suppliers are going to be rewarding you for those ones?

MR SONN: Ja, so, you know, it really comes down to, we would literally sit across the table from a supplier and have a discussion about where we believe it is more justified or not justified. Some of the allowances might be proposed through the conversation by the supplier as opposed to a basic rebate. It may make more sense for us to have a swell allowance.

There are additional incentives which as partners we drive, like a growth incentive, where it places the onus on us as the retailer to support the growth of a certain category, and in order for that allowance to kick in, which is a benefit to us, we have got to grow the category to a certain level, so…

I think I said earlier the trading terms is an annual negotiated discussion where, you know, we would sit down and say, you know, what is feasible, what makes sense in this particular category that we are supplying, if I use an example like milk, which is a very competitively priced product, and if you are not competitive, you are going to see your volumes decline.

It might not make sense for us to have a basic rebate, which then ultimately comes back in the cost of the product that gets passed onto the customer. It might make more sense to have a promotional allowance that we manage together to be able to promote that product, which the suppliers is willing to contribute to at various times of the year.

So those would be, I think that is sort of the tone and the nature of the kind of conversations that happen when there really is not a sort of “one size fits all”, other than those sort of three component parts of the allowances that we would see as part of the trading terms.

MR KHUMALO: And the size of the supplier, does is… [Intervened]

MR SONN: Critical.

MR KHUMALO: Is it critical to whether or not they are charged the…? [Intervened]

MR SONN: Critical. The size and the nature, so when we talk to our branded multi-national suppliers, this is an area they are far more familiar with and so it would be something that they can reference against what they do with others they obviously supply. We have a supplier who is an ED supplier, a black-owned business whose, cash flow is fundamentally important to them, they get paid seven days.

Normally to be paid in seven days it would attract a discount because we are paying you, you know, quite quickly after statement. In that particular instance there is a zero discount so that it is in both of our interests that that supplier is successful, and so we would negotiate with that as the overriding context, and those are just examples of the nature of those conversations that I had with, in agreeing that.

CHAIRPERSON: I was asking you about your... You said you have got the sponsor entry program of new suppliers.

MR SONN: Yes.

CHAIRPERSON: Can you just speak more on that and also, and what percentage of your supply, like how does this fit into the bigger Woolworths' program of developing, on supplier development?

MR SONN: Yes. So we have… ja, I would prefer not to talk about the percentages but I can give you the broad flavour of it.

CHAIRPERSON: Ja.

MR SONN: So we have set aside as a business to invest a percentage of nett profit after tax into our supplier development program, and we make that available to suppliers on a loan basis, and it would start with the demand for the product because what we found is to just bring products into the business because there is a great story behind them or because the business is black owned is not necessarily the most sustainable, or is not the most sustainable way to grow a business, and so it starts with where there is a demand.

The supplier, I was referencing earlier on the pet food side, which is a black-owned business, we used to import those products from

Ireland and we wanted to bring that locally, and there was a business that was about to be set up by three black industrialists who have experience in the pet food area but needed funding to set that facility up, it is obviously a high tech business.

We funded part of that and through our funding of it, other funding houses, like that DTI, PIC, sometimes the Banks, on the basis that Woolworths is willing to fund the supplier gives the supplier access to other sources of funding that then helps them get into the market, so those are the ways that we go about that.

CHAIRPERSON: Okay. You also, and then linking that question to what you said about, you said 84% of your Woolworths food stores are located in the metropolitan areas.

MR SONN: Yes.

CHAIRPERSON: And only about 16% are in the country towns.

MR SONN: Yes.

CHAIRPERSON: And you specifically said PE, East London and Bloemfontein. Does Woolworths have any presence in the townships, truly rural areas, let us say Transkei, Thohoyandou, this is on the food side?

MR DE VILLIERS: Madam Chair, yes, I will answer that one. Yes, we do have exposure. The most recent one we opened is in Thohoyandou, we just opened a food market in Thohoyandou when the new mall launched there.

We did try to expand our footprint for foods into the country towns in the outlying areas, but also the transport cost is quite relative to the turnover that we can do, so it is a function of the size of the market and a potential turnover that we can do in those markets. We also trade, for example, in Umtata, by example.

CHAIRPERSON: Okay. Just linking that to your supply development program, to what extent does Woolworths, for example, source its fresh products, or any products for that matter, on the food side in those areas, Umtata or in Thohoyandou, from the local communities? We gave the context to everyone we have asked this question to.

We have had a lot of complaints from these communities, especially black communities, where they feel supermarket chains have come and set up shop in their areas and affecting the previous retailers that were there or driving them out of the market, and these are retailers that used to source from them and they cannot even supply these new supermarket chains, and I just want to understand that.

To what extent are you, as Woolworths, supportive of the manufacturers and producers in the communities in those areas specifically, I could say previously disadvantages areas, ja?

MR SONN: Yes. So some of these facilities, some of these suppliers have a presence in the metropolitan areas where we trade, they build factories there.

In the case of more in the agricultural side within our grower base there certainly are farmers and growers and suppliers that then supply into our established suppliers, so they would supply a specific raw material or help to compensate or compliment the volume that the supplier that supplies directly into us has. In some cases those suppliers will supply directly into us. It is something which I do not think we are doing enough of and something that, I made reference earlier to our aspiration in terms of increasing our black spend.

So what often happens is you will have a supplier that is able to get a piece of land next to a farmer that supplies lettuce into ourselves, and we would strike up a relationship between, or our direct supplier would have a relationship with that grower and they would supply their lettuce into our supplier, they then do not have to set up a pack house, I mean, all of the costs that go with supplying Woollies and they are able to build their business, so that overtime, they can become a direct supplier to us as well, rather than putting all of that onerous strain on them from the start to, you know, manage cash flow, invest well ahead of the curve when their volumes are still quite small.

So I think we do have it, we do not have enough of it. It is something that should be and is a big focus of ours going forward.

CHAIRPERSON: Okay, just to be more specific, and if you are not able to answer this question because you are not, you do not have the information, and the information may be that you just, it is not something that you were prepared to answer here today, for example to look at your Thohoyandou food store, are you sourcing from any local black suppliers there?

MR SONN: Ja, so that is one of the challenges with centralised distribution, is our ability to source locally from the local community for the local store, so we do not have, we do not have …[intervenes]

CHAIRPERSON: A holding point.

MR SONN: Well, we do not have an aggressive strategy, firstly, to expand our stores into township areas, so that is the first point, which I think would make us quite different to some of the retailers you might have been describing earlier, but where we are, and not only necessarily in those areas, there are local communities surrounding existing stores, where we would like to be able to offer those local producers access to our stores.

Our current model does not facilitate that easily, because everything is centrally distributed and centrally planned, so the flexibility we have within a store and still maintain the Woolworths controls is something we have to apply our minds to address, and I cannot speak with any degree of confidence, but I do not know whether, I do not believe we are sourcing any specifically from Thohoyandou.

CHAIRPERSON: Okay. Would this challenge apply to PE, East London, Umtata?

MR SONN: Broadly, yes.

CHAIRPERSON: Okay, okay.

MR DE VILLIERS: Madam Chair, just to add, our exposure into those markets in terms of trading expenditure is actually very small relative to the total chain.

CHAIRPERSON: Okay. I know you have indicated that you do not have any exclusive leases. What is Woolworths' view on exclusive leases, or let me this question differently, what does Woolworths understand to be the purpose of exclusive leases by those retailers that do contain them in their lease agreements?

MR DE VILLIERS: I think the purpose of, they are trying to control their market, they make an investment, it is about 'derisking' the investment, because most retailers will trade better on their own, meaning as the sole supermarket in the shopping centre versus having three other centres or three other stores that is selling the same kind of products as they do.

So, it is about protecting their investment and protecting their growth going forward, I think that is why those clauses came about historically.

CHAIRPERSON: In instances where some of these exclusive clauses have been in existence for a very long time and creating a concern for this inquiry, what would be, how would you suggest that this inquiry approaches this, in terms of the duration, what duration would you propose, but also what factors would you like us to consider, what would you suggest that we look at if we wanted to encourage that the market does away with these exclusivity agreements?

I know this is a difficult question and not an easy, I do not know how to structure it myself, but basically we just want to understand from a player in the market, you are facing them, you are experiencing them, and if you do not apply them, surely you are being a victim to them, and we want to understand, there is an element of protection or there may be a good justification for having them initially and we want to understand then should there be a suggestion to do away with them at some point, what should that point be and what would you suggest, or assist us on the justification with doing away with them, the basis, what basis can we put forward to any, to the retailer that still contains and that still practices these, and comfortably they are so?

MR DE VILLIERS: Maybe, Madam Chair, to answer you to start with the end. I think exclusive leases over the history in South Africa has really driven a fragmentation of the market, so for us it is more important to have as many of the retailers in a single centre, because you want to create dominance, you want to create maximum feet, maximum energy, maximum destination, maximum pull.

If there is exclusivity, all it means is somebody gets left out and it drives another centre down the road, and it drives another centre further down the road, and over a period of time you then, and all of those centres also need line stores and small retailers and not everyone can survive.

Some centres have a greater ability to pull everyone compared to somebody who is not, and so you see property investment, investments being made that cannot, is not sustainable in the long run because somebody comes and puts something up down the road that is more attractive, more nicer, and not everyone can come in.

So from our perspective, we did run into exclusivities, we do not like them, we do not support them. I think they are very different to the duration of lease. They in my mind are two fundamentally different items.

As to your question what to do with it, you know, our view is they should not be there in the market place. I think if the playing field is levelled, everyone upfront can decide whether they enter into the scheme or not enter into the scheme.

I can understand why some of the retailers feel aggrieved about it because they invested, they took the risk to build the scheme up and got it through its growth years. Most centres can take three, four years and big super regionals can take up to five years before they really start working and shifting the market and build their customer base, and they have gone that road, so they supported, did not trade well and had to support the growth of it.

So there is a strong argument to say now that the centre finally reach its dominance and I was a key part of getting you to be successful, now you bring somebody else in and I lose 20% of my trade and you are splitting the trade, because ultimately the trade in a given market is, the cake is the size of the cake.

It is not by putting another retailer in that the cake gets bigger, the cake just gets cut up differently, and so it is a complex space, but from our perspective, we would prefer that they are not there.

CHAIRPERSON: And what is your view to the restriction of sizes, because we have also seen that where some of the retailers that used to have exclusivity clauses will then waive exclusivity in favour of allowing a competitor to come in, but will restrict the size of that operator's business, and what is your view to that?

MR DE VILLIERS: It is in my mind the same thing, there is no difference between the two. It is still an exclusivity because they are saying I am allowing you in but I do not want you to grow, I am allowing you in because we want Woolworths, in our case we want you to bring the higher Allison feet in but I do not want you to get too big so that you can compete with us, so, you know, and so from our perspective it is one and the same thing.

CHAIRPERSON: Yesterday we had a discussion with a Bank that gave us some insights on looking at the success of a development, for example, which goes to the point that you made, that the justification, the initial justification for these exclusive leases would be that I was there from the beginning and assisted you to grow this development to where it is, at a point where it starts to make money you then bring in a competitor which starts to ride on the channel of our own revenue that I could make going forward.

In trying to understand, what would define, if we were to look at an existing development, a new development is a different situation altogether, but when you look at exclusive leases that are in long existing developments, for example, we were told that one of the key things that would define the success of that development would be the customer feet, the footfall, which must translate into trading, what did they call it, trading density, yes, trading density, and would you say that that would be a fair way of looking at whether a development or a shopping centre is actually a successful centre for us to make a determination as to whether or not any existing leases or exclusive leases are justified?

MR DE VILLIERS: I think it is very difficult to try and make a call on the back of trading densities whether somebody is successful or not successful, and hence whether exclusivity should be waived or not, because I think trading densities is impacted by so many economic factors and the demographic of the market in which you trade and how that market is growing or not growing, and the disposable income in that market, so I think that is a very difficult one.

I think the cleanest way is either to say, you know, in terms of the historic agreements to define a period in saying after the lease has been running for so long it is not important anymore, and a ruling need to be made about going forward whether these exclusivities are being allowed or not.

I know a lot of our landlords are insisting and trying not to enter into those agreements.

CHAIRPERSON: What if there is a clear pattern that shows growth in the trading densities in relation to a particular development, for example, would that still be an issue if one looks at the trading densities?

MR DE VILLIERS: Yes, you would, but, I mean, remember, you do not trade in an isolated nucleus. It is quite one dimensional if our people are looking at it, because two or three centres could have opened over the period just in that same trade node.

Because of the exclusivity it happened, and so the trading densities will soften, so that centre automatically because of the exclusivity would lose 20%, 30% of its turnover because it is just going down the road to a more exciting centre, and how do you deal with that in the trading numbers, and they are saying it is soft, therefore you are going to perpetuate the period.

CHAIRPERSON: Okay, in fact, we went into specifics in relation to this on the centres themselves, and there was a discussion with one of the stakeholders on, for example on the Fourways Mall, and we were told that if you look at Fourways Mall, Fourways Mall does not compete necessarily as a mall, it does not compete with the other shopping centres that you find there.

There is Pineslopes where there is Pick'nPay, there is Leaping Frog where there is a Shoprite, and just a kilometre or less ... [intervenes]

MR DE VILLIERS: Cedar, Cedar Square, ja.

CHAIRPERSON: There is Cedar Square with Pick'nPay and Woolworths, and Woolworths is also at Fourways Mall, and there is Woolworths down the road in Broad Acres Shopping Centre, and another one further down as you go towards Dainfern. What is your view on what would be, what is your view, Morris, on this, do those centres, small centres compete with Fourways Mall, in your view, you have a Woolworths there?

MR DE VILLIERS: Yes, they do. Back to the initial example, there is just so much food spent in that total node, and they get carved up in a different way because the shopping purposes are all different, whether it is Pine Slopes or Cedar, it is about convenience, it is on my way home, left hand side, left in, I do not pay for parking, I can buy bread and milk, a cup of coffee, I can meet my friends and move on. If I want to spend a half a day in a shopping centre then I will go to Fourways, if I want to go fashion, I want to see a variety of different fashion stores.

So the purpose of shop is different, and we know typically in a Fourways, in big regional malls there is a certain size that you can take a food store to because Fourways Mall, Sandton cannot fulfil a convenient shop purpose.

So if the intention of the shopper is about pure convenience, they will all visit the convenience centre. It is about in and out and the ability to stop in front of the front door, walk in, get my goods, climb in the car and leave again as quickly as possible, and preferably not pay for parking.

CHAIRPERSON: Let me be more specific to Woolworths, for example, you opened your Woolworths at Cedar Square long after the Woolworths at Fourways Mall had been operating, and on the point that, if we were to look at trading densities and whether there is competition or not, the point you made that you could lose some people to the new development and therefore it is difficult to focus on one dimension when you measure whether or not there is a development or there is a growing trading density.

In the case of Woolworths, did you experience any drop in the sales or in the footfall in relation to your Woolworths Foods in Fourways Mall as a result of you opening the one in Cedar Square?

MR DE VILLIERS: Yes, no, I understand. Let me answer you in this way, the drive to convenience is extremely strong, so whether we participate in that drive to convenience and open a store in Cedar Square was in order to be able to play in the environment of convenience, people on their way homeward bound.

It is a market that we are not capturing in Fourways Mall. Now, when we did open we did calculate and anticipate that we will take sales out of Fourways Mall and the trading densities for a period of time would shrink, and over time it should recover again, but on the total basis it was still better off for us to open in Cedar Square, and it makes financially sense for us to open a big store in Cedar Square, and we recently extended the store in Cedar Square … [intervened]

CHAIRPERSON: To capture that convenience market.

MR DE VILLIERS: To capture that convenient market, because you will find customers, the purpose of shop and why they go there are really fundamentally different between Fourways Mall and Cedar.

CHAIRPERSON: So you are basically saying that there is a difference, we also need to look at the purpose of the shopper?

MR DE VILLIERS: Ja.

CHAIRPERSON: Okay. So a customer that goes to a shopping mall is looking for a different thing to that of a shopper who goes to a convenience centre like Cedar Square, Broad Acres.

MR DE VILLIERS: And maybe to add, you can have external factors. Our turnover in Fourways is probably half of what it used to be, purely because construction or intersections or the road works that is happening, so there is so much external factors.

The wealth is there, but they are not either shopping a different and they change their shopping patterns, so there is a lot of factors that can happen in the centre, what you pay for parking to the construction to your ability to get in and out of those environments, that has an impact on trading densities, and that is why, in my view, trading densities … [intervenes]

CHAIRPERSON: Let us say prior to the construction, because the construction at Fourways is fairly recent, it is in the past two years that you said it is experiencing that, but Fourways Mall Woolworths has been in existence as well, I mean, has been co-existing with the one in Cedar Square, for example. What was your experience then prior to the construction of the roads, as well of the mall?

MR DE VILLIERS: Ja, in a clean scenario, if one compares it, there will be transfer of cannibalization, there always is, there always is, and whether we did open or not and it was in a very attractive convenience centre, we in Fourways Mall would have still lost the sales.

CHAIRPERSON: Would that make your Woolworths in Fourways Mall a competitor to the one in Cedar Square therefore, or do you consider, would Woolworths in Fourways Mall consider the one at Cedar Square to be a competitor to yourself, to be competing with it?

MR DE VILLIERS: No, not really, I mean, they … [intervenes]

CHAIRPERSON: Because you are looking at a different shopper.

MR DE VILLIERS: They fulfil a different purpose, ja.

CHAIRPERSON: Yes.

MR DE VILLIERS: Yes, there is some level of competition between the two, but they fulfil a different purpose.

CHAIRPERSON: Okay.

MR SONN: Chair, if I could maybe just add to that? So classically what we would do in those formats as well is, it is also about the product makeup in those stores, so Fourways would carry a certain catalogue that supports that customer mission.

When we opened Cedar, understanding the specific mission of that customer, it is going to be more convenience, more prepared, more fresh, and so it will be an edited version and we would not necessarily carry the types of items that customers would want to do a trolley shop on, so it all works together from that point of view.

CHAIRPERSON: No, we are asking, I am asking this question just to understand the nature of competition, as well as what could be the geographic market definition in an urban setup like that, where you have all these stores that are not very far from each other, in less than 10 kilometres, less than 5 kilometres in most instances from each other, and it is still a difficult thing for us to understand from the submissions that have been made, at least in relation where these exclusive leases may still be applicable.

I am not saying they are in that scenario, I am just making that as an example.

MR DE VILLIERS: But I think in that scenario to talk about a distance of one kilometres, three kilometres, it is nonsensical because you, we are surprized when we open a store in Pretoria and it is affecting stores in Johannesburg. How people shop, when we pull our card data we think people shop just one or two stores, you are surprized, sometimes they shop at 15 different locations. So you just, you know, it is so wide, so much variety, so I do not think you can pull a circle of three kilometres, one kilometres or 10 kilometres around any environment and saying that is the trade node.

CHAIRPERSON: So what would you suggest we, what would be the, especially on this issue of exclusivity, what would you suggest to be, what indicators, what should we be looking for to influence the geographic market definition and at the end to be the deciding point as to whether certain stores compete with one another or not, like some people will tell us there is already, this has been defined already at the tribunal level, but we just want to understand from a business point of view because you are the ones who are opening these stores and you know exactly what you are doing, you know whether your store is going to cannibalize by the new store you are opening or not or, ja?

MR DE VILLIERS: Madam Chair, in my view there are so many factors and so complexed that to go down that road is not where the answer lies. It is either you do away with it or it is time-related. There cannot be anything other than that, it has to be that simple but, you know, anything else beyond that becomes a maize to try and … [intervenes]

CHAIRPERSON: Yes, to try and understand it.

MR DE VILLIERS: Ja.

CHAIRPERSON: Thank you, thank you very much.

MR KHUMALO: So, Mr De Villiers, based on what you said I would like to understand what are the more important factors in determining whether or not a store competes with another, I mean, you just blew our understanding out of the water of distance, for instance?

You would have seen from our questions that there is references to 8 kilometres, and the like, but what are the key considerations? You mentioned the shop purpose, for one, but what would determine whether or not a store is taking away business from another?

MR DE VILLIERS: Mr Khumalo, the market is, it is maybe how to just choose the right words to answer you, it is very difficult to define the market. It is very dynamic and you cannot draw a circle around it and say that is exactly the market, unless you locate it 400 kilometres away from anything else and only that households and only those farmers will come into that little town and shop, then you can define and accurately calculate the market.

When Mall of Africa opened you see the impact of stores and the breadth and width of stores that is impacted, whether it is all the way from Polokwane to, it takes away from all over.

So a big regional centre like that, or whether it is Sandton, you know, how far or wide it pulls from people coming to shop at it. You have farming communities that will drive 400 kilometres just for the day to come and shop at Sandton or Mall of Africa, so it is very, very difficult to define. So when you come into convenient centres or in neighbourhood centres, those areas of trade is probably easier to defined, but yet with somebody passing through there you have an “intersectory” trade that is still happening in that space.

So I think all stores compete with each other, whether it is a standalone, a CBD store in a different environment, because most of our customers have choice, whether they shop in the CBD of Johannesburg or they shop in Soweto or they take a day out to come and shop in Sandton, it is that broad, and the more we unpack our Woolworths card data, where you can understand the intelligence around, we cannot sometimes communicate with the customer but we can see the buying patterns of where they shop.

We are always amazed at how far and wide, what we call “sales transfer” or ‘cannibalization’ that happens between our stores when you open a store, and when the economy goes down, the cannibalization tends to be higher, when the economy is growing, it tend to hide some of that cannibalization, so you always see it moves in cycles in sync with the economy.

<u>MR KHUMALO</u>: So then what would be the importance of adding in your lease agreement as Woolworths that a convenience centre should not change its purpose to then maybe become a regional if it does not really matter, because, you know, so if I as a shopper can go there, whether or not it is a regional or a convenience, you know, shopping centre, why does it matter to you that it must retain its identity?

<u>MR DE VILLIERS</u>: Yes. Mr Khumalo, if we can go back to the previous example of Fourways? Fourways’ purpose is to be a dominant regional fashion destination that is what it is.

So we go into Fourways as the destination for that particular trade node and we build a big beautiful store, all our fashion components in there that is what it is supposed to, the role that it is supposed to fulfil, that is what we sign up for upfront, before we make the decision.

Up comes Cedar just across the road, it just happened to be owned by the same owner. We say to them that is about convenience, it is about how you get in, how do you park, what do you pay for parking tariffs, whether it is free, because that purpose is about intercepting the homeward bound customer going home, or the lady after she drops the kids off school, on her way home to stop for a cup of coffee, it fulfils a different role.

So the purposes of our convenient leases is to say if you are selling the scheme to us and you are selling it to us as a convenience centre, we can see the gap in the market and we will sign up as a convenience centre, but we do not want you to change the nature of it and start put national fashion in that centre and now you are trying to take away from Fourways, that is not what we are signing up for.

Id that is your intention, please disclose it upfront because then we can factor it into our decision-making, as to whether we participate or do not participate.

So the purpose of those clauses is really just you hold them true to the intent that they sold us and what we sold onto our Board when they granted us the right to go ahead with the deal.

MR KHUMALO: So if the owner realises that, you know, for some reason or another the convenience store is no longer, you know, making business sense and the market demands that he expands it, how difficult or easy is it for that owner of that shopping centre to change its identity?

MR DE VILLIERS: I do not think it is ... [intervenes]

CHAIRPERSON: Just, sorry, just to add to that, is it possible that the owner can come to a view, to this view and yet Woolworths is still happy with the old model, is that possible in this kind of situation, so can the benefits of having a convenience centre like Cedar Square change over time for a developer and yet remain the same for Woolworths? Because you are still happy with that convenience shopper who is still passing by, and why would that be, maybe just to add to the question that you have been asked?

MR DE VILLIERS: I think you need to take the factor, Mr Khumalo, the size of the centre. So Cedar is quite large, it is over 20 000 square metres, so typically when somebody comes with about 20 000 square metres, you know that he needs to put in more than just the normal convenient restaurants, you need some element of fashion, and that is fine and we are not objecting to it. What we are objecting to is that if you have the big national fashion brands in the regional mall and he has vacancies, and a way for him to fill his vacancies is to try and get a national fashion into that centre. That we are saying to him is, you know, that is not purpose.

If it is any convenient related tenant or entertainment tenant, please go ahead, if you want to extend the centre, extend the centre, so we are not objecting to it.

It is only when you come to, when you sit in the shadow of a big regional mall and you have big fashion brands that take up big space and now you want to duplicate it in your centre right across the road, that, we are saying, you know, that is not what we sign up for here or that you disclose upfront here.

MR KHUMALO: So based on that, could I conclude that two regional centres within a kilometres or 5 kilometres from each other do compete with one another?

MR DE VILLIERS: I think they do compete, it is just, you know, we do not want to fragment the market further that is really... From a food point of view you automatically fragment the market when you sign up into Cedar next to Fourways, but it is to capture the different purpose of shopping.

CHAIRPERSON: Is your concern that, would you lose that convenience shopper or, I am trying to understand what your concern is, is it losing that convenience shopper in Cedar Square or is it that you would not have enough of a customer, so that shopping destination customer, or enough of a shopping destination customer to support the store in Fourways as well as support the store in Cedar Square in that kind of setup if that were to happen?

MR DE VILLIERS: You basically fragment the market.

CHAIRPERSON: So the fragmentation basically results in this problem that you end up having stores that are not performing well?

MR DE VILLIERS: Ja.

CHAIRPERSON: Okay.

MR DE VILLIERS: But maybe to add also is we do not want, you know, Cedar to change the purpose of what it signed up for, you know, it was signed a convenience centre, so but it becomes inconvenient because now to get the big fashion spaces in they take the parking away, they put the parking into structure parking that goes in to paid parking, you know.

So it is more the on cost or how the centre is going to impact on the convenience aspect of that centre, and that was the original attraction of the centre, why the customers would go there, food shoppers were to go there.

CHAIRPERSON: Okay. There is a question coming from one of my colleagues as to, on the issue of defining the geographic market within the context of these shopping centres and the fact that you find, in a case where you find, like in that Fourways situation, and then the question is could the catchment area be the decisive or defining point here, the catchment area for each store, or would these not be overlapping anyway, would they not be, like what would your view be?

MR DE VILLIERS: Are you referring to the food trade?

CHAIRPERSON: Food trade, yes.

MR DE VILLIERS: Ja, the catchment areas in that example will always overlap.

CHAIRPERSON: Hugely so?

MR DE VILLIERS: Ja, hugely so, ja.

CHAIRPERSON: Okay.

MR KHUMALO: So for me you would have seen we have some questions around tenant mix clause. Do they matter, based on the type of centre that you are in, for instance, it is starting to be clearer me for where you want to keep your convenience store to be the same, but do you have tenant mix clauses in the original centre?

MR DE VILLIERS: The tenant mix clauses for a regional mall, or taking again Fourways, the size of store that we put in is a function of the size of the market, how big the centre they are going to develop, and also how big all the other competitors is, so what tenant clauses are there is to capture what the landlord present to us. So he is saying to us take 10 000 square metres in Fourways Mall, I have got all these other big boxes that is coming in, this is where they are positioned in the centre, and the tenant clauses are there to capture them as that is your intent, they are going to be of that size, and if they are not there of that size, then you need to replace them with a similar or equivalent tenant of that nature, because our investment decisions are based on the power of what that centre is, and for Fourways to be powerful, dominant in its area, it needs to have a certain level of gravitas that comes with it, and that is what the purpose of those clauses are, as to intend to capture what the landlord said he is due to deliver, and what we factored in in making our investment decision.

MR KHUMALO: So if say we come to an agreement at the end of the inquiry with the other food retailers that no more exclusive leases, can a tenant mix clause not be used to serve the same purpose? In the beginning, I as, you know, Khumalo (Pty) Ltd, am one of the big four, I am saying, right, Mr Landlord, this is what you are saying you are going to have as tenants, right, and they are going to be located here and this is their size, and now Woolworths wants to come with a food offering and I am saying that is not what you said in the beginning, can that not be used in the similar way?

MR DE VILLIERS: I cannot speak for my competitors' leases or how it is written. In the case of our leases it is saying these are the major anchors that you specify and they are critical to the size of our investment. It does not capture the whole, all the tenants in the centre at all, and if they are not there, you need to replace them with a similar or equivalent food anchor, so whether it is a Pick'nPay there and tomorrow it is a Checkers, it is neither here, it is a similar or equivalent to us. You need a big food anchor on that side of the mall to ensure that the mall is sustained.

I think, Mr Khumalo, as to your question, I think it goes to the degree of how you specify that clause and whether, yes, there is potential risk that it can there, but it is a function of how that clause reads at the end of the day.

In our case it does not read like that, it deals saying these are the material tenants in the centre that is critical for us to trade there, and if they are not there, then it gives us the right to break the lease and go, or elect to stay on if we so wish.

So the mechanism there is really about not preventing somebody in, it gives us the flexibility to be able to exit the centre and not having to trade for the full period while there is a big vacancy in the centre and it is not trading.

CHAIRPERSON: In a new development, were Woolworths inverted as one of the anchor tenants, do you prescribe to the landlord as to where they must locate the rest of the tenants in a development?

MR DE VILLIERS: Madam Chair, we do not prescribe, they come to us with a concept. So on a big regional mall, like Fourways or any other mall, they will show the layout. We would comment about the tenancies that surround us or near us, is it complimentary to us?

So it does not make sense to have a low Alison tenant next to us when we are trying to appeal to a high Alison, so either they will group them in the tenancies, the adjacencies of the tenant, so the landlord will come and present, most of the large landlords normally would do that automatically upfront, when they place the tenancies in the various centres.

So our focuses mainly is who is your main anchors, where are we positioned and how does the flow work, and is our side of the centre, because we fulfil an anchor role, is it going to be quiet, you know, are we sitting in a dead end of the centre, what else are you putting in, a coffee shop in nearby, and are you putting some exciting tenants that can create excitement for the people to come to this side of the mall, and is the mall balanced in terms of flow of foot traffic, that is what we will typically look at.

CHAIRPERSON: Okay, thank you.

MS GRIMBEEK: Just a couple of questions from my side. If you can just maybe help us to understand how it works when there is a new property development, so would Woolworths be the firm that approaches the property developer or landlord to say I see you are developing a new mall, we think we would want to take up space there, or will you always be first approached by landlords with something and he will put something on the table for you to consider?

MR DE VILLIERS: I think about far the majority, over 90% of the times we are approached.

In some small convenience centre cases, we might see a new site or the suburb is expanding and identify and seeing, okay, but this centre looks interesting, maybe there is enough of a market there for us now to go and open a store, and we will go and knock, go and knock on their door, on the owner's door then.

MS GRIMBEEK: Okay, and I also just wanted to ask you about the different component that make up the rental that you pay per square metres in a shopping centre or mall, if you could maybe just help us to understand the different components.

So we understand from previous submissions there is something called the "base rental" and a "turnover rental". How are these components calculated and are there any other components of the rental that you pay that we should be aware of?

MR DE VILLIERS: I think, firstly, Ms Grimbeek, I think we are quite unique in the market as to how our rental deal is structured, and it has been like that for many, many years.

So typically we would pay what we classify a 'basic rent', non-escalating over the duration of the lease period. So, by example, if you chose a number, say R100 per square metres, and R100 per square metres will not escalate for the full 10 years' period of a typical food store.

What happens thereafter is that the end of year one the turnover becomes what we call the "threshold turnover", so after year one the growth in turnover we would pay between year two and one, and three and one, and five and one, meaning, so after year one we do a turnover of, say R200, in year two we do a turnover of R400, that difference between the two would attract turnover rental, and so the turnover rental, the purpose of the structure of this deal is that we are basically partners, because if you are not looking after the centre or you charge too much for the parking or it is not convenient or it is not well tenanted, our turnover will suffer, and hence your turnover rental will go backwards.

So the whole purpose of the design of that rental structure is that we ensure that the landlord cannot just demand the fixed escalation every year and not maintain the centre and basically walk away from his investment, so we pay a basic non-escalating and a turnover component that gets calculated at the end of each year, relative to what the base turnover was.

We pay all our meted consumption charges, so we pay for electricity, we pay for water, and in some cases we would pay, if we are on the centre's air conditioning, we would pay a percentage of the centre's air conditioning costs, but in most cases we have our own dedicated air conditioning systems. That by large is 90% of what we pay for. In some cases in the regional malls there might be a contribution towards marketing funds, but that is about it, ja.

In some of the very old historic leases there might be a contribution towards common area charges, but they are really in the minimum in our case.

MS GRIMBEEK: Okay, then a final question from my side. We understand that anchor tenants in a shopping mall or centre will pay a lower rental per square metres than other line tenants or, you know, your smaller independent stores.

If you could maybe just try to help us understand the rationale for this, so why would, you know, a small store of, I do not know, 50 square metres pay a higher rate per square metres than a store of 3 000 square metres size, for argument sake?

MR DE VILLIERS: I think the simplest way to put it, it is demand and supply, you know. It is an international trend, it is not unique to South Africa, and in the Western world and in Europe it is exactly the same concept.

The developer needs the anchor tenant, who is going to pull the feet. The small line store is not necessarily going to draw the feet to the centre, they are complimentary to the centre, and they need the anchor to survive.

So if we do not pull the feet into the mall, that is why we sit at the far end of the mall, in the deep spaces in the mall, in order to pull the feet past the small line store. His success is dependent on our ability and our other big anchors in the South African market to draw feet into the centre, and if they do it successfully, then everyone trades well, and hence I think they will pay a different rental structure.

MR KHUMALO: You mentioned something like "common area charges". Can you clarify what that is?

MR DE VILLIERS: Mr Khumalo, common area charges might be, the landlord would calculate the electricity for the malls, the air conditioning for the malls, the cleaning of the centre toilets, the security to the centre, which is a charge that he cannot, he has global charges and then each of the tenants would pay a percentage of that total bill.

Normally, typically is, what is that ratio of the store size relative to the centre size, and the landlord would try and recover his cost that way.

So if you represent 2% of the footprint in the centre, you will pick up 2% of that component of the bill.

MR KHUMALO: And on top of that, do you still pay your individual electricity and water?

MR DE VILLIERS: Yes, yes, we do.

MR KHUMALO: And all the retailers are just happy to do that?

MR DE VILLIERS: No, it is a point of negotiation, you know, from us. We try to negotiate those things out and not enter into those kind of arrangement, because you have no control over it, you know, whether he is managing it efficiently or not efficiently, so, you know, we venture into all our own refuse removal as far as we can, possibly, and not make use of the centre's refuse removal because we can control the cost better.

CHAIRPERSON: Just my last question.I tried to understand, just to link up to the question that was asked by my colleague on the discount that is afforded to an anchor tenant, on the rental paid by the anchor tenant, and basically wanting to know if is it possible at all, is it ridiculous to even suggest it or think of it that there could be a clearly identified percentage when parties negotiate, if they bring Woolworths as a second anchor tenant and you are getting a discount because you are a second anchor tenant in that mall and therefore you are going to be getting discount, is it possible to apportion a percentage as a component of that rental so that it becomes clearer to anyone who is looking at the leases, as to why so much discount are given to bigger retailers and this big difference between a smaller player and the bigger player.

Because this is a complaint that we are faced with as an inquiry from the smaller retailers in shopping centre in general, not just in the food sector but all the players in the shopping centres are complaining about the rentals that they are having to pay compared to those that are paid by bigger retailers, probably Woolworths would be included in that category of bigger retailers?

MR DE VILLIERS: I think if one takes just one step back before we answer, the issue about discountable leases.

So the developer needs blue chip tenants with long leases in order to raise capital in order to develop the scheme, which is basically what the banks would have shared with you, and the Banks do not take into account the small little retailer and do not lend against, our understanding of it, against those small retailers.

So the developer, and to kick start the scheme needs the blue chip tenants’ leases as far as possible, and normally that makes up a big component.

To answer your question as to, and that is, you know, because they need us upfront, then it is a point of demand and supply, do we want to go into the centre, the landlord desperately needs us, then the rental is very attractive, or we want desperately to come in, we end up paying a lot more.

As to the discount between, in our view it is not a discount, you know. The small guy is saying there is a discount, we see it not as a discount. It is what we can afford to pay in order to make that investment pay for us relative to the risk that we are taking. It is exactly the same for the small guy, he is going to do a certain turnover.

It is the same as renting a house, I mean, you can rent an expensive house, you can rent a cheap house. Now to say I am renting an expensive house, now I am complaining because, you know, I am paying too much rent.

It is about the decision you take upfront about the viability of the investment decision you are about to take, and it is driven by demand and supply.

CHAIRPERSON: Ja, but the difference being that, we are just trying to understand, if for example you are to look at, let us make an example of Sandton, if you look at Sandton as a shopping centre, so you want to, is there a base figure, base amount of what the rental is there and therefore, let us say you have got a smaller player that is paying R150 and there is a Woolworths and Woolworths is paying R50, can we take it that you have been given a two thirds discount to the rental?

So what would be the price of the rental, what is the price of the rental in that shopping centre, or does it become commoditized in the sense that it is about what you are able to negotiate and what you are not able to negotiate as a player?

MR DE VILLIERS: Madam Chair, I wish we could pay those kind of rents in Sandton, we would love to.

CHAIRPERSON: Per square metre, per square metre.

MR DE VILLIERS: Per square metre, no, no, I understand. Firstly, the line stores we sign up for 10 years and we lock into a rental agreement over a period of time.

The small line stores sign up for three years, so his rent levels are very different. If there is lots of vacancies, the rent will be much lower, if there is a big demand and they have a long list of tenants that want to come in, the rent can go up to R1 000 per square metres for the small tenant.

So you are trying to compare and take a snapshot now of what somebody pays per square metres, relative to us who signed a deal twenty years ago and trying to compare the two agreements. It is not … [intervenes]

CHAIRPERSON: Comparable.

MR DE VILLIERS: Ja.

CHAIRPERSON: Okay, thank you.

Alright, thank you very much, we have no further questions.

Thank you very much for your submissions.

MR DE VILLIERS: Thank you.

MR SONN: Thank you, chair.

HEARING ADJOURNS

- - - - - - - - - - - - - - -