Managing Director's Operating Review

Two acquisitions show our strategy in action

2022 was a year of recovery, in which we started to see a return to 'business as usual' after the extraordinary events which have shaped all our behaviour since March 2020. Both on our own account through our trading businesses, as well as in the wider context of the huge change unfolding within the Kingdom itself, it was a year of acceleration and opportunity after three years in which those facets were in short supply.

Strategic developments

During the year, through the Company's wholly owned subsidiary Future Retail for Information Technology Company ('FRIT'), we acquired an effective 85.3% stake in Ykone S.A.S ('Ykone'), a profitable international influencer marketing agency with a proprietary technology offering, focused on travel, beauty, fashion and luxury brands, with a presence in Europe, Asia, the US and the Middle East. Ykone provides end-to-end services on strategy, talent management, content production and monitoring to more than 200 leading brands across the globe including the MENA region. This strategic investment positions us strongly to make the most of the significant opportunity which lies ahead in retail e-commerce through best-in-class digital marketing, and to further deepen our e-commerce value chain.

We also acted decisively in 2022 to increase our online sales as a proportion of total revenue. Moving towards fully owning the customer experience and better integrating our online offering, through FRIT in July we acquired 62% of the shares of International Applications Trading Company Ltd ('IATC'), the company which developed and currently operates the Danube and BinDawood e-commerce channels. As part of the transaction agreement, BinDawood Holding will invest a further amount of up to SAR 160M in IATC over a two-year period to support the development of the platforms and the roll-out of a network of state-of-the-art dark stores and fulfilment centres to optimize operations, fully integrate the customer experience and provide shorter lead delivery times. To this end, ten fulfilment centres were opened during 2022.

Looking to the future, and having demonstrated in 2022 that we can successfully make appropriate acquisitions, we are confident in our ability to explore further inorganic growth, particularly in other GCC markets which provide a natural opportunity for growing revenues both organically and through our enhanced online platform.

One significant development towards the end of the year was the announcement by the Ministry of Hajj & Umrah that the pilgrimage in 2023 will revert to 'open' Hajj for the first time since before the pandemic. In the two Holy cities, Mecca and Medina, the buying power of our local customers is directly affected by the number of international pilgrims. In 2023, when the limit of 1 million pilgrims is lifted, the number of visitors will revert to former levels almost instantly. This will have an immediate impact on the disposable income in circulation in that region, which in turn will reflect significantly higher sales for BinDawood and Danube branches in those locations, as indeed it will in the hotel and restaurant sectors. Pre-pandemic, annual sales directly associated with the pilgrim market represented 15% of total revenue; in 2022 this number had fallen to 12%. In 2023 we anticipate that it will return to approximately 15%.

Going forward, our immediate strategy is to reduce costs rather than to raise prices. We began this cost reduction process in 2022, as evidenced by the investment we have made by bringing further strength and experience into our commercial team. They are now engaging with our trusted partners and suppliers to agree more favourable terms, whilst simultaneously we have begun reducing the number of non-performing items on our shelves. This new strength on the commercial side has already started to help us to recover our gross margins, for which the first evidence came through in Q4 2022.

Our employees are critical to our future, so we have started a programme aimed at seeking out efficiencies in the way our stores are staffed and to encourage greater levels of productivity. We encourage our employees to think and behave like owners of their branches, so that every branch remains profitable – our fundamental objective as a business. We also invested in the development of a new HRMS (Human Resource Management System) during the year. This will shortly bring significant benefits for all our employees in terms of better and faster access to their own comprehensive information and will go live in H1 2023.

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Managing Director's Operating Review (continued)

Our strategy is underpinned by a significant expansion of our dark store footprint, with the stated intention of growing our dark stores from under 10 around Jeddah in the Western Region to more than 50 across an expanded geographical area to include Dammam in the Eastern Region and Riyadh in the Central Region. Testing of this new operating model was carried out successfully throughout H2 2022 in the Jeddah region. The ingredients for success are undoubtedly there: consistently high customer demand, a larger and more localized collection of dark stores each covering a smaller catchment area, more vehicles and staff to service the execution and delivery requirements and, as a result, significant sales growth. The operational planning and investment in technology in Q4 which sits behind this refreshed model is now delivering results – the very significant growth in monthly online sales from approximately SAR 3.3 million in Q3 2022 to SAR 4.8 million in Q4 2022 has given us full confidence to keep the shelves stacked high, with increased levels of product availability across our range.

We are building a fully automated 'mega dark store' run by robots in Bahra, located between Mecca and Jeddah, spanning some 16,000 square metres. This state-of-the-art operation will be delivered in H2 2023 and will be complemented by the new fulfillment centres we created in 2022. Our strategy to open more stores, in more cities, will allow us to deliver goods to our customers faster and more easily, with an overall delivery target of 'under 30 minutes' as against an approximate average of one hour at present.

Operational and Financial performance

Sales in 2022 were 11.7% higher than those for 2021, as we saw shoppers returning to our stores and responding positively to our loyalty program launched earlier in the year.

Operating expenses for the year to December increased to SAR 1,294.7M, reflecting higher employment costs, expenses associated with branch openings as well as acquisition-related costs. Net profit declined to SAR 124.7M in 2022 as compared with SAR 240.6M in the prior year, reflecting the impact of higher operating costs which could not be fully offset by the higher gross profit and other income. As a result of all these factors, the net profit to sales ratio slipped to 2.5% in 2022 from 5.5% in 2021. The financial position of the Company continued to be strong. At year end, the Company had no debt and a cash balance of SAR 509.3M, an increase of SAR 25.2M as against 2021.

In 2022 we worked hard to protect our market share. Our immediate priority was to ensure we regained customers who had naturally drifted away during the pandemic and in order to speed up that process we embarked on a heavily discounted promotional campaign. During this period we saw an increase in our market share which, coupled with deliberately reduced margins, left us better placed from a strategic perspective by year end. Our strategy was to increase sales and, by doing so, to increase the overall numbers of customers. Average basket sizes naturally dropped, owing to our decision to reduce prices, but the lower transaction sizes increased the number of customers in our stores which was our primary aim.

This increase in the number of customers, coupled with the investments we have made in our online offering through enhanced technology, together with our expanded store footprint, leaves us well positioned to grow revenues in 2023. This objective is well supported by our new loyalty programme, which attracted over 3 million members in 2022.

Simultaneously with this increase in customers, as mentioned above we started the process of reinforcing the commercial side of our business in anticipation of a sales drive in early 2023. This powerful combination of an enhanced commercial team, together with a larger base of highly incentivized and loyal customers, should enable us to recover margins in the year ahead. In a year when Hajj will return to former levels, this bodes well for a sustainable recovery in 2023 and beyond.

Outlook

Businesses across the whole world are facing unexpected headwinds of one kind or another in this post-Covid era and we are no different. What we do have on our side, however, is vast experience in leading our sector in the Kingdom, new inorganic growth in the shape of two important acquisitions and an economic landscape which is primed for continued progress as the Kingdom drives ahead with delivering Vision 2030.

The return of pilgrims to former levels in 2023 will greatly assist our own return to the revenue levels of the recent past; we have a keen eye on costs as we expand our geographic footprint and reach into new markets with new formats; the two acquisitions of 2022 are both making immediate and meaningful differences to the execution of our strategy and to our wider financial performance; our investment in market-leading technology is starting to allow us to deliver better and faster customer experiences; and the strengthening of our leadership on the commercial side of our business is beginning to help us recover our margins to former levels.

Our vision remains to be the best grocery retail brand in Saudi Arabia, where the dynamic economic landscape genuinely presents a future full of opportunity for all our stakeholders: our loyal customers, our dedicated staff, the expanding communities in which we operate, and our current and future shareholders.

Khalid BinDawood
Managing Director