

Entry in new markets: development of a discounter in Perú

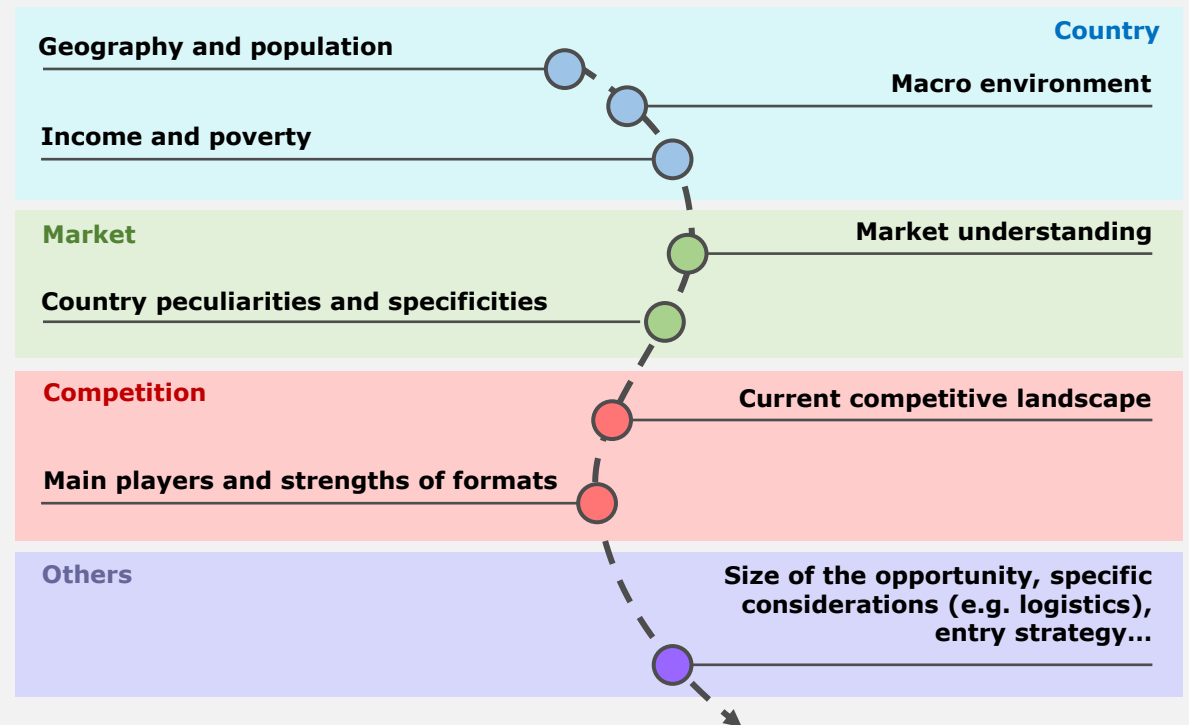
Is there potential to develop a discount format in the Peruvian grocery market?

At some point, when retailers reach a certain size, state of maturity and financial stability, question marks on new avenues for growth start to arise. Consequently, possibilities for expansion in new countries flourish and with them, a good number of uncertainties: is there space for me in the new country? How is the market situation? Which are the competitive threats? Which is my potential?

When **evaluating the entry in a new market** it is key to perform a **thorough country, market and competitive landscape analysis** in order to **determine the viability of the project** and **size the opportunity**. In our view, it is essential to **understand the key drivers** and **peculiarities of the market** and analyze the differences and **adaptations vis-à-vis core geographies** to reach a solid conclusion on the feasibility of the opportunity.

With all the information in their hands, management and shareholders are in a better position to make a proper decision.

*In order to have a **holistic and truthful market understanding** on which to base our decision on **whether or not to recommend to pursue the market opportunity**, we conduct a deep dive on the market and its competitive situation. For this, **we perform a desktop analysis**, but we always complement it with an **extensive groundwork** to understand in-situ each player's positioning, price level, commercial formula, strengths and weaknesses... Moreover, we also conduct a **thorough customer research** to add more clarity to our understanding.*

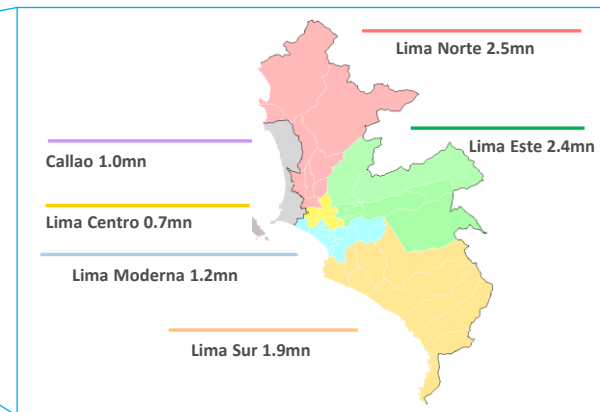


Market opportunity, main advantages and potential drawbacks

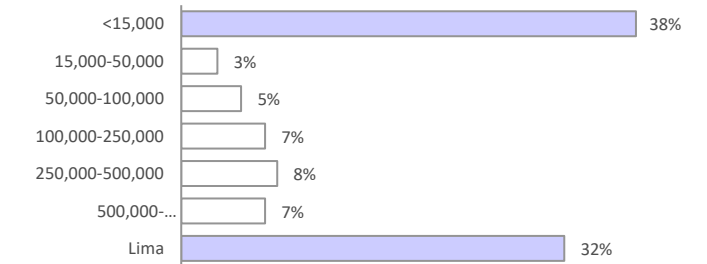
Perú is a country of c.31 mn inhabitants with a strongly **polarized population structure**: most Peruvians live either in small towns or large cities and approximately **one third of the total inhabitants reside in Lima**, the capital.



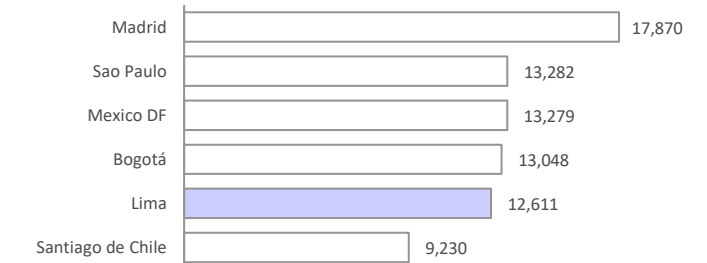
Cities	Inhabitants	%
Metropolitan Lima	9,904,727	32%
Arequipa	869,351	3%
Trujillo	799,550	3%
Chiclayo	600,440	2%
Iquitos	437,376	1%
TOP5	12,611,444	40%
Piura	436,440	1%
Cusco	427,218	1%
Chimbote	371,012	1%
Huancayo	364,725	1%
Tacna	293,119	1%
TOP10	14,941,334	48%
Rest	16,685,765	54%



Structure of population | Breakdown by size of cities - 2015



Inhabitants per km² | Urban areas - international benchmark



Geographically, **Peru is a complex country** as the Andes mountains run parallel the country's pacific coast, **dividing the territory between coast (the most populated area) and mountains + jungle**. This **complicates logistics for retailers** and makes coastal areas, especially **Lima** but also he north, the **most interesting areas**.

The country is less developed than leading LATAM economies but Peru exhibited the **highest growth among the largest geographies in the region** during the last years. Besides, its forecasts are also very optimistic.

Lima Metropolitana (consisting of the urban areas of Lima and Callao) **concentrates almost half of the country's wealth** (48% of the total households' income).

The **majority of the Peruvian population** belongs to the **lowest socioeconomic stratus** (c.70% of the inhabitants correspond to the D and E SES), while middle class (SES B and C) represent a much lower proportion (only 27%). However, **middle income population in the country has a higher relevance than the average of LATAM.**

There are **remarkable characteristics and living standards** that impact the grocery retail sector **which favour proximity formats.**



The **limited ownership or access to vehicles** influences the average distance customers are willing to travel to conduct their purchases (only 11% of the population).



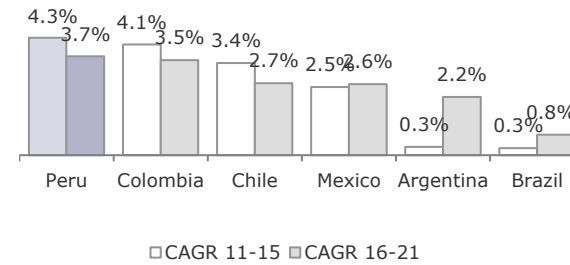
The **lack of fridges in the country** (c.50% of the Peruvians do not own this appliance) implies that food cannot be safely stored for long periods, therefore increasing the frequency in purchases and diminishing the sizes of the baskets.



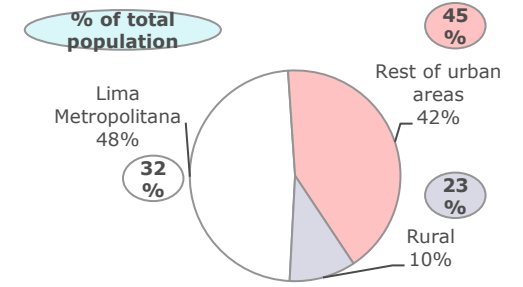
Moreover, **reduced living space** implies that households have limited stocking space and prefer purchasing necessary items daily rather than stocking up large baskets.

Furthermore, these characteristics are **considerably more pronounced in the lowest socioeconomic groups.**

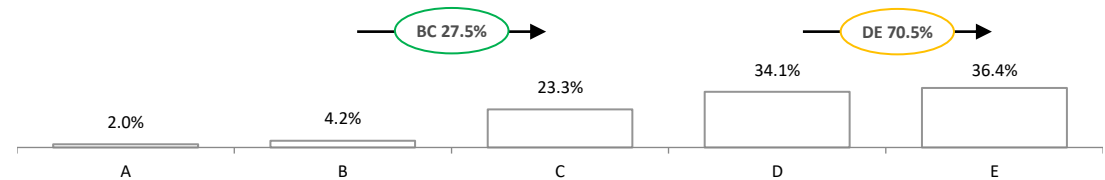
GDP evolution in local currency | Constant prices – % – CAGR 2011-2015 and 2016-2021



Distribution of income | Breakdown by Lima Metrop. vs. rest of areas – % of total – 2015



Population by SES level | % – 2016



Food consumption represents 27% of the total household expenditure (very large proportion indicating that grocery value formats will be well-accepted). However, **eating out is also relevant in the country** due to long distances between residential and working areas, poor infrastructure, and dense traffic.

The **average annual per capita expenditure of Peruvians in food and beverages amounts to USD613**, one of the lowest figures among LATAM countries, but a strong growth is expected in the forthcoming years. However, **grocery consumption in the wealthiest areas is notably higher** (i.e. c.25% more than the average in Lima Metropolitana).

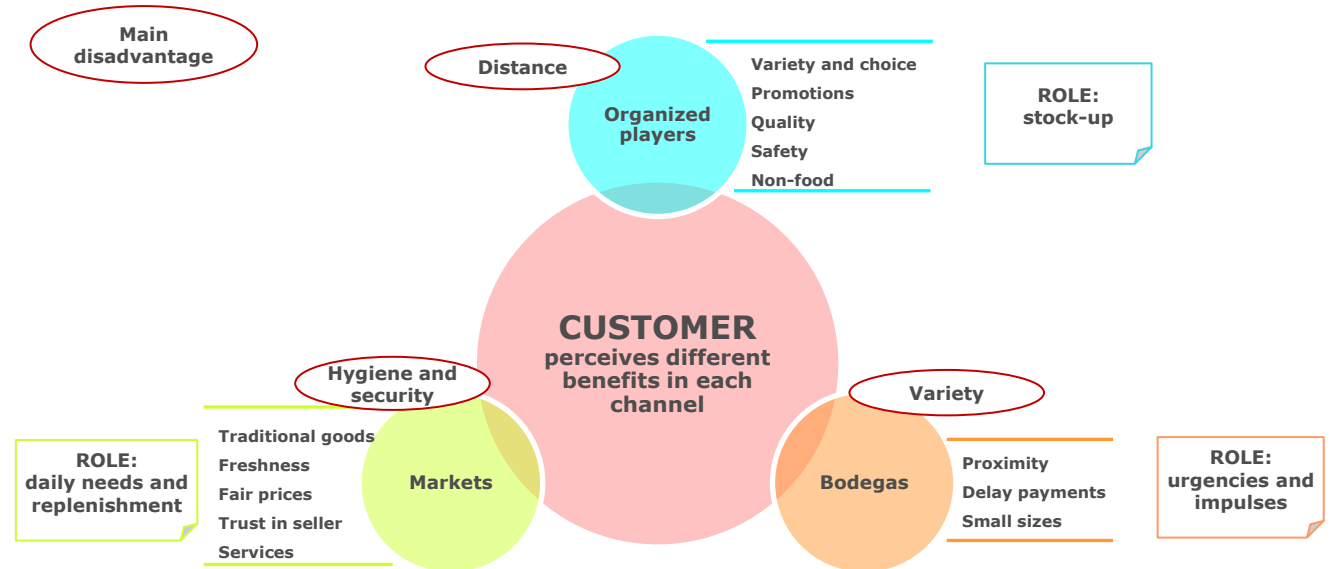
Grocery expenditure per capita | Benchmark – USD



The market shows a **very low modernization level** with a strong dominance of traditional players, **open markets and “mom&pop shops”** locally known as bodegas, which **account for c.80% of the total food retail**. In markets, the main products customers can find are **fresh goods** (F&V, Meat and Fish), legumes and condiments, however, **markets offer other products and services**, ranging from ready-to-eat or footwear to even electronics and beauty services. **Bodegas are traditional small shops** (usually of less than 20 sqm) with a **limited assortment of convenience** (cold drinks, alcohol, tobacco...) and replenishment categories.

On the other hand, **modern grocery distribution (MGD) accounting for the remaining 20%**, has one of the lowest representations in the continent, far behind neighbouring countries such as Argentina, Colombia and Brazil with figures over 40%.

Main benefits, disadvantages and roles of each channel



Hypermarkets is the channel with the strongest footprint in Perú, representing close to **70% of the total sqm** of the modern market. As a secondary format, **supermarkets** (mainly semi-attraction formats) **show a significant but much lower weight**, with only 25% of the representation. **Discounters and convenience formats are clearly underdeveloped** in the country, however, both have shown a **considerable growth in recent years**, triggered by the entry of new banners.



308 stores



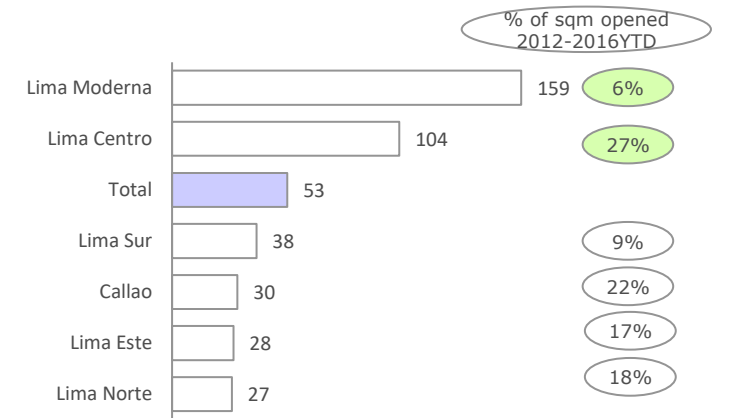
26 sqm/1,000 inhabitants

Given the weak relevance of MGD in the market, **competition is relatively low**: the country shows **one of the lowest densification figures of the continent**, with an average of 26 sqm/1,000 inhabitants, far behind geographies such as Colombia or Brazil. **Departamentos in the coast** (especially Lima, Ica and Lambayeque) are the **most competitive areas**.

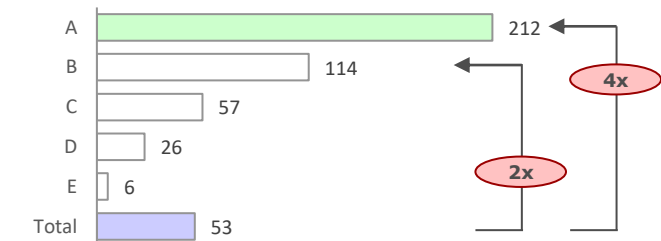
The total number of modern grocery shops in Perú is very low and **amounts to only 308**. MGD is **mainly concentrated in Lima**, especially in the wealthiest neighbourhoods while the rest of areas are usually virgin regions controlled by traditional. **MGD presence increased notably in the last years** and companies are growing mainly in the capital, but are starting to expand to other regions.



Sqm per th inhabitants | Breakdown by districts



SQM/th inhabitants | Breakdown by socioeconomic level – 2016YTD

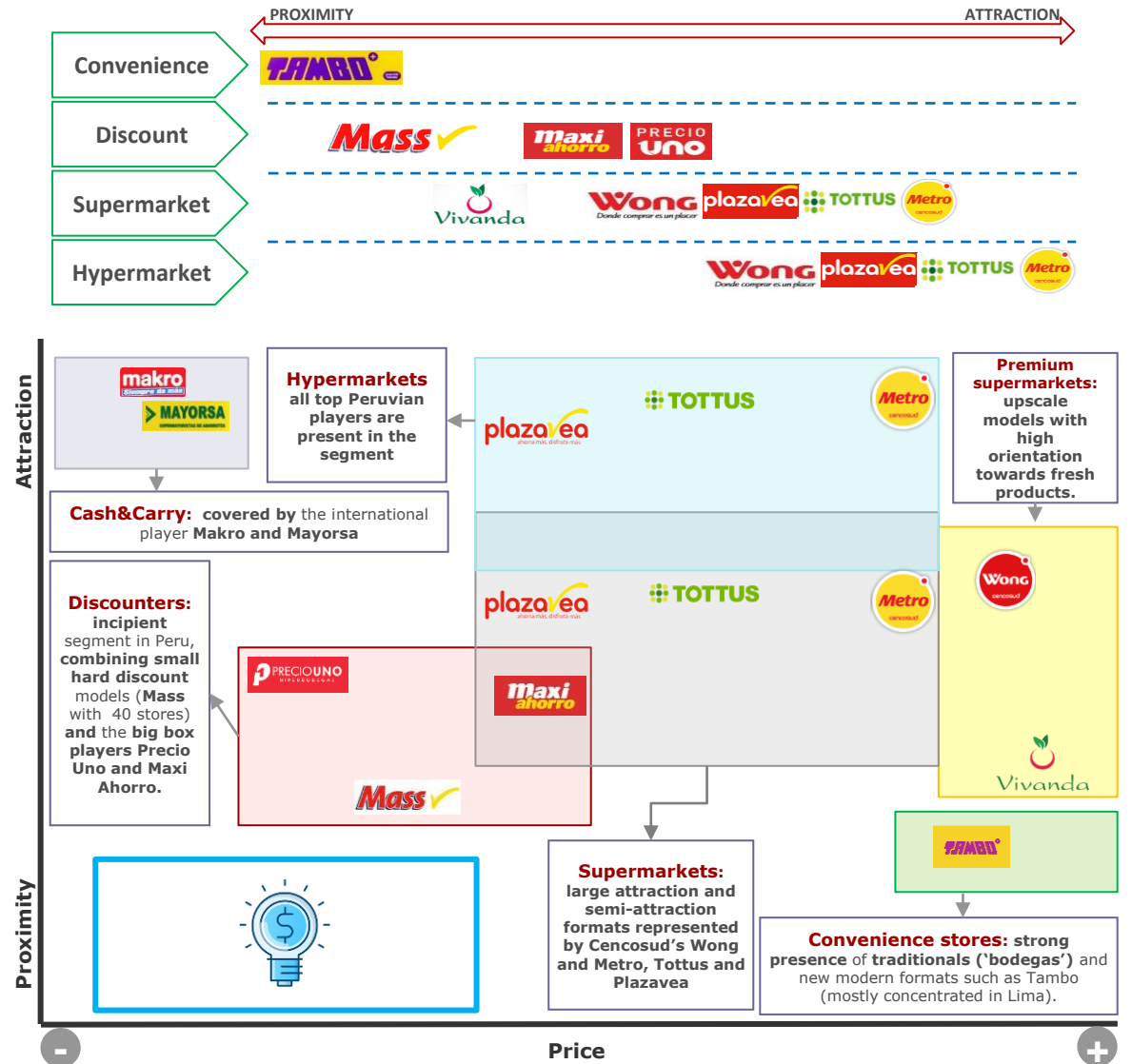


Grocery market is very concentrated and the top 5 companies represent 98% of the MGD. There are **three main organized groups in Perú: Cencosud, Supermercados Peruanos and Falabella.** Cencosud is only focused on the hypermarket and supermarket segments, while Supermercados Peruanos and Falabella have also a modest footprint in the discount channel.

The majority of stores operated by MGD players in Peru **are large boxes** (70%) intended for attraction shopping. There is a **very limited presence of proximity players** and only the convenience stores Tambo, some Mass discounters and supermarkets Vivanda operate in this segment.

The discount format still has a marginal presence and most of the stores of this segment are located in Lima. Mass is the player with highest number of shops, although it operates only 40 points of sales. However, in our opinion, Hiperbogedas Precio Uno (with only 4 stores), operates the most compelling model.

On the other hand, **mass market formats are more widespread.** Plazavea is the leader of the channel, but, in our opinion, Tottus exhibits the most attractive commercial proposition. However, there is a **low differentiation between mass market players.**



Once our analysis is done, we are in a good position to recommend or not this strategic movement and start discussions with management on how to pursue this opportunity.