

# Korean Discount Brands: Another Aldi is Born

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## Executive Summary

Similar to other countries like the UK and Australia, the discounter model is taking form in Korea and transforming food retail and distribution. The so-called “hard discounter” model has worked well in countries where consumers have not been made nervous by repeated food safety issues, wages are sufficiently high, and prices are elevated enough that discounters can provide more than a 20% discount against national brands. Considering

Korea's current weak domestic consumption patterns, we believe that the hard discounter format will be well-accepted by local Korean consumers.

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## New Store Formats Gaining in the UK

Source: Bernstein, Mirae Asset Global Investments (2017)

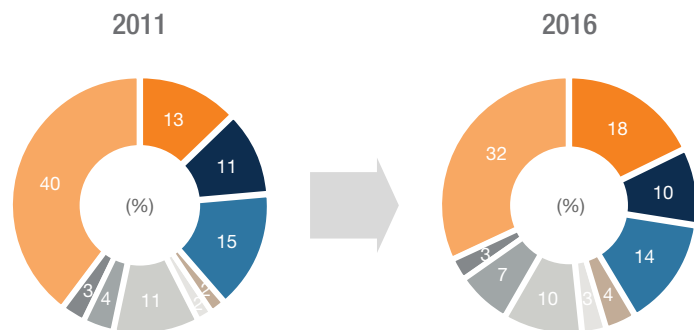
Share of Market	Super/Hyper	Convenience	Non Grocers	Hard Discount	Online	Bargain Stores	Non Grocers Owned by Grocers
2010	56.2%	19.5%	17.5%	3.2%	2.2%	1.0%	0.5%
2011	55.7%	19.9%	16.7%	3.4%	2.5%	1.2%	0.6%
2012	55.4%	20.5%	15.5%	3.7%	2.9%	1.4%	0.6%
2013	54.2%	21.2%	14.4%	4.4%	3.4%	1.7%	0.7%
2014	52.0%	21.8%	14.1%	5.3%	4.1%	1.9%	0.8%
2015	50.2%	21.9%	14.1%	6.2%	4.7%	2.2%	0.8%
2016E	48.6%	22.1%	13.9%	7.0%	5.3%	2.3%	0.9%
2017E	47.1%	22.3%	13.6%	7.7%	5.9%	2.5%	0.9%
2018E	45.9%	22.6%	13.3%	8.2%	6.5%	2.5%	1.0%
2019E	44.8%	22.8%	13.0%	8.7%	7.1%	2.6%	1.0%
2020E	43.9%	23.0%	12.7%	9.1%	7.6%	2.6%	1.0%

“No Brand” is the first such hard discounter to have been introduced in Korea, and the company aims to undercut national brand pricing by 40%. No Brand will be operated by E-Mart, the leading grocery retailer in Korea.

### Korea Retail Market Breakdown

Source: KOSIS, Retail Magazine, Citi Research, Mirae Asset Global Investments (2017)

■ Online ■ Department Store ■ Hypermarkets ■ Duty-Free Stores  
■ SSM ■ Mom & Pop ■ CVS ■ Home Shopping ■ Others



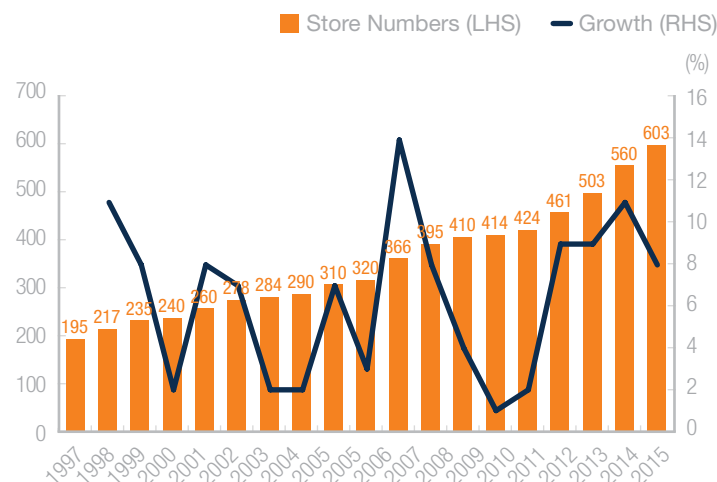
### Aldi Case Study

Before exploring No Brand in Korea, it is worth considering the history of Aldi, a private German company started in 1961. Aldi has been a disruptor in the space and has proven its business model in many developed markets, notably in the UK and Australia. Aldi’s business model rests on two pillars: sharply lower costs compared to normal grocery operators and complete domination of private offers (contributing to more than 90% of Aldi’s total sales).<sup>1</sup> The key for Aldi’s business model resides in delivering high-quality private labels of similar quality to that of national brands at 20% lower pricing.<sup>2</sup> Since the firm pursues a lower-than-industry pricing strategy, gross margins tend to register several percentage points lower than that of competitors’. Operating costs are also substantially lower than those of peers. Aldi hires a considerable number of math graduates every year because the firm does not identify itself as a retailer, but rather as a process engineer continuously striving to find a way to move products in the quickest and easiest manner possible.

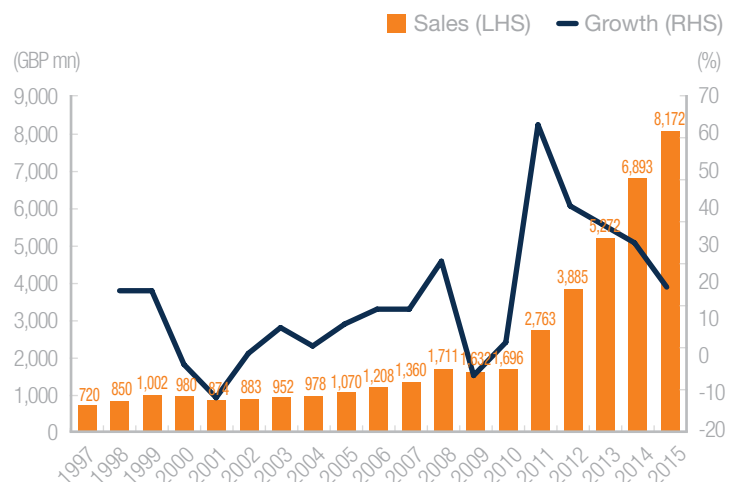
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### Store Numbers and Openings Growth (Aldi UK)

Source: Kantar, Planet Retail, Bernstein Analysis (2017)



### Sales and Sales Growth (Aldi UK)



<sup>1</sup> Company Disclosures, Mirae Asset Global Investments (2017)

<sup>2</sup> Discussions with former Aldi Group Managing Director of the UK and Ireland

Property and staff account for more than half of the cost base for a typical grocery store. On the property expenditure side, Aldi tends to build its own stores, leveraging in-house expertise on the development of maximally cost-effective store formats. Not only does this drive higher sales leads, such store configurations reduce land costs per square meter compared to peers. The biggest cost differential originates from labor inputs, as typical grocery operators spend around 8-9% of sales on staff, whereas this figure stands only at 3% for Aldi.<sup>3</sup> As an example, an average US supermarket of 1,000 square meters earning USD 750K sales per month would employ 60 personnel, of which 40 would be full-time employees including a store manager. On the other hand, Aldi would have a headcount of 12 for a comparable store.

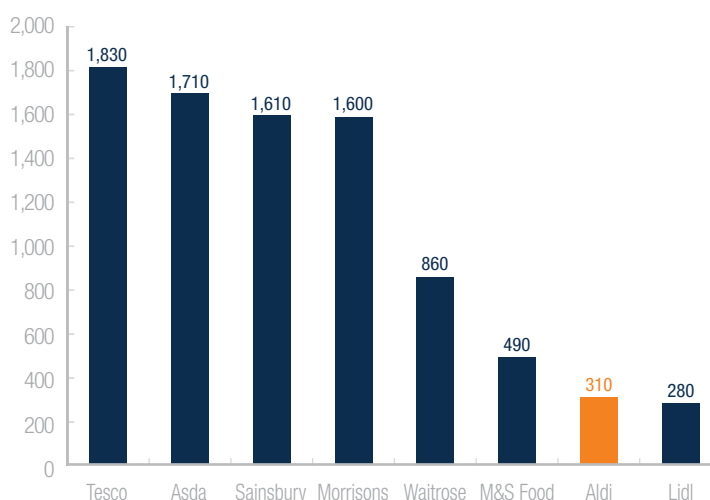
How is this possible? Aldi's differentiated efficiency draws from two major tasks – replenishment of products and the check-out process. Concerning replenishments, the traditional food retailer would send goods from a manufacturing plant to a proprietary distribution center for repackaging prior to transporting to the individual store. Once the product arrives at the store, it would be unloaded and unpacked for shelf presentation for customer selection. In contrast, suppliers for Aldi produce private label products in a shelf-ready packaging format at the factory level. While the package may also pass through Aldi's warehouse, it remains there for a comparatively short period (one or two days). Upon store arrival, truck drivers will bring the pallets into the stores as consumer-compatible units, thereby avoiding packaging or unbundling processes. The first to touch the product is the individual shopper. Aldi's workforce only places the pallet into position and removes empty pallets.

More importantly, mainstream supermarkets carry between 25,000 and 40,000 stock keeping units (SKUs), whereas Aldi only offers around 1,300 SKUs to cover 75% of the breadth in categories.<sup>4</sup> Moreover, check-out times for Aldi are three to four times faster than main competitors. Aldi's cashiers can scan roughly 45 items per minute thanks to longer counter belts (twice

the conventional length) in conjunction with multi-dimensional, expanded bar codes for immediate scanning.<sup>5</sup> Lastly, the scanned items are placed back into trolleys so that customers independently finalize packaging outside, which reduces waiting time for the following customers. Until now, this model has worked well in countries with more expensive price points to match higher wages, which we believe is the case in Korea today.

### Number of Products to Fulfill 50% of Sales

Source: Store Visits, mySupermarket, Kantar, Which?, Bernstein Analysis, Mirae Asset Global Investments (2017)



### E-Mart and No Brand

E-Mart launched its No Brand products in 2015 with sales of less than KRW 30 billion, which jumped to KRW 190 billion in 2016. The company has about 50 new stores planned for 2017 with medium-term targets of KRW 1 trillion in sales by 2020. The firm has already launched 1,000 product SKUs and is aiming for 1,200 SKUs by 2017.<sup>6</sup>

<sup>3</sup> Ibid

<sup>4</sup> Discussions with former Aldi Group Managing Director of the UK and Ireland

<sup>5</sup> Ibid

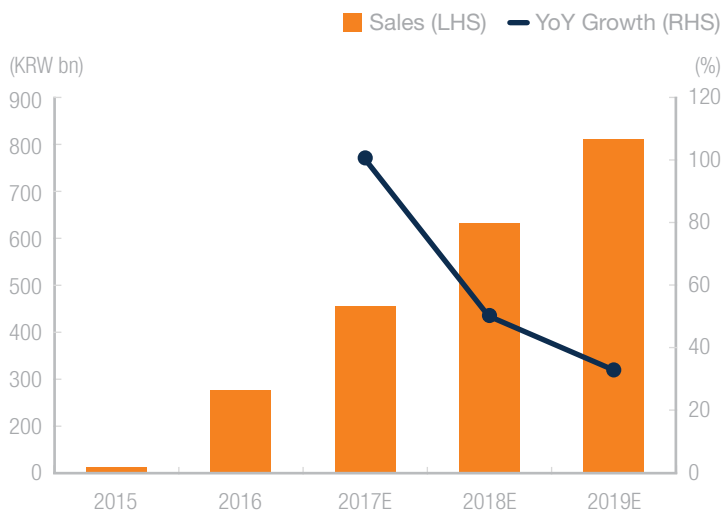
<sup>6</sup> Mirae Asset Global Investments (April 2017)

We channel checked one of the No Brand stores at Hanam Starfield Mall in Seoul last December and found similarities to an Aldi store that we visited in Sydney, Australia in terms of the store

atmosphere and complete merchandizing of private brands. As a matter of fact, E-Mart benchmarks against Aldi for their No Brand stores.

## No Brand Sales Trend and Forecasts

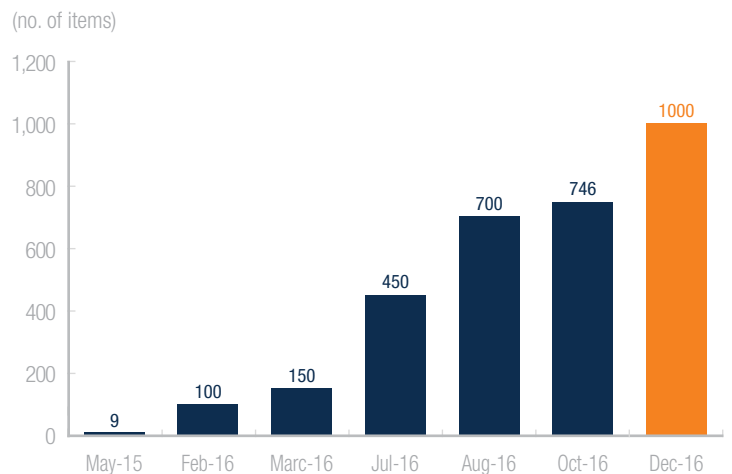
Source: Company Reports, Citi Research (2017)



When Aldi enters a new market the initial hard work is centered on local consumers' habits and tastes. It also requires time to form a strong supplier base via a trial and error process. E-Mart is a leading food retailer in Korea that already enjoys an intimate understanding of Korea's tastes and habits. The group also enjoys sourcing power as they have nearly 38% market share in the hypermarket industry.<sup>7</sup> This has helped E-Mart produce 1,000 No Brand SKUs in less than two years. In fact, it was interesting to hear that the hit products for No Brand were not commodity products like tissue or water, but instead, chocolates, butter cookies, potato chips, and even diapers. These categories suggest that the quality gap often associated with no name discount brands is something that E-Mart seems to have solved by producing quality products that meet or exceed the expectations of shoppers. Nearly half of the products are sourced

## No Brand Number of SKUs

Source: Company Reports, Merrill Lynch (2017)



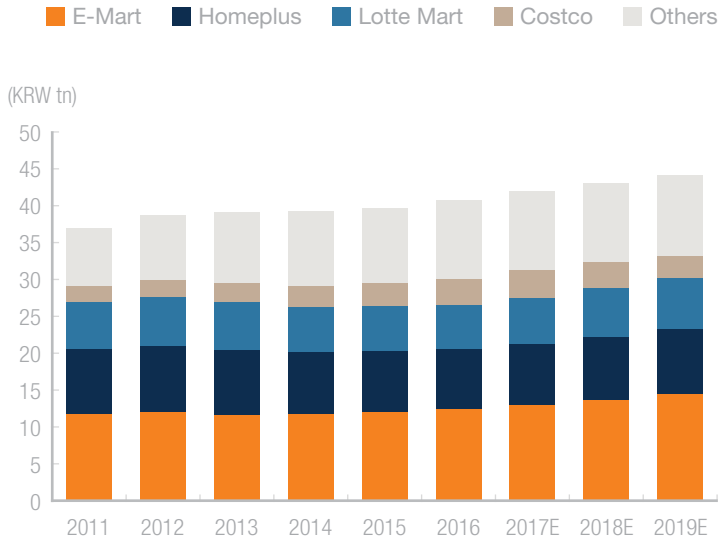
from overseas, mostly in Southeast Asia. For instance, the potato chips are produced by the same original equipment manufacturer ("OEM") that makes Frito-Lays chips in one of the Southeast Asian countries. Multinationals make exceptionally strong returns on capital employed in Emerging Asia partially because they usually outsource manufacturing.

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<sup>7</sup> Euromonitor, Mirae Asset Global Investments (2017)

## Korean Hypermarket Revenues

Source: Company Disclosures, Citi Research Estimates, Mirae Asset Global Investments (2017)



Multinationals typically build a factory to meet their quality standards and then sell the factory to third parties to thereafter closely monitor them, which drastically reduce their costs. Thus, it has not been difficult for E-Mart to find quality OEMs overseas. Many Korean manufacturers are running at sub-optimal utilization rates, making it easier to find good suppliers that are often ranked number 3 or 4 in the industry, and even leading players at times.

E-Mart was a Korean stock market darling during the heydays of hypermarket formats but it has gone through its fair share of difficulties in the past several years. Now, fresh investments into formats like Online and Traders (warehouse style supermarket similar to Costco) have become the new growth drivers for the company. As long as No Brand can deliver quality products at materially cheaper price points than national brands (40% or more), the format should work well without any major competitors present in other developed markets. We believe No Brand is to become the dark horse for E-Mart and the Korean food retail industry as a whole in the foreseeable future.

## No Brand Store in Hanam (Seoul, Korea)

Source: Mirae Asset Global Investments (2017)



## Complete Set of Merchandising

Source: Mirae Asset Global Investments (2017)



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