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9B19M017

Supergroup limited/SOUTH AFRICA: Contextual leadership from TURNAROUND TO STRATEGIC niche

Caren Scheepers and Mike Ward wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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On January 9, 2018, Peter Mountford, chief executive officer (CEO) of the logistics company Supergroup Limited (Supergroup),[[1]](#footnote-1) was considering his dilemma while on his commute to Supergroup’s head office in Morningside, Sandton. Glimpsing Sandton City’s Mandela Towers through Johannesburg’s early morning sunlight, Mountford reflected on South Africa’s slow development since Mandela’s release from prison and the first democratic election in 1994. Earlier in the week, shareholders had asked Mountford’s executive team whether Supergroup should be focusing its investment strategy outside Africa. Mountford, too, was concerned about the Supergroup’s concentration in Africa and had been pondering the ideal weighting of offshore activities. He observed that Supergroup’s strategy was being informed by its history.

career experience

Mountford’s early career with the South African Breweries Limited had introduced him to the art of turnarounds. Later, his experience with Rand Merchant Bank Holdings provided Mountford with a strong foundation in banking. In 1998, his yearning for a hands-on management role, together with his strong financial skills, attracted him to Supergroup, where Mountford assumed responsibility at the Group, which was a leading transport logistics and mobility group providing end-to-end supply chain solutions, fleet management and dealership services.

Sadly, Mountford’s experience managing the Group’s logistics was not optimal. At that time, Supergroup’s strategy had been to minimize ownership of assets, focusing instead on technology and software—the intellectual capital of an integrated supply chain solution (a concept known as “fourth party logistics”). Trucks, warehouses, and equipment were sourced as required from other parties, making planning complex and eroding profit margins. Mountford did not concur with this strategy and instead joined Supergroup’s biggest competitor, Imperial Group Limited, taking charge of its consumer logistics division for the next eight years.

Mountford’s return to Supergroup in 2009 as the urgently recruited “turnaround” CEO was seared into his memory: over the preceding 18 months, Supergroup’s share price had plummeted precipitously from R15[[2]](#footnote-2) to 40 cents, obliterating R6.1 billion of shareholder value (see Exhibits 1–2). Mountford and his executives were summoned to meet with 18 banks, to which the company collectively owed more than R3.6 billion. Mountford was offered 30 minutes to present reasons why Supergroup should not be placed into liquidation. It was the toughest session of his career. Mountford later called his wife, telling her he had potentially made a mistake and should never have accepted the challenge. However, some minutes later, he received a phone call from one of the larger banks that had attended the earlier meeting. Mountford was informed that several of the bankers at the meeting supported him, offering testimony to his competence; they agreed to support his efforts to turn around Supergroup.

2009: Survival

In 2009, Supergroup posted a loss of R1.4 billion, market capitalization was R360 million, and the balance sheet reflected R3.6 billion in debt. Immediate action was required, and the strategy was obvious: stop the bleeding, sell underperforming assets, and refinance the debt—but not necessarily in that order. The banks had agreed to bide their time, giving support as much as possible. Once management earned the right to survival, they needed to rethink their strategy.

It was imperative to cut costs; the corporate structure was overstaffed, and expenses were high and represented a “low-hanging fruit” opportunity. For the year ending June 2009, corporate costs had been R116 million. A year later, these were less than R72 million. The corporate structure had been reduced dramatically. A voluntary mass exodus of staff from various divisions, fleeing the struggling company, proved fortunate: Supergroup was largely able to avoid traumatic and expensive retrenchments and rationalizations.

In the preceding years, Supergroup had diverted from their core logistics activities and invested heavily in retail—namely, Mica Hardware (Mica) stores and AutoZone South Africa (AutoZone), an automotive spare parts retailer. Together, they accounted for R350 million of the R1.4 billion loss. In contrast to competitors, Mica’s franchised stores were focused on the do-it-yourself market (versus building materials) and were in expensive shopping centres in Gauteng and Western Cape provinces in South Africa. Mountford’s efforts to sell Mica to retail giant Massmart Holdings Limited elicited an offer from the franchisees, who also guaranteed R207 million of debt in arrears, making sale to the franchisees an attractive exit strategy. Mountford was also able to sell AutoZone at a good value, securing R435 million. In total, the sale of these two companies reduced debt to about R2.7 billion.

Supergroup had also taken on the importation, assembly, and distribution of a range of Chinese trucks—a disastrous deal with high turnover and an operational loss margin of 18.8 per cent. Mountford decided to exit the business immediately because the price differential between the Chinese trucks and the mainstream trucks from Europe and the United States was less than 10 per cent. Mountford was able to negotiate a debt-for-equity swap with some of the Chinese officers of the banks concerned, which removed a R500 million loan associated with this division.

In October 2009, Supergroup raised additional capital through a highly dilutive rights issue of 2.5 billion shares. For every 100 shares owned, shareholders were offered 410 rights-offer shares at 45 cents—a significant discount to the closing share price of 96 cents. Lenders and minority shareholder Allan Gray agreed to underwrite the offer, ensuring a R1 billion capital inflow to strengthen the balance sheet. Management intended to run the Group at a maximum interest-bearing debt-to-equity ratio to shareholders funds of 40 per cent, despite several analysts decrying the new gearing levels as very conservative.

By 2012, all the businesses were performing relatively well, and Supergroup achieved zero borrowing. Initially, all assets in Supergroup were held as security by the banks, and it had taken almost a year to regain control. Over this period, Colin Brown, Supergroup’s chief financial director, struggled to finalize various debt restructuring deals; it was only once the Group achieved zero net borrowings in June 2012 that future facilities could be finalized.

Dealerships

After the disposal of Mica and AutoZone, Mountford had to decide whether to retain Supergroup’s motor vehicle dealerships. The automotive industry was highly cyclical, and new car sales had been decreasing in South Africa over the previous two years. In 2010, Supergroup owned 15 dealerships, each generating positive earnings but with very low margins, at 1.5 per cent operating profit as a percentage of sales as opposed to the market leaders’ margins, which were almost double that at 2.8 per cent. The executives wanted to retain these businesses because they perceived them as excellent brands in South Africa with loyal and dedicated employees. Mountford was convinced that the dealership team, headed by dealership CEO Graeme Watson, was world class, and, if awarded appropriate capital, they could turn things around.

A further consideration was that dealerships were largely self-funded—once adequately capitalized. Dealerships were largely funded on floor plans, as a result of which they could operate on a zero-working-capital basis. With appropriate gearing, the return on investment could be over 30 per cent. Watson and Mountford believed that the team could improve their operating margins to 3 per cent—which they ultimately achieved, with R34 million before tax profits from the South African branches in 2010. Over the next few years, the number of dealerships in South Africa increased to 56, representing the retail requirements of major commercial and passenger fleets of most South African manufacturers. Since 2016, Supergroup had purchased a further 34 Ford Motor Company and Kia Motors Corporation dealerships in the United Kingdom, which soon became similarly profitable.

Fleet Lease and Supply Chain

Supergroup relaunched their vision in supply chain, their main competence, focusing on technologies and skills such as market mapping and forecasting; warehouse management systems; and transport planning, scheduling, and optimization systems. In the fleet leasing business, they procured vehicles optimally, on a lease to third parties, and provided maintenance systems and appropriate fully integrated technology including visibility systems to the vehicles’ drivers. For the banks, Supergroup guaranteed residual values on the vehicles at very conservative levels. In Supergroup’s view, “vanilla trucking” or offering the basic transport services with trucks, was cutthroat, and acquiring retail space was too competitive and could not be their focus. Instead, Supergroup focused on fully integrated supply chain solutions. They sought to manage their clients’ procurement, international freight forwarding, clearing, warehousing, distribution (primary and secondary), shelf merchandising,[[3]](#footnote-3) selling, and even debtors’ administration.

Mountford and his executive team restored the businesses to reasonable health over the next fourteen months, managing to show a profit of close to R220 million in 2010.

2013: ACQUISITIONS

By 2013, Mountford and Brown had decided that they had achieved the right to invest and expand the business. They had a strategic agenda for growth, although Mountford recognized this as a potentially difficult phase. After what they had been through with Supergroup, Mountford and Brown expected it to be more challenging to invest conservatively than it had been to cut costs. They agreed to focus on strategic niche sectors, sourcing particular individuals and management teams that they believed were ready to grow those businesses. They also agreed that they were not going to pay excessively high prices for acquisitions. Finally, they set the maximum leverage at 40 per cent.

In supply chain, Mountford and Brown considered the high growth areas of worldwide fast-food distribution as one region of interest. They also regarded the demanding but high value pharmaceutical supply chains as interesting.

Supergroup’s sophisticated visibility systems were ideally suited to handle the complexity related to supply logistics in automotive parts. For example, if there was an order for an automotive part within a dealership network placed before 8:00 a.m., Supergroup could source and deliver it by 11:00 a.m.. Sudden emergencies could be managed on an as-needed basis. The Group’s visibility portal, called “My Dashboard,” formed the control centre of a warehouse management scheme and a transportation planning, scheduling, and optimization system. Users could click on “My Dashboard” and the current status of orders would be displayed—somewhat akin to a car dashboard—with on-time delivery levels averaging 99.8 per cent. Users could select the “Exceptions” button and view every order that was out of a standard time specification on any action. Whatever the reason—warehouse picking, delivery, cargo, or traffic jam— an explanation would appear explaining why a delivery had not met the criteria, as would as an update of the current status.

Supergroup’s acquisition strategy was not always successful; for example, their attempt to acquire a company with significant pharmaceutical volumes ended in failure. However, the Group maintained decent traction on over-the-counter medicines and continued to grow this client base.

SUPERGROUP BRANDING

After the destruction of value experienced in 2008, Supergroup could not be described as a cherished brand. With no marketing manager or department, Mountford had to design the Group’s brand strategy. He began by developing brand consistency across all businesses. One of Mountford’s lecturers at Warwick Business School, Peter Doyle, had emphasized that brands had a natural integrity and defensive ring about them and that it was better to turn a bad brand into a good one than to develop a new brand. Mountford found the name “Supergroup” a bit ambitious, so they changed the branding to show the name as a single word and used the initials “SG”—such as in “SG Fleet Group”—to add operational unity to subsidiaries across the Group. In most instances, the dealerships retained all their own operation brands.

EXPANDING FLEET Leasing INTO AUSTRALASIA

To dilute South Africa’s high level of political risk, Supergroup needed to roll out mobility solutions in the United Kingdom and Europe. This approach proved successful: Supergroup bought 75 per cent of In Time Express Logistik, a European supply chain company, in November 2015.

As well, Supergroup’s Australian operations had grown to 149,000 vehicles on fleet lease. Clients included many major parastatal and corporate fleets in Australia. In Mountford’s opinion, there were still massive growth opportunities across corporate Australia. However, Supergroup decided against investing in motor dealerships in Australia, where the automotive industry traded at low operating margins and had very high property and labour costs.

The Group was also reserved about logistics. Australia’s strongly unionized labour environment for long-distance trucking was tricky, necessitating frequent and complicated changes of drivers and cargoes. There were opportunities, however, in niche technology-driven integrated supply chain solutions. In New Zealand, SG Fleet Group soon became one of the largest fleet businesses.

FUTURE SCENARIOS

Supergroup did not want to abandon South Africa, and it remained committed to a diversified geographic spread of businesses. Capital was available in South Africa, and although the Group did not want to walk away from Africa, it also did not perceive the continent in an unrealistic, positive light. Mountford realized that every business opportunity in Africa was difficult because management skills were scarce, legal systems were unreliable or different, and infrastructure was often inadequate. But, there were exceptions. Zimbabwe had proven to have great management skills, as had Ghana. A bad experience in Angola had made them weary, and Nigeria was considered relatively high risk. Kenya had offered a positive experience: Supergroup had built an adequate fleet leasing business there. The question remained whether the Group should expand and integrate a solid supply chain further across Africa.

The Group’s strategy was to continue building its mobility solutions across the three core elements: 40 per cent supply chain, 40 per cent fleet leasing, and 20 per cent dealerships. Supergroup sought to have about 70 per cent of its profit before tax outside Africa and 30 per cent from within Africa. It believed that there were huge growth opportunities in Europe and Australia and that the company should follow these. Ideally, dealerships would remain a complementary activity, providing maintenance and sourcing vehicles, but it would not be the primary driver of the business.

Supergroup was not considering expanding into South America, and the United States was viewed as a step too far. Mountford acknowledged that in the United States, they would need to be state specific—for a start. He first wanted to focus on being successful in the United Kingdom and Europe. Eastern Europe was also an option because there were numerous opportunities to acquire companies there. Mountford also recognized that there were numerous uncertainties in the environment.

Despite the difficulties in operating from South Africa, the Group completed five acquisitions in 2017, and two more were envisioned for 2018. What, Mountford wondered, should be the focus of their future acquisitions?

EXHIBIT 1: SUPERGROUP Share Performance

Source: Supergroup price data: IRESS Database, retrieved from http://researchdomain.iress.co.za/Default.aspx, accessed on November 28, 2018; The authors created the graph from data sourced from the IRESS database, which the University Pretoria subscribes to.

EXHIBIT 2: SUPERGROUP Comparative Ratio Analysis

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| *year ended June 30* | **Supergroup Ltd.** | | | | | | | | | | | **10-Year Medians** | | |
| **Supergroup Ltd.** | **Imperial Holdings Ltd.** | **Trencor Ltd.** |
| **2007** | **2008** | **2009** | **2010** | **2011** | **2012** | **2013** | **2014** | **2015** | **2016** | **2017** |
| Return on Equity | 21.3% | 0.3% | 4.3% | 6.8% | 13.0% | 17.5% | 19.0% | 18.0% | 17.5% | 13.5% | 13.5% | 13.5% | 17.8% | 14.3% |
| Return on Net Assets | 14.6% | 7.4% | 9.3% | 9.4% | 11.9% | 17.8% | 15.9% | 16.2% | 15.0% | 12.2% | 12.3% | 12.3% | 13.7% | 8.0% |
| Net Profit Margin | 4.2% | 0.1% | 0.4% | 1.6% | 4.0% | 5.1% | 7.0% | 6.6% | 5.2% | 3.7% | 3.6% | 4.0% | 3.5% | 34.1% |
| Operating Margin | 8.2% | 4.4% | 3.5% | 4.5% | 6.6% | 8.0% | 9.7% | 9.4% | 7.6% | 5.7% | 5.7% | 6.6% | 5.4% | 44.2% |
| Effective Tax Rate | 23.3% | −63.9% | −23.6% | 23.4% | 25.0% | 34.1% | 25.5% | 27.3% | 26.0% | 28.2% | 30.2% | 25.5% | 31.0% | 1.1% |
| Interest Cover | 2.2 | 0.9 | 1.0 | 1.7 | 3.0 | 4.9 | 7.6 | 5.9 | 5.7 | 4.9 | 4.8 | 4.8 | 4.0 | 3.8 |
| Efficiency (Net Asset Turn) | 1.8 | 1.7 | 2.7 | 2.1 | 1.8 | 2.2 | 1.6 | 1.7 | 2.0 | 2.1 | 2.2 | 2.0 | 2.5 | 0.2 |
| Equity Multiplier | 2.9 | 3.3 | 4.2 | 2.0 | 1.8 | 1.5 | 1.7 | 1.6 | 1.7 | 1.7 | 1.7 | 1.7 | 2.2 | 2.8 |
| Inventory Days | 37.4 | 38.5 | 10.6 | 15.6 | 19.3 | 20.4 | 26.2 | 34.9 | 45.3 | 32.5 | 33.3 | 32.5 | 46.2 | 13.3 |
| Receivable Days | 75.3 | 96.7 | 97.9 | 52.8 | 70.0 | 45.6 | 75.4 | 69.4 | 55.6 | 39.9 | 41.0 | 69.4 | 42.3 | 104.0 |
| Creditor Days | 83.9 | 94.5 | 101.3 | 75.9 | 88.2 | 80.0 | 103.1 | 96.7 | 94.5 | 71.4 | 74.4 | 88.2 | 66.8 | 51.6 |
| Cash Cycle | 28.8 | 40.7 | 7.2 | −7.6 | 1.1 | −14.0 | −1.6 | 7.7 | 6.4 | 1.0 | −0.1 | 1.1 | 23.9 | 64.8 |
| Current Ratio | 0.9 | 1.1 | 0.9 | 0.9 | 1.1 | 1.3 | 1.3 | 1.4 | 1.3 | 1.3 | 1.2 | 1.2 | 1.3 | 1.5 |
| Quick Ratio | 0.7 | 0.8 | 0.8 | 0.8 | 0.9 | 1.1 | 1.1 | 1.1 | 0.9 | 0.9 | 0.8 | 0.9 | 0.7 | 1.5 |
| P/E Ratio | 10.0 | 93.4 | −0.9 | 11.2 | 6.5 | 1.6 | 8.9 | 10.4 | 11.9 | 13.0 | 13.4 | 10.4 | 10.3 | 9.5 |
| 5-Year Total Return |  |  |  |  |  |  |  |  |  |  | 19.3% | 19.3% | 18.5% | 20.7% |
| 7-Year Total Return |  |  |  |  |  |  |  |  |  |  | 77.7% | 77.7% | 47.5% | 40.5% |
| Beta |  |  |  |  |  |  |  |  |  |  | 0.46 | 0.46 | 1.09 | 1.24 |

Note: P/E = price to earnings.

Source: Supergroup Ltd, Imperial Holdings Ltd. and Trencor Ltd financial data, based on analysis from the IRESS Database, retrieved from http://researchdomain.iress.co.za/Default.aspx, accessed on November 28, 2018; The authors created the table from data sourced from the IRESS database, which the University Pretoria subscribes to.

1. Supergroup Limited/South Africa was listed on the Johannesburg stock exchange (JSE Limited). See the company’s profile at www.supergroup.com. [↑](#footnote-ref-1)
2. R = ZAR = South African rand; yearly average exchange rate in 2009 was US$1 = R8.418; exchange rate on January 9, 2018, was US$1 = R12.39. [↑](#footnote-ref-2)
3. In South Africa, it was customary for suppliers to merchandise the shelves in stores. [↑](#footnote-ref-3)