

chief executive officer's report



JW Basson CHIEF EXECUTIVE



BUSINESS ENVIRONMENT

The period under review continued to be a time of high consumer spending in South Africa, mainly on credit and particularly in the areas of durable and semi-durable goods. The spending spree was fuelled, inter alia, by the availability of money created by low interest rates as well as by the growing disposable income of a burgeoning black middle class, popularly referred to as the "Black Diamonds" that has as its wellspring the Civil Service and the business community. During this time the market was awash in credit as lenders extended facilities to all and sundry in the months leading up to the introduction of the National Credit Act. Initially consumers seemed undeterred by the several increases in interest rates, but towards the end of the period there were clear signs that the rate at which consumers were spending had peaked.

The high consumer spending locally, supported at lower income levels by the government's generous social grants, has led to what could be an over investment in retail space, especially in the durable and semi-durable sectors. Because food retailing is not to the same extent affected by fluctuations in the market, it should be less affected by the present slowdown than most other areas of retail.

Outside the borders of South Africa, trading in Africa is complicated. Red tape is slowing down the movement of goods between countries and numerous trading opportunities are lost because of a lack of cooperation between African countries. South Africa's trading structures have to be reviewed to keep pace with the growth elsewhere in Africa.

There is much talk of a "United Nations" of Africa, but for that to become a reality the continent will have to do away with its many trading blocks, different sets of duties and regulations, and the endless restrictions on trade. Despite these challenges, the Group is positive about investing in Africa, especially the commodity-rich countries and we are pleased with the trading results achieved during the past financial year.

Most African countries are still at that stage of their development where they have to import most processed food products. With South Africa unable to resolve the many export bottlenecks, these countries are turning increasingly to Europe, the Far East and South America. This is a sad situation, for the potential for business in Africa is vast, with its immense wealth in natural resources only starting to be tapped.

During the year the situation was exacerbated by constant interruptions in the availability of product ranges from local manufacturers underestimating the growth in consumer demand. This affected the provisioning of our stores in Africa, forcing us to source replacement products internationally. The long-term implication of these continuing shortages is that South African manufacturers will find it difficult to regain space on supermarket shelves once their production problems have been resolved.

OPERATIONAL REVIEW

The past financial year was a period of strong growth across all sectors of the business. Despite industrial action that disrupted operations in South Africa in the first quarter of the financial year, all three retail food chains performed well while some of our businesses elsewhere in Africa are becoming profit contributors offering an increasingly important springboard for future growth. During the year under review Shoprite Holdings increased turnover by 16,2% from R33,5 billion to R39,0 billion and trading profit by 27,6% from R1,3 billion to R1,6 billion. Turnover in the Group's operations outside South Africa continued to grow strongly, increasing turnover, in rand terms, by 28,4% to R4,3 billion.

The past year provided convincing testimony to the extent to which our continued investment in infrastructure and technology is paying off. It enabled us to curtail what could otherwise have been a major disruptive influence on our business. I am alluding to the ongoing



THE GROUP'S NETWORK OF DISTRIBUTION CENTRES

enabled it to maintain a more consistent flow of merchandise to stores



interruptions in the supply of crucial product ranges already referred to above. This led to a marked decline in supplier service levels and the erratic execution of orders. Due to our network of distribution centres established over the years we could stockpile supplies and maintain a more consistent flow of merchandise to stores. The supply problems nevertheless resulted in considerable sales losses and placed the whole of the food retail sector under pressure in terms of consumer expectations.

During the year we continued to invest in systems and infrastructure, but particularly in people. Eight years ago we started bringing top young graduates into the business and training them extensively to manage its complexities, for retail has become a highly specialised, highly sophisticated discipline. In doing so we substantially enhanced the quality of senior and middle management. The greater efficiencies we now achieve, assisted by extensive real-time sales data, are reflected in our trading margin which in the last three years has grown from 3,5% to 4,1%.

SUPERMARKETS IN SOUTH AFRICA

Due to its extensive and sophisticated infrastructure the Group did not experience problems in managing the year's strong growth in consumer demand, despite the fact that the inbound supplier service levels reached an all-time low. The shift in demographics which has seen the emergence of an ever-expanding black middle class is continuing to benefit the retail sector and the Shoprite chain in particular, impacting on both turnover and profitability. To accommodate the upsurge in demand the Group continued with its comprehensive store refurbishment programme which also saw the introduction of a wider range of aspirational and lifestyle products.

The improved product offering was complemented by extending existing service departments and adding new ones in the form of liquor stores and in-store pharmacies. The concept of new-generation stores offering more extensive product ranges at the most competitive prices was underpinned by a robust marketing programme.

The service departments reflect in their offerings the shift to fresh as well as prepared foods in consumer buying patterns. They also cater to more discerning shoppers who value quality, variety and access to what is rare and out of season. In addition to the liquor stores and pharmacies all the service departments, which include the bakeries, meat markets, wine departments and delicatessens, have done particularly well. The number of liquor stores and pharmacies is growing steadily. A major restriction on the growth of pharmacies is the shortage of pharmacists. The introduction by the meat markets of innovative branded products has substantially boosted turnover and profits while the wine departments managed to increase wine sales by 16% in an otherwise stagnant local wine market. In a survey conducted among its readers, a specialist South African wine magazine in its June 2007 issue also reported that, bar one, the wine departments of our Shoprite and Checkers stores provided the best wine offering of all the country's supermarket chains.

During the reporting period internal food price increases rose to 5,6% compared to less than 3,0% during the corresponding 12 months. This compares with food inflation of 8,5% reported by the Department of Statistics. In certain food categories such as meat, dairy and maize products, inflation was particularly high, changing buying patterns at the bottom-end of the market with consumers having to down-trade. Food inflation will become an issue in the year ahead, having already, according to newspaper reports, ignited a spate of strikes across the private and public sectors by workers feeling their standard of living is declining.

Shoprite

Despite being hardest hit of the three retail chains by the industrial action in the first quarter of the financial year, Shoprite still exceeded its budget for the year. It remains the country's most frequented food chain and is benefiting substantially from the government's largesse in social grants.

chief executive officer's report

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At the same time support from the black middle class that now numbers 2,6 million consumers, is also growing. Considerable potential therefore still exists for the opening of new stores in the country's previously disadvantaged areas where developers are now keener to invest in bricks and mortar than in the past, having learnt to manage the risks.

In August 2006 Shoprite was selected South Africa's foremost food retailer when it won the Grocery and Convenience Store category in the annual Top Brands survey conducted by Markinor in association with the Sunday Times. In the Loyalty Index, as measured by AMPS, Shoprite again scored the highest of all food retailers, with 39% of consumers stating they shop exclusively at Shoprite as against the 32% of its closest competitor.

Checkers

Acceptance of the repositioned Checkers by members of the higher LSM consumer segment has increased, and support from its target market – the LSM 8 to 10 income groups – continued to grow during the review period. Buoyed by a high-visibility advertising campaign, turnover and profit grew at a faster rate than in the case of Shoprite, although off a lower base. The service departments within the stores were particularly successful as the chain further increased its focus on freshness by extending its ranges of perishable and value-added products. The extended trading hours offered by many of its stores in urban areas also proved highly popular with time-strapped professionals shopping after hours.

During the reporting period both Checkers and Shoprite continued to strengthen their individual identities, further clarifying their positioning and appeal and reducing cannibalisation between brands. Independent research shows a 25% increase in consumers' understanding of their individual identities.

Usave

The Usave concept of a limited product range forms an integral part of the Group's footprint within and outside the borders of South Africa. It extends our choice of formats and acts as a valuable strategic tool in exploiting business opportunities around us. At the same time it is a highly successful business concept with sales growth of 35,2% in the past year and a return on capital that consistently exceeds 30%. Central to its success has been the development of good quality private labels that provide good margins while selling at highly competitive prices. Focusing mainly on dry goods, this versatile, low-cost format is equally at home in urban and rural environments. Usave now operates just on 100 stores and the intention is to speed up the roll-out in the new financial year.

SUPERMARKETS OUTSIDE SOUTH AFRICA

The Group's non-RSA operations continued their robust growth throughout the year and ended the reporting period with turnover

29,4% higher. The biggest contributions came from Zambia, Mozambique and Angola, while Nigeria is soon to join the ranks. Shifting the Group's focus to the commodities-rich countries of West-Africa was a timeous one. Nigeria is becoming one of the world's foremost oil producers while Angola is already pumping 1,65 million barrels of crude oil per day. We presently operate in Ghana, Nigeria and Angola, and will soon open our first supermarket in the Democratic Republic of Congo (DRC).

However, the frustration of doing business in Africa is also great and, amongst others relate to the physical problems of provisioning certain stores in Africa. The commodity-rich countries in particular are hard at work improving roads, harbours and air links to manage their growth, but their infrastructure is still well below internationally acceptable standards. Lead times, especially through harbours, vary from 60 to 120 days and we are obliged to annually destroy merchandise worth millions that has passed its sell-by dates due to transport delays.

Further afield we remain confident about our future in India where we operate one hyperstore in Mumbai on a franchise basis. We expect that the restrictions prohibiting foreigners participating independently in the retail trade will be relaxed. In the meanwhile we are biding our time. India is, of course, also a major manufacturer and we source an extensive range of products there for our stores in Africa and the Indian Ocean islands.

OK FRANCHISE

The franchise division also reported a year of solid growth both in turnover and trading profit, which was 14,1% and 21,1% higher respectively. The division, which has 260 members in rural and urban areas in South Africa and some neighbouring countries, has established the trusted OK trademark as an umbrella brand for four different formats. The most recent of these formats, OK Value, accommodates potential franchisees with limited financial resources by setting slightly lower entry standards, thereby providing them with a platform from where they can grow into the larger formats, should they so wish. A new development has been the creation of a franchise liquor outlet under the trademark Enjoy, a logical extension of the Group's franchise brands, given the strong growth in the number of own liquor stores.

FURNITURE

Operating in a difficult trading environment, the furniture division nevertheless had a satisfactory year, with the House & Home chain in particular growing way beyond the rest of the sector. Unlike food retail, which experienced rising inflation throughout the reporting period, the furniture sector had to contend for almost the entire period with virtually no inflation, largely because of new technology becoming more affordable as its applications increase. Like its competitors, the furniture division therefore continued focusing on low-margin volume business

to achieve its targets, balancing it with the higher returns achieved on direct imports and furniture sales. The division's non-RSA business is also increasing. It already operates stores in Namibia, Botswana, Swaziland, Lesotho and Mozambique, with Angola and Zambia under consideration.

SUSTAINABILITY

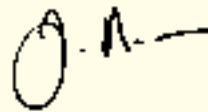
In this document we report on how we manage our business to ensure it continues to survive and we look beyond the figures to how we meet the triple-bottom line requirement of promoting economic growth, community welfare and environmental integrity. We therefore discuss how we create staff equity and develop our almost 69 000 employees at all levels to manage and operate the business efficiently; how we involve ourselves through our corporate social investment programmes in the well-being of the community and strive to correct imbalances of the past with broad-based black economic empowerment (BBBEE) initiatives; how we protect consumers through our assiduous attention to all aspects of product safety; and how we safeguard the integrity of the environment through the responsible manner in which we design and build new shopping centres and the rigorous manner in which we adhere to the highest safety and health standards in operating them.

In advancing BBBEE we have focused on two diverse areas – farming and the visual arts. We devised an agriculturally-based project promoting job creation and entrepreneurship in the rural areas. A number of small emerging farmers are involved in raising livestock for sale through the meat markets in all our stores.

The other project aimed at enterprise development lies at the other end of the spectrum of human endeavour. Called Strokes of Genius, it is a concept aimed at establishing a market for young local artists needing an outlet for their works.

ACKNOWLEDGMENT

It was a good year to be in retail, and it is a deeply satisfying feeling to look back and savour the breakthroughs made, the successes recorded, the profits achieved. But one also knows it did not come easily, that attaining the results we did required many sacrifices, great dedication and unremitting hard work over many long hours. I therefore want to thank everyone who contributed to this great joint effort – the members of the board, my colleagues in the management team and our staff as well as our suppliers and consultants.



JW Basson
Chief Executive

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