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BUSINESS ENVIRONMENT

The 12 months to end June 2010 was a challenging period for the South African economy. The effects of the global economic crisis and the sharp rise in the cost of living expenses across a broad spectrum, from energy and transport costs to municipal rates and taxes, was countered by positive consumer response to tumbling internal food inflation which declined from 15,8% in 2009 to an average of 2,2% during the past financial year, and which was supported by a strong rand.

In the low-inflation market of the reporting period, retailers had to sell substantially more just to match the turnover of the previous reporting period. This was particularly true for mass market retailers of basic goods where the prices of staple products such as rice, oil, mealie meal and washing powder were up to 30% cheaper than a year ago. With consumer disposable income under pressure, competition for the consumer's rand became ever fiercer with price assuming paramount importance.

RESULTS ACHIEVED

The Group continued to build on its historical price positioning based on offering the best value at low prices and by sticking resolutely to these principles, the Group retained the loyalty and support of customers across all income groups. In the period under review the Group derived the full benefit from the changes and improvements it had effected to its business model over the past several years. Central to that was the decision that the Group would take charge of its own destiny; that it would own its own information tech-



JW Basson, Chief Executive Officer

nology and logistics infrastructure and as far as possible lessen its dependence on third parties.

With its core business food retailing, the plummeting food inflation referred to earlier, presented a major challenge to the Group. Although it was measured at 2,2% for the full period, in the second six months of the year food inflation dropped to just 0,2% while in the limited-range Usave, serving the price-sensitive consumer at the lower-end of the market and where staple foods form a considerable part of the consumer basket, deflation of more than 4% was recorded.

Under those circumstances the Board considers it a significant achievement that the Group as a whole could achieve total turnover growth of 13,6% to R67,402 billion for the 53 weeks of the reporting period compared to the 52 weeks of the 2009 financial year. Included in the overall figure is the negative turnover growth of 2,1% reported by the Group's non-South African supermarket operation and which was brought about by the strengthening of the rand against most African currencies. However, in constant currency terms, turnover growth of 18,0% was achieved, confirming the healthy state of the Group's operations outside South Africa.

Despite the low food inflation putting increased pressure on food retailers contending with substantially high cost inflation, the Group was able to achieve trading profit of R3,490 billion, an increase of 18,7% over the previous year. The trading margin of 5,18% is a factor of the stringent controls that reduced stock losses due to theft and further efficiencies

from its investment in information technology systems and logistics infrastructure.

In times of financial hardship, consumers, also those in higher income groups, tend to gravitate to stores they believe offer the best prices and value, and to prefer cheaper alternatives to their usual brands. With its three formats of supermarkets covering the whole consumer market and with every individual brand focusing exclusively on its target market and its divergent needs the Group has been ideally placed to serve these markets.

All three of the Group's major chains increased their customers and market share. The loss of jobs, which occurred primarily in the Group's customer base, was to a certain extent countered by the increase in the government's social grants of which the Shoprite chain's typical customers are the main beneficiaries. The government now distributes some R89 billion social grants, calculated to benefit 12 million to 13 million people. A substantial portion of these grants is used to buy food. Divisional marketers tailored the offerings to these recipients with considerable success and helped the chain grow turnover through its enhanced price image building consumer trust in its lower prices.

The repositioning of Checkers for higher-income consumers with its premium offerings of up-market cheese, meat and wine brands strengthened its standing with consumers and the brand is increasingly favoured as the first choice in new developments.

Although being in all respects primarily a food retailer, management has over time added a number of specialist departments and value added services to offer a one-stop shopping format to consumers. While these departments were not primarily established to contribute to total profit, they do serve as an invaluable generator of traffic to Group supermarkets as consumers increasingly feel the benefit of convenient services that complement their traditional food and general merchandise needs.

The Group devoted the year under review to investment in, inter alia, extensive additions to its logistics infrastructure, information technology systems, workforce management structure and store expansion programme and now finds itself perfectly poised to gain maximum advantage of the imminent upswing in the economy. It opened a net 87 new stores, many of them in disadvantaged areas. It is also investing in new and additional distribution facilities to handle the growth envisaged. The Group also increased



Wine Route, Checkers Van der Lingen, Paarl

expenditure on training and recruitment. Currently, the Group employs 88 000 people of whom more than 10 000 work in its stores outside South Africa. This is a gain of almost 7 000 jobs over the year, remarkably achieved at a time when unemployment has risen to 25,3% of the labour market. It is expected that a further estimated 5 700 jobs will be created during the next year.

GROUP SERVICES

Supply chain management

The Group has created and continues to increase its strategic lead in the supply chain, through its ongoing investment and recognition of the supply chain's strategic importance. Today, a highly sophisticated supply line services 1 166 Group outlets in 16 countries where the Group trades. Improved levels of product availability contributed to market share gains while the drive to reduce inventory levels, despite the growth in both sales and the number of outlets, is paying dividend.

In its most basic form the supply chain consists of strategically placed distribution centres linking the flow of product from vendors to stores at which customer demand ultimately drives the movement of product.

Information technology and a fleet of refrigerated and ambient trucks enable the movement of product and the flow of information.

The Group prides itself in running a state-of-the-art distribution operation and becoming the first South African retailer to receive the much acclaimed ISO 9002 accreditation for import and export handling.

Centralised distribution is now regarded as a competitive advantage for the Group enabling it to stabilise supply lines in times when supplier service levels drop. By controlling its supply line, merchandise can be buffered, countering vendor out-of-stocks and volatile trading patterns, while offering an opportunity to buy in against price increases. The desired result is inevitably, to consistently allow customers to find the items on their shopping list – thereby keeping their custom and their loyalty.

Controlling the whole supply chain has also made it possible to introduce a great many cost-saving efficiencies, thus providing the mechanism to drive prices down daily. The Group's supply chain now presents the opportunity to re-engineer its retail stores and improve its utilization of space by dedicating the minimum area to storage and the maximum area to trading space.



Chief Executive's Report continued



Distribution Centre, Brackenfell

Merchandise is delivered to stores by a combination of almost 850 trucks and trailers based at distribution centres throughout the country. The fleet is owned by the Group and operates 24 hours a day, seven days a week. A highly sophisticated transport route planning and scheduling system, optimises store deliveries and integrates the operations of the distribution centre and the transport division.

This channel to market is not only environmentally friendly by reducing the number of trucks on the road, but it empowers small to medium sized suppliers, who can now deliver to one point and avoid the need to heavily invest in either warehousing or vehicles.

A substantial portion of the investment in information technology and logistics infrastructure earmarked over the next four years will be applied to the upgrading and extension of the Group's distribution centres in Centurion, Gauteng as well as Cape Town and Durban.

Of these the largest is located in Centurion, between Johannesburg and Pretoria, where distribution facilities have virtually doubled from 80 000 m² to 145 000 m². The main building of 114 000 m² will be the largest distribution centre under one roof on the continent.

On completion at the end of the 2010 calendar year the facility will serve as the

distribution point for about 90% of ambient products delivered to approximately 380 stores in the Gauteng area and beyond.

More than 1,100 suppliers will be delivering their products to the centre where they are stored, collated, and then distributed to retail stores on a high-frequency basis.

The new Centurion distribution centre was developed in a responsible manner using environment-friendly approaches to construction. This was followed through with further investment in environment-friendly design that includes treatment of waste water and an ability to recycle waste. Central reclamation forms part of the Group's safety and recycling programme, for the removal of damaged stock at the earliest opportunity, to avoid possible contamination of other products and control waste.

In Cape Town approximately 45 000m² of new space is being added, allowing the consolidation of three existing leased centres, reducing costs and inefficiencies. Construction on the Durban site will start during the new financial year while the Group continues to operate from rented facilities.

The Group's customers will continue to enjoy the benefits and rewards of this strategic initiative. Our trading partners are critical to this collaborative platform and equally benefit in the efficiencies and savings.

Information technology

Significant investments have been made in information technology infrastructure and applications to support the Group's growth and diversity. Special emphasis has been placed on improving the efficiency and agility of this department in responding to the Group's rapid growth strategy. It already has one of the largest central data warehouses in South Africa, supporting a well developed business intelligence capability. Continuous system improvements, upgrades and implementations are undertaken to ensure valid, accurate and prompt processing of the ever-increasing transaction volumes generated by the business.

A start was made during the year with the replacement of the current buying purchase order management and central stock ledger systems with the relevant SAP-modules. This includes the automation of import and export processes.

Property

The property division plays a key role in the growth of the Group. Its primary function is to identify and create trading opportunities in developing areas in South Africa as well as in those countries on the continent and on the Indian Ocean islands where the Group does business. As the Group's primary business is that of a food retailer and not a property owner, the property division will first try to acquire space in existing or planned developments in the areas identified. Only if such opportunities are not available and the area is considered strategic to the Group's development plans will it create the necessary space itself, either in the form of a shopping centre or a stand-alone supermarket.

Beyond the borders of South Africa, where capital for property development is presently at a premium, the Group is more often than not obliged to undertake its own developments as it is presently doing, inter alia, in Angola and Nigeria. The division, which employs its own project team, will oversee the construction of the buildings and its subsequent management, as it does in the case of all the other buildings in its portfolio, currently valued at approximately R3,7 billion. Capital expenditure on new stores opened during the year totalled R870 million.

In addition, the property division undertakes all property negotiations, enters into contracts, liaises with tenants, rents out space and sells properties in the portfolio which are no longer of strategic value to the Group's development needs.



OK Minimark, Malmesbury

OTHER OPERATING SEGMENTS

These include the results of the Franchise Division, MediRite and Transfarm, as well as Computicket. Their combined turnover increased by 34,4% to R3,869 billion and their trading profit by 155,0% to R118,2 million.

OK Franchise

The division's turnover slowed in the 12 months to June 2010 compared to the previous year. As in the rest of the Group, turnover was no longer bolstered by high food inflation and the increase of 8,9% in sales to a large extent reflects real growth. That this growth is below that of the Group is to a certain extent a reflection of extreme poverty found in many of the rural areas in which a great many of the members of OK Franchise operate their stores. However, strict operating controls and careful management of resources generated trading profit above sales growth.

Over the years the division introduced four OK brand formats for different sized businesses – OK Foods, OK Grocer, OK MiniMark and OK Value. Each has its own set of requirements to which franchisees have to adhere should they want to trade under its banner. Of the division's 276 members, 158 are OK branded stores. The remaining franchisees either operate as wholesalers under the Megasave brand or are buying partners.

In addition to those in South Africa, there are also franchisees in Botswana and particularly Namibia, where the OK brand has become well established.

The division recently introduced a liquor store concept under the name Enjoy and in the period under review gained nine new members.

The division's strength is the bulk buying capacity of the Group. The best possible prices are negotiated for franchisees that enjoy generous payment conditions. Training is provided for members' floor staff, management guidance is given and joint advertisements placed for which members identify the products and their prices.

MediRite

The MediRite chain of pharmacies, located within the Group's supermarkets and hyper stores, was not noticeably affected by the recession. It recorded growth on existing business of 35% while total turnover increased by 60% due to the opening of 23 new pharmacies that brought the total number at year-end to 104. Of the newly opened outlets, 11 are in supermarkets located in disadvantaged areas. The highly trained staff of the 34 MediRite pharmacies in such areas also provides a valuable community service by giving, on request, basic medical advice to low-income earners who don't have ready access to medical services.

MediRite's success in a challenging market is ascribed to its pricing model, which is one of the lowest in the industry. However, during the first six months of the year growth was restricted by the erratic flow of product from wholesalers.

Where in the past the balance between prescriptions and over-the-counter sales was more or less equal, during the reporting period the weight shifted to prescriptions.



Distribution Centre, Centurion



Chief Executive's Report continued

Management believes this shift resulted not only from highly competitive pricing but also reflects consumers' growing trust and confidence in MediRite pharmacies. Having become a substantial player in the area of prescription medicine, MediRite has seen medical aid societies become more willing to sign direct service provider contracts with the division.

In December 2009 MediRite acquired Transfarm Pharmaceutical Wholesalers which sells and distributes a wide range of pharmaceutical products and surgical equipment to hospitals and clinics, dispensing doctors and veterinary surgeons as well as to private and corporate pharmacies. Transfarm, which continues as an independent business, greatly reduces MediRite's dependence on other wholesalers and by the end of the reporting period some 90% of the chain's stock requirements were already being channelled through Transfarm.

In view of the dire shortage of trained pharmacists in South Africa and to sustain its future growth, MediRite a few years ago introduced a generous bursary scheme for matriculants wishing to study pharmacology at univer-



Computicket, Shoprite Nonqubela, Khayelitsha

sities and technikons. At present there are 86 bursary holders committed to work at MediRite once their studies are completed.

Computicket

The potential of Computicket, South Africa's leading ticketing company with offerings covering the whole spectrum of leisure activities, came to full fruition when acquired by the Group. It gave Computicket a presence in every Checkers and Shoprite supermarket and hyperstore making it accessible to a much broader consumer base. In addition to its traditional ticketing services the company a year ago also moved successfully into the travel market, selling packages mainly on line and through its call centre.

In the period under review a substantial investment was made in the technology infrastructure supporting Computicket to retain and enhance its business as the premier ticketing solutions provider in the country. Its website was also upgraded to facilitate booking transactions while international best practice has been incorporated in its operations.

ACKNOWLEDGMENT

That we have become the market leader in food retailing in Africa is not due to a few individuals, but to the combined efforts of everyone who works in the Group. It has taken initiative, sacrifice, faith and sheer old-fashioned hard work to bring us to where we are today. The past 12 months were some of the most challenging I can remember in all my

years, but we managed to come out of this period stronger than before and ready to face up to the challenges of the new year. My heartfelt thanks to management and staff for their commitment and determination that made us win through.

JW Basson
Chief Executive Officer

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Medirite, Checkers Hyper N1 City, Goodwood