

# Chief Executive's Report

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JW Basson

## BUSINESS ENVIRONMENT

The business environment during the reporting period presented many challenges to the retail sector. Against the background of the lacklustre performance of the economy as a whole, the disposable income of consumers, particularly those in the lower income groups, came under increased pressure. Factors such as high household debt and the surging cost of essential services like electricity and transport eroded their spending power. Although a strong rand has partially

shielded local consumers from the full effect of international food and energy costs, it has also hampered exports from this country and inhibited job creation. Although the sale of durable goods such as motor vehicles saw a resurgence as more affluent consumers took advantage of low interest rates, spending on fast moving consumer goods remained depressed with few factors present that indicate an improvement.

Management has a growing concern over the ability of many smaller local suppliers to survive. High input costs and rigid labour regulations make it increasingly difficult for them to remain competitive in relation to imports. Their departure would not only increase unemployment in some of the sectors in which the Group does business, but would also jeopardise supplies of certain product categories. Contingency plans to obtain such products from alternative sources are in place to protect the Group against any potential fallout.

## OPERATIONAL REVIEW

Price competition amongst food retailers in the South African market remained fierce. To assist consumers and protect its position of consistently offering the lowest prices, the Group's supermarket chains kept price increases to the minimum by passing on cost savings to consumers. More than 40% of its product categories could thus be purchased for the same or a lower price than during the previous reporting period.

Internal food inflation averaged -0.1% for the reporting period (2010: 2.2%) compared to the official food price inflation of 3.2%. Against this background, turnover for the 52 weeks to June 2011



## Applying international best practice to all aspects of the business, management continued to strengthen the low price-positioning of its supermarket brands, resulting in 64.3% of all South African consumers shopping at the Group's chains according to AMPS.

grew by 7.3% compared to the 53 weeks of the previous year. On a comparable 52-week basis the growth was 9.7%.

Stringent cost management and the ongoing improvement in efficiency levels enabled the Group to increase its trading margin to 5.5%. Management considers this a satisfactory performance in the face of considerable increases in operating costs, such as staff salaries, rentals and electricity, in the second half of the year.

### CORE BUSINESS

The Group's core business – its three supermarket chains, Shoprite, Checkers and Usave, which between them cover the entire LSM consumer spectrum in South Africa – traded successfully during the reporting period. Shoprite, the largest of the three in terms of turnover and the number of stores, remains the dominant player in the middle to lower income sectors despite more fierce competition from an increasing number of participants. It countered this by expanding its presence in economically disadvantaged residential areas in particular with full-service supermarkets that include pharma-

cies providing increased access to prescription and self-medicating remedies. During the reporting period, a net 11 new stores were opened to bring the total in South Africa to 331.

Checkers further entrenched its position in the higher income consumer segment to the extent that 53% of its customers now fall within LSM 8-10. The brand's repositioning has been so successful that it is increasingly the preferred anchor tenant for many new shopping centres countrywide. It was, for the third consecutive year, the fastest growing supermarket chain in the country. It continued to expand its ranges of specialist offerings, such as estate wines, exotic cheeses, and branded fresh meat products.

Usave's low cost structures enable it to consistently sell comparable products at lower prices than its competitors. Its strategic role in an increasingly competitive local market has grown during the reporting period. In order to gain access to desirable sites, it is implementing innovative ways of developing stores in conjunction with landowners. It will be intensifying its store opening programme in the new financial year.

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## Chief Executive's Report (continued)

Applying international best practice to all aspects of the business, management continued to strengthen the low price positioning of these brands. In doing so, the Group is benefiting from recent AMPS research which shows that consumers are visiting more than one store to cherry-pick items on price. Research from the same source shows that the Group's chains are now being frequented by 64.3% of all South African shoppers.

In the recent 2011 Sunday Times Top Brands Awards, the winners of which are voted in by consumers, the Shoprite Group won the convenience and grocery store category for the second consecutive year and for the fifth time in the history of the awards.

During the reporting period the Group opened a net 54 supermarkets, of which 46 are within the borders of South Africa. It now operates 816 supermarkets, 700 of which are within the country. In order to ensure that it has access to areas where it will want to trade in future, it is also increasingly buying land and buildings for potential development. It plans to open at least the same number of stores in the new financial year of which 16 will be elsewhere in Africa.

### GROUP SERVICES

Management believes that the Group is well-positioned for future growth, due to its extensive infrastructure for product sourcing and distribution, multi-layered store network for the different brands, some of the most sophisticated information technology (IT) systems available to support its operations, and management who is experienced in every aspect of the business. By applying the principles of continuous supply, stores are being re-engineered to enlarge trading

space and allow for the introduction of some of the latest trends in layout and presentation.

It is an accepted fact that food retailing is a replenishment business. The supply chain is therefore crucial to the success of any food retailer.

The Shoprite Group resolved more than 17 years ago that it could only derive maximum efficiency from the supply chain if it controlled every stage of that process. At the same time, it started investing in the most advanced IT systems to support the supply chain functions. These systems are regularly upgraded to stay abreast of the latest international developments.

In the past two years the Group has invested substantially in extending its distribution facilities with major additions to its centres in Brackenfell and Centurion, with the latter remaining the largest in Africa.

### COMPLEMENTARY SERVICES

The idea of enabling customers to do all their shopping under one roof was further expanded with the introduction of in-store pharmacies (under the name MediRite) and liquor outlets (under the name LiquorShop). The latter are located at or very close to the entrances to Shoprite or Checkers supermarkets. Both extend a service to customers and, in doing so, enhance their shopping experience.

During the reporting period MediRite increased its number of outlets from 104 to 121 and it is budgeting for another 22 in the new financial year. Its pharmacies enjoy secure supply lines from its fellow subsidiary, Transpharm Pharmaceutical Wholesalers, which now has depots in Cape Town as well as Gauteng, providing 93% of their total



product range and offering the opportunity of direct purchases from international markets. Despite the subdued growth experienced by the liquor industry as a whole, LiquorShop grew apace in the reporting period, opening 37 outlets in key areas to bring its number of outlets to 120. Growth will accelerate further in the new financial year, with 40 new outlets on the cards, depending on the rate at which licences are issued. LiquorShop offer a comprehensive collection of spirits and other alcoholic drinks.

Several years ago, the Group introduced the Money Market concept to enhance its offering of a one-stop shopping experience through its supermarkets. The Money Market counters continue to expand their range of services, from money transfers and flight and bus tickets to the payment of electricity bills, municipal services and traffic offences. As part of this service, tickets for almost all major sports, cultural and entertainment offerings are offered through Computicket, the country's largest ticket vendor.

### NON-RSA EXPANSION

The Group continued to expand its operations into Africa and has made great strides in establishing a presence across the continent years ahead of its competitors. It will enter its 17th African country before the end of 2011 with the opening of a Shoprite supermarket in the business district of Kinshasa in the Democratic Republic of Congo. The expansion programme in Nigeria is on track, with four Shoprite supermarkets scheduled to open during the next year and a great many other opportunities are also currently being investigated.

New Shoprite supermarkets will also open in Angola, Botswana,

Ghana, Madagascar and Uganda in the new financial year. The Usave chain will also be extending its footprint by opening its first branch in Zambia early in the new financial year as part of a roll-out of six outlets in African countries.

In order to counter the effects of an expensive rand, the Group now imports merchandise for its African operation from many other countries in addition to South Africa. At the same time, management is continuously trying to convince South African manufacturers to establish operations in the countries where the Group does business. The Group's challenge is to remain at the forefront of food retailing on the continent. It meets this challenge by identifying and obtaining choice locations in cities and countries where it plans to establish or expand its presence; by constantly upgrading existing stores to ensure that they continue to represent an exciting shopping experience, or by moving them to new locations where they are closer to the heart of developing city centres.

### FURNITURE DIVISION

The Furniture Division, which operates three chains – House & Home, OK Furniture and OK Power Express – experienced a difficult trading year. Retailers had to contend with deflation of on average 15.7% in home entertainment and appliance products.

In spite of these adverse conditions, the furniture division increased turnover by consistently pricing its product ranges very competitively and by increasing the number of direct imports, which not only kept it competitive, but also provided a better profit margin. Of the three chains, the two targeting the lower to middle income



## Chief Executive's Report (continued)

market – OK Furniture and OK Power Express – showed the strongest relative growth. The results of House & Home, which reported a drop in turnover, largely reflect the financial difficulties of its higher income market. Total turnover was at R3,060 billion – 1.9% above 2010; while trading profit, at R131 million was marginally above that of the previous year.

The division continued to grow strongly in terms of new outlets. In the year to June 2011, a net 20 new stores were added – 16 under the OK Furniture brand, three House & Homes and one for OK Power Express to bring the total number of stores to 300, of which 30 are outside the borders of South Africa. OK Furniture is by far the dominant brand, with 232 of the 300 stores trading under this name.

### OK FRANCHISE

18 The franchise division of the Group uses the Group's supermarket procurement capacity to offer franchisees competitive prices coupled with the resources and skills to provide their customers with a viable shopping experience.

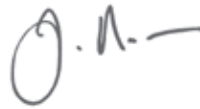
It was a trying time for all the division's members who are independent traders doing business all over South Africa and Namibia, as well as in Botswana. Because of their dependence on a single store, they are vulnerable to any downswing in the economy. A highly competitive environment, low food inflation, and steep increases in input costs placed a strain on members' profitability.

The OK Franchise Division (OKFD) increased turnover by 7.8%, while operating profit grew due to overhead costs lagging the growth in income. A major development during the reporting period was the

offer made for Metcash's franchise division, which will provide OKFD with a further platform to grow its business and franchisees, representing some two years of organic growth without altering its risk profile. The transaction was ratified by the Competition Authority after year-end and will see some 150 members added to OKFD, albeit with a smaller turnover base for the majority of those compared to existing OKFD franchises.

### ACKNOWLEDGMENT

It has always been an honour for me to lead a team so dedicated and so set on success as the management and staff of the Shoprite Group. With some I have worked for many years; others are new to the team, but together they share the same ideal: to be the best, however difficult the times may be. This frame of mind stood them in good stead during the past financial year, which presented them with many challenges, all of which were tackled with a will to win. My grateful thanks go to all of them.



**Whitey Basson**  
Chief Executive Officer

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