Financial Report

Statement of comprehensive income

Sale of merchandise
- As a general rule most international retailers report their results in full weeks. The Group also uses this accepted accounting practice, with the result that an extra week is included approximately every five to six years. This extra week was included in the previous year’s results. This obviously distorts the growth on previous year and, where applicable, the effect of this extra week is indicated. Comprehensive pro forma information have been included on page 98 of the Integrated Report.
- Total turnover increased by 8.4% to R141.000 billion, a very good performance seen in context of the state of the economy in Africa, and the rest of the world for that matter, in general. Turnover grew by 10.6% when the extra week in the previous year is excluded. In a climate of political and economic instability and high unemployment, domestic growth has slowed even further. These factors, in itself, make the performance of the Group more impressive.
- Turnover growth during the second half of the year came under pressure, especially in Non-RSA when most of the currencies in countries the Group trades in depreciated against the rand and US dollar. In local currencies those countries continued to give a satisfactory return. In RSA the turnover growth was almost on par with the first semester, mainly due to a number of very successful promotions which ensured that customers remained loyal to our brands.
- The following table gives the relevant turnover per segment:

<table>
<thead>
<tr>
<th>Segment</th>
<th>52 weeks</th>
<th>53 weeks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales Growth</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>2017</td>
<td>2016</td>
<td></td>
</tr>
<tr>
<td>Supermarkets RSA</td>
<td>10.5</td>
<td>8.0</td>
</tr>
<tr>
<td>Supermarkets Non-RSA</td>
<td>13.5</td>
<td>11.7</td>
</tr>
<tr>
<td>Furniture</td>
<td>6.2</td>
<td>4.3</td>
</tr>
<tr>
<td>Other Segments</td>
<td>7.7</td>
<td>7.0</td>
</tr>
<tr>
<td>Total Sales</td>
<td>10.6</td>
<td>8.4</td>
</tr>
</tbody>
</table>

- Supermarkets RSA reported a 8.0% growth in turnover to R101.734 billion with a 10.5% growth when the extra week in the previous year is excluded. Although the average customer remained financially stressed, Supermarkets RSA had a number of highly successful promotions, such as Black Friday and Littl Shop, which contributed to its turnover growth. The Group continues with its innovations in value added categories like cheese, wine, meat and during this year there was a big drive on ready-to-eat and ready-to-cook which is finding favour with the more affluent customers.
- Supermarkets RSA opened a net 90 outlets during the year.
- Average internal food inflation increased from 3.5% in 2016 to 5.9% in 2017 but has been decreasing steadily over the last number of months. This in comparison to the official food inflation of 10.0% for the 2017 financial year, which confirms that not all increases were passed on to the customers.
- Supermarkets Non-RSA continued to see headwinds with the continued low price of oil in world markets and a concurrent lack of foreign currency in the oil producing countries, such as Angola and Nigeria. However, the Group continued with its strategy of importing inventory to ensure that customers have a proper range of products available to them. This contributed to this segment’s good performance with a reported growth of 11.7% (13.5% when measured against 52 weeks), contributing R24,840 billion to Group turnover after conversion to rand. In constant currencies the growth in turnover was 31.6% (33.8% compared to 52 weeks). Supermarkets Non-RSA opened a net 28 new outlets during the year outside of South Africa.
- Trading conditions for the furniture business also remained difficult, but it managed to increase turnover by 4.3% to R5,432 billion. When compared to 52 weeks the growth was 6.2%. The strongest turnover growth was again reported by OK Furniture at 10.4%, which targets middle- to lower income consumers, while House & Home saw a decrease of 11.3%. Credit participation reduced even further to 20.8%, due to the new compulsory affordability assessments with the resultant negative effect on finance and insurance income. The furniture division opened 23 new stores, but closed 32 loss making stores during the year.

Gross profit
- Gross profit comprises primarily gross margin after markdows and shrinkage. In line with IFRS (IAS 2: Inventory and IFRIC Circular 9/2006), the Group deducted settlement discounts and rebates received from the cost of inventory. During the year the Group changed its accounting treatment of advertising rebates because of the additional guidance provided by IFRS 15. This is due to the fact that the advertising rebates result from a process of negotiating the best product price with the supplier and not a result of Shoprite providing a distinct good or service.
- The Group maintained gross profit margins as a result of efficiencies in systems and logistics infrastructure, the latter now able to handle bigger volumes due to the new and extended distribution centres. This resulted in the gross profit margin increasing to 23.99% compared to 23.58% in the previous year. Gross profit increased by 10.3% to R33,826 billion, higher than turnover growth. Shrinkage remains well under control, but crime (robberies, theft and burglaries) is increasing by the day, forcing the Group to increase its spend on security and loss control.

Other operating income
- Other operating income increased by 7.0% to R2,615 billion, mainly due to an increase in franchise fees received, commission received and investment income. Net premiums earned had a 7.69% reduction, while finance income decreased by 0.61%, both a direct consequence of the reduction in the credit sales business that flowed from the changes made to the affordability assessments.

Expenses
- Cost management remains a high priority for the Group as trading margins are always under pressure due to the increased competition in food retailing.
- Depreciation and amortisation: The Group is continuing to increase its investment in information technology. It is also opening new stores while simultaneously implementing an on-going refurbishment programme for older stores. On average, stores are revamped every seven to eight years. In addition, 160 new corporate outlets were opened during the year with 51 closing down.
- Operating leases: 109 net new corporate stores were opened during the year and the increase in turnover also saw a commensurate increase in turnover rentals paid. Certain lease payments were reduced by head leases that were either not renewed or were renegotiated during the year.
- Employee benefits: The increase in staff costs of 10.5%, higher than turnover growth, was mainly due to the resulting staff requirements of increased turnover as well as the number of new store openings. Productivity improvement continued with additional focus on improving and maintaining in-store service levels. Included in employee benefits are provisions for long term incentives to retain staff.
Other operating expenses: These costs, which increased by 9.4%, cover expenses such as electricity and water, repairs and maintenance, security and credit card commissions paid. The Group maintained its provision for reinstatement of leased buildings where it has an obligation to maintain the exterior of such buildings. The growth in other expenses was mainly due to the increases in repairs and maintenance (revamps and other normal expenses) and security expenses growing more than turnover growth, the latter due to the need to safeguard our customers and stores against burglaries and armed robberies which is on the increase. During the year the increase in electricity was less pronounced than in previous years and only increased by 8.4%.

Trading profit Trading margins increased even further from 5.60% to 5.76%, due to the increase in gross profit and proper management of expenses.

Foreign exchange differences As stated in the accounting policies, the assets and liabilities of foreign subsidiaries are converted to rand at closing rates. These translation differences are recognised in equity in the foreign currency translation reserve (FCTR). In essence, most foreign exchange differences in the statement of comprehensive income are due to US dollar denominated short-term loans of operations outside South Africa and balances in US dollar held in offshore accounts.

During the year the rand strengthened against the US dollar and in addition we also saw a devaluation of the Angola kwanza, the Nigeria naira and the Zambia kwacha which affected the short-term loans. The result was a currency loss of R236 million compared to a loss of R46 million in the previous financial year. The current year’s loss resulted mainly from losses realised on forward foreign exchange rate contracts which were entered into in anticipation of a weakening of the rand against the US dollar.

The table below gives the approximate rand cost of a unit of the following major currencies at year-end:

<table>
<thead>
<tr>
<th>Currency</th>
<th>2017</th>
<th>2016</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>US dollar</td>
<td>13.038</td>
<td>14.775</td>
<td>12.126</td>
</tr>
<tr>
<td>Euro</td>
<td>14.916</td>
<td>16.393</td>
<td>13.581</td>
</tr>
<tr>
<td>Zambia kwacha</td>
<td>1.416</td>
<td>1.514</td>
<td>1.641</td>
</tr>
<tr>
<td>Angola kwanza</td>
<td>0.078</td>
<td>0.089</td>
<td>0.100</td>
</tr>
<tr>
<td>Mozambique metical</td>
<td>0.217</td>
<td>0.221</td>
<td>0.282</td>
</tr>
<tr>
<td>Nigeria naira</td>
<td>0.043</td>
<td>0.052</td>
<td>0.061</td>
</tr>
</tbody>
</table>

Net interest paid
The Group utilised overnight call facilities for both short-term deposits and borrowings for the year. As in the past, the Group funded all capital projects utilising short-term borrowing and cash reserves.

Net interest paid decreased to R114 million for the year compared to a net payment of R324 million in the previous year. The bulk of the convertible bonds converted to shares during the year and the last interest payment was thus forfeited.

In addition the Group is faced with the requirements of IAS 39 for the treatment of the interest on the convertible bonds. IFRS requires the debt component of the convertible bonds to be measured at amortised cost, using the effective interest method at the Internal Rate of Return. The interest expense calculated at the Internal Rate of Return of 10.09% amounted to R187 million for the year under review compared to the actual interest paid amounting to R147 million at the coupon rate of 6.5%.

Income tax expense
The effective income tax rate is higher than the nominal income tax rate due to certain non-deductible expenses such as leasehold improvements as well as income tax losses in certain Non-RSA countries that cannot be utilised for Group purposes. The non-deductible expenses reduced this year, with the result that a slightly lower rate is reflected. In a few of the Non-RSA countries, a minimum tax is applicable, contributing to the higher overall tax rate.

Headline earnings per share
Headline earnings per share increased 13.1% from 905.0 cents to 1,023.2 cents and result mainly from the increase in gross profits on top of a good turnover growth as well as the new stores opened. Diluted headline earnings per share increased by 11.9% from 903.3 cents to 1,007.4 cents. This dilution was due to the shares issued when the convertible bonds were converted. Should the effect of the extra week in the previous year be excluded, then this growth would have been 16.1%.

Statement of financial position
Non-current assets
Property, plant and equipment and intangible assets
During the year, the Group spent R5.167 billion on property, plant and equipment and software compared to R4.752 billion in 2016. The Group is also continuing with its policy to purchase vacant land for strategic purposes and building retail premises when no developers can be found. During the year, the Group spent R851 million on such land and buildings. The investment in refurbishments amounted to R740 million, while R1.068 billion was spent on new stores (excluding land and buildings), R1.276 billion on information technology and the balance on normal replacements. The Group is continuing with the process of upgrading its merchandising, master data and central stock ledger systems. The roll out of these systems has started in August 2017 and is expected to continue for the full financial year. Capital commitments of R1.807 billion have been made relating to improvements for the next financial year.

Intangible assets consist mainly of goodwill paid for acquisitions, trademarks acquired and software. Goodwill represents the premium paid for certain businesses and is tested for impairment annually based on the value-in-use of these businesses, calculated by using cash flow projections.

Software represents the Group’s investment in certain computer software that is used in its daily operations. The Group continued its investment in new SAP software. Software is amortised over its useful life of three to seven years.

Trademarks mainly represent the purchased Computicket, Transpharm and Seven Eleven/Friendly Grocer trademarks and is amortised over 20, 16 and 20 years respectively.

Deferred income tax assets
Deferred income tax is provided, using the liability method, for calculated income tax losses and temporary differences between the income tax bases of assets and liabilities, and their carrying values for financial reporting purposes. This asset developed primarily from provisions created for various purposes as well as the fixed escalation operating lease accrual.

Held-to-maturity investments
Local currency cash and short-term deposits in Angola and Nigeria are subject to onerous local exchange control regulations. The Group is, however, still in an expansion phase in both countries and said cash can still be used for its local trade. The Group has invested some surplus cash in Angola in US dollar linked Angolan government bonds as part of its hedging strategy against a possible devaluation.
Current assets

**Inventories**
Inventories amounted to R17.794 billion, an increase of 18.2% on the previous year. The inventory turn, based on cost of merchandise sold, was 6.5 times (2016: 6.9 times). The increase in inventory resulted mainly from the following:
- The provisioning for a net 109 new corporate stores; and
- The extension to the DCs in Centurion, Brackenfell and KZN with more suppliers and products now flowing through these facilities.

**Trade and other receivables**
Trade and other receivables mainly represent instalment sale debtors, franchise debtors, receivables from medical aid schemes, buy-aid societies and rental debtors. Adequate allowance is made for potential bad debts and the outstanding debtor's book is reviewed regularly.

The allowance for impairment and unearned finance income in respect of instalment sale debtors amounted to 23.8% compared to 19.4% the previous year. This increase was to take cognisance of the general debt environment, additional provisions in Non-RSA where instalment sales are in its infancy and to maintain the Group's conservative approach.

The allowance for impairment is now done by utilising a basic Chain Ladder Method with explicit allowance for expected write-offs while the Group is preparing for the implementation of IFRS 9 on Financial Instruments which will require the recognition of a potential impairment at the time of the initial credit transaction.

**Cash and cash equivalents and bank overdrafts**
Net cash and cash equivalents amounted to R2.709 billion at year-end, compared to R3.819 billion in 2016. This movement was mainly due to the capital expenditure, including land and buildings, of R5.167 billion as well as the unfavourable month-end which saw creditors being paid before the accounting month-end. The Group has also invested in US dollar linked Angolan bonds. See held-to-maturity investments above.

Current liabilities

**6.5% Convertible bonds**
These convertible bonds converted during the year when R4.587 billion of bonds were converted and R108 million of bonds were redeemed. 27 149 869 new shares were issued in the process.

**Provisions**
Adequate provision is made for post-retirement medical benefits, reinstatements, onerous lease contracts, long term employee benefits and all outstanding insurance claims. The Group has settled a major portion of the post-retirement medical liability in the past. The remaining liability relates mainly to pensioners and will be settled during the next financial years.

**Hire purchase sales**
The Group continued to supply credit facilities as part and parcel of its furniture business. The management and administration of this debtor's book is done in-house as the granting of credit is deemed an integral part of selling furniture.

**Shoprite insurance**
The Group operates its own short-term insurance company as part of the furniture business and as an insurance vehicle for its own assets. During the year under review net premiums earned relating to third parties amounted to R384 million compared to R416 million the previous year. Net premiums for credit protection amounted to R254 million compared to R270 million in the previous year. As in the past, the Group accounts for premiums earned and extended guarantee fees over the life of the policy. In South Africa insurance premiums are invoiced and earned on a monthly basis. This is in line with the National Credit Act.

At year-end the insurance company had a Capital Adequacy Requirement as per the Insurance Act of R161 million, with actual net statutory assets amounting to R628 million giving rise to a cover of 3.9 (2016: 3.5) before the declaration of dividends to the holding company.