Financial report

The results have been prepared taking into account the effect of hyperinflation in Angola. The currency devaluation in Angola, together with high levels of consumer inflation over the past three years have necessitated that the Group account for the results of its Angola operations on a hyperinflationary basis in accordance with IAS 29: Financial Reporting in Hyperinflationary Economies, effective from 3 July 2017. Comprehensive pro forma information has been included on pages 88 to 91 of the Integrated Report.

Statement of comprehensive income

Sale of merchandise

- Turnover growth for the 12 months to 1 July 2018 was 3.1% (3.6% excluding the hyperinflation adjustment) to R145.306 billion. Excluding the Angola operation, the Group managed to increase turnover by 5.5% with the Supermarkets RSA operating segment delivering a strong performance with a 5.7% growth on the back of low inflation. Even though the Group had to trade in a climate of increased labour action, the Listeriosis outbreak, high unemployment and currency devaluations, the Group managed to deliver a strong performance. Turnover growth during the second half of the year came under pressure, especially in Non-RSA with the devaluation of the Angola kwanza by 50.2% against the US dollar since December 2017.
- The following table gives the relevant turnover per segment:

	52 weeks Sales Growth %	52 weeks 2018 Rm	52 weeks 2017 Rm
Supermarkets RSA	5.7%	107 547	101 734
Supermarkets Non-RSA	(7.0%)	23 106	24 840
Furniture	9.8%	5 967	5 432
Other Segments	5.2%	9 463	8 994
Total Operating Segments	3.6%	146 083	141 000
Hyperinflation effect		(777)	–
Total Sales	3.1%	145 306	141 000

- Supermarkets RSA reported a 5.7% growth in turnover to R107.547 billion. Average internal food inflation decreased from 5.9% in 2017 to 0.1% in 2018 with no increase in the foreseeable future. This in comparison to the official food inflation of 4.5% for the 2018 financial year, which confirms that customers were shielded from price increases. In real growth terms the Supermarkets RSA division delivered a strong performance taking into account that the Group subsidised the 1% VAT increase as well as the introduction of the Health Promotion levy (sugar tax). The very successful Little Garden as well as the Black Friday and Red Friday promotions made headlines during the year. The Checkers brand is continuing to improve its fresh offering through the FreshX concept stores of which there are already 13 stores open. Supermarkets RSA opened a net 105 outlets during the year.
- Supermarkets Non-RSA recorded negative turnover growth of 7.0% mainly attributed to the normalised performance of the Angola operation following the 65.0% compound growth in turnover over the prior two years and the 50.2% devaluation of the Angola kwanza since December 2017. Excluding Angola supermarkets, Supermarkets Non-RSA managed to achieve a positive sales growth of 3.0%. A significant drop-off in Supermarkets Non-RSA internal inflation from 14.4% in the previous year to only 1.1% for the current year was also experienced. In constant currencies the growth in turnover was 1.2%. Supermarkets Non-RSA opened a net 23 new outlets during the year.
- Trading conditions for the furniture business remained challenging, but it managed to increase turnover by 9.8% to R5.967 billion. The strongest turnover growth was again reported by OK Furniture at 11.4%, which targets middle- to lower income consumers, while House & Home saw an increase of 4.9%. Credit participation reduced to 14.7% of sales, due to the new compulsory affordability assessments with the resultant negative effect on finance and insurance income. The division opened 20 new stores during the period, but ended the year with four less outlets as unprofitable stores were closed.

Gross profit

- Gross profit comprises primarily gross margin after markdowns 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.
- The Group is in the process of rolling out the SAP IS Retail system to all its stores changing the valuation of stock from the retail method of accounting to moving average cost, both methods approximate cost as described in the Group's accounting policy. The SAP IS Retail system enables the Group to manage gross margin by line item.
- The Group continued to maintain its price competitiveness in the face of stiff competition, not only from existing players but also new entrants to the market. It also continued with its strategy of subsidising certain basic foodstuffs in an effort to ease the plight of customers battling with price increases on every front.

- Despite cutting the margins on basic foods, 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 enabled the Group to keep the gross profit margin at 23.9% compared to 24.0% in the previous year. Gross profit increased by 2.7% to R34.7 billion, in line with 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 6.3% to R2.8 billion, mainly due to an increase in franchise fees received, commission received and investment income. Net premiums earned had a 14.8% reduction, while finance income increased by 9.2%, both a direct consequence of the reduction in the credit sales business that flowed from the changes made to the affordability assessments. Investment income increased as a result of the investment in USD Index Linked Angola Government Bonds and Angola Treasury Bills to act as a hedge against anticipated future currency devaluations.

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 continued its investment in information technology and logistics infrastructure during the year. 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, 166 new corporate outlets were opened during the year with 42 closing down.
- **Operating leases:** 124 net new corporate stores were opened during the year and the increase in turnover also saw a commensurate increase in turnover rentals paid. Increases in property taxes were above inflation which had a negative impact on the Group.
- **Employee benefits:** The increase in staff costs of 3.4%, which is higher than turnover growth, was mainly due to the resulting staff requirements of increased turnover as well as the number of new store openings, offset by a decrease in share-based payment arrangements. 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 5.7%, 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. The Group is investing in technology and energy saving hardware to ensure future cost reductions.

Trading profit

Trading margins decreased from 5.76% to 5.51%, due to the softer performance of the Supermarkets Non-RSA operations.

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 weakened against the US dollar and in addition we also saw a devaluation of the Angola kwanza and the Zambia kwacha which affected the short-term loans. The result was a foreign currency loss of R251 million compared to a loss of R236 million in the previous financial year. The current year's loss resulted mainly from losses due to the devaluation of the Angola kwanza.

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

	2018	2017	2016
US dollar	13.710	13.038	14.775
Euro	15.972	14.916	16.393
Zambia kwacha	1.370	1.416	1.514
Angola kwanza	0.055	0.078	0.089
Mozambique metical	0.229	0.217	0.221
Nigeria naira	0.045	0.043	0.052

Net interest paid

The Group utilised overnight call facilities for both short-term deposits and borrowings during the year and secured longer term offshore funding to fund its expansion outside the RSA borders.

Net interest expense, when compared to the corresponding period, increased due to additional funding required for capital projects in the current year, the specific buy-back and cancellation of ordinary shares to the value of R1.8 billion and due to the forfeiture of the last interest payment of the convertible bonds in the prior year.

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. In a few of the Non-RSA countries, a minimum tax is applicable, contributing to the higher overall tax rate.

Headline earnings per share

Basic headline earnings per share decreased by 5.2% from 1 023.2 cents to 969.6 cents as a result of the weaker Supermarkets Non-RSA results. Diluted headline earnings per share decreased by 3.8% from 1 007.4 cents to 968.7 cents. This dilution results from the dilutive potential of full share grants awarded to employees in terms of the long-term incentive bonus plan.

Statement of financial position

Non-current assets

Property, plant and equipment and intangible assets

During the year, the Group spent R5.336 billion on property, plant and equipment and software compared to R5.167 billion in 2017. 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 R581 million on such land and buildings. The investment in refurbishments amounted to R1.060 billion, while R1.028 billion was spent on new stores (excluding land and buildings), R1.220 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 project is on time with the last store and distribution centre going live in January 2019. Capital commitments of R1.621 billion have been made relating to improvements for the next financial year.

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The adoption of hyperinflation accounting resulted in an increase of R2.140 billion in property, plant and equipment, mainly impacted by the property portfolio of the Group's operations in Angola.

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 higher of the fair value less cost to sell or 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 ten 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 are subject to onerous local exchange control regulations. The Group is, however, still in an expansion phase in Angola and said cash can still be used for its local trade. The Group has invested surplus cash in Angola in USD Linked Angola Government Bonds as well as Treasury Bills as part of its hedging strategy against a future possible devaluation.

Current assets

Inventories

Inventories amounted to R18.0 billion, an increase of 0.9% on the previous year and in line with turnover growth. The inventory turn, based on cost of merchandise sold, was 6.2 times (2017: 6.5 times). The increase in inventory resulted mainly from the following:

- The provisioning for 124 net new corporate stores;
- The extension to the DCs in Centurion, Brackenfell and KZN with more suppliers and products now flowing through these facilities; partially countered by
- Improved inventory management outside South Africa.

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 debtors book is reviewed regularly.

The allowance for impairment and unearned finance income in respect of instalment sale debtors amounted to 24.0% comparable to the previous year at 23.8%.

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 (after deducting overdrafts) amounted to R3.5 billion compared to R2.7 billion in 2017, mainly due to a favourable month-end, which caused creditors to be paid after accounting month-end of 1 July 2018.

This increase was offset by the specific buy-back and cancellation of ordinary shares in the amount of R1.8 billion and a further increase in USD Index Linked Angola Government bonds and Angola Treasury bills to the value of R2.4 billion to hedge against a possible further devaluation of the Angola kwanza.

Current liabilities

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 R327 million compared to R384 million the previous year. Net premiums for credit protection amounted to R210 million compared to R254 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 R142 million, with actual net statutory assets amounting to R762 million giving rise to a cover of 5.4 (2017: 3.9) before the declaration of dividends to the holding company.

Situated in the flourishing agricultural hub of Mbombela in the lowveld of Mpumalanga, the Timbali Technology Incubator is a company that has found access to a market for young, inexperienced and unemployed rural people through the Shoprite Group. These women from Timbali amaVeg farm and pack quality vegetables in large quantities for Freshmark, the Group's fresh produce procurement arm, on a weekly basis. Freshmark's growth plans have enabled amaVeg to flourish and its workers to provide for their families and the community.

Read more about the various ways in which the Group supports the long-term development of communities around it in the 2018 Sustainability Report on www.shopriteholdings.co.za