

IMPLEMENTATION OF IFRS 16: LEASES

The purpose of this announcement is to communicate Shoprite Holdings' adoption of IFRS 16: Leases (IFRS 16) effective for financial years beginning on or after 1 January 2019. The Group hereby publishes its restated 30 June 2019 financial results accordingly.

IFRS 16 is a new financial reporting standard on leases replacing the previous IAS 17: Leases (IAS 17), requiring an accounting change. The main objective of IFRS 16 is to recognise and reflect a company's lease obligations in its financial statements by aligning the accounting and presentation of operating leased assets with those of owned and finance leased assets.

The Group has adopted the new standard with effect from 1 July 2019 using the full retrospective approach. Accordingly, the Group's 30 June 2019 comparative financial results have been restated from a transition date of 2 July 2018.

IFRS 16 has a significant impact on the presentation and classification of the statement of comprehensive income, statement of financial position, the statement of cash flows and certain key performance metrics. However, it has no impact on the Group's underlying economic model, revenue or net cash flow.

The application of IFRS 16 requires the majority of the Group's leased property, vehicles, machinery and equipment and other small item leased assets to be brought onto the statement of financial position in accordance with the aforementioned approach. The Group has elected not to recognise right-of-use assets and lease liabilities for low-value assets and short-term leases. The Group defines low-value assets, as assets with a cost price below R75 000. Low-value assets comprise IT equipment. Short-term leases comprise equipment and vehicle leases with a term of 12 months or less.

On the statement of financial position, IFRS 16 requires the recognition of a lease liability and a corresponding right-of-use asset. At the commencement date of a qualifying lease, the lease liability and corresponding asset are raised by discounting future lease payments. Management uses the rate implicit in the lease for vehicle leases and the lessee's incremental borrowing rate for all other leases. Whilst the lease liability and right-of-use asset are initially recognised at the same value, except in the case of prepaid leases, they reduce differently over the lease term as explained herein.

On the statement of comprehensive income, IFRS 16 replaces the previously recognised straight-line rental expense required under IAS 17 with a straight-line depreciation charge over the shorter of the underlying assets' useful life and the lease term. The right-of-use asset therefore reduces by the depreciation charge. The IFRS 16 lease liability results in an implied interest charge on the outstanding lease liability. The lease liability reduces over the term of the lease by the value of the lease payments, net of the implied interest charge, as payments are made. It is for this reason that IFRS 16 is dilutive to profit before tax and earnings per share at the initial stages of a lease and accretive at the end of the lease. However, over the term of the lease, the finance charges and depreciation will equal the rental payments.

In accordance with IAS 36: Impairment of assets, on recognition and at each reporting date, the right-of-use asset is subject to impairment testing and any such impairments are classified under items of a capital nature in the statement of comprehensive income.

The impact of the IFRS 16 adoption on the Group's 30 June 2019 results is summarised as follows:

On the statement of financial position:

- An IFRS 16 lease liability of R21.5 billion and right-of-use asset of R15.7 billion has been raised;
- Retained earnings has been reduced by R4.0 billion inclusive of a R3.3 billion adjustment to opening retained earnings on 2 July 2018;
- A deferred income tax asset of R1.0 billion has been raised. This is due to temporary differences between the lease liability and right-of-use asset;
- Trade and other receivables decreased by R0.8 billion due to a reclassification of prepaid leases to right-of-use assets; and
- The fixed escalation operating lease accrual and onerous lease provision of R1.5 billion has been derecognised.

On the statement of comprehensive income:

- Group sales and gross profit are unaffected;
- Depreciation increased by R2.5 billion due to the creation of the right-of-use asset;
- Operating lease expense declined by R4.2 billion as a result of the derecognition of the IAS 17 straight-line rental expense;
- There was an increase in the net monetary gain on the creation of the right-of-use asset. It is important to note that these restated results still apply hyperinflation accounting in accordance with IAS 29: Financial reporting in hyperinflationary economies;
- Group trading profit increased by R1.7 billion;
- Exchange rate losses increased by R0.5 billion mainly due to the Group's US dollar leases. From the 2020 financial year, the Group will apply net investment hedge accounting to reduce this impact;
- Items of a capital nature increased by R0.4 billion as a result of the required annual impairment testing on the right-of-use asset created;
- Finance costs increased by R1.8 billion. This is due to the implied interest charge raised on the aforementioned R21.5 billion IFRS 16 lease liability;
- Group profit before tax declined by R1.0 billion to R5.4 billion; and
- Previously reported diluted headline earnings per share of 779.9c decreased by 81.4c to 698.5c.

On the statement of cash flows:

- Lease payments which were previously included in operating activities are now allocated between principle and finance costs. The principle lease payments are included in financing activities and the finance cost remains in operating activities;
- The Group's net cash flow is not affected; and
- Dividends paid are not affected.

The application of IFRS 16 does not impact the Group's underlying business, operations, liquidity or cash flow. It also does not affect the Group's business strategy on leasing or otherwise.

The complete restated comparative financial information for the 2019 financial year included in Annexure A is the responsibility of the directors of Shoprite Holdings. It has been prepared for illustrative purposes only and has not been reviewed or reported on by the Group's auditors.

The Group is hosting an IFRS 16 briefing webcast call on 18 February 2020. It will be hosted by the Group chief financial officer, Anton de Bruyn, and will follow the format of a short presentation followed by an opportunity for questions and answers. Registration will be via www.corpcam.com/shoprite18022020. The presentation will be available on the company website www.shopriteholdings.co.za shortly before the webcast begins.

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Sponsor: Nedbank Corporate and Investment Banking

ANNEXURE A: RESTATEMENT OF FINANCIAL RESULTS

PRO FORMA STATEMENT OF COMPREHENSIVE INCOME

	As previously reported 52 weeks to 30 Jun '19 Rm	Impact of IFRS 16 30 Jun '19 Rm	Restated 52 weeks to 30 Jun '19 Rm
Sale of merchandise	150 395	—	150 395
Cost of sales	(115 074)	—	(115 074)
GROSS PROFIT	35 321	—	35 321
Other operating income	3 218	—	3 218
Depreciation and amortisation	(2 640)	(2 513)	(5 153)
Operating leases	(4 643)	4 189	(454)
Employee benefits	(11 997)	—	(11 997)
Other operating expenses	(13 303)	—	(13 303)
Net monetary gain (hyperinflation)	920	27	947
TRADING PROFIT	6 876	1 703	8 579
Exchange rate gains/(losses)	115	(458)	(343)
Items of a capital nature	(80)	(416)	(496)
OPERATING PROFIT	6 911	829	7 740
Interest received from bank account balances	273	—	273
Finance costs	(845)	(1 814)	(2 659)
PROFIT BEFORE INCOME TAX	6 339	(985)	5 354
Income tax expense	(2 068)	194	(1 874)
PROFIT FOR THE PERIOD	4 271	(791)	3 480
OTHER COMPREHENSIVE INCOME, NET OF INCOME TAX	(2 773)	120	(2 653)
Items that will not be reclassified to profit or loss			
Re-measurements of post-employment medical benefit obligations	3	—	3
Items that may subsequently be reclassified to profit or loss			
Foreign currency translation differences including hyperinflation effect	(2 776)	120	(2 656)
TOTAL COMPREHENSIVE INCOME FOR THE PERIOD	1 498	(671)	827
PROFIT ATTRIBUTABLE TO:	4 271	(791)	3 480
Owners of the parent	4 260	(792)	3 468
Non-controlling interest	11	1	12
TOTAL COMPREHENSIVE INCOME ATTRIBUTABLE TO:	1 498	(671)	827
Owners of the parent	1 487	(672)	815
Non-controlling interest	11	1	12
Basic earnings per share (cents)	768.2	(142.9)	625.3
Diluted earnings per share (cents)	767.3	(142.6)	624.7
Basic headline earnings per share (cents)	780.8	(81.6)	699.2
Diluted headline earnings per share (cents)	779.9	(81.4)	698.5

PRO FORMA STATEMENT OF FINANCIAL POSITION

	As previously reported as at 30 Jun '19 Rm	Impact of IFRS 16 30 Jun '19 Rm	Restated as at 30 Jun '19 Rm
ASSETS			
NON-CURRENT ASSETS	30 212	16 028	46 240
Property, plant and equipment	21 444	—	21 444
Right-of-use assets	—	15 741	15 741
Intangible assets	3 077	—	3 077
Government bonds and bills	2 516	—	2 516
Loans receivable	1 664	—	1 664
Deferred income tax assets	629	1 000	1 629
Trade and other receivables	882	(713)	169
CURRENT ASSETS	33 969	(41)	33 928
Inventories	20 889	—	20 889
Trade and other receivables	4 197	(41)	4 156
Current income tax assets	480	—	480
Government bonds and bills	500	—	500
Loans receivable	196	—	196
Cash and cash equivalents	7 707	—	7 707
ASSETS HELD FOR SALE	814	—	814
TOTAL ASSETS	64 995	15 987	80 982
EQUITY			
CAPITAL AND RESERVES ATTRIBUTABLE TO OWNERS OF THE PARENT			
Stated capital	7 516	—	7 516
Treasury shares	(605)	—	(605)
Reserves	19 152	(3 962)	15 190
	26 063	(3 962)	22 101
NON-CONTROLLING INTEREST	114	(8)	106
TOTAL EQUITY	26 177	(3 970)	22 207
LIABILITIES			
NON-CURRENT LIABILITIES	11 204	17 807	29 011
Lease liabilities	—	19 158	19 158
Borrowings	9 044	—	9 044
Deferred income tax liabilities	568	(30)	538
Provisions	289	(18)	271
Fixed escalation operating lease accruals	1 303	(1 303)	—
CURRENT LIABILITIES	27 614	2 150	29 764
Trade and other payables	19 495	(170)	19 325
Contract liabilities	791	—	791
Lease liabilities	—	2 320	2 320
Borrowings	2 662	—	2 662
Current income tax liabilities	423	—	423
Provisions	119	—	119
Bank overdrafts	4 124	—	4 124
TOTAL LIABILITIES	38 818	19 957	58 775
TOTAL EQUITY AND LIABILITIES	64 995	15 987	80 982

PRO FORMA STATEMENT OF CASH FLOWS

	As previously reported 52 weeks to 30 Jun '19 Rm	Impact of IFRS 16 30 Jun '19 Rm	Restated 52 weeks to 30 Jun '19 Rm
CASH FLOWS FROM OPERATING ACTIVITIES	635	2 269	2 904
Operating profit	6 911	829	7 740
Less: investment income and finance income earned	(764)	—	(764)
Non-cash items	2 362	3 258	5 620
Changes in working capital	(3 520)	(8)	(3 528)
Cash generated from operations	4 989	4 079	9 068
Interest received	1 020	—	1 020
Interest paid	(874)	(1 810)	(2 684)
Dividends received	22	—	22
Dividends paid	(2 430)	—	(2 430)
Income tax paid	(2 092)	—	(2 092)
CASH FLOWS UTILISED BY INVESTING ACTIVITIES	(4 693)	(24)	(4 717)
Investment in property, plant and equipment and intangible assets to expand operations	(3 709)	—	(3 709)
Investment in property, plant and equipment and intangible assets to maintain operations	(1 571)	—	(1 571)
Prepayments for right-of-use assets	—	(24)	(24)
Proceeds on disposal of property, plant and equipment and intangible assets	265	—	265
Proceeds on disposal of assets held for sale	184	—	184
Payments for government bonds and bills	(1 017)	—	(1 017)
Proceeds from government bonds and bills	1 444	—	1 444
Amounts paid to Resilient Africa (Pty) Ltd	(51)	—	(51)
Other loans receivable advanced	(437)	—	(437)
Cash inflows from other loans receivable	204	—	204
Acquisition of operations	(5)	—	(5)
CASH FLOWS FROM FINANCING ACTIVITIES	4 397	(2 245)	2 152
Repayment of lease liability obligations	—	(2 245)	(2 245)
Purchase of treasury shares	(115)	—	(115)
Proceeds from treasury shares disposed	13	—	13
Repayment of borrowings	(4 271)	—	(4 271)
Borrowings raised	8 770	—	8 770
NET MOVEMENT IN CASH AND CASH EQUIVALENTS	339	—	339
Cash and cash equivalents at the beginning of the period	3 470	—	3 470
Effect of exchange rate movements and hyperinflation on cash and cash equivalents	(226)	—	(226)
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	3 583	—	3 583
Consisting of:			
Cash and cash equivalents	7 707	—	7 707
Bank overdrafts	(4 124)	—	(4 124)
	3 583	—	3 583