IFRS 16 BRIEFING

FINANCIAL REPORTING OF IFRS 16

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Headlines

IFRS 16 is an accounting change:

- It aligns the financial reporting of leased assets with owned assets
- Requires our predominantly leasehold business to report under a freehold model
- Introduces theoretical lease liabilities and assets, with implied interest and depreciation charges

IFRS 16 has no impact on our underlying economic model:

- Our leasehold strategy provides operational flexibility and enables debt and interest charges to be kept to a minimum

Headlines

IFRS 16 will not change:

- The fundamentals of our performance - turnover, tax and dividends paid
- Cash flows generated by the Group
- Our strategic objectives and the positive trajectory of our earnings to date

IFRS 16 however does change:

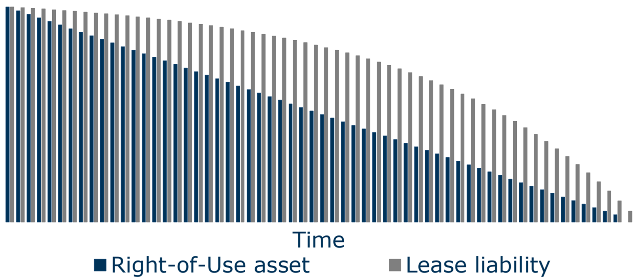
- Certain key performance metrics, including: EBITDA, EBIT, HEPS, ROCE and gearing ratios
- The recalibration of performance metrics will be clearly explained in this presentation

Implementing IFRS 16

- IFRS 16 applies to the Group **from FY20 onwards** - interim results to be published under IFRS 16 on **22 October 2019**
- The Group has adopted the **full retrospective approach**
- Historic financial information has been **restated** and **performance metrics recalibrated** as if IFRS 16 had always applied
- Full retrospective approach significantly more onerous than the alternative "modified" approach, but provides stakeholders and management with **greater insight** and **year-on-year comparability**

IFRS 16 principles - Balance Sheet

Illustrative example: Value of right-of-use asset and lease liability over time



Value of lease asset and lease liability are **equal at inception**, but reduce at different rates over the lease term

- Asset depreciates on a **straight-line basis** over lease term
- Liability attracts interest at the implied borrowing rate at inception and is reduced by rental payment **(interest portion declines over time)**

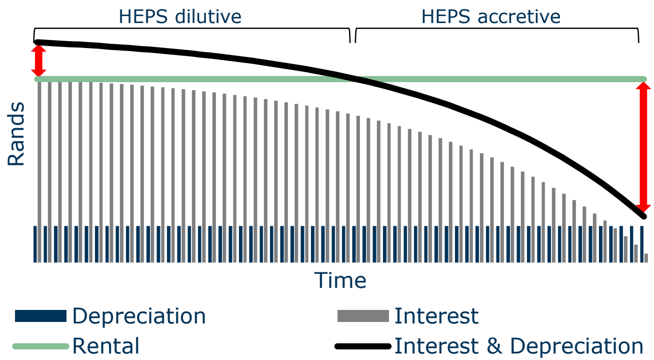
- All long-term leases now brought on to balance sheet, including leases on **property, equipment and vehicles.** This excludes leases where payments are variable in nature, for example turnover rentals

- Lease liability determined as the **present value of future rent payments** over the lease term, discounted at an average portfolio borrowing rate of 8.8%

- A corresponding **right-of-use asset is capitalised** at the same value as the lease liability

IFRS 16 principles - Income Statement

Illustrative example: Rent = depreciation + interest over lease term



IFRS 16 has **no impact on the income statement or cash flows** over the full lease term

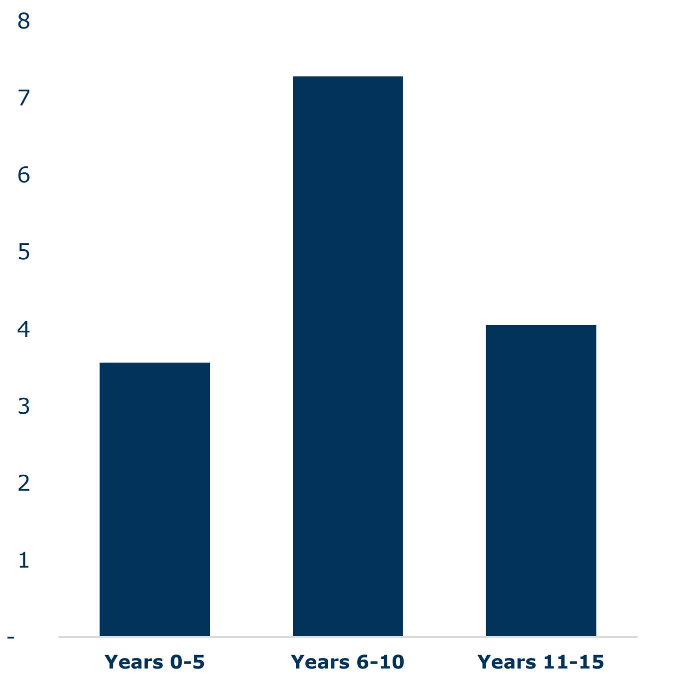
- IFRS 16 is earnings dilutive towards the beginning of the lease term (front-loaded lease costs) and accretive towards the end of the lease term

- **Straight-line rent replaced by depreciation and interest**
  - Straight-line depreciation on right-of-use asset
  - Interest charge on lease liability is greater at the beginning of the lease, reducing over time
  - The total IFRS 16 lease expense is now front-loaded
- EBITDA* increases with rent expense removed from income statement
- Trading profit, PBT, HEPS and ROCE impact depends on the relative maturity of the lease portfolio

* Earnings before interest, tax, depreciation and amortisation

Lease Portfolio

Lease liability by years to maturity – Rbn



- **Predominantly leasehold operating model**
  - Greater operational flexibility versus a freehold model
  - Provides low gearing options
  - Limits debt and interest
- Average lease term of **10 years**
- Our extensive **lease portfolio is stable**, with ongoing lease renewals, new stores and renegotiations, keeping our portfolio at the **mid-way point**
- Included in our portfolio are a number of **head-leases** held over strategic franchise sites

Head-lease Portfolio

Landlord ⟷ Pick n Pay ⟷ Franchisee

Head-lease: Landlord ⟷ Pick n Pay — Lease liability

Sub-lease: Pick n Pay ⟷ Franchisee — Net investment in lease receivable

- Properties held under head-leases are sub-let to franchisees, with the **right-of-use asset held by the franchisee**
- IFRS 16 requires Pick n Pay to recognise a **lease receivable** and an equal and opposite lease liability (present value of future rent payments)
- Head-leases have **no impact on the Group's net asset value** on the balance sheet
- Head-leases have **no impact on the income statement** - rent received replaced by interest received and rent paid replaced by interest paid

No change to fundamental performance and value creation

	FY19 PRE-IFRS 16 Rm	IMPACT Rm	FY19 POST-IFRS 16 Rm
Turnover*	86 271	-	86 271
Tax paid	817	-	817
Free cash flow	1 900	-	1 900
Annual dividend paid	1 098	-	1 098

IFRS 16 does not change:

- The way we run our business
- Turnover, and distributions to staff, shareholders and governments
- Free cash flow generated

* Presented on a 52 week basis

No change to dividend paid

	FY19 PRE-IFRS 16 Rm	FY19 POST-IFRS 16 Rm
Headline earnings*	1 647	1 428
Annual dividend paid	1 098	1 098
Dividend cover	1.5x	1.3x

- **No impact on cash flow**
- HEPS remains our key performance measure:
  - IFRS 16 has permanently changed the water level
- Headline earnings for FY19 of R1.6bn now recalibrated to R1.4bn
- **Cash dividend unchanged - expressed as a ratio of recalibrated HEPS is now at a dividend cover of 1.3 times earnings**
- Our dividend for FY19 remains R1 098m and the dividend cover of 1.3 times will be carried forward

* Presented on a 53 week basis

Summary of IFRS 16 Accounting Changes

	FY19 PRE-IFRS 16 Rm	IMPACT Rm	FY19 POST-IFRS 16 Rm
Net property rent paid/(received)*	1 954	- 2 004	- 50
Depreciation*	1 026	+ 1 562	2 588
Trading profit*	2 049	+ 867	2 916
Net interest paid*	91	+ 1 178	1 269
Net profit after tax*	1 555	- 205	1 350
Net lease smoothing provision	- 1 467	+ 1 480	13
Lease liability	-	+ 15 427	15 427
Lease asset	-	+ 10 103	10 103
Lease receivable	-	+ 2 110	2 110
Net asset value	4 317	- 1 360	2 957

Accounting changes include:

- Net property rent all but eliminated
- Depreciation moves from R1.0bn to R2.6bn
- Net interest paid increases from R91m to R1.3bn
- Lease liability of R15.4bn
- Right-of-use asset of R10.1bn
- Lease receivable of R2.1bn

* Presented on a 52 week basis

Recalibration of Performance Metrics

INCOME STATEMENT*	FY19 PRE-IFRS 16	IMPACT	FY19 POST-IFRS 16	FY18 POST-IFRS 16
EBITDA#	**R3 251m**	**+ R2 418m**	**R5 669m**	**R5 196m**
EBITDA margin	*3.8%*	*+ 2.8%*	*6.6%*	*6.5%*
Trading profit before forex	**R2 044m**	**+ R913m**	**R2 957m**	**R2 759m**
Trading profit before forex margin	*2.4%*	*+ 1.0%*	*3.4%*	*3.4%*
PBT excluding forex and capital items	**R2 062m**	**- R264m**	**R1 798m**	**R1 592m**
PBT margin	*2.4%*	*- 0.3%*	*2.1%*	*2.0%*
HEPS excluding forex	**325.90c**	**- 36.26c**	**289.64c**	**247.57c**
% growth yoy	*17.4%*		*17.0%*	

- IFRS 16 recalibrates certain key performance metrics
- **Full retrospective adoption** – all historic financial information restated and fully comparable

* Presented on a 52 week basis
# Excluding capital items and share of associate income

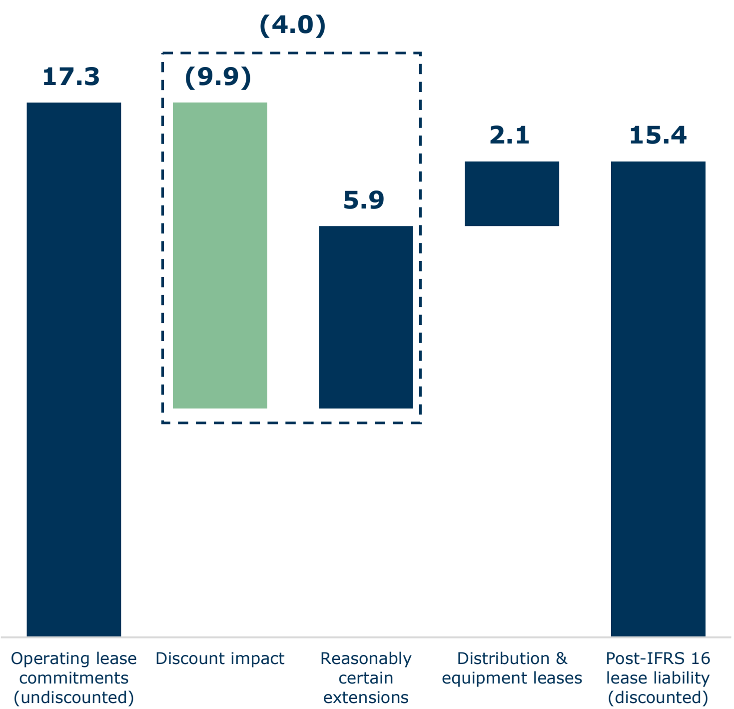
Recalibration of Performance Metrics

BALANCE SHEET	FY19 PRE-IFRS 16	FY19 POST-IFRS 16	FY18 POST-IFRS 16
Total debt, net of cash	R1.6bn	R17.0bn	R15.9bn
ROCE (EBIT as a % of capital employed)	48.4%	16.1%	15.8%
WACC	12.4%	11.3%	11.1%

- **IFRS 16 recalibrates key performance metrics:**
  - Long-term and short-term debt, net of cash, moves to R17.0bn with the inclusion of R15.4bn of theoretical lease liabilities
  - ROCE now 16.1%
  - WACC moves from 12.4% to 11.3%
- IFRS 16 has not changed the Group’s funding model
- Group continues to have no structured long term debt
- **IFRS 16 does not impact the Group’s risk profile, its liquidity and its ability to raise funds**

Impact of IFRS 16 - Lease Liability

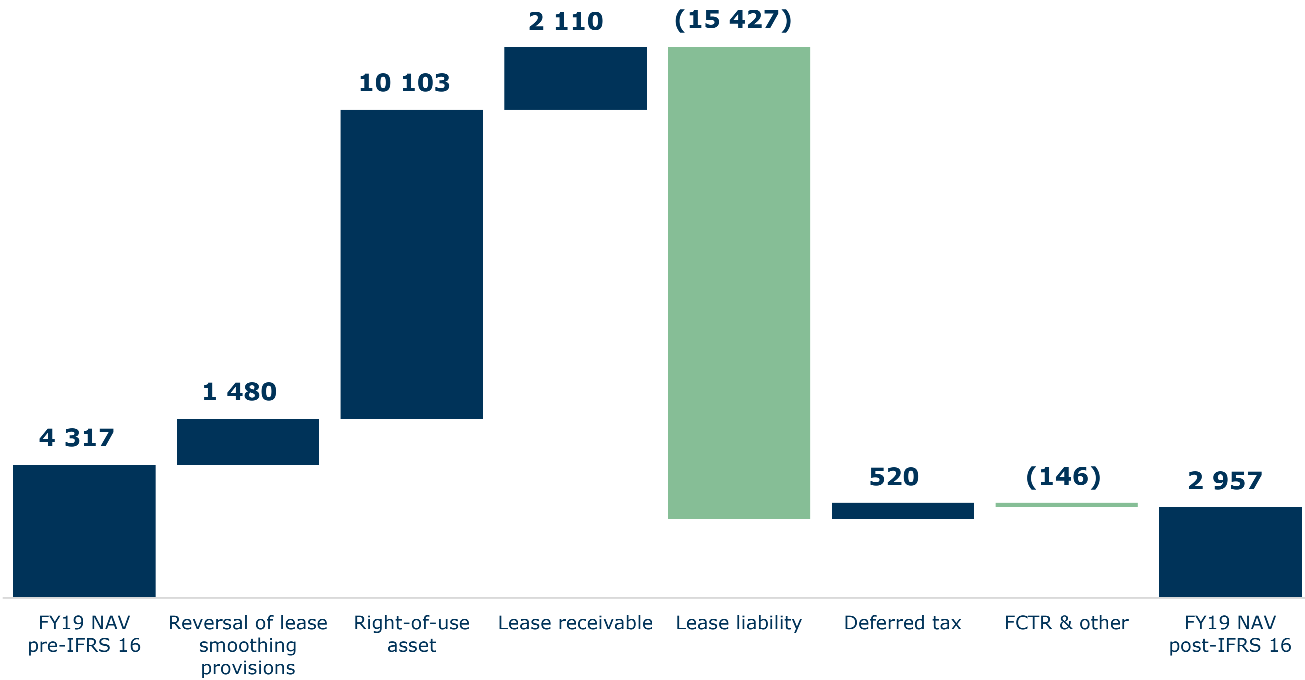
Lease liability pre- and post-IFRS 16 - Rbn



- The IFRS 16 lease liability is the present value of all future rent payments over the lease term, discounted at applicable borrowing rates at inception
- IFRS 16 lease liability at end FY19: R15.4bn
- In line with the Group's undiscounted lease commitments as previously disclosed
- The R15.4bn includes a lease liability of R2.1bn for which the Group holds a corresponding franchise sub-lease receivable

Impact of IFRS 16 - Net Asset Value

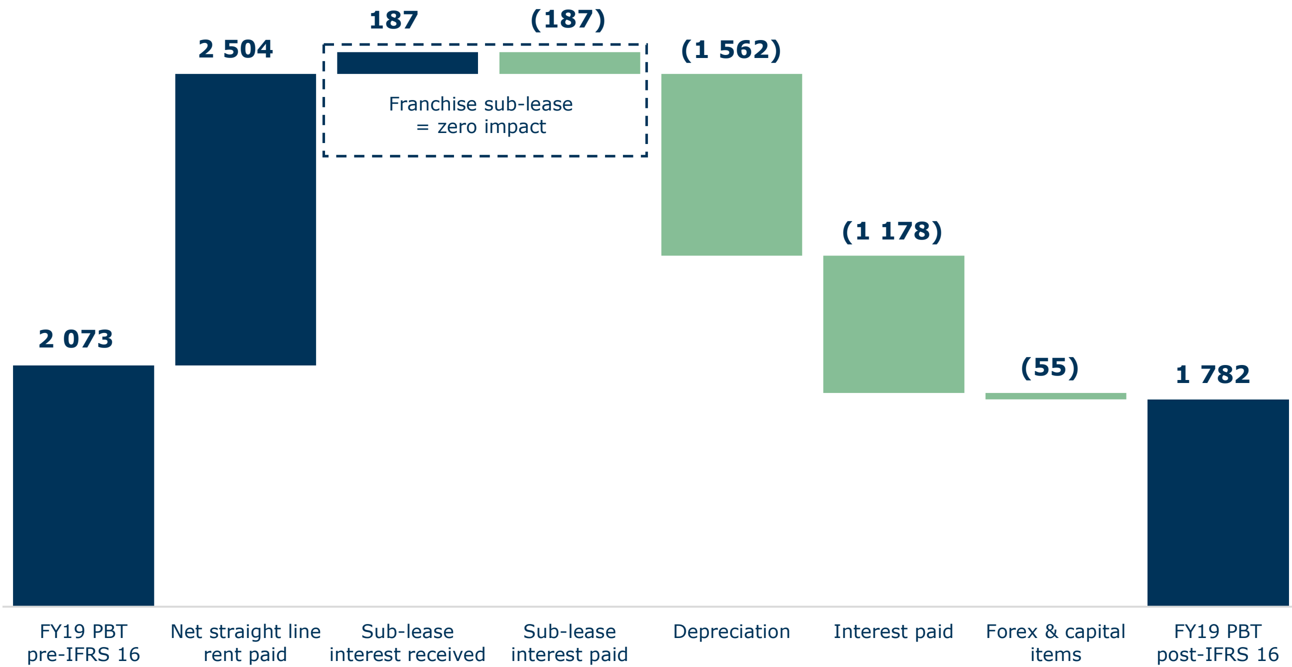
NAV pre- and post-IFRS 16 - Rm



- IFRS 16 reduces equity by R1.4bn

Impact of IFRS 16 - Profit Before Tax

Profit Before Tax pre- and post- IFRS 16* - Rm



* Presented on a 52 week basis

In summary

- IFRS 16 applies to the Group from FY20 onwards - interim results to be published under IFRS 16 on **22 October 2019**

- The main impacts of IFRS 16:
  - Balance sheet – recognition of lease assets and liabilities
  - Income statement - rent replaced by depreciation and interest
  - Key performance metrics, including gearing ratios and return on capital
  - Full retrospective adoption

- IFRS 16 will not change:
  - Our underling economic model, the way we run our business, and the trajectory of our earnings to date
  - Fundamentals of our performance - turnover, tax and dividends paid
  - Cash flows generated by the Group
  - Our strategic objectives

Q&A

FAQs

Q. Will the IFRS 16 implied increase in indebtedness on your balance sheet affect your debt covenants or cost of funding?

- The Group has no long-term funding, and our short-term facilities have no covenants in place
- Major short-term funders have confirmed that IFRS 16 will have no impact on either the size of our facilities or the cost of our funding

Q. Based on the changes to your gearing ratios, will your capital structure be revisited?

- IFRS 16 is simply an accounting change, and will not impact the Group’s ongoing review of appropriate levels of capital funding
- We will continue to manage our business as we always have - IFRS 16 has no impact on our underlying economic model, or the fundamentals of our performance

FAQs

Q. Will the recalibrated dividend cover of 1.3 times earnings remain in place going forward - or will the dividend cover change as IFRS 16 becomes "accretive" to earnings over time?

- While it is true that IFRS 16 is dilutive to earnings at the beginning of a lease, and accretive towards the end - our portfolio has reached a point of stability at the mid-way point of its maturity
- Due to the substantial size of our portfolio, with over 2 500 qualifying IFRS 16 leases, and the fact that we are constantly opening new stores, renegotiating and terminating leases - we expect to stay at the mid-way point of our portfolio over the long-term
- Looking forward, the "recalibrated" dividend cover of 1.3 times earnings will remain in place

FAQs

Q. What effect does the change in HEPS value have on the Group's remuneration policy?

- HEPS remains the Group's primary performance metric for our executive share incentive scheme
- IFRS 16 has permanently recalibrated HEPS. Adjusted values will be applied retrospectively as the primary performance metric for our Forfeitable Share Plan, with the same growth hurdles in place
- IFRS 16 has introduced some forex-related volatility related to our USD based leases in Zambia. The Remuneration Committee will review the forex volatility related to Zambian leases, and may elect to focus on a HEPS measure excluding any non-cash forex gains or losses if appropriate

FAQs

Q. At what point will the IFRS 16 earnings impact change from dilutive to accretive?

- We expect our large lease portfolio to remain at a stable mid-way point in its maturity profile over the long-term
- As a result, any year-on-year positive or negative impacts from the statement are not expected to be material
- We have adopted the full retrospective approach - restating all historic financial information and performance metrics. Stakeholders must now focus on past and future growth trends under IFRS 16

FAQs

Q. Is the Group's approach to lease negotiations going to change?

- No - IFRS 16 does not change the way we manage our business, or the way we manage our lease negotiations
- The fundamentals of the lease negotiation do not change:
  - we remain committed to reducing the cash cost of each lease wherever possible
  - we add a variable element to our lease where appropriate (turnover rental)
  - we negotiate fair and reasonable annual escalations
  - we look for shorter-dated leases where appropriate, with longer leases over strategic sites
  - we procure head leases over strategic franchise sites

FAQs

Q. Can the Group avoid forex exposure in Zambia by changing its USD leases to kwacha? Or will the Group consider hedging solutions?

- Wherever possible, the Group holds local currency leases outside of SA to avoid exposure to foreign currency volatility
- The Group manages its foreign currency exposure, including through hedging, as and when appropriate, in order to maximise Group profitability

Q. Has IFRS 16 had an impact on the Group's share of associate income?

- Any impact from IFRS 16 has been immaterial on our 49% share of the earnings of TM Supermarkets in Zimbabwe

FAQs

Q. Why has IFRS 16 impacted gross profit?

- Gross profit has also been restated under IFRS 16, although the change is not material
- The R103m IFRS 16 benefit to gross profit in FY19 (with a similar adjustment in FY18) is related to property, equipment and vehicle leases held in respect of our distribution centres
- The related rent cost previously recorded in cost of sales has been removed - and replaced by depreciation, also recognised within cost of sales, with the implied interest charge recognised within finance costs

Q. Why has IFRS 16 reduced the Group's inventory valuation by R3.8m?

- The presentation of distribution costs has changed, as discussed above, and as a result, the related allocation of these costs to the inventory value has also changed

FAQs

Q. Rent paid has always been recognised as part of occupancy costs, and depreciation charges as part of operations costs. Where will IFRS 16 depreciation charges be recognised?

- IFRS 16 depreciation on property leases recognised within occupancy costs
- IFRS 16 depreciation on distribution centre leases recognised within cost of sales
- IFRS 16 depreciation on all other equipment and vehicles recognised within operations costs

Q. If the Group terminates a long-term lease, does the IFRS 16 liability effectively represent the full cost of what the Group has to pay to exit the lease?

- No - termination / exit costs depend entirely on the underlying terms and conditions of the lease and are subject to a negotiation with the landlord

Q. Why did the adoption of IFRS 16 result in a R60m reduction to intangible assets?

- Intangible assets previously recognised on the procurement of strategic head leases are now included in the valuation of related franchise leases

FAQs

Q. The restated FY19 income statement now includes a lease termination gain of R20m under capital items (R150m in FY18) - why?

- The IFRS 16 liability is always greater than the IFRS 16 asset over the term of the lease - because the asset is depreciated on a straight line basis, while the liability is reduced by rent payments, net of implied interest charges
- If a lease is renegotiated or terminated part-way through its term, the lease liability and lease asset are de-recognised, with the net value (net of termination costs) recognised as a capital gain in the income statement

Q. Why has IFRS 16 had an impact on the Group’s tax rate?

- The adoption of IFRS 16 has a limited impact on the Group’s effective tax rate, as most adjustments are subject to deferred tax
- However, certain unrealised forex adjustments relating to US-dollar based rentals in Zambia are not subject to tax, and therefore do have an impact on the Group’s tax rate

FAQs

Q. The Group has changed its ROCE calculation from a HEPS-based methodology, to an EBIT-based measure - why?

- A benchmark measure for Return on Capital Employed (ROCE) is:
  - EBIT* / Average shareholders' equity plus average long-term borrowings
- EBIT is the most relevant measure of operational performance, before the impact of any funding considerations. It is the measure used widely by our peers across the industry
- Traditionally the Group used HEPS as its performance measure in ROCE, as we have traditionally had low levels of gearing – and any interest paid had a relatively small impact on ROCE
- However, with the introduction of R1.2bn of IFRS 16 implied interest charges, HEPS is no longer the relevant performance metric for ROCE

* Earnings before interest, tax, capital items and share of associate's income

FAQs

Q. What impact would the modified approach have had on Group earnings?

- The modified approach does not restate previously published information
- All adjustments to prior period earnings would be taken against opening retained earnings
- This removes any year-on-year comparability and provides no insight into performance trends
- Our previously published growth in HEPS (excluding forex) in FY19 was 17.4%. Under IFRS 16, with a full retrospective restatement, we delivered HEPS (excluding forex) growth of 17.0%. This demonstrates that IFRS 16 has had no material impact on the Group’s underlying performance