CREATING VALUE THROUGH OUR BUSINESS MODEL

Our business model describes how we create and preserve long-term sustainable value, and minimise value erosion, for all our stakeholders – through the effective and balanced use of our capitals – while keeping the customer at the centre of everything we do. Our business model is underpinned by strong corporate and social governance, with our unique and enduring values at its core.

Our management teams devoted much of their energy and focus this year to navigating significant economic and operational disruption brought by the Covid-19 pandemic. The effectiveness of the Group's operating model has been tested many times over more than five decades, but never more so than during the current crisis. The Group, through extraordinary teamwork, decisive and responsible action, and an unwavering commitment to the principles and objectives of its long-term plan, has preserved the stakeholder value under its care.

Capitals as inputs into our business model

Financial

Our financial resources include equity and debt funding, and earnings generated and retained by the Group. We rely on our financial resources to fund our growth plans, enhance the quality of our estate and customer offer, invest in new infrastructure, systems and technologies, upskill and develop our staff, and advance the growth engines of our long-term strategy.

Capital inputs at the beginning of the year included:
- R3.0 billion of shareholders' equity
- R3.0 billion of short-term borrowings
- R1.9 billion of cash balances

Constraints and challenges faced during the year included:
- Worsening macro- and socio-economic conditions and constrained consumer spending, exacerbated by the economic impact of Covid-19
- Volatility and illiquidity in local debt markets as a result of the pandemic
- Currency weakness and hyperinflation in the Rest of Africa segment

Relevant material issue: "Consumer environment", "Funding liquidity" and "Foreign investment returns" – refer pages 35, 37 and 38

Intellectual

The Group's experience, data, systems and processes enable us to understand our customers and how we can serve them better. Centralisation, including advanced forecast and replenishment systems, supports greater operational efficiency, alongside our outstanding information technology infrastructure. Our growing range of own brand products suit every customer's budget.

Capital inputs at the beginning of the year included:
- 3 strong brands: Pick n Pay, Boxer and TM Supermarkets
- Smart Shopper loyalty programme
- Enterprise-wide SAP operating and reporting system
- Food technicians and product developers

Constraints and challenges faced during the year included:
- Remote working to meet physical distancing requirements in support offices
- Increased cybersecurity concerns
- Supply chain disruption and demand planning under Covid-19

Relevant material issue: "Security of supply" and "Digital security" – refer pages 36 and 38

Social and relationship

Our stakeholder relationships are governed by our values and the enduring principle that doing good is good business. We rely on these relationships to earn the loyalty of our customers, generate more jobs, contribute to the communities we serve and to develop local suppliers and small businesses.

Capital inputs at the beginning of the year included:
- Customer-led long-term strategy
- Meaningful corporate social investment programme
- Strong platforms for stakeholder engagement
- 10 000 local suppliers and service providers

Constraints and challenges faced during the year included:
- Low economic growth and high unemployment impacting the socio-economic welfare of the communities and customers we serve
- Community protests in response to a lack of local municipal service delivery led to store closures in our more vulnerable communities

Relevant material issue: "Consumer environment" – refer page 35

Manufactured

We use physical infrastructure within our operations that includes our store estate, distribution capacity, and information technology platforms. We rely on this manufactured capital to procure, transport, store and display our products in a range of store formats – enabling us to serve customers across a diverse socio-economic spectrum.

Capital inputs at the beginning of the year included:
- 1 925 stores
- Strong support offices
- 15 distribution centres and two online distribution centres
- Valued partnerships with transport logistics providers

Constraints and challenges faced during the year included:
- Store closures and reduced trading hours as a result of Covid-19
- Reinforced health and hygiene standards to keep our stores and operations safe for customers and staff
- Extended periods of load shedding in South Africa, Zambia and Zimbabwe
- Escalating cost of energy, fuel, water and other utility costs

Relevant material issue: "Health and safety", "Security of supply", "Digital security" and "Climate change" – refer pages 36, 38 and 39

Human

Valued colleagues across Pick n Pay, Boxer and TM provide critical skills, talent, ambition and diversity that underpin a winning team. We rely on and invest in our human capital to provide our customers with convenient and reliable access to high-quality, safe and competitively priced products and value-added services, with great service in outstanding stores.

Capital inputs at the beginning of the year included:
- 54 900 employees in our company-owned businesses
- 35 100 employees across our franchise stores

Constraints and challenges faced during the year included:
- The physical and mental well-being of our staff throughout the Covid-19 crisis
- The Group's transition towards a more formal, functional outsourced model in its supply chain
- Voluntary and other severance programmes to improve productivity and efficiency

Relevant material issue: "Talent management" – refer page 39

Natural

We utilise environmental resources during production, distribution and the sale of consumer products. We are committed to reducing our consumption of natural and scarce resources in our operations and, with thousands of suppliers and millions of customers, we are extremely mindful of our broad reach and our broad impact.

Key environmental impacts last year:
- Carbon footprint – 889 595* tonnes CO_2e
- Water consumed – 1 117 megalitres
- Waste diverted from landfill – 60%

Constraints and challenges faced during the year included:
- Drought in the northern and eastern parts of South Africa, and in Zambia and Zimbabwe
- The impact of water scarcity on hydro-electricity in Zambia and Zimbabwe, and sustained and prolonged power outages in these regions

Relevant material issue: "Climate change" – refer page 39

* *Amended post initial publication to reflect subsequent independently verified data (previously reported as 934 164.9 CO_2e tonnes).*

Our operating model ensures we utilise our capital inputs across our retail operations in the most effective and efficient manner to optimise our capital outputs and outcomes for all. Our business model maintains a virtuous circle which balances the needs of our stakeholders in a fair and equitable manner, while effectively managing the trade-offs between our capitals. The balance and stability provided by the Group's operating model – guided at all times by the underlying principle that doing good is good business – has underpinned the strength of the business throughout the Covid-19 crisis and has safeguarded the interests of all stakeholders at a time of unprecedented disruption.

Our business model maintains a virtuous circle

Through our business activities, we serve customers across the diverse spectrum of southern African communities – and we are South Africa's most inclusive retailer.

We provide a competitive customer offer

We provide a leading product range, including value-added services, at competitive prices through high-quality stores that are conveniently located within customer reach.

We run cost-effective and efficient operations

The Group has built an increasingly efficient supply chain, lean store operations and support offices, and an effective franchise model. Cost and efficiency savings are invested into a competitive customer offer.

We source and buy products effectively and responsibly

We buy better for customers, underpinned by ethical sourcing and food safety standards that contribute towards securing sustainable future supply.

Our business activities are supported by a team of retail specialists driven by a high-performance culture

Our customer-focused, talented and diverse retail team execute our long-term growth plans. These plans support employment within the communities we operate in.

We stimulate economic and social upliftment within the communities we serve

Our successful strategy supports investment in our communities, in line with our ethos of doing good is good business, as captured in our enduring values and our mission statement as set out on pages 3 and 10.

- **Governance**: the Board influences the strategic direction of the Group and oversees remuneration and incentives linked to the capitals
- **Material risks and opportunities**: external conditions, trends and internal factors influence business activities and performance, creating a growth environment or restricting ability to create value
- **Strategy and resource allocation**: business activities support and drive resource allocation plans to achieve short, medium and long-term strategy
- **Stakeholders**: participate in our shared value creation through a range of engagements and relationships
- **Performance**: business activities have financial and non-financial implications that can impact the capitals available to the Group

Our capital outputs

Our capital outputs include the wide range of products and services that we sell to our customers under our Pick n Pay, Boxer and TM brands, including food, groceries, clothing, general merchandise, liquor and other value-added services. As a result of our retail operations, we produce by-products and waste (including food waste, our packaging impacts and carbon emissions). Due to our broad reach, our by-products and waste must be properly managed to mitigate any adverse impact on the availability of natural capital and to safeguard our social license to operate in the short, medium and long term. Read more in our 2021 Sustainable Living Report, available online from end June 2021.

Our capital outcomes

Our business activities and capital outputs transform the capitals during the year. Our capital outcomes include a range of internal and external consequences for our stakeholders, which are outlined in more detail on the following pages of this report.

Action taken to enhance positive outcomes, minimise negative outcomes, and manage our capital trade-offs

Financial

Covid-19 trading restrictions – constrained sales growth at 4.3%
Covid-19 operational response – additional costs of R200 million

- Strengthened customer offer – market-leading food and grocery performance, up 10.0% year-on-year
- Effective and targeted promotions – selling price inflation kept to 3.8%
- Supply chain productivity and efficiency – gross profit margin expansion to 19.8%
- Staff restructuring – once-off severance costs of R200 million
- Strong cash and working capital management – comparable net cash position up R500 million year-on-year
- Uninterrupted dividend cycle – R900 million paid to shareholders
- Leaner operating model in Rest of Africa – mitigating difficult economic conditions and currency weakness

Intellectual

- Covid-19 restrictions over non-essential value-added services – all related commission and other income down 0.5% year-on-year
- Met customer demand for contactless payment solution – over 13 billion contactless payments processed
- Strengthened partnership with TymeBank – 3 million accounts now open
- Launched mobile virtual network operator – low-cost airtime and data through PnP Mobile and Boxercom
- Value and innovation through Pick n Pay own brand – 1 500 new products launched; sales participation now at 25%; insourced product development
- Sustained investment in Smart Shopper loyalty programme – R3.5 billion provided in loyalty savings; 300% growth in redemption of personalised discounts; 75% sales participation
- Sustained investment in digital innovation – online customers tripled; 700% growth in on-demand online service

Social and relationship

- Feed the Nation Covid-19 relief campaign – raised R136 million, provided 28 million meals to vulnerable families in South Africa
- Business development – 10 new entrepreneurs in our Spaza-to-Market store programme
- Pick n Pay is a member of leading ethical trade membership organisation SEDEX (Supplier Ethical Data Exchange) and SIZA (Sustainability Initiative of South Africa)
- Low prices on fresh produce and Live Well products, providing our customers with greater access to healthy choices
- The Pick n Pay School Club supports 2.3 million learners at 3 155 schools

Manufactured

Covid-19 response – store closures, reduced trading hours, physical distancing measures

- Expanded digital shopping platform to meet accelerated online demand – including through the purchase of on-demand app Bottles and the launch of online clothing sales
- R1.6 billion of capital investment – programme scaled back as a result of Covid-19
- Capital spend well balanced – new stores (50%); refurbishments (20%); infrastructure (30%)
- Property reset to maximise investment returns – 112 new stores; 34 conversions; 43 closures
- Boxer centralised supply increased to 55% – new distribution centre in Polokwane
- Collaboration with suppliers minimised Covid-19 supply chain disruption – product availability maintained at 95%
- Improved efficiency of transport model – fewer trucks, fewer kilometres, lower costs

Human

- Staff appreciation – bonus paid to essential staff working at the frontline of the Covid-19 crisis
- Staff recognition – performance bonuses for outstanding performances under challenging conditions
- Strengthened health and wellness programmes – addressed physical and emotional impact of Covid-19
- Greater productivity – voluntary severance programme right-sized our operational teams
- Administrative efficiency – targeted severance programme addressed support structures
- Growing business – 2 000 new jobs created through store opening programme
- Appointed two functional outsource partners in our supply chain – providing greater skill, efficiency, stability
- Achieved disability targets, including through learnership programmes
- Ongoing progress in meeting diversity targets in senior management – with significant improvement in junior and middle management roles

Natural

- 43.6% reduction in energy intensity from a 2008 baseline
- 8 465.6MWh of solar energy generated, reducing our carbon footprint by almost 8 000 tonnes CO_2e
- We consumed an estimated 1 006 megalitres of water, a reduction on last year's consumption (2020: 1 117 megalitres)
- Local sourcing: our clothing division increased its local sourcing by close to 40%
- 4 500 duplicate and uneconomic lines discontinued – contributing to significant reductions in food waste
- 1.6 million reusable shopping bags sold
- We recycled/recovered 61% of total waste generated, including 17 576 tonnes of cardboard and paper, 2 234 tonnes of plastic and 10 tonnes of metal
- Organised community clean-ups in adherence with Covid-19 regulations, with 1 426 volunteers collecting 2.7 tonnes of waste

Annual strategic targets met
Satisfactory progress
More to do

Unpacking the significant capital trade-offs we made during the year

Our capitals are transformed by our business activities and strategic business decisions. As part of this, we prioritise certain resources and stakeholder requirements above others. Our strong and experienced management team operates within a sound risk management framework that considers the social and environmental impact of our decisions and operations. Read more about our risk management from page 33.

Our capital trade-offs are further informed by our corporate governance framework, which ensures that we align our interests with those of our stakeholders and create and preserve sustainable value and a leading customer offer. Our ethical value system further guides our everyday decision-making. Read more in our governance section from page 85.

Management's judgement in prioritising stakeholder needs and capital resources was particularly significant this year. Many difficult decisions were made in the face of the unprecedented circumstances of the Covid-19 virus. Our management team led with distinction, acting decisively, pragmatically and primarily in best interests of our staff and customers. This ensured that our business continued to grow, adapt and innovate, without placing stakeholders under undue risk.

Covid-19 response:
Reduced trading hours; physical distancing; health and hygiene costs; and some store closures

The Covid-19 crisis necessitated an effective response that would keep our operations safe and working, provide customers with essential food and groceries, and assist government efforts to slow the spread of the virus. The Group understood that our response would come at a financial cost. However, as an essential service during the crisis, our efforts to stay open and working were a social imperative.

We reinforced our health and hygiene standards, reduced our trading hours to support government-imposed curfews, reduced the number of customers allowed in store at any one time, and closed stores for sanitising where positive cases of the virus were identified among staff. These combined measures incurred additional operating costs of R200 million in FY21, and caused some disruption and inconvenience to stakeholders. However, they were essential to deliver business continuity and safeguard our staff and customers' well-being.

Capitals impacted – Short term

Capitals impacted – Long term

Working capital investment:
Maintaining the availability of essential food and groceries

Our Group, alongside other retailers, has played a significant role in providing customers with confidence in the supply of essential food and groceries throughout the crisis. The Group recognised the importance of maintaining consistently high levels of on-shelf product availability to allay any public concerns around food security. We understood that this would come at a cost, and would impact the Group's short-term working capital targets.

The Group worked closely with suppliers to minimise disruption across the supply chain. We invested significantly in our core food and grocery lines to maintain product availability at 95% over the year, and particularly over our busy month-end trading periods. The Group's range optimisation initiatives removed 4 500 slow moving and uneconomic lines from the business, which mitigated the cost impact of this strategic investment into fast moving essential lines.

Capitals impacted – Short term

Capitals impacted – Long term

Property reset:
Store closures and conversions to drive investment returns

The Group has a broad, multi-format store estate, operated on an owned and franchise basis, and trading through the Pick n Pay, Boxer and TM brands. The Group maintains the overall quality of its estate through new stores, an ongoing refurbishment programme, store closures where necessary, and conversions between formats and brands. Store closures and conversions can be difficult decisions to make, and the long-term impact on divisional performance, store staff and franchise partners is always considered.

The Group closed 43 stores this year, across all formats, and converted 34 franchise stores to company-owned Pick n Pay and Boxer stores, including 22 supermarkets. While there was some limited short-term disruption, the converted stores are all delivering stronger sales performances and improved profitability, and the Group has reduced the risk on its franchise debtor's book. The Group remains committed to harnessing the flexibility of its estate and operating model to secure the right format for each site and generate the greatest investment return.

Capitals impacted – Short term

Capitals impacted – Long term

Project Future:
Staff restructuring programmes to improve productivity and efficiency

Project Future is the Group's long-term modernisation programme. It is aimed at accelerating the Group's growth and efficiency objectives to ensure it maintains its momentum in an increasingly challenging economic environment. Employee costs are the Group's largest operating expense. As such, several Project Future initiatives have focused on improving staff productivity and efficiency across the business. Staff restructuring and severance programmes add short-term once-off costs, and can bring anxiety and uncertainty for those affected. However, they are necessary for the business to build a modern, efficient and agile workforce, better able to serve our customers over the longer term.

The Group incurred R200 million in once-off compensation costs related to voluntary and structured employee severance programmes undertaken during the year. This resulted in the removal of approximately 1 600 roles from the business, targeting improvements in store and support office efficiency. Half of these costs were recouped through cost savings in the second half of FY21, with the balance to be recouped over FY22. Notwithstanding these initiatives, the Group created over 2 000 new roles through its store opening programme this year.

Capitals impacted – Short term

Capitals impacted – Long term

Rest of Africa:
Developing the right operating model

Difficult trading conditions persist in our Rest of Africa operations, including local currency weakness, high-levels of inflation and escalating unemployment. The Group is cognisant of the real risks of trading in emerging market economies in the Rest of Africa, including complex political, economic and operational challenges. However, these markets provide significant growth opportunities, driven by young and growing working-age populations and the rapid formalisation of informal retail markets.

The Group is repositioning its Rest of Africa store operations, most notably in Zambia, into an increasingly cost-effective and efficient limited range discount model. This provides customers with a tighter range of targeted products (including more own brand) at unbeatable value. The Group has taken decisive action to close under-performing stores, to reduce the size of others, and to eliminate US dollar-based leases and other expenses. While short-term prospects remain constrained, the Group is committed to driving long-term sustainable growth in the Rest of Africa, at acceptable levels of risk, and without comprising core South African operations.

Capitals impacted – Short term

Capitals impacted – Long term

Outlook for 2022

Notwithstanding the considerable progress delivered over the past eight years, it is the Group's FY21 performance that will stand out for its extraordinary resilience under the most challenging of circumstances.

The Group grew its market share over the year, accelerated its momentum on improving the efficiency and productivity of its operations and was able to provide its customers with ever greater value, including through a growing own brand offer and a highly personalised loyalty programme.

The Group has a strong plan to deliver long-term sustainable value creation, anchored by a strong balance sheet, low gearing levels, and strategic funding partners who continue to demonstrate ongoing support for the Group and its long-term growth strategy.

The Group recognises the growing risks around climate change and the need for responsible, ethical business practices that support the well-being of the communities we serve. We continue to place a strong focus on being an environmentally and socially conscious retailer that is responsive to the needs of our customers and the regions within which we operate. Our efforts in this regard are driven by our People n Planet initiative, which is the umbrella under which all our sustainable development programmes fall.

Through the actions taken during the year, we have strengthened our capital inputs and supported our strategic growth engines going into FY22.

FY22 investment plans include a strong store pipeline across our Pick n Pay and Boxer formats, ongoing store refurbishments, further investment in expanding the reach of the Group's central supply chain, and ongoing investment in the Group's modern and flexible system infrastructure. Read more in our CFO report on page 72.

We remain confident that the actions taken during the year both in our response to the Covid-19 crisis, and in our commitment to modernising the business through Project Future, have positioned us well for long-term growth. The Group remains confident that it will succeed in funding future capability requirements with available capital inputs, notwithstanding the difficult economic conditions in the countries in which we trade.