



# Reports to Shareholders

Chris Seabrooke (outgoing Chairman), Mark Lamberti (outgoing Chief Executive Officer and incoming Chairman), Grant Pattison (incoming Chief Executive Officer) and Guy Hayward (Chief Financial Officer) against the background of the Makro distribution centre in Chlookop, Johannesburg.



# Sound Strategies and Excellent Management



Chris Seabrooke

Massmart's performance in the 2007 financial year once again reflected the soundness of its strategies, the excellence of its management, the positioning of its portfolio of wholesale and retail formats and the effectiveness of its channel and shared services forums.

## Strategy and performance

Massmart's performance in the 2007 financial year once again reflected the soundness of its strategies, the excellence of its management, the positioning of its portfolio of wholesale and retail formats and the effectiveness of its channel and shared services forums. This was assisted by favourable economic conditions in South Africa and satisfactory economic conditions in the other African countries in which it has operations (excluding Zimbabwe where economic indicators continue to deteriorate).

Headline earnings per share (HEPS), before charges for the Group's recent BEE transaction, increased 36,4% and HEPS after the charges for the BEE transaction grew 28,9% to 540,4 cents per share. HEPS has increased by over 30% per annum since listing in 2000. The Group's high cash conversion ratio has enabled it to establish a dividend policy at a lower level of 1,7 times cover. Dividends and distributions per share have increased by 43,9% p.a. compounded over the period since listing.

While share prices will vary with market conditions, over a period the average growth in share price should reflect the growth in intrinsic value per share. The growth in Massmart's share price from 930 cents at the 2001 financial year-end to 8 800 cents at the 2007 financial year-end represents an implied compounded annual growth in intrinsic value of 45,4%. This is indeed a tribute to the achievements of management and in particular to the leadership of outgoing CEO, Mr Mark Lamberti.

## The CEO's succession

As advised last year, Mr Grant Pattison was appointed CEO Designate to succeed Mr Mark Lamberti as CEO at 30 June 2007. This was the culmination of an effective and transparent succession planning process that had been under way since 2004.

I am pleased to advise that the succession has been smooth. I believe that Grant has taken over the leadership role very effectively and is well positioned to continue the sound and progressive management of the Group.

## Governance and directorate

As of 1 July 2007, the Board of Massmart comprises two executive directors, one non-executive director and 11 independent non-executive directors, five of whom are black and three of whom are female.

As mentioned previously, my Board colleagues and I are unanimously of the view that the interests of Massmart's stakeholders will be best served by the retention of the skills and experience of Mark Lamberti as Chairman of the Board.

The chairmanship will continue to be completely non-executive and subject to all existing policies relating to remuneration and tenure. In keeping with sound governance practice, the chairs of the four Board committees will continue to be held by independent directors and recognising that Mark Lamberti is not considered independent I will function as the Group's lead independent director and as Non-executive Deputy Chairman.

During the year Dr Lulu Gwagwa and Mr Kuseni Dlamini joined the Board as independent non-executive directors. We are delighted to have them with us and to enjoy the benefit of their contribution.

In December 2006, Mr Fanus Nothnagel resigned as an executive director of the Group. We thank him for his contribution to the Group during the four years he was with us.

I am pleased to report that the Board and all of its committees functioned well during the year. The non-executive directors have an appropriate mix of retail, financial, governance and human capital skills.

# Sound Strategies and Excellent Management

## The Board regards its key functions as:

- the keepers of strategy;
- the monitors of risk;
- the custodians of management excellence; and
- the overseers of performance of the Company.

I refer stakeholders to the detailed Corporate Governance Review contained in this report.

## Sustainable development

The Group continues to focus on sustainable development and a detailed report is included in these financial statements.

Massmart proactively addresses the inequalities of the past and unequivocally embraces the vision of a united South African society in the future. BEE targets continue to be the sole qualitative element of executive incentive schemes in order to provide further impetus to the Group's programmes.

## Shareholders

I am pleased to welcome all new shareholders who have invested in the Group during the year. The Group now has 8 191 registered shareholders representing a 23,6% increase over the prior year. These include 5 763 individuals.

The Group has no controlling shareholder or shareholder of reference and its shares are widely held in South Africa and abroad. At the reporting date the foreign shareholding in Massmart amounted to 74% by number of shares. The majority of these shareholders are domiciled in the USA, with the balance predominantly in the United Kingdom and Europe.

The number of Massmart's shares which traded in the past 12 months was 117,3% of issued share capital making Massmart one of the more liquid shares on the JSE.

## Tribute

Mr Mark Lamberti retired on 30 June 2007 after 19 years at the helm of the Massmart Group which he was instrumental in founding. The financial performance of the Group over this period (and especially since listing), the strategic balance and growth of the Group's portfolio of assets and its highly capable management team are all a tribute to Mark's leadership and vision.

I take this opportunity of expressing sincere and grateful thanks to Mark on behalf of the Board, management and stakeholders of Massmart for all that he has achieved in the dedication of his career to the establishment and growth of this exceptional Group.

I wish Mark and his wonderful wife, Annette, and their family, success, happiness and health in the next chapter of their lives which I am sure will feature many personal and business achievements in South Africa and abroad. I am delighted that we will all continue our association through the board of Massmart.

## Appreciation

I record my personal appreciation to my colleagues on the Board, to the outgoing CEO and the incoming CEO and the management team for their unflinching support, and also to the Group's professional advisors and bankers for their services to the Group.

It has been a pleasure and an honour to lead the Board of this exceptional Group over the past four years and I look forward to my new role of Deputy Chairman and lead independent director with commitment and enthusiasm.



Chris Seabrooke

10 October 2007

# A Year of Exceptional Results



Mark Lamberti

This year's performance has perpetuated Massmart's high rate of compounded sales and profit growth.

Massmart's record of value creation stands as a testament to the efforts of many people, past and present, from the highest to the lowest echelons of the organisation.

It is a rare privilege to be able to conclude one's nineteen-year tenure as a chief executive by reporting such exceptional results to stakeholders.

Off the base of an excellent 2006 and in the midst of a retail economy that was proving to be an embarrassment to the bears, Massmart commenced the 2007 financial year with clear strategic focus, but group-wide anticipation of change, mainly around the Chief Executive transition and the rationalisation of assets, management and systems in Massbuild and Masscash. As the year unfolded, the general state of the consumer economy provided a solid platform both for the implementation of these initiatives and for the exploitation of the Group's low cash price competitive positioning.

Despite gradually increasing inflation and a rise in interest rates from 10,5% to 12,5% over the year, household consumption expenditure growth accelerated (particularly in services, food and semi-durables), abetted by the increase in formal employment and real wages. With consumer confidence sustaining the high levels reached in early 2005, and retail industry volume growth averaging 9,1% over the period, retail and wholesale confidence was extremely buoyant, the latter reaching an all-time high in the second quarter of 2007.

Against this backdrop, most retailers reported high rates of comparable store sales growth, although anecdotal evidence suggests that higher interest rates and the introduction of the National Credit Act depressed the sales growth of certain credit retailers in the second quarter of 2007. Aggressive space expansion occurred across all sectors of South African retail as new stores, formats and categories were added. The quality of these investments will be tested in less favourable economic times.

In contrast, low cash prices and rising product inflation, particularly in food, enabled Massmart to sustain high rates of sales growth, while the Group maintained its conservative approach to store development ending 2007 with 238 stores occupying almost one million square metres in 14 southern African countries, trading through four clearly targeted major divisions, each a market leader in its chosen segment.

Massmart's sales increased 16,2% to almost R35 billion, with pre-tax profits of R1,6 billion and earnings of R1,1 billion, exceeding R1 billion for the first time. All sales growth in the current year was organic, increasing the Group's lifetime annual organic growth to 34%. The strength of the trading performance was best reflected in the 36,4% growth of headline earnings per share to 571,9 cents per share, before charges for Thuthukani, our black economic empowerment transaction. Headline earnings per share after charges for Thuthukani grew 28,9% to 540,4 cents, producing a 32% compounded growth of headline earnings per share since listing in July 2000. Return on equity increased from 46,4% to 51,8%.

The year's performance has perpetuated Massmart's high rate of compounded sales and profit growth. Annual sales growth has compounded at 23% since founding in 1992, 22% over 10 years and 19% since listing in 2000. Earnings before interest, tax and asset impairments has compounded annually at 41% since founding, 47% over 10 years and 36% since listing.

# A Year of Exceptional Results

## A year of excellent strategic implementation

Massmart's strategic approach and principles, carefully described in this report last year, were manifest throughout the past financial year in wide ranging implementation initiatives. For the most part these centred on cautious organic growth, further rationalisation of the asset base and the simplification of organisational and management structures in each division, with a view to enhancing efficiency while eliminating complexity and cost.

Massdiscounters' role as southern Africa's leading **general merchandise discounter** (trading under the Game and Dion brands) was enhanced with: the opening of 13 new stores (including two trial Dion Wired stores and three new stores in Africa); the conversion of three large-format Dion stores to Game; the discontinuation of clothing; the establishment of a trial regional distribution centre; and several major systems enhancements.

Masswarehouse (trading as Makro) entrenched its leadership in **warehouse club discounting** by: refining the interior design to emphasise new specialist departments; commencing the construction of a new store planned to open in Pretoria East in October; formulating extensive value-adding, information-rich point-of-sale material to enhance customer decision-making; and enhancing supply chain improvements to better cope with the peaks of the festive period.

Massbuild, now South Africa's leading **home improvement retailer**, demonstrated the efficacy and extent of its strategic conception with: the refurbishment of five Builders Warehouse stores; the re-branding of De La Rey, Servistar and half of Federated Timbers as Builders Warehouse, Builders Express and Builders Trade Depot respectively; the integration of the Servistar and De La Rey finance, merchandise and marketing functions with those of Builders Warehouse; the closure of the Servistar and De La Rey head offices; and the installation of SAP systems in Servistar and De La Rey.

Masscash, southern Africa's leading **food wholesaling** business (trading under the CBW, Jumbo and Shield formats), enhanced its footprint and efficiency with: the acquisition of two stores; the acquisition of three new "hybrid" retail/wholesale outlets; and the integration of Jumbo and Shield under one divisional management team.

The successful implementation of the strategies and plans described above, concludes a period of internal focus and consolidation, once more positioning Massmart to seek and exploit external opportunities for growth and profitability.

## A year of enhancing sustainability

In past reports I have articulated at length our philosophy towards enhancing the long-term sustainability of the Company and its stakeholders. In brief, we remain contemptuous of gains today which prejudice or mortgage tomorrow.

Extensive detail on Massmart's progress with matters affecting sustainability is featured elsewhere in this report but the following developments were particularly noteworthy.

## Leadership

The succession process that the Board embarked on some years ago was completed on time and according to plan. The organisation and its major stakeholders have adapted easily to the changes and the transfer of power was seamless, efficient and effective. With the benefit of hindsight, there is nothing that we could have done differently or better.

On 1 July 2007 Grant Pattison was appointed Chief Executive of Massmart.

Grant is well equipped to lead your company. His intellectual agility is obvious, inter alia, in his impeccable academic record, he has thoroughly interpreted and imbibed his extensive functional and line experience, his judgement is evident in the consistently positive impact of his strategic, structural and operating decisions on the Company, and his leadership has earned him the unqualified followership of his colleagues. He enjoys the confidence of the Board and the Company and we look forward to Massmart's continued progress under his stewardship.

On the same date I became Non-executive Chairman of the Board and Chris Seabrooke, Massmart's lead independent director, was appointed Deputy Chairman. Concurrently, Grant reconstituted the Executive Committee, which now comprises 10 members.

The growth and rationalisation of the Group saw numerous changes to head office and divisional organisation and management structures, to further facilitate succession and align the best available talent with the leadership challenges of Massmart and its large focused divisions.

## Transformation

Massmart is committed to playing a constructive part in the transformation of South African society, specifically in regard to every aspect of Broad-based Black Economic Empowerment and the recent scorecard as formulated by the Department of Trade and Industry.

Insofar as ownership is concerned, the implementation of Thuthukani, Massmart's Black Economic Empowerment transaction, has resulted in 7,1% of the Company being owned by 11 858 previously disadvantaged employees, who enjoy full voting rights and received their first dividend of 49,25 cents per share (averaging R593 per participant) in February.

Notwithstanding the skills shortage, our progress with employment equity has been slower than we would have liked, particularly at the most senior executive levels. At the time of writing nine (five of whom are women) of the 50 executive directors of the Company and its major subsidiaries are from previously disadvantaged groups.

## Investor relations

Our dedication to facilitating accurate stakeholder understanding of the Company through extensive qualitative and quantitative disclosure, resulted in Massmart's 2006 Annual Report being ranked third of the largest 100 companies, based on market capitalisation, on the JSE, by Ernst & Young.

## Environment

Consistent with the growing societal awareness of mankind's deleterious impact on the environment, we have initiated a practical and realistic programme of addressing those aspects of our business that could affect our environment. Energy consumption, packaging, food sourcing and water consumption are among these.

## In conclusion

This is the nineteenth annual report I have written since being appointed as the Managing Director of Makro on 1 August 1988. I am pleased that the performance captured in this final report has no precedent.

Looking back, the reports have evolved in concert with the size and sophistication of the Group, the quality and competence of my colleagues, and my own evolution as a manager and leader. No matter how difficult or challenging the times they reported on, each of the reports reflected progress, optimism and a conviction that Makro, becoming Massmart, would be an extraordinary company. Today it is, and the record of value creation through a high rate of compounded sales and profit growth stands as a testament to the efforts of many people, past and present, from the highest to the lowest echelons of the organisation. Their good decisions dwarfed the bad ones.

For my own part, I am filled with gratitude for the leadership opportunity and the privilege of having been closely associated with the men and women of Massmart, particularly those who served as Board and Executive Committee members over the years. I learnt from all of them and am thankful that my association with them will continue, albeit more distantly.

It was with a deep sense of accomplishment that I vacated my office for Grant on 30 June 2007.



**Mark J Lamberti**

10 October 2007

# Poised for Sustained Superior Growth



Grant Pattison

The Group is poised for sustained superior growth.

The annual strategic review and budget processes reveal a group that is in good health.

## CEO succession

On 1 July 2007 I assumed executive responsibility for Massmart Holdings Limited.

This was the culmination of a three-year process during which leadership momentum was maintained and uncertainty among stakeholders minimised. From a personal perspective, my assumption of increasing responsibility over the past year ensured my preparedness for the role and my thanks are due to Mark Lamberti, Chris Seabrooke and the Board, the Executive Committee members, and other senior leaders of the business for their support and confidence.

Together we have handled the subtle complexities and obvious challenge that a change of leadership demands.

## A healthy group

The annual strategic review and budget processes reveal a group that is in good health, although fully committed to continuous improvement. I feel confident that:

- the **Strategy** is rigid enough to ensure market differentiation, management focus and shareholder understanding, but flexible enough to allow an entrepreneurial response to change and opportunities;
- the **Structure** is formal enough to ensure oversight and control, but informal enough to allow rapid communication, candid rapport and critique;
- the **Leadership** cadre has the competence, confidence and intellect to interpret their individual and collective experiences, and integrate the learning into their philosophies, principles and judgment;
- the **Portfolio** of four focused divisions is appropriate, each a low-price leader in its chosen sector, differentiated by market positioning, merchandise mix, business model and cash characteristics, but bound by a common dedication to high volume, low gross margin, low-cost distribution, and the pursuit of additional value through collaboration;
- our **Reputation** is one of transparent excellence; and
- the **Group** is poised for sustained superior performance.

The leadership challenge is therefore to avoid overconfidence, complacency and undue internal focus, and to remain vigilant to competitive threats and opportunities. Change is a constant and where there is no change – we must create it.

## Refining the strategy and portfolio

Our strategic model is focused on answering the following questions:

- **“Who are we?”**  
with our definition of purpose or Mission.
- **“What do we want to achieve?”**  
with our definition of victory or Vision.
- **“Where are we now?”**  
with a review of the current reality summarised in this annual report.
- **“How do we plan to get there?”**  
with our three-year strategic plan, communicated as Vision 2010.

This year's annual review concluded that while our strategic plans need updating and revision, our strategies at Group and Divisional levels are sound: we are a sub-Saharan African business; our business model relies on low expenses and cash-generative sales to underpin price leadership; we operate large stores; we are focused on general merchandise, food and liquor; we structure ourselves so that each operating division is both differentiated and complementary with its own management team focused on fulfilling customer needs; supported by value-adding service divisions that lead, direct control, service and facilitate only when necessary; and we are highly incentivised on growth.

In recent years, we have focused on simplifying the Group, consolidating acquisitions and smaller operating entities and brands under four divisions and management teams. By July 2007 this process was almost complete, allowing us to focus externally on the competitive environment and search for new sources of growth.

## Vision 2010

We believe insight is not a crystal-ball exercise, trying to predict the Group's response to a single version of an envisaged future. Rather it is an informed discussion, exploring possible and likely scenarios, and positioning the competencies and assets of the Group to best respond to an unpredictable future.

We also believe that strategic thinking and planning must consider trade-offs. Taking one action often means sacrificing another, making prioritisation and effective resource allocation imperative.

Perhaps most importantly we believe strategy is about communication: to our internal stakeholders so that operating

decisions can be made in context; to external stakeholders, including shareholders, to enable them to articulate their interests; and perhaps even to our competitors so that they are clear about where we intend to apply our capabilities and competencies.

Accordingly, Vision 2010 represents the Group's strategic agenda for the next three years.

**Leadership excellence and transformation:** In today's world – as the battle for talent intensifies and current and potential leaders become more demanding about what sort of life they want to lead and what sort of people they want to become – to develop and attract excellent leaders, we need to get better.

In our human resource practices, recruitment, remuneration, job design, performance management, education, training and career management will be re-examined from the bottom up – ensuring modern and world-class practice and systems.

In human capital development, we have established a virtual university, which collaborates with leading institutions around the world in designing executive and retail leadership programmes. We will build on this foundation to develop and retain the best executives and leaders.

In our transformation practices, we will continue to strive to become a truly South African business in all respects – one that respects the individual; values collaboration, diversity and performance; and ensures equal opportunity for those who want to deliver.

**Comparable growth:** Generating real comparable store growth requires both competitive trading and the management of our store portfolio so that stores are opened

and closed as customers move, with the net increase in space adding value. We will continue to manage, develop and improve this measure closely, using the tools at our disposal.

**Organic growth:** Understanding that property is a long-term investment, we will continue to monitor expert opinion on ten-year market and demographic trends at local level to make responsible property decisions and avoid being led solely by opportunistic property developers.

**Greenfield and acquisitive growth:** In addition to growing the core business, we will look for opportunities to leverage our mass-merchandising skills in new markets and formats and will, within the disciplines of our strategy, either develop or acquire new businesses.

**Supply chain:** To achieve long-term volume growth in comparable stores, and meet the physical challenge of managing high in-stock levels, of numerous stock keeping units, in very high-volume stores, we will invest in people, processes and systems from point of sale backwards into our supply chain.

**Private label:** The best retailers in the world leverage their abilities to create and build their own brands alongside leading national brands in a way that builds the category and profitability. This will require us to invest in new skills, partnerships and systems.

**Financial services:** While we have no intention of competing in this market, we believe there is an opportunity to create third-party relationships that leverage our customer base, improve the level of competition in this market and reduce the switching cost of credit.

**Sustainability:** We will continue to focus on developing practical plans in the areas of black economic

empowerment, environment and corporate social investment. We have developed internal measurement systems and introduced an incentive to improve our empowerment scores; we are developing plans to improve our environmental performance in energy and water consumption, packaging, ethical sourcing and waste disposal; we are focusing available corporate social investment funds on a group school feeding scheme, while maintaining our support of other programmes in the education arena.

## Looking forward

For the 14 weeks to 30 September 2007, total Group sales grew 12.5% with comparable store sales growth of 10.7%. While the fundamental economic environment is healthy, inflationary pressures remain. Combined, high real wage increases, rising food inflation, high oil prices and widespread capacity constraints run the risk of introducing secondary inflation. This could herald a sustained period of CPI-X outside of the Reserve Bank's target range with resultant higher interest rates.

Notwithstanding the possibility of tighter monetary policy, the outlook for growth looks good. Over and above the opportunities the economy provides, we are doing things that will improve Massmart's competitiveness that should produce relatively superior growth of shareholder value.



Grant Pattison

10 October 2007

# Massmart Annual Citation Awards

FROM LEFT  
Massmart Retailer  
of the Year  
Willie de Villiers  
  
Massmart  
Amagugu Award  
John Hawksley



Massmart Spirit of  
Entrepreneurship Award  
Richard Fuller

Massmart Young  
Achiever of the Year  
Michela Adams

Massmart Socially  
Responsible Division  
of the Year

Masscash – represented by  
Jane Bruyns and Garth MaClou

*Masscash, the winning division in 2007, was recognised for exceptional progress in the areas of Broad-based Black Economic Empowerment and Corporate Social Investment. This included achieving the highest BBBEE score in the Group of 43,6% and also investing the highest percentage of profit after tax in the Group on focused Corporate Social Investment projects.*

Chief Executive  
Officer's Award  
Phineas Manamela

*The Chief Executive Officer's Citation was awarded to Phineas Manamela, a store manager, for his remarkable presence of mind and professional management of the events immediately following an accident in the Builders Warehouse Edenvale store. Phineas's response ensured that the injured parties received immediate access to the best available private medical care, thereby reducing their trauma whilst also protecting the reputation of Builders Warehouse.*



**FROM LEFT**  
**Massmart Division  
 of the Year**

Masswarehouse – represented by Pieter Schoeman, Thuli Mpshe, Gert Lourens, Kevin Vyvyan-Day, Derick Kalan, Doug Jones, Garry Hendry, Chris Nezar and Bruce Cayzer

*Masswarehouse, the winning division in 2007, achieved a 76% increase in annual Economic Value Added for the financial year ending June 2007.*



**FROM LEFT**  
**Performance  
 Excellence Awards**

**André du Preez**  
 Masswarehouse,

**Johan van Wyk**  
 Massdiscounters,

**Janet Pieterse**  
 Massbuild,

**Brian Pillay**  
 Masscash,

**Brenda Shelly**  
 Massmart Holdings Limited

# Massmart Annual Citation Criteria

Massmart annually awards citations for excellence in eight award categories:

## THE MASSMART RETAILER OF THE YEAR AWARD

goes to the individual who is seen to exert significant influence over retail practice in the Group or industry, and who committed retailers in the Group would wish to emulate. Among the very demanding criteria for this award are:

- demonstrated commitment to the Massmart Ethical Code of Conduct;
- demonstrated an intimate understanding of markets and competitive environment served by the division;
- demonstrated ability to identify and creatively leverage sound retail decisions in the best commercial interests of the Group;
- sought out by peers in the wider group for his/her retail expertise and advice; and
- acknowledged by divisional superiors, peers and subordinates as providing retail thought leadership.

## THE MASSMART DIVISION OF THE YEAR AWARD

goes annually to the division that achieves the greatest improvement in Economic Value Added performance in a given financial year as calculated by Massmart Finance. This is calculated as the percentage improvement, rather than as an absolute figure, using the division's audited financial results for the year.

## THE MASSMART SOCIALLY RESPONSIBLE DIVISION OF THE YEAR AWARD

goes annually to the division that achieves most in the areas of Broad-based Black Economic Empowerment, Corporate Social Investment, Environmental Stewardship, Employee Relations and Ethical Conduct.

## THE MASSMART AMAGUGU AWARD

goes to the individual who best represents Massmart's core values of dignity and respect, integrity, accountability, stewardship, trust and diversity. Award criteria include:

- demonstrated commitment to the Massmart Ethical Code of Conduct;
- demonstrated ability to place legitimate interests of the Division/Group above his/her self-interest.
- demonstrated commitment to treating associates and stakeholders with dignity and respect regardless of the situation in which they are encountered;
- demonstrated commitment to behaving in a way that is consistently honest and fair and never manipulative of the rights of others; and
- commitment to demonstrating, through example, that he/she and the organisation are honest, fair and reliable in its dealings with all stakeholders and associates.

## THE MASSMART SPIRIT OF ENTREPRENEURSHIP AWARD

goes to the individual who demonstrates extraordinary commercial and business acumen, in achieving results beyond what would be reasonably expected with the resources that are available to him/her. Award criteria include:

- demonstrated commitment to the Massmart Ethical Code of Conduct;
- demonstrated ability to create and mobilise action around a relevant vision for the future that is creative, clear, insightful and inspiring;
- demonstrated ability to recognise and leverage opportunities that lead to significant commercial benefit for the Division/Group;
- demonstrated ability to grow and develop Massmart's market share and/or competitive advantage (often by recognising opportunities that our competitors miss);
- demonstrated ability to "push the envelope" by intelligently balancing risk and returns in commercial decision-making; and
- demonstrated ability to grow shareholder value.

## THE MASSMART YOUNG ACHIEVER AWARD

is made to an "up and coming" individual under 30 years of age who has demonstrated exceptional retail expertise that is disproportionate to his/her level of experience. Award criteria include:

- demonstrated commitment to the Massmart Ethical Code of Conduct;
- clear track record of performance for a minimum of three years with the Group;
- achievement of exceptional performance levels/results/returns in area of direct responsibility, typically achieving beyond the reasonable expectations of the assets/resources under his/her control; and
- demonstrated ability to make sound decisions in the best interests of the Group.

## MASSMART PERFORMANCE EXCELLENCE AWARDS

are made to individuals who consistently achieve exceptional levels of performance in all areas of job performance. Each division and Massmart Holdings is entitled to make one award in this category which focuses primarily upon individual impact.

## THE MASSMART CHIEF EXECUTIVE OFFICER'S CITATION

is awarded, at the discretion of the Massmart CEO, to an individual who has demonstrated exceptional performance in any of the areas that comprise retail endeavour.

# A Group in Good Health



Guy Hayward

We continually strive to improve the quality of Massmart's external financial reporting, as well as trying to better the technical disclosure in our annual report...

...and so earlier this year we were thrilled when the Massmart 2006 annual report came third overall in the Ernst & Young South African annual report survey.

We continually strive to improve the quality of Massmart's external financial reporting, as well as trying to better the technical disclosure in our annual report – but trying always to keep the details and explanations clear and simple even as the accounting standards become increasingly complex and technical. Earlier this year we were thrilled when the Massmart 2006 annual report came third overall and was awarded an *Excellent* rating in the Ernst & Young South African annual report survey.

## Financial targets

The Group has clearly stated medium-term financial targets or measures that we believe represent optimal performance levels within the income statement or balance sheet, or the combination of both. Certain of these targets are “stretch targets” that will only be achieved in two to three years and with exceptional performance.

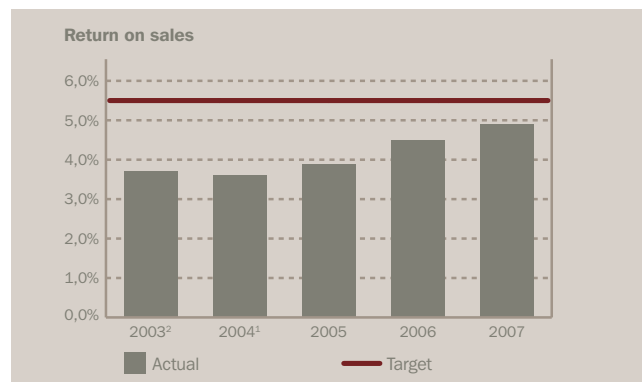
These target ratios are shown below:

MEDIUM-TERM TARGET RATIOS	DEFINITION
ROS > 5,5%	Return on sales (ROS) is the ratio of operating profit before tax (excluding asset impairments) to sales
ROE > 35%	Return on equity (ROE) is the ratio of headline earnings to average ordinary shareholders' equity (not adjusting for any intangibles previously written off)
Gearing < 30%	Gearing is the ratio of average long-term interest-bearing debt to average ordinary shareholders' equity
Dividend cover of x1,7	Dividend cover represents the ratio of headline earnings to dividends declared and paid to ordinary shareholders

## Return on sales (ROS)

This ratio combines all the key elements of the income statement, being sales, gross margin, supplier income, expenses (including depreciation and amortisation), and net finance charges. Every important financial aspect of the retail or wholesale business model is captured in this ratio. The largest asset investment at the level of the division is in working capital (being inventory and trade receivables), with the concomitant liability (in trade payables), and the relative success of management's impact on net working capital will therefore be reflected in changed net finance charges. The ROS target by division can be found in the “Looking Forward” section on page 6 and the Divisional Reviews on pages 56 to 71. In the “Looking Forward” section we refer to trading ROS. The difference between trading profit before tax and EBITA is the corporate net interest of R185,9 million (2006: R111,4 million) and the IFRS 2 charge of R54,3 million (2006: zero) relating to the BEE transaction.

Progress to date – Massmart's current ROS is 4,9% (prior year 4,5%). Massmart has grown its ROS every year since 2000 and we believe that the ROS target of 5,5% remains achievable in the medium term.

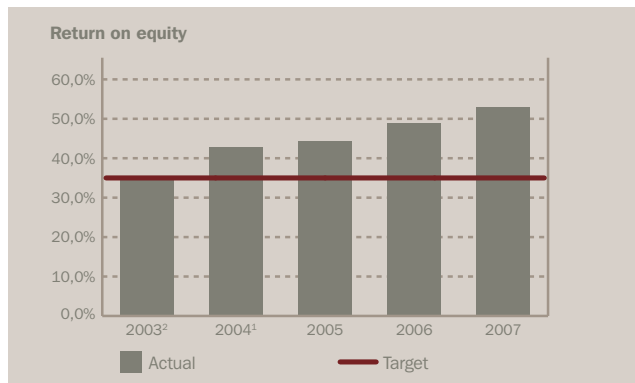


# A Group in Good Health

## Return on equity

Massmart is committed to delivering superior returns to shareholders. The Group's medium-term targets are to exceed a 35% return on average ordinary shareholders' equity.

Progress to date – Massmart's return on average shareholders' equity was 52,8% (2006: 48,9%).



The Divisions are responsible for delivering operational returns, being the returns to net working capital and non-current assets excluding goodwill and trademarks. Massmart, through the Board and Executive Committee, is responsible for delivering investment returns that will also include the book value of intangibles (raised on acquisitions or otherwise), as well as setting the Group's gearing levels that will influence returns to shareholders and the overall risk profile.

As part of this, the Divisions are recapitalised annually by Massmart with non-interest-bearing shareholders' funds that are equivalent to the book value of long-term assets in each Division. Each business therefore must fund its net working capital position through cash or interest-bearing debt, depending upon the characteristics of that business model. This process enables divisional returns to be evaluated and compared on a consistent basis across the Group, and from one year to the next. This policy has not yet been rigidly applied in CBW due to minority shareholders in that business.

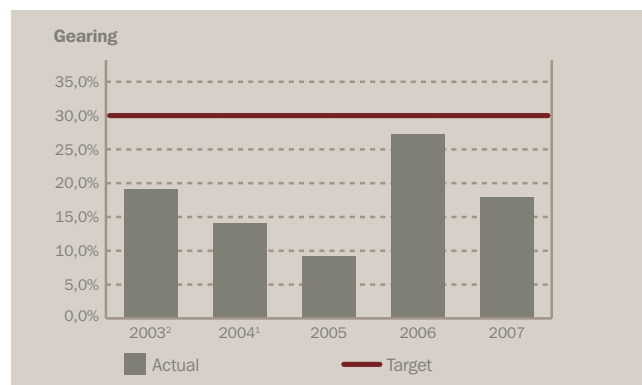
Adjusting for goodwill and trademarks previously written off, i.e. reversing the accounting write-offs allowed previously, the Group's return on average shareholders' equity exceeds 25%. Depending upon the purchase price, retail and wholesale acquisitions tend to generate significant accounting goodwill due to the relatively low net asset values of those business models.

## Gearing

Given the Group's high cash generation and its preference for leasing rather than owning stores, it is difficult to permanently and meaningfully gear (i.e. trade in a net interest-bearing debt position) the Group over the long term. It may be possible to gear the Group through a strategy of owning rather than leasing all stores, but this would potentially reduce asset and equity returns. Massmart prefers some level of gearing, up to a maximum of 30%, in order to leverage the return on shareholders' equity but without introducing excessive financial risk to the Group. However, depending upon the cash characteristics of a target company, this gearing ratio may be increased but probably to no higher than 50%. In addition, our store lease obligations represent a form of permanent gearing.

As the period-end balance sheet tends to be unrepresentative of the Group's average net cash or debt position during the year (showing higher cash balances as monthly creditors are paid after month-end), the Group's gearing levels can be calculated using the net interest paid (or received) for the period as a proxy. Our preference, however, is to use the Group's disclosed medium-term (classified as long term in the annual financial statements) and long-term interest-bearing debt as these amounts represent the Group's formal debt commitments over the longer term.

Progress to date – the Group averaged gearing of 18,0% (2006: 27,3%) for the financial year.



## Dividend cover

Massmart's current dividend policy is to pay total annual cash distributions representing a x1,7 dividend cover ratio, unless circumstances dictate otherwise. During the year, this was reduced from x2,0. This ratio is not a target – because it is already being achieved – but is disclosed to give clarity on future dividend levels. The Board believes that this lower dividend cover ratio is appropriate given the Group's current and forecast cash generation, planned capital expenditure and gearing levels.

The Board has no desire to build up a cash reserve and so will, where practical, reduce dividend covers and/or may execute a share buyback – depending upon the actual share price and our view of its valuation – in order to return surplus cash to shareholders.

HISTORICAL DIVIDEND COVER RATIOS:					
	2007	2006	2005	2004 <sup>1</sup>	2003 <sup>2</sup>
Dividend cover	x1,7	x2,0	x2,0	x2,0	x2,5

## Acquisitions

There were no major acquisitions concluded during the financial year. The remaining 49% minority shareholding in De La Rey (re-branded to Builders Warehouse) was, however, acquired with effect from 1 July 2006 and a portion of the 2005 Servistar (re-branded to Builders Express) purchase consideration was deferred to August 2007 and so has recently been settled in cash.

## Accounting policies

There were no significant changes in accounting policies during the year.

The results for Makro Zimbabwe were, however, deconsolidated as Massmart can no longer be said to be controlling the day-to-day management of that business following legislative changes in that country. Control is defined as “the power to govern the financial and operating policies of the entity so as to obtain benefits from its activities”. The financial effect was minimal. For more details on Makro Zimbabwe, see note 8 in the annual financial statements on page 135.

## Black Economic Empowerment staff equity issue

Massmart’s Black Economic Empowerment (BEE) staff equity issue that was formally approved by Massmart shareholders in July 2006 became effective from October 2006 and so was included for the first time in these financial results.

Full details on this BEE staff equity issue were published in the June 2006 circular issued to shareholders, but for completeness the main financial points are repeated below:

- Equity representing 10% of the Massmart ordinary issued shares, pre-dilution, or 9,1% post-dilution was issued.
- There were two categories of participant, being the General Staff and Scarce Skills, and separate trusts were formed for both.
- Although the essential equity structure is option-like with a strike price of R49,98, the actual legal instruments are two classes of preference shares. The reason preference shares were used was to give the participants voting rights and, in one case, a right to dividends as explained below.
- The first category, ‘A’ preference shares, was a once-off issue to the General Staff Trust, called the Thuthukani Trust, for the benefit of all 14 500 permanent employees in the Group at that time. These shares have voting rights equal to those of ordinary shares and have a right to dividends on the following basis: 25% of the ordinary dividend in year 1 (being 2007), 50% of the ordinary dividend in year 2 (2008), 75% of the ordinary dividend in year 3 (2009), and 100% of the ordinary dividend in year 4 (2010). These ‘A’ preference shares are converted into Massmart ordinary shares, for the direct use or benefit of each beneficiary, in three equal annual tranches commencing on 1 October 2010.
- The second category, ‘B’ preference shares, was issued to the Scarce Skills Trust for the benefit of current and future black managers in the Group. These shares also have equal voting rights but do not attract dividends. These shares convert into Massmart ordinary shares, for the direct use or benefit of each beneficiary, in four equal annual tranches commencing from the end of the second year of the issue date.

The IFRS 2 *Share-based Payment* charge arising from this BEE staff issue is R372,8 million. In terms of IFRS 2, this amount will be amortised over the life of the scheme, being six years, commencing from 1 October 2006. The current year’s charge was R54,3 million (for a nine-month period) and the figure for 2008 is anticipated to be R76,2 million. South African tax legislation currently does not allow any tax deduction associated with this non-cash charge.

Using the estimated total IFRS 2 charge of R372,8 million suggests that the total likely dilution to ordinary shareholders of this transaction is 3,3%. This amount does not take into account forfeitures by employees which will reduce the dilution effect. At year-end, the BEE transaction was not yet dilutive, primarily due to the adjusted strike price, including the IFRS 2 charge, being higher than the average share price over the year.

Accounting convention requires Massmart to deduct the appropriately weighted portion of the Thuthukani dividend from headline earnings when calculating headline earnings per share (HEPS). Given that headline earnings has already been reduced by the associated IFRS 2 charge, this amounts to a degree of double-counting for the “cost” of the dividend that is unavoidable under current accounting conventions. Given the stepped increases in the Thuthukani dividend outlined above, growth in HEPS will therefore lag growth in headline earnings. For more details on the calculation of headline earnings and HEPS, see note 12 in the annual financial statements on page 138.

A new circular has been issued clarifying the calculation of headline earnings and HEPS (*Circular 8/2007 Headline Earnings*). Details on the effect of this circular are contained in note 2 in the annual financial statements on page 128.

## Income statement

This review covers the consolidated income statement shown on page 119, and the related notes on the ensuing pages.

Detailed commentary on divisional-specific issues is provided in the Divisional Reviews on page 56 to 71.

### Sales

Our General Merchandise prices for the financial year, using the Group’s sales mix, averaged inflation of 0,5%. Food inflation increased particularly in commodities where price inflation was as high as 20% in certain categories. Combined product inflation for the Group’s Food and Liquor was 8,1%, while Home Improvement reported inflation of 6,5%. The Group’s average product inflation rate for the 2007 financial year was 4,9%.

Although there is some pressure on product prices from South African core inflation rising, this is expected to abate slightly from the first quarter of calendar 2008 due to the base effect. We are expecting average Group inflation to be 6% for the 2008 financial year.

Total sales of R34 807,6 million increased by 16,2% over 2006, both years representing 52 weeks’ trading. The Group’s existing businesses and stores reported 12,5% sales growth, and non-comparable stores added 3,7%.

During the financial year, the Group opened 15 new stores, closed eight stores, deconsolidated two and acquired five stores, thereby increasing its trading area by an unweighted 3,7% to 994 277 m<sup>2</sup> (unweighted meaning that the new space has not been proportionately adjusted if only open for part of the financial year).

# A Group in Good Health

The new stores were:

- in Massdiscounters, three Game stores were opened in Gauteng, three in Western Cape, and one in Northern Cape, Eastern Cape, Blantyre (Malawi), Dar es Salaam (Tanzania), and Accra (Ghana);
- also in Massdiscounters, two new-format Dion Wired stores were opened, one in Pretoria and one in northern Johannesburg;
- in Masscash, CBW acquired three stores in the greater Bloemfontein region, in the central part of South Africa, and two stores in the Johannesburg region; and
- in Massbuild, Builders Warehouse Western Cape opened a store in Cape Town and Builders Express opened a store in Jeffreys Bay, Eastern Cape.

The stores closed were Game Bruma (Gauteng) and Game La Lucia (KwaZulu-Natal); Dion Edenvale (Gauteng); CBW in Gauteng and Eastern Cape; and Federated Timbers in Northern Cape and two in Western Cape. Over the next few years there will be some store closures as we refresh the store portfolio, closing underperforming or poorly sited stores when the leases have expired.

## Gross profit

Gross profit of R6 371,9 million reflects an 18,3% gross margin that is greater than the prior year's 17,7%. The reasons for this improvement were twofold: the first, and most significant, being the portfolio effect from the greater contribution by the fastest growing and higher margin Massbuild businesses, and the second being slightly higher gross margins in CBW due to Food inflation in that business.

The Group's gross margin will always be dependent upon the sales mix across the Divisions and the required trading aggression occasioned by competitor activity, but is expected to improve marginally due to the increased contribution from the faster growing Massbuild division. Gross profit includes rebates and other forms of income earned from suppliers as well as ongoing revenue from sales of cellular products and airtime.

## Other income

Other income of R157,1 million (2006: R117,0 million) comprises royalties and franchise fees from in-store third parties, property rentals, investment income (excluding interest), finance charges from Massdiscounters' consumer credit book, and sundry management and administration fees. These are shown in more detail in note 5 in the annual financial statements on page 133.

## Expenses

Total expenses of R4 855,7 million (2006: R4 102,5 million) represent 14,0% of sales, slightly higher than the prior year's 13,7% of sales. We expected this ratio to increase slightly due to the increased proportion of the higher-cost Massbuild businesses, but the Group was also impacted by several larger items described in more detail below. With 15 new stores opened during the financial year, some of these stores would not yet be trading at optimal levels and so will temporarily distort expense and sales ratios. As trading levels accelerate, these stores will become more efficient and the ratios will improve towards Group norms. Costs and cost-productivity remain areas of continual focus across the Group.

Due to ongoing store refurbishments and new stores, the depreciation and amortisation charge of R240,9 million (2006: R202,9 million) increased ahead of sales growth, and will continue to increase as it reflects the higher capital costs of this expansion. Game and Builders Warehouse have been refurbishing their stores, resulting in higher depreciation charges. Due to these refurbishments, the annualisation of depreciation arising from the capital expenditure on new stores in 2007, and that arising from the new store expenditure scheduled for 2008, the Group's depreciation charge for 2008 will grow by more than the rate of sales growth.

Employment costs of R2 449,8 million (2006: R2 079,0 million) are 17,8% higher than the prior year. Included in these figures are the IFRS 2 *Share-based Payment* charges of R73,3 million (2006: R17,2 million) which are significantly higher due to the Thuthukani BEE Staff Scheme. Including this IFRS 2 charge, at 7,0% of sales, employment costs are higher than last year's equivalent figure of 6,9% and remain the Group's single largest operating cost. The existing businesses employed 9% more employees mostly for new stores and had annual salary and wage increases of 7% to 8%. Makro used a higher number of employees due to the increase in inventory volumes through its stores.

Due to the significant degree of incentivised remuneration for the Group's staff, management and executives, total employment costs will generally increase at a rate greater than inflation when exceptional performance is achieved, as was the case in 2007. For the forthcoming financial year the Group's salary increases are between 5% – 7% while the wage increases, that have all been finalised, are between 7% – 8%.

Occupancy costs, the Group's second-biggest operating cost, increased 14,2% to R846,0 million (prior year R740,5 million). As a percentage of sales, however, this figure at 2,43% is lower than the prior year equivalent of 2,47%. Total trading space increased by 3,7%. The increase in trading space does not include the increased space from new distribution centres. Adjusting for the lease-smoothing in both years shows that annual cash occupancy costs increased by 17,6%. There are several reasons for this increase. In some cases, the rentals on new stores in Massdiscounters and Massbuild are higher than those for the older stores – this situation is exacerbated by lease-smoothing. Another factor is the annualisation of rental charges from stores opened in the prior year.

The "lease-smoothing" accounting policy applicable to operating leases has the effect of keeping comparable-store lease charges broadly equal from one year to the next, and so any increase between years would therefore be from new stores. Another effect of this lease-smoothing accounting policy is that annual lease escalations will no longer increase the Group's lease charge.

## Other significant items

Included in operating profit is a net unrealised loss on foreign exchange transactions and translations of R41,4 million (prior year net unrealised gain of R33,3 million). Of this, R18,1 million relates to realised and unrealised exchange differences from Massdiscounters' African stores (prior year: gain of R17,6 million) and the balance of the net translation loss arose primarily from IAS 39 *Financial Instruments: Recognition and Measurement* adjustments relating to forward-exchange contracts held at Massmart.

In addition, the decision to close the original Dion format resulted in a total asset impairment pre-tax charge of R14,1 million.

Finally, included in "Other Operating Costs" in the prior year is a net monetary gain of R22,2 million arising from the hyperinflation accounting of the Makro Zimbabwe operation. This was deconsolidated in 2007 and so there is no equivalent figure.

#### Operating profit

Group operating profit of R1 673,3 million (2006: R1 328,1 million) is 26,0% ahead of prior year and has improved from 4,4% to 4,8% of sales. This improvement arose from different actions across the four Divisions but can broadly be summarised as: sales growth exceeding cost growth; good cost control in Massdiscounters, Makro and CBW; slightly increased gross margins in CBW; and a greater contribution from the higher-margin Massbuild. Given the cost increases highlighted above and the expected lower level of sales volumes, cost control and efficiency remain key imperatives for the Group.

#### Net finance charges

Net interest paid of R44,4 million (2006: R32,2 million) increased due only to the inclusion of a once-off R18,1 million interest charge. This payment related to a settlement reached recently between a major financial institution and the South African Revenue Service (SARS). In 2001, the Group entered into a five-year structured finance arrangement, effectively a medium-term loan, with that financial institution. Interest payable on the loan was partly linked to changes in the tax profile of the financial institution. Massmart bore the risk of any adverse tax consequences relating to the structured finance arrangement. In 2006, this arrangement was challenged by SARS which disallowed certain deductions claimed by the financial institution and resulted in the R18,1 million interest charge which is in full and final settlement of any tax consequences flowing from the arrangement. In terms of the financial institution's settlement with SARS, the terms of which are confidential, this payment is not tax-deductible.

Taking into account anticipated capital expenditure and excluding any unforeseen developments or new initiatives, the Group will remain net geared for two years. Using long-term interest-bearing debt, the Group was 18,0% geared (2006: 27,3%).

#### Taxation

The total tax charge of R554,8 million represents a tax rate of 34,1% compared to the prior year charge of R444,6 million at 34,3%. Two factors caused the current year rate to be higher than the standard corporate rate, the first was the higher charge from the Secondary Tax on Companies (STC), arising from the higher dividends paid, which increased from 3,2% to 3,6% within the effective tax rate. The second was the effect of two significant non-deductible expenses, being the IFRS 2 charge of R73,3 million and the R18,1 million interest charge discussed above.

Excluding the impact of STC and IFRS 2, Massmart expects its future effective tax rate to be at or near the South African corporate rate of 29%, although higher tax rates in certain foreign jurisdictions may marginally increase this.

Massmart is not concerned about any specific element of historical tax risk in the Group, but there is the uncertainty that material adjustments arising from potentially unfavourable tax assessments from the past tax returns, some of which have not yet been assessed by SARS, could impact future after-tax earnings. In addition, SARS can re-open any tax assessment within three years of issuing such assessment.

#### Headline earnings

Headline earnings of R1 092,2 million are 30,6% greater than the prior year. Adjusting for the first-time inclusion of the IFRS 2 charge arising from the Thuthukani BEE scheme increases revised headline earnings to R1 146,5 million with a growth of 37,0%.

Slightly more shares in issue and the effect of the Thuthukani dividend of 4,4 cents per share, explained above and in note 12 in the annual financial statements on page 138, marginally reduced the HEPS increase to 28,9%. After adjusting for the potential future conversion of 3,58 million share options, the diluted headline EPS of 530,9 cents is lower than actual HEPS of 540,4 cents. It should be noted that under IFRS 2 the approximately 20 million 'A' and 'B' preference shares issued under the Thuthukani BEE scheme are not yet included in the diluted headline earnings calculation. As noted earlier, however, the total dilution to ordinary shareholders expected from this BEE transaction is 3,3%.

#### June 2008 financial year

It should be noted that this coming financial year will be a 53-week trading period, with the additional week occurring in the second half of the financial year. The extra week's gross margin disproportionately exceeds the incremental increase in operating expenses for that week and so Group profits will be higher. The estimated effect of the 53<sup>rd</sup> week on sales, sales growth and profit will be properly disclosed at that time.

#### Balance sheet

This review covers the consolidated balance sheet shown on page 120 and the related notes on the ensuing pages.

#### Non-current assets

Property, plant and equipment of R1 123,8 million (2006: R944,3 million) and goodwill of R1 346,8 million (2006: R1 196,4 million) together represent the greatest proportion of the Group's non-current assets.

Over the past few years Massmart has been refurbishing and building new stores and during this year expenditure of R391,3 million (2006: R314,3 million) was spent on property, plant and equipment. Of this, R123,8 million (2006: R173,1 million) was replacement capital expenditure, while the balance of R267,5 million (2006: R141,2 million) was invested in new capital assets, including new stores.

A detailed reconciliation of the movements in property, plant and equipment is shown in note 13 on pages 139 and 140.

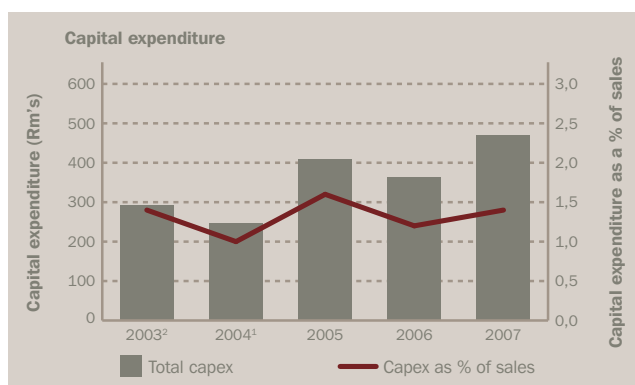
Goodwill increased by R150,4 million, primarily reflecting the goodwill arising from the July 2006 acquisition of the De La Rey 49% minority as well as minor goodwill from the acquisition of CBW store managers' minority interests. Under IFRS, all goodwill must be tested annually against the value of the business units with which it is associated and, if overstated, that goodwill must be impaired (see note 14 on page 141 for more details). Jumbo Cash & Carry (Pty) Limited recognised a goodwill impairment of R12,2 million arising from a minor acquisition in 2001. Details on goodwill can be found in note 14 in the annual financial statements on page 141.

The figure of R130,2 million (2006: R102,3 million) in "Other

# A Group in Good Health

intangibles" (note 15 on page 142) represents computer software that IFRS requires to be disclosed in this category. The "depreciation" charge arising from this asset category is classified as amortisation.

Capital expenditure for 2008 is budgeted at R595 million, which is higher than previous annual expenditure levels due mainly to the inclusion of the new Makro store in the budget figure. As can be seen in the graph below, despite the significant growth of the Group and the acceleration in new stores and refurbishments, capital expenditure has generally represented 1,0% – 1,6% of Group sales.



## Investments and other financial assets

Investments of R241,2 million (2006: R190,9 million) comprise mainly a R168,2 million investment in a treasury and international costing module, revalued to reflect foreign-denominated assets within that module (note 16 on page 143).

Other financial assets include loans of R173,4 million (2006: R190,7 million) that comprise primarily amounts attracting zero percent interest totalling R127,1 million (2006: R144,5 million) owed by participants in the Massmart employee share purchase trust. This loan amount reduces as employees sell their shares and repay the related loans and increases where executives elect to own Massmart shares rather than options issued by the trust. The finance lease deposit of R39,3 million is related to the financing of the Makro Strubens Valley store (note 17 on page 145).

## Deferred tax

The deferred tax asset of R432,8 million (2006: R409,5 million) arises primarily from numerous temporary differences, including tax deductions on trademarks, the operating lease liability, and unutilised assessed losses. This asset should reduce over time as the associated tax benefits are utilised. More detail is provided in note 18 on page 146.

## Current assets

Net inventories of R4 027,3 million (2006: R3 221,0 million) represent approximately 52 days' sales (using the historic basis), higher than the prior year figure of 48 days. Inventory levels were deliberately increased in Massdiscounters as we felt that previous in-stock service levels were too low, potentially resulting in lower sales growth, and also in Masscash in response to the supply chain constraints currently being

experienced by major South African food suppliers. The food inventory situation is expected to normalise during 2008, but the higher inventory levels in Massdiscounters will be maintained.

In general, Massdiscounters, being a retail discounter with 90 stores, has the highest inventory levels and its sales days in inventory are almost double that of Massmart's wholesale businesses (Masswarehouse and Masscash). Builders Warehouse also has higher inventory days given the broader and deeper merchandise range in those stores.

The net inventory of General Merchandise at R2 816,6 million represents 69,9% of total net inventory. This is to be expected given the higher inventory days in that category. See note 19 on page 147.

Total trade receivables and prepayments, net of provisions, is R1 876,5 million and has increased by 6,0% over the 2006 figure of R1 770,0 million. See note 20 on page 148. Although trade credit is offered to customers in all Massbuild businesses and in Masscash, it is well controlled and kept within the Group's parameters, and does not affect the Group's working capital.

Of Massmart's total sales, approximately 1,3% represents consumer credit sales. Included in trade receivables and prepayments are net trade accounts receivables of R980,8 million (2006: R860,8 million) which have increased by 13,9%. This is lower than the sales growth and signals continued effective management of trade credit in the Group. There are also total consumer accounts receivables of R283,4 million (2006: R264,5 million). This consumer credit, being hire-purchase and revolving credit, is found only in Massdiscounters. For more detail, refer also to the commentary on credit risk in the Financial risks section below.

Due to payments to creditors being made shortly after each month-end, cash balances in the Group at year-end are not representative of the average level of cash or overdraft during the remaining period. The amount by which the net month-end cash balance is overstated in comparison to the average for the month cannot be accurately calculated but is approximately R1 billion.

## Non-current liabilities

This total category comprises medium-term bank loans, capitalised finance leases, income received in advance from extended warranties, the operating lease liability arising from the lease-smoothing adjustment, deferred tax and long-term provisions. Non-current interest-bearing liabilities are R402,7 million (2006: R519,7 million). This balance reduced as the final amortising payments on two R150 million five-year loans were paid during the financial year. During the 2006 financial year, another two R250 million five-year loans were raised to finance the Massbuild acquisitions. Interest on both loans was fixed at 8,8% and 8,7% respectively.

Capitalised finance lease balances are R89,2 million (2006: R90,0 million).

Non-current non-interest-bearing liabilities are R556,9 million (2006: R474,7 million) and are partly higher due to deferred extended warranty income of R93,2 million (2006: zero).

The main balance is the operating lease liability of R461,8 million (2006: R472,5 million) which will be released over the remaining period of the Group's operating leases.

Included in non-current liabilities is the long-term provision of R45,0 million (2006: R39,0 million) arising from the actuarial valuation of the Group's potential liability arising from post-retirement medical aid contributions owed to current and future retirees. This liability is unfunded. With effect from 1999, post-retirement medical aid benefits were no longer offered to new employees joining the Group.

Details of all non-current liabilities, excluding deferred tax, are included in notes 24 and 25 on pages 153 and 156.

The deferred tax liability of R115,5 million (2006: R97,2 million) arises primarily from prepayments and property, plant and equipment. More detail is provided in note 18 on page 146.

#### Current liabilities

Trade payables of R5 285,8 million (2006: R4 604,7 million) represent approximately 67,8 days of cost of sales (using the historic basis), which is similar to the prior year figure of 68,2 days. As noted earlier, due to payments to creditors being made shortly after each month-end, the Group trade payables balance at year-end is not representative of the average during the remaining period. The amount by which the year-end trade payables is overstated in comparison to the average cannot be accurately calculated but is approximately R1 billion.

The current taxation liability of R534,4 million (2006: R410,9 million) reflects the Group's liability for provisional corporate tax payments that are generally payable within days of the financial year-end.

### Cash flow statement

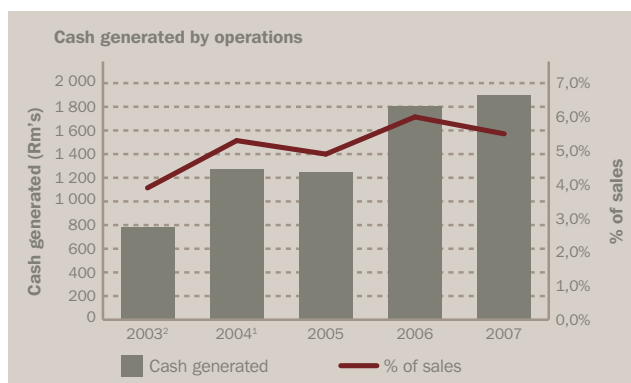
The consolidated cash flow statement is shown on page 121.

Operating cash before working capital movements of R1 926,4 million (2006: R1 543,6 million) is 24,8% higher than prior year and closely approximates this year's operating profit before depreciation, amortisation and impairment of R1 940,5 million, demonstrating the cash underpin of Massmart's earnings.

Cash taxation paid of R531,6 million (2006: R487,4 million) was lower than the growth in taxable income due to the timing of year-end cash tax payments.

Due to the increase in the dividend payout ratio in February 2007, the relative increase in the total dividend paid in cash has been distorted and this year's amounts paid of R565,1 million are 40,3% above the prior year figure.

Total capital expenditure (replacement and expansion) was R470,8 million. Capital expenditure for 2008 is budgeted at R595 million, which is higher than previous annual expenditure levels due mainly to the inclusion of the new Makro store in the 2008 figure.



### Financial risks

#### Liquidity risk

Liquidity risk is considered low due to the Group's conservative funding structure and its high cash generation. Massmart's liquidity requirements are continually assessed through the Group's cash management and treasury function. The Group has total banking facilities, incorporating overnight, short- and medium-term borrowings, letters of credit, forward exchange contracts and electronic fund transfers, of R3 492,2 million (2006: R3 492,2 million). As at June 2007, total interest-bearing debt amounted to R567,9 million (2006: R756,7 million). For more detail refer also to note 38 on page 171.

As the Group begins to build inventory levels for the festive season, net interest-bearing debt will increase up to a maximum of approximately R1,0 billion in November, but will reduce rapidly as peak year-end trading accelerates.

#### Interest risk

Interest rate exposure is actively monitored due to the Group's significant intra-month cash movements and the seasonal changes in its net funding profile during the financial year. As noted above, interest rates on the remaining two new medium-term bank loans are fixed at 8,8% and 8,7% respectively.

#### Credit risk

Credit is available to wholesale customers at Masswarehouse, Massbuild and Masscash, and is adequately controlled by using appropriately trained personnel, applying credit granting criteria, continual monitoring and the use of software tools. A portion of the trade debtors book in Shield is insured with an international insurance company and a further portion is secured through general notarial bonds, pledges and other forms of security.

Massmart is only exposed to consumer debt through its hire-purchase and revolving-credit debtors books in Massdiscounters. The net book of R283,2 million (2006: R264,5 million) is conservatively managed, adequately provided for and represents approximately seven months' credit sales. For more detail, refer also to note 38 on page 171.

# A Group in Good Health

## Currency risk

Where possible and practical, currency risk in the Group is actively managed. All foreign-denominated trading liabilities are covered by matching forward exchange contracts. Foreign-denominated assets are not covered by forward-exchange contracts, as these are permanent assets held for the long term.

## Technical review

The Board reports that the appropriate accounting policies, supported by sound and prudent management judgement and estimates, have been consistently applied, except for deconsolidating the results of Makro Zimbabwe (noted earlier).

The Group's accounting policies are governed by IFRS and the AC 500 series as issued by the Accounting Practices Board. Guidance has been obtained from IFRICs and circulars effective on 10 October 2007. Due to the nature and volatility of Exposure Drafts (EDs), no review has been provided.

A detailed technical review can be found in note 2 in the annual financial statements on page 128.

The Group maintains the view that the standards set the minimum requirement for financial reporting. The financial statements in this annual report have been prepared with the aim of exposing the reader to a very detailed view of the numbers, using a simplified approach, in the hope of facilitating a deeper and informed understanding of the business.

## Going-concern assertion

The Board has formally considered the going-concern assertion for Massmart and its subsidiaries and believes that it is appropriate for the forthcoming financial year. See page 118 for more detail.

## Appreciation

I would like to acknowledge and pay tribute to the high-quality performance and significant effort invested by my Financial colleagues and their teams at all the Massmart Divisions, and to the many members of the Deloitte audit teams, throughout the year, but especially over the two financial reporting periods.



**Guy Hayward**

10 October 2007

---

### Notes:

1. 2004 – pre-IFRS and Furnex classified as a discontinued operation.
2. 2003 – pre-IFRS, lease-smoothing and Furnex classified as a discontinued operation.