Letter from the Executive Directors

Overview
Massmart’s tenth year was memorable. In the first half we won the South African Non-Listed Company Award and, despite difficult trading conditions, produced a performance ahead of competitors. In the second half, we successfully listed the company on the Johannesburg Stock Exchange and maintained the sales growth to exceed R10 billion for the first time and achieve record profits and returns for the year.

Our progress was the result of strategic clarity and rigorous implementation.

The former arose from a firm view on the composition, structure and trends of the industry and markets in which we compete; the latter was a tribute to the business processes adopted by the 9 500 people who choose to work for your company.

We believe that you are entitled to the detail on how we go about the business of Massmart. This maiden annual report as a public company seeks the support of shareholders by establishing a high standard of disclosure of relevant information that will engender understanding and insight.

Environment

Consumption patterns have been dramatically affected by emigration, immigration, unemployment, the informal sector, crime, HIV/AIDS, a deteriorating exchange rate, the export of currency, duties, electrification, increased relative expenditure on services, the introduction of cell phones, casinos and the lottery, micro-lending, the decline in the relative prices of durables compared with non-durables and the changing disparity in income levels.

During the past year, these factors contributed to the evolution of a new South African consumption profile, with ample evidence that upper, middle and lower income consumers are altering their patterns, rates and modes of retail purchasing.

National retail sales grew at an average of 7%, approaching 9% in the second half. However, real growth averaged 3%, which was higher in durables and semi-durables and lower in food. Most of the nominal growth in food was a result of inflation, which reached 7% in the second half following supply-side shocks.*

The competitive tensions in South African retail are exacerbated by excess retail space and capacity. Ignoring the country’s low per capita retail sales of R3 500 per annum (Poland R15 900, Argentina R29 200, Australia R31 800 and the United States R74 000), South African property developers continue to invest in new retail space. Over 500 000 m² are planned for 2001. This will continue to drive retail consolidation, chain rationalisation and redundant space.

* Source - Econometrics
In this environment the consumer at all levels is aware and demanding of blatant value.

Strategy
Massmart’s existence and growth was founded on two simple precepts:

The first is that scale is a necessary prerequisite to sustainable competition in the mass distribution of branded consumer goods.

From the outset we recognised that the maturity of the South African distribution industry was such that little opportunity existed to grow a single retail or wholesale brand to the required scale. What was possible was broader, deeper market penetration and the dominance of selected product categories through the acquisition, consolidation and growth of a portfolio of retail and wholesale brands.

To this end we pursued a fast growth strategy of category development through acquisition and aggressive organic development. Since 1990 seven companies have been acquired and integrated and one new format was founded, adding 350 000 m² of retail space and resulting in compound annual sales growth of 28%.

Today Massmart is South Africa’s fourth largest retail and wholesale group and the leading distributor of general merchandise, trading through five focused formulae or chains, which collectively ensure industry prominence in seven major product categories.

In formulating this multi-format growth strategy, we recognised both an opportunity and a challenge. The opportunity was that more formats could penetrate the market more broadly by satisfying the specific needs of more customer segments. The challenge was that functional duplication and consequent higher costs would prevent a multi-format group from performing as well as a single format retailer of similar size.

To overcome this we formulated our second precept, namely that the performance of a multi-divisional group can be enhanced by internal collaboration and joint initiatives. Three major areas of intra-group opportunity were identified: expense reduction through improved efficiency, margin enhancement through consolidated procurement, market penetration through co-ordinated management of the retail mix and group-wide executive development. Each of these has been a significant and growing source of profit in recent years.

These precepts have been captured in Massmart’s “Chain and Channel” business model that guides the decisions and actions of group and divisional management. It is subject to constant review and has evolved in response to external developments and the emergence of internal opportunities. The model emphasises a focus on each market segment through unique trading formats (the Chains) lead by dedicated management teams. At the same time the benefits of
Massdiscounters operating highlights

- 5 new stores, 1 closure, 8 conversions
- 8% same-store sales growth
- Game - Dion merger successfully concluded
- Strong profit growth from Game African stores

The Chains

The growth of the Massmart portfolio of chains is founded on the following principles:

- An aggressive, competitive trading stance in each chain, comprising a unique mix of location, format, product categories, merchandise ranges, promotional activity and services, each directed at a clearly defined market segment.
- A strong participation in one or more of the seven large product categories which collectively constitute 87% of Massmart's sales.
- The development of an expanding regional presence.
- Favourable cash characteristics.
- A quest for high comparable store sales growth.
- Acquisitions that are value accretive, enhance category influence, add strategic value to Massmart and are enhanced by Massmart’s ownership and collaborative activity.

In adhering to these principles over the past year, each of the chains made pleasing progress towards their strategic and operational objectives, achieving new levels of sales and profits in the delivery of superior value to customers.

Without focused chains, customers cannot be satisfied; without collaboration between the chains, shareholders suffer. There is no trade-off.

Massdiscounters

Massdiscounters, comprising the group’s general merchandise discount retail chains, fared well in a year of consolidation following the merger of Dion and Game under one management team in early 1999. Despite the disruptions resulting from the rationalisation of head offices, warehouses and systems, the division implemented an aggressive store development programme and maintained its focus on the trading imperatives.

Sales grew 20% to R3 845 million as space grew 17% to 256 000 m² and same-store sales grew 8%. Market share gains were registered in most product categories. Five new stores, one closure and eight conversions resulted in 49 Game and 15 Dion outlets at year-end. This reflects the decision to position Dion primarily as a regional chain in the high density Gauteng province of South Africa, with Game dedicated to the establishment of a strong national presence and the rapid increase of its highly profitable 5-store base north of South Africa.

Gross margins, expenses, bad debt and shrinkage were well controlled but excess stocks - a result of the repurposing of stores on conversion - reduced net working capital. Profits before interest and tax rose 137% to R121 million. Pre-tax profits of R97 million increased the return on sales to 2.5%, still well below Massdiscounters target of 5%.

During the current year, progress will be made through further merger cost savings, the opening of at
least three new stores, improved stack management enabled by a single systems platform, the establishment of Dion as a regional chain, increased consumer awareness of Game through a corporate branding campaign intended to entrench the chain’s positioning of “More than you thought for less than you think”, enhanced authority and clarity in the presentation of tightly edited assortments in every merchandise category and the identification of new store opportunities in Africa.

Following a short tenure as managing director, Allan Herman resigned to emigrate. Grant Pattison, who has been a director of Massdiscounters since its inception, was appointed managing director with effect from October. This appointment supports the drive to substantially strengthen the leadership of this large and profitable division that now employs 5,955 associates.

**Makro**

While no new space was added to Makro’s 111,000 m² during the year, annualisation of the Zimbabwean stores, acquired in September 1998, enhanced the same-store sales growth of 14%. Pleasing gains of market share were registered in all product categories. Sales of R3,923 million, firm gross margins and excellent control of assets, expenses and working capital resulted in a 25% increase of profits before interest and tax to R55 million. Makro’s pre-tax profits of R89 million rendered a 2.3% return on sales, close to the division’s target of 3%.

The political turmoil in Zimbabwe and the consequent currency weakness and constraints led to delays in repatriating dividends. Although trade remained relatively buoyant, it was decided that only 50% of the R6 million profit would be brought to account.

Makro’s residual interests in the Drop Inn and Benny Goldberg’s liquor businesses were wound up during the year at a cost of R2.4 million.

During the year Bruce Cayzer (Food) and Tony O’Gorman (General Merchandise) were appointed to the board. Makro currently employs 2,382 associates. The constructive and innovative relationship between the company and organised labour produced the second consecutive two-year wage agreement with SACCAWU.

Since its inception, Makro has invested in information systems that keep it at the forefront of its requirements. Following careful assessment, it has been decided to implement the SAP Retail system. This system will integrate with the already operative SAP financial system and is expected to enhance inventory and customer management at reduced cost, while enhancing upstream and downstream eCommerce.

For some years the management of Makro has been committed to the implementation of “The Makro Deal”, a customer centric growth strategy, which delivers price leadership from a foundation of an exceptionally low cost base through integrated investment in assets, people and processes. The past

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**Makro operating highlights**

- 14% same-store sales growth
- “Makro Deal” strategy successfully implemented
- Successful disposal of non-core assets
- Profit growth through category and merchandise innovation

![Growth (%)](image)
The year’s performance was directly attributable to category, merchandise and customer management innovations arising from this strategy, which will form the cornerstone for the achievement of the division’s targeted returns in the short term.

**Shield**

As a voluntary buying association, Shield’s sales growth is determined by the number and participation of its independent retailers and wholesalers. Membership rose to 506 during the year and improved participation by many members resulted in a sales increase of 16% to R1,724 million, excluding inter-group sales to CCW. Expenses and bad debts were well controlled but profits were depressed by the separation of CCW and Shield and the start-up costs of eShield, referred to below. Profits before interest and tax increased 15% to R39 million. Pre-tax profits of R48 million rendered a 2.8% return on sales, approaching the division’s targets of 3%.

Shield’s success is primarily determined by the quality of its relationships with members, some of whom have been valued trading partners since the company’s formation in 1973. The company’s ability to understand and adequately serve the unique needs of this important segment of the distribution trade has been greatly enhanced by two recent initiatives.

The first was the creation of eShield, an internet-enabled trading portal, which allows the proprietary sharing of information and the processing of transactions between Shield and its members. Launched in March this year and currently operative in 237 outlets, eShield will enhance the company’s understanding of its customers’ buying patterns and is expected to reduce costs and improve efficiency for Shield and its members. Sales since launch to the end of September of R116 million reflect pleasing progress towards our long-term objective of half of all sales being transacted through this medium.

The second was the appointment of Rob Suttle as sales director. Over the past eighteen months the leadership and management of the company’s sales force fell below the required standard. This appointment signals a commitment to upgrade the motivation, development and focus of the Shield sales force in the interests of its members.

These two initiatives, together with the company’s established excellence in controlling costs and bad debt, are expected to enhance the Shield offering and sustain the company’s record of sales and profit growth.

**CCW**

Three new stores, the annualisation of a fourth and the introduction of liquor in four outlets, effectively increased space to 52,500 m² and sales 38% to R1,143 million. Comparable sales grew 16%. Margins, costs and shrinkage were well controlled resulting in profit before interest and tax rising 41% to R31 million. Pre-tax profit of R36 million, 3.1% of sales, exceeded the division’s target of 3%.

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**Shield operating highlights**

- 9 year record of unbroken sales and profit growth
- Successful implementation of eShield
- Profit growth depressed by eShield start-up costs
Research has established exciting growth possibilities for CCW’s low cost owner-manager cash-and-carry formula. In anticipation of faster growth, the chain’s management, buying capability and systems were strengthened during the past year.

This, together with aggressive new store development, will ensure continued growth and high returns.

The Channel
The term “Channel” is used to describe any centralised or collaborative activity that enhances profitability beyond that which would normally be achieved by the Chains as stand alone entities.

The key tenet is that the Channel must add value or reduce cost without adding complexity to, or diverting focus from the Chains.

Massmart’s profitability was materially enhanced over the past year through progress in the following areas of channel activity.

Procurement
Under the guidance of individuals acknowledged by the business as leaders in their disciplines, two forums have been established to improve merchandise procurement and to develop mutually advantageous strategic relationships with our suppliers. During the past year these forums beneficially restructured trading relationships with over 120 key suppliers who acknowledge Massmart as an efficient, desirable route to market.

Cost reduction
A forum for non-merchandise procurement has similarly engaged with suppliers to ensure the group’s purchasing of services is agglomerated and directed to good effect. Internal benchmarking across all major cost centres has resulted in improved processes and costs. A number of functions are now centralised and shared by all divisions.

Information technology
Massmart has chosen to outsource the development and operations of its information technology to three outsource partners. The manner in which the outsource contracts are structured has ensured a lower cost for the group than was previously achieved in-house. Concurrently we have embarked on a process to strengthen our internal IT competence to drive strategy and implementation, ensure the achievement of objectives and returns and control the outsource partners. Massmart invests in IT appropriate to each Chain’s needs, while ensuring group-wide integration to enhance inter-divisional collaboration. Investment in appropriate cost-effective eCommerce applications – mainly B2B and trade exchanges – is a priority.

Retail co-ordination
Store locations, retail positioning, promotional activity and pricing are coordinated to optimise customer value and market penetration.

CCW operating highlights

- 16% same store sales growth
- 3 new stores
- Introduction of liquor to 4 stores
- Strengthened management and buying capabilities
Executive development

The shortage of executive talent in the retail industry has necessitated centralised management of executive development and succession. The group continues to attract and retain high potential individuals through investing in the development of technical, managerial and leadership skills. Retention is enhanced by competitive remuneration, the allocation of responsibility, incentivisation and meaningful equity participation.

Structure and Governance

Massmart’s management structures and processes support the business model. Starting with the Massmart board, the formal management of the group devolves through divisional boards and executive committees that ensure governance, control and integration. In contrast, the informal management of the group is open, inclusive, communicative and relaxed.

The roles and responsibilities of the holding company, the Chains and the Channel are clearly defined.

During the year a number of senior appointments strengthened the capability of the holding company.

- Christopher Seabrooke was appointed a non-executive director of the Massmart board and chairman of the Audit and Remuneration committees.
- Dan Barrett was appointed Chief Operating Officer, assuming line responsibility for the divisions from January and the Chairmanship of the Makro, Shield and CCW boards from August.
- Mark Huxtable was appointed Chief Information Officer in January, mandated to guide and control Massmart’s investment in information technology, eCommerce and logistics.
- Guy Hayward was appointed Group Finance Executive responsible for financial and management accounting throughout the group.

The Boards and Executive Committees of the Chains were similarly strengthened.

Listing on the Johannesburg Stock Exchange

Following a decade of growth and development, Massmart was listed on the Johannesburg Stock Exchange on the 4th July 2000 by way of a private placing of 40 million shares at R12.50 per share, at which price the offer was 65% oversubscribed. This effectively eliminated the group’s under-capitalisation, which arose from past acquisitions being funded partially from borrowings instead of shareholders’ equity.

Of the 197 million shares now in issue, 81 million (41%) are owned by Wooltru, 61 million (31%) by SHV (the Dutch multinational which founded Makro South Africa in 1971), 15 million (8%) by management and 40 million (20%) by the public. The illiquidity arising from a tightly-held private placement will be rectified by Wooltru’s stated intention to release its shares in Massmart by February 2002.

Regional and segmental reach

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Sales by customer segment (%)

- End user (LSM 6-8) 49%
- Resale (LSM 2-6) 51%
Complementary product categories

Dominant Categories (Sales > R600 m)

- Groceries
- Liquor
- Appliances
- Video and Audio
- Multimedia and Office
- Sport and Outdoors
- DIY

Cash characteristics (% of sales)

- Cash
- Trade credit (< 30 days)
- Retail credit

Appreciation

The past year was cause for celebration. Sound strategies and implementation produced record results in each division.

Our growing ability to collaborate and work together as a group enhanced these results while the listing of the company positioned Massmart for future growth.

All of this was a tribute to the people who have chosen to make Massmart an important part of their lives. Our sincere gratitude is due to all of them, from part-time associate to board member.

Colin Hall, past chairman of Makro and Massmart and a director of your group since 1997, resigned in September. For over a decade his vision and counsel contributed to the development of Massmart and its leadership. For this we thank him.

Prospects

We are pleased with our progress in recent years. Massmart is now positioned as a major participant in South African retail and wholesale. Our portfolio of focused differentiated value formats serves a broad spectrum of consumers with complementary product categories that collectively generate positive cash flows. This balanced risk profile has been achieved through sound acquisition and growth strategies, implemented by a growing cadre of extraordinary retail leaders and managers.

Over the past four years we have enjoyed good growth and rising returns and we believe that following the listing, your group is better placed than ever to extend this record by exploring and exploiting the exciting growth prospects currently under review.

We are ever mindful that we will be assessed not in absolute terms, but relative to our peers. Our deep commitment and obligation is therefore to interpret and respond to challenging trends and difficult conditions with world class practices that ensure superior performance in the retail sector.

In the current year Massmart will improve earnings per share ahead of expectations for the retail sector.

Mark J Lamberti
Chairman of the Board and Chief Executive Officer

Dan Barrett
Director and Chief Operating Officer

Steve Leggatt
Director and Chief Financial Officer