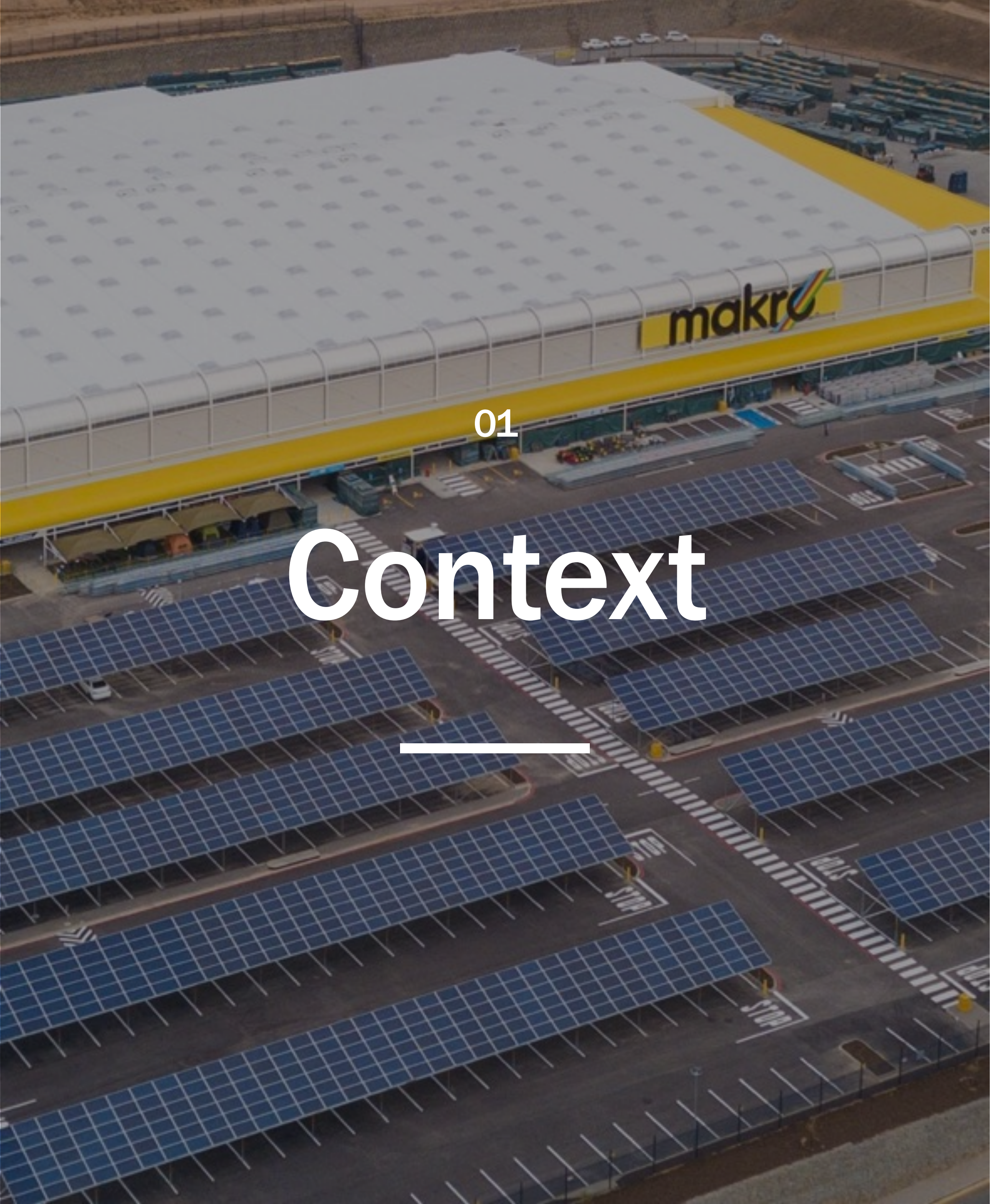
Massmart + Walmart

IFRS 16 Leases

AGENDA

01 CONTEXT
02 ADOPTION
03 IMPACT
04 TRANSITION
05 Q&A



01

Context

IASB
- Comparability and transparency
- Borrowings vs leasing

Old IAS 17 Leases
- Dual lease model
- Off-balance sheet treatment

New IFRS 16 Leases
- Single lease model
- All leases on balance sheet

Journey

Commenced in 2016

Moved from a decentralised to **centralised IT solution**

Abstraction

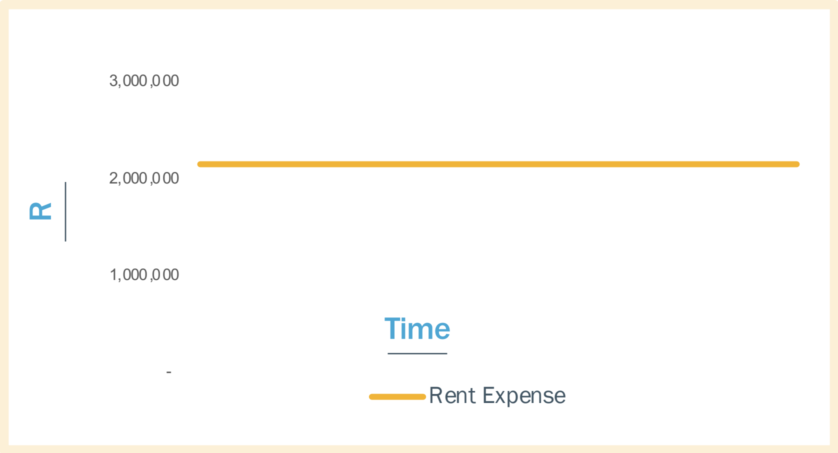
- Over 120 data points
- 550 real estate
- 2,300 non-real estate

IAS 17 vs IFRS 16

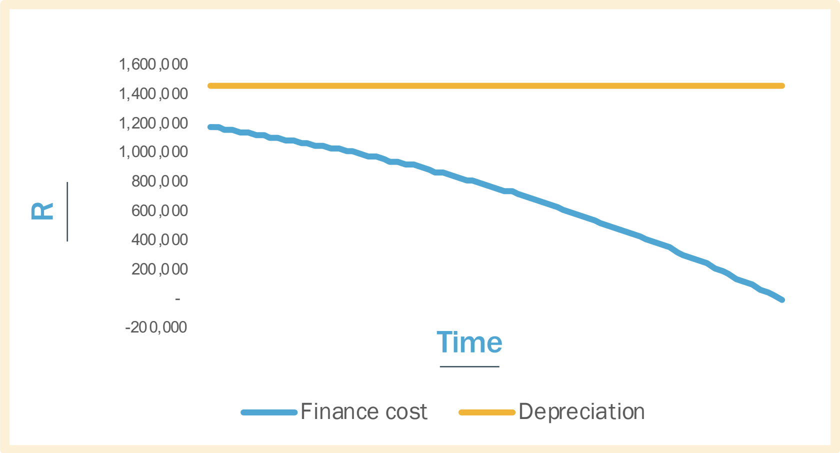
IAS 17

IFRS 16

EXAMPLE INCOME STATEMENTS

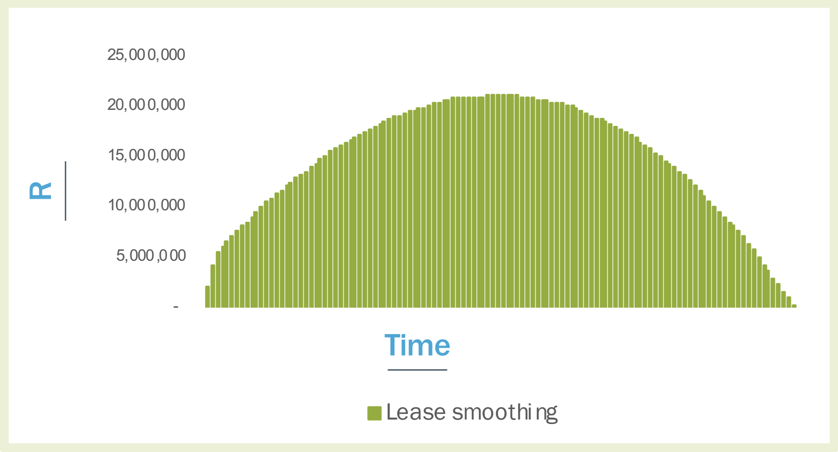


Rent expense recognised on a straight-line basis

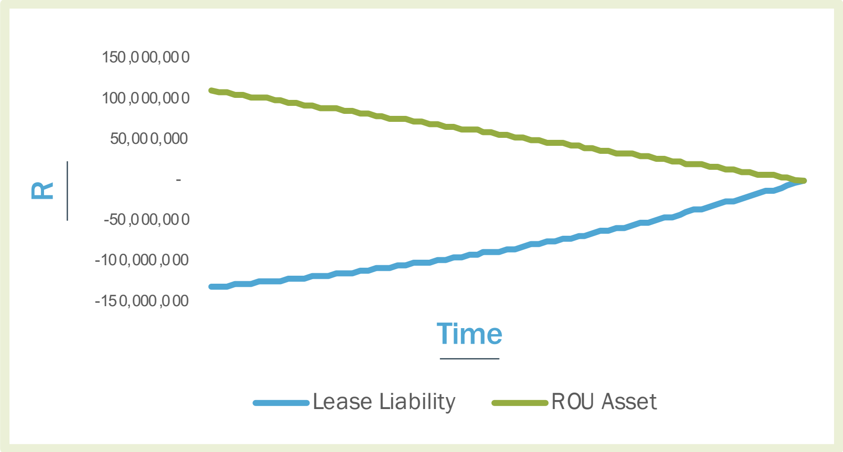


Smoothed depreciation expense and diminishing finance cost

EXAMPLE BALANCE SHEETS



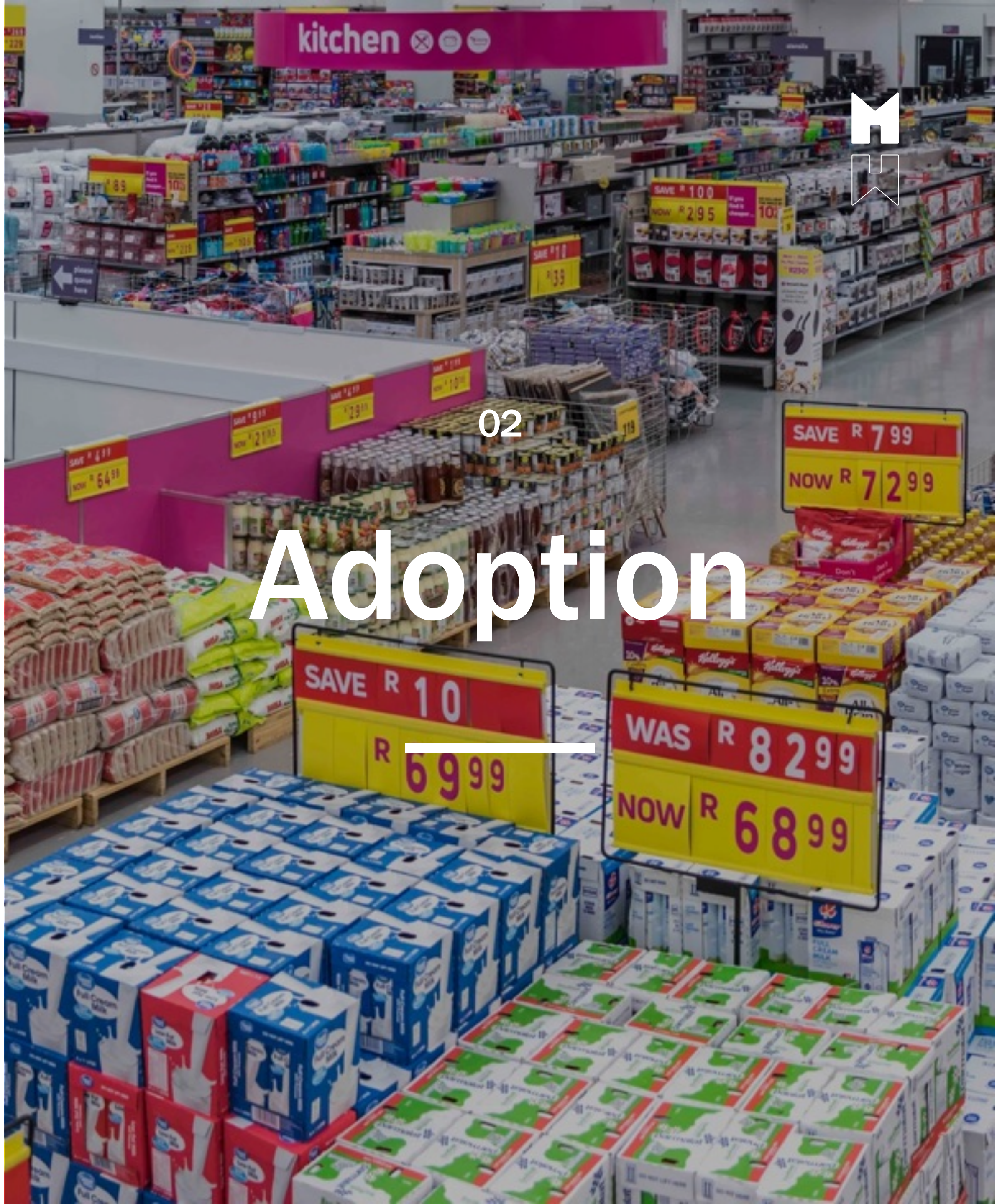
Lease smoothing liability raised to enable the smoothing of escalating lease payments above



ROU asset and lease liability

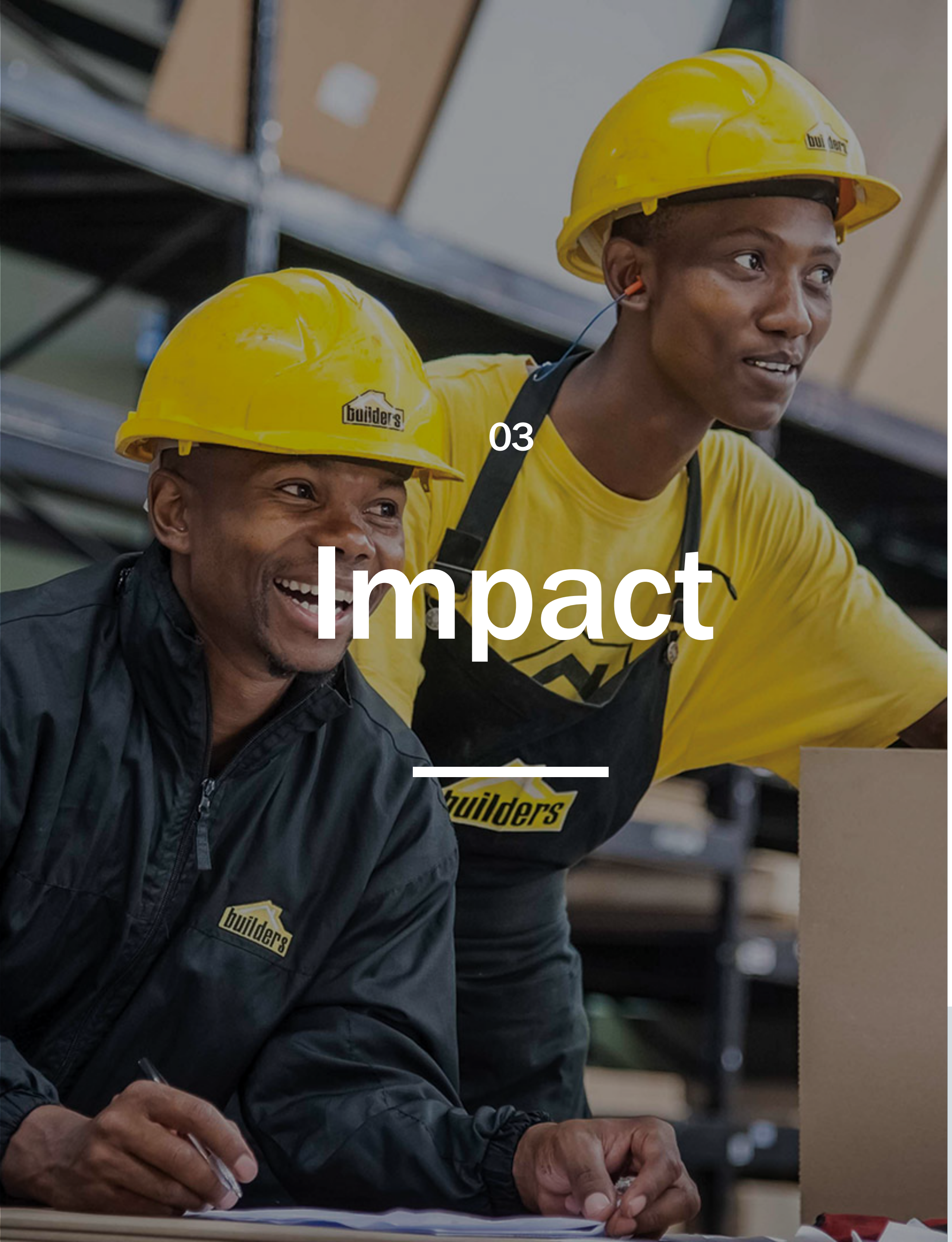
No change to strategy

Leasing continues
to be a critical part of
our business model



02

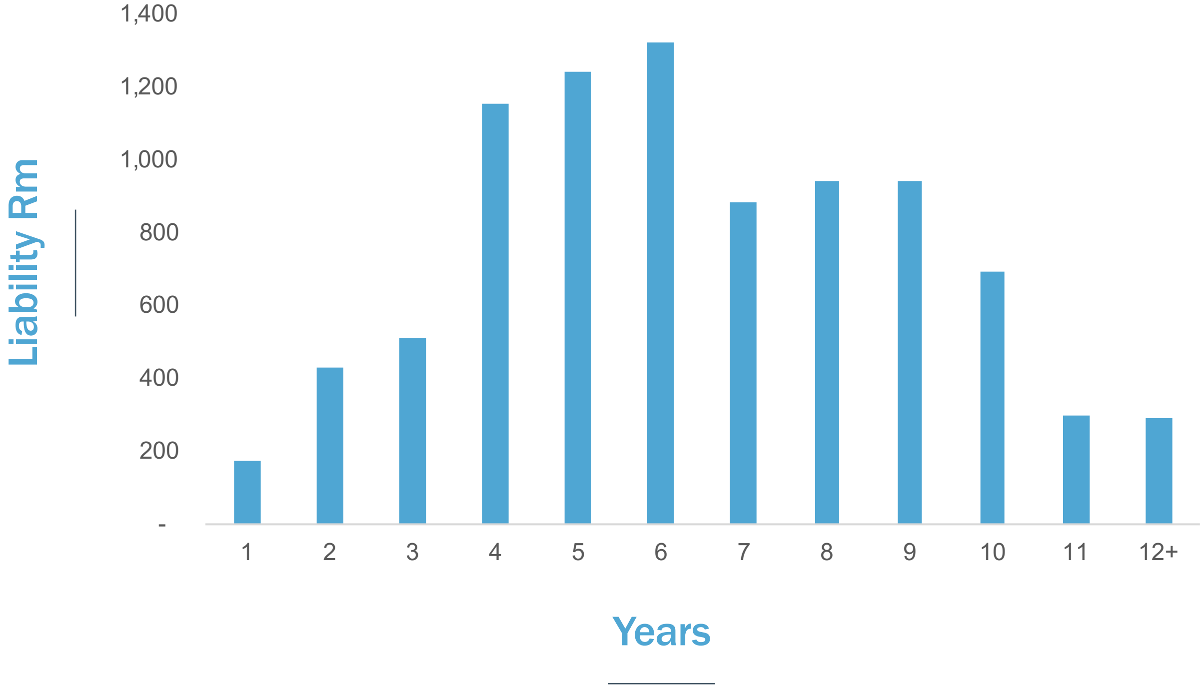
Adoption



03

Impact

Massmart Lease Portfolio

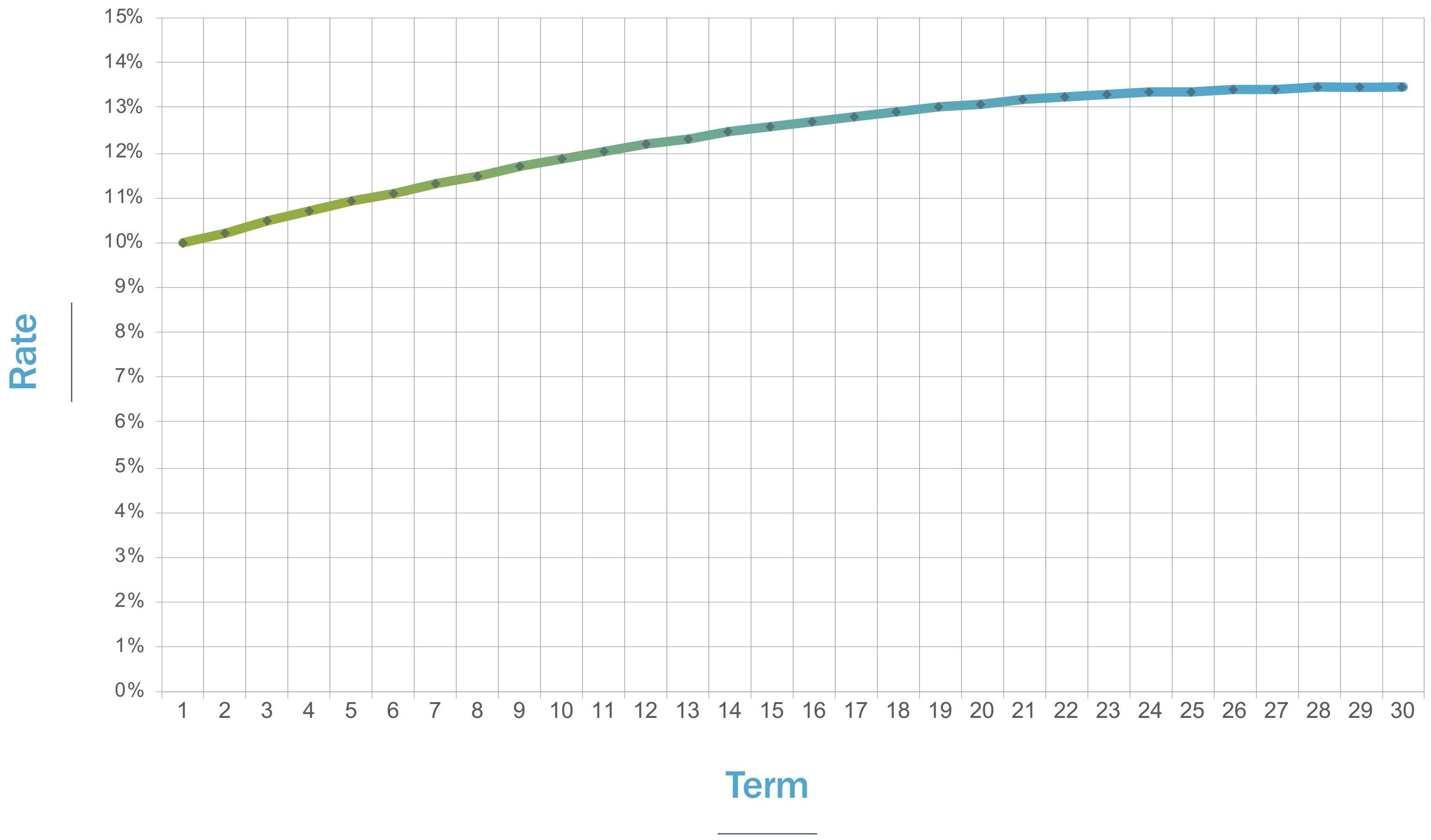


Real estate

Average initial term:
Approximately 7 years

Average remaining period:
Approximately 5 years

Discount Rate



Inputs considered:

- Local borrowing rates
- Unsecured rate
- Lease start date
- Lease term

Application:

- Discount rate based per lease on remaining term at transition

Lease Liability

Lease liability at adoption date:

Present value of the operating non-cancellable lease commitments at December 2018

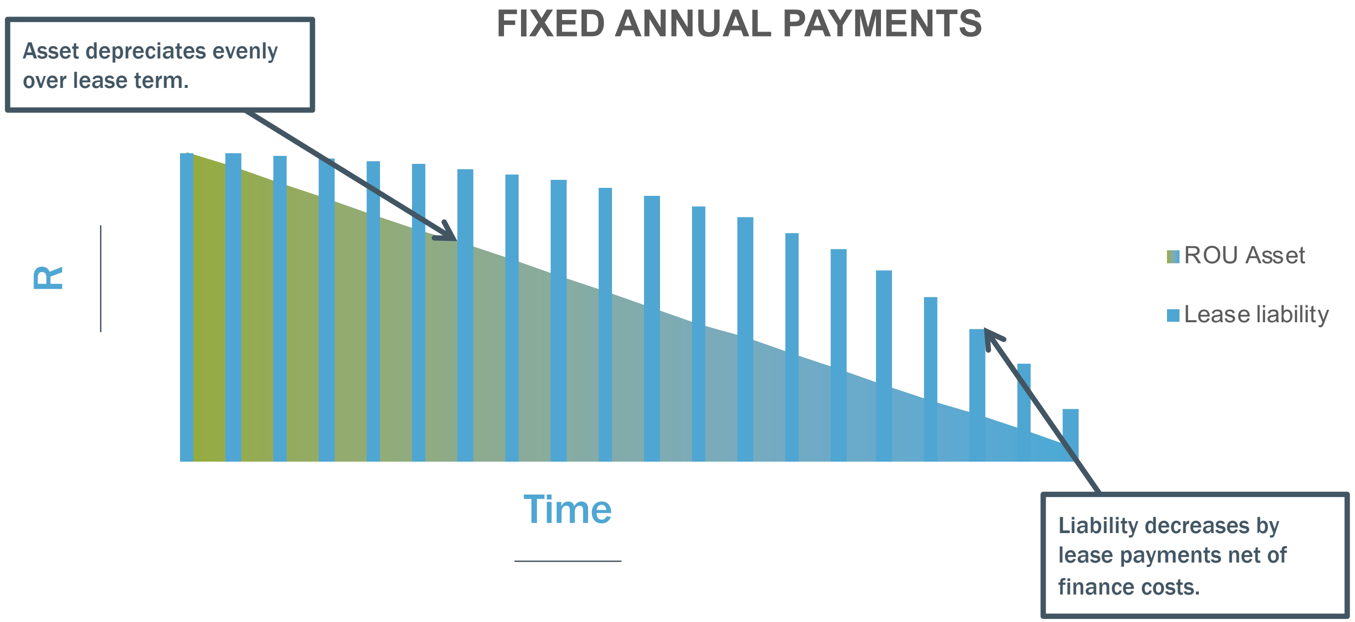
Lease term =
Non-cancellable lease commitments
+ extension/option if reasonably certain

Net lease commitments

Rbn	DECEMBER 2018	RESTATED DECEMBER 2017
Real estate		
Short-term		
Year 1	**2.3**	2.3
Year 2 to 5	**7.8**	7.9
Subsequent to year 5	**6.1**	4.9
	16.2	15.1
Short-term		
Year 1	**0.1**	0.0
Year 2 to 5	**0.1**	0.0
Subsequent to year 5	**-**	-
	0.2	0.0
	16.4	15.1

Balance Sheet

Key changes



All leases will be recognised on Balance Sheet:

- Right-of-Use (ROU) asset
- Lease liability

Lease liability is initially raised at the net present value of future lease payments.

ROU asset is initially raised at a value equal to the lease liability adjusted by payments made to lessor before lease commencement date.

The lease liability and ROU asset differ in value over the lease term due to:
The lease liability decreasing by the lease payments net of the finance costs incurred.
The ROU asset decreases through depreciation evenly over the lease term.

Opening Balance Sheet 2019

Assets

Capitalised lease assets to increase by R8.5 billion (a)
The difference of approximately R1.5 billion seen between the ROU asset and lease liability is due to the adoption entry whereby the ROU asset is further adjusted by the derecognition of lease prepayments, the lease smoothing liability, impairment, onerous leases, incentives and initial direct costs.

Trade and other receivables to decrease by R118 million (b)
The adjustment relates to the removal of the prepaid rental on the operating leases which is allocated against the ROU asset on adoption.

Condensed Consolidated Statement of Financial Position

Rm	ADJUSTMENTS	DECEMBER 2018 (AUDITED)	IFRS 16 ADOPTION ENTRIES	2019 OPENING BALANCE
ASSETS				
Non-current assets		**14,165.8**	8,530.0	22,695.8
Property, plant and equipment	(a)	**9,647.2**	8,530.0	18,177.2
Goodwill and other intangible assets		**3,656.3**	-	3,656.3
Investments and other financial assets		**119.2**	-	119.2
Deferred taxation		**743.1**	-	743.1
Current assets		**20,605.2**	(118.1)	20,487.1
Inventories		**12,180.9**	-	12,180.9
Trade, other receivables and prepayments	(b)	**5,693.2**	(118.1)	5,575.1
Taxation		**361.3**	-	361.3
Cash on hand and bank balances		**2,369.8**	-	2,369.8
Non-current assets classified as held for sale		**11.6**	-	11.6
Total assets		**34,782.6**	8,411.9	43,194.5

Opening Balance Sheet 2019

Equity and liabilities

Condensed Consolidated Statement of Financial Position

Rm	ADJUSTMENTS	DECEMBER 2018 (AUDITED)	IFRS 16 ADOPTION ENTRIES	2019 OPENING BALANCE
EQUITY AND LIABILITIES				
Total equity		**6,528.6**	(227.1)	6,301.5
Equity attributable to owners of the parent	(c)	**6,514.0**	(227.1)	6,286.9
Non-controlling interests		**14.6**	-	14.6
Non-current liabilities		**3,694.5**	8,706.7	12,401.2
Interest-bearing borrowings	(d)	**2,254.1**	10,060.6	12,314.7
Deferred taxation		**76.7**	-	76.7
Other non-current liabilities and provisions	(e)	**1,363.7**	(1,353.9)	9.8
Current liabilities		**24,559.5**	(67.7)	24,491.8
Trade, other payables and provisions	(f)	**21,925.1**	(67.7)	21,857.4
Taxation		**205.3**		205.3
Bank overdrafts		**1,744.0**	-	1,744.0
Interest-bearing borrowings		**685.1**	-	685.1
Total liabilities		**28,254.0**	8,639.0	36,893.0
Total equity and liabilities		**34,782.6**	8,411.9	43,194.5

Equity to decrease by R227 million (c)
The equity adjustment relates to the initial impairment of the ROU asset at adoption.

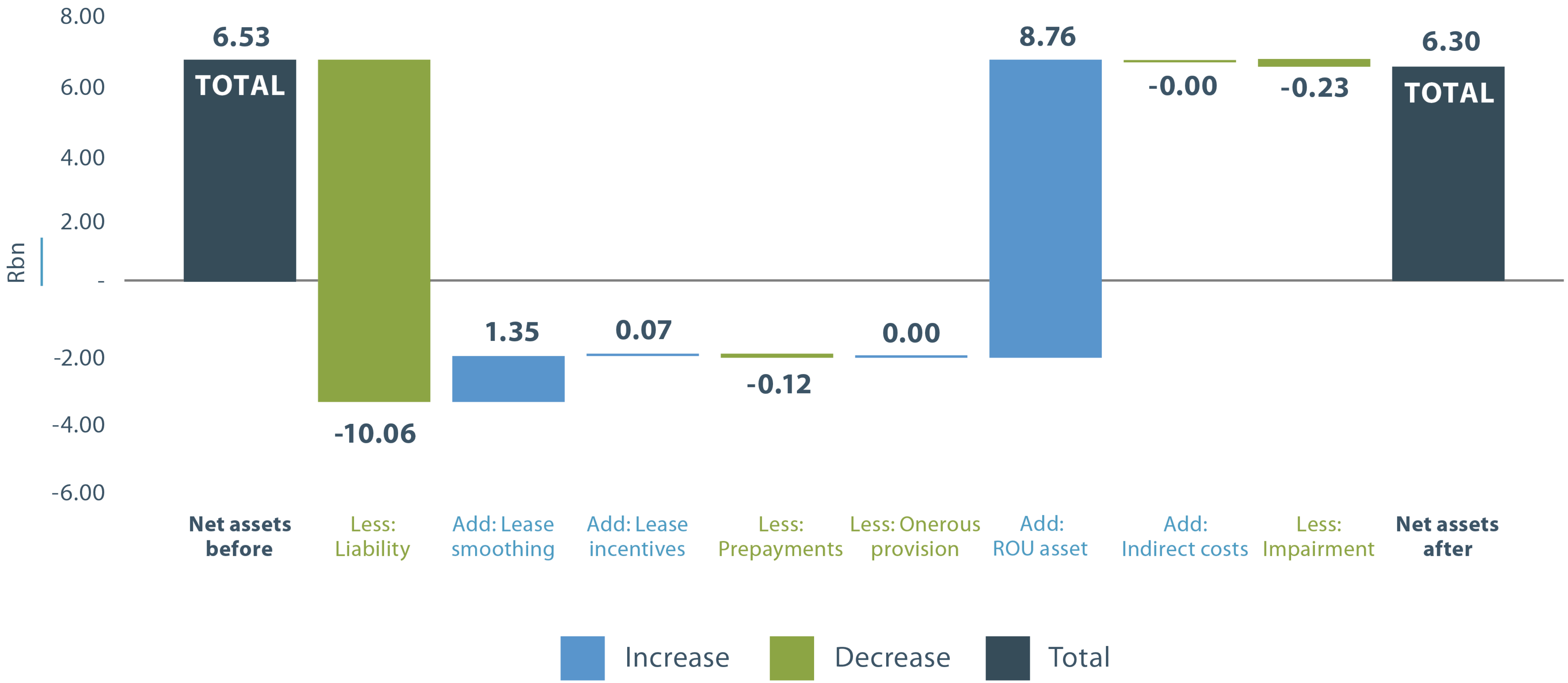
Interest-bearing borrowings to increase by R10 billion (d)
The initial recognition of the lease liability will be raised on a present value basis, discounting the minimum lease payments over the term of the lease, on the same basis as the previously capitalised lease liability under IAS 17.

Other non-current liabilities and provisions to decrease by R1.4 billion (e)
This adjustment relates to the removal of the full operating lease smoothing liability which is allocated against the ROU asset on adoption.

Trade, other payables and provisions (f)
The adjustment relates to the reversal of the lease incentives and onerous lease provisions.

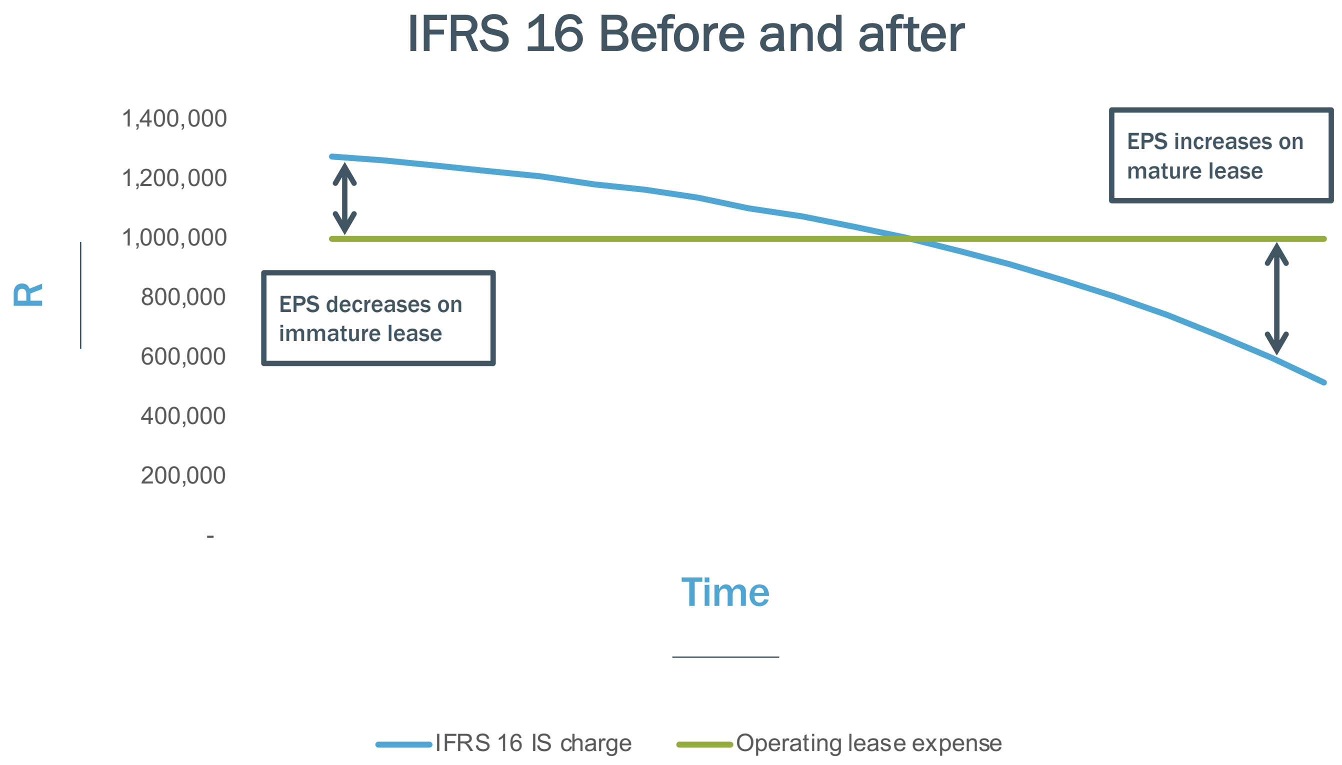
Net Asset Reconciliation

Balance Sheet at adoption



Income Statement

Key changes



Smoothed operating lease expense replaced by:

- Straight-line depreciation
- Finance costs diminishing over the lease term

Total charge to the Income Statement over lease term before and after IFRS 16 is the same

Impact on Profit before Tax (PBT) and Earning per Share (EPS) depends on the maturity of lease portfolio

- The cost to the Income Statement is front loaded due to finance costs
- Therefore, the cost to the Income Statement will be higher on a new lease vs an older lease

Depreciation to increase by R1.7 billion (g)
Due to the increased capitalised lease asset portfolio the depreciation expense will increase.

Occupancy to decrease by R2.4 billion (h)
The previously recognised rental charge on the operating leases is no longer recognised on the Income Statement and is removed.

Operating profit to increase by R722.6 million (i) and earnings to decrease by R289.5 million (j)
These numbers are heavily driven by the maturity status of the current lease portfolio.

Finance costs to increase by R1.1 billion (k)
Due to the recognition of the lease liability, is now recognised in the Income Statement over the lease term.

Taxation (l)
Temporary differences relate to IFRS 16 entries backed out of the accounting profit.

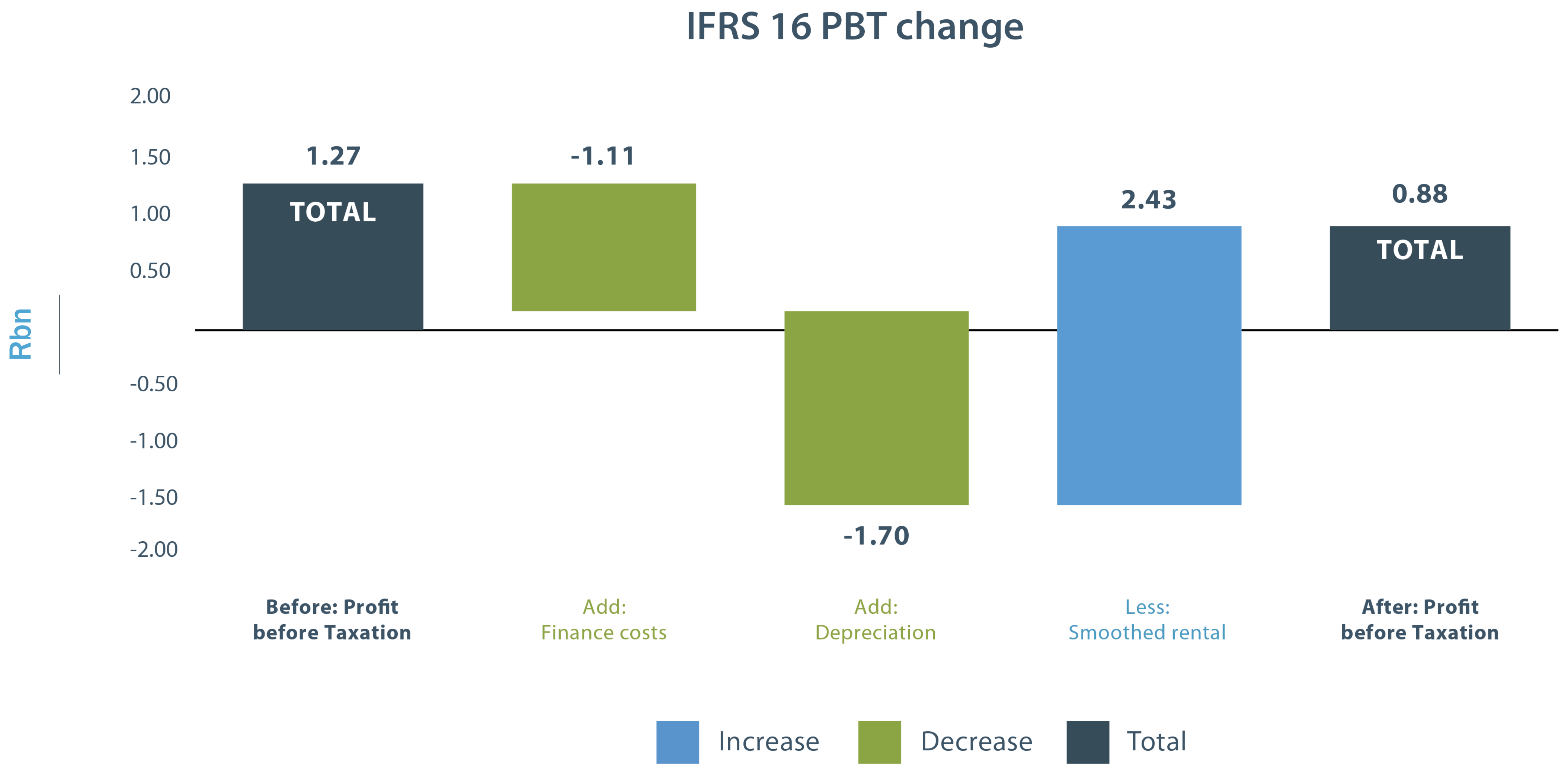
2018 Pro Forma Income Statement

Condensed Consolidated Income Statement

Rm	ADJUSTMENTS	52 WEEKS DECEMBER 2018 (AUDITED)	IFRS 16 PRO FORMA	52 WEEKS DECEMBER 2018 (PRO FORMA)
Revenue		91,180.6	-	91,180.6
Sales		90,941.6	-	90,941.6
Cost of sales		(73,250.4)	-	(73,250.4)
Gross profit		17,691.2	-	17,691.2
Other income		231.0	-	231.0
Depreciation and amortisation	(g)	(1,134.6)	(1,703.2)	(2,837.8)
Employment costs		(7,582.9)	-	(7,582.9)
Occupancy costs	(h)	(3,491.3)	2,425.8	(1,065.5)
Other operating costs		(3,644.5)	-	(3,644.5)
Trading profit before interest and taxation	(i)	2,068.9	722.6	2,791.5
Restructuring costs		(161.0)	-	(161.0)
Impairment of assets		(21.4)	-	(21.4)
Insurance proceeds on items in PP&E		8.0	-	8.0
Operating profit before foreign exchange movements and interest		1,894.5	722.6	2,617.1
Foreign exchange loss		(2.7)		(2.7)
Operating profit before interest		1,891.8	722.6	2,614.4
- Finance costs	(k)	(648.8)	(1,112.8)	(1,761.6)
- Finance income		25.1	-	25.1
Net finance costs		(623.7)	(1,112.8)	(1,736.5)
Profit before taxation		1,268.1	(390.2)	877.9
Taxation	(l)	(399.4)	100.7	(298.7)
Profit for the year	(j)	868.7	(289.5)	579.2
Profit attributable to:				
- Owners of the parent		888.6	(289.5)	599.1
- Non-controlling interests		(19.9)	-	(19.9)
Profit for the year		868.7	(289.5)	579.2

2018 Pro Forma PBT Reconciliation

IFRS 16 PBT adoption impact



No impact on net cash (p)

Net cash outflows from operations (n)
Increase due to the rental payments (m) no longer recorded offset by the increased finance costs

Cash outflows from financing activities (o)
Increase due to the lease payments on the lease liability

*An interest rate of 11.9% applied for discounting pro forma cash flows

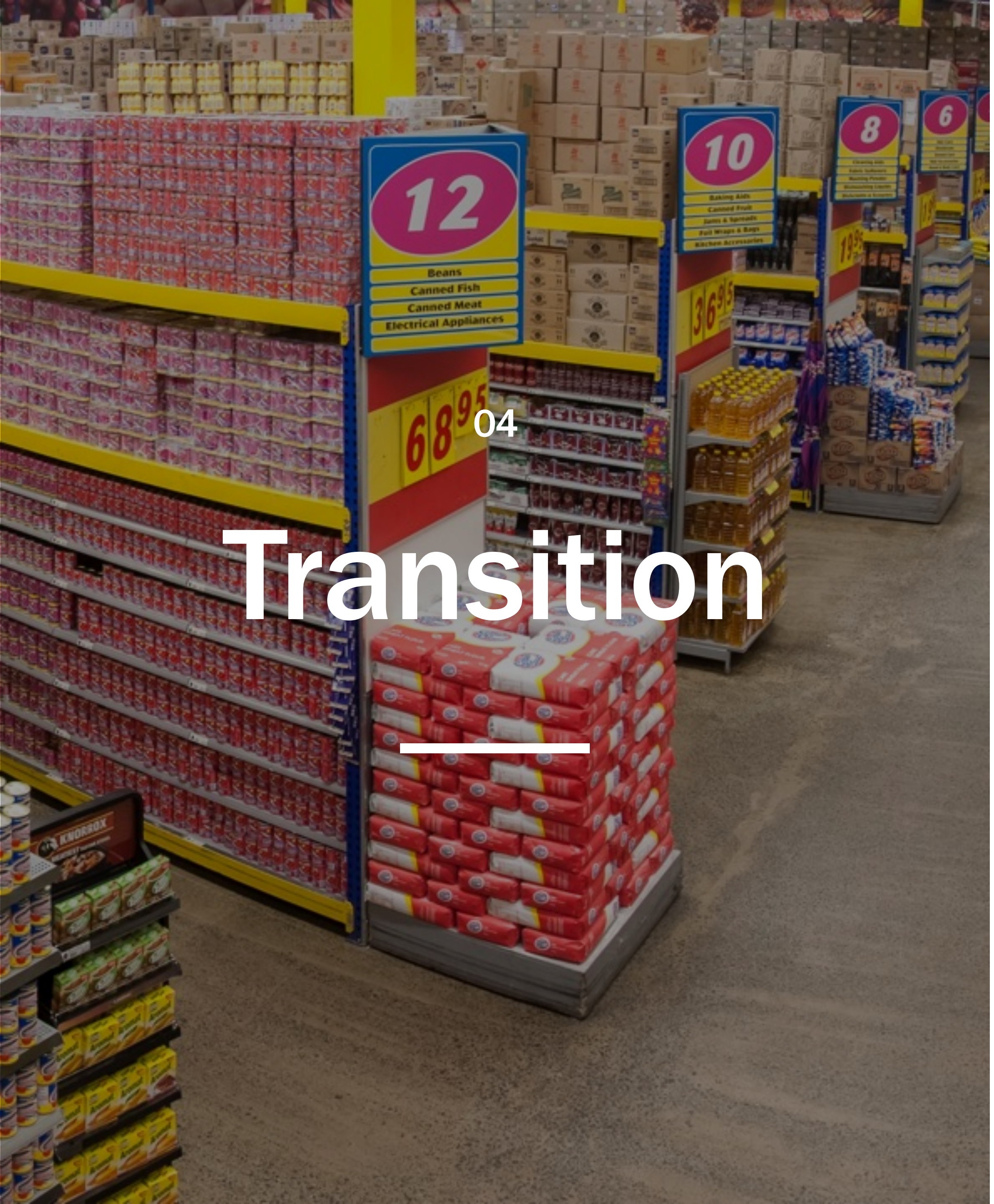
2018 Pro Forma Cash Flow Adoption Impact

Condensed Consolidated Statement of Cash Flows

Rm	ADJUSTMENTS	BEFORE	RECLASSIFY OPERATING LEASE PAYMENTS	RECLASSIFY FINANCE COSTS AND CAPITAL PAYMENTS	AFTER
CASH FLOWS FROM OPERATING ACTIVITIES					
Operating cash before working capital movements	(m)	3,409.6	2,328.7	-	5,738.3
Cash generated from operations		2,863.8	2,328.7	-	5,192.5
Finance costs paid	(n)	-508.0	-	-1,112.8	-1,620.8
Net cash inflow from operating activities		**1,342.0**	**2,328.7**	**-1,112.8**	**3,670.7**
CASH FLOWS FROM FINANCING ACTIVITIES					
Decrease in non-current liabilities	(o)	-583.7	-	-1,215.9	-1,799.6
Net cash inflow/(outflow) from financing activities		**238.7**	**-**	**-1,215.9**	**-977.2**
Net increase/(decrease) in cash and cash equivalents	(p)	**33.8**	**2,328.7**	**-2,328.7**	**33.8**

2018 Pro Forma Adoption Key Financial Metrics

	BEFORE	CHANGE	AFTER
Income statement (2018 pro forma)			
Trading profit margin	2.3%	0.8%	3.1%
EPS (cents)	410.6	-133.8	276.8
Balance sheet (at adoption date)			
Net debt (Rm)	2,313.3	10,060.6	12,373.9
Net debt/EBITDA	0.8	1.5	2.3
Net debt/EBITDAR	0.4	1.5	1.9
Cash flow (2018 pro forma)			
Cash flow from operating activities (Rm)	1,342.0	2,328.7	3,670.7
Cash flow from financing activities (Rm)	238.7	-1,215.9	-977.2



04

Transition

Modified retrospective adoption

- Adjust opening January 2019 retained earnings

ROU asset at adoption to equal lease liability adjusted for:

- lease smoothing liability;
- Impairment;
- onerous leases; and
- incentives and direct costs.

Massmart will provide a pro forma analysis for illustrative purposes to enable comparability of financial numbers in the June 2019 Interim results.

Massmart + Walmart

Q&A

Questions or suggestions regarding IFRS 16 Leases?
Email info@massmart.co.za

Pro forma basis of preparation and assumptions

Basis of preparation

The pro forma financial information has been prepared to illustrate the impact of IFRS 16 - Leases on the financial year ended 30 December 2018 had the standard been effective 1 January 2018 ("IFRS 16 - Leases Impact") on the assumption that the IFRS 16 - Leases Impact occurred on 1 January 2018 for the purposes of the group income statement and the Group Statement of Cash Flows. The pro forma financial effect for the Group Statement of Financial Position reflects the financial impact of adopting IFRS 16 on 1 January 2019 using the modified retrospective approach and because of its nature, the pro forma may not fairly present Massmart's financial position, results of operations or cash flows.

The pro forma financial information has been prepared using the accounting policies of Massmart which comply with IFRS and are consistent with those applied in the audited financial information.

The pro forma financial information is presented in accordance with the JSE Listings Requirements and the SAICA Guide on Pro forma Financial Information.

The Directors of Massmart are responsible for the pro forma financial information included.

Ernst & Young Inc.'s independent reporting accountants' report on the pro forma financial information, is available for inspection at our registered offices.

Pro forma assumptions

The finance costs adjustment reflects the calculated interest when applying the average Massmart incremental borrowing rate as at 1 January 2019 to the cumulative lease liability as at 1 January 2018. The cumulative lease liability as at 1 January 2018 was calculated as the present value of the remaining future lease payments using the average Massmart incremental borrowing rate as at 1 January 2019.

Makro Woodmead lease

IFRS 16 has no impact on the accounting of existing finance leases, only leases that were accounted historically as operating leases. Please note though that our 2018 financials included a correction of an error with regard to a 99-year land lease for our Woodmead Makro store which was accounted for as a finance lease since last year. Please refer to page 53 (restatement) and 64 (note 7 and 8) of our Integrated Annual Report. The adoption of IFRS 16 does not have a bearing on the treatment of the above Makro Woodmead finance lease.