WHL

WOOLWORTHS HOLDINGS LIMITED

Impact of IFRS 16 on Financial Reporting

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5 December 2019

IFRS 16 AGENDA

Introduction
Our transition approach & key principles
Lease portfolio & discount rates
Impact on financial statements & key metrics
Closing

INTRODUCTION

KEY MESSAGES

Effective beginning of 2020 financial year (1 July 2019)

- June 2019 annual results reported on an IAS 17 basis
- First published results on an IFRS 16 basis will be our 2020 interim results presented on 20 February 2020

Significant impact on our financial reporting:

- **Balance sheet:** Right-of-use (ROU) asset and Lease liability brought onto the balance sheet
- **Income statement:** change in structure and categorisation of costs
  - Operating profit and margin increases – rental cost replaced with depreciation and finance costs
  - PBT and EPS decreases initially, as lease portfolio is on average in the earlier part of lease term
- **Key ratio** changes: EBITDA, Operating margin, ROCE, ROA and debt ratios

IFRS 16 does not impact our financial fundamentals, operations or cash flow. However, there has been increased focus on reducing the tenure and increasing the flexibility and variability of our lease agreements

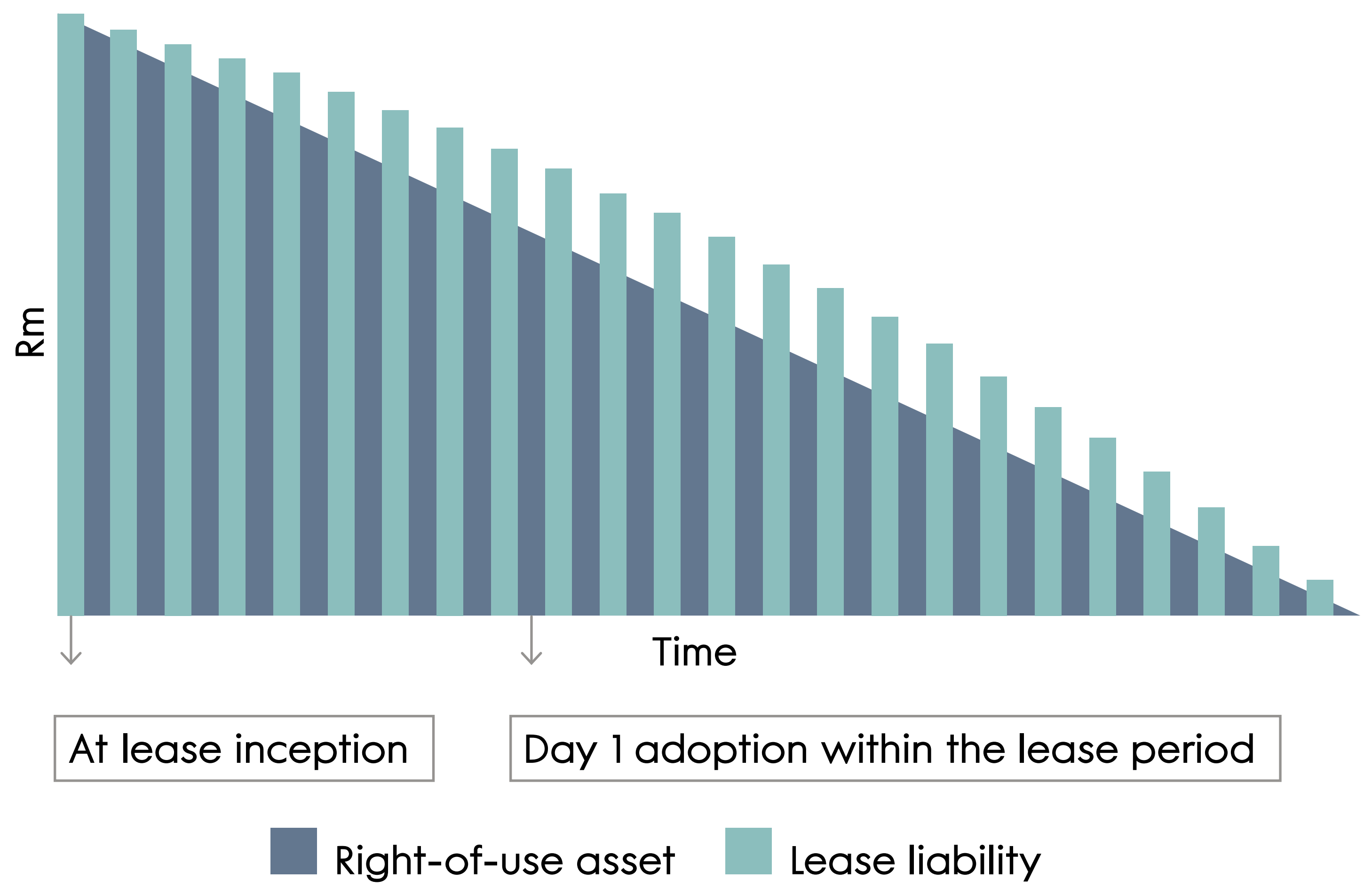
We have communicated our strategic intent to pursue opportunities to optimise space across the Group, with a focus on 'right-sizing' the portfolio in David Jones taking into account the growth in online sales and other structural changes

Leasing remains a key part of our business model

BALANCE SHEET

ALIGNS THE REPORTING OF LEASED ASSETS TO OWNED ASSETS

Asset and liability profile



A ROU asset and Lease liability is brought onto the balance sheet:

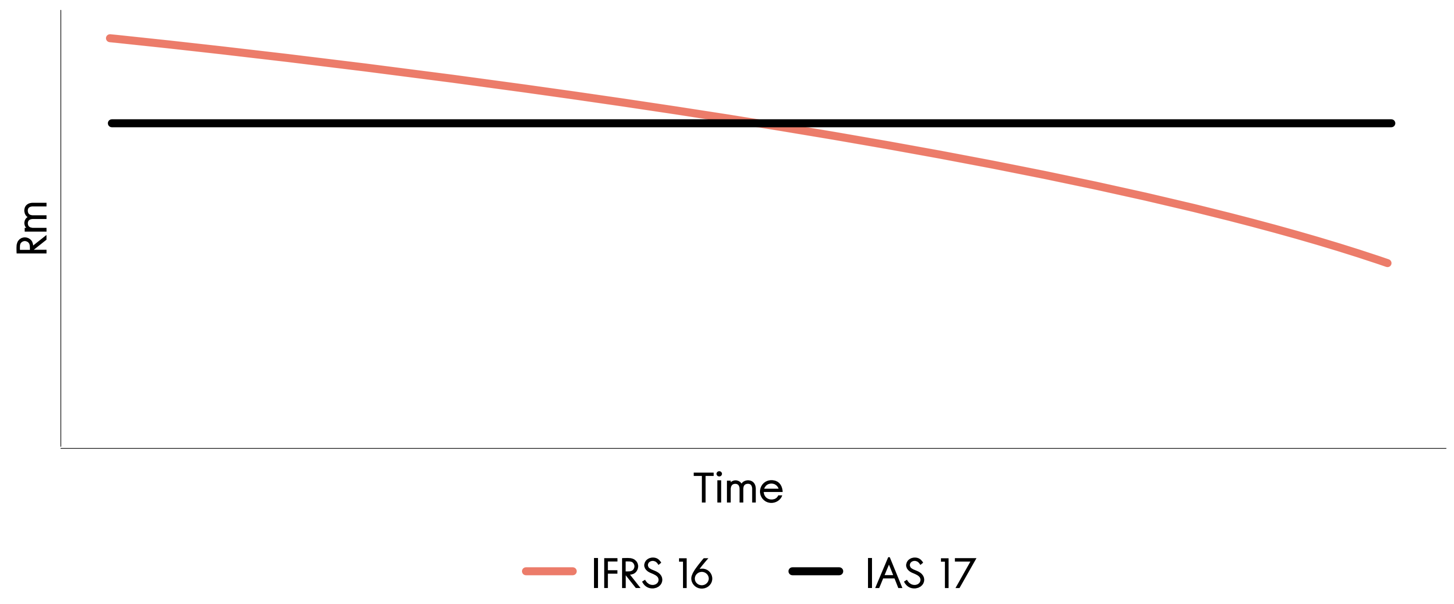
- The Lease liability is raised at the present value of future lease payments
- At **lease inception** the ROU asset equals the Lease liability, adjusted for landlord incentives
- On adoption of IFRS 16 within a lease period, the Lease liability will be greater than the ROU asset

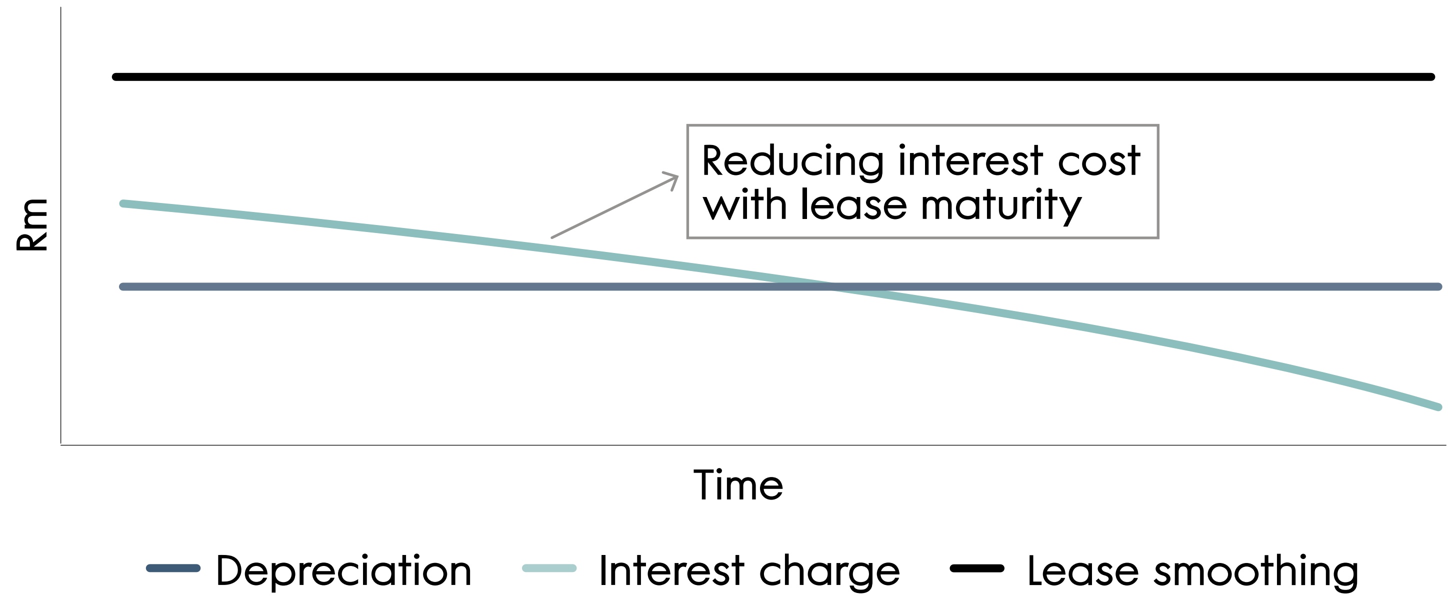
Over the lease term the asset and liability differ in value:

- The ROU asset depreciates evenly, and is subject to annual impairment testing
- The Lease liability decreases by the rental payments, net of finance charges which reduces over time

INCOME STATEMENT

Over the full lease term, the total charge to the income statement is the same under IAS 17 and IFRS 16





IFRS 16 changes the expense characteristics and recognition pattern of the leased asset

The straight-line operating lease expense (IAS 17) is replaced with:

- Depreciation of ROU asset (straight-lined over lease term)
- Finance charge on the Lease liability (reduces over lease term)

The impact on PBT and EPS depends on the elapsed period of the lease term

IFRS 16 is dilutive to EPS at the beginning of a lease and accretive at the end, due to the finance charge reducing over time

OUR TRANSITION APPROACH & KEY PRINCIPLES

OUR TRANSITION APPROACH

We have adopted the **modified retrospective approach**

- Comparative amounts are not restated. Opening retained earnings is adjusted on Day 1 (1 July 2019). Pro-forma results for FY20, excluding IFRS 16 adjustments, will be presented to enable comparability to FY19
- We have opted to use certain practical expedients under the modified retrospective approach e.g. Use of hindsight in determining the lease term; the use of 'grandfathering' to assess whether a contract contains a lease on initial application
- The Lease liability is initially recognised at the net present value of the remaining future lease payments
- The ROU asset is initially raised equal to the Lease liability less lease incentives – adjusted for periods elapsed
- Fair value lease adjustments and onerous provisions are derecognised and offset against the ROU asset on adoption
- Straight-lining Lease liability will be derecognised and offset against equity on adoption

KEY PRINCIPLES

Under the standard there are certain key considerations that one has to take into account when establishing the Lease liability. These include classification of leases, lease terms and discount rates

- Lease commitments have been established after undertaking an extensive exercise evaluating each store and non-store lease agreements, such as distribution centres, warehouse facilities, offices and supply chain contracts
- Lease terms are based on the non-cancellable period of the lease + exercise of options to extend or renew leases where these are considered 'reasonably certain'
- Turnover based portion of rentals are excluded from lease commitments as they are contingent on sales levels
- Discount rates are based on incremental borrowing rates taking into account base rates, margins and lease terms
- ROU asset subject to annual impairment testing

LEASE PORTFOLIO & DISCOUNT RATES

GROUP LEASE PORTFOLIO

	Group	WSA	DJ	CRG
Number of leases	1 068	492	69	507
Average remaining lease term (years)	8.7	7.4	11.2	3.3
Average remaining lease term with no options (years)	6.7	3.7	9.6	2.7
Weighted average remaining lease term (years)	12.8	8.5	16.5	8.1
Weighted average remaining lease term with no options (years)	9.5	4.4	13.2	6.0
Lease multiple (times)	7.3	5.9	10.9	4.8

The lease term includes option periods where these were considered reasonably certain. While this provides business flexibility, it extends the lease term and increases the liability

The lease terms for DJ are considerably longer than WSA and CRG due to DJ being a department store occupying sizable space in major centres

The CRG weighted average remaining lease term is substantially higher due to the longer lease terms for flagship stores and also includes the Botanicca Head Office. Excluding Botanicca, the weighted average remaining lease term is 6.4 years

The lease multiple is the Lease liability divided by the annual straight-lined rental

DISCOUNT RATES

	Discount rate
Woolworths	9.5%
David Jones	4.5%
Country Road Group	4.3%

Discount rates are not implicit in our leases and is therefore based on incremental borrowing rates, taking into account:

- Lease term
- Base rates and margins – per country
- The Group's specific debt profile

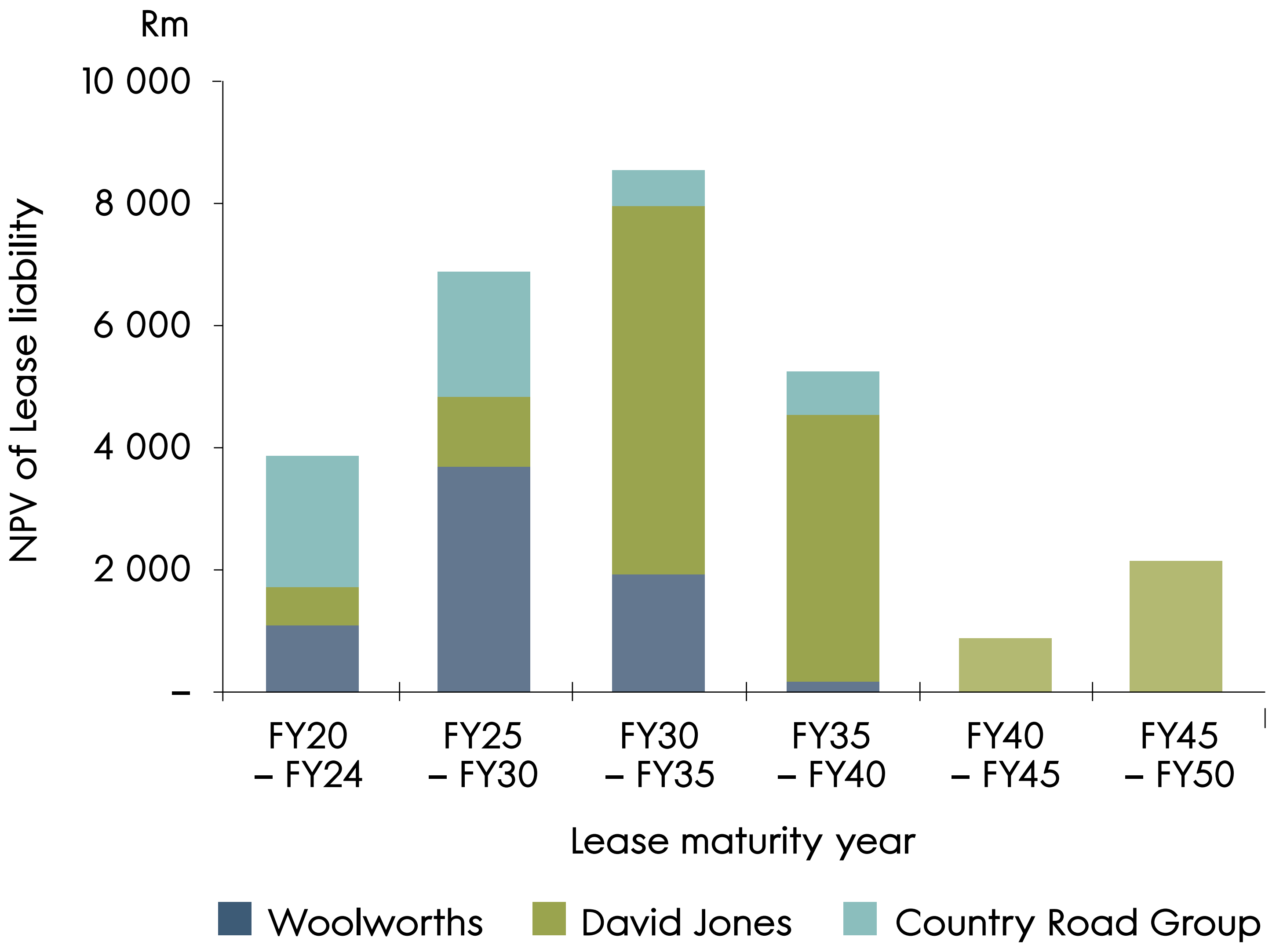
The Australian incremental borrowing rates are aligned to the expected refinancing outcome

The discount rate used for DJ is higher than CRG due to longer lease terms

Discount rates are marginally higher than current borrowing rates due to longer lease terms

GROUP LEASE PORTFOLIO

Lease liability maturity profile



The Group portfolio consists of 1 068 leases with a weighted average remaining lease term of 13 years

As a Group, we are on average 45% into the lease term, and 35% on a weighted average basis

The liability in FY50 consists of a single Tier A David Jones store. The lease period includes a full option period although we have an earlier break clause

The Botanicca head office in Australia is included in the FY35 – FY40 period for DJ and CRG

IMPACT ON FINANCIAL STATEMENTS & KEY METRICS

DAY 1 – GROUP BALANCE SHEET

	2019 Closing Rm	Day 1 Adjustment Rm	2020 Opening Rm
ASSETS			
Non-current assets	**24 032**	**20 889**	**44 921**
Right-of-use asset	–	19 739	19 739
Deferred tax	1 522	1 202	2 724
Fair value lease adjustment	52	(52)	–
Current assets	**11 897**	**–**	**11 897**
TOTAL ASSETS	**35 929**	**20 889**	**56 818**
EQUITY AND LIABILITIES			
TOTAL EQUITY	**9 443**	**(3 027)**	**6 416**
Equity attributable to shareholders of the parent	9 428	(3 027)	6 401
Non-current liabilities	**15 850**	**21 853**	**37 711**
Lease liability	–	23 846	23 846
Operating lease accrual	552	(552)	–
Provisions and fair value lease adjustment	1 535	(1 378)	157
Deferred tax	63	(63)	–
Current liabilities	**10 636**	**2 064**	**12 691**
Lease liability	–	2 364	2 364
Operating lease accrual	63	(63)	–
Provisions and fair value lease adjustment	969	(237)	732
TOTAL EQUITY AND LIABILITIES	**35 929**	**20 889**	**56 818**

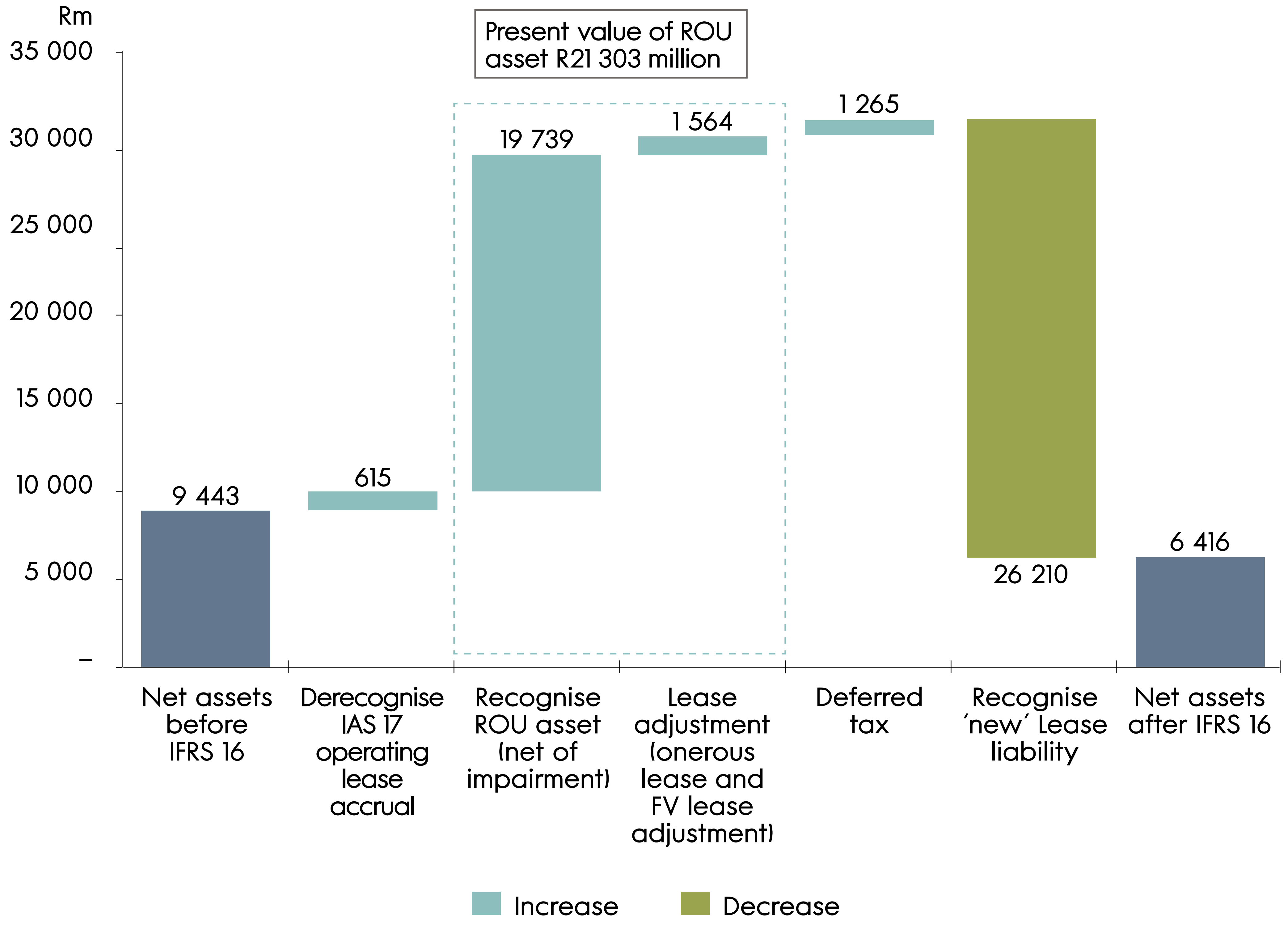
The modified retrospective approach requires an adjustment to opening retained earnings on 1 July 2019 (Day 1)

ROU asset of R19.7 billion raised, with a deferred tax liability, net of lease adjustment and onerous lease provision and impairment

Net impact on equity is R3.0 billion

Lease liability of R26.2 billion raised, with a deferred tax asset

NET ASSETS



Rm
35 000
30 000
25 000
20 000
15 000
10 000
5 000
–
Present value of ROU asset R21 303 million
9 443
615
19 739
1 564
1 265
26 210
6 416
Net assets before IFRS 16
Derecognise IAS 17 operating lease accrual
Recognise ROU asset (net of impairment)
Lease adjustment (onerous lease and FV lease adjustment)
Deferred tax
Recognise 'new' Lease liability
Net assets after IFRS 16
Increase
Decrease

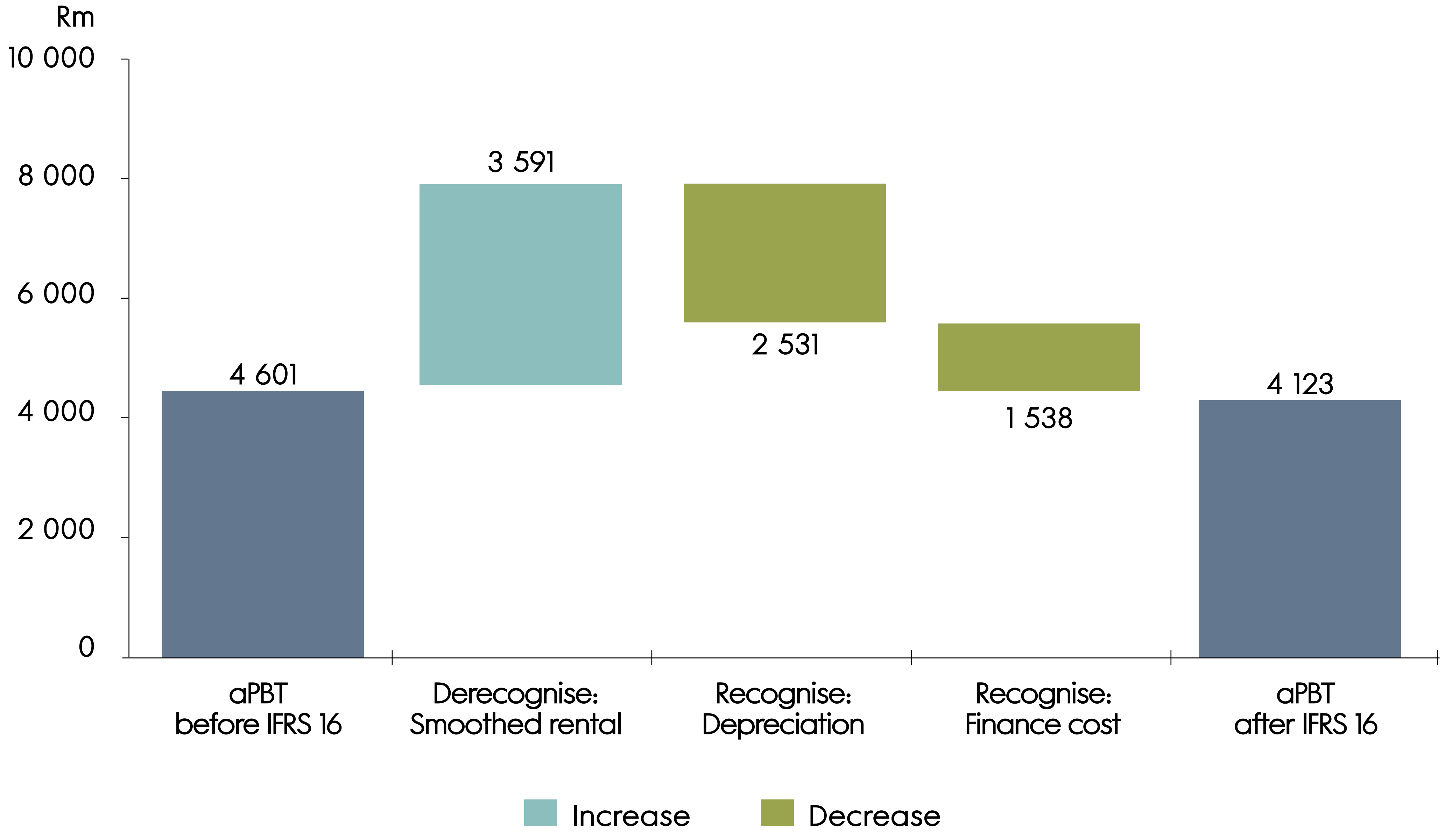
FY19 INCOME STATEMENT

	2019 Report Rm	IFRS 16 Rm	2019 After Rm
Revenue	73 788	–	73 788
Turnover and concession sales	78 335	–	78 335
Concession sales	(6 578)	–	(6 578)
Turnover	71 757	–	71 757
Cost of sales	44 284	–	44 284
Gross profit	27 473	–	27 473
Other revenue	1 956	–	1 956
Expenses	24 079	(1 060)	23 019
Store costs	17 497	(1 053)	16 444
Other operating costs	6 582	(7)	6 575
Operating profit	5 350	1 060	6 410
Investment income	75	–	75
Finance costs	1 119	1 538	2 657
Profit/(loss) before earnings from joint ventures	4 306	(478)	3 828
Earnings from joint ventures	295	–	295
Adjusted profit before tax	4 601	(478)	4 123
Tax	(1 186)	138	(1 063)
Adjusted profit after tax	3 415	(340)	3 060

Reversal of lease expense and recognition of depreciation of ROU asset

Finance costs on Lease liability

FY19 aPBT ADJUSTMENT



Key assumptions: new stores opened during the period are included from inception of the lease; leases renewed or options exercised during the year included for the entire year; stores closed during FY19 excluded from calculation; discount rate used is incremental borrowing rate applied for Day 1 adjustment and all other lease terms have been assumed the same as of Day 1 (1 July 2019)

FY2019 IMPACT ON KEY METRICS

		Before IFRS 16	Change	After IFRS 16
INCOME STATEMENT				
EBIT	Rbn	5.4	1.0	6.4
Operating margin	%	7.5	1.4%	8.9
aPAT	Rbn	3.4	(0.3)	3.1
HEPS	cents	330.4	(9.3%)	299.8
Interest cover	times	7.3	(4.0)	3.3
BALANCE SHEET				
Debt ratio	%	40.2	31.3%	71.5
Net Debt	Rbn	12.5	26.2	38.7
Net debt to EBITDA	times	1.6	3.0	4.7
ROCE	%	13.2	(4.1%)	9.1
CASH FLOW				
EBITDA	Rbn	7.7	3.6	11.3
Operating cash flow	Rbn	6.3	3.8	10.1
Free cash flow	Rbn	1.9	–	1.9

Rent is replaced with depreciation of a lesser amount which increases operating margin

Interest is recognised which, together with depreciation, is greater than the rent reversal, therefore reducing HEPS

IFRS 16 adds a new lease liability to the balance sheet increasing overall debt and corresponding balance sheet ratios

The lease liability increases capital employed and the ROU asset increases total assets. Net debt therefore increase, while ROCE reduces

No change to free cash flow. Free cash flow measure redefined to include repayments of obligations under leases

Bank covenants are not impacted. IFRS 16 adjustments would be reversed for covenant purposes

CLOSING

LOOKING AHEAD

FY20 Interim results (February 2020)

- FY19 reported on an IAS 17 basis
- Opening balance sheet restated to include Day 1 adjustments
- FY20 interim results to be presented on a post IFRS 16 and a pro-forma pre-IFRS 16 basis to enable comparability

FY20 Full-year results (August 2020)

- As per interim, FY19 would be reported on an IAS 17 basis
- Full year results to be presented on a post IFRS 16 and a pro-forma pre-IFRS 16 basis to enable comparability

Beyond FY20

- FY21 (and FY20 as a comparable) will be prepared and presented on IFRS 16 basis only

RECAP OF KEY MESSAGES

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QUESTIONS?
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