CHIEF FINANCIAL OFFICER'S REPORT

"Sound capital management sustains shareholder returns in challenging conditions"

INTRODUCTION

Holdsport increased its total gross dividend by 9.4% to 350.0 cents for the year due to sound capital management despite weak sales growth and a decrease in operating profit.

The group's headline earnings per share (HEPS) for the period decreased by 11.5% to 455.0 cents, whilst core headline earnings per share (core HEPS) decreased by 10.9% to 489.0 cents.

In evaluating the performance for 2017 shareholders should take into account that the aggregate foreign exchange adjustment during the current year was a loss of R19.5 million compared to an aggregate profit of R8.4 million during the prior year.

Core headline earnings before foreign exchange adjustments reduced by 2.3% to 522.3 cents per share in 2017 following an 18.8% increase in the previous year.

Return on net assets decreased to 53.6% (2016: 70.5%). The group's cash conversion[1] for the year improved to 74.4% (2016: 66.7%). The return on shareholders' interest (ROE) decreased to 19.1% from 22.9% for the previous year.

The group has applied the provisions of the Companies Act and provides summarised financial statements to shareholders in this Integrated Annual Report. These audited summarised financial statements appear on pages 58 to 64.

The following review of the group's financial performance for the year ended 28 February 2017 is limited to the key line items of the statement of comprehensive income and the statement of financial position which have a material impact on performance, and should be read together with the audited summarised financial statements and the supplementary information provided elsewhere in this report. Shareholders are reminded that the group audited financial statements are available for inspection at the company's registered office during normal business hours and on Holdsport's website, www.holdsport.co.za.

STATEMENTS OF COMPREHENSIVE INCOME

Sales

Holdsport's low sales growth in a particularly challenging retail environment follows strong growth in the comparable 2016 financial year.

Total retail sales increased by 4.4% (2016: 12.4%) to R1.75 billion for the year from R1.68 billion in the previous year and the group recorded selling price inflation of 8.5% (2016: 8.1%).

The 1.8% comparable store sales increase (2016: 9.4%) consisted of a 2.1% increase in Sportsmans Warehouse stores (2016: 10.7%) and a 0.6% increase in Outdoor Warehouse (2016: 5.3%).

Sportsmans Warehouse opened two stores and expanded one store, whilst Outdoor Warehouse relocated one store, expanded one store and added one new store. The time weighted average trading space increased by 3.4% and trading density increased by 1.0% to R20 668 per m^2 (2016: R20 456 per m^2).

The Wholesale Division's sales to external customers not part of the group increased by 54.9% and increased by 25.8% in total (2016: 24.8%), predominantly due to the acquisition of the Second Skins and African Nature businesses.

The performance of the business units is also covered in the divisional review on page 9.

Total income

Total income, which comprises gross profit and other income, grew by 6.4% (2016: 11.1%) to R888.1 million.

The total income margin, which reflects total income as a percentage of sales, increased from 48.3% to 48.6% and the gross margin increased to 48.0% from 47.9%.

Segmental sales	2017 Rm	2016 Rm	Change on prior year %	Comparable store sales growth %
Sportsmans Warehouse	**1 335.1**	1 278.6	4.4	2.1
Outdoor Warehouse	**418.1**	400.2	4.5	0.6
Retail sales	**1 753.2**	1 678.8	4.4	1.8
Wholesale Division	**75.4**	48.6	54.9	
Total sales	**1 828.6**	1 727.4	5.8	

[1] Cash conversion = cash generated from operations minus all capital expenditure divided by EBITDA.

CHIEF FINANCIAL OFFICER'S REPORT (continued)

Trading expenses

Trading expenses excluding foreign exchange adjustments as a percentage of sales increased to 32.7% from 31.1%. This was partly due to the acquisition of the two businesses in the Wholesale Division which have lower operating margins than the group's retail business. The comparable numbers reported below exclude non-comparable stores and the new businesses acquired.

Total trading expenses excluding foreign exchange adjustments increased by 11.3% as set out in the table below:

Analysis of trading expenses	2017 Rm	2016 Rm	Change on prior year %	Expense as % of turnover 2017 %	Expense as % of turnover 2016 %
Employment costs	223.1	201.1	10.9	12.2	11.6
Occupancy costs	176.0	159.2	10.6	9.6	9.2
Depreciation	54.3	47.4	14.6	3.0	2.7
Amortisation	13.8	13.0	6.4	0.8	0.8
Advertising costs	23.1	21.3	8.5	1.3	1.2
Other operating costs	106.8	94.7	12.8	5.8	5.5
Trading expenses before forex gains/ losses	597.2	536.7	11.3	32.7	31.1
Foreign exchange losses/(profits)	17.2	(11.3)	(252.3)	0.9	(0.7)
Trading expenses	614.4	525.4	16.9	33.6	30.4

The absolute growth in trading expenses is attributable to the following:

- Employment costs increased by 10.9% and by 5.8% if the two business acquisitions, non-comparable store costs and the share-based payment charge of R11.4 million (2016: R11.6 million) relating to the Holdsport Forfeitable Share Plan (FSP) are excluded.
- Occupancy costs increased by 10.6% and by 7.5% on a comparable basis. Weighted retail trading space increased by 3.4%.
- Depreciation increased by 14.6% as a result of Holdsport's continuing store refurbishment (including relocations and expansions). The group's depreciation policy is aggressive with fixtures being written off over four years. This approximates the typical five-year lease terms of stores and leads to a stable and consistent maintenance profile.
- Holdsport recorded a loss on foreign exchange transactions of R17.2 million for the year, compared to a profit in the previous year of R11.3 million. The balance of foreign exchange adjustments is included in the cost of sales.

  Holdsport's policy is to take out forward exchange contracts to cover all its imported merchandise commitments against volatile exchange rate movements and this has been applied consistently with previous years. This accounting adjustment does not have an operational or cash flow effect.
- Other operating costs include IT costs, bank fees and transaction charges, security costs, maintenance and insurance and increased by 12.8%. On a comparable basis other operating costs increased by 6.1% from the previous year.

Operating profit

Operating profit decreased by 11.4% to R273.7 million (2016: R308.9 million), rendering an operating profit margin of 15.0% for the year, down from 17.9% in the previous year.

If the effect of the foreign exchange losses and profits is excluded, operating profit decreased by 2.5% from the previous year and the operating margin for the current year decreased to 16.0% from 17.4% in the previous year.

Net finance costs

Net finance costs increased from R4.8 million in 2016 to R7.6 million in the current year due to the increase in net debt from R36.6 million to R72.5 million.

Profit after tax

The group generated a profit after tax of R191.2 million for the year, a decrease of 12.6% on the R218.8 million in the previous year.

The effective tax rate remains higher than the normal South African corporate tax rate of 28% owing to the tax charge for the store in Namibia which is taxed at 33% and certain non-deductible expenses.

STATEMENT OF FINANCIAL POSITION

The group's net asset value per share was 2 444.7 cents per share at year-end (2016: 2 332.4 cents).

Assets and capital expenditure

Holdsport incurred capital expenditure of R60.3 million in 2017 (2016: R73.5 million) on maintaining and expanding its retail operations, which included two expansions, one relocation and three new stores.

The group expanded the Wholesale Division by acquiring two businesses for R38.5 million.

Working capital

Inventory

The group has invested an additional R35.9 million in inventory, which ended 11.5% higher than the previous year. The inventory levels increased due to the 3.4% gross increase in trading space as at year-end and the impact of the weaker exchange rate on the cost of imported products. The group's stock turn reduced to 2.0 times (2016: 2.2 times). Inventory ageing was similar to last year and allowances for obsolescence are also at similar levels.

Trade creditors and other payables

Trade and other payables as a percentage of stock on hand decreased from last year due to the timing of replenishment.

Given the high level of directly imported product, combined with typically slow stock turns for the sporting goods industry, Holdsport cannot improve its working capital efficiency by getting creditors to fund a greater portion of its investment in inventory. This is factored into the group's margin expectations and achievement.

Working capital and general banking facilities

Holdsport currently has working capital facilities in South Africa and Namibia with Standard Bank. The working capital facilities consist of a general banking facility of up to R150 million, which may be availed of by way of overdrafts and overnight advances, and two facilities of R50 million each for forward exchange contracts and letters of credit for imports respectively.

Holdsport's full overdraft of R150 million under its working capital facilities were available and undrawn as at 28 February 2017. Standard Bank may cancel or reduce the working capital facilities amount without notice.

Other reserves

The group introduced the Holdsport Forfeitable Share Plan (FSP) in 2011 and have awarded R73.0 million of Holdsport shares over the last six years. The initial cost of acquiring the Holdsport shares awarded to participants in the FSP is recorded as a reserve in terms of IFRS 2: Share-based Payment Expenses. Subsequently, R11.4 million has been expensed during 2017 to recognise the cost of these awards to staff over the vesting period (2016: R11.6 million).

Derivative instruments

The derivatives at year-end consist of fair valued open foreign exchange contracts.

Debt

The group's term debt was refinanced during the year and R160 million is repayable to Standard Bank on 31 August 2018.

The group's net debt amounted to R72.5 million at the end of the current year (2016: R36.6 million).

The group is able to service its debt with its existing lenders without penalties and complies comfortably with all debt covenants.

None of the material loans have any conversion or redemption rights.

Capital expenditure

The board has approved capital expenditure of R66.3 million for the 2018 financial year to support its strategies. This has been allocated as follows:

- R65 million for store development and maintenance, including three new stores and expanding two stores; and
- R5 million for IT, motor vehicles and other capital expenditure.

CASH FLOW

Cash and cash equivalents decreased by 6.3% to R87.5 million (2016: R93.4 million).

The group generated R311.4 million (2016: R316.9 million) in cash from operating activities during the year. This was used primarily for dividend payments (R138.8 million), the Holdsport FSP (R15.4 million) and investment in store maintenance and development (R60.3 million). The R30.0 million increase in term debt was used to fund the R38.5 million invested in acquiring two new businesses.

SHARE BUY-BACK

The group purchased Holdsport shares for R0.9 million in accordance with the general

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authority granted by special resolution of the company's shareholders passed at the company's annual general meetings held on 12 August 2015 and 1 August 2016 in compliance with the relevant provisions of the JSE Listings Requirements and the Companies Act, No. 71 of 2008. Holdsport held 2.92% of its issued shares in treasury at 28 February 2017.

DIVIDEND POLICY

The group is in a strong financial position which, coupled with its strong cash generation, allows it to pay a final gross dividend of 220 cents per share.

The total dividend for 2017 is covered 1.5 times by the year's core HEPS excluding foreign exchange adjustments in accordance with the group's dividend policy, which is to have dividends covered approximately 1.5 to 2 times. The group paid an interim dividend of 130 cents per share which brings the total dividend for the year to 350 cents per share, a 9.4% increase on last year. The total gross dividend for the year represents a gross dividend yield of 5.7% on the year-end share price of R61.22 per share.

ACCOUNTING POLICIES AND STANDARDS

The accounting policies and standards applied by the group have remained consistent with those applied during the prior period.

FINANCIAL TARGETS AND OUTLOOK

Holdsport achieves high cash conversion and attractive margins due to a culture of rigorous cost management, economies of scale, a diverse product offering and its purchasing expertise.

Financial targets have been reviewed relative to the performance for 2017 and to reflect the expected trading conditions and operating environment for the 2018 financial period.

Selling price inflation is expected to remain at high-single digits for the year.

Holdsport indicated at the time of its listing in 2011 that it wished to open two to three new stores per annum over the following three to five years. The group is on track to achieve this objective as set out in the table on page 31. However, these stores may initially not be as profitable as the group's current operations.

ACKNOWLEDGEMENTS

In closing I would like to thank my finance colleagues for their enthusiasm and dedication in maintaining a high standard of financial reporting and control in the business.

Cobus Loubser
Chief Financial Officer

Cape Town
20 June 2017

Targets		Target* 2018	**Actual 2017**	**Actual 2016**	Actual 2015	Actual 2014
Gross margin	(%)	48.0	**48.0**	47.9	47.6	48.2
Operating margin	(%)	17.0	**15.0**	17.9	17.3	17.6
Inventory turn	(times)	2.2	**2.0**	2.2	2.3	2.1

* Excluding effect of foreign exchange adjustments.