# Assessment of Professional Competence
# November 2016

# Pre-released information

| żinga Fashions (Pty) Ltd documentation | | |
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żinga Fashions (Pty) Ltd is a fictitious company, and all events as well as the names of all persons associated with this company, as mentioned in this Assessment of Professional Competence, are purely fictitious in nature and any resemblance to real persons, living or dead, or to an actual business entity is purely coincidental.

## DOCUMENT A

## EMAIL FROM HARRY MNISI TO FINANCIAL ACCOUNTANT

| | |
|---|---|
| **From:** | Harry Mnisi |
| **Sent:** | Friday, 4 November 2016, 08:45 AM |
| **To:** | Financial Accountant |
| **CC:** | |
| **Subject:** | Welcome |

Hi there

Welcome aboard. I know that since you joined us on Tuesday, it's been a hectic couple of days for you. It seems decades ago that Sally and I started this business and we are always very excited about welcoming new talent to the żinga fashion empire.

I thought it could be useful for you to review the attached presentation that Sally and I made a couple of weeks ago. This will provide some background information on żinga – probably more interesting than reading financial statements and new employee induction manuals! The context of the presentation was that we were approached by First Regional Investment Bank who thinks we should be listing on the JSE within the next three years. These discussions are on-going so please keep it confidential.

Happy reading and let's touch base on Monday.

Regards
Harry

**POWERPOINT ATTACHMENT: PRESENTATION TO FIRST REGIONAL INVESTMENT BANK**

## żinga Fashions (Pty) Ltd

*Brands for people who have a zing in their step*

**Presentation to First Regional Investment Bank**

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# 1. Our history

- Founded in 1999 by Sally Whiteley and Harry Mnisi
- The first żinga store opened in Sandton City, Johannesburg, in October 2001, providing consumers with an appealing urban casual clothing range for women and men
- 10th żinga store opened in Gateway Shopping Centre, Durban, in 2005
- 2007 saw the launch of the H&S store at the V&A Waterfront, Cape Town, showcasing an amazing collection of luggage and leather products
- The company secured the master licence for the Sala™ headwear range for South Africa in 2010, a major coup as Sala is one of the leading global formal and casual headwear brands
- The 50th group store opened in Brooklyn Mall, Pretoria, during 2011
- żinga's social media campaign was recognised as one of the most innovative brand building exercises during 2013

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## 2. Our shareholders and directors

*100% owned by directors*

| Shareholder | Responsibility | Shareholding |
|---|---|---|
| Sally Whiteley | CEO | 35% |
| Harry Mnisi | CFO | 35% |
| Belinda Jantjies | Director: Store operations | 10% |
| Gavin Marx | Director: Buying and merchandise | 10% |
| Refilwe Mapoe | Director: Human resources | 10% |

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## 3. żinga business model

| | |
|---|---|
| Our people → | People are our greatest asset. We are transparent, authentic, open to new ideas and take responsibility |
| Our customers → | Our customers are the life blood of our business. They deserve the best service and should enjoy the experience of being in our stores |
| Our merchandise → | Product range should be fashionable, excellent quality, aspirational and value for money |
| Our retail footprint → | We seek prestigious locations in prime shopping centres. Our reach extends beyond bricks and mortar and we engage through social media too |

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## 4. Stores

| | żinga | H&S |
|---|---|---|
| **Number of stores** | 66 | 26 |
| **Product range** | Leisurewear and accessories<br>Unique headwear range | Leather products (non-apparel) and luggage |
| **Target market** | Women and men LSM 7+, aged 25 to 55 | All ages, premium products |
| **Sought after customer perception** | Distinctive, earthy and high quality product designs<br>Spacious store layout | Destination shop<br>Affordable luxury products |
| **Average store size** | 280 $m^2$ | 216 $m^2$ |

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## 5. Company strategy

- **Customer experience** should be that they window shop at competitors and buy our merchandise
- We are **not a bank** and do not provide credit to customers as that may confuse our focus
- Our buyers travel internationally at least twice a year to assess fashion trends but **attempt to source most products from South African suppliers** (shorter lead times and lower import duties on locally manufactured finished products)
- **Intense analysis** of customer buying patterns and product sales data to identify 'winners' and 'losers' early and react rapidly
- **Listening** to our customers and employees; they provide the best feedback
- Keep investing in our **social media platforms** and spurn traditional advertising
- **Visiting our competitors'** stores at least once a month

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## 6. SA clothing retail industry

- **Dominated by a few players** (Mr Price, Truworths, Pep Stores, Foschini, Woolworths, Edcon)
- Unprecedented growth in new shopping malls expected to slow down
- **International clothing retailers** (Zara, TopShop, The Gap, H&M, etc.) have expanded and are rapidly expanding into South Africa, cannibalising sales from specialist fashion retailers. Perceived higher brand positioning of global brands yet competitive pricing
- **Online retailing** is growing due to convenience (shop anytime and free delivery), wide product range and increasing awareness of price differentials
- **Consumer spending under pressure** due to low economic growth, high levels of unemployment, impaired credit records, inflationary pressures and rising costs of basic foodstuffs
- Majority of clothing, footwear and leather goods **imported** which provides a major challenge to retailers due to exchange rate volatility

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## 7. Key risks

**Major business risks** żinga faces:

a. **Increasing competition** from global fashion brands that have entered SA market directly

b. Customer spending is linked to **underlying economic conditions** (gloomy forecasts for next three years)

c. **High indebtedness** of majority of SA **consumers** which could be a major constraint to industry growth

d. **Fashion industry** is notoriously fickle (forecasting trends and anticipating demand) and any misjudgements could lead to short-term losses/declining profits

e. Increasing overhead costs due to **inflationary pressure**, volatile fuel prices, rising electricity costs may impact our operating margins (żinga may not be able to pass on all cost increases through higher product pricing)

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## 8. Summarised financial information

| żinga Fashions (Pty) Ltd September year end | 2014 Audited Rm | 2015 Audited Rm | 2016 Draft Rm |
|---|---|---|---|
| **Sale of merchandise** | 590,4 | 701,9 | 827,7 |
| Cost of sales | –280,4 | –334,1 | –397,3 |
| **Gross profit** | 310,0 | 367,8 | 430,4 |
| Other income | 3,0 | 4,2 | 5,0 |
| **Operating costs** | | | |
| Employee costs | –77,9 | –91,9 | –107,6 |
| Occupancy costs | –52,5 | –62,4 | –74,5 |
| Other operating costs | –55,5 | –65,3 | –77,8 |
| **EBITDA** | 127,1 | 152,4 | 175,5 |

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## 8. Summarised financial information

| żinga Fashions (Pty) Ltd September year end | 2014 | 2015 | 2016 |
|---|---|---|---|
| **Key indicators** | | | |
| Revenue growth | 16,8% | 18,9% | 17,9% |
| EBITDA growth | 17,5% | 19,9% | 15,2% |
| | | | |
| Number of stores at year end | 74 | 86 | 92 |
| Weighted average number of stores | 72 | 80 | 89 |
| | | | |
| Average store size ($m^2$) | 260 | 261 | 262 |
| Average revenue per store (Rm) | 8,2 | 8,8 | 9,3 |
| | | | |
| Trading density (revenue/$m^2$) | R31 538 | R33 616 | R35 496 |
| | | | |

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## 8. Summarised financial information

| żinga Fashions (Pty) Ltd<br>September year end | 2014 | 2015 | 2016 |
|---|---|---|---|
| **Sale of merchandise** | **Rm** | **Rm** | **Rm** |
| Stores opened pre FY2014 | 575,0 | 618,5 | 665,7 |
| Stores opened in FY2014 | 15,4 | 33,0 | 35,0 |
| Stores opened pre FY2015 | 590,4 | 651,5 | 700,7 |
| Stores opened in FY2015 | – | 50,4 | 105,9 |
| Stores opened pre FY2016 | 590,4 | 701,9 | 806,6 |
| Stores opened in FY2016 | – | – | 21,1 |
| **Total for the year** | 590,4 | 701,9 | 827,7 |
| | | | |

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## 8. Summarised financial information

| żinga Fashions (Pty) Ltd<br>September year end | 2014<br>Audited<br>Rm | 2015<br>Audited<br>Rm | 2016<br>Draft<br>Rm |
|---|---|---|---|
| ***Non-current assets*** | 81 | 101 | 102 |
| Property, plant and equipment | 75 | 94 | 94 |
| Deferred tax | 6 | 7 | 8 |
| | | | |
| ***Current assets*** | 195 | 244 | 386 |
| Inventories | 85 | 105 | 131 |
| Trade and other receivables | 25 | 30 | 35 |
| Net proceeds sale and leaseback | – | – | 64 |
| Cash and cash equivalents | 85 | 109 | 156 |
| | | | |
| **Total assets** | 276 | 345 | 488 |

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# 8. Summarised financial information

| żinga Fashions (Pty) Ltd<br>September year end | 2014<br>Audited<br>Rm | 2015<br>Audited<br>Rm | 2016<br>Draft<br>Rm |
|---|---|---|---|
| **Share capital and reserves** | 177 | 227 | 286 |
| ***Non-current liabilities*** | 40 | 45 | 49 |
| Long-term loans | 25 | 25 | 25 |
| Straight-line operating leases | 4 | 7 | 10 |
| Deferred tax | 11 | 13 | 14 |
| ***Current liabilities*** | 59 | 73 | 153 |
| Trade and other payables | 53 | 65 | 80 |
| Straight-line operating leases | 1 | 2 | 2 |
| Sale and leaseback suspense acc. | – | – | 64 |
| Tax payable | 5 | 6 | 7 |
| | | | |
| **Total equity and liabilities** | 276 | 345 | 488 |

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# 8. Summarised financial information

| żinga Fashions (Pty) Ltd<br>September year end | 2014 | 2015 | 2016 |
|---|---|---|---|
| **Key indicators** | | | |
| Dividends paid (Rm) | 41 | 50 | 58 |
| | | | |
| Inventory turnover | 3,3 | 3,2 | 3,0 |
| Trade and other payables days | 69 | 71 | 73 |
| | | | |
| Return on equity (ROE) | 46,5% | 44,4% | 40,9% |
| | | | |

*Note: The summarised financial information does not take into account the correct accounting for the sale and leaseback of the head office building that occurred shortly before year end (correcting journal entries to be processed).*

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## 8. Summarised financial information

**High level commentary** on results:

- Revenue growth 2014 through 2016 driven largely by new store openings
- Forecast new store openings in FY2017 – five more żinga stores and two H&S stores
- Gross profit margin has been stable at between 52,0% and 52,5% over past three years
- EBITDA margin of ±21% comparable to most listed competitors and a testament to żinga's financial discipline and innovation
- ROE of >40% an excellent return on investment
- Cash management is conservative and no plans to raise any additional debt
- Forecast EBITDA growth of at least 15% per annum in FY2017 to FY2019

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## 9. Opportunities

**Growth opportunities**

- ➪ Potential for another 15 żinga stores and 10 H&S stores in South Africa
- ➪ New store openings in selected African countries (30 potential sites identified)
- ➪ Increase our market share while competitors (Woolworths, Foschini and Truworths) focus on offshore expansion
- ➪ Ongoing investment in żinga online channel and collaboration with other online retail channels (Zando, etc.) to make our products available to current and future customers
- ➪ Sell Sala headwear range through other groups – store within store concept
- ➪ Acquire GBC, a niche South African kids clothing business with 35 stores, thereby diversifying our product range and leveraging our scale
- ➪ Start our own distribution centre in Johannesburg to lower logistics and distribution costs

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## 10. Benchmarking against our competitors

żinga Fashions (Pty) Ltd is far smaller than most listed clothing retail groups. However, comparison of certain ratios is interesting …

| | 2015 | | | | 2016 |
|---|---|---|---|---|---|
| | **Mr Price** | **Truworths** | **Foschini** | **Queenspark** | **żinga** |
| Number of stores | 1 150 | 747 | 2 724 | 56 | 92 |
| % cash sales | 82% | 30% | 54% | 100% | 100% |
| Average revenue per store (Rm) | 15,0 | 15,1 | 5,9 | 9,2 | 9,3 |
| Average store size ($m^2$) | 498 | 467 | 264 | 463 | 262 |
| Gross profit margin | 41,1% | 55,2% | 47,3% | 56,2% | 52,0% |
| EBITDA/revenue | 18,2% | 28,5% | 17,4% | 9,9% | 21,2% |

*Woolworths not included above due to their mix of food and clothing – not comparable*
*Edcon unlisted, therefore not all figures are available*

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## 10. Benchmarking against our competitors

żinga's numbers compare well against most large competitors

- Our trading density (revenue per $m^2$ of trading space) is higher than all competitors per prior slide
- Our EBITDA margin is at the top end of the range, beaten only by Truworths

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## 11. Compelling features of żinga

- ➪ Driven management team that has a direct interest in business through shareholdings
- ➪ Respected retail brands and authenticity with customers
- ➪ Enormous scope for revenue growth
- ➪ Attractive target for foreign retail groups entering South Africa (we could command a high value for our business for foreign groups to acquire our store footprint)
- ➪ Excellent financial results

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## 12. Potential listing?

**Context:**

- First Regional Investment Bank approached us to consider a listing on the Johannesburg Stock Exchange within the next three years

**Appealing features** to us:

- ➪ Opportunity for żinga shareholders to realise some wealth by selling shares as part of listing process at an attractive valuation. Enable us to diversify wealth
- ➪ Listing would elevate our profile and status with customers, suppliers and partners
- ➪ Access to capital to pursue selected acquisitions

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**DOCUMENT B**

**EMAIL FROM SALLY WHITELEY TO HARRY MNISI**

| | |
|---|---|
| **From:** | Sally Whiteley |
| **Sent:** | Wednesday, 9 November 2016, 08:45 AM |
| **To:** | Harry Mnisi |
| **CC:** | |
| **Subject:** | Various issues |

Hi Harry

I have been thinking about that slide you included in the First Regional Investment Bank presentation regarding our gross profit margins versus some of the larger listed clothing retail groups. Our GP margin looks good but are we treating all our income and expenses in the same way as these listed groups? Showing items below the GP line that should be part of GP (or vice versa) could have a significant impact on our GP% and we may be misguided in comparing ourselves to the listed groups.

Just a thought: At a dinner party last weekend, I met someone who is an internal auditor by profession and we talked about the value that an internal audit function can bring to an organisation, such as a reduced external audit fee. I think that this is particularly relevant given our recent concerns about high external audit fees. Is this not something we should investigate? Please let me have your thoughts on this.

Another thought: I was listening to an interview with a retail industry analyst on Radio 702 last week, who highlighted the importance of the 'comparable sales growth' ratio. I have always wondered whether our calculation of this ratio is consistent with those of our listed competitors?

Regards
Sal

## DOCUMENT C

## EMAIL FROM HARRY MNISI TO FINANCIAL ACCOUNTANT

| | |
|---|---|
| **From:** | Harry Mnisi |
| **Sent:** | Thursday, 10 November 2016, 07:43 AM |
| **To:** | Financial Accountant |
| **CC:** | |
| **Subject:** | Sale and leaseback transaction |

Hi again

I'm so glad you are now on the team, because things are extremely hectic at the moment and I am finding it difficult to get to everything. We have had some transactions recently that we have not dealt with previously, so your up-to-date technical knowledge will be useful during the finalisation of our annual financial statements for external audit purposes.

On that point, I have prepared the following summary (see below) with some more information on our recent sale and leaseback transaction. Please have a look at this with a view to discussing it with me early next week.

**Information on sale and leaseback transaction**

Included in the carrying amount of our property, plant and equipment is an amount relating to the head office building.

The head office building was purchased on 1 October 1999 for R19 900 000 and had an estimated useful life of 50 years (we review this annually and have never found it necessary to change it). This building was valued at R24 250 000 as at 1 October 2001.

To boost our cash flow, the building was sold to an unrelated company for R73 500 000 (including VAT) on 1 August 2016. Both parties are VAT vendors. The building was immediately leased back for a period of ten years. The monthly rental amounts to R200 000 (excluding VAT) and is payable in arrears, with a guaranteed residual value of R70 million at the end of the lease term. The lease contract also includes the option to renew the lease for a further ten years. We are responsible for insuring the building during the lease term.

Buildings (owned and leased) are carried in accordance with the revaluation model. The most recent valuation was performed at 30 September 2016 and amounted to R65 500 000 (excluding VAT). The previous revaluation was performed at 30 September 2014, at which time the building was valued at R60 million (excluding VAT). We transfer revaluation surpluses to retained earnings as the relevant asset is used.

We will not be early adopting IFRS 16.

Thanks in advance.

Regards
Harry

## DOCUMENT D

## EMAIL FROM HARRY MNISI TO FINANCIAL ACCOUNTANT

**From:** Harry Mnisi
**Sent:** Thursday, 10 November 2016, 08:23 AM
**To:** Financial Accountant
**CC:**
**Subject:** Inventory obsolescence

Hi yet again

Further to my earlier email, I need your assistance with a few additional matters.

As you are aware, our external auditors, Hasara & Co, are currently busy with the audit of the financial statements for the financial year ended 30 September 2016. I am scheduled to meet with the audit engagement partner, Cedric Hasara, early next week to discuss the draft auditor's report and any outstanding audit matters that may impact this report.

I know that the auditors are concerned about the possible misstatement of the inventory obsolescence allowance, and that this is likely to feature prominently in our discussions. The following figures were used to compute the inventory balance which is reflected in the trial balance as at 30 September 2016:

| **Division** | **Total inventory balance (per inventory age analysis)** | **Obsolescence allowance** | **Allowance as % of total inventory** |
|---|---|---|---|
| | **R** | **R** | **%** |
| żinga Stores | 107 267 121 | 7 510 313 | 7 |
| H&S Stores | 31 884 123 | 340 456 | 1 |
| **Total** | **139 151 244** | **7 850 769** | **6** |

I would appreciate your assistance with the review of the reasonableness of the obsolescence allowance. I will forward more information in this regard to you next week, so please set some time aside to attend to this.

Your assistance in helping me prepare for the meeting with Mr Hasara will be greatly appreciated!

Regards
Harry