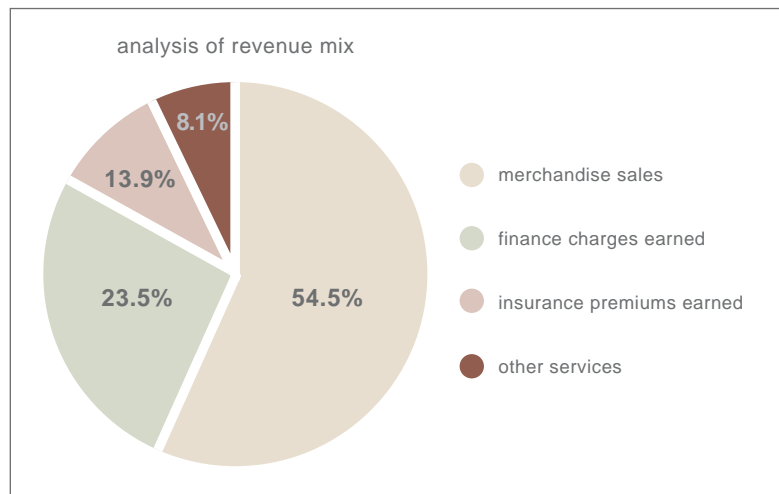
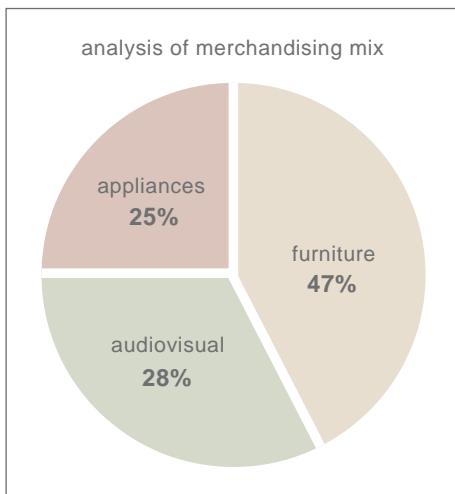


# chief executive's report

“Because the Lewis Group consistently offers choice, convenience and well-managed credit, we continue to build lifetime relationships and loyalty with our customers.”

**Alan Smart**  
(Group Chief Executive Officer)





### Introduction

Over the past year we have focused on delivering increased wealth to our shareholders, real value and exceptional service to our customers and a stimulating working environment for our staff.

### Trading environment

Government's disciplined fiscal policies have laid a solid foundation for growth. The stable interest rate and inflation environment, together with real wage increases and further tax relief, has enhanced the disposable income of consumers particularly those in our target market of LSM 4 to 7.

Many commentators have reported on the structural changes in the economy which have given rise to a new emerging middle class. As this is the market served by the group we are witnessing this shift first-hand and are also benefiting from the increased spending power of these newly-affluent consumers.

We believe the structural shift will be sustained as the middle income market gain increasing access to formal housing and electricity, improved levels of education and ultimately employability, as well as benefiting from employment equity.

The economic elevation of our population is well demonstrated in the 2005 Lifestyle

Standards Measurement (LSM) data published in the All Media and Products Survey (AMPS). In 2001, the people in the LSM groups 4 to 7, our target market, accounted for 44.6% of South Africa's total economically active population. This figure had grown to 50.4% by 2005, with an additional 2.5 million consumers entering the middle income market which represents a 19.5% increase.

### Operating performance

Revenue increased by 14.5% to R2 874.5 million, driven by merchandise sales growth of 16.0% to R1 567.8 million. Unit sales volumes rose by 21.6%. Comparable store merchandise sales grew by 12.6%. Second half sales growth was particularly strong reflecting a growth rate of 17.3%.

The sales growth can largely be attributed to the merchandise strategy adopted over the past year. Product sourcing both locally and through a direct import programme has further enhanced our value-for-money merchandise offering. Our strategy of working closely with our manufacturers has resulted in exclusivity of product and design, with the resultant margin benefits.

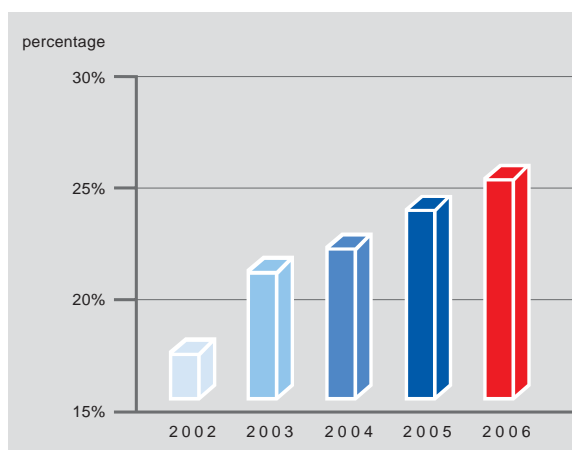
The merchandise margin increased from 34.5% to 34.9%, reflecting the impact of the group's merchandise procurement strategy.

All three chains showed solid increases in merchandise sales. Lewis grew by 12.1% to R1 318.1 million, Best Electric showed a 31.4% improvement to R164.3 million while Lifestyle Living grew strongly off a relatively low base to post a 68.1% increase to R85.4 million. Detailed performance of the three trading brands is contained in the Operations Report on page 31.

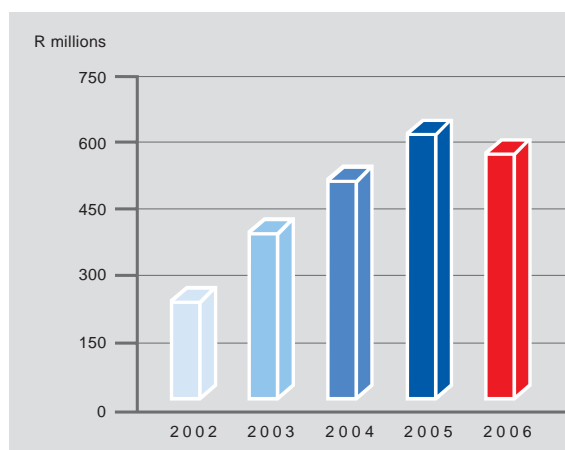
The South African operations generated 89.6% of revenue, while the 46 stores in the neighbouring countries of Botswana, Lesotho, Namibia and Swaziland accounted for 10.4%.

Price deflation for the period was 5.6%. Furniture sales, which account for 47% of total sales, increased by 11.3% in Rand terms and 11.0% in unit sales. Electronic and electrical appliance sales grew by 20.6% in value and 29.4% in volume.

normalised operating margin



operating cash flows



In last year's annual report, we commented on the increasing trend towards cash sales as a result of price deflation. This posed a challenge to the group and I am pleased to report that cash sales have now stabilised at 30%.

Prudent credit management and collections, coupled with the favourable credit environment, continues to reflect in the improvement of the debtors book. The impairment provision as a percentage of the debtors book declined from 14.4% to 12.6% reflecting the quality of the receivables.

Normalised operating margin improved from 23.6% to 25.3% as a result of stronger sales growth, higher gross profit and containment of costs. Normalised operating profit grew by 22.8% to R728.6 million.

Lewis continues to generate significant operating cash flows which have funded the following:

- Share repurchase of R151.9 million.
- Dividends paid during the year of R156.9 million.
- Increased working capital of R160.5 million.

**Store expansion**

During the year, six Lewis Stores, 14 Best Electric and three new-format Lifestyle

Living stores were opened and eight non-performing stores were closed, including four old-format Lifestyle stores. In addition, Lewis opened in townships near major metropolitan areas during 2005, with significant success. Further new stores are planned for township malls in the new financial year. The group plans to open 25 stores across the three chains in the forthcoming year.

All stores are treated as stand-alone business entities and are required to achieve a specified return on investment and level of profitability.

**Black Economic Empowerment (BEE)**

The attainment of a "BB" EmpowerDEX rating in May 2006 establishes a solid platform to consolidate and facilitate broad-based empowerment within the group. The areas of our strengths and opportunities for improvement have been clearly identified, and this, with the formation of a Transformation Committee in March 2006, will position us to implement further strategies.

**Credit legislation**

The National Credit Act was approved in parliament in October 2005 and the regulations released in February 2006. The company is confident that its leading-edge credit granting and current IT systems will assist it in meeting the requirements of the Act. The new Act is effective from 1 June 2007. There are issues that need to be clarified before implementation date but the revenue effect of the National Credit Act is expected to be neutral.

**Growth strategy**

The group's strategy is focused to increase shareholder wealth through sustainable growth. The key elements of the strategy are:

- **Organic sales growth**  
A core strategy of the group is to increase sales from existing stores through innovative procurement, ranging and managing the merchandise mix. Marketing and credit management will focus on



continuing to sell into the current customer base as well as attracting new business.

- **New branch expansion**

The group has identified 150 store opening opportunities (58 Lewis; 48 Best Electric and 44 Lifestyle Living) in the long term. Site selection is fundamental and the group targets 25 stores per annum. For the coming financial year, eight Lewis, 12 Best Electric and five Lifestyle Living stores are scheduled to be opened.

- **Business expansion**

The development of ancillary products through strategic partnerships and the formulation of new formats.

- **Acquisitions**

Lewis remains opportunistic in acquiring value added businesses that leverage off its core competencies.

- **Human resources**

Continue to recruit, retain, develop and train all our staff.

**Outlook**

Current sales indicate that the trading environment will remain buoyant. Consumer confidence is expected to remain high as tax relief and infrastructure development programmes announced by the Minister of Finance flow through to the economy.

The changing South African economy is causing the emerging middle class to provide a continuing stimulus to overall domestic demand. We believe that Lewis is well positioned to take advantage of a favourable trading environment and our outlook remains positive.

**Thanks**

Our staff have once again performed beyond expectations and I extend my sincere thanks to them for a job well done. To our loyal customers, we thank you for your support. Our suppliers and manufacturers have also made an enormous contribution to our performance for which I thank them. Last but not least, I wish to thank the members of the media and the investment community for their continued interaction with the group.

**Alan Smart**  
Group Chief Executive Officer