Chief executive officer's report

The businesses that comprise Deneb are the non-media businesses that were unbundled out of Seardel Investment Corporation Limited (Seardel) and separately listed on the JSE effective 1 December2014.

Although the Deneb Group has only been in existence in its current formation since October 2014, the common control principle allows us to report the numbers for the 12 months ended 31 March 2015 and the comparative period as if the Group had been in its current form for the entire period. We believe that reporting the numbers in this way is the most meaningful for users of the information.

The results to March 2015 reflect the two main themes that have been recurring in the results for the past few years.

- The first is that the economic environment, particularly for the manufacturing businesses, remains challenging. Indeed, the past financial year, with the industrial action that took place within our own businesses as well as those of our customer and supplier bases, coupled with inconsistent electricity supply, has proven to be particularly challenging.
- The second is that we have been working diligently to make incremental changes to the businesses so that they become more resilient to adversity. These incremental changes take the form of discontinuing unprofitable businesses or product lines whilst, on the other hand, looking to enter new growth areas and diversify and deepen quality revenue streams.

The above factors have meant that we were able, despite the tough conditions, to report an attributable profit of R209 million, albeit with the assistance of some once-off items.

Although details of the underlying factors affecting the results are dealt with in the commentary under the various segments, it should be noted that the attributable profit as reported contains the following notable items:

(1) R72 million of tax income was recorded in the current year through the recognition of a deferred tax asset arising from historic assessed losses;

(2) investment properties were revalued up by R70 million in the current period against R21 million in the prior period;

(3) R17 million of losses from discontinued operations were recorded relating to the closure of the Group's factory stores. This business was the last remnant of the Group's apparel manufacturing business which was disposed of in the prior financial period; and

(4) the comparative financial results included R39 million of once-off income relating to the settlement of a legal claim.

Overall we view the current year's results as mixed. On the one hand, we are pleased to report the strong attributable profit, however, as is explained in the segmental commentary below, the year was not without its challenges. That being said, the fact that the Group is quite strongly profitable in a challenging year is testament to the improving resilience of the various businesses.

Much work has gone into improving the balance sheet over the past few years. To this end, interest-bearing debt stands at 19% of total asset value at year-end, down from 21% a year ago. We believe that the quality of assets reflected on the balance sheet has also improved over the last few years, with properties now representing 37% of the R3 billion total asset value.

Property segment

The value of Deneb's total property portfolio increased by 4% to just over R1,1 billion. This growth is after accounting for R68 million of disposals during the period, countered by development expenditure of R43 million.

Revenue increased 9% to R129 million whilst revenue from external tenants increased by 34% to R96 million and now represents 74% of the total revenue for this segment.

Operating profit before finance costs increased by 48% to R153 million, up from R104 million in the prior period. However, it should be noted that the current year's profit number includes a R70 million upwards revaluation of investment properties against R21 million in the prior period.

The upward revaluations are testament to the success of the New Germany and Mobeni Industrial Park developments.

Branded product segment

The branded product segment recorded revenue growth of 47% to R1,4 billion, however, operating profit before finance costs declined 52% to R20 million.

The performance of this segment was affected by our decision to invest heavily in Seartec, our office automation and electronics distribution business. This investment included strengthening the management structures, expanding the product profile, improving the facilities by moving into higher profile properties in a number of the major centres, spending on the IT backbone of the business and increasing its exposure by upping the marketing spend. These interventions increased the cost base quite significantly, but we are confident that the investments made will see enduring benefits over the medium term.

The performance of this segment was also affected by a relatively poor year in the toy business, nothwithstanding continued turnover growth. The rapid depreciation of the Rand leading up to the busy Christmas season put pressure on margins and this, coupled with an increased level of returns post-Christmas, saw operating profits fall below those achieved in the prior period.

On the positive side, the distribution of interactive gaming delivered a strong performance, with operating profits up year on year on the back of securing the rights to distribute Electronic Arts games.

In addition, the acquisition of the sports brands, mentioned in the prior year report, saw Brand ID's performance improve markedly. This start-up business has now reached breakeven, in line with expectation, and we anticipate that it will become a contributor going forward.

As a more general point on this segment, we have previously mentioned that we were continuing to invest in marketing and distribution platforms, with much of this investment being ahead of expected future revenue growth. In the main, these investments have been completed and we would anticipate that, in the absence of any new acquisitions, the operating cost base will remain more stable over the next few years. Should the anticipated turnover growth materialise, we should see an improvement in operating margins.

Textile segment

Trading conditions for the businesses within this sector remained challenging throughout the period under review.

Although operating profit is up 15%, this year's profit includes an impairment reversal of R13 million. Adjusting for this non-recurring item saw operating profit fall by 21% to R28 million. The performance of this segment was influenced by a reduction in the value of public procurement tenders awarded, which directly affected revenues, resulting in them being down 3%. Rising energy costs, downtime as a result of loadshedding and a strike at one of the operations in this segment, as well as industrial action in the customer and supplier base, all combined to negatively affect the result.

Having said that, given the problems experienced, we are pleased at how well the textile businesses withstood the tough year and this reflects the work that the management teams within these entities have done to improve the quality of revenue and operating efficiencies.

Operating margins remain wafer-thin and are weighed down by the last of the loss-making businesses in our manufacturing space. Progress is being made on a number of new initiatives that will look to address the margin concern.

Industrial segment

Although revenue was up 6%, operating profit was down 30% to R25 million. However, the current year's profit includes an asset impairment of R3 million relating to an asset that is surplus to requirements and is to be sold to free up property space for external rental. Adjusting for the once-off impairment saw operating profit falling by 20%.

The decline in profitability within this segment is for the same reasons as those mentioned for the textile segment. As with the textile businesses, we are pleased that the initiatives taking place within this segment resulted in relatively stable results in spite of the headwinds experienced.

Stuart Queen
Chief Executive Officer

Cape Town
22 September 2015