Chief executive officer's report

The Group recorded a total comprehensive income for the year of R98 million. This is a decline of R113 million (53%) from the R211 million recorded in the prior year. The main reason for the decline is that in the prior year a deferred tax asset was recognised, resulting in a R72 million credit being recorded on the taxation line. In the current year, a R39 million taxation charge was recorded, a swing of R111 million.

From an overall Group perspective, the following are the main points to note:

- Turnover is marginally up (1,9%), which reflects the difficult market conditions within the industries that the Group serves. A small improvement in gross margin saw gross profit climb by 3,8%, slightly ahead of the turnover growth. The continued strong focus on cost control saw fixed cost increases restricted to 2,3%. The overall effect is that operating profit before impairments and revaluations was up 7,9% to R133 million.
- During the course of the year, certain Group companies tenanted the Observatory property and this building was reclassified as an owner-occupied property. This affected the comparability of the Group's results as the R76 million upwards revaluation of the Group's property portfolio in the current year was only slightly below the R79 million recognised in the prior period. However, the portion of the revaluation relating to investment properties, and thus recognised in the income statement, was R31 million in the current period compared to R70 million in the prior period.
- The increase in finance costs is due to the prior period being lower than normal as Deneb had short-term use of the cash raised in the Seardel rights issue prior to unbundling.
- The high effective taxation rate at 42,3% is largely due to the change in the capital gains tax rate and the resultant adjustments required to deferred taxation.

The significant Rand weakness experienced during the year and the severe volatility leading up to the busy Christmas and back-to-school period put margins under pressure, particularly in the Branded Product Distribution segment. The industries that the Group primarily serves within the manufacturing segments, namely, retail, automotive, mining, construction and agriculture remained under pressure. These external factors are not once-off events and are likely to recur at least in the short to medium term. We will continue to focus on cutting out waste and gearing the Group to operate effectively in lower margin environments.

It is important to note that the strong focus on costs does not restrict spending on building future revenue streams and finding new distribution channels. Indeed, in evaluating the results, consideration should be given to the fact that there are a number of businesses that are either in a turnaround or start-up phase. These businesses are being developed with an eye to the future but are still loss-makers for now. Collectively, these loss-making businesses were responsible for turnover of a little over R300 million and recorded some R40 million in losses. We carry these losses as we believe that these businesses will become contributors in time. However, should it be necessary, the Group could exit from them with very limited effect on the established businesses.

Segmental results

Property segment

The value of the Group's property portfolio increased by R66 million (5,9%) to just over R1,17 billion. This growth incorporates R49 million spent on acquisitions and development costs, R73 million of upwards revaluation, offset by disposals totalling R55 million.

Revenue increased by 5,9% to R137 million with revenue from external tenants representing 71% of the total revenue. Operating profit before finance costs decreased by 15% to R129 million. However, during the period, the Observatory property was reclassified from an investment property to an owner-occupied property. This has affected the comparability of the results as although the total upwards revaluation for the current year at R76 million is similar to the R79 million recorded in the prior period, the revaluation that was recorded in the segmental result was R31 million in the current period versus R70 million in the prior period. If the property revaluations are excluded, operating profit for the current year at R99 million was up 19% from the R83 million recorded in the prior period.

We continue to evaluate potential acquisitions to augment our industrial property portfolio. Seller's yield expectations have proved sticky in a rising interest rate cycle. However, one of the advantages of being a diversified Group is that we can remain patient and look to acquire value-enhancing properties only if they meet our criteria.

Branded Product segment

Revenue for this segment was flat at R1,4 billion, however, operating profit before finance costs declined to R2 million from R20 million in the prior period.

Three main issues affecting the performance of this segment are:

1. We have mentioned in the prior reports that we took a decision to invest heavily in our office automation business, raising the cost base quite considerably. This investment included strengthening the IT infrastructure, raising the profile of the business through increased marketing spend and improving systems. The investment in IT meant that we were effectively incurring double costs whilst the new systems and processes were being developed. When the new systems become fully operational, legacy costs from the old systems will reduce. To this end, included in the current year's figures, is a R6 million restructuring provision. Once the restructuring is completed, we anticipate annual savings in excess of R20 million, which will start to be realised in the second half of the next financial year. The investment and restructuring was necessary to allow the business to compete in an increasingly competitive environment.
2. We are investing in a number of start-up businesses with a view to deepening distribution channels. Although these businesses remain loss-making for now, we are pleased with the progress being made.
3. The rapid depreciation of the Rand, particularly leading up to the busy Christmas and back-to-school period, had quite a significant effect on realised margins.

If one excludes the losses being incurred implementing the turnaround strategies and in the start-up businesses, this segment would have delivered an operating profit of R45 million off a turnover of R1,1 billion. An operating margin of a little over 4% in itself reflects some of the difficulties experienced with the Rand depreciation and pressure facing consumers. It's not all down to external factors though, there are improvements to be made in the established businesses and we are working on improving efficiencies. We remain confident that the investments being made into the loss-makers will deliver returns to shareholders in the future. This segment remains a key growth area for the Group.

It's pleasing that, as anticipated in the prior year's report, Brand ID, which was a start-up entity five years ago, has now become profitable.

Industrial segment

The businesses within this sector interface with the retail, automotive, agriculture, mining and construction industries. These sectors of our economy, notably agriculture and mining, have been under severe pressure and volumes supplied to many of our traditional customers have been lower year-on-year. It is hence pleasing that, on the back of volumes from new customers, turnover growth of 8,3% can be reported. The turnover growth, coupled with better margins and tight cost control, saw operating profit improve by 48,8% to R37 million. However, the prior-period result included an asset impairment of R3 million. Adjusting for the impairment still sees operating profit improve by 30,7%.

It is encouraging that, despite the difficult environment, the hard work put into these businesses by the respective management teams is starting to bear fruit.

We have recently announced the acquisition of a new business, Premier Rainwatergoods Proprietary Limited, a manufacturer of gutters, downpipes and roofing accessories, which will fit into this segment.

Textile segment

Trading conditions for the businesses within this sector remain challenging.

The prior year's results included an impairment reversal of R13 million. If one adjusts for this once-off event, operating profit declined by 2,6% to R27 million. It is testament to the management teams within this sector that small profits can be eked out of what are difficult businesses. The strategy for this sector is one of containment whilst we look to transition the businesses into higher margin areas. In this regard, good progress is being made in some of the businesses.

Stuart Queen
Chief executive officer
1 August 2016