Chief executive officer's report

We are pleased to report good growth for the year with EPS up 46%, HEPS up 22% and NAV per share up 20% to 415 cents. These results reflect that within Deneb there are a number of businesses that continue to deliver good, solid results even in difficult economic conditions.

In overall terms, turnover grew by 7% to just over R2,9 billion. Gross profit increased by 18% on the back of improved margins while overheads grew by 9%. As a result, operating profit before finance costs grew by 26%. The Group completed a share buyback in September 2016, which saw it buy back 24% of its shares in issue for R268 million. This, coupled with the funds spent on the acquisition of Premier Rainwatergoods, resulted in net finance costs increasing by 27% to R80 million.

Deneb's underlying subsidiaries can be categorised into four main groups.

In the first instance, we have good, solid businesses that continue to grow strongly. Over the past five years on a compounding basis, these businesses have grown turnover by 16% and core operating profit by 22% per annum. They are now responsible for over R1,9 billion of turnover and deliver net operating margins in excess of 10% after accounting for all centralised head office costs.

The second set of businesses are mostly start-ups that are being developed with an eye to the future. These businesses have largely delivered on expectations and are coming along well. Although they may not all make it to become mature businesses, we are optimistic that most will join the first group and become good contributors in time.

The third group of businesses have poor fundamental economics but strong management teams and muddle through eking out small profits. These businesses are not likely to shoot the lights out anytime soon but they don't cost the Group very much to maintain them. We are working on opportunities to shift them into areas that would enable them to deliver better returns and move them into the first group.

The final group has, disappointingly, not been able to find the required traction. This failure is due to a combination of the general poor economics in the industries they serve and our own inability to strategically reposition them onto a more sustainable path. Both of these factors are exacerbated by the challenging economic environment. We had hoped that these businesses could be fixed over time by following a growth strategy. However, given the general state of the economy we may need to be a bit more pragmatic in our outlook towards them.

Although the results overall represent another good step forward for the Group, we are cognisant of the fact that, in absolute terms, they do not represent a suitable return on the asset base. The plans to remedy the fourth group of businesses above will make a marked difference to the operating margins and return on equity calculations.

Segmental results

Property segment

The value of the Group's property portfolio increased by R46 million (4%) to R1,22 billion. This growth incorporates R9 million spent on development costs and R51 million of upwards revaluation, offset by disposals totalling R14 million.

Revenue increased by 10% to R150 million with revenue from external tenants representing 71% of the total. Operating profit before finance costs increased by 4% to R135 million. If the property revaluations are excluded, operating profit for the current year was up 6% to R104 million.

We have said in previous reports that we are looking to grow our property portfolio and this remains the case despite the fact that in reality we have been a net seller of property. We seem to have a different view to other buyers as to what fair acquisition yields should be. However, rather than changing our expectations, we will continue to look for opportunities that fit into our model even if it means being a bit more patient. We see our ability to remain patient as the fundamental strength of a diversified portfolio.

Industrial Manufacturing segment

The Industrial Manufacturing segment continued to power ahead.

The acquisition of Premier Rainwatergoods earlier in the year has proven to be successful and the management team has assimilated themselves seamlessly into the Group. In return, we hope and expect to be a good shareholder for them in the long term. The results of this business as well as strong growth in the existing operations saw revenue up 32% to R643 million and operating profit up 53% to R56 million. This growth comes on the back of 49% growth in the previous reporting period and this segment is now becoming a very meaningful contributor to the Group.

Branded Product segment

Revenue for this segment was down R21 million (1%) to R1,38 billion, however, operating profit before finance costs increased to R15 million from the R2 million recorded in the prior period.

The Prima Group, which comprises Prima Toys, Prima Interactive, the Empire Group and some smaller start-ups, had a very strong year with operating profit up 47% over the prior year. These businesses continue to deliver very good returns, which is testament to the efforts of the competent management teams within them.

On the other hand, the performance of our office automation business has been very disappointing. The new management team, appointed halfway through the year, has been working tirelessly to clean it all up. As part of this clean-up we have taken a number of large write-offs on the chin, which have affected the overall results of this segment.

Our sporting goods business, Brand ID, had a little stutter on its growth path. This business sells quite high-value discretionary durable goods and the segment of the market that it serves has undoubtedly been under pressure. Towards the end of the year it took a decision to exit some of its lower margin product ranges and consolidate its management structures to reduce its breakeven point. If one excludes the once-off costs incurred in this business then it remained profitable for the period under review.

Textile segment

The general economics of the businesses within this sector remain challenging. Although revenue was up 8%, operating profit was down R12 million (45%) to R15 million. The main reason for the decline in operating profit was a R19 million forex loss in the current year compared to a small profit in the previous year. It is the Group's policy to cover forward any currency exposure once the selling prices have been established in order to lock in the cash margin. Ordinarily, if forex losses are recorded up to the time that the goods are delivered, it will result in higher margins when the goods are sold. This will be true in this instance as well, but the long lead times inherent in these businesses mean that a large portion of the countervailing gross profit improvement will only take place in the next financial year.

As we have mentioned in previous reports, the general poor economics of the textile sector mean making even a modest return incredibly hard work and require an enormous amount of skill from the respective management teams. We are fortunate that we have strong people at the head of each of these businesses. The work done in our home textile business justifies a specific mention. Over the past five years the turnover of this business has remained relatively flat, but five years ago some 80% of the turnover came from selling unbranded products to the major retail chains. This year that percentage was down to a little over 50% with the difference coming out of areas that are more dependent on the quality of service rather than price. We believe that this is an altogether more sustainable business model.

Distribution

We are pleased to be able to re-introduce a distribution of 3 cents per share. We did not pay a distribution in the previous year as we reserved funds to complete the share buyback mentioned above.

Stuart Queen
Chief executive officer
4 September 2017