

Corporate governance

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Introduction

The Steinhoff group and its directors are fully committed to the principles of corporate governance and application of the highest ethical standards in the conduct of its business. The group endorses the principles of openness, integrity and accountability advocated by the code of corporate practices and conduct (the code) set out in the King II Report on Corporate Governance (King II). Efforts made in the group over a number of years conform to current international trends towards improving transparency in reporting and accountability. In all dealings, we strive to ensure that the interests of stakeholders are foremost in our decisions and that they are fully informed of the process. The board believes that the group complies with the code.

The key principles underpinning the group's governance are set out in this statement. The group believes that a corporate culture of compliance with applicable laws, regulations, internal policies and procedures is a core component of good corporate governance. Steinhoff believes that while compliance with the form of corporate governance is important, compliance with the substance of corporate governance and good citizenship in each jurisdiction where we operate will lead the group in the right direction.

The board charter

The board operates under an approved charter which regulates the way business is conducted by the board in

line with the principles of sound corporate governance. The board charter, modelled on the principles recommended by King II, incorporates the powers of the board, providing a clear division of responsibilities and accountability of the board members, collectively and individually, to ensure a balance of power and authority. The annual self-evaluation process to review the effectiveness of the board, its committees and individual directors has also been entrenched.

Ethics

We have adopted a code of ethics, committing to the highest standards of conduct. The code of ethics has been approved by the directors and a formal ethics programme rolled out throughout the group. This code, *inter alia*, addresses conflicts of interest.

The group operates on the basis of decentralised management across numerous countries. All employees are required to maintain the highest level of ethical standards in ensuring that the group's business practices are conducted in a manner that, in all circumstances, is above reproach.

Steinhoff continues to expand its performance-driven culture of appropriate disclosure and transparency in which individual executives and employees assume responsibility for the actions of the business. The integrity of new appointees in selection and promotion processes is continuously assessed. The code spells out our commitment

to shareholders and stakeholders, as well as policies and guidelines on the personal conduct of management officials and other employees.

Board of directors

The board of directors is appointed by shareholders and is responsible to shareholders for setting the direction of Steinhoff through establishing strategic objectives and key policies.

Our board of directors currently consists of 13 directors, seven of whom serve as executive directors and six who serve as non-executive directors. Three alternate executive directors were appointed during the year under review. The board considers Claas Daun, Dirk Ackerman, Jannie Mouton and Drs Len Konar and Franklin Sonn as independent non-executive directors, as described in King II. A period in excess of 3 years has expired since Norbert Steinhoff resigned from his employment with the group. He is now considered to qualify as an independent non-executive director. The non-executive directors, drawing on their skills and business acumen, ensure impartial and objective viewpoints in decision-making processes and standards of conduct. They enjoy significant influence in deliberations at meetings. Steinhoff's directors have a wide range of business-related expertise, as well as significant experience in financial, commercial and furniture industry activities. Directors are appointed on the basis of skill, acumen, experience and level of contribution to and impact on the activities of the group. Terms of office of non-executive directors are subject to three-year rotation provisions, while executive directors are appointed for terms of office not exceeding five years, subject to the company's general conditions of service.

Directors must dedicate sufficient time to be able to monitor, evaluate and provide effective commentary to the board and management on the financial and operational information supplied to the board.

All directors have access to management, including the company secretary and the legal department, and to information required to carry out their duties and

responsibilities fully and effectively. Directors are encouraged to stay abreast of the group's business through independent site visits and meetings with senior management. Directors are provided with guidelines on their duties and responsibilities and a formal orientation programme has been established to familiarise incoming directors with the group's business, competitive posture and strategic plans and objectives.

The board meets at least four times annually and more frequently, if circumstances or decisions require. Directors declare their interests in contracts and other appointments at all board meetings. Meetings are conducted according to a formal agenda, ensuring that all substantive matters are properly addressed.

The main responsibilities of the board include:

- regular review of the strategic direction of investment decisions and performance against approved plans, budgets and best-practice standards
- determination of policy and processes to ensure integrity

Meeting dates

Director	12 September 2005	5 December 2005	8 March 2006	5 June 2006
BE Steinhoff	√	√	√	√
MJ Jooste	√	√	√	√
DE Ackerman	√	√	√	√
CE Daun	√	–	√	√
KJ Grové	√	√	√	√
D Konar	√	√	√	√
JF Mouton	√	√	√	√
FJ Nel	√	√	√	√
FA Sonn	√	√	–	√
NW Steinhoff	√	√	√	√
IM Topping		Appointed 05/12/2005	√	√
DM van der Merwe	√	√	√	√
JHN van der Merwe	√	√	√	√
RH Walker	√	Resigned 01/11/2005	√	√
JNS du Plessis (alternate director)*	√	√	√	√
HJK Ferreira (alternate director)		Appointed 05/12/2005	√	√
SJ Grobler (company secretary – alternate director)		Appointed alternate director on 05/12/2005	√	√

* Reclassified from independent non-executive director to executive director with effect from 15 March 2006.

of the group's risk management and internal controls, communication and reporting and directors' evaluation

- rating the company's performance against approved budgets and prevailing economic conditions
- approving major capital expenditure programmes and significant acquisitions and disposals
- ultimately responsible for regulatory compliance
- although the board formally delegates power and authority to executive management, it remains ultimately responsible to retain full and effective control over the group and decisions on material matters are reserved by the board (including but not limited to capital expenditure, procurement, property transactions, borrowings and investments other than pre-approved materiality levels)
- the process, selection and appointment of directors, on recommendations of the nomination committee.

Structured management succession planning for purposes of identifying, developing and advancing future leaders in the group is an important element in the management process.

Subject to specific fundamental, strategic and formal matters reserved for its decision, the board may delegate certain responsibilities to a number of standing committees, which operate within defined terms of reference laid down by the board, as referred to below. The board has executive, audit and risk, human resources and remuneration, nomination and group risk advisory committees to assist with its duties. Refer to page 54 for board committees.

Accountability

The CEO is responsible and accountable to the board for all group operations. The CEO has appointed managing directors (MDs) of the main operating divisions to assist in discharging this responsibility. The duties and responsibilities of the MDs are detailed in a formal role description, together with limits of authority, and these are approved and reviewed annually by the CEO.

The company's policy of decentralisation and flat organisational structure means that each region is managed autonomously. Each region has its own operational, marketing and social responsibility budget. Each business division is responsible for its own results and responds individually to customer needs, pricing policies, and in its choice of social responsibility programmes.

Company secretary

All directors have access to the advice and services of the company secretary, supported by the legal department, and are entitled and authorised to seek independent and professional advice about affairs of the group at the group's expense. The company secretary is responsible for the duties set out in section 268G of the Companies Act.

The certificate required to be signed in terms of subsection (d) of the act appears on page 69.

Remuneration report

Philosophy

The group human resources and remuneration committee is responsible for the remuneration strategy of the group,

the approval of mandates for incentive schemes within the group and the determination of the remuneration of executive committee members, relative to local and international industry benchmarks. It also makes recommendations to the board regarding the remuneration of Steinhoff directors.

Employees in general

The following principles are used to determine appropriate remuneration levels:

- Employees linked to compulsory and binding bargaining structures and forums are paid accordingly
- Team performance-related incentive systems are, however, optional to ensure achievement of targets
- Supervisory and middle management's remuneration is linked to competency levels and team performance
- Underperformance is not incentivised and active steps are taken to improve individual performance or for that individual to leave the group, in line with accepted practices
- Strong long-term incentives are created to ensure that performers are retained
- The collective incentives promote and reward entrepreneurial skills according to performance.

The board applies the principles of good corporate governance relating to directors' remuneration. The company strives to strike a balance between the need to protect shareholders' interests and to provide the appropriate incentives to management and staff to ensure that sustainable value is being developed and maintained. Governance of directors' remuneration in Steinhoff is performed by the human resources and remuneration committee.

The remuneration philosophy of Steinhoff is to attract, retain and motivate executives while giving due consideration to remuneration levels, both within and outside the group. To meet these objectives, the committee duly considers external market representative surveys.

The company's primary executive remuneration objective is to reward executive directors to ensure that their

interests are as far as possible commensurate with the interests of shareholders.

Annual bonus arrangements have been structured so that stretching targets are based on corporate, business unit and individual performance.

In setting remuneration levels, the committee commissions an independent evaluation of the roles of the executive team, and also of the next levels of management within the company. The committee takes independent advice from consultants on market-level remuneration, based on comparisons with other furniture manufacturing companies with which the company competes for executive talent.

The committee recognises the importance of linking rewards to business and personal performance and believes that the arrangements implemented provide an appropriate focus on performance and balance between short- and long-term incentives. The annual bonus plan and long-term incentive arrangements provide a significant portion of the total reward for the achievement of stretching target level business and personal performance objectives. Higher proportions of performance-based reward are available for the delivery of exceptional personal business performance, resulting in enhanced shareholder value.

The human resources and remuneration committee constantly monitors market practice to remain competitive, to ensure that reward policy supports company strategy and to reflect good corporate governance practice. The committee has implemented changes to Steinhoff's incentive strategy to help deliver enhanced shareholder returns. At this time, no other substantial changes to the company's policies on directors' remuneration are envisaged over the next year and in subsequent years. However, the committee may develop policy and, should it determine any changes to be appropriate, will report such changes to shareholders through established channels of consultation and reporting.

Executive directors

Remuneration for executive directors consists of a basic salary, a performance-related incentive bonus, retirement contributions, medical scheme membership and long-term share incentive schemes. All benefits are established in terms of the remuneration principles outlined here. In line with the group's remuneration philosophy, remuneration is reviewed annually by the human resources and remuneration committee after evaluating each executive director's performance, including that of the group CEO. In addition, the remuneration packages are benchmarked individually taking into account local, regional and global responsibilities. Details of the remuneration of the directors and information on share rights are set out on pages 146 to 151 of the financial statements.

Basic salary and benefits – salaries for executives are reviewed annually in September. Salaries are adjusted based on market-related activities, the group's performance and the individual's performance.

Annual bonus – the committee uses an annual performance bonus as an incentive to executives to achieve predetermined financial targets based on earnings growth and cash flow. The committee sets the financial targets of the executives and these targets are reviewed regularly.

Share incentive schemes – the company has share incentive schemes for senior executives which were approved by shareholders at the annual general meeting on 6 December 1999 and 1 December 2003 respectively. The committee grants rights which reflect the executive directors' remuneration. Rights granted are subject to time limits and clearly measurable performance criteria. The criteria set in respect of the rights granted with effect from 1 December 2003 in respect of 37 022 506 shares have been achieved and will mature in three tranches with effect from 1 December 2006. The human resources and remuneration committee will continue to implement a long-term incentive scheme by making further grants on an annual basis requiring clearly measured performance criteria to be met.

Non-executive directors

Fees for non-executive directors are recommended to the board by the group human resources and remuneration committee and reviewed annually with the assistance of external service providers. The committee takes cognisance of market norms and practices, as well as the additional responsibilities placed on board members by new acts, regulations and corporate governance guidelines. Options and share awards are granted to non-executive directors for their commitment and contributions to the affairs of the group.

Non-executive directors receive an annual fee for their input. The annual fee consists of a base fee, a committee membership fee and a fee for chairing the various committees. Steinhoff pays for all travelling and accommodation expenses for board meetings.

Due to the increased responsibility of non-executive roles in recent years, such fees are set at a competitive market level (based on analyses provided by consultants).

In line with best practice, the independent non-executive directors do not have service contracts and are not members of the group's pension schemes.

Management reporting

Management reporting disciplines include the preparation of annual budgets by operating entities. Monthly results and the financial status of operating entities are reported against approved budgets. Profit projections and cash flow forecasts are reviewed regularly, while working capital and borrowing levels are monitored continually.

Financial control and reporting

The directors are responsible for ensuring that group companies maintain adequate records, and for reasonable, accurate and reliable reporting on the financial position of the group and the results of activities. Financial reporting procedures are applied in the group at all levels to meet this responsibility. Holding company executives meet regularly with operating management on a formal basis

and are effectively involved in the major decision-making processes of all group companies. Financial and other information is constantly reviewed and any action necessary is taken immediately.

The financial statements are prepared in accordance with International Financial Reporting Standards (IFRS).

Internal control and risk management

We operate a robust internal control structure. The executive team is responsible for implementing the risk management strategy; ensuring that an appropriate risk management framework is operating effectively across the group; embedding a risk culture throughout the group; and providing the board and the audit and risk committee with a consolidated view of the risk profile of Steinhoff, identifying any major exposures and mitigating actions. This strategy supports the board in discharging its responsibility for ensuring that the wide range of risks associated with the company's diverse operations is effectively managed in support of the creation and preservation of shareholder wealth. The board's policy on risk management encompasses all significant business risks to the group, including financial, operational and market and general risk (which includes compliance risk), which could undermine the achievement of business objectives. This system of risk management is designed so that the different business units are able to tailor and adapt their risk management processes to suit their specific circumstances. Risk assessment and reporting criteria are designed to provide the board with a consistent, company-wide perspective of the key risks.

The system of internal control, which is embedded in all key operations, provides reasonable rather than absolute assurance that the company's business objectives will be achieved within the risk tolerance levels defined by the board. Regular management reporting, which provides a balanced assessment of key risks and controls, is an important component of board assurance. The chief financial officer provides confirmation on a quarterly basis to the board that financial and accounting control frameworks have operated satisfactorily on a consistent basis. The board

also receives assurance from the audit and risk committee, which derives its information, in part, from regular internal audit reports on risk and internal control throughout the group. The company's internal audit function has a formal collaboration process in place with the external auditors to ensure efficient coverage of internal controls and to eliminate duplication of effort.

The key features of the internal control system that operated throughout the year covered by the financial statements are described under the following headings:

■ **Control environment**

The board has put in place a documented organisational structure with clearly-defined and understood lines of responsibility and delegation of authority from the board to operating units. There are established policies and procedures, including the code of ethics, to foster a strong ethical climate.

■ **Identification and evaluation of business risks and control objectives**

The board has the primary responsibility for identifying the major business risks facing the group and for developing appropriate policies to manage those risks. The risk management approach is used to focus the attention of directors and management on the group's most significant areas of risk and to determine key control objectives. This process is supported by group risk advisory.

■ **Information systems**

The group operates a comprehensive annual planning and budgeting system with an annual budget approved by the board. There is a financial reporting system which compares results with plans and the previous year every month, to identify any significant deviation from approved plans. Reports include a monthly cash flow analysis projected for 12 months, which is used in determining whether the group has adequate funding for its future needs.

■ **Risk management**

The board of Steinhoff recognises the critical importance of the risk management function and takes ultimate

responsibility for this function. The company is fully committed to complying with the risk management requirements and mandates of King II, and an enterprise-wide integrated risk management approach has been adopted in line with international best practice. The board is supported by executive and non-executive committees in the identification and management of risks, and the process is highlighted above.

The internal control department regularly reviews the implementation and management of the risk profile through the internal audit process.

The group manages risk in three categories with a varying degree of central guidance. The risks within each major risk category and the risk management process of the major risks facing the group are discussed in more detail below:

■ **Financial risk management**

The group's financial instruments consist mainly of deposits with banks, local money market instruments, accounts receivable and payable, loans to and from subsidiaries, leases, hire-purchase agreements and some derivatives. Derivative instruments are used by the group for hedging purposes. Such instruments include forward exchange and currency contracts and interest rate swap agreements. The group does not speculate in the trading of derivative or other financial instruments other than in the normal course of operations. In addition, the chief financial officer and central finance function play a major role in identifying and managing these risks through various forums which communicate and train operational finance executives in managing these risks.

Those major risks include:

• **Currency risk**

Our business model is underpinned on the strategy of locating production and sourcing operations in emerging low-cost economies and supplying finished products into developed economies. Currently, our revenues outside southern Africa are earned

principally in euro, sterling and Australian dollars. Our operating costs and expenses for our major European retail businesses are in sterling and Australian dollars, while Pennypinchers, Timber City and the Unitrans motor retail businesses operate in rand. On the other hand, our sourcing operations in the East mostly deal in US dollars, and all our manufacturing operations are located in emerging markets and these costs are therefore incurred principally in rand, zloty, forint and hryvnia. Also, as we are a South African-listed company, our reporting currency is rand. The group's reported profits, net assets and gearing are all affected by movements in foreign exchange rates.

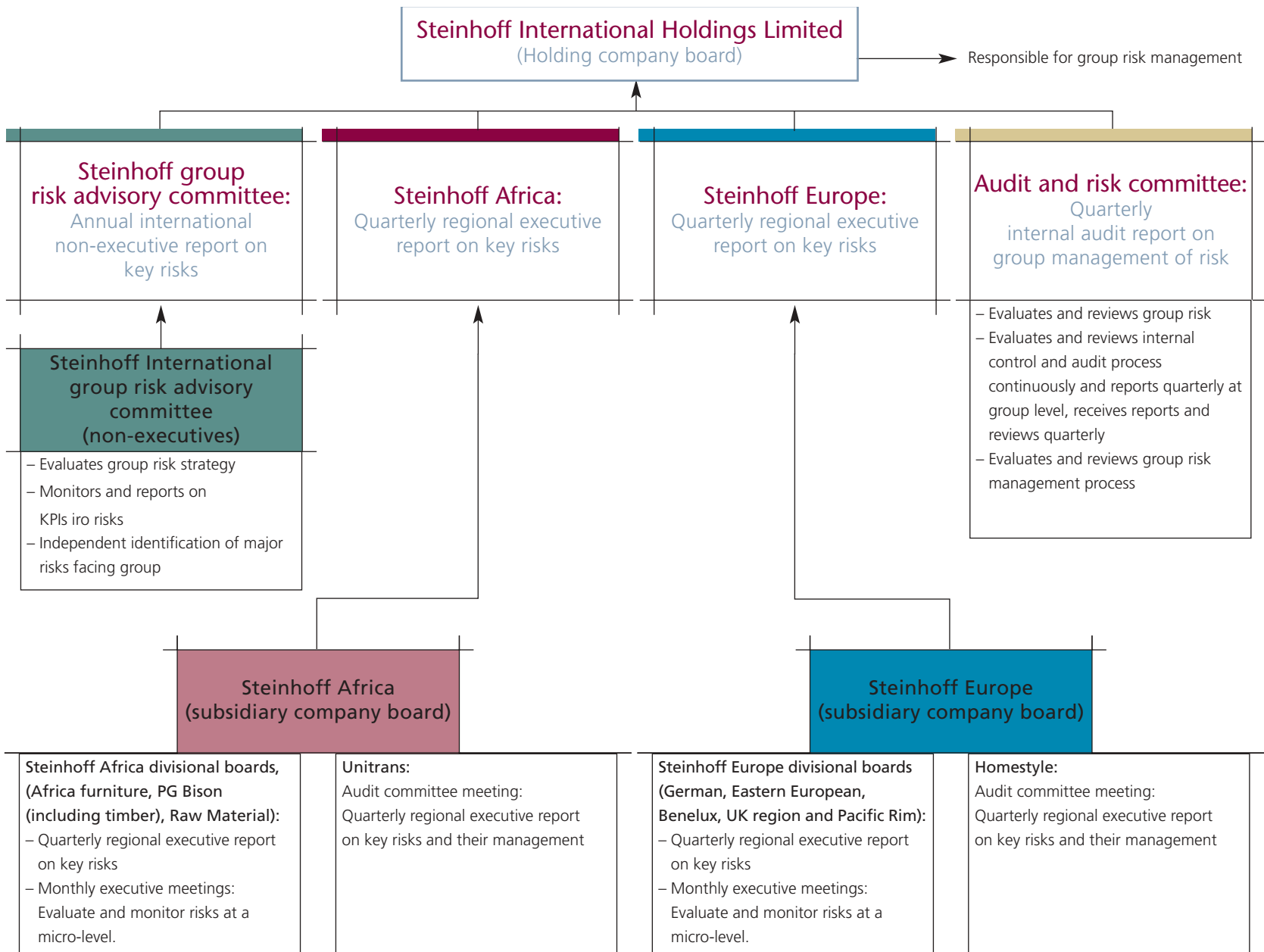
The responsibility for monitoring and managing these risks is that of management in conjunction with the central treasury and foreign exchange support functions. Since inception, the businesses have experienced a period of decline in emerging currencies against the euro, and during the period under review, both the zloty and rand have appreciated strongly against the euro and the US dollar, respectively. The mix and interaction of currencies in our business model is closely managed to protect the natural hedge which exists within some of our business units.

Through various management forums, the group provides guidelines to key management in managing the risks. It is group policy to hedge exposure to cash and future contracted transactions in foreign currencies for a range of forward periods but not to hedge exposure for the translation of reported profits.

Additional information is highlighted in the chief financial officer's report.

• **Treasury risk management**

A finance forum consisting of senior executives of the group meets on a regular basis to analyse currency and interest rate exposure and to re-evaluate treasury management strategies in the context of most recent economic conditions and forecasts.



- **Liquidity risk management**

The group manages liquidity risk by monitoring forecast cash flows and ensuring that adequate unutilised borrowing facilities are maintained. Cash surpluses and short-term financing needs of manufacturing and sales companies are mostly centralised at the African and European central offices, respectively. These central treasury offices invest net cash reserves on the financial markets, mainly in short-term instruments indexed to variable rates.

- **Interest rate management**

Interest rate exposure is managed within limits agreed by the board. Given the group's global reach and strategy of low-cost manufacturing and sourcing in emerging markets and sales in developed countries, the group follows a policy whereby it maintains a balance between fixed and variable rate loans to reflect more accurately the different interest rate environments, the relevant currencies, and the effect which relevant interest rates have on our operations and consumer spending within these environments. These variables are taken into account to minimise the impact on earnings and maintaining a reasonable competitive, market-related cost of funding.

As part of the process of managing the group's borrowing mix, the interest rate characteristics of new

borrowings and refinancing existing borrowings are positioned according to expected movements in interest rates.

- **Credit risk management**

Trade accounts receivable and short-term cash investments pose a potential credit risk to the group. The group's trade accounts receivable consist mainly of a large and widespread customer base. Group companies continually monitor the financial position of their customers, and appropriate use is made of credit guarantee insurance. The granting of credit is controlled by application and account limits. Provision is made for both bad debts, and at year end management did not believe there was any material credit risk exposure which was not already covered by credit guarantee insurance of bad debt.

- **Operational risk management**

At operational level, the group runs a number of risk control initiatives including safety management, security, fire defence, environmental and quality control initiatives. In addition, the risks explained below have been identified by the risk advisory committee as key risks facing the business and are actively managed and reported on by all operations:

- **Competition risk**

Furniture and household goods are subject to fashion trends and geographic consumer tastes. Consumer tastes and fashion trends can change rapidly. We need to anticipate or respond to changes in consumer tastes and fashion trends in time to ensure our products remain relevant.

In this respect we collaborate closely with our strategic retail customers and retail business units which deal with the final consumer on a daily basis. We encourage retail partners to assist and advise us on our portfolio and product range as these are developed, and aim to secure orders for the product range prior to manufacturing or sourcing our ranges. Our collaboration with retail customers allows us key insight into consumer demand from price to after-sales service expectations.

The furniture and household goods market in Europe is fragmented and highly competitive and consists of a large number of manufacturers who produce products similar to Steinhoff, none of whom dominate the market. Competition is generally based on product quality, timing of delivery, product design, product availability, brand name recognition, price and customer service.

In certain of our overseas markets, particularly Germany, the UK and Australia, we compete with a number of companies, some of which are larger than our group. While we believe we have a number of competitive advantages in the markets in which we operate, we need to maintain our competitive position in all or any of these markets.

- **Acquisition risk**

In recent years we have grown both organically and through a number of strategic acquisitions and joint venture arrangements which have contributed significantly to the growth of our business and operations. Our ability to continue to grow our

Management is acutely aware of the risks associated with vertical integration

business in new markets will depend in part on our success in identifying and making appropriate acquisitions and joint venture arrangements in future. Our future operating results will depend on our ability to manage and integrate the operations of the past, as well as any future acquisitions and realise the synergies which made the acquisition viable at that time.

A formal due diligence process and procedure is in place which sets out the approach and framework to be used when acquisitions are being made. This includes continued strategic analysis of intended targets, development of acquisition criteria, both in terms of the group's strategic direction and potential value creation for the respective business units of the group. A dedicated mergers and acquisition department reviews and manages the entire process relating to mergers and the application and implementation of business combinations. Subsequent acquisitions to any business units are identified and tasked with realising the synergies locked in the acquired business. Reports on the progress of these synergies are reviewed at board level.

- **Supply risk**

Our operations depend on our ability to source reliable supplies of raw materials of appropriate quality. As our business model depends in part on the reliable sourcing of low-cost raw materials, we seek to attain greater control over our supply of raw materials. The principal raw materials we purchase from third parties for use in our operations are leather, fabrics, timber, particle board, foam and springs. We do not have any long-term contracts for the purchase of our raw materials from third parties, other than our timber supply arrangements in South Africa (where we own and continue to invest in timber plantations and sawmills to supply our own manufacturing operations) and in Russia (where we have a longer-term contract for the supply of timber).

In addition, some of our customers require that we source all our timber used in our products from forests that are FSC (Forestry Stewardship Council)

certified. In November 2001, the government of South Africa announced its scheme to privatise large portions of FSC-certified forests. We currently source the major portion of our domestic timber needs through parties operating, or who are in the process of obtaining, concessions in FSC-certified South African forests. If a substantial portion of these FSC-certified forests is sold to parties who fail to keep such certification, or who decide to export such FSC-certified timber, prices for this timber could increase significantly and we could lose all or part of our FSC-certified timber sources, adversely affecting our results of operations.

Through our restructured timber division under the successful PG Bison brand, and our much-publicised investment in the North Eastern Cape Forests project (see details in the review of Africa operations), our timber strategy and risks associated with future supply is reviewed quarterly at board level and we believe we have appropriate triggers in place to bridge a possible supply gap until our own forestry initiatives are in full operation. Furthermore, with the restructuring of our own textile operations and given our sourcing expertise elsewhere, we are now back in a position where we are able to adapt our supply arrangements as the economy and currency fluctuate.

Lastly, the group fosters a preferred-customer relationship with its suppliers through swifter payments and regular orders evidenced by the group's cash flow. These long-term relationships secure a preferred-customer status with suppliers which also provides some security in long-term supply.

- **Risks associated with vertical integration**

Studies have shown that risks of vertical integration are the creation of bureaucracy, complacency and general cost inefficiencies. This could be aggravated by volatile market conditions, which results in the firm losing its flexibility in adapting to general market conditions. Management is acutely aware of the risks associated

with vertical integration and therefore the focus remains to retain the group's flexibility in sourcing from third parties, and the International Sourcing department in China plays a significant role in this regard.

In addition, management focuses on team building and intergroup cooperation with a view to deriving synergies classically associated with vertical integration models.

We can also consider including the following: Fully integrated companies may be less adaptive than other firms to the turbulence of economy-wide changes, for two reasons:

- Firstly, fully integrated companies have many vertical links between their product lines leading to high interdependence among them and such interdependence may make it hard for a firm to adapt to business cycles or technological changes that influence the market. This obviously creates difficulties in changing strategies, abandoning obsolete technologies, monitoring information about product markets or filling unevenly balanced upstream or downstream capacity.
- Secondly, a fully integrated company is less adaptive to the turbulence created by economy-wide changes, in that it has moved too far away from its centre of gravity or core-competency. Vertical integration that is not tightly linked to the firm's original business may result in a lack of information among corporate level executives about the non-core businesses, which creates difficulties in coordinating the complex interactions between business units.

If the integration is constrained, tightly vertically linked to the core product, in our instance household goods, corporate executives can better recognise and understand the implication of economy-wide changes for coordination of the non-core and core product lines.

- **People risk**

Our strategic development and growth depends in part on the continued contributions of a number of our senior executive officers and key employees. As our business develops and expands, we believe our success will depend on our ability to manage, attract and retain skilled and qualified personnel. Competition for skilled employees in the furniture industry is intense.

Steinhoff has addressed this key risk by the recent launch of a comprehensive employer of choice programme which aims both to attract skilled and qualified personnel and retain the key employees necessary to secure the success of the group.

Reward and incentive schemes are also in place to align people goals to that of the group and its shareholders. Training is prioritised to develop skills and hedge against the risks posed by skills shortages in Steinhoff's business arena.

HIV/Aids

Aids poses risks to Steinhoff in terms of lost productivity and increased costs in our operations in southern Africa. The incidence of Aids in southern Africa, which is forecast to increase over the next decade, poses risks to Steinhoff in terms of potentially reduced productivity, our ability to recruit skilled employees and increased related costs. In addition, the increased incidence of Aids may lead to a decrease in consumer spending within the local population, which could adversely affect demand for our products in southern Africa. The potential impact of Aids on our operations and financial condition will be determined by a variety of factors, including the number of HIV infections among our employees, the progressive impact of HIV on infected employees' health, and the medical and other costs associated with the disease, most of which are beyond our control. During an independent study conducted in 2003, it was estimated that approximately 24% of the South

African workforce would have been infected with HIV/Aids by 2006. The study further found that, compared to the general population of South Africa, Steinhoff has a moderate risk profile.

Various initiatives are undertaken by the group to counter this risk, further details of which are contained in the sustainable development report.

Labour disputes

Our operations and financial condition may be adversely affected by labour disputes or changes in labour laws in the various jurisdictions in which we operate. The largest concentration of our employees is in South Africa and Poland. Labour laws may continue to change in South Africa in future in a manner which could adversely affect our business. Significant labour disruptions at any of our operations could have a material adverse effect on our business, operating results and financial condition.

In certain rural areas of Poland where we operate, there is little organised labour activity and membership in labour unions is low. However, following Poland's accession to the EU in May 2004, Polish labour unions have become more prevalent. While we strive to maintain a good relationship with our workforce in all the regions in which we operate, an increase in organised labour activity may affect our profitability, to the extent such increase in organised labour activity leads to work stoppages or demands for increased levels of compensation.

- **Pension and provident fund risk**

A suitably qualified board of trustees exists, which, together with professional investment advisors and internal investment subcommittees, is responsible for evaluating the effectiveness of investment decisions. The group remains committed to its pension obligation to current and former employees, and to pensions in general as a key part of its remuneration package.

- **Insurance and risk management**

The group undertakes an annual assessment in conjunction with the insurance brokers of the risk exposure relative to assets and possible liabilities arising. All risks are considered adequately covered, except for political risks. Self-insurance programmes are in operation covering primary levels of risk at a cost more advantageous than open market premiums. Regular risk management audits are conducted by the group's risk management and insurance consultants, whereby improvement areas are identified and resultant action plans implemented accordingly. Assets are insured at replacement values.

- **Market and general risks**

- **Downturn in the global economy**

Historically, the furniture and household goods industry has been cyclical, generally fluctuating with economic cycles and conditions. Demand is sensitive to general economic conditions, including housing activity, interest rate levels, current economic growth, credit availability and other factors which affect consumer spending habits. Due to the discretionary nature of most furniture and household goods purchases and the fact that they often represent a significant expenditure to the average consumer, such purchases may be deferred during times of economic uncertainty. These general economic factors affect not only the ultimate consumer, but also impact mass and speciality retailers, which are our primary customers.

In recent years, global economic conditions have been volatile, due in part to terrorist activity, ongoing geo-political concerns and substantial movements in global stock markets and stock indices. As a result, consumer confidence has been inconsistent. For example, the overall size of the German furniture retail market, from which we derive a significant portion of our revenues, has been static for the last six years, and only recently showed signs of improving. Recessions or prolonged economic downturns in the markets in which we operate could affect our industry and thus

have a material adverse effect on our business, financial condition or results of operations.

Steinhoff maintains a geographic and industrial diversity of businesses as a natural hedge to protect the group against an economic downturn in specific regions. The geographical spread of the manufacturing, sourcing and warehousing functions allows units to quickly adjust operations to counter market difficulties. The ability for units to adapt in certain circumstances, together with a review of market forecasts, is reviewed and measured at regional board level, which consists of all key operational directors, such as the raw material, manufacturing and timber divisions, which are able to provide key insights in this regard. Steinhoff is expecting an increased interest rate environment for most of the markets in which the group currently operates.

- **Regulatory environment**

Our operations are subject to various laws and regulations in the jurisdictions in which we operate, relating to such matters as health and safety, employment, antitrust and environmental issues. Future changes in such laws and regulations could also have an adverse effect on our business, financial condition or results of operations.

Various forums, led by functional experts, are used throughout the group to communicate the effect and direction of possible legislative and regulatory changes in the countries in which we operate to key management in various business units.

- **Concentration risk**

A large portion of our furniture sales in southern Africa, which represent a material portion of our sales in the region, is sold to a relatively small number of major retail groups. We have no long-term written contracts with these customers for the purchase of products, but instead sell our products under short-term purchase orders, consistent with general industry practice. The loss of any significant customer, whether

through business failure or otherwise, or a substantial reduction in purchases by any such customer in southern Africa, could have a material adverse effect on our business and results of operations if we were unable to replace such customer or purchases.

Also, we may be regarded by the South African anti-trust authorities as having a large market share in the South African furniture market, and our South African operations are subject to certain anti-competition legislation and regulatory oversight. Certain expansions of our operations in South Africa through acquisitions may require regulatory approval. While to date all our South African acquisitions have been approved by regulatory authorities, it is possible that in future we may not receive approval to make additional acquisitions or that such approval may be subject to various conditions, which could affect our ability to expand our operations in that market.

In addition to refusing to grant approval for certain potential acquisitions, the anti-trust authorities may take other actions which could prevent further growth of our market share in South Africa in other ways.

- **Political and economic risk**

South Africa's exchange control regulations restrict the export of capital from the common monetary area.

transactions between South African residents (including companies) and non-residents of the common monetary area are subject to exchange controls enforced by the South African Reserve Bank (the SARB). In general, South African companies are not permitted to export capital from South Africa or to hold foreign currency without the approval of the SARB and are required to repatriate to South Africa profits of their foreign operations. In addition, South African companies are restricted from providing financial assistance, such as loans and guarantees, to non-South African subsidiaries without SARB approval. We currently have SARB approval to retain profits of our non-South African subsidiaries and joint ventures outside South Africa, but if we were to lose this permission, South African exchange control restrictions could hinder our normal corporate functioning, particularly our ability to fund acquisitions, capital expenditures and operations outside South Africa.

Black economic empowerment (BEE) is a programme launched by the South African government to redress the inequalities of the past by giving previously disadvantaged groups in South Africa (Africans, coloureds and Indians) economic opportunities previously not available to them. This includes measures such as employment equity, skills

Steinhoff maintains a geographic and industrial diversity of businesses as a natural hedge to protect the group against an economic downturn

development, targets for ownership, management and preferential procurement. BEE reaches much further than affirmative action programmes in other countries. BEE is actively supported in South Africa, and has many benefits such as preferential-supplier status to government and other compliant-businesses. Should Steinhoff fail to manage BEE compliance and the required business return on investment, the result of our operations and ultimately our profitability may be adversely affected.

Political or economic instability in South Africa or regionally may have an adverse effect on our operations and profits.

Political and economic risks throughout central and eastern Europe may adversely affect our operations. Our operations in Poland, Hungary, the Ukraine and Asia may be adversely affected by political and economic risks related to central and eastern Europe. As countries in central and eastern Europe continue the transition to a market economy through increased development and structural reform, rapid fluctuations in consumer prices, interest rates and GDP may continue to occur, making local economies generally weaker and more volatile than the economies of more developed countries.

■ Main control procedures

The board has adopted a schedule of matters which is required to be brought to it for consideration, thus ensuring that it maintains full and effective control over appropriate strategic, financial, organisational and compliance issues. The board has identified a number of key areas that are subject to regular reporting to the board, including treasury, legal and other matters. Financial controls and procedures are in place, including procedures for seeking and obtaining approval for major transactions and organisational changes, as well as organisational controls involving the segregation of incompatible duties and controls relating to the safeguarding of assets.

■ Monitoring

The board has delegated to executive management implementation of the system of risk management and internal financial control. The operation of the system is monitored and a programme of reviews focusing on key aspects of the business has been carried out.

The board conducts a review of the operation and effectiveness of this system of internal financial control annually. The board considers that there have been no weaknesses in this system that have led to any material losses or contingencies during the last year or the period from the balance sheet date to the date of this report.

The directors accept responsibility for maintaining appropriate internal control systems to ensure company assets are safeguarded and managed, and losses arising from fraud or other illegal acts are minimised. Control systems are continually monitored and improved in accordance with generally accepted best practices.

Internal control and audit

The internal audit department is a function established at corporate level, reporting to the audit and risk committee, to assist executive management and the audit and risk committee in the effective discharge of their respective responsibilities by means of independent financial, internal control and operational systems reviews.

The internal audit function operates in terms of an internal audit charter approved by the audit and risk committee.

Internal audit evaluates and assesses the adequacy of risk management processes and internal control frameworks and reports any significant issues, including supplying recommendations to improve these processes through active and constructive resolutions. The internal audit function reviews the effectiveness of financial and non-financial controls over all processes that contribute to the achievement of organisational objectives. It further provides information on the status and results of the annual audit plan.

The internal audit function has been internalised with dedicated group personnel charged with the responsibility of undertaking internal audits independently from operational management at Steinhoff Africa and Unitrans. In other parts of the group, the internal audit function has been outsourced to independent professional service providers.

Stakeholder communication and investor relations

The board considers that balanced and understandable communication of the group's activities to stakeholders is essential and strives to clearly present any matters material to a proper appreciation of the group's position. The interests and concern of stakeholders are addressed

The group adopts a proactive stance in disseminating appropriate operational information to stakeholders

wherever possible by communicating information, as it becomes known, regardless of the potentially positive or negative impact.

The group values its dialogue with both institutional and private investors and has a proactive approach to these relationships. There is a regular two-way communication with investors and analysts, presentations after the interim and preliminary results and site visits. The results for the current year were again presented to the Investment Analysts Society in Johannesburg and, simultaneously, to invited institutional shareholders globally via electronic medium.

The directors seek to build on a mutual understanding of objectives shared between the company and its institutional and private shareholders through a regular series of meetings and presentations. Shareholders are invited to write to the chairman (or any other director) and express their views on any issues of concern at any time. Shareholders can also attend the annual general meeting at which they have an opportunity to ask questions and the chairman presents a review of results and current business activity. At last year's annual general meeting, all resolutions were passed on a show of hands. After the vote, the level of proxies lodged on each resolution was announced at the meeting. The chairmen of the audit and risk, nomination, and human resources and remuneration committees are also available at these meetings to take any relevant questions.

The group adopts a proactive stance in disseminating appropriate operational information to stakeholders through print and electronic news releases and the statutory publication of the group's financial performance.

The website, www.steinhoffinternational.com enables all shareholders to access results presentations and detailed information on the group and its portfolios.

Fraud and illegal acts

The group does not engage in or accept or condone the engaging in of any illegal acts in the conduct of its

business. The directors' policy is to actively pursue and encourage prosecution of perpetrators of fraudulent or other illegal activities should they become aware of any such acts. The group has implemented a fraud line to facilitate reporting any fraud or illegal acts, which is managed and administered by KPMG.

Insider trading

The group has an insider trading policy, which prohibits directors and officers from dealing in Steinhoff's shares, as well as the shares of listed subsidiaries of the group, either directly or indirectly, on the basis of unpublished or price-sensitive information regarding the business or affairs of the group and its listed subsidiaries. Employees are advised not to deal, directly or indirectly, in Steinhoff shares or warrants or shares of listed subsidiaries of the group on the basis of unpublished or price-sensitive information. No director or officer who is privy to unpublished price-sensitive information may trade in Steinhoff shares or warrants during embargo periods determined by the board. These include the periods between the end of the interim and annual reporting periods and the announcement of financial and operating results for such reporting periods.

A report of all dealings by directors and officers in the shares of Steinhoff and its listed subsidiaries is tabled at each board meeting. Any share dealings by directors of the company and its major subsidiaries, or the company secretary, are notified to the JSE for publication via the Stock Exchange News Services (SENS).

Interest in contracts

The group has a policy regulating disclosure of interest in contracts. The policy dictates that all employees disclose any interest in contracts to assess any possible conflict of interest. The policy also dictates that directors and senior officers of the group must disclose any interest in contracts as well as other appointments to assess any conflict of interest in fiduciary duties.

During the year under review, save as disclosed in the financial statements, no directors had a significant interest

in any material contract or arrangement entered into by the company or its subsidiaries.

Going concern

The directors report that, after making enquiries, they have a reasonable expectation that the group has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going-concern basis in preparing the financial statements.

Board committees

For the year under review, the various committees comprised executive and non-executive directors. The composition has subsequently changed and, from 11 September 2006, the board committees (excluding the executive committee) will comprise non-executive directors only. All committees discussed on page 54 and 55 operate within defined terms of reference and authority granted to them by the board.

The audit and risk committee considered the position of Deloitte & Touche and resolved that Deloitte & Touche is independent of the group and recommended the reappointment of Deloitte & Touche as auditors.

This view and recommendation was endorsed by the board of directors on 11 September 2006.