

# Financial officer's report



The group's emphasis on balancing risks through selective participation in investments, different currencies, different funding structures, supply chain operations, acquisitions and monetary jurisdictions have delivered the desired result.

This review aims to provide a clearer view of the group's performance during the year under review. The review is not comprehensive and should be read in conjunction with the annual financial statements presented on pages 65 to 153.

## Group financial summary

The results were delivered in a period where market conditions in continental Europe, the UK and the Pacific Rim continued to be subdued. South Africa continued to experience strong consumer demand as a result of consumer confidence and sound economic fundamentals.

Despite weak market conditions in Europe and the Pacific Rim, the continued investment in brands, innovative

operating strategies and continued operational improvements have resulted in strong organic growth in the manufacturing businesses across the globe. Organic growth was further supplemented by recent investments, most notably that of Unitrans and Homestyle, which became subsidiaries with effect from 1 January 2005 and 30 June 2005, respectively.

In the period under review, revenue increased by 70% in South African rand to R32 238 million, while operating profit increased by 38% to R2 658 million. Profit before tax was R2 445 million, an increase of 36% compared to the 30 June 2005 results.

The group continues to measure its performance in both its reporting currency (rand) and euros to measure real performance that excludes, to a degree, the fluctuation in its reporting currency. The group's performance in rand and euro is summarised below:

	Rand millions			Euro millions		
	2006	%	2005	2006	%	2005
Revenue	32 238	70	18 958	4 123	72	2 397
Operating profit	2 658	38	1 931	351	43	245
Headline earnings	1 959	26	1 557	251	27	197
EBITDA	3 384	43	2 365	433	45	299
HEPS (cents)	173	25	138	22	29	17
NAV per share (cents)	953	32	724	104	17	89
Distribution per share (cents)	37,5	25,0	30,0			

Comparisons with results for the 12 months to 30 June 2005 are affected by acquisitions, capital items such as the restructuring initiatives (mainly of the group's timber interests in South Africa), the impairment of the group's investments in Zimbabwe, exchange rate movements in this period, the group's transition to International Financial Reporting Standards (IFRS), black economic empowerment (BEE) transactions, and circular 9/2006 – a revised interpretation issued by the South African Institute of Chartered Accountants (SAICA).

### Currency

The group continues to minimise and manage earnings volatility through appropriate foreign exchange risk management programmes. In rand terms, changes in the exchange rate have significant influence on the group's earnings, with approximately 46% (2005: 52%) of the group's revenues denominated in currencies other than the rand. The impact of the inclusion of Homestyle as a subsidiary on the proportionate contribution of foreign currency-denominated revenue was reduced by the full-year inclusion of Unitrans. However, if the Unitrans motor retail business is excluded, the foreign currency-denominated revenue of the group comprises

67% (2005: 67%). The actual foreign revenue achieved in currencies other than South African rand, denominated in euro, increased by 61% from €1 138 million to €1 830 million.

The group is able to manage the exchange rate exposure of its operating companies by matching foreign currency revenue with foreign currency expenditure. The group also strives to hedge itself against long-term foreign currency risks by matching financial liabilities in the same currency as the capital commitments these funds are intended for. The average exchange rate used for converting euro income and expenditure to rand was R7,8196: €1 compared to R7,9091: €1 for the year ending 30 June 2005. The closing exchange rate (rand:euro) was R9,1600: €1 (2005: R8,0965).

Given the first-time consolidation of Homestyle, the group has been more exposed to the British pound than in the past.

### Acquisitions

The most notable acquisitions that affected the group's comparable results in the current period were that of the Homestyle Group plc and Unitrans Limited.

Homestyle, acquired by Steinhoff on 30 June 2005, had no income statement effect on the group's 30 June 2005 results, although the balance sheet was consolidated for that period. In the current year, Homestyle reported turnover of GBP451,1 million for the 52 weeks ended 1 July 2006 and generated a pre-tax loss of GBP5,0 million before one-off reorganisation costs of GBP4,0 million. Homestyle's results had an expected adverse effect on the group's operating margins. The turnaround plan at Homestyle is well on track and adverse margins are expected to improve by the latter part of the following financial year.

The revenue of Unitrans (acquired 1 January 2005) included in the consolidated results of the group was R13,4 billion in comparison to only six-month turnover of R5,6 billion included in the results of the June 2005 financial year. Unitrans reported operating profit for the year ended 30 June 2006 of R552 million. The motor retail industry is notorious for its high revenue and low margins. During the year under review, the motor retail division segment contributed revenue of R10 324 million and operating profit of R327 million to the consolidated results of Unitrans. This segment's low operating margins, and the fact that only six months of the Unitrans results were included in the group's 2005 results, distorted operating margin comparability.

### Exceptional items (capital items)/non-headline earnings items

The restructuring of the group's timber interests in South Africa resulted in closure costs of R54 million (2005: R9 million), while the current-year impairment charge of R28 million (2005: R39 million) relates mostly to the impairment of capital investments in Zimbabwe.

## Restatements

### IFRS

The group is reporting under IFRS for the first time for the year ended 30 June 2006 and, accordingly, comparatives have been restated where required. The transition to IFRS has been accounted for in accordance with IFRS 1 (First-time Adoption of International Financial Reporting



Jan van der Merwe (Chief financial officer)



Frikkie Nel (Financial director)

Standards) with 1 July 2004 as the effective date of transition. The group also adopted SAICA circular 9/2006 retrospectively. The reconciliation between IFRS, South African Generally Accepted Accounting Practice and other restatements is detailed in note 40 of the annual financial statements of the group.

#### Circular 9/2006

Previously, the group had accounted for certain rebates received and settlement discounts granted as income and expense in the income statement. In terms of circular 9/2006 issued by the SAICA, these rebates received and settlement discounts granted need to be set off against turnover and cost of sales and, where applicable, estimated at the date the related asset is recognised and capitalised to the cost of the asset. As a result, the revenue and cost of sales in the comparative financial statements have been restated to reflect the net turnover or cost of sales and, where applicable, the income recognised has been reversed against the cost of the asset and the depreciation charged for the prior year decreased.

#### SIC 12 – Transaction recognition criteria

In circumstances where equity in a subsidiary or associate company is disposed and serves as security for the funding of the proceeds receivable, the accounting recognition of the disposal of such shares in the group financial statements is deferred until the funding subject to the security of the equity sold has been fully repaid.

During the June 2005 year, Unitrans (an associate at the time of the transaction) entered into a BEE transaction whereby it sold 11,6 million shares to an approved BEE company, Fundiswa. Fundiswa funded this transaction initially via a loan that was later replaced with preference shares. Steinhoff assisted Fundiswa in this transaction by providing security for the funding. During the time of the transaction, Unitrans was an associate of Steinhoff and Steinhoff did not assume control over the shares nor did it have any influence on the board of Fundiswa and therefore the transaction was viewed as a straight shares-for-cash transaction.

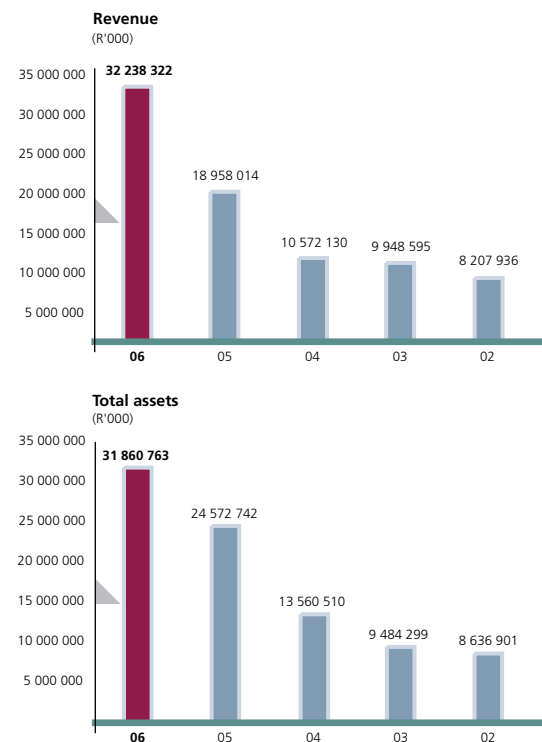
In the year under review, this view was revisited and subsequently changed. It was concluded that Steinhoff retains the majority of the risks and rewards pertaining to the 11,6 million shares, as Steinhoff will remain eligible to at least a 50% interest in equity participation (should Fundiswa dispose of the shares at any time in future) and that the guarantees from Fundiswa and its ultimate shareholders are not believed to be robust enough to argue that the majority of the risks from the transactions have been effectively transferred to Fundiswa. The revised estimate places the transaction within the requirements of SIC 12 (Consolidation of ‘Special-purpose Entities’ (SPE)) and Steinhoff is therefore required to account for the risks and rewards pursuant in Fundiswa (effective consolidation of Fundiswa). The comparable results and financial position have been restated accordingly.

A similar transaction was concluded during the year in which Steinhoff provided ultimate security for the funding which Micawber 455 (Proprietary) Limited, an accredited BEE company, utilised to acquire 26 million shares in KAP International Holdings Limited, an associate of Steinhoff, for a consideration of R86 million. The transaction is structured in the same manner as the Fundiswa transaction (described above) and as such the group’s current-year results include the effective consolidation of Micawber until the risks and rewards of this transaction will be transferred to Micawber.

#### Interest

Net finance charges were R291 million compared to R193 million for the year ending 30 June 2005. The increased finance charges reflect the group’s higher activity levels, and the full-period inclusion of the net finance charges of Homestyle, Steinhoff Asia Pacific and Unitrans. For the period ending 30 June 2006, interest cover was 9,1 times compared to 9,9 times for 2005.

Given the group’s global reach and strategy of low-cost manufacturing and sourcing in emerging markets and sales into developed countries, the group follows a policy whereby it maintains a balance between fixed and variable rate loans. This policy reflects more accurately the different



interest rate environments and the effect 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 maintain an overall competitive, market-related cost of funding.

In this respect the group has swapped all the US dollar-denominated cash flows relating to the seven- and ten-year US dollar notes into euro-denominated cash flows and a EURIBOR-linked variable interest rate to better match the inherent financial risks of this funding arrangement to the business environment the funds were intended for. The group has elected for the swap to be designated as a fair value hedge, and is valued as such in the financial statements.

## Cash flow and net debt

The major items affecting cash flow are summarised below:

	R millions	
	2006	2005
Cash generated before working capital changes	3 350	2 401
Working capital changes	(45)	(977)
Inventory	213	(146)
Debtors	409	(714)
Creditors	(667)	(117)
Cash generated from operations	3 305	1 424
Investing activities	(5 978)	(2 479)
Financing activities	3 375	3 036

The group continues to generate significant cash from its operations. The reduction in inventory and debtor levels in a period of higher activity is encouraging and reflects the group's particular focus on cash flow in measuring and rewarding the performance of its decentralised business units. The strategy to build long-term supplier relationships with a specific emphasis on being a preferred customer and long term price reductions through settlement discounts, etc is evident in the reduction of the creditor balances. All these factors led to a reduction in working capital

requirements from R977 million to R45 million which further increased cash generated from operations to R3 305 million (2005: R1 424 million).

As a result of the sustained quality of earnings, net cash flow from operating activities (as adjusted for dividends and capital distributions paid) per share increased by 140% to 237 cents per share.

Tax paid increased to R340 million (2005: R201 million), while the taxation charge increased to R428 million (2005: R213 million), representing a 17,5% tax rate compared to the 11,9% effective tax rate reported last year. The increased tax rate was mainly as a result of the full-year consolidation of Unitrans and Homestyle. Unitrans reported an effective tax rate of 32%, higher than the normal statutory South African corporate tax rate of 29%, largely as a result of one-off tax adjustments which are not expected to be repeated going forward, while the benefit of Homestyle's tax losses will only be accounted for when the business reports a profit, which is expected in the next financial year.

At 30 June 2006, Steinhoff had net interest-bearing debt of R3 566 million (30 June 2005: R1 894 million) resulting in a debt:equity ratio of 30% (30 June 2005: 21%), well within the group's targeted debt:equity range.

## Investing activities

### Investment in associates

#### *Amalgamated Appliance Holdings Limited (AMAP)*

AMAP is listed on the JSE and specialises in the manufacture, supply and distribution of household electrical and electronic durables. Following the disposal by Salton Inc of its interest in AMAP, Steinhoff acquired 53 259 690 AMAP shares for R264 million. The acquisition became effective on 1 October 2005. At year end, Steinhoff owned an effective interest of 26,65% in AMAP and equity earnings of R34,5 million were accounted for as associate earnings in the year under review.

#### *KAP International Holdings Limited (KAP)*

KAP is listed on the JSE and acts as a holding company for its investments in a diverse set of manufacturing

businesses. Effective November 2005, Steinhoff acquired 88,76 million shares in KAP. The purchase consideration of R316 million, equivalent to 356 cents per share, represented a discount of 6,3% to the closing market price of KAP's shares of 380 cents per share on 4 November 2005, being the date on which the purchase price was agreed. The acquired shares represented 20,97% of KAP's issued share capital. In addition Steinhoff assisted with a BEE investment (Micawber – see above) which increased the effective contribution by 6,14% to 27,11% and resulted in associated earnings of R28 million for the year under review.

### Investment in brands and operational improvements

The continued investment in brands, innovative operating strategies and operational improvements has resulted in strong organic growth in the manufacturing businesses across the globe. During the year under review, the group invested R3,5 billion in existing businesses to strengthen its future organic growth opportunities. The majority of these funds were spent in acquiring successful brands and improving existing manufacturing operations. Some brands acquired were subject to third-party license agreements. During the year the group incurred royalties of R338 million (2005: R238 million), some of which were paid in respect of the acquired brands. Investments in manufacturing operations included the acquisition of improved equipment expected to enhance efficiencies and secure innovations in the manufacturing businesses.

### Other investment and funding activities

The remaining R1,8 billion was invested in:

- The acquisition of the remaining shareholding in Steinhoff Asia Pacific Holdings (Pty) Limited. Steinhoff now owns 100% of this entity.
- The acquisition of the Cargo Homeshop retail business through its subsidiary, Steinhoff UK Holdings Limited.
- The selective participation in funding the expansion of select strategic retail partners in the European Union.

- The acquisitions of Unitrans Limited, most notably the investment in the UK-based logistical companies Concorde Logistics Services Limited and TechXpress Limited.
- The initial investments in the North Eastern Cape Forests joint venture and Goeie Hoop (Proprietary) Limited as described in the operational review of Africa.

## Depreciation

Depreciation for the period increased from R425 million to R637 million, mostly as a result of the full-year consolidation of Unitrans, a business that is asset intensive.

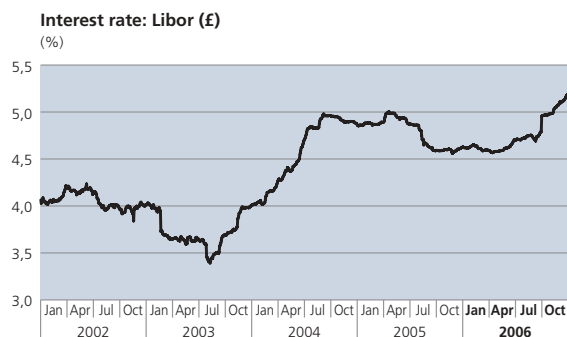
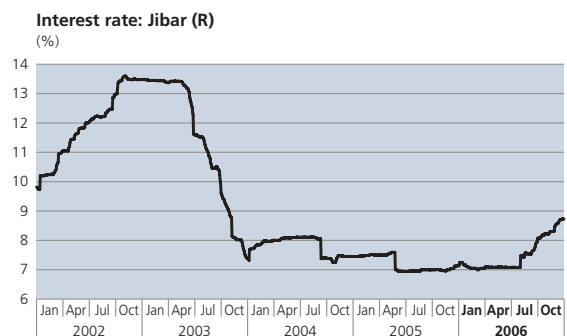
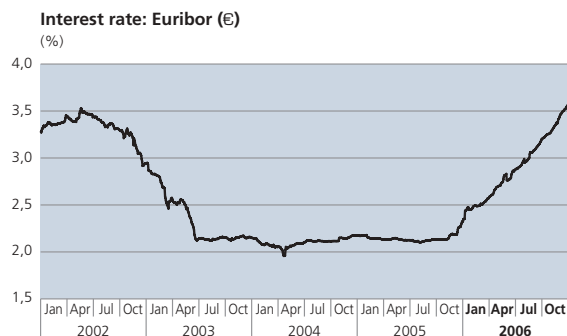
## Funding and borrowings

The group's day-to-day operations are financed primarily from own cash flows. The group's central treasury function operates a cash-pooling system that enables any cash shortfalls in business units to be funded by cash generated in the rest of the group or financed by short-term banking facilities.

### Convertible bond

On 30 June 2006, Steinhoff issued a seven-year, rand-denominated, convertible bond (the bond) to raise R1,5 billion (before expenses). The bond pays interest six-monthly at a fixed rate of 5,7% pa and is convertible into 54,74 million Steinhoff ordinary shares at an issue price of 2 740 cents per share (representing a conversion premium of 32,5% to the prevailing underlying share price at the date of pricing). The bond is convertible into shares at the election of the bondholders. The company holds, subject to conditions, rights on early redemption. The bond was issued exclusively to international investors and is listed on the Singapore Stock Exchange.

In terms of IAS 39, the convertible bond is a compound financial instrument and should be split in a liability and equity portion. Using the effective interest rate method, 78,53% of the R1,5 billion was recognised as a liability. The transaction cost was also attributed to a liability and equity portion, using the same allocation percentage.



The net proceeds from the bond are earmarked for investment in the North-Eastern Cape Forests project (NECF), described in more detail under the operational review section of this report.

**Variable rate, cumulative, non-redeemable, non-participating preference shares (perpetual preference shares)**

The group's permanent capital base was further strengthened by the net proceeds of R378 million from the issue of a further tranche of perpetual preference shares.

### Shareholder information

At 30 June 2006, the group had 1 141 billion shares in issue (2005: 1 131 billion) with the weighted average number of shares for the year being 1 133 billion (2005: 1 128 billion). At year end, the group's share trust held 4,7 million shares (2005: 4,1 million) which have been netted off against issued ordinary share capital as treasury shares. In addition, the company has reserved for allocation and issue on conversion 54,7 million ordinary shares under its obligations to the holders of convertible bonds issued on 30 June 2006.

For the year, headline earnings per share increased by 25% to 173 cents (2005: 138 cents), while fully diluted earnings per share increased by 22% from 134 cents to 164 cents. The balance sheet remained strong and net asset value per

ordinary share increased by 32% in rand terms to 953 cents from 724 cents in 2005. Return on average ordinary shareholders' funds for the period remained stable at 21%.

The closing share price at 30 June 2006 was 2 135cps with a high of 2 476cps during May 2006 and a low of 1 500cps during July 2005.

Liquidity in our shares remains high with 81% of the weighted shares in issue being traded during the 12 months (71% during the previous 12 months ending June 2005).

Throughout the past 12 months Steinhoff International Holdings Limited has been ranked in the JSE Limited's Top 40 Index in terms of both total market capitalisation and free float (100%). Steinhoff International Holdings Limited has provided investors with a 27,85% five-year compound growth in shareholder value.

### Share incentive scheme

The directors are authorised to issue, allot or grant rights to a maximum of 10% (2005: 10%) of the issued share capital of Steinhoff International Holdings Limited from time to time in terms of employee share incentive schemes. Certain details of participation in the share incentive scheme are set out in note 22 of the annual financial statements. The rights have been actuarially valued in terms of IFRS 2 and a charge of R40 million (2005: R46 million) has been accounted for as personnel expenses, as set out in note 3.3 of the annual financial statements.

### Distribution

Previously, we announced our intention to maintain distribution in accordance with historical policy and to increase distribution in line with performance after taking into account operational requirements. Going forward we are committed to grow distributions in line with earnings.

For the current year, the board have approved a cash distribution of 37,5 cents out of our share premium account. The company has substantial share premium which can be used for distribution.

**Net cash flow** from operating activities (adjusted for dividends and capital distribution) per share increased by 140% to 237 cents per share

## Key areas where management's judgement has been applied

### Depreciation rates

IAS 16 – Property, plant and equipment differs in certain respects from the previous SA GAAP equivalent, AC 123 – Property, plant and equipment, applied by the group until 30 June 2005. IAS 16 states that an entity is required to measure the residual value of an item of property, plant and equipment as the amount the entity estimates it would currently receive for the asset if the asset was already of the age and in the condition expected at the end of its useful life. The group has previously under SA GAAP accounted for residual values based on the requirement of AC 123. Although the group made use of all available market information in assessing the residual value and useful lives of these assets, these could vary depending on a variety of factors, such as technological advancements, property markets, etc.

### Decommissioning and restoration provisions

Changes in estimated decommissioning and restoration liabilities that occurred before the transition date to IFRS have been adjusted for at the transition date on a net basis in accordance with the provisions of IFRIC 1 and the applicable exemptions under IFRS 1. Estimating the future costs of these obligations is complex and requires management to make estimates and judgements as most of the obligations will only be fulfilled in the future, and contracts and laws are often not clear regarding what is required. The resulting liabilities can also be influenced by changing technologies and geopolitical factors in various countries.

### Impairments and fair valuations

Impairment assessments on property, plant and equipment, goodwill and intangible assets are performed annually. The intangible assets and goodwill impairment tests are mainly tested using the relief-from-royalty method or discounting the expected future cash flows generated by these assets. The relevant cash flow is then discounted using the weighted average cost of capital (WACC) and the present value of these cash flows is compared to the current net asset value and, if lower, the

assets are impaired to the present value. Management uses its best estimates when forecasting market conditions and expected useful lives that drive these calculations, but these estimates can also be influenced by changing technologies, product life cycle and geopolitical factors in various countries.

WACC drives many of the group's fair valuation estimates, for example the fair valuation of acquired intangible assets that are recognised in terms of IFRS 3.

The WACC rate differs from country to country. The resulting present value for similar cash flows year-on-year will be influenced by changes in the WACC rate. External uncontrollable variables such as rising interest rates influence the WACC rate, and could result in impairments. The principal assumptions used in calculating the carrying value of intangible assets are highlighted in note 9 of the financial statements.

Lastly, the group owns and manages timber plantations for use in manufacturing timber products. The Faustman formula is applied by an independent valuer in determining the fair value of the plantations. In the current year, the carrying value of the group's consumable biological assets was increased by R97 million. The Faustman formula is host to many variables such as cost of land per hectare, timber prices, timber yields, etc that are influenced by many factors and could result in material fluctuations in the fair valuations of the group's timber interest.

### Valuation of financial instruments

The valuation of derivative financial instruments is based on the market situation on balance sheet date. The value of these derivative instruments fluctuates daily and the actual amounts realised may differ materially from the value at which they are reflected on balance sheet date.

## Financial risk management

The group's success in its overall strategy is largely attributed to its business philosophy that supports decentralised, autonomous business units that trade in an arm's-length, entrepreneurial culture to remain

competitive. The board recognises that some elements of risk management can only be achieved on an integrated basis, and, as such, financial risks such as exchange rate risk, interest rate risk, liquidity risk, insurance risk and commodity price risks are controlled centrally as summarised above and explained under the risk management section of the corporate governance report.

The primary key performance indicators (KPIs) on which operational management are measured and used to manage the financial performance of the business proved successful and remain in place. These include:

- the analysis of sales and products against budget and how the business is regenerating itself in the short term
- trends in market and internal volumes which give insights into the underlying business growth
- cash flow generated
- cost growth rates, through which we manage and analyse the cost base in relation to sales
- operating profit margin progression over time, which demonstrates the overall quality of business and earnings.



Jan van der Merwe  
Chief financial officer



Frikkie Nel  
Financial director