

## Chairman and CEO report

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# Joint report by chairman and chief executive officer

## Dear shareholder

Steinhoff's 2006 financial year was a remarkable year for the group. Our investment, since listing, in our talented and committed team came to fruition in the current year, as evidenced by the revenue and earnings growth. The changes in the industry and global economy in recent years enabled the group to position itself as a global player which provided growth from a stable base and a global footprint, and will continue to do so in future.

The group's strategic, global positioning of its operations has yet again delivered the desired results. The business model of geographically spread operations and accompanying strategies of supply chain participation through vertical integration is the platform from which sustainable growth is being delivered.

The group's manufacturing and sourcing operations benefited from its investment in an expanded retail base. Despite challenging market conditions outside South Africa, the extension of the group's retail distribution base is poised to deliver sustainable benefits in future.

Trading conditions in continental Europe remain competitive, despite moderate signs of recovery.

The consolidation trend in these markets continues and the group is well positioned to exploit these through market coverage in terms of variety of product and price points as

well as sourcing networks. The investments in brands, both through development and acquisition, have benefited both the group and its strategic retail partners via exclusivity agreements. The Polish and Hungarian operations performed well. The Benelux region, through its accelerated roll out of the Henders & Hazel concept, showed a satisfying improvement in profitability towards the latter part of the financial year. It is anticipated that this concept will enable the Benelux operations to continue to grow under this new business model, which should contribute to improved performance in the years ahead.

In addition to growth in existing markets, the group continues to pursue and secure new markets. In the year under review, the group secured new sustainable supply agreements to Scandinavia, France and the Far East. These achievements were the result of its geographic reach and position as a preferred supplier to leading retailers in those markets.

In the UK, the group should continue to benefit from its investment in Homestyle. Despite difficult trading conditions and decisive restructuring actions, Homestyle is now well positioned to grow. Its operating profitability has already improved in the last six months of the financial year. The commercial relationship with Steinhoff, as a significant supplier to Homestyle, has exceeded initial expectations and benefited the group through incremental business from its retail distribution base. Steinhoff's UK manufacturing



businesses delivered a strong performance and are well positioned for further growth.

Consumer confidence and spending patterns in the Pacific Rim region were subdued, with the furniture retail market in Australia and New Zealand remaining static during the year under review. Focused rebranding initiatives, the development and store roll outs of the new brand, BayLeatherRepublic, and store format conversions are showing signs of improved performance. The International Sourcing division in China continued to perform well, and is rapidly becoming a key contributor to the continued success of the divisions it serves within the group.

South Africa's household goods sector continued to experience strong demand and Steinhoff Africa's furniture division performed particularly well due to its positioning to capitalise on increased consumer spending and a wider consumer base. The increases in fuel prices and the continued high consumer spending and its accompanying inflationary impact has resulted in interest rate hikes. This may cause a slowdown in the buoyant market conditions which prevailed for household goods. To address these effects, actions have been implemented in all southern African operations to remain competitive, while maintaining profitable growth.

PG Bison again delivered record results. All Steinhoff's timber interests have now been rebranded under the successful PG Bison brand. This resulted in an expanded integrated value chain, stretching from the plantations to value-added products supplied directly to the ultimate consumer.

The raw material division experienced tough trading conditions as a result of import competition. The textile division was repositioned during the year to improve future contribution.

The consistently sound operating performance delivered by Unitrans vindicates the group's investment in this company.

During recent years, we have made significant progress in creating value and enhancing our trading platform which

allows us to produce a stable, healthy cash flow throughout the economic cycle. This year's solid results were achieved against a background of a challenging world economy, volatile commodity prices, political instability in the Middle East and the impact of stronger operating currencies.

The results for the year under review represent an encouraging balance between Steinhoff's historical strengths, such as customer focus, and supply efficiency and return on the investment programme of the past few years. The return on recent investments also represents a healthy mix of revenue growth and enhanced internal earnings as a result of the extra volume and efficiencies group companies were able to realise from these investments.

Our integration philosophy of driving market-related internal efficiencies, coupled with acquisitive growth, will remain the focus of the group for the immediate future.

All new investments, assessed on a risk-adjusted return basis, are expected to be earnings enhancing and support our aim of retaining our credit rating for our principal operating subsidiaries and associates.



**Bruno Steinhoff (Executive chairman)**

## Performance

The highlights for the year were:

- Group revenues increased 70% in rand and 72% in euro
- Headline earnings per ordinary share increased 25% in rand and 27% in euro
- R3,3 billion cash generated from operations
- Net cash flow (adjusted for dividends and capital distributions paid) per share was 237 cents, up from 95 cents in 2005
- Distribution to shareholders increased 25% to 37,5 cents per share.

The group's revenues increased by 70% from R18 958 million to R32 238 million. A substantial portion of this increase was attributable to the first-time consolidation of the full-year results of Unitrans (2005: six months) and Homestyle which became subsidiaries with effect from January 2005 and July 2005, respectively.

The wholesale, distribution and retail segment of the business now comprises 71% (2005: 51%) of Steinhoff's group revenues. It is anticipated that this segment will be



**Markus Jooste (Chief executive officer)**

further expanded to facilitate increased participation through additional added-value segments of the supply chain.

The group generated 46% (2005: 52%) of its revenues in currencies other than South African rand, principally euro, pound sterling and Australian dollar. 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 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.

Headline earnings attributable to ordinary shareholders increased by 26% from R1 557 million in the year ended 30 June 2005 to R1 959 million.

Headline earnings per ordinary share increased by 25% to 173 cents (2005: 138 cents) with basic earnings per ordinary share improving 21% to 166 cents (2005: 137 cents).

The weighted average number of ordinary shares in issue was 1 133,3 million (2005: 1 128,1 million).

Ordinary shareholders' funds at 30 June 2006 amounted to R10 873 million (2005: R8 187 million). The return on average ordinary shareholders' funds was stable at 21%. The net asset value per ordinary share grew to 953 cents from 724 cents per share as at 30 June 2005.

The group's cash flow from operations was R3 305 million (2005: R1 424 million). Cash generation is calculated after taking account of the net increase in working capital of R45 million (2005: R991 million). Net cash flow from operating activities (as adjusted for dividends and capital distributions paid) is 237 cents per share (2005: 95 cents per share) and exceeded headline earnings per share at 173 cents, confirming the group's quality of earnings. Positive cash generation was achieved through good working capital management, as well as containing inventory and debtor levels, despite the substantial increase in activity levels.

The group's operating margin decreased, as expected, to 11,3% (2005: 12,5%) excluding, for comparative purposes, the lower margins of the motor retail business of Unitrans. The decreased margin is attributable to the inclusion of Homestyle and the retail operations in the Pacific Rim, which, as a result of continued tough trading conditions in the UK and Australasia, made lower proportionate contributions to group operating profits. The continued improvement and growth in the retail trading results is anticipated to impact favourably on margins. The group continues to benefit from improved efficiencies throughout the supply chain and the group's favourable terms of supply of finished products for resale. Margins should also improve once the current process of integrating and rationalising activities in the Pacific Rim, notably in the logistics function, have been completed.

## Balanced growth

The group will continue to drive efficiencies through its network of manufacturing, warehouse, distribution and retail trading platforms. Central to this strategy is the group's growing brand portfolio and the continued investment in its heritage of quality and affordability, innovation and branding excellence. This in turn will energise the core categories which comprise our business.

Steinhoff's international brand strategy, focusing on acquiring and developing key trade and consumer brands, is expected to continue which will lead to further sustainable growth. Steinhoff Africa's furniture divisions implemented various strategies to enhance the awareness of its different furniture brands. Steinhoff Africa's furniture divisions were the official shirt sponsors to the World XV rugby team. Steinhoff is the first South African-based public company to sponsor the World XV rugby team. Steinhoff co-branded the Steinhoff International brand with its strongest brands in South Africa and the UK. The ever-popular Grafton Everest and Harveys furniture retail brands were used for matches in South Africa and the UK, respectively. The key sponsorship objective was to generate brand awareness for the Steinhoff group.

The furniture division also sponsors the richest horse racing event in Africa, the Gommagomma Challenge. The next race is scheduled to take place on 5 May 2007.

In Europe, our growing brand portfolio is well positioned to enable us to penetrate new markets, while our continued investment in these brands aims to not only retain existing markets, but also expand to new consumer segments within these markets.

In Africa, our continued investment and focus behind our vertical integration strategy aims to hedge our supply risk, balance our business mix, and improve our market responsiveness which increasingly sophisticated customers demand.

Following Steinhoff's investment in Homestyle, the current year marks the start of our turnaround plan which focuses on improved awareness and market penetration. Above-the-line marketing spend was concentrated through advertising behind the core trade names such as Harveys, Bensons for Beds, Sleepmasters and Bed Shed. Encouraging results are already evident, and our market share position has improved across the focused range of categories identified to best suit our business model. Marketing investment will also continue to focus on the systematic upgrading and remodelling of Homestyle outlets, to better match changing consumer needs.

Careful review of in-store representation covering location, space and range for our key categories across both Freedom group in the Pacific Rim and Homestyle in the UK has yielded important insights into consumer behaviour at the point of purchase. The group's economies of scale, increased retail investment, and diverse supply structures enable its European retail outlets to improve operations such as stock management, increased floorspace utilisation and enhanced customer service. Further operational efficiencies and emphasis on the realignment of store layouts based on consumer demand is expected to drive earnings growth.

The development of the Henders & Hazel store-in-store concept in the Benelux countries has opened further

opportunities for the group in Europe. The concept secures dedicated floorspace and access to the consumer at lower investment than traditional routes. The concept further aligns the supply network's needs to that of the retailer and consumer, providing valuable insights into changing market conditions. The continued experience and benefits, for example optimum terms and speed to market, have yielded desired returns and future direction that will assist Steinhoff and our retail partners to offer superior consumer solutions.

The development and success of the Henders & Hazel concept, coupled with the success of the Esprit furniture and Novalife concept, have enhanced the innovation capabilities within the group and achieved a renewed organisational vitality among management. Innovation remains a key performance indicator throughout the group.

## Corporate activity

In addition to the corporate transactions detailed in Steinhoff's interim results announcement (8 March 2006), and those concluded by Unitrans and reported in its own results announcement (23 August 2006), the group concluded the following corporate transactions during the year under review:

- With effect from January 2006 Steinhoff, through one of its European subsidiaries, acquired the remaining issued ordinary share capital held by management in the retail operations conducted through Steinhoff Asia Pacific Holdings Pty Limited (formerly Bravoscar Nominees Pty Limited) in Australia and New Zealand. The purchase consideration was settled by the assumption of debt in Steinhoff Asia Pacific and the issue of Steinhoff shares, which are subject to certain "lock-in" arrangements with the management concerned.
- On 30 June 2006 Steinhoff issued a seven-year, rand-denominated, convertible bond (the bond) to raise R1,5 billion (before expenses). The bond was issued exclusively to international investors and is listed on the Singapore Stock Exchange. The net proceeds from the bond are earmarked for investment in the North Eastern Cape Forestry project (NECF), which is currently being developed by PG Bison.

- During the year Steinhoff continued to participate in funding expansions in the European Community of Poco International, its strategic retail partner in that region.
- Steinhoff Investment Holdings Limited issued a further tranche of variable rate, cumulative, non-redeemable, non-participating preference shares.

## Stakeholder philosophy

Raw material procurement is a crucial activity for a furniture producer, and the strategic emphasis now placed on this area of the business is also a major contributor to improved profitability. Operationally, plant efficiencies continue to receive ongoing focus, and we look forward to continued steady improvement in the coming year.

Customers will continue to lead our business. Customers' perceptions of our ability to create value for them are fundamental to our ability to maintain and grow our business. Innovation and differentiation in our products, customer service and people will continue to be the key behind driving value throughout our organisation.

The board views our shareholders and the broader investment community as partners in the business and strives to create value for these stakeholders in return for their continued faith and active interest in the group.

Our access to capital markets and our ability to attract debt at acceptable cost will continue to remain a key focus of the group.

Competitive tax rates and tax exemptions in developing countries have played a major part in the development of the group and sustained job creation in these areas. The group remains committed to attract tax dispensations and take great care in our business tax planning to retain our sustainable and competitive position aimed at fulfilling our staff's long-term goals.

Our core values espouse integrity, concern for the safety of people and the environment, continuous improvement, accessibility and accountability. We strive to listen to our stakeholders and share what we learn. In addition to our spirit of transparency, we have developed many leading-edge policies, including our approach to corporate governance and communications. Our well-received sustainable development report demonstrates our efforts to collaborate with all stakeholders. Our success in this area is important to maintaining approval from our communities and protecting our licences to operate.

Steinhoff and its competitors operate in a global environment across many different jurisdictions around the world. The furniture industry remains a labour-intensive

**Central to our strategy** is the growing  
brand portfolio behind a heritage  
of quality and affordability

industry and the organisation continues to work closely with a number of industry stakeholders to ensure that trade agreements are adhered to and products, services and capital are allowed to move unencumbered and the group is able to compete internationally.

We welcome the developments on long-term infrastructure projects expenditure in South Africa as this creates jobs, reflects confidence to the international investor community and ultimately provides the country with competitive logistical and societal support services. The capability of government to provide both the finance and organisational capability to deliberate, prioritise and deliver on important infrastructure projects has improved significantly. It signals confidence in the region.

Disappointingly, the better performance of the South African economy over the last three years has done little to reverse the downward trend in formal sector employment or to relieve poverty. The sustained high fuel price and recent increases in interest rates, driven by the volatile rand and rapid rise in consumer and producer prices, are placing strains on the economy. The weaker rand has recently driven up inflation and, while it is possible that interest rates might increase further in the short term, we expect that interest rates and inflation will turn favourable in 2007 and that the economy will once again move towards targeted levels.

## Our values

Our decentralised operations are bound by a set of shared corporate values across the whole of the Steinhoff group.

These are:

- putting the customer first at all times
- valuing teamwork as a means to attain our objectives
- striving for consistency and excellence in all our operations
- creating an environment of trust and mutual respect
- relentlessly pursuing results.

By believing in the same things and behaving in the same manner, we ensure that our customers enjoy a constant quality of experience in every location. We attract, recruit and retain talented people to give Steinhoff a distinct competitive edge in the marketplace: a clear and strong company culture supports this goal.

Our purpose in formalising and communicating the values to our people is to embed them into the fabric of our organisation. To do so, we encourage our teams across the globe to discuss what each value means to them in their local environment – it is vital that our people are involved in their interpretation and understanding how to apply them.

Having a strong sense of who we are and how we operate not only enhances customer experience, it also aids the

integration of businesses we have acquired by fostering a shared sense of purpose.

Our strategy is clear. The Steinhoff Way ensures we have a common set of operational tools and processes. Our values will affect the way we go about delivering value and create a positive working environment to be proud of.

## Our people

At Steinhoff, we recognise our people as a valuable asset. We aim to be an employer of choice, attracting and retaining high-quality individuals to ensure we continually enhance our performance and achievements.

We recognise that the continued development of our employees is integral to the successful delivery of our strategy. We have therefore introduced a formal worldwide programme to ensure sustained efforts in branding the group, among future and current employees, as an employer of choice.

Our entrepreneurial management team is experienced and knowledgeable in our business. Our culture aims to be non-bureaucratic and to encourage leadership at all levels. Our challenges are to recruit and retain the best people in our industry and to continue to develop an entrepreneurial culture built on responsible risk-taking.

Management compensation is linked to those of shareholders through a long-term incentive plan tied to total shareholder return and a short-term incentive plan based on variables that we believe correlate to shareholder return.

Compensation policies have been developed to attract and retain the best people for our business.

To protect the future of the group, the board and the human resources and remuneration committee reviews succession planning annually. Formal programmes have been adopted to encourage advancement from within. Certain positions have been designed as training positions, giving management candidates an opportunity to develop a wider skill set and knowledge base.

**We aim to be** an employer of choice,  
securing enhanced performance and top  
achievements

## Corporate governance

Steinhoff seeks to comply with best practice and the principles underlying corporate governance. We believe we have a board with the diverse talents needed to ensure good governance as well as guiding the group strategically and commercially.

The group supports sound practices which are increasingly being demanded in terms of good corporate governance. Policies and control systems for managing risk, our environment, business ethics, black economic empowerment, affirmative procurement, occupational safety and health, HIV/Aids, product quality and many others are firmly entrenched as a way of daily operational life in the group.

Many of the group's strategies are long term by nature and consequently our environmental and social practices have become a natural part of our business. We believe this forms part of our corporate and social responsibility which is important for long-term business sustainability and success.

The board recognises that available capital from international markets is increasingly being invested in companies operating in economies which demonstrate sound corporate governance practices and an overall commitment to sustainability.

## Building on our strengths through synergistic, organic and acquisitive growth

Steinhoff has prospered and grown since listing, despite operating in an extremely competitive marketplace and competing against major international players. Future growth in the domestic economy and the recovery of the economy in the Pacific region and the European Community will present the opportunity for organic growth for which the group is well positioned. We believe that Steinhoff has developed an international competitive ability through its processes and people which can be judiciously expanded globally to generate further growth. We continue to look for opportunities that will enhance value creation, expand our

geographic footprint and meet our criteria for affordability, risk profile, potential competitiveness and sustainability.

The goals we have set for ourselves are:

- Continue to provide superior return on investment that exceeds cost of capital, outperforming our peer group in total shareholder return
- Work to align our people practices with our business goals, emphasising consistency, fairness, shared responsibility and rewards
- Achieve a competitive advantage in all business segments by improving our cost positions while using our efficient systems to be a low-cost supplier
- Deliver top-quality products with superior customer service to remain the preferred supplier to existing customers, while developing new markets for our expanded production base and attracting and retaining new customers.

## Outlook

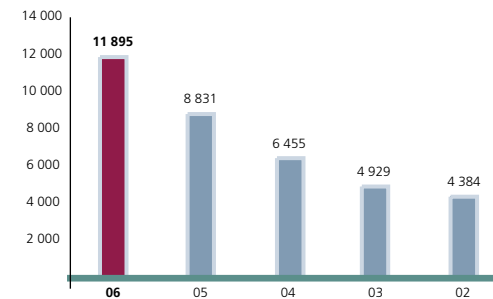
We believe our strategy of meeting jurisdictional requirements, together with greater vertical integration, provides synergies supporting growth for the year ahead.

The restructuring of Homestyle continues. It will provide a sound base from which its turnaround in the latter half of the year under review is expected to continue to deliver substantial growth in operating profits. As a result, the balance of the group's operations in the UK, Eastern Europe and Pacific Rim also stand to further benefit from their trading relationships with Homestyle.

In the German region, the group continues to grow through its existing brand and product strategy, and relationships with major retailers, mail order companies and buying groups. The new Esprit product range has been successful, with 120 studios already opened and further roll out planned. The group continues to investigate opportunities for brand expansion through own-brand development and acquisitions. The German economy is showing moderate signs of recovery and increased consumer confidence. The level of order books for the group's main product categories and new ranges is growing. The successful Henders & Hazel store-in-store

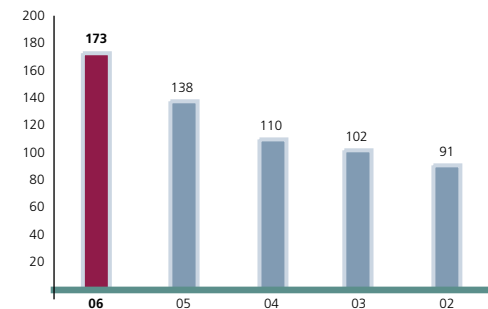
Shareholders' funds

Rm



Headline earnings per share

(cents)



concept of our Benelux operations is being extended to other European destinations.

Steinhoff International Sourcing in China will increasingly contribute to the success of the divisions it serves, in particular the UK region, Australasia, the German region and South Africa. The sourcing base is being expanded to increase the group's supplier base. Initiatives are well advanced to improve the logistics and distribution function to provide a more efficient service to the group. In respect of Australia, project "Renew" (the repositioning of the existing Freedom brand) and new store openings under the BayLeatherRepublic brand all bode well for improved performance in the current financial year and beyond.



The South African retail sector is expected to become more competitive as a result of macroeconomic factors impacting on consumer confidence and disposable income. The combination of the timber interests and their rebranding under PG Bison is expected to deliver sustained growth in future. PG Bison's NECF particle board project is well under way and is expected to be commissioned in January 2008, which will add capacity of 1 000m<sup>3</sup> of particle board per day. This will further strengthen and improve PG Bison's competitive position in import replacement and the anticipated continued high level of demand in the structural industry.

The acquisition by Unitrans of Concorde Logistics and TechXpress provides a base for Unitrans' international expansion, and these acquisitions will assist in exploiting synergies within the larger Steinhoff group. It is anticipated that Unitrans will deliver a satisfactory performance in the current financial year.

Management expects to achieve growth in headline earnings from continuing operations for the current financial year.

## Appreciation

We wish to extend our sincerest thanks to our shareholders, bankers, analysts and brokers for their continued belief, contribution and investment in the group during this year. To our sponsor, advisors and consultants, thank you for your contribution to our achievements and success this year.

To our most important asset, the employees of Steinhoff, we thank you for the continued hard work, effort and enthusiasm with which you embrace and live our vision and strategy.

As always, we express our gratitude to our board and committee members for their diligence and attentiveness throughout the year, contributing to the growth of the business and its shareholder value, as well as entrenching exemplary corporate governance.

## A final word

We believe several aspects characterise Steinhoff as we know it today: Leadership in our industry, our commitment to innovation and our passion to deliver. We are conscious of our commitments to various stakeholders and are confident the organisation is well positioned to deliver to expectation.

**Bruno Steinhoff**  
*Executive chairman*

**Markus Jooste**  
*Group chief executive*