



Incentivisation

A transparent and competitive environment encourages outstanding performances that are justly rewarded. True empowerment – achieved by setting people free to grow and reach their full potential.

- 18 years of sustained growth in shareholder value
- Annual compound growth rate in headline earnings per share in excess of 30% over the past 18 years
- Revenue for the year grows 23,0% to R77,3 billion
- Operating profit up 22,3% to R3,7 billion
- R4,1 billion generated in cash with wealth creation of R13,9 billion
- Income attributable to shareholders rises 21,8% to R2,4 billion
- Headline earnings per share of 804,6 cents, up 22,6%
- Total distributions per share of 369,0 cents per share
- Successful transition to IFRS reporting



Peter Nyman
Financial director



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Introduction

Financial results were pleasing, with good contributions from Bidvest's international businesses, notably the new European acquisitions. Within South Africa, increased investment in national infrastructure, construction sector growth and buoyant consumer spending proved beneficial for several divisions. However, a stable but strong rand for much of the period increased international competition, keeping margins under pressure.

Despite these challenges, all business units maintained strong cash flows.

Bidvest maintained its record of sustained growth in shareholder value. The compound annual growth rate in headline earnings per share over 15 years is 25,8%. The growth rate is somewhat understated as headline earnings per share for the early years were not adjusted for International Financial Reporting Standards (IFRS).

People often ask why there is a difference between the 18 years of our existence and our financial reporting over 15 years. The explanation is that for the first three years of our existence Bidvest had a holding company structure and results for that period are not comparable and therefore are not included.

In 2006 we adopted IFRS. The effect was a reduction in the previously reported 2005 profit attributable to shareholders by R93 million.

Highlights

Revenue grew 23,0% to R 77,3 billion (2005: R62,8 billion) and includes the contribution of Deli XL for the first time. Operating profit was up 22,3% at R3,7 billion (2005: R3,0 billion).

Headline earnings per share of 804,6 cents reflect growth of 22,6% (2005: 656,4 cents).

Profit attributable to shareholders of the Company rose 21,8% to R2,4 billion (2005: R2,0 billion).

Cash generated by operations was R4,5 billion (2005: R4,2 billion) while wealth created rose to R13,9 billion (2005: R12,0 billion).

International growth and disposals

International acquisitions and offshore disposals are highlighted.

In respect of Lithotech France the most practical and ethical way of resolving a frustrating situation was to dispose of the business to a consortium consisting of management and write off the loss. To save French jobs, we also agreed to finance a €7 million loan to the new owners, secured by bonds on the business, French properties.

In an unrelated development, another business based in France – Ontime's French national car transport subsidiary, was closed down. The operation proved unprofitable despite extensive restructuring.

Debt and deal-making

The Deli XL transaction was funded through Bidvest's banking facilities. The arrangements in no way impair Bidvest's ability to carry through major transactions, both within Africa and offshore.

Bidvest debt is currently at historically high levels, yet the debt-to-equity ratio remains within the target level of 40%. The Group has been criticised by some analysts for its cautious approach to debt and its "lazy balance sheet". We believe our approach is prudent, particularly in view of the potential for extreme volatility in South Africa.

Higher gearing was prompted by a particularly favourable interest rate climate. Within South Africa, rates were at

the lowest level in a generation until the 0,5% increase by the Reserve Bank in early June. Bidvest exploited the opportunity to borrow at extremely competitive rates. The Group is an acquisitive company and further gearing will be utilised should favourable opportunities present themselves.

Our balance sheet remains strong. Bidvest develops cash-generative businesses to their full potential, instils a culture of vigorous capital management at operational level and uses cash from mature businesses to fund growth businesses and acquisitions. This pragmatic approach has served us well and will not be abandoned. Bidvest's credit rating has been maintained.

Greater flexibility

Increasing flexibility is evident in Bidvest's approach to ownership when examining possible acquisitions. Traditionally, Bidvest has preferred to take 100% equity ownership which results in control of the cash flows and no conflicts of interest between the shareholders and the business.

There are occasions, however, when Bidvest no longer strives for 100% control. Greater flexibility is necessary for various reasons.

Many Bidvest divisions are industry leaders, particularly in South Africa. A strategic interest rather than full control of a related business enables Bidvest to continue to grow.

In South Africa, Bidvest is mindful of its BEE responsibilities. The Group contributes to enterprise development by supporting black-owned businesses. There may be occasions when operational support and facilitation of a company's growth strategy can best be accomplished by buying equity without affecting the status of the original black owners as majority shareholders.

In some markets in which Bidvest has little experience, there are good grounds for limiting one's exposure until a better understanding of the region has been developed. We, therefore, preferred to take strategic stakes in the initiatives in Dubai and India.

In areas of Bidvest core competence our focus is still 100% ownership. In other areas, the Group will be flexible and judge each case on its merits.

International standards

The current accounts are IFRS compliant. The 2005 accounts were restated to permit meaningful comparison. We decided not to restate 2004 numbers to enable us to present a three-year picture in the financial statements, as the effort and cost far outweighed the potential benefits, particularly in light of the relatively minor effect of IFRS on the results. The new accounting approach offers an investor a common base of understanding across multiple jurisdictions and businesses. However, after more than a year of work on the IFRS conversion, we continue to hold reservations.

IFRS helps the experts. A common accounting methodology is employed by listed companies wherever they are based. However, the methods can be complex. Numerous oddities occur and have been thoroughly debated in professional journals. As a result, these quirks are understood by the specialist, but not the layman.

This shortcoming has received relatively little attention. For several years, the need for transparency in corporate affairs has been emphasised. Transparency surely cannot be promoted when some aspects of the accounts are opaque from a non-specialist's perspective.

Without a thorough understanding of the nature of calculations, the non-specialist is lost. This situation sits uncomfortably with the overall intention of corporate reforms; namely, to foster improved governance by

making the workings of a business understandable to all stakeholders, not just sophisticated investors and accounting professionals.

Furthermore, IFRS creates another level of complexity in trying to manage one's business. In Bidvest we manage the business with a returns focus on actual cash flows rather than by complicated IFRS standards.

Incentivisation

IFRS requires share-based payments to be recognised as an expense at the date of grant and, therefore, introduces an additional non-cash expense into the financial statements. The cost of Bidvest share-based payments in 2006 came to R50,1 million (2005: R37,6 million).

Bidvest has a special interest in the application of share options as a means of enhancing performance. Over many years, share options have shown themselves to be an effective tool in leveraging Bidvest success and rewarding our "owner-managers" for exceptional efforts.

Bidvest is carrying out a review of its share option schemes and, notwithstanding the financial implications of options at this stage, will continue to use this tool as a motivator for staff and a reward for exceptional performance.

Share buy-backs

As part of the BEE initiative with Dinatla in 2003, existing shareholders were awarded options to acquire shares in Bidvest at R60 per share. It is anticipated that in December 2006 option-holders will exercise their rights to the 18 million shares available to them.

In order to minimise the dilution, Bidvest acquired an additional five million shares on the open market. The buy-back programme cost R508,8 million in 2006 (2005: R532,1 million) and the shares are held as treasury shares.

Applauding government

BEE funding in both listed and unlisted South African companies may become easier as a result of government's proposed amendment to section 38 of the Companies Act. This clause currently prevents a company from providing financial assistance to a third party to enable the third party to buy equity in the company.

The effect of the current legislation is to stop a business from securing a strategic BEE partner because the prospective black owners cannot raise sufficient funding without a "hand-up" from the company.

Bidvest called for the removal of section 38 in last year's annual report because of the adverse effects on BEE ownership initiatives. We understand that an amendment is imminent with the necessary proviso that financial assistance from the company requires the special approval of its shareholders and may not be advanced if it endangers the solvency of the business.

Bidvest applauds government for taking prompt action to clear this obstacle to wide-ranging BEE ownership.

The government is also considering the deductibility of interest for tax purposes in respect of shares purchased in a BEE transaction. It might also be appropriate to consider the extension of interest deductibility to all share purchases.

Government action

Another initiative by the South African government – abolition of the Regional Services Council levy – is also welcomed. The expected saving at Bidvest in 2007 will be in excess of R50 million. The abolition reduces the cost of doing business while cutting red tape. The effects are particularly positive for small business.

In recent years, South Africa's democratic government has demonstrated that it is both amenable to suggestion and extremely efficient at revenue collection. The receipts of the South African Revenue Service have significantly exceeded expectations, creating a possible opportunity for further review and reform of certain aspects of our tax system. The Group paid R14,7 billion in taxes and duties of which R12,9 billion was paid to South African authorities, most of which was collected on behalf of government.

Business risks

Bidvest is exposed to numerous financial risks; including interest and exchange rate risk. Risks cannot be abolished, but they can be mitigated. The Bidvest structure creates a balance due to its geographic spread and wide range of multi-faceted businesses.

To some extent the Group is protected from an interest rate rise due to our long-term loans which locked in relatively low interest rates.

The rand's vulnerability was evident at the close of the financial year while its ability to stage a recovery was apparent a few weeks later. The gyrations underline the prudence of the Bidvest policy of taking forward cover and conservative gearing policies.

The contribution of Bidvest's offshore interests – already considerable – is enhanced by a depreciating rand. Some consumer-focused South African businesses may achieve higher sales when the price of imports falls. Those engaged in local manufacture can be adversely affected, however.

Similarly, the interest rate climate affects different Bidvest businesses in different ways. Higher rates inhibit credit

extension and can constrain sales to the consumer. However, higher rates and inflationary pressures may prove beneficial in business-to-business trading activities.

Diversification does not make Bidvest risk-neutral. Bidvest is an opportunistic and acquisitive business; misreading the potential within an acquisition is an abiding risk. Tension is evident between the urge to grow and the need to become more watchful as scale aggravates the consequences of one false step. Early in Bidvest's life, a deal-making miscalculation involving a small or mid-size transaction was easily manageable. At a higher level of magnitude, the consequences could be more severe.

Bidvest's track record indicates this risk is well managed, but there is no room for complacency. Business risk receives intense scrutiny at Bidvest. To this end, the risk committee is being expanded to harness fresh opinions and ensure vigorous debate across a wider forum.

The future

Inflation is expected to trend higher in the coming year while interest rates in South Africa – and some international markets – are moving to higher levels. These factors suggest that deflationary pricing pressures may ease to the benefit of many of Bidvest's trading businesses.

Bidvest divisions are strongly cash-generative. Considerable resources are available for continuing investment in new capacity and infrastructure. The strong financial base also creates a platform for further growth, both organic and acquisitive.

Personal note

I have served Bidvest as financial director for over 15 years. The position has provided an opportunity to work with stimulating and insightful executives and directors on four continents; for which I am most grateful. I am currently working with my successor, financial director designate David Cleasby, and have the satisfaction of knowing that I will be leaving my portfolio and the Group's shareholders in good hands.