

Chief financial officer's report



Alex Smith Chief Financial Officer

INTRODUCTION

This report is intended to provide additional insight into the financial performance of the Altron group as well as some of the key financial risks that have been identified. The report needs to be read in conjunction with the consolidated annual financial statements presented on page 106 to 189.

As referred to in the chief executive's review, the impact of the slow recovery in the South African economy continued to impact our group and in this regard the financial year ended 28 February 2010 reflected the benefit of the diverse portfolio of businesses included in the Altron group. Each of the group's three main areas of focus, represented by Altech, Bytes and Powertech, experienced different dynamics dependent on the nature of their revenue streams and the sectors that they service. In particular, the strong annuity income base of Altech offset margin pressures at Bytes and the low level of demand experienced by Powertech.

FINANCIAL PERFORMANCE

Altron's results were significantly affected by both of these factors, although the impact differed at each of the subholding companies. The primary effect can be seen in the group's revenue line which declined by 10%, primarily due to the poor performance by Powertech where revenue declined by some 25%.

It was pleasing that our overall EBITDA margin remained relatively stable at 8.9% compared to 9.0% in the prior year through good margin enhancement at Altech which offset the declines experienced at both Bytes and Powertech. The EBITDA performance of each of the subholding companies was as follows:

- > Altech's EBITDA margin improved from 11.6% to 12.7% as a result of the resilience of its larger operations, the increased contribution from the higher margin East African businesses as well as increased margins from its various acquisitions concluded during the year.

- > Bytes' EBITDA margin reduced from 7.1% to 6.6% as a result of margin pressure across many operations. However, the margin pressure was compounded by poor performances from the Bytes Specialised Solutions Retail ATM business and the Bytes Document Solutions UK business.
- > Powertech's EBITDA margin reduced from 7.8% to 5.9% driven by the reduced volumes through many of its businesses but more specifically in the cables business.

The performance of the rand had a dramatic effect on the group in terms of foreign exchange losses as well as a reduced rand contribution from our growing number of offshore operations. The impact of this is shown in the table hereunder and demonstrates that by excluding this factor our EBITDA margin in fact improved to 9.3%.

Impact of appreciating rand

	Altech	Bytes	Powertech	Altron
EBITDA	1 165	393	424	1 987
EBITDA margin	12.7%	6.6%	5.9%	8.9%
Forex losses	23	25	60	91
Effect of translation of foreign operations	51	6	3	60
Adjusted EBITDA	1 239	424	487	2 138
Adjusted EBITDA margin	13.2%	6.7%	6.6%	9.3%

Effect of translation is difference between current year results translated at average rates for full year, versus average rate for prior full year.

Depreciation and amortisation charges increased from R438 million to R510 million (16%), reflecting the substantial investments that have been made in the group over the past three years, both in terms of capital expenditure and acquisitions. This, together with the lower activity levels, resulted in operating profit declining by 18% to R1.5 billion, reflecting an operating margin of 6.6%.

Capital items represented an expense of R105 million in the current year compared to R21 million in the prior year. The main items in the

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current year were the R66 million write-off of intangible assets within Altech UEC and goodwill impairments of R75 million, offset by R35 million of profits arising on the disposal of various assets. The goodwill impairments reflect the underperformance of Powertech Calidus (R21 million), Powertech IST Industrial (R20 million) and Bytes Document Solutions UK (R30 million). Although it was disappointing to have to again reflect goodwill impairment in Powertech IST this year, it was applicable to a different division. As indicated last year, the way in which goodwill has been allocated in this business could result in repeatedly creating these issues if all the businesses do not perform consistently with our original expectations. The IST Industrial division is dependent on large capital projects, and has been negatively affected by the consequences of the financial crisis. If all the IST divisions are aggregated and compared to the original purchase price, no write-downs of goodwill would have been required.

The group has seen a significant reduction in its net finance costs of 30% from R108 million to R76 million due to a combination of improved working capital management as well as the benefit of lower interest rates. The net effect was that profit before tax reduced by 22% to R1.3 billion.

Our tax charge for the current financial year amounted to R457 million, 13% lower than the prior period and representing an effective tax rate of 35.2%. If the impact of STC and capital items is eliminated from each period, our effective tax rate amounted to 29.7%, compared to 27.0% in the prior year. The differential in the current year from the statutory rate is primarily due to the non-recognition of a deferred tax asset in respect of tax losses in Altech UEC where we are entitled to claim a 150% deduction in respect of research and development costs. However, given the profitability levels in that business, it was not considered prudent to recognise any such asset. The higher effective tax rate increased the decline in profits to 27% and, after minority interests are taken into account, the profit attributable to Altron equity holders was down 35% at

R543 million for the year. With a minimal increase of shares in issue this year, basic earnings per share were down 35%, headline earnings per share decreased by 28% and adjusted diluted headline earnings per share declined by 22%.

Financial position

The strong rand also impacted the balance sheet, being the key driver behind the reduction in net asset value per share from R15.50 to R15.04. Foreign currency translation differences for the year amounted to R432 million which, after adjusting for minorities, erased 86 cents off our net asset value per share.

Despite this effect, non-current assets increased from R5.2 billion to R5.8 billion, reflecting the substantial investments made in income-generating assets in the current year of some R1.1 billion and a further R192 million on acquisitions. The majority of the investment was made by Altech in its East African operations. Included in intangible assets are some R600 million of capacity acquired on the Seacom and TEAMS undersea cables with estimated useful lives of between 15 and 20 years. The increase in property, plant and equipment is primarily driven by the continued investment into data cable infrastructure in East Africa and reflects total capital expenditure of R751 million.

The reduction in the investment in working capital has been particularly pleasing with some R384 million of cash generated. While cash and cash equivalents appear to have reduced by R853 million on the face of the balance sheet, these amounts must be netted off against the bank overdraft balances within current liabilities. If this is done, there has been virtually no movement in our net cash balances against the prior year, despite the fact that R1.2 billion has been applied in investing activities.

The group remains very conservatively geared at 25.8% on a gross basis and 7.3% on a net basis. Gross borrowings increased slightly to just over R1.6 billion, though included in this figure are R363 million of future payments related to Altech’s Seacom capacity purchase. If this is excluded, borrowings actually declined by nearly R300 million. Our focus in the coming year will remain on cash generation and further reduction in borrowings.

At the balance sheet date, the group had no contingent liabilities. No information provided in previous reports has been restated and the group has received no financial assistance from government in the current year.

Included at the end of this report is the value added statement for the year under review. Value created of R5.5 billion declined by 6% compared to the prior year, reflecting the lower activity levels. Value created per employee increased by 2% and corporate social investment increased to 6.7% of profit after tax.

KEY INTERNAL INITIATIVES

Management of working capital

As a result of the global financial crisis in late 2008 and the identification of access to funding as a key risk area, one of our main focuses was the management of working capital in order to reduce funding requirements in this regard and also to pay down some of the debt taken onto the balance sheet in recent years.

As is evident from the graph on working capital days, I am pleased to be able to report that the group significantly reduced its investment in working capital over the year. All the underlying businesses contributed in some way to the R384 million of cash generated out of working capital, with the largest contribution coming from Powertech. Due to diligent focus on reducing inventory levels, particularly at Aberdare Cables, these levels reduced from 46 days to 43 days. Debtor and creditor days were maintained at acceptable levels, resulting in the net investment in working capital reducing from 21 days to 18 days.

Working capital				Days
2010	(81)	43	56	18 net working capital days
2009	(81)	46	55	21 net working capital days
2008	(89)	48	57	16 net working capital days
2007	(85)	58	53	26 net working capital days

Accounts receivable days
 Inventory days
 Accounts payable days

The challenge for the coming year will be to maintain the same discipline while growing the revenue line. However, given our desire to continue reducing gearing on the balance sheet, the focus will remain on working capital management in order to minimise funding requirements associated with the expansion of the business – keeping net investment in working capital at below 20 days.

Capacity alignment

Over the last 18 months there has been a substantial reduction in demand in Powertech's manufacturing businesses, particularly at Aberdare Cables, where volumes were down some 40% from the peak. Given the high fixed cost base and with no signs of significant recovery, it became imperative to restructure capacity to fit the new demand levels in order to achieve acceptable returns on capital invested.

A great deal of work has been completed on restructuring the cost base, involving a headcount reduction of more than 1 000 employees as well as various other cost-cutting initiatives. Although the impact is not evident in these results it should be felt more significantly in the coming year.

Management of the cost base

Cost control was identified as a key mechanism for protecting the performance of the group and the focus has been on examining and reducing unnecessary cost structures within all the group's operations.

The most significant progress has been made in the Powertech group, driven by the necessity of rightsizing the manufacturing capacities as discussed above. However, the focus was not merely on manufacturing costs, but also on sales, general and administration costs. A key component of these costs is personnel costs although the impact of skills shortages makes it difficult to contain costs in this area. As a result the most meaningful cost control was in respect of non-remuneration expenses. At Altech and Bytes, costs were contained to around 2%, well below an inflation rate of 6% and at Powertech a much more aggressive approach reduced costs by some 17% compared to the prior year.

Cost control continues to enjoy a high priority in the way we are managing the various operations around the group. With the recovery still muted, we will ensure that our attention remains in this area in order to maximise the profitability of the group.

Adequacy of the finance function

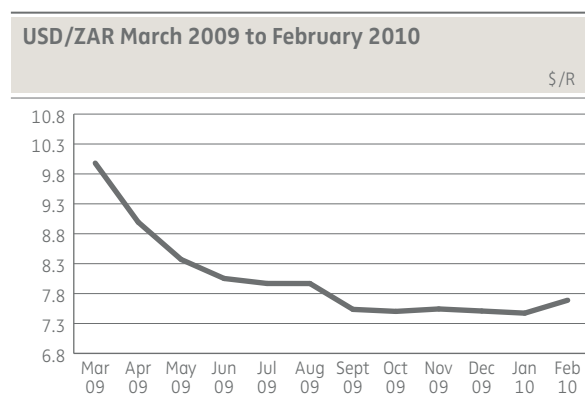
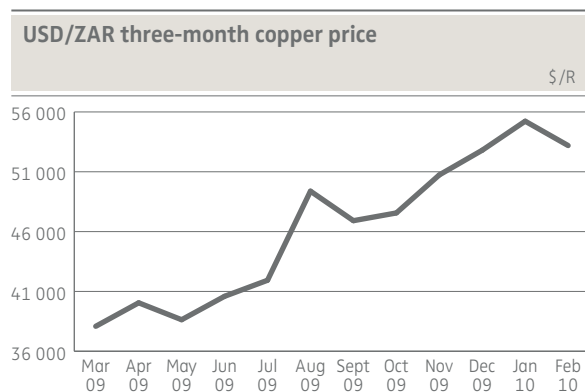
During the year we reviewed the adequacy and expertise of the group's finance function through an internal process. We believe that the finance function is appropriately staffed, though some areas of weakness were identified. These principally related to new acquisitions, where the finance departments are being transitioned to meet the requirements of a large, publicly listed group. Action plans have been developed to address the areas of weakness and are being implemented.

KEY FINANCIAL RISKS

Access to funding

This risk should be seen in the context of the R500 million loan funding due for repayment on 3 September 2010. Access to funding was extremely significant for the group although liquidity constraints have started easing during the course of this year, particularly in terms of larger blue-chip corporate entities. Furthermore, the significant work done on the balance sheet has resulted in a reduction in interest-bearing borrowings and a good cash performance from the group.

In the light of this and assuming no further economic shocks which may change the liquidity environment, we do not perceive a significant risk attached to the refinancing of this loan.



Commodity price movements/foreign exchange movements

The volatile environment in which we operate is most evident in commodity prices and in the movements in foreign exchange rates, both significant risks areas. The group's policy is not to speculate in these areas and the risks are managed as follows:

- > Foreign exchange exposures, where there is no natural hedge available, are hedged immediately through the use of forward exchange contracts. This is done centrally through Altron treasury in order to leverage off our purchasing power, effectively monitoring, controlling and ensuring compliance with exchange control regulations. Compliance is monitored both by internal and external auditors. This conservative approach to foreign exchange exposures addresses the risk of a depreciating rand and resultant possible foreign exchange losses.
- > Our largest exposure to commodity prices relates to copper utilised in energy cables. With regards to supply into the formal sector such as Eskom and the municipalities, the copper price risk is passed on to the customer. However, we carry the risk of copper price movements in terms of supply to the informal sector, such as the electrical wholesalers. Hedging of copper purchases is not an option due to the way the external market price adjusts to changes in the copper price. Consequently, risk in this regard is managed through minimising the length of time between the raw material purchase and the finished goods sale. Significant progress has been made in this regard by reducing finished goods stock levels and ensuring correct inventories in relation to market demand. This has increased finished goods stock turns to around ten from a historic norm of six.

Credit risk on debtors

The various credit departments throughout the group must be complimented for the vigour with which they have controlled our debtors' books during the year. As a result, we have seen a reduction in both bad debt expense and bad debt provision levels. However, the increased risk associated with the recoverability of debtors is still prevailing in the economy and may be further heightened due to the slow recovery. This risk therefore remains high on our agenda and the same diligence will need to be applied. In the light of our focus on growth, an increased vigilance over credit limits and credit granting criteria will also be required.

KEY FOCUS

Having made significant progress in terms of balance sheet management, cost control and capacity alignment, we are now in a position to change our primary focus to the markets we serve and growing the revenue line. The focus of the finance function across the group will remain on managing the key financial risks identified above, maintaining a strong system of internal controls and providing meaningful support to operational management.

CONCLUSION

The last year has been extremely challenging, with disappointing results. Nevertheless it is pleasing to note the resilience of the Altech results and the maintenance of revenue levels within Bytes. Although not evident in the results, huge progress has been made in terms of cost-efficiency targets that were set and management teams around the group must be complimented on the diligence with which they have pursued these goals. As a result, we are confident that we will see the rewards from these efforts as the economy recovers.

Alex Smith – Chief Financial Officer

May 2010

"The measure of the value created by the group is the amount of value added by its diverse manufacturing, distribution and other activities to the cost of raw materials, products and services purchased. This statement shows the total value created and how it was distributed."

Value added statement

	2010		2009	
	R million	%	R million	%
Revenue from continuing operations	22 336		24 768	
Paid to suppliers for material and services	(16 906)		(19 068)	
Value added	5 430		5 700	
Income from investments*	89		187	
Total value created	5 519		5 887	
Value distribution				
Employees	3 580	65	3 533	60
Capital providers	701	12	937	16
Finance costs	163		292	
Dividends to Altron shareholders	372		490	
Dividends to minority shareholders in subsidiaries	166		155	
Central and local government	470	9	614	10
Company taxation	381		505	
Secondary taxation on companies	45		61	
Rates and taxes; licences and levies	39		42	
Skills development levy	5		6	
Subsidies granted by the government	—		—	
Corporate social investment (CSI)**	56	1	62	1
Reinvested in the group to maintain and develop operations	712	13	741	13
Depreciation and amortisation	510		438	
Retained profit	171		345	
Deferred taxation	31		(42)	
	5 519	100	5 887	100
Value added ratios				
Number of employees***	12 311		13 366	
Revenue per employee (Rand)	1 814 312		1 853 060	
Value created per employee (Rand)	448 298		440 446	
Corporate social investment – % of profit after tax	6.7%		5.4	

*Income from investments includes interest received, dividend income and share of associates' profits.

**CSI includes education, training and social upliftment projects.

***These are permanent group employees.

