# FINANCIAL REVIEW

## The Group achieved pleasing results for the financial year ended 30 September 2015 despite a vulnerable South African economy, sustained competition and significant cost push. The following highlights underpinned the performance:

- Volume growth and share gains in most key categories
- Second half recovery in fruit exports
- Progressive expansion of bakery margins
- Containment of operating costs
- Successful exit of biscuits and Pepsi
- Acquisition and integration of the Nigerian joint venture

## Financial performance

**Continuing operations** – excluding the Phase I B-BBEE share-based payment charge and the impairment of Quantum Foods shares relating to the Phase II B-BBEE transaction participants.

Revenue from continuing operations increased by 6% to R18.7 billion (7% excluding Pepsi and biscuits) for the year under review. Despite the competitive landscape, pleasing volume growth was achieved in key categories.

| Revenue analysis by region (R'm) | 2015 | 2014 | % change |
|---|---|---|---|
| South Africa | **16 125** | 15 461 | 4 |
| Africa | **900** | 812 | 11 |
| Rest of world | **1 723** | 1 426 | 21 |
| **Continuing operations** | **18 748** | 17 699 | 6 |
| Discontinued operations | **–** | 3 591 | (100) |
| **Group revenue** | **18 748** | 21 290 | (12) |

### *Essential Foods*

Essential Foods delivered exceptional results in a low growth and contested environment, while successfully navigating challenging soft commodity procurement vagaries. The first half delivered strong maize volumes which came under pressure in the second half due to exponential cost push inflation. Bakeries continued to make progressive strides in expanding its operating margin through the relentless focus on key value drivers underpinning the strategy. A turnaround in rice profitability was achieved due to a strong increase in volumes and efficiencies. Pasta continued to contribute positively. Essential Foods recorded a 31% increase in operating profit for the year to R1.3 billion, while operating margin improved from 9.2% to 11.3%.

### *Groceries*

The Groceries division successfully exited both biscuits and Pepsi, while achieving excellent growth in wheat biscuits, cornflakes and long-life juice. The smaller brands underperformed, requiring increased attention. Groceries recorded a 26% increase in operating profit for the year to R435 million, while operating margin improved from 7.2% to 9.1%.

### *International*

The newly divisionalised International business contributed 14% of total revenue and grew well ahead of the local market, bolstered by favourable international supply and demand dynamics in fruit exports in the second half. International recorded a 23% increase in operating profit for the year to R445 million, while operating margin improved from 16.0% to 17.0%.

Cost of goods sold increased 4% to R12.8 billion, benefiting from robust conversion cost containment initiatives and procurement savings. Significant cost push was offset by rigorous cost control and the extraction of efficiencies across the value chain, resulting in a 5% increase in other operating expenses to R4 007 million for the year.

The Group gross profit margin, as a result, improved from 30.4% to 31.9%, whilst the operating profit margin (before items of a capital nature) expanded a further two percentage points to 11.5% during the year under review. Operating profit, before items of a capital nature, and adjusted as per above, increased by 28% to R2 153 million (2014: R1 680 million).

| Revenue analysis by segment (R'm) | 2015 | 2014 | % change |
|---|---|---|---|
| Essential Foods | **11 335** | 10 652 | 6 |
| Groceries | **4 797** | 4 773 | 1 |
| Cereals and other | **2 420** | 2 362 | 2 |
| Beverages | **2 377** | 2 411 | (1) |
| International | **2 616** | 2 274 | 15 |
| Continuing operations | **18 748** | 17 699 | 6 |

| Operating profit analysis by segment (R'm) | 2015 | 2014 | % change |
|---|---|---|---|
| Essential Foods | **1 278** | 976 | 31 |
| Groceries | **435** | 346 | 26 |
| Cereals and other | **252** | 221 | 14 |
| Beverages | **183** | 125 | 46 |
| International | **445** | 363 | 23 |
| Other | **(5)** | (5) | – |
| Continuing operations* | **2 153** | 1 680 | 28 |

* Before items of a capital nature and adjusted for the impact of the Phase I B-BBEE transaction.

| Operating margin by segment | 2015 | 2014 |
|---|---|---|
| Essential Foods | **11.3%** | 9.2% |
| Groceries | **9.1%** | 7.2% |
| Cereals and other | **10.4%** | 9.4% |
| Beverages | **7.7%** | 5.2% |
| International | **17.0%** | 16.0% |
| Group continuing operations | **11.5%** | 9.5% |

The summarised operating profit above demonstrates each segment's contribution to the overall results. Further detail is provided in the operational reports on pages 42 to 55.

### Total Group earnings

The strong underlying financial performance of the Group has, however, been impacted by the effect of the 6 October 2014 unbundling of Quantum Foods, discontinued operations and the impact of the 2006 Phase I B-BBEE share-based payment charge.

Total Group headline earnings per share, on an adjusted basis, increased by 23% to 832 cents per share (2014: 678 cents per share).

Earnings for the Group in total, on an adjusted basis, increased by 28% to 807 cents per share (2014: 629 cents per share).

#### *The impact of the non-operational costs related to the Phase I B-BBEE transaction*

The 2006 Phase I B-BBEE transaction, benefiting more than 11 000 employees, is a cash-settled scheme. The number of participants, since inception, has declined to 2 579 as at 30 September 2015 (2014: 3 218), as a result of general staff turnover and the exit of Quantum Foods' employees. The pre-tax value paid to such beneficiaries amounts to R374 million since its inception in 2006. The outstanding obligation is remeasured to fair value taking into account the Pioneer Foods share price at each reporting date. For the year under review the share price increased by 66% from R118.00 to R195.76, resulting in a charge of R307 million. In 2014 the share price increased by 35%, from R87.50 to R118.00, resulting in a charge of R187 million.

#### *Quantum Foods unbundling*

Quantum Foods was unbundled on 6 October 2014. During the year under review, a loss on the disposal of treasury related Quantum Foods shares and impairments in respect of Quantum Foods shares held by the 2012 Phase II B-BBEE consolidated special purpose vehicles, were recognised.

| Group summary | 2015 | 2014 | % change |
|---|---|---|---|
| Total earnings (R'm) | **1 130** | 965 | 17 |
| ***Earnings per share (cents)*** | ***613*** | *527* | *16* |
| Plus: Items of a capital nature (after tax) (R'm) | **97** | *90* | *8* |
| Headline earnings (R'm) | **1 227** | 1 055 | 16 |
| ***Headline earnings per share (cents)*** | ***665*** | *576* | *15* |
| Adjusted for after-tax effect of the Phase I B-BBEE transaction (R'm) | **307** | 187 | 64 |
| Adjusted headline earnings (R'm) | **1 534** | 1 242 | 24 |
| ***Adjusted HEPS (cents)*** | ***832*** | *678* | *23* |

Income from investments increased to R39 million (2014: R22 million), as a result of healthy cash balances and the higher interest rate.

Profit before tax amounted to R1 766 million (2014: R1 400 million) after financing costs of R142 million (2014: R138 million) and income from joint ventures and associates of R71 million (2014: R70 million). Bokomo Namibia, Bokomo Botswana and Bowman Ingredients SA delivered solid results, while Heinz recovered from supply chain difficulties in the first half.

Adjusted headline earnings per share from continuing operations, before the Phase I B-BBEE share-based payment charge, increased by 30% to 832 cents per share (2014: 637 cents per share).

Earnings from continuing operations, on an adjusted basis, increased by 34% to 831 cents per share (2014: 619 cents per share).

## Financial position

Capital expenditure investment for the year amounted to R652 million (2014: R486 million) and included R170 million in capital commitments carried forward from the previous financial year.

| Capital expenditure (R'm) | 2015 | 2014 |
|---|---|---|
| Expansion | **186** | 270 |
| Replacement | **466** | 216 |
| **Total** | **652** | 486 |

Significant projects undertaken during the year included the Epping bakery and the completion of the Malmesbury mill upgrades. The balance of the capital expenditure included general asset care including a R218 million investment in the bakery fleet. Proceeds on the sale of property, plant and equipment of R176 million (2014: R56 million) included the disposal proceeds in respect of the old bakery fleet and the biscuit and Pepsi lines. The Board committed to the expansions of the Aeroton bakery in Gauteng and the Atlantis Weet-Bix plant. These are the major components of the R492 million in capital commitments carried forward to the 2016 financial year.

| Return on average net assets (%) | 2015 | 2014 |
|---|---|---|
| Essential Foods | **36%** | 30% |
| Groceries and International | **24%** | 20% |
| Continuing operations | **32%** | 26% |

The strong financial performance, and the astute capital expenditure investment, translated into a marked improvement in the return on net assets at a Group and segmental level.

### Debt and financing facilities

| Debt and financing facilities – continuing operations (R'm) | 2015 | 2014 | % change |
|---|---|---|---|
| Third-party debt relating to the 2012 Phase II B-BBEE transaction partners | **502** | 501 | – |
| Own debt | **1 352** | 1 273 | 6 |
| Total debt | **1 854** | 1 774 | 5 |
| Less: Cash | **1 449** | 1 108 | 31 |
| Net debt | **405** | 666 | (39) |
| Net debt excluding third-party debt | **(97)** | 165 | (159) |
| *Net debt to equity ratio (%) excluding third-party debt* | **(1%)** | 3% | |
| EBITDA* | **2 488** | 2 006 | 24 |
| *Net debt-to-EBITDA ratio (%) excluding third-party debt* | **(4%)** | 8% | |

* Before items of a capital nature and adjusted for the impact of the Phase I B-BBEE transaction.

Net interest-bearing debt, excluding third-party debt related to the Phase II B-BBEE transaction partners, decreased by R262 million to a net positive position of R97 million or a net debt to equity ratio of -1% (2014: 3%). The Group's net debt to EBITDA ratio, on an adjusted basis, is -4% (2014: 8%).

The Group's total syndicated debt facilities amounts to R3.5 billion, which is secured with five financial institutions. The Group is satisfied that the healthy cash generated from normal operating activities will continue and along with the above facilities, will meet working capital requirements and the expansion plans of the foreseeable future.

## Statement of cash flows

| Cash flow analysis (R'm) | 2015 | 2014 | % change |
|---|---|---|---|
| Net cash from operating activities | **2 512** | 2 134 | 18 |
| Change in working capital | **(546)** | 28 | |
| Inventory | **(268)** | (19) | |
| Debtors | **(289)** | (334) | |
| Creditors | **12** | 417 | |
| Other | **(1)** | (36) | |
| Cash effect from commodity hedging | **16** | (8) | |
| Cash generated from operations | **1 982** | 2 154 | (8) |

Net cash from operating activities amounting to R2 512 million (2014: R2 134 million including discontinued operations) improved 18% on the prior year. Working capital investment for the year under review increased to 14.0% of revenue (2014: 11.5%). The increase was due to the timing of the payment for raw material imports and significant maize price inflation. Working capital continues to be managed optimally.

Proceeds on the sale of property, plant and equipment of R176 million (2014: R56 million) mainly included the disposal proceeds in respect of the old bakery fleet, and the biscuit and Pepsi lines.

Effective 1 March 2015, the Group invested R81 million for a 51% interest in Food Concepts Pioneer Limited, a Nigerian group of bakeries. A conservative fix and optimise strategy will be followed to achieve profitability in the medium term.

On 1 October 2015, all conditions precedent for the disposal of the Group's interest in Maitland Vinegar Works (Pty) Ltd were met. At 30 September 2015, the assets and liabilities relating to this interest have been presented as assets held for sale.

As announced on SENS on 23 April 2015, Pioneer Foods entered into an agreement to acquire 50% in Future Life Health Products (Pty) Ltd. On 9 November 2015, the Competition Tribunal of South Africa granted conditional approval of this transaction. The conditions will have no negative impact on the commercial merits of this investment.

The Group is satisfied that the healthy cash generated from normal operating activities will continue and along with the above finance facilities, will meet working capital requirements and the expansion plans of the foreseeable future.

## Dividend

A final dividend of 237 cents per share has been declared for the year ended 30 September 2015 (2014: 156 cents per share). The total dividend for the year is therefore 332 cents per share (2014: 221 cents per share). This translates to a dividend cover ratio of 2.2 times (2014: 2.5 times), including discontinued operations. It remains the Company's stated intention to target a lower dividend cover ratio for the foreseeable future.