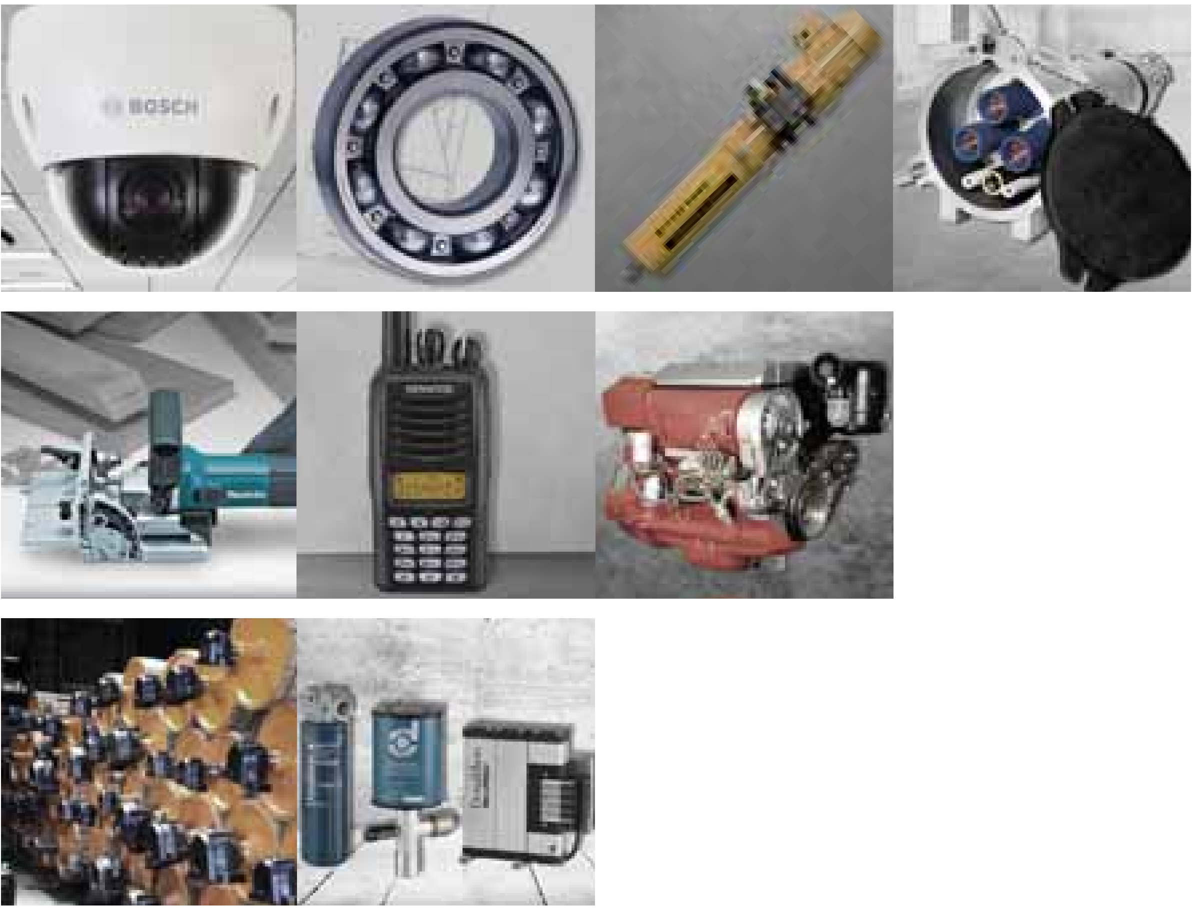


Hudaco

Integrated Report including the annual financial statements

for the year ended 30 November 2012

Contents

Profile

Hudaco Industries is a South African group specialising in the importation and distribution of high-quality branded industrial products, mainly in the southern African region. Hudaco businesses serve markets that fall into two primary categories. The bearings, power transmission and diesel engine businesses supply engineering consumables mainly to mining and manufacturing customers whilst the security, power tool and automotive aftermarket businesses supply products into markets reliant on consumer spending.

Hudaco sources branded products, mainly on an exclusive basis, directly from leading international manufacturers and to a lesser extent from local manufacturers. Hudaco seeks out niche areas in markets where customers need, and are prepared to pay for, the value Hudaco adds to the products it distributes. The value-added includes product specification, technical advice, application and installation training and troubleshooting, combined with ready availability at a fair price. The group has a network of specialised branches and independent distributors throughout southern Africa to ensure product availability to its customers. With the exception of Deutz Dieselpower, in which Deutz AG has a 30% share, all Hudaco businesses are 15% owned directly by BEE shareholders.

Highlights and challenges

Turnover up **10%**	Dividends up **6%**
Headline earnings per share up **5%**	Exports to Africa up **25%**

52 employees graduate from Wits Business School

58 successful technical trainees

35 bursaries granted to staff and their family members

151 managers receive share appreciation rights – wider participation

Investment Analysts Society award for best reporting and communication: "Industrial – Basic Industry, Manufacturing and General Industry"

Recent large acquisitions, FHS and Global, perform above expectations

Performance restored at Bearings International

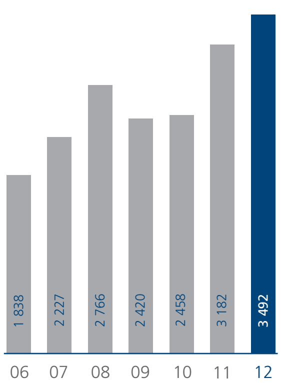
Mining strikes impact on last quarter trading

SARS challenging treatment of BEE structure

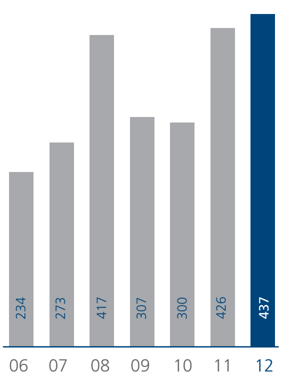
Results in brief

30 November	2012	2011	% change
Turnover (Rm)	3 492	3 182	10
Operating profit (Rm)	437	426	3
Headline earnings (Rm)	339	324	5
Attributable earnings (Rm)	340	324	5
Headline earnings per share (cents)	1 071	1 024	5
Dividends per share (cents)	465	440	6

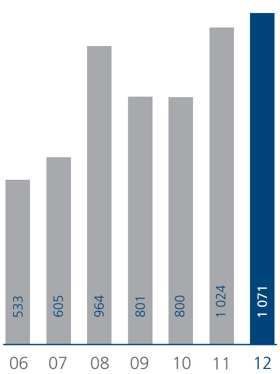
Turnover (Rm)



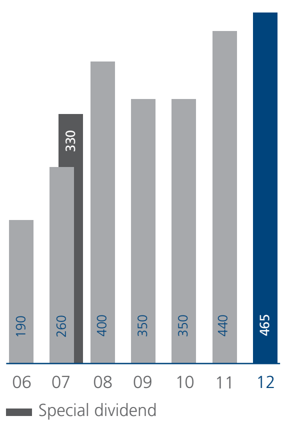
Operating profit (Rm)



Headline earnings per share (cents)



Dividends per share (cents)



Engineering consumables

Bearing International – keeping the wheels of industry turning

Principal activities	Businesses
Bearings The distribution of bearings, chain, seals, geared motors, electric motors, transmission products and alternators.	**Bearings International** has over 40 branches across South Africa. The main bearing brand distributed is FAG, which is of German origin.
Diesel engines and spares The distribution of Deutz diesel engines and Deutz spares and the provision of service support.	**Deutz Dieselpower** represents Deutz AG – one of the world's leading independent manufacturers of diesel engines.
Power transmission The distribution of geared motors, belting, hydraulics, filtration solutions, kits and accessories, pneumatics, industrial hose, conveyor drive pulleys, variable speed drives, special solid and hollow round steel, specialised thermoplastic pipes and fittings, electrical cabling, plugs and related products to the manufacturing, mining and agricultural aftermarkets.	**Power transmission** Ambro Sales, Astore Africa, Belting Supply Services, Bosworth, Ernest Lowe, Filter and Hose Solutions, Midrand Special Steels, Powermite and Varispeed.

Consumer-related products

Rutherford – power tools for industry

Principal activities	Businesses
Automotive products The distribution of clutch kits, lead-acid batteries, automotive ignition leads and oil and hydraulic seals to the automotive and industrial aftermarket.	**Abes Technoseal and Deltec** distribute seals and Valeo clutch kits, and maintenance free batteries respectively.
Security equipment The distribution of intruder detection, access control and related CCTV equipment, including design and integration of systems, fibre-optics, fire detection and video over IP installations.	**Elvey Security Technologies and Pentagon** distribute DSC and Optex security equipment.
Communication equipment The distribution of professional mobile radio equipment and radio systems integrator.	**Global Communications** distributes Kenwood and JVC communication equipment.
Power tools The distribution of power tools, marine engines and survey equipment.	**Rutherford** distributes Makita power tools and Mercury marine engines.

Group

Elvey Security Technologies – safeguarding assets

Key drivers	R million	2012	2011
GDP growth	Sales	2 280	2 187
Mining activity	– Ongoing	2 157	2 112
Mining investment	– Acquired 2011 and 2012	123	75
Mining mechanisation	Operating profit	280	274
Manufacturing activity	– Ongoing	266	267
Electricity usage management	– Acquired 2011 and 2012	14	7
	Average NOA*	1 169	1 093
	Number of permanent employees	1 878	1 811

** Net operating assets*

For more information on engineering consumables, see page 25: Investing in Hudaco

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Key drivers	R million	2012	2011
Consumer spending	Sales	1 223	1 006
Building activity	– Ongoing	835	759
Employment levels	– Acquired 2011 and 2012	388	247
Vehicle sales	Operating profit	169	163
Analogue to digital migration	– Ongoing	119	121
	– Acquired 2011 and 2012	50	42
	Average NOA*	487	366
	Number of permanent employees	685	638

** Net operating assets*

For more information on consumer-related products, see page 28: Investing in Hudaco

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Key drivers	R million	2012	2011
Exchange rates	Sales	3 492	3 182
Acquisitions	– Ongoing	2 981	2 860
	– Acquired 2011 and 2012	511	322
	Operating profit	437	426
	– Ongoing	373	377
	– Acquired 2011 and 2012	64	49
	Average NOA*	1 773	1 469
	Number of permanent employees	2 588	2 469

** Net operating assets*

Board of directors

Non-executive directors

Royden Vice (65)

BCom, CA (SA)

Independent non-executive chairman of the board and the remuneration and nomination committee

Royden retired in 2011 as CEO of Waco International, but remains chairman of the group. He joined Waco in 2002. He is a non-executive director of Murray & Roberts Holdings, chairman of Puregas and a governor of Rhodes University.

Royden was CEO of Industrial and Special Products at the UK-based BOC group. He was also chairman and CEO of African Oxygen Limited (Afrox) and Afrox Healthcare.

Royden joined the board in 2007 and became its chairman in 2009.

Dolly Mokgatle (56)

BProc, LLB, H.Dip Tax Law

Independent non-executive director and member of the audit and risk management committee and remuneration and nomination committee

Dolly is an executive director of Peotona Group Holdings. She is a non-executive director of several listed and unlisted companies, including Sasfin Holdings, Kumba Iron Ore, Lafarge Mining and Lafarge Industries. Dolly was appointed chairman of Zurich Insurance (RSA) and the State Diamond Trader in October 2012.

Other positions include associate governor of Michael-house (KZN) and University of the Witwatersrand Foundation.

Dolly was the CEO of Spoornet from 2003 to 2005. Prior to that she was the managing director of the Transmission Group in Eskom and also served as chairman of the Board of Electricity Distribution Industry Holdings and as deputy chairman of the National Energy Regulator of South Africa.

Dolly joined the board in March 2011.

Stuart Morris (67)

BCom, CA (SA)

Independent non-executive director, chairman of the audit and risk management committee and member of the remuneration and nomination committee

Stuart is a non-executive director of Group Five. Zurich Insurance (RSA), City Lodge, Rolex Watch (SA) and Mwana Africa plc, and chairman of Sasol Pension Fund and Wits Donald Gordon Medical Centre.

He worked for KPMG South Africa for over 30 years, ultimately becoming senior partner and a member of the KPMG International executive and board. He was Nedbank Group financial director from July 1999 until he retired in 2004.

Stuart joined the board in 2009.

Dhanasagree "Daisy" Naidoo (40)

Masters in Accounting (Taxation), CA (SA)

Independent non-executive director, member of the audit and risk management committee and chairman of the social and ethics committee

Daisy serves as an independent non-executive director on the boards of Mr Price Group, Mercantile Bank, Marriott Unit Trust Management Company, Old Mutual Unit Trust Managers, STRATE, and Omnia Holdings. She is also a member of the audit committee of the Council for Higher Education, the South African Qualifications Authority and the Tax Court of South Africa.

She served as the national exco member of the Association of Black Securities and Investment Professionals, heading up Strategic Alliances until September 2011, when her term ended.

She spent 9 years with Sanlam Capital Markets, including as head of the Debt Structuring Unit.

Daisy joined the board in March 2011.

Executive directors

Stephen Connelly (61)

ACMA

Chief executive and executive committee chairman

Stephen immigrated to South Africa in 1976. In 1982 he was a founding partner of Valard Limited where he served as financial director until he was appointed managing director in 1987. He was appointed group chief executive of Hudaco in 1992, shortly after its acquisition of the Valard group.

Clifford Amoils (51)

BCom, BAcc (Cum laude)
CA (SA)

Group financial director and member of the executive committee and social and ethics committee

Clifford was a partner at Grant Thornton for 21 years and headed up its audit division. He served on Grant Thornton International's Audit Advisory Committee and is a member of the Financial Reporting Investigation Panel of the JSE.

He joined the board in 2009.

Graham Dunford (48)

N Dip: Mechanical Engineering

CEO: Bearings and power transmission and member of the executive committee and social and ethics committee

Graham joined Hudaco in 2001 when it purchased Bauer Geared Motors, where he was the managing director. He became CEO: Electrical power transmission in 2005, CEO: Power transmission in 2009 and CEO: Bearings and power transmission in 2010. He was appointed executive director in July 2010 after serving as an alternate director since January 2009.

Executive committee

Stephen Connelly (61)
ACMA
Chief executive
30 years' service

Clifford Amoils (51)
BCom, BAcc (Cum laude), CA (SA)
Financial director
4 years' service

Bob Cameron-Smith (64)
N Dip: Marketing Management
CEO Rutherford
39 years' service

Graham Dunford (48)
N Dip: Mechanical Engineering
CEO Bearings and power transmission
24 years' service

Service is with Hudaco and businesses acquired

Chief Executive

Engineering Consumables

- **Bearings**
  - Bearings International
- **Power Transmission**
  - Ambro Sales
  - Astore Africa
  - Belting Supply Services
  - Bosworth
  - Ernest Lowe
  - Filter and Hose Solutions
  - Powermite
  - Varispeed
- **Diesel Engines and Spares**
  - Deutz Dieselpower

Consumer-related Products

- **Power Tools**
  - Rutherford
- **Security Equipment**
  - Elvey Security Technologies
  - Pentagon
- **Communication Equipment**
  - Global Communications

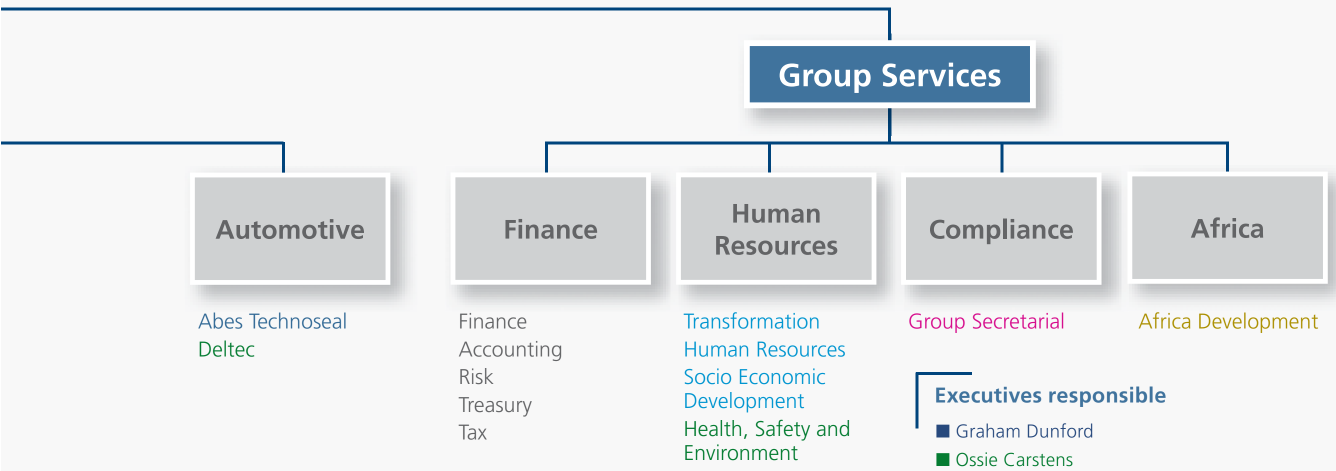
Jonny Masinga (35)
N Dip: HR Management,
B Tech: HR Management,
B Tech HR Development,
MAP
Group executive:
Transformation and
human resources
2 years' service

Gilbert da Silva (65)
ACIS
CEO Bearings International
42 years' service

Reana Wolmarans (46)
BProc, LLB, H.Dip: Labour Law
Group secretary
4 years' service

Jack Edery (61)
BCompt (Hons), CA (SA)
CEO Elvey Security Technologies
17 years' service

Ossie Carstens (47)
N Dip Mechanical Engineering; GCC (Mechanical) MBA
CEO Deutz Dieselpower and non-executive chairman
of Belting Supply Services and Deltec
4 years' service



Executives responsible
- Graham Dunford
- Ossie Carstens
- Bob Cameron-Smith
- Jack Edery
- Gilbert da Silva and Graham Dunford
- Clifford Amoils
- Jonny Masinga and Clifford Amoils
- Reana Wolmarans and Clifford Amoils
- Stephen Connelly and Graham Dunford

Seven-year review

R million	2012	2011	2010	2009	2008	2007	2006
Group statement of income							
Turnover	3 492	3 182	2 458	2 420	2 766	2 227	1 838
Profit before interest and tax	445	426	300	307	417	273	234
Net finance costs less dividends received	48	42	17	28	40	(5)	(7)
Profit before taxation	397	384	283	279	377	278	241
Taxation	47	46	26	24	57	83	76
Profit after taxation	350	338	257	255	320	195	165
Non-controlling interest	11	13	5	6	23	13	6
Headline earnings	339	325	252	249	297	182	159
Capital items	1	(1)	(18)	(6)	10	1	(9)
Attributable earnings	340	324	234	243	307	183	150
Shares in issue (000) (weighted average)	31 646	31 617	31 466	31 023	30 836	30 178	29 870
Earnings per share (cents)							
– headline	1 071	1 024	800	801	964	605	533
– basic	1 074	1 026	745	784	995	606	502
Dividends per share (cents)	465	440	350	350	400	260	190
Special dividend per share (cents)						330	
Group statement of financial position							
Property, plant and equipment	205	182	131	91	92	74	67
Goodwill	594	516	331	117	131	77	57
Intangible assets	49	49	34	18	25		
Deferred taxation	11	11	23	11	(5)	1	1
Inventories	919	813	663	597	780	544	452
Trade and other receivables	684	616	423	356	507	399	355
Trade and other payables	(592)	(586)	(420)	(326)	(488)	(435)	(382)
Taxation	(6)	(8)	(6)	(10)	(33)	(30)	(24)
Net operating assets	1 864	1 593	1 179	854	1 009	630	526
Investment in preference shares	2 181	2 181	2 181	2 181	2 181	2 181	
Net (borrowings) cash	(17)	166	262	335	69	317	238
Employment of capital	4 028	3 940	3 622	3 370	3 259	3 128	764
Interest of shareholders of the group	1 670	1 494	1 287	1 150	1 015	807	728
Non-controlling interest	26	31	27	34	40	29	22
Equity	1 696	1 525	1 314	1 184	1 055	836	750
Shareholders for special dividend						101	
Subordinated debenture	2 181	2 181	2 181	2 181	2 181	2 181	
Amounts due to vendors on acquisitions	151	234	127	5	23	10	14
Total capital employed	4 028	3 940	3 622	3 370	3 259	3 128	764
Group statement of cash flows							
Cash generated from trading	458	458	327	333	450	334	248
(Increase) decrease in working capital	(121)	(129)	12	166	(235)	(71)	(62)
Cash generated from operations	337	329	339	499	215	263	186
Taxation paid	(54)	(46)	(49)	(63)	(56)	(81)	(65)
Net cash from operating activities	283	283	290	436	159	182	121
Investment in new operations	(229)	(164)	(184)	(7)	(140)	(35)	(11)
Investment in property, plant and equipment	(39)	(64)	(50)	(17)	(20)	(17)	(16)
Investment in preference shares						(2 181)	
Discontinuation of business				7			
Dividends and interest received	202	205	218	203	212	83	8
Net cash from investing activities	(66)	(23)	(16)	186	52	(2 150)	(19)
Proceeds from issue of shares		2	7	8	4	14	3
(Decrease) increase in finance leases	(3)	3					
Subordinated debenture issued						2 181	
Finance costs paid	(237)	(234)	(234)	(235)	(249)	(81)	
Dividends paid	(163)	(124)	(120)	(129)	(214)	(67)	(54)
Net cash from financing activities	(403)	(353)	(347)	(356)	(459)	2 047	(51)
Net (decrease) increase in cash and cash equivalents	(186)	(93)	(73)	266	(248)	79	51

Discussion with the **Chairman and Chief executive**

How did Hudaco perform in 2012?

This was a year of two parts. In the first nine months Hudaco was trading strongly with demand for our engineering consumables products well up on 2011. However, the second part, which began in the last quarter of our financial year, was severely impacted by the strikes in the mining sector, particularly in the platinum mines. The mining industry is our biggest market segment. We estimate that the group lost R75 million in sales due to the stoppages which, at a 40% gross margin, amounts to R30 million in lost operating profit. Under the circumstances, Hudaco has delivered a reasonable set of results this year.

Sales are up 10% to R3,5 billion whilst operating profit rose 3% to R437 million. Headline earnings per share grew 5% to 1 071 cents. Due to the lost sales in the final quarter of the year, the group carries an additional R45 million in inventories which would, in a normal year, be split between cash and debtors.

The engineering consumables segment, the largest contributor to profits, delivered 62% of operating profit this year – up 2% on last year – on sales of R2,3 billion. The consumer-related products segment increased operating profit by 4% on sales of R1,2 billion, up 22%.

Importantly, all significant acquisitions made over the past three years are performing to or ahead of plan.

What is the Hudaco business model?

Our objective is to offer customers more than just a product in a box. In addition we offer advice on product selection, quick availability and technical advice and training – what we call value-add. In our acquisition efforts we seek to acquire agencies for products where customers either already require these characteristics or, by introducing them, we think we can increase customer loyalty to the brand.

South Africa has not and is not training enough people with technical skills to replace those lost to the economy through retirement and emigration. For this reason, Hudaco's value-add offering is in demand by our customers. Hudaco is in the fortunate position of being able to maintain its technical skills base through loyal and motivated employees. We are also able to quickly and easily train new staff through training offered internationally by our suppliers and our own in-house training programmes. *13, 39*

Are acquisitions still a key objective?

In a low organic growth environment, which characterises Hudaco's main markets at present, particularly the South African mining and manufacturing industries, Hudaco generates more cash than is required to fund growth. This allows and encourages the company to pursue a growth strategy primarily based on acquisitions.

We seek to acquire businesses distributing products not already in our portfolio because acquiring distribution rights for brands which compete with products already in our stable introduces risks to existing relationships. Major world manufacturers are invariably already represented locally and changing distributors usually only take place when the local owners of the distribution rights wish to disinvest. Consequently, acquisition opportunities present themselves rarely, which means that our acquisition strategy has to be opportunistic in nature. *37*

Discussion with the Chairman and Chief executive

As the South African regulatory environment tightens, and the cost of compliance rises, there will continue to be a stream of privately-owned businesses offered for sale. We therefore expect to continue to find opportunities to acquire attractive businesses that will contribute to earnings growth at relatively low risk.

We maintain a permanent wish list and have a list of targets currently under consideration.

We added three businesses this year. Deltec, a distributor of batteries that currently focuses on the automotive aftermarket, was acquired to complete our power offering for underground mining equipment. We now have all three power sources, diesel engines, electric motors and batteries in our portfolio. Keymak and Proof Engineering are bolt-on businesses and make flexible PVC hose and flameproof electric couplings, respectively, to local standards protecting them from potentially cheaper imports, whilst complementing the product ranges of existing Hudaco businesses.

What are Hudaco's strategic objectives and how did you perform against them?

The group has three main strategic objectives: acquisitions – dealt with above; expanding sales into Africa; and increasing black representation in senior management.

12 Investment in neighbouring countries, particularly Mozambique, Zambia and southern Congo, appears to be ramping up faster than we initially anticipated. As a result, during the year we appointed a senior manager as "Africa Champion" to co-ordinate and speed up efforts to capture a share of these markets. Hudaco's direct exports into neighbouring countries were 6% of sales in 2011 amounting to R200 million. We set ourselves an objective is to increase this to R500 million by 2015. In 2012 it was R250 million.

Despite low staff turnover, particularly at senior management level, we continue to make meaningful progress on increasing black representation in senior management. The Group Transformation and Human Resources Executive, appointed in 2011, is having an impact in two important areas: Preparing previously disadvantaged employees for senior appointment by devising and implementing training courses to equip them with the necessary skill sets; and through succession planning identifying specific vacancies and, where possible, matching them with internal candidates with specific timelines to get their capabilities up to speed. We currently have two black Exco members, two black people and two women heading business units and six women chief financial officers of whom two are black.

What is the status of the tax queries on the BEE structure?

By 2007 it had become (and it still remains) an economic imperative for a business like Hudaco to have strong BEE credentials. To achieve this, Hudaco introduced black shareholders to the group through a leveraged structure designed to facilitate the BEE investment at a price the BEE partners could afford. We have received a notice from SARS indicating that they believe that our BEE structure was a scheme designed to avoid tax and that they intend imputing taxable interest on Hudaco and disallowing STC credits arising on the preference dividends received.

33 We strongly disagree with the SARS interpretation of our motivation. When the structure was put in place, we obtained advice from senior counsel that our case would stand up to scrutiny. This has been reconfirmed since receiving the notice. If SARS assess us, we will contest the assessment vigorously as we remain confident of our position. Further information is set out on pages 33 and 34 of this integrated report.

Do you have concerns for 2013 and beyond?

The economic turmoil in Western economies resulting from the bubble in asset values in 2008 is taking a long time to settle. A new threat is also emerging. Western governments (including South Africa) have been spending more than they collect in taxes for many years now. As economic growth stagnates and tax receipts fall, governments are unable to cut back on welfare programmes thus exacerbating fiscal deficits. This is adding to countries' economic difficulties and pushing out the prospects of a global economic recovery.

The consequent negative impact on world economic growth and on demand for and prices of South Africa's mineral exports means the South African economy is unlikely to grow much until these issues are resolved. Hopefully the infrastructure – electricity and rail – required to allow the country to capitalise on any recovery will be in place by then.

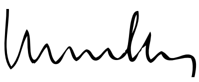
We would urge the Government to use this time to take steps to make the country more investor friendly, by focusing on achieving a reversal of the ratings downgrades.

What is Hudaco's earnings outlook for 2013 and beyond?

15 Given the above scenario, we do not expect much organic growth in our traditional markets – South Africa's mining and manufacturing sectors – in the near future. Meaningful growth will therefore come from the group's acquisition programme and from our efforts to take advantage of growth in neighbouring countries.

All businesses in the group are generating good returns on assets managed. Some, such as Rutherford, Global Communications and Filter and Hose Solutions, are already operating in growth markets. Others, such as Deltec and Pentagon, are positioning themselves to take advantage of growth to come. As a result we are confident that the group will continue to grow earnings in the years ahead.

Royden Vice
Chairman



Stephen Connelly
Chief executive

Welcome to the world of Hudaco

Where we have come from

1890's

Formation

In 1891, just five years after the discovery of gold on the Witwatersrand, J Hubert Davies started an industrial equipment supply business in Johannesburg. By the turn of the century, the business was a major player in the distribution of mechanical and electrical industrial products and, in 1917 it was converted into a private company, which facilitated the introduction of senior managers as shareholders and directors.

1930's

First JSE listing

In September 1938, Hubert Davies and Company Limited listed on the Johannesburg Stock Exchange. It delisted almost four decades later, in 1977, when it became a wholly-owned subsidiary of Blue Circle Limited. The United Kingdom-based industrial group had already acquired a substantial interest in the company three years earlier.

1970's

Expansion and decentralisation

In the 1970's, Hubert Davies expanded its product offering and branch network to extend across southern Africa. Then a strategic decision was made to specialise by product and activity, in order to provide more focused customer service and achieve improved market penetration. Following on from this, a management philosophy of decentralising decision-making and responsibility was introduced. These strategies are still in place today.

1980's

Second JSE listing

In line with the specialisation trend amongst businesses at that time, Hudaco Industries was established as a separate autonomous company in 1981, owning the group's distribution businesses. In May 1984, with banks as partners, management, under the leadership of Bruce MacInnes acquired control of Hudaco Industries from Blue Circle, in what was then the largest South African private equity leveraged buyout. On 14 November 1985, Hudaco Industries Limited listed on the Johannesburg Stock Exchange at a subscription price of R1,50 per share, with a market capitalisation of R29 million. Several large acquisitions followed, including listed companies Frencorp, Valard and Elsec.

2000's

B-BBEE shareholding

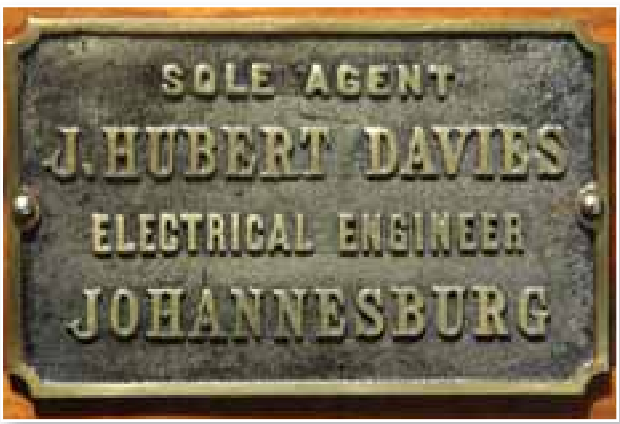
In 2007 (see page 33), the group sold 15% of the majority of its operating businesses to black, previously disadvantaged, shareholders as part of a B-BBEE initiative.

33

Today

A quality industrial distributor

Today, with a proud history of over 120 years since J Hubert Davies saw the long-term business potential of the initial gold rush, the group remains true to its roots. The group now employs over 2 500 people and has a market capitalisation of about R3,5 billion. Its shareholders include many blue-chip players in the South African retirement investment industry.



This nameplate was removed in 1938 from a worn out "Trusty" paraffin oil engine no. 574 which was made by the Trusty Engine Works, Cheltenham, Gloucestershire, England in 1893, and supplied by Mr J Hubert Davies to a gold mine at Sabie, Eastern Transvaal.

Welcome to the world of Hudaco

Our mission

Hudaco has been an important part of the South African business landscape for more than a century. Our mission is to develop and manage a sustainable business for the benefit of all stakeholders, in both current and future generations. Accordingly, we welcome the initiative of the King Commission and the JSE to place at the centre of our decision-making processes the creation of sustainable and long-term value for all our stakeholders, i.e. not just our shareholders.

ACHIEVING HUDACO'S MISSION

We aim to produce superior returns for our **SHAREHOLDERS** by efficiently managing our business and by taking advantage of acquisitive and organic growth

We safeguard our strong market shares by offering quality products and ready availability to our **CUSTOMERS**

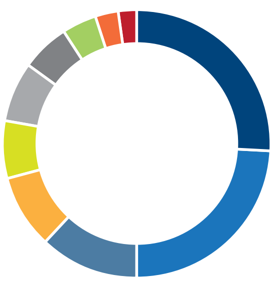
We establish enduring partnerships with our **SUPPLIERS**, combining their leading world brands and our distribution strengths in southern Africa

We ensure that a significant part of Hudaco's strength – its **PEOPLE** – thrive in a decentralised, dynamic and challenging business environment

We are committed to playing a part in the transformation of **SOUTH AFRICA'S SOCIETY** and economy to help redress the inequities of the past

We aim to achieve these objectives in a manner governed by the highest standards of ethical conduct, sensitive to the needs of the **COMMUNITIES** in which our businesses operate and conscious of our responsibilities for safety and the **ENVIRONMENT**

Sales by market sector – 2012



Sector	(%)
Manufacturing	26
Mining	24
Wholesale and retail	12
Security	9
Automotive	7
Exports	7
Construction	6
Public sector	4
Agriculture	3
Other	2

Rutherford – survey equipment for use above or below ground

What we do and how we add value

Through our operating businesses, Hudaco's core activity is the importation and distribution of branded industrial consumable products. The three main success factors we seek to achieve are as follows:

- We seek out and secure exclusive distribution rights from leading international manufacturers with a global brand presence and a commitment to maintaining market leadership, particularly through technical innovation.
- We look for products where we can add value through the distribution chain through stockholding, product availability and providing technical support. Typically these would be technical specification, advice on usage or installation and customer training. The amount of value-add is established by determining whether the customer's purchasing decision could be influenced by the addition of a technical support function.
- We focus on offering engineering consumable products. These would typically be maintenance spares for critical customer equipment. Purchasing decisions for these items are made easily and quickly without onerous tender procedures.

Hudaco sources products from more than 600 international suppliers scattered across the industrialised world. We supply some 20 000 active customers from over 140 southern African branches (most of which are in South Africa), and carry 225 000 line items in stock. Demand is relatively inelastic, with low line item sales predictability, whilst supplier lead times can range from three months to well over a year, in extreme cases. Stockholding is therefore Hudaco's most important asset as our key competitive advantage is the ability to offer availability on demand.

Most emerging economies, including South Africa, lack a manufacturing industry with the necessary economies of scale to produce products which we (and our competitors) import.

Our products are distributed throughout southern Africa by our 19 businesses. In most countries we supply through local distributors, but we have branches in Namibia where we have a longer track record of doing business and more recently in northern Mozambique, where our customers have indicated a requirement and good distributors are hard to find. 39

Our suppliers rely on our understanding of the specific challenges of doing business in Africa, particularly the political and regulatory risks and the limitations which the size of these economies pose, and appoint us to represent their brands in markets which they would not ordinarily have been able to access. Crucially, we must adapt continually to the dynamics of doing business in Africa. Technical support is provided from South Africa until we have developed locals with managerial and technical skills.

The group value-added statement measures the wealth the group has created in its operations by "adding value" to the cost of raw materials, products and services purchased. The statement below summarises the total wealth created and shows how it has been shared by the stakeholders who contributed to its creation. Also set out below is the amount retained and re-invested in the group for the replacement of assets and the further development of operations.

Group value-added statement

R million	2012	2011
Turnover	3 492	3 182
Less: Cost of materials, facilities and services from outside the group	2 361	2 115
Value-added	1 131	1 067
Capital items	8	
Dividends received on preference shares	202	201
Total wealth created	1 341	1 268
Distributed to:		
Employees – salaries, wages and other benefits	654	605
Government (gross contributions)	357	300
Indirect contributions, duties and levies	(310)	(253)
Net finance costs	250	242
Shareholders – dividends	163	125
Maintain and expand the group		
– profits retained	188	213
– depreciation, amortisation and impairment	39	36
Total wealth distributed	1 341	1 268

Statement of gross contributions to the Government in South Africa

R million	2012	2011
Company income tax and STC	46	46
Customs and excise duty	70	51
Skills development levies and assessment rates	7	7
Value-added tax not recognised as input credit	1	1
Direct contribution to Government	124	105
Add the following collected on behalf of the Government:		
Value-added tax (net)	106	92
Employees' tax	126	102
	356	299

Our business segments

In compliance with IFRS, we have identified two reportable segments within the group, namely engineering consumables and consumer-related products. Our bearings and power transmission and diesel engine businesses supply engineering consumables mainly to mining and manufacturing customers, while the power tool, security equipment and automotive aftermarket businesses supply products into markets influenced to a greater degree by consumer spending.

Engineering consumables

In 2012, 65% of turnover and 62% of operating profit

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The engineering consumables segment is the main contributor to Hudaco's operating profits. The segment distributes a range of engineering products including bearings, hydraulics, pneumatics, filtration products, special electrical cables, conveyor belting, pulleys, drives, electric motors, thermoplastic pipes and fittings, and comprises the following main businesses:

- Bearings International has almost 50 branches across South Africa. The main bearing brands distributed are FAG, KOYO and KML. It also distributes chain and electric and geared motors.
- Deutz Dieselpower represents Deutz AG – one of the world's leading independent manufacturers of diesel engines.
- Filter and Hose Solutions is a leading distributor of Donaldson filters, filtration solutions, kits and accessories. The heavy duty and automotive industries represent a significant portion of its customer base.
- Power Transmission is a collective term for the following businesses supplying mechanical and electrical power transmission products: Ambro Sales, Astore Africa, Belting Supply Services, Bosworth, Ernest Lowe, Filter and Hose Solutions, Midrand Special Steels, Powermite and Varispeed. The new additions of Keymak and Proof Engineering have fitted well with Astore and Powermite, respectively.

Consumer-related products

In 2012, 35% of turnover and 38% of operating profit

The consumer-related products segment houses five businesses:

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- Abes Technoseal supplies a range of automotive replacement parts, primarily clutches and oil seals.
- Deltec, acquired in 2012, is a distributor of imported maintenance free batteries, representing leading brands such as Varta, Global, Forbatt and US Battery.
- Elvey Security Technologies is a leading distributor of electronic security equipment.
- Global Communications is a provider of integrated telecommunications infrastructure and two-way radios from leading international producers such as Kenwood and JVC.
- Rutherford distributes Makita industrial power tools and Mercury and Mariner marine engines, the Topcon range of survey equipment and Troxler nuclear gauges for construction purposes.

The Hudaco head office

The Hudaco head office regards itself as more than just an investment holding company. We see our main role as the creation of an environment where good managers can thrive. It also plays an important role in providing strategic direction and through sharing best practices. We buy and integrate, rather than buy and hold. While our trading activities may occur under the name of individual businesses, a common theme is adding value through the distribution of recognised brands with a strong technical support function in sectors we understand.

The head office essentially performs three functions:

- Management of a portfolio of businesses through acquisition, divestiture and merger activities; the appointment of key executives, remunerating them so as to keep the group strategic objectives front of mind and the initiation of tactical and strategic moves with a focus on sustainability from a group perspective.
- Providing limited group services to our businesses or facilitating group-wide initiatives, but only if costs can be significantly reduced through scale or to more effectively manage risk.
- Managing investor relations, Hudaco provides an opportunity for our shareholders to participate in ownership of our underlying businesses. These are usually previously privately-held businesses to which they would not ordinarily be able to gain exposure.

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These functions are explained further in the section 'Doing business with Hudaco' (page 37).

Where our products go to in Africa

South Africa as the portal to Africa

One of Hudaco's key strategies is to increase its footprint in Africa. Notwithstanding that we are already selling into much of the continent, the growing potential in this region requires a more dedicated and focused approach to best promote our substantial market offering. We think we can make better use of existing distribution channels and networks to create synergies within our group to better penetrate these markets.

The following steps have been taken to achieve this strategy:

- *A senior manager has been appointed to focus on developing business in Africa.*
- *We are initially targeting countries that are growing fast and have a relatively settled regulatory environment.*
- *The initial target zone is predominantly sub-equatorial countries strong in mining.*
- *We will consider setting up Hudaco branches in partnership with local entities in the identified locations.*
- *To ensure customer satisfaction and loyalty, the branches will carry sufficient stock and offer comprehensive technical support.*

The map above reflects the African countries into which we already sell directly or in which our local customers use the products bought from us.

The risks we face

In the table below, we highlight the key risks faced by the group and how these risks are mitigated:

Risk	Explanation	Potential exposure	Mitigation	Residual risk assessment	Associated opportunity
Foreign exchange rate risk – significant strengthening of the Rand	If the Rand strengthens, the purchase prices of our products drop and selling prices must be reduced to remain competitive. This reduces gross profit and since our expenses are Rand-based, they do not decline. Net operating profit decreases. (See page 32.)	For each 10% by which the Rand strengthens, operating profit decreases R100 million per annum.	Management of quantities and lead times helps to delay the impact. Management intervention to increase gross margins. The primary risk cannot be mitigated.	Variable depending on extent. This risk is integral to our strategy of holding inventory to provide customers with ready availability of imported goods with long lead times.	A weakening of the Rand by more than the inflation rate would result in gross profits rising faster than expenses, increasing the operating profit margin.
Inadequate supply of electricity	The lack of electricity is a constraint on GDP, a significant driver for Hudaco, and is likely to remain an issue until 2015. The mining industry, in particular, tends to be affected when power is in short supply.	Unable to quantify.	Geographic diversification to other southern African countries. Acquiring businesses that serve different sectors, some of which are less dependent on electricity supply.	Some impact already being felt. This risk is integral to our strategy of supplying to industries that happen to have high electricity requirements.	Potential to sell batteries and generators to industry.
Credit risk	Although credit risk is well spread and larger debtors are usually blue chip, government now awards large contracts to new BEE entities, on which we have to take credit risk.	R40 million.	We manage the delivery process as closely as possible and will strive to find other ways to minimise this risk.	Unlikely. This risk is a consequence of BEE procurement.	If managed well, there are significant opportunities in supplying the requirements of government.
Not meeting BEE requirements	Although Hudaco has put in place an appropriate BEE shareholding structure and targets on the DTI scorecard have been achieved, this is against a backdrop of ever changing requirements. Certain industries (e.g. mining) have their own charters with different requirements. Sales may be lost through not having adequate BEE credentials.	Unable to quantify.	The group transformation and human resources executive monitors legislation and charter requirements to keep our businesses abreast of new requirements. He helps to ensure the necessary certifications have been obtained by each business. Aspects such as ownership requirements are escalated to board level.	Less than even chance. This strategic risk is part of doing business in South Africa and is always front of mind in operations.	We have been able to grow the group through acquisitions because we offer strong BEE credentials to vendors. Also, competitors are faced with the same BEE challenges so we are able to attract business from those that fall short of requirements.
Changes in tax legislation	The Taxation Laws Amendment Act of 2011 introduced legislation that will result in the preference dividends arising from an investment made by Hudaco declared in financial years commencing on or after 1 January 2013 becoming taxable. (See page 34.)	R8 million to R56 million per annum.	Consideration is being given as to whether the current preference share investment remains the most appropriate investment for Hudaco.	The most likely impact will be a decrease in profit after tax of R33 million per annum. Impact at the lower end or top end is considered unlikely. This risk was assumed in 2007 with the introduction of black shareholders through a leveraged transaction. This was to address the strategic objective of transformation.	The BEE structure is complex and may have affected market perceptions of Hudaco. This will no longer be the case if the tax changes ultimately result in an unwind of the financial instruments associated with the structure.

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Risk	Explanation	Potential exposure	Mitigation	Residual risk assessment	Associated opportunity
Tax risk on group restructure	The restructuring of the group in 2007, which was aimed at introducing BEE shareholders, resulted in a low effective tax rate. SARS have given us notice that they intend imputing taxable interest on Hudaco and disallowing STC credits arising on the preference dividends received.	Exposure on the interest deduction is R65 million per annum since November 2007, totalling R345 million to date. Disallowing STC credits adds R92 million. SARS are likely also to seek to impose interest and 200% penalties, which would take the maximum exposure to R1,5 billion.	When the structure was put in place, we obtained advice from senior counsel that our case would stand up to scrutiny. This has been reconfirmed since receiving the notice. If SARS do assess us, we will contest the assessment vigorously as we remain confident of our position.	Less than even chance. This risk was assumed in 2007 with the introduction of black shareholders through a leveraged transaction. This was to address the strategic objective of transformation.	No associated opportunity.
Natural disaster at supplier or customer	A natural disaster could cripple a factory of a major supplier or the operations of a major customer.	R20 million.	We carry up to six months' stock which gives time to react to such an event. Major suppliers generally operate from several factories in different cities and/or countries. The loss of a factory could be disruptive to the supply of certain products but production would be quickly moved to other factories. The group has a widespread supplier and customer base and is not overly reliant on any single one. Insurance is held against supply interruptions.	Less than even chance. This is always a risk in a supply chain environment.	Natural disasters do not represent an opportunity to the group, except to the extent that those competitors whose suppliers do not have the same level of geographic diversification as ours may be affected more heavily.
Loss of key executives in businesses or at group level	Four members of the executive team reach retirement age within the next five years. The risk is that transition could have a significant negative effect on the group. Some businesses are sold to us as an exit strategy for some of the existing owners. Succession planning and integration into the group is therefore vital for sustainability of the business.	Unable to quantify.	The group has a formal succession policy. Succession plans are considered annually by the remuneration and nomination committee. Other members of the group executive team have developed in-depth knowledge of each business. Earn-out periods keep vendors in acquired businesses to facilitate transition.	Highly unlikely. The risk is always prevalent but arises specifically through the strategy of growing the group by acquiring entrepreneurial businesses.	Retirement of members of the executive team creates visible opportunities to which the next level of management can aspire. This provides them with an incentive to prove their value through superior performance.

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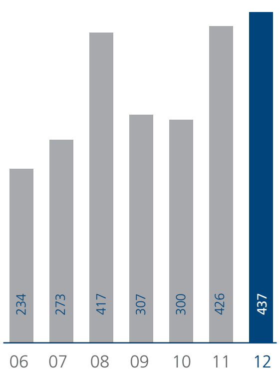
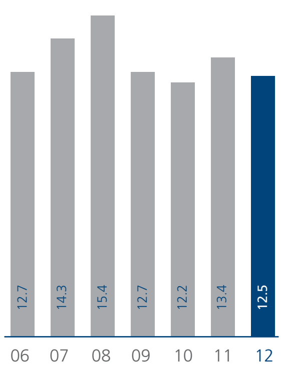
Risk	Explanation	Potential exposure	Mitigation	Residual risk assessment	Associated opportunity
Loss of a major brand	While the portfolio of brands is diverse, there are two major brands the loss of which will have a significant effect on the results of the group. These brands, each of which contributes 10% to 15% of group operating profit, will be hard to replace.	Up to R60 million in operating profit per annum per brand.	Maintaining strong relationships with principals and serving them well in the South African market. This is monitored by the audit and risk committee. The relationships with these brands is managed by the group chief executive. Acquisitions increase the number of suppliers and dilute exposure to these two brands. The element we cannot mitigate is the risk that a major principal ceases to exist.	Highly unlikely. This risk follows from the strategy of representing quality major international brands.	There would not be an opportunity associated with the loss of one of the group's two major brands. The loss of a lesser brand may present an opportunity to bring into the portfolio a brand that has something more to offer.
Poor acquisition	Acquired business performs well below expectations or exposes the group to significant unexpected risks.	R150 million.	Approving acquisitions on the basis of thorough due diligence reviews conducted by professionally qualified advisors and by our own experienced acquisitions team.	Unlikely. This risk is introduced by the strategy to grow the group by acquisition.	Quality acquisitions add significant value to the group.
Sustained labour unrest in the mining or manu-facturing sectors	Of group turnover, 24% is sold directly to the mining industry and 26% into manufacturing, much of which is to service the mining industry.	R30 million.	The group has a diverse customer base both within and outside of mining. It is unlikely that all types of mining will be affected.	Better than even chance.	This provides an incentive to further diversify the customer base through extending our range of products and customer geographies.
Ineffective insurance	The risk that there is a major loss, e.g. through fire and that the insurance claim is not met because the policy was defective or the insurer fails.	R100 million.	Insuring through reputable long-established underwriters and engaging high-quality insurance brokers as advisors.	Will not occur.	No associated opportunity.

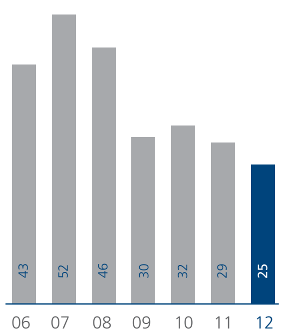
Operating profit (Rm)



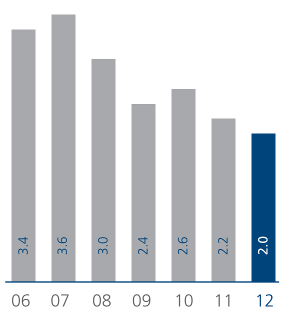
Operating profit margin (%)
Operating profit/Turnover



Return on NOA* (%)
Operating profit/Average NOA



NOA* turn (times)
Turnover/Average NOA



** Net operating assets*

Drivers of profitability and sustainability

3

The main drivers of the profitability and sustainability of Hudaco are set out in the Group at a glance section on page 3.

One of the key factors in securing sustainability of the individual businesses is their ability to represent quality world brands. As a result, significant focus is placed on ensuring that our businesses preserve strong relationships with the top brands that they currently represent and that we provide our principals with a market position in South Africa commensurate with their position in the world market. Focus is also placed on ensuring we keep in touch with market developments and make changes to or increase our portfolio of brands where appropriate so as to be able to meet the needs of our customers on a sustained basis.

Our people

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In order to add value as described on page 13, the skills and experience of our people, i.e. our internal knowledge management systems, are critical to each of our growth areas.

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Defending our market share depends on our ability to advise the customer on the correct specification and use of the product. It is a general trend in South Africa that technical expertise has tended to move from the user to the supplier. Our ability, therefore, to add value to our customers depends heavily on our technical support function. The nature of the products we sell is such that the sales teams also need strong technical skills in addition to selling skills. Very often it is up to us to identify the customer's real need. The chart on page 39 reflects where our people are stationed so as to be in a position to provide superior service to customers as and when required.

To achieve acquisitive growth, our acquisitions team needs to demonstrate deep insight and experience in the engineering sector. This is to be able to instil confidence in the seller of a business that we understand the market within which he operates and that a growth model post-acquisition is achievable, both for the seller (in terms of his earn-out targets) and for shareholders in Hudaco (in terms of contribution to group profits).

Our decentralised approach to management of our businesses means that we need people with strong administrative and financial skills, both in the businesses and at group level. The general deterioration in ethics in South Africa, accompanied by rising levels of fraud, makes these skills all the more important.

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Given the skills shortage in South Africa at present in all these categories, investment in our people remains a key component of the sustainability of our business model. (For more information on how we invest in our people, refer to the Building future capacity in Hudaco section on page 40.)

How we measure success

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Our mission and what we seek to do to achieve it for the various stakeholders are set out on page 12 of this report. We measure success through financial and non-financial assessments:

- Customers – growth in market share, measured where information is available and using customer satisfaction reviews;
- Suppliers – retention of significant brands, principal relationship reviews, benchmarking the market position of a brand in South Africa with its market position internationally;
- Our people – management and technical retention; success on educational programmes; health and safety records; support for wellness initiatives;
- Transformation – employment equity: appointment and promotion of black people to more senior positions; proportion and success of black people on our educational programmes; Black Economic Empowerment: empowering previously disadvantaged South Africans to own equity in the company;

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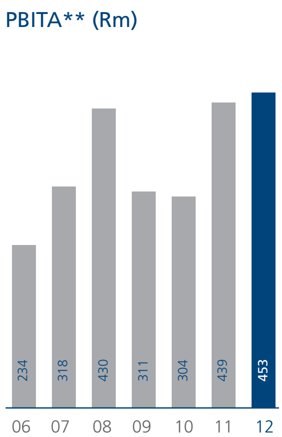

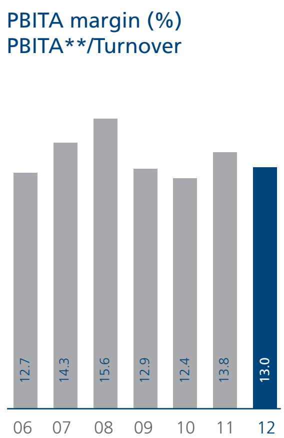

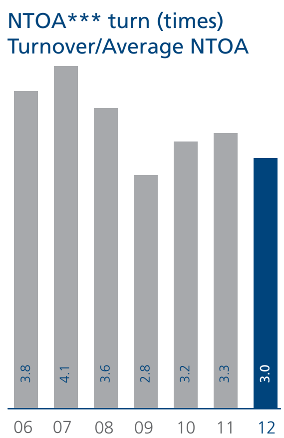

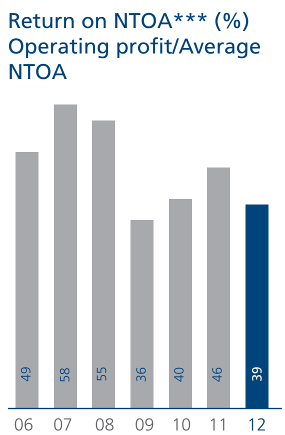

*** Operating profit before amortisation   *** Net tangible operating assets*

- Communities – success of students on our BEE bursary programme, support for and success of our corporate social investment initiatives; and
- Shareholders – the primary measures are financial and are detailed hereunder.

The key financial characteristics of the group are high returns on net operating assets and strong cash flows. These are used to fund additional working capital as our businesses grow, pay market-related dividends and invest in new businesses when opportunities are found.

Our overriding financial objective is to achieve long-term growth in earnings and dividends per share, and our internal operating measures and incentive programmes are geared towards this goal. We measure our financial performance as follows:
- We target real growth in heps over the medium and long term. Heps for 2012 is 1 071 cents as compared to 1 024 cents in 2011. Compound growth in heps over the past 10 years has been 13%, from 316 cents in 2002. We estimate that, had not been for the mining strikes this year, it would have been 14%.
- Hudaco aims to achieve earnings growth at a rate at least in line with the earnings of the All Share Industrial Index (J257). Since 2002, earnings in the J257 showed compound growth of 14,7%. To achieve this, we encourage our businesses to grow while producing a return (over time) exceeding the cost of capital.
- The main operating performance measure used by the group is RONTA – the Return (PBITA) on average Net Tangible Operating Assets (NTOA) employed during the year. NTOA is total assets excluding investments, goodwill, intangibles and cash, less current liabilities excluding interest-bearing debt. Each business is measured against its own benchmark – its objective being to maximise its RONTA by managing the balance between the operating profit margin (%) and net operating asset turn (times). The lower the operating profit margin, the higher the net operating asset turn has to be to achieve a return exceeding the cost of capital.

Industrial distribution businesses such as ours typically generate an operating profit margin of between 8% and 15%. A NOA turn of between three and four times is usual and requires management to achieve the right balance between the elements of working capital, i.e. inventory, receivables and supplier credit.

A RONA of 15% roughly equates to the pre-tax cost of capital at current interest and income tax levels. We use this as the 'hurdle rate' for new investments. We have set an internal target of RONTA of no less than 30% for the group as a whole. In 2012 the return on net tangible operating assets was 39% (2011: 46%).

How we impact the environment and society

Our businesses are generally not involved in manufacturing, but operate warehouses and branch networks with low direct environmental and social impacts. We are, however, aware that our choice and location of suppliers have important consequences on our collective environmental impact.

Opportunities to minimise our environmental and social impacts are therefore primarily by consideration of the environmental and social performance of our suppliers, through:
- The origin of raw material inputs and the recycled content of products;
- Pollution abatement in manufacturing processes;
- Environmental performance of product (such as in the case of our diesel engines);
- The energy intensity of manufacturing and transportation methods;
- Fair labour practices; and
- Social contributions.

Environment-Friendly Design Concepts – Makita Corporation

Makita's concept for environment-friendly products began with an assessment of the recyclability of the product range in 1992, and environment-friendly design began in earnest with the launch of Makita's global environment charter in 1993. Today they improve the energy efficiency of products, reduce weight and extend product life, and use environment-friendly materials to develop, manufacture, and sell products that are recyclable or safe for disposal.

Makita will endeavor to fully understand environmental impacts we may cause and periodically review the environmental objectives and goals within the technically and economically possible range.

Makita will comply with applicable laws, regulations and standards concerning the environment. Moreover, Makita will take preventive action against environmental pollution, based on their environmental principles.

For more on Makita's commitment to the environment see www.makita.biz/environment

We do not screen new businesses for their environmental and social performance, nor do we formally assess suppliers. However, all of our businesses are required to be certified against environmental, health and safety, quality and social management systems for internal risk management – respectively, the ISO 14 001, OHSAS 18 001, ISO 9 001 and ISO 26 000 standards. Where we acquire businesses without these ISO certifications, we put in place a programme to ensure they obtain the certifications within an appropriate timeframe.

As importers, we understand that our products generally travel long distances before they eventually reach our customers. This is a consequence of our business model and our geographic location at the southern tip of Africa. We aim to achieve economies of scale by scheduling orders efficiently and streamlining our logistics operations, thus minimising our carbon footprint. Bearings International, which has about one-third of all branches in the group, has established satellite distribution centres in Cape Town and Durban. This has meaningfully reduced its transportation footprint in that it now sends one consolidated long-haul load per week to each of those centres whereas in the past it would send smaller loads to each separate branch in the area, several times per week.

Owing to our comparatively low purchases from global suppliers as a proportion of their total sales, our ability to influence their manufacturing methods is small. For example, our total annual Makita power tools purchases are less than two days' production from Makita's factories globally.

Most of our brands are manufactured according to the stringent environmental standards of Japan and Europe, which generally exceed the requirements of the countries where their products are used (e.g. the relatively poor South African emissions standards on diesel engines).

Environmental and social performance of suppliers is being driven by the largest markets which they supply (such as the EU and the US). As these markets tend to be progressive leaders in the environmental and social landscape, they will have much more influence on the production standards of our suppliers than we could ever have.

In those few instances where we source unbranded products directly from manufacturers, we visit the factories concerned and assess informally whether there are any evident reasons, such as inappropriate labour practices or pollution, why we should not buy from that supplier.

Similarly, there is limited opportunity for us to develop post-consumer collection, recycling or recovery of our used products. Generally, our products are either serviceable (as in the case of diesel engines or power tools) or are disposed of post-use by our customers (as in the case of filters and hoses). Certain of our products contain hazardous components such as circuit boards, but the volumes are too small to formalise collection, recycling or disposal systems. Metal components from our power tools are sent for recycling, and contaminated water from our diesel engine workshops is treated prior to disposal.

In line with our new approach to integrated reporting and increased transparency of disclosure, we recognise that it would be appropriate for us to collect more information about the environmental and social impacts of both our suppliers' and our businesses' activities. We also, however, need to be practical, recognising that our ability to influence change will be small. For 2013 therefore, our efforts regarding supply chain sustainability will be limited to information gathering alone, followed by a determination as to where and how interventions may be possible and productive.

Emissions and fuel efficiency – Deutz AG

The differentiators of our diesel engines in the market are linked to sustainability issues. We are the only suppliers of air-cooled motors, with a fan robust enough for mining operations. The fuel consumption of our engines is also 15% more efficient than competitors' motors. Deutz AG spends around 10% of turnover on research and development annually, and the company's current focus areas include exhaust emissions and fuel efficiencies.

Environmental management system – Deutz AG

In 2003 Deutz AG introduced on a voluntary basis an Environmental Management System whose conformity with the international norm DIN EN ISO 14001 was independently audited and reconfirmed in 2011. With this programme Deutz set themselves voluntary targets for reducing the environmental impacts that can arise as a result of their commercial activities. This reinforces their endeavours to make a sustainable contribution towards protecting the environment.

Communicating our values

Hudaco subscribes to sound corporate governance. We are aware of our financial reporting obligations, respect the confidentiality of our business partners and investors, and strive to achieve the right balance between consistency and autonomy in our various businesses.

Although these values have not fundamentally changed, the introduction of King III and its requirements for integrated corporate reporting presented us with the opportunity in 2011 to revise our thinking with regard to communicating these values.

We acknowledge that the opportunity for our staff, suppliers and investor community to interact with the executive team is limited. In this 2012 integrated report we try to build on the base set in 2011 to provide a more thorough disclosure of our values, activities and performance to a broader range of stakeholders.

King III

This is Hudaco's second integrated report prepared in terms of the JSE's requirements for Integrated Reporting and the King III Code on Corporate Governance, published by the Institute of Directors of Southern Africa, and now applicable to all listed companies. It also meets all the other legal requirements to which the company must adhere (such as the new Companies Act).

This report tries to integrate the operational, financial and sustainability (environmental, social and governance) issues in relation to the key drivers of the business. In the report, we explain how the executives of Hudaco have applied their minds to considering these issues while developing the business' strategy.

While we acknowledge that there are still areas to improve in Hudaco's reporting and we remain committed to addressing these in subsequent reports, we believe that, building on our 2011 report, this 2012 report moves us closer towards best international practice, provides stakeholders with a more detailed view of our activities for the past year and outlines our approach to these issues in the years ahead. Hudaco's reporting complies with application level C of the Global Reporting Initiative (GRI) sustainability guidelines on economic, environmental and social performance, adopted by the group in 2010.

Reporting framework for 2012

This integrated report is used as a vehicle to communicate our evolving business model and the quality of the decisions that have led to our financial results. Our revenue, profits, social and environmental impacts and benefits accrue from our many business units that do not report independently in the public domain. In this report we try to strike a balance between adequate composite reporting at a group level, and communicating sufficient detail of the underlying operations.

In compiling this integrated report, the following were taken into consideration:

- The Hudaco mission;
- Our strategic objectives to achieve the mission;
- The Hudaco business model;
- Input received from the stakeholder engagement process;
- Reporting requirements for a listed company, including legislation; King III and JSE Listings Requirements;
- Performance and developments during the year; and
- Matters we believe are of relevance to stakeholders.

Stakeholder engagement

In terms of the requirements of sustainability reporting standards, we asked stakeholders what material information they required to maintain a mutually successful and sustainable business relationship. Stakeholders we are accountable to are: investors, shareholders, principals/suppliers, staff, customers and communities in the vicinity of our premises. In this report, we aim to provide each with information on material issues as identified in the table on page 23.

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We have rated the following stakeholders as the most significant (in no particular order) based on the likelihood that they will access and use this report, our ability to provide information that will be useful to them and their level of interaction with the group:

- Shareholders and investors, current and future, private and institutional;
- Staff: the 2 600 people in Hudaco's 19 businesses; and
- Principals/suppliers.

Winner of
Investment Analysts Society award
for best reporting and communication 2012:
Industrial – "Basic Industry, Manufacturing and General Industry"

The table below details the issues considered by stakeholders to be material. These were determined through our stakeholder engagement process, which included discussions with members from each of the stakeholder groups, either directly or through executives of our businesses. At interim results discussions, the investment community were invited to suggest further disclosure where they identified a need for specific information, as were bankers during annual review meetings. The diagram on page 24 identifies where issues raised by stakeholders were dealt with in this report.

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Stakeholders' material issues

Stakeholders	Relationship	Reason	Material issues	Communication forum
Private shareholders and institutional investors	Shareholders	Derive dividend income from trading performance and capital appreciation from market value of Hudaco shares	• Compliance, governance • Share price, dividend policy, return on investment, profitability • Management competence • Growth strategy • Business model • Acquisitions – deal flow and success of outcomes • Management remuneration • Risks	• Integrated and interim reports • Results presentations • Informal discussions • Hudaco website • Annual general meeting • Press interviews
Bankers	Financiers	Take credit risk on and derive interest and fee income from Hudaco. They would like Hudaco to introduce more gearing	• Statements of financial position, comprehensive income and cash flows	• Integrated and interim reports
End users of products	Customers	Hudaco supplies them with quality products at reasonable prices and technical support to sustain their operations	• BEE credentials • Brand • Product quality • Technical support • Service turnaround • Pricing • Reputation	• Personal contact • Product marketing • Service levels • BEE scorecard • Business unit websites
Management of businesses	Management, potential vendors	Rely on Hudaco for their livelihood and meeting career aspirations as well as for investment-related returns through the share appreciation bonus scheme	• Hudaco brand, association with quality products, endorsement in market through association • Treasury function, insurance, company secretarial functions, internal audit • Synergies within group • Management and resource support from centre for growth • Company structure, relevance of Hudaco group issues to operational companies • Business model • Leadership succession planning, careers, knowledge management systems • Functional relationships with group management • Cash position during earn-out process • Remuneration	• Integrated report • Results presentations (internal) • Management conferences • Personal contact • Retirement fund reports
Owners of privately-owned businesses	Potential vendors	Hudaco provides a potential exit strategy or a means of realising the value in their businesses and building a career within the group	• Acquisition and earn-out process • Exit opportunities • BEE credentials • Support for growth opportunities	• Integrated report • BEE scorecards • Personal contact

Stakeholders	Relationship	Reason	Material issues	Communication forum
Principals	Suppliers	Rely on Hudaco for a route to market without them having to establish a presence in SA, a relatively small market which has significant regulatory complexities	• Market shares • Sales forecasts • Stockholding and ordering processes • Distribution strengths • Customer penetration • Cultural barriers in dealing with local buyers • Credit-worthiness	• Personal contact • Integrated report • Business unit websites
Employees of Hudaco and businesses	Staff	Rely on Hudaco for their livelihood (during and post-employment) and personal development to meet career aspirations	• Career development • Leadership succession planning • Remuneration • Skills retention and development • BEE	• Integrated report • Policy documentation • Personal contact • Retirement fund reports
Government	Tax collector, Transformation regulator	Rely on Hudaco to collect and remit indirect taxes, to pay direct taxes and to progress B-BBEE	• VAT • PAYE • Income tax • Dividends tax • Customs duty • B-BBEE	• Statutory returns • Integrated reports • Results presentations • Correspondence • B-BBEE certification

Relevance of report sections to broad groups of stakeholders

Welcome to the world of Hudaco and How Hudaco is governed

- All stakeholders

Investing in Hudaco

- Institutional investors
- Private shareholders
- Bankers
- Corporate finance houses
- Analysts
- Sponsors
- Government

Hudaco

Doing business with Hudaco

- Current and future business vendors
- Customers
- Principals/suppliers

Building future capacity in Hudaco

- Current and future staff
- Unions
- Regulators
- Management
- Communities

Investing in Hudaco

Existing businesses

We possess distribution rights for excellent product brands mainly on an exclusive basis for Africa south of the equator. A consistent group objective is optimising growth within our existing portfolio – i.e. improving geographic spread, increasing the product offering and increasing market share. Growth is augmented by the acquisition of additional agencies through acquisitions.

The group's activities are divided into two segments: engineering consumables and consumer-related products.

Engineering consumables

Bearings International – special bearings reduce downtime and increase capacity

FHS – Filtration Solutions for heavy duty applications

The engineering consumables segment comprises the following main businesses and activities:

- Bearings International has over 40 branches across southern Africa. The main bearing brand distributed is FAG.
- Deutz Dieselpower represents Deutz AG – one of the world's leading independent manufacturers of air cooled and liquid cooled medium-sized compact diesel engines.
- Filter and Hose Solutions is a leading distributor of Donaldson filters and filtration solutions, kits and accessories for heavy duty and automotive applications.
- Power Transmission products is a collective term for the following businesses supplying mechanical and electrical power transmission products: Ambro Sales, Ampco, Astore Africa, Belting Supply Services, Bosworth, Ernest Lowe, Powermite and Varispeed.

The main business of this segment is the supply of replacement parts for mining and industrial machinery.

Performance

In 2012 the engineering consumables segment comprised 65% of group turnover and 62% of group operating profit. Turnover grew by 4% to R2,3 billion and operating profit grew 2% to R280 million. 3

Businesses supplying replacement parts are generally more dependent on economic activity (GDP) than fixed investment (GDFI) growth. This tends to make the earnings of the engineering consumables segment less cyclical compared with, for instance, distributors of capital equipment. During economic downturns, customers may mothball capital equipment from which they can strip replacement parts, but this generally does not last long and demand soon resumes. Being low value critical items, our products are generally not very price sensitive.

The main bearing and other consumable brands stocked by Hudaco are of European or Japanese origin. The possibility of Chinese and Indian brands taking market share from Hudaco is sometimes seen by analysts as a threat. However we believe the opposite is true. Because parts sourced from these countries are usually lower in quality, customers are reluctant to compromise by buying cheaper parts with an unknown brand because the consequence of fitting sub-standard parts in terms of downtime significantly outweighs the cost saving. When manufacturers in these countries reach the appropriate quality to price standard – as they eventually will – Hudaco will be a logical and sought after local distributor. In fact we already carry many brands from these countries alongside our more established brands. So, rather than a threat it should be seen as an opportunity.

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Refer to page 38 for a geographic analysis of the source of engineering consumables.

Bearings International

The largest business by turnover in this segment, Bearings International had a good year notwithstanding that, due to its broad exposure to the general economy through its 40+ branch network, it was badly affected by the strikes in the transport and mining industries in the latter part of the year. Although, due to the strikes, turnover was below 2011, operating profit showed satisfactory growth through better margin and expense management. Progress was also made in reducing slow-moving stock, a task made easier by the more logical layout of inventory in its new premises.

Deutz Dieselpower (DDP)

Deutz diesel engines are designed (and priced) for constant load applications and its main market is the mining industry. Underground mining – gold and platinum – accounts for 60% of sales. Most Deutz engines sold in sub-equatorial Africa – broadly the geographical area for which DDP has responsibility – are fitted as replacement engines to equipment manufactured in other parts of the world and imported by original equipment distributers such as Sandvik and Atlas Copco. Most of DDP's sales of engines are replacements for engines at the end of their life cycle – there being only a few small OE manufacturers in this region. The margin on parts is higher than on new engines, so a key strategy to grow profitability is to grow the engine population. We do this by offering excellent support for Deutz engines wherever they are located and however they arrived in our territory. A key initiative this year was to increase volume sales of parts by taking market share from pirates by reducing prices and by offering slightly lower quality parts without compromising performance. Initiatives similar to this by motor car manufacturers are becoming common. Although this is a multi-year programme, pleasing results were already evident in the second half of the year. However, DDP was also badly affected by the strikes in the gold and platinum mines and, as a result, both sales and operating profit were below 2011 levels.

Filter and Hose Solutions (FHS)

Filter and Hose Solutions had an excellent year, continuing to take advantage of demand for higher performance (hence higher priced) fuel, oil and air filters demanded by new generation diesel engines which offer higher performance to weight ratios than previous generation engines whilst being designed to meet ever stricter world-wide emission standards. These engines, operating in dusty open cast mining applications, are FHS' main market. Open cast mining is growing faster than underground mining, particularly in neighbouring countries, and was less affected by the strikes in the final quarter of 2012.

Filter and Hose Solutions – one-stop filtration solutions

Sunday Times **Top 100 companies 2012** measured by total return to shareholders over five and 10 years, **Hudaco** was ranked **58th** and **38th**, respectively.

TOP 100

Principal brands Mechanical power transmission

NORGREN	agru	NCR	Habasit	Donaldson	MALCORP	FILTREC
European pneumatic equipment. Sole distributor since 1959	Thermoplastic valves from Austria. Sole distributor since 1995	Industrial hose from Thailand. Sole distributor since 2002	Transmission and conveyor belting from Switzerland. Distributor since 1970	Heavy duty filtration systems from USA. Distributor since 1994	High performance industrial hose from Malaysia. Sole distributor since 2003	High performance hydraulic filtration from Italy. Sole distributor since 2003

Power transmission businesses

The Power transmission businesses delivered solid results. Bosworth had a poor year partly due to poor management but also because customers, particularly Eskom, deferred delivery of pulleys as project completion was pushed into 2013. Powermite had a good year and has plans to substantially expand its specialised cable business in 2013. The specialised steel businesses battled in a low demand, over supplied market.

Outlook

Two macro-economic factors affect the performance of the engineering consumables segment:

- Activity (output) in the mining and manufacturing sectors; and
- Rand strength or weakness.

The mining sector in South Africa is heavily dependent on support from the local manufacturing industry. These two market segments are significant users of engineering consumables and represent 67% of Hudaco's engineering consumables segment sales. The outlook for mining in South Africa over the next few years is muted and in our view will remain so until there is resumption in growth in the world economies and until infrastructure constraints, electricity and rail capacity mainly, are overcome.

Investment in neighbouring countries, particularly Mozambique, Zambia and southern Congo, appears to be ramping up faster than we initially anticipated. As a result, during the year we appointed a senior manager as "Africa Champion" to co-ordinate and intensify efforts to capture our share of these markets. Hudaco's direct exports into neighbouring countries in 2011 were R200 million or 6% of sales. We have set ourselves an objective to increase this to R500 million by 2015. In 2012 it was R250 million.

We do not try to predict what the exchange rate of the Rand will be. For a discussion on the impact of exchange rate movements on our financial results see page 32.

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Powermite – electrical power transmission solutions

Principal brands
Electrical power transmission

Variable speed drives from Japan. Sole distributor since 1992

Geared motors from Germany. Sole distributor since 1989

Own range of electrical plugs and sockets since 1974

Plugs and sockets from Germany. Sole distributor since 1974

Electrical feeder systems from Europe. Sole distributor since 1970

Principal brands
Bearings International

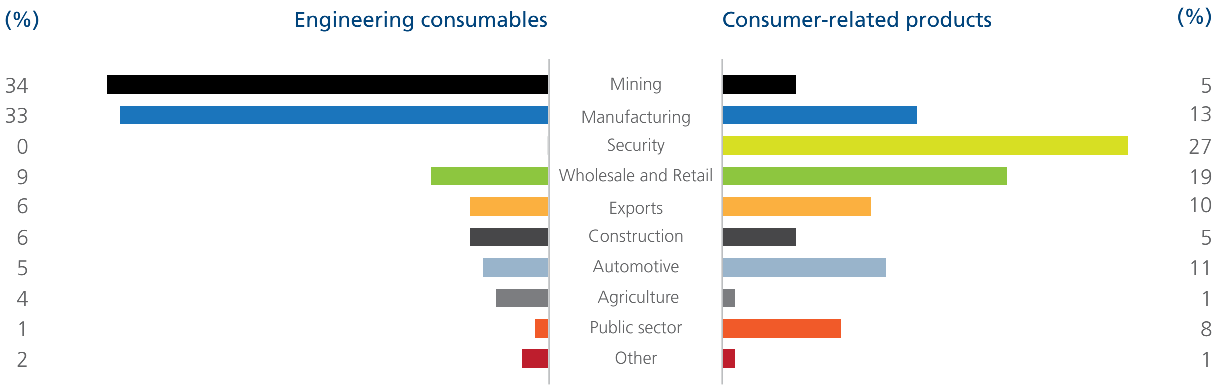
Precision bearings from Germany. Distributor since 2005

Ball and roller bearings from Japan. Sole distributor since 1962

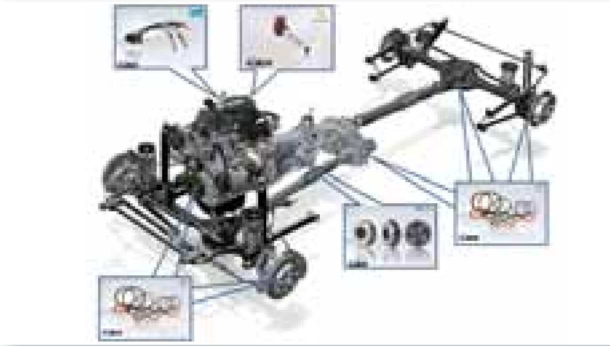
Principal brand
Deutz Dieselpower

Air and liquid-cooled engines from Germany 22 - 520Kw. Sole distributor since 1969

Sales by market sector – 2012



Consumer-related products



Abes – clutches, seals and ignition leads for the automotive aftermarket

Elvey – market leader in intruder detection solutions

The Consumer-related products segment comprises the following main businesses and activities:

- Automotive: Abes distributes a range of automotive replacement parts, primarily Valeo brand clutches, ignition leads and oil seals. Deltec, a distributer of high quality maintenance free batteries, was acquired this year to complete our power offering for underground mining equipment. We now have all three power sources: diesel engines, electric motors and batteries, in our portfolio.
- Elvey Security Technologies is the largest distributor of DSC electronic access control security equipment. Its main customers are the rapid response firms like ADT.
- Rutherford distributes Makita industrial power tools, Mercury marine engines, survey equipment and nuclear gauges.
- Global Communications is a provider of integrated analogue and digital telecommunications infrastructure and a distributer of Kenwood telecommunication and radio equipment.

The main business of this segment is the distribution and supply of products to intermediaries for ultimate use by consumers or in applications driven by consumer spending.

Performance

3 In 2012 the Consumer-related products segment comprised 35% of group turnover and 38% of group operating profit. Turnover grew by 22% to R1,2 billion whilst operating profit grew only 4% to R169 million.

Businesses in this segment supply products which wear and need to be replaced in reasonably predictable timeframes. Usage, with the exception of the Global Communications product range, is generally more dependent on economic activity (GDP) than fixed investment (GDFI) growth. This tends to make the earnings of this segment, as it is with the engineering consumables segment, smoother than businesses dependant on investment spending. Brand loyalty is high.

Rutherford

Rutherford, which reached its centenary this year, enjoyed a good sales year but price increases, which are usually linked to a weakening in the Rand, were
31 difficult to achieve and sustain due to the volatility of the currency this year (see page 31). As a result margins came under pressure and operating profits were flat. Makita industrial power tools once again increased unit sales as it broadened its customer base by expanding into neighbouring territories. The marine business continues to trade in a very subdued highly regulated market whilst the instrumentation business performed poorly due to the mining strikes at the end of the year.

Rutherford – Power Tool Company of the Year

Rutherford was voted DIY Trade News Power Tool Company of the Year Gold Award winner 2012. The poll was online and open to power tool dealers and the industry. "We feel this makes it all the more special" said Robert Cameron-Smith, Marketing Manager.

Elvey Security Technologies

Elvey increased sales and maintained profits in a difficult market which saw a number of competitors retrenching staff and downsizing operations. There is little in the way of new housing and commercial premises coming on stream so the business mainly relies on replacement and upgrades. Attempts to find a good quality alternative product line were reaching finality as the year drew to a close and we are hopeful that we will be able to launch the new range early in 2013. Pentagon, our systems design and supply business, had a poor year with few new projects coming on stream.

Elvey Security Technologies

CCTV on the move – a solution to fleet abuse

The Problem

The abuse of company vehicles by employees is a problem faced by all fleet owners.

"Unchecked, it can significantly undermine profits and compromise service delivery, which is why company owners are increasingly embracing mobile DVR technology," says Zane Greeff, technical director of Elvey Security Technologies.

Jaco Benadie, General Manager of Urban Africa Protection Services, which provides a range of security services in Limpopo Province, was challenged by ongoing problems such as excessive petrol consumption, private use of vehicles and tardy responses to call-outs.

"Without monitoring systems, employers have no idea what's happening out in the field," says Mr Benadie.

"Its common for drivers to use both company time and vehicles to do their shopping, park off under a tree rather than patrol the streets or ferry private passengers around. Misuse of company vehicles is a most frequent occurrence in the security industry, leads to increased fuel consumption, accidents and missing vital alarm call-outs. This is obviously detrimental to the business.

"A great deal of time, money and effort goes into training employees and building a client base. It's therefore critical to be able to monitor the appropriateness of the reactions of personnel in the various situations they face."

The Solution

Mr Benadie decided to have his company vehicles kitted out with mobile DVR systems. He worked closely with the Elvey team and, together, they devised a tailor-made solution that has the following characteristics:

- *Operates on a normal car battery.*
- *A multi-information display feature and a recording application for license plate number, time, GPS, speed and station information.*
- *A four-camera system that allows for the capture of imagery from inside as well as of the driver, passenger and the front, left and right sides of the vehicle. It also enables the control room operator to view the surroundings and has:*
  - *Mobile dome cameras with TVL (television line) resolution to provide excellent colour reproduction and image detail.*
  - *Automatic Gain Control that lowers the internal settings if signals received by the lens are strong, or raises them when the signals are weak.*
  - *Automatic picture signal adjustment to prevent loss of detail.*
  - *Back Light Compensation (BLC) to enable the cameras to detect differences in illumination and to increase the range of the luminance to prevent any noticeable differences in the pictures.*
- *The ability to automatically connect to the control room WIFI network and back-up data and footage while vehicles are on the company premises during shift changes, which has serious cost-saving implications.*
- *Makes it possible to remotely view the location of a vehicle at any time.*

Mr Benadie adds: "The cameras help keep my staff honest. Since the installation of the system, there has been no abuse of our vehicles, no lifting of strangers and, most importantly, there have been no accidents. Its good for the environment too – the less our vehicles are driven, the less carbon is released. We're saving time and money and letting our customers and staff know that we are serious about the service we provide."

Global Communications

Global Communications had another excellent year. The specialised systems integration part of the business continues to take advantage of the migration from analogue to digital communication throughout Africa. Customers are mainly in the public sector and include: municipalities, hospitals, police and defence forces, who all utilise sophisticated communication equipment for control and monitoring purposes.

Abes Technoseal

Abes Technoseal had a poor year losing market share to cheaper lower quality clutch kits imported from China. We believe that this is a cyclical development and that fitters, unhappy with the replacement warranty costs, will eventually return to more reliable brands such as Valeo.

Deltec

Deltec performed well in its first few months in the group.

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See page 38 for a geographic analysis of the source of consumer-related products.

Outlook

The major macro-economic factors affecting the profitability of the Consumer-related products segment are:

- Consumer spending;
- Rand strength or weakness; and
- Analogue to digital migration.

Due to on-selling arrangements in the segment's distribution chain, we are unsighted as to the final use of our product range and therefore cannot say with precision which sector drives growth. For example, when we sell intruder detection equipment to installers, we do not know whether it is to be used in residential, commercial or industrial environments, for new developments or for upgrades to existing systems. We therefore use general trends, such as consumer spending and total GDP, for forecasting the outlook for this segment of our business.

Trading conditions in this segment are expected to moderate in 2013. The rapid growth in consumer spending over the past few years fuelled by growth in public sector employment followed by above inflation wage increases and the expansion of the social grant programme must be coming to an end. This will impact on consumer spending in general including new car sales and housing construction, areas close to our hearts. The Rand exchange rate, notwithstanding some spikes, has been steady over the last year which has made price increases hard to achieve and we make no attempt to guess how it will perform in 2013.

Acquisitions

2012 was a quiet year for acquisitions. Three small acquisitions were made: Keymak, Proof Engineering and Deltec.

As the South African regulatory environment tightens, the cost of compliance rises and BEE qualifications become more onerous, there will continue to be a stream of privately-owned businesses available for purchase. We therefore expect to continue to find opportunities to acquire attractive businesses which will contribute to earnings growth at relatively low risk.

Principal brands
Elvey Security Technologies and Pentagon

Sole distributor of Canadian manufactured DSC products since 1990. Holder of distribution rights on complimentary Tyco brands.

Japanese intrusion detection devices.
Sole distributor since 1987

USA manufacturer of intrusion control panels and equipment.
Sole, distributor since 1987

Innovative and unique range of Access Control products manufactured in Ireland.
Distributor since 2010

South African Manufacturer of access control systems.
Distributor since 2011

South African Manufacturer of access control systems.
Sole distributor since 2003

Range of locally and internationally sourced security accessories and CCTV products. Alarm Supples distributed exclusively through Elvey since 1994

Specialised German-designed IP and analogue CCTV products.
Distributor since 2005

Canadian based Open Platform Video Management System that allows the use of most 3rd party camera devices.
Sole distributor since 2012

Principal brands
Rutherford

Japanese industrial power tools.
Distributor since 1968
Sole distributor since 1985

Outboard motors from USA.
Sole distributor since 1986

Petrol inboards and sterndrives from USA.
Sole distributor since 1986

Global positioning systems and survey instrumentation from Japan and USA.
Sole distributor since 1969

Nuclear gauges used for compaction control of soil, concrete, asphalt and aggregate from the USA.
Sole distributor since 1974

Principal brands
Abes Technoseal

Oil seals from Germany.
Preferred distributor since 1950

Ignition cables from France.
Exclusive distributor since 2007

Light duty clutch kits from France.
Exclusive distributor since 2005

Clutch kits from Japan.
Sole distributor since 2007

Clutch kits from Korea.
Exclusive distributor since 1994

Principal brands
Global Communication

PMR equipment and radio networks. Sole distributor for southern Africa since 1987

CCTV cameras and video systems
Distribution started in 2009

AE Rutherford Limited, an engineering merchant, was established in 1912 by Mr AE Rutherford, situated at 76 Bree Street, Cape Town. The company was purchased in 1924 for £2,000 by the Gearing family, who were to own and manage the business until selling to Mitchell Cotts in 1977. It was sold to Landlock in 1983 and to Valard in 1989. Valard was acquired by Hudaco in 1992.

It specialised in sales of general engineering requisites and consumables, including woodworking machines and tools, belt drives, stone and ore crushers and screens, as well as concrete and 'macadam' mixers.

From these early beginnings, the roots of today's broad-reaching Rutherford operation associated with leading agencies such as Makita Industrial Power Tools and Mercury Marine engines, were evident in the sale of equipment such as Tauco and Van Dorn electric drills, alongside Penta petrol/paraffin and Skandia diesel marine engines and Archimedes outboard engines.

Rutherford has distributed Makita power tools since the 1960s and was appointed sole distributor for southern Africa in 1985. It has taken Makita to clear brand leader in the industrial power tool market in the region. Makita training centres in Germiston, Cape Town and Durban are dedicated to educating South African operators in the safe use of Makita power tools.

Its marine division also offers technicians employed by its dealers and partners the benefits of a marine academy.

The V.I. Instruments division has earned the distinction of being market leader in compaction measurements for road construction.

Rutherford CEO Bob Cameron-Smith believes the core factors for a successful 100 years have been world-renowned brands backed by a depth of quality technical know-how."In our economy, it is rare to find so many long-serving employees. Our management team averages 19 years with the company. At the same time we're nurturing a group of bright, young up and coming team players who will ensure a sound succession plan in the medium to long term."

Cameron-Smith says his current objective for building on Rutherford's century of service is to consolidate the company's position as a leading supplier.
In recent years, the company has expanded its footprint by including other avenues of distribution and expanding its reach into neighbouring African countries.

"We enjoy excellent relationships with all our overseas suppliers and are committed to introducing their latest releases to our customers in southern Africa."

Every investment opportunity is weighed against the alternative opportunity of buying our own shares. Taking into account that privately held businesses are being purchased at a PE of between 4 and 7, whereas the group is trading at a PE of about 10, buying our own shares does not make sense.

For an investor, the opportunity Hudaco represents is having line of sight through to these attractive new businesses.

Businesses are invariably bought on an earn-out basis, which is attractive to sellers who believe their businesses have exciting growth prospects. It simultaneously provides a cushion for Hudaco if the businesses do not perform to sellers' expectations. Detailed valuation processes are designed to minimise risk and ensure that we do not overpay. In terms of such earn-out arrangements, a portion of the purchase price is usually paid up-front, with the remainder dependent on the level of performance achieved over three years.

Ideally we would like to have a reasonable level of financial gearing and our acquisition strategy may well result in our achieving this objective in the near future if we raise debt to finance further acquisitions. We seek to ensure that interest on senior debt is covered at least five times by operating profit. In addition, we aim to operate with net senior debt no higher than 50% of total shareholders' funds.

Interactions with investors reveal that they would like more visibility on the success or otherwise of individual acquisitions. This information is not disclosed because we believe that providing more detailed information on individual businesses would be prejudicial to our competitive position. As a result, we follow the segmental reporting requirements of International Financial Reporting Standards and do not break down the information any further. However, the aggregated results of businesses acquired in the past two years can be found in the statement of comprehensive income on page 65.

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Acquiring distribution rights for a competing brand is generally not feasible where we already represent a major global brand. We therefore look to acquire businesses distributing products not already in our portfolio. Major manufacturers with a global presence are invariably already represented locally, and opportunities to bring those rights into the Hudaco portfolio usually only take place when the local owners of the distribution rights wish to disinvest. Consequently, opportunities to acquire new distribution rights present themselves only rarely, which means that our acquisition strategy has to be opportunistic in nature. We do, however, maintain a wish list and have a shortlist of targets currently under consideration. However, we remind investors that accounting standard IFRS 3, requiring intangibles in an acquisition to be fair valued and amortised, results in acquisitions often not adding to earnings to the same extent as they had in the past.

The impact of changes in foreign exchange rates on Hudaco

As we are predominately an importer, prices charged are linked to the Rand exchange rate. While Hudaco's sales line is affected by exchange rate movements, the group's expense line is affected by the local rate of inflation. This imbalance represents a real risk that sales could be falling in response to a strengthening Rand whilst expenses are rising. The result will be a margin squeeze. We estimate that a 10% strengthening of the Rand could result in a R100 million fall in operating profit over a full financial year.

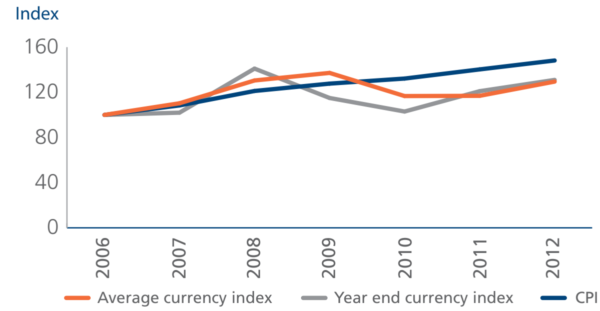
Over time, one would expect the Rand to weaken by the inflation differential between South Africa and its trading partners, allowing us to pass on imported inflation to our customers at roughly the same rate as the local inflation rate. As we are well aware, the Rand is volatile and does not follow the inflation rate differential in the short term. As an importer of our particular portfolio of products, we find ourselves exposed primarily to the Rand-Euro and Rand-Dollar exchange rates. Many of our suppliers manufacture from plants positioned all over the globe, and are therefore able to hedge themselves against currency exposures by shifting production capacity between currency regions.

The Rand appreciated significantly against the currencies of most developed economies between early 2009 and September 2011. The depreciation of the Rand since September 2011 has been most welcome but the volatility the currency has experienced has made pricing a challenge and margins have been kept under pressure. They should improve as older inventory, ours and that of our competitors, works its way out of the system. The graph below shows how the weighted exchange rate index for the basket of currencies that Hudaco purchases has moved relative to the consumer price index (CPI).

Ilustration of the impact on the group of a 10% change in the exchange rate without management intervention

Scenario	Base case	Rand strength-ens 10%	Rand weakens 10%
Sales	100	90	110
Cost of goods	60	54	66
Gross profit	40	36	44
Operating costs	30	30	30
Operating profit	10	6	14

Historical movement in foreign exchange rates for Hudaco's basket of currencies



We have taken out forward exchange contracts to meet future payment obligations in accordance with our hedging policies. Management of our foreign currency exposure is based on the principle of avoiding speculation. All foreign currency liabilities are covered forward (hedged) by the time ownership of the asset passes to Hudaco. In addition, approximately 30% of orders on suppliers are also hedged to guard against spikes in exchange rates.

Response times to exchange rate fluctuations through pricing changes, both up and down, have traditionally been fairly quick (about three weeks to a month) but there is a built-in cushion in our five-month stockholding so prices on all products may not change at the same time.

Deutz AG has developed live production data systems so Deutz Dieselpower is able to enter orders directly onto the manufacturing line. This has resulted in a higher degree of manufacturing flexibility and quicker response to customer requests. The move to just-in-time ordering processes reduces exposure to exchange rate risk.

BEE structure and taxation

The group's effective rate of taxation this year is 12% (2011: 12%). The reason why this rate is so much lower than the 28% official company tax rate is the tax-free dividends received on the preference shares acquired by a subsidiary pursuant to the sale of businesses in 2007. The preference shares were funded from the proceeds of the restructuring process and serve as security for the funding that was obtained by Hudaco Trading. The structure is designed to remain in place until 2017 but in future years the tax rate should increase as incremental trading profits are taxed at the full rate. Changes to legislation may also increase the effective tax rate. (Refer risk table on page 16.)

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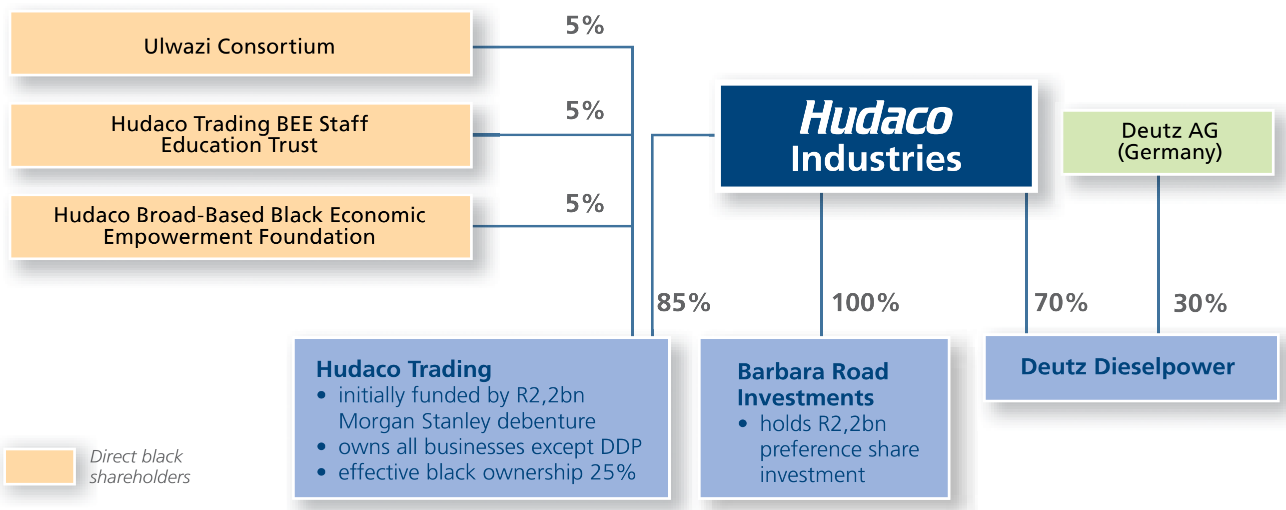
The BEE restructuring, a step deemed critical to the long-term sustainability of the group, introduced direct BEE ownership of 15% in the group's primary operating subsidiary, Hudaco Trading, bringing its total black ownership, including indirect ownership through mandated investments, to 25%. This resulted in it qualifying for the maximum number of points available for equity ownership in terms of the BEE scorecard prescribed by the Department of Trade and Industry. In addition to giving up 15% of their shareholding in perpetuity, shareholders at the time bore an initial accounting cost, determined using the Black-Scholes option pricing model, of R44 million by way of an IFRS 2 charge in the statement of comprehensive income. Deutz Dieselpower, our diesel engine business, which has its supplier, Deutz AG of Germany, as a 30% shareholder, chose not to participate in this restructuring.

The direct BEE ownership in Hudaco Trading is held by The Hudaco Trading BEE Staff Education Trust and The Hudaco Broad-Based Black Economic Empowerment Foundation with 5% each and a consortium of individual entrepreneurs, the Ulwazi Consortium, with 5%.

The BEE shareholders were introduced in such a way as to avoid the need for them to have to borrow money on onerous terms. This addressed the risk that if the economy did not track forever upwards, allowing the company to pay increasing dividends to finance the purchase of the shares, all or some of the BEE shareholders' investment would have to be forfeited to the finance providers. In the event, given the very difficult trading conditions in 2009 and 2010, the decision to structure the entry of the BEE shareholders in this manner turned out to be prescient. Proposed tax changes seem to be aimed at impacting on the viability of BEE transactions implemented in this manner.

Abridged group structure



The mechanism that was used to achieve the objective set out above was as follows: Hudaco Trading was formed as a new company with nominal share capital owned 85% by Hudaco and 15% by the BEE shareholders. Hudaco Trading borrowed R2,2 billion from Morgan Stanley by issuing a debenture. It used the money to purchase the trading operations from other Hudaco companies (100% owned) at fair value. The proceeds received by the other Hudaco companies were used to purchase preference shares from a company in the Cadiz group.

We have received a notice from SARS indicating that they believe that our BEE structure was a scheme designed to avoid tax and that they intend imputing taxable interest on Hudaco and disallowing STC credits arising on the preference dividends received. We strongly disagree with the SARS interpretation of our motivation. When the structure was put in place, we obtained advice from senior counsel that our case would stand up to scrutiny. This has been reconfirmed since receiving the notice. If SARS do assess us, we will contest the
17 assessment vigorously as we remain confident of our position, notwithstanding the fact that the notice contains third party information, obtained during SARS' discovery processes, regarding the structure, about which we previously had no knowledge whatsoever. For quantification of the potential impact, see the risk table on page 17.

16 The Taxation Laws Amendment Act of 2011 introduced changes to legislation that will make dividends declared in financial years commencing on or after 1 January 2013 on the preference share investment taxable at the full tax rate of 28%. The board is in the process of determining the most appropriate way forward. The likely impact is described in the risk table on page 16.

Black Economic Empowerment

During 2012, all businesses were again audited by independent verification bodies and all our businesses except DDP achieved level 4 or better against the DTI codes. All except two new businesses achieved value-added supplier (vas) status. Bearings International achieved level 2, meaning that its customers are able to claim 156% of their spend with us for the purpose of their own scorecard. Level 4 companies with vas status contribute 125% of the spend value towards their customers' rating. Deutz Dieselpower is the only business within the group which is not housed within the BEE structure and has improved its rating from level 6 to level 5 contributor, from having been at level 8 two years ago.

Business	BBBEE Status level	Value adding supplier	BBBEE Procurement recognition
Bearings International	2	Yes	156%
Abes Technoseal, Ambro Sales, Astore Africa, Belting Supply Services, Bosworth, Ernest Lowe, Filter and Hose Solutions, Global Communications, Varispeed, Midrand Special Steels, Rutherford, Elvey Security Technologies, Powermite	4	Yes	125%
Deltec, Keymak	4	No	100%
Deutz Dieselpower	5	Yes	100%

While it is difficult to quantify, we are of the opinion that our enhanced BEE standing has resulted in the following benefits:

- Business won;
- Customers retained; and
- Attracting potential acquisitions – the acquisitions we have made in the last three years were previously 100% owned by white shareholders. Our BEE status has become critical to our acquisitive success.

40 – 47

See pages 40 to 47 for further details of our transformation programme.

The Department of Trade and Industry has issued a draft set of revised codes for comment. If they are finalised as they are, our BEE ratings are likely to drop initially, but we expect those of our competitors to do the same.

Shareholder analysis
as at 30 November 2012

Shareholder analysis	Number of shares	% of issued shares	Number of shareholders
Portfolio size			
1 to 1 000 shares	1 023 117	3,23	2 705
1 001 – 5 000 shares	1 644 138	5,20	687
5 001 – 10 000 shares	1 221 859	3,86	160
10 001 – 100 000 shares	8 117 962	25,65	253
Over 100 000 shares	19 638 627	62,06	55
Total[1]	31 645 703	100,00	3 860
Category			
Banks and nominee companies	1 319 409	4,17	23
Financial institutions and pension funds	23 550 775	74,42	235
Individuals	5 087 634	16,08	3 520
Other corporate bodies	1 687 885	5,33	82
Total[1]	31 645 703	100,00	3 860
Shareholder spread			
Public	30 965 059	97,85	3 827
Non-public	680 644	2,15	33
Directors and associates[2]	676 444	2,14	32
Share trust	4 200	0,01	1
Total[1]	31 645 703	100,00	3 860

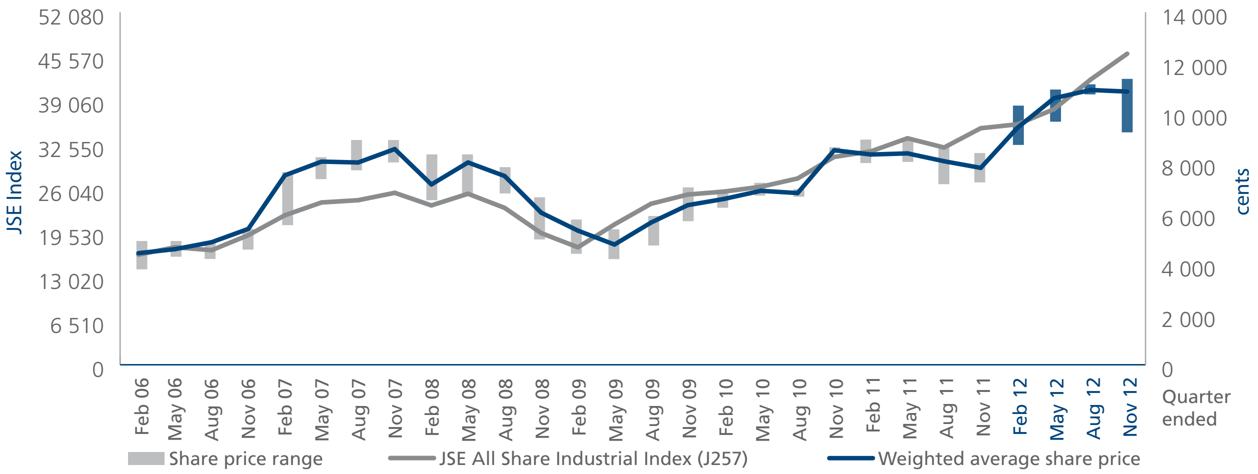
	Number of shares held	% of issued share capital
Major shareholders		
Beneficial shareholders holding more than 3%		
Old Mutual Life Assurance Co (South Africa)	3 020 346	9,54
Government Employees Pension Fund	2 673 502	8,45
Nedgroup Investments Value Fund	1 538 800	4,86
Foord Balanced Fund	1 331 332	4,21
Fund managers holding more than 3%		
Old Mutual Investment Group (South Africa)	6 724 687	21,25
Foord Asset Management	4 854 964	15,34
Public Investment Corporation	2 515 235	7,95
Investec Asset Management	1 866 575	5,90
Sanlam Investment Management	1 338 750	4,23
Abax Investments	1 312 592	4,15

(1) *Excludes 2 507 828 shares held by a subsidiary company.*
(2) *Directors' holdings are set out in note 27.1 to the financial statements.*
A list of shareholdings of senior management is available on request from the group secretary.

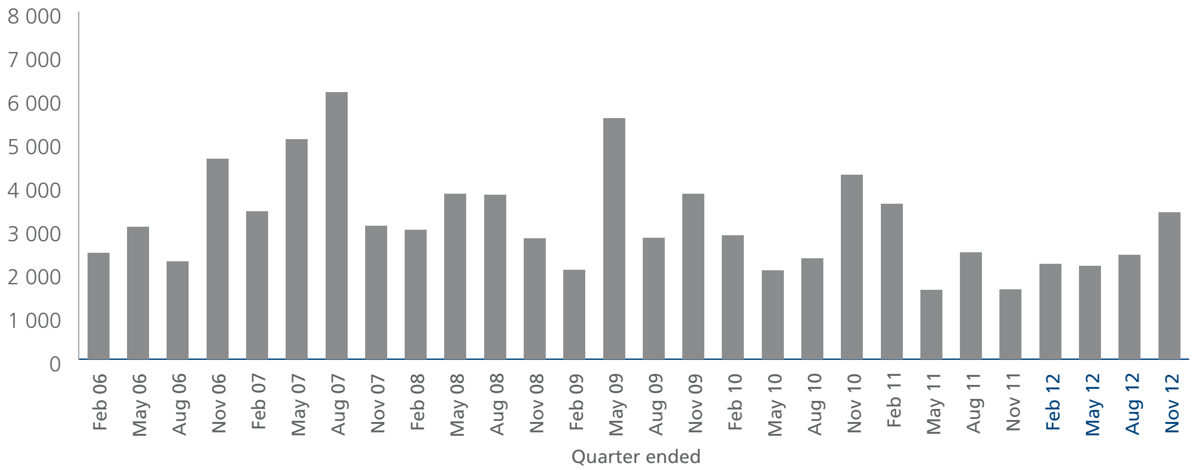
Share information

for the year ended 30 November 2012

Share price history



Volume traded on JSE (000)



	2012	2011	2010	2009	2008	2007	2006
JSE statistics							
Market price (cents)	11 200	8 475	8 501	6 600	5 600	8 500	5 400
NAV per share (cents)	5 277	4 721	4 080	3 681	3 282	2 623	2 429
Number of shares in issue (000)*	31 646	31 646	31 540	31 240	30 923	30 754	29 993
Market capitalisation (Rm)*	3 544	2 682	2 681	2 062	1 732	2 614	1 620
Price:earnings ratio (times)	10,4	10,1	10,9	7,2	8,1	14,3	12,4
All Share Industrial Index PE ratio (J257)	18,7	17,4	17,3	15,9	11,4	16,3	15,4
Dividend yield (%)	4,2	4,3	4,1	5,8	5,8	2,4	2,8
All Share Industrial Index dividend yield (J257) (%)	2,4	2,6	2,1	2,2	3,6	1,9	2,1
Annual trade in Hudaco shares							
Number of transactions recorded (000)	12 034	7 427	5 506	4 963	4 966	4 967	3 081
Volume of shares traded (000)	10 121	9 243	11 461	15 113	13 355	17 682	12 362
Percentage of issued shares traded*	32	29	36	48	43	54	41
Value of shares traded (Rm)	1 062	757	822	791	974	1 390	585

** Excludes 2 507 828 shares purchased by a subsidiary company.*

Doing business with Hudaco

In keeping with the principles of integrated reporting and sustainability, we believe it is valuable to our stakeholder engagement programme to include a section in this report explaining our business model to potential business sellers as well as to international manufacturers potentially wishing to enter the South African market.

Acquisitions

Hudaco's first priority is to take advantage of organic growth opportunities within the markets it serves. However, after funding organic growth and paying generous dividends to shareholders, Hudaco's high cash-generating characteristics mean that cash is still available to fund the acquisition of new businesses. We use acquisitions of successful (and usually privately held) businesses to provide an additional platform for future growth.

We believe that there are many private business owners in South Africa who are aware of Hudaco, like our management style and consider our buyout formula attractive. When the time is right, we hope they will approach us directly with a view to possibly selling their businesses to us.

Our board has agreed on a strategy to pursue acquisitions more aggressively, with the aim of:

- Ideally closing one major acquisition of at least R300 million turnover every two years;
- Continuing to acquire smaller usually bolt-on businesses; and
- Concluding a major, R1 billion-plus acquisition, if such an opportunity can be found.

During 2012 we made two small bolt-on acquisitions in Keymak, a manufacturer and distributor of specialised flexible PVC hose mainly for the mining industry, that fits well with Astore, and Proof Engineering, a leading supplier of flame and explosion proof cable connectors and explosion proof light fittings, mainly to the mining industry, which will operate as a division within Powermite. In addition, we acquired Deltec, a distributor of imported maintenance free batteries, representing leading brands such as Varta, Global, Forbatt and US Battery. The business of Deltec is an ideal fit for Hudaco in that it focuses on selling batteries to the automotive and standby markets but has only a weak presence in the mining industry. Hudaco will be able to utilise its experience and expertise in these markets to enhance Deltec's position, resulting in long-term benefits to shareholders.

Target criteria

Our acquisition target criteria are businesses that mostly are/have:

- Customers which require value-added distribution
- An identifiable competitive advantage, e.g. strong brand/s
- Already profitable and earning good returns
- In growth markets
- Distribution rights for products which are not currently offered by any business within the group
- Strong general and financial management and good controls
- A presence in non-capital, engineered products
- Selling to markets in southern Africa
- Preferably headquartered in Johannesburg.

Where practicable, Hudaco seeks to:

- Purchase the business not the company
- Enter into service agreements with management
- Include earn-out arrangements
- Purchase for cash, unless the acquisition is large enough to warrant issuing shares.

Acquisition opportunities are evaluated based on the impact on Hudaco earnings per share for the price paid and risk taken. We endeavour to structure transactions to ensure a contribution to group earnings as quickly as possible. PE ratios (or PBITA multiples) are the main guideline for price, with RONA ratios assessed to understand efficiencies.

Our success factors

Below we list what we have learned from our experiences thus far – factors that we believe have contributed to our successes, and will stand us in good stead in future transactions:

- The quality of the personal relationships between Hudaco and the seller of the business is the most important factor for a successful acquisition. We don't impose joint purchasing or tendering, preferring to preserve each business' route to market. Managing directors of businesses that come into the group may be invited to play a wider role within the group once they have completed their three-year earn-out and they have proved to us and to themselves that they are comfortable in a corporate-listed environment. We benefit greatly from the presence of the seller of a successful business on our team as they often bring with them experience and ideas worth sharing across the broader group.
- Our decentralised structure helps to ensure that the businesses that we buy remain intact (i.e. the brand, the staff and the reputation). Hudaco only intervenes when performance requires it.

- We seek to minimise the additional administrative burden placed on the new business in its transition from privately held to part of a listed group. Group executives attend monthly board meetings and assist in familiarising the team with the additional reporting requirements. These are explained during the acquisition process and are contained to those essential for maintaining proper control.
- For sellers seeking an improved BEE rating, we are able to provide maximum points for ownership as required by the Mining Charter and high scores in certain other categories. Each business within Hudaco has its own BEE score. Typically an acquired business could go from level 8 to level 4 overnight as a result of being part of Hudaco.
- We don't impose the same performance targets on each business. The Hudaco group is diverse enough to accommodate differing performance criteria. We recognise that not all of our businesses will achieve the same return on net operating assets.
- We are flexible enough to structure transactions to accommodate the unique circumstances of each vendor. For example, for a seller approaching retirement, part of the earn-out arrangements could involve successfully grooming a successor.

Group services

Services currently handled at head office, and provided free of charge to operating businesses, are tax, company secretarial, treasury (including foreign exchange), insurance, employee benefits and group risk (including internal audit and IT governance). Buying foreign exchange through head office is easier and cheaper for a business than dealing directly with a bank. Businesses enjoy lower bank charges, rates of interest and lower insurance premiums by being part of the Hudaco group.

Principals/suppliers

26,27, 30 Hudaco's businesses distribute top-quality branded products and have represented their major principals for many years. The dates the relationships commenced are set out with the brand logos on pages 26, 27 and 30.

The following factors strengthen our ability to retain existing distribution rights:

- Key is market share. If our local market share is similar to what our principal enjoys internationally, distribution rights are unlikely to be disturbed.
- The local southern African market is small in world terms making entering it directly frequently not worthwhile.
- South Africa is heavily regulated with unique laws (BEE) not well understood by the international community. Further, the regulatory and compliance landscape is not stable – new BEE requirements for example are now an annual occurrence. This tends to dissuade suppliers from entering the market directly.
- Corruption. South Africa is steadily climbing international corruption tables. Suppliers perceive that rights to conduct business are subject to government patronage and that awarding government business is accompanied by demands for payoffs. For legal and reputational risk reasons international corporations avoid doing business in such environments themselves.
- Long relationships (frequently on a personal level) and a well-established distribution footprint – both of which are hard if not impossible to replicate.

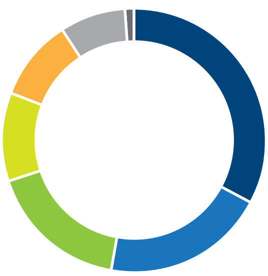
Business unit managers regularly visit suppliers to update them on local developments and agree on future plans. They also do their best to identify where suppliers are (and where they are headed) in terms of world market share pecking order. No one supplier accounts for more than 8% of group sales.

Head office personnel are informed and involved in relationships where the agency accounts for sales above a certain threshold and where its loss could have a significant impact on the group. Where a risk of loss of distribution rights emerges due to a supplier's financial difficulties, progress would be followed closely to establish the future home of the product. If all fails, an alternative supplier brand will be sought.

Sole distributorships are often not allowed in terms of international competition laws, and therefore cannot be contractually specified, but single agencies can still be the *de facto* situation.

Source of products – 2012

Engineering consumables (%)



Consumer-related products (%)

Business model

Hudaco is an importer and distributor of high-quality branded industrial consumable products. Two key elements of its success are: only selling products which require value to be added and its decentralised management style.

Value-add can be some or all of the following:

- Availability
- Product identification, specification and supply
- Advice on usage or installation
- Customer training

Decentralising management has the following advantages:

- Allows faster decision-making
- Empowers employees
- Leads to high standards and disciplines

For more information on what we do and how we add value, refer to page 13.

13

Where our people work

	Number of employees		Number of employees
Gauteng	1 780	Mpumalanga	66
KwaZulu-Natal	212	Free State	63
Western Cape	198	Eastern Cape	57
North West	118	Namibia	12
Limpopo	72	Northern Cape	10

Where to find us