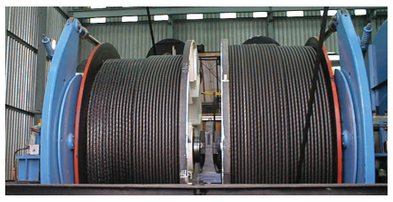
Hudaco

Audited preliminary report

for the year ended 30 November 2013



- Sales **up 13%** to **R3,9 billion**
- Sales into Africa **up 40%**
- Comparable earnings per share **up 4%** to 983 cents
- Headline earnings per share **down 13%** to 928 cents
- Final dividend maintained at 310 cents per share

Hudaco Industries is a South African group whose principal activity is the distribution of high quality branded industrial and electronic products 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 with a bias towards consumer spending. Adding value to the product sold by offering instant availability, advice and training etc. is a key part of Hudaco's business model.

Results

The group has delivered reasonable results in an uncertain and difficult to manage economic environment. The second half of the year is now regularly characterised by periods of industrial strike action which close targeted industries or businesses for weeks at a time. This year automotive manufacturing and distribution and mines (for the second year running) were targeted. The Rand exchange rate weakened significantly in 2013 which is good for exporters and Hudaco but due to the currency's volatility the full benefit of pricing to replacement was not obtained this year.

Comparable earnings per share increased 4% to 983 cents. Comparable earnings have been calculated as if the restructuring of the financing of the BEE transaction (which happened on 28 February 2013) had taken place before the start of the 2012 financial year and also excludes the charge to income (2012: gain) arising from adjustments to estimated earn-out payments on acquisitions. Previous to the revision of IFRS 3 this would have been included in goodwill.

Group sales of R3,9 billion are 13% up on last year whilst operating profit is up 7% to R469 million. The operating profit margin declined from 12,5% to 11,9% mainly due to difficulties in pricing to replacement with the volatile currency, coupled with slightly lower sales than planned for.

The ***Engineering Consumables Segment*** is the biggest profit contributor to the group. Mining and manufacturing account for 66% of sales in this segment whilst acquisitions continue to strengthen the sales base and spread. Trading conditions were tough as low commodity prices resulted in mining cutbacks and a focus on reducing costs. Strike activity impacted demand in the second half of the year. In response to lower demand from mining customers, cost cutting measures were implemented in Bearings International and Deutz Dieselpower during the year.

In 2013 the *Engineering Consumables Segment* comprised 63% (last year: 65%) of group turnover and 59% (last year: 62%) of group operating profit. Turnover grew by 9% to R2,5 billion and operating profit grew 4% to R292 million.

The ***Consumer-Related Products Segment*** businesses supply products which either wear out or need to be replaced in reasonably predictable timeframes, or require upgrading as more efficient products with additional features are introduced. Our security and communication equipment businesses improved profits in 2013 but power tools and automotive products were flat.

In 2013 the *Consumer-Related Products Segment* comprised 37% (last year: 35%) of group turnover and 41% (last year: 38%) of group operating profit. Turnover grew by 20% to R1,5 billion whilst operating profit grew 18% to R199 million.

Headline earnings per share is down 13% because of the increased tax charge resulting from the restructuring of the BEE financing arrangements set out below (the effect of which was communicated to the market in February and June 2013), and the accounting requirement for earn-out adjustments.

Our longer term policy remains to pay a dividend of about 40% of comparable earnings but this year we have decided to maintain the dividend at 465 cents, which represents 47% of comparable earnings.

The financial position is sound. The group has R204 million in net borrowings at year end (last year: R17 million) but a further R180 million will be borrowed early in the new year mainly to finance the acquisition of Dosco, GPM and Joseph Grieveson now that all of the suspensive conditions have been fulfilled. Inventories have been reasonably well managed given the declining Rand – they are up 20% to R1 104 million but this includes acquisitions. The return on net operating assets in 2013 is 22,1%, down on the 24,6% of last year but still well above our pre-tax cost of capital, which is approximately 15%. We have alerted shareholders in the past that this number is bound to decline as acquisitions are made and goodwill increases.

BEE financing arrangements restructured

As detailed in a SENS announcement in February 2013, the financing arrangements pertaining to the group's BEE transaction have been restructured. Cadiz redeemed the preference share investment of R2 181 million and as a result Morgan Stanley, the existing funder of the BEE transaction, exercised its option to put to the group the debenture issued by Hudaco Trading Pty Ltd. Consequently, the BEE funding arrangements that were intended to be financed externally until August 2017 have been financed internally by the Hudaco group since 28 February 2013.

As a result of the restructuring:

- the group statement of financial position no longer reflects a preference share investment of R2 181 million or a subordinated debenture liability of R2 181 million;
- with effect from 1 March 2013, the group statement of comprehensive income no longer reflects preference dividends received of R201 million per annum or debenture interest paid of R234 million per annum;
- basic earnings and headline earnings will decrease by approximately R33 million or 103 cents per share per annum; and
- for the financial year ended 30 November 2013, the effect of the abovementioned items on basic and headline earnings per share is 77 cents, plus there has been a further charge of 17 cents because of a one-off Securities Transfer Tax payment of R5,5 million on the redemption.

The BEE shareholders continue to hold their shares in Hudaco Trading and the BEE credentials of all entities in the Hudaco group remain intact.

Tax challenge

The group is facing a challenge from SARS in relation to the funding arrangements for the BEE structure put in place in 2007. In a SENS announcement on 12 February 2013, stakeholders were advised that assessments had been received from SARS for the financial years 2007 to 2011 relating to certain aspects flowing from the implementation of the BEE structure. SARS has set out detailed descriptions of other very complex arrangements connected to the structure and entered into by third parties without Hudaco's knowledge, or suspicion, which presumably resulted in tax leakage to the fiscus.

The amounts assessed by SARS comprise R1,3 billion under the general anti-avoidance regulations (GAAR) and R0,6 billion under alternative grounds of Hudaco having allegedly having become entitled to an amount because of the security arrangements. The amounts are broken down as follows: Tax on re-categorised interest imputed on Hudaco – R279 million, tax imputed on Hudaco as it allegedly became entitled to an amount because of the security arrangements – R143 million, impact of STC credits disallowed – R72 million, interest – R446 million, penalties – R987 million. It is assumed that SARS will take a similar approach in respect of the year ended 30 November 2012 and the three months to the redemption of the preference shares on 28 February 2013.

The maximum potential exposure, reflected as a contingent liability, is considered to be the assessment under GAAR of R1,3 billion plus a further R0,4 billion assumed for 2012 and 2013, including further interest and penalties.

Based on advice from senior counsel, Hudaco remains confident of refuting the assessments. Hudaco has lodged objections to the assessments and will continue to pursue all appropriate legal remedies. SARS was to have responded to these objections by mid-October 2013 but has invoked its right to extra time and now has until mid-February 2014. Hudaco has also lodged an application in the High Court to have the assessments set aside on a number of grounds, including constitutional aspects.

In respect of the requirement to "pay now, argue later", rather than face a demand for the full amount, Hudaco has agreed to pay an amount of R20 million per quarter and the remainder will be deferred until the legal process has run its course, which Hudaco estimates is likely to be two to three years. Two quarterly payments had been made by year end and these have been accounted for as taxation paid in advance. We hope that despite receiving these payments, SARS will expedite the legal process.

Prospects

The South African mining industry and the manufacturing and service sectors supporting that industry account for about half of Hudaco's sales. Low commodity prices and insufficient infrastructure, particularly electricity and rail capacity, are short-term issues impacting these industries. Longer term challenges, affecting their very viability include annual strikes. It indeed becomes more challenging each year to do business in South Africa. Prospects in neighbouring countries are better but commodity price weakness and the threat of new indigenisation legislation negatively affect investment decisions.

Consumer spending appears to be weakening but our businesses are positioned in niche areas which we believe will continue to perform satisfactorily.

Until economic circumstances improve we foresee only modest organic volume sales growth in South Africa although exports into Africa should grow a little faster. Earnings in 2014 will however be impacted positively by a combination of factors; pricing to replacement, cost reductions effected in 2013 and the contribution from recent acquisitions, particularly Dosco, GPM and Joseph Grieveson, which have come into the group from December 2013.

Declaration of final dividend no 54

Final dividend number 54 of 310 cents per share is declared payable on Monday, 10 March 2014 to ordinary shareholders recorded in the register at the close of business on Friday, 7 March 2014.

The timetable for the payment of the dividend is as follows:

Last day to trade cum dividend	Friday, 28 February 2014
Trading *ex* dividend commences	Monday, 3 March 2014
Record date	Friday, 7 March 2014
Payment date	Monday, 10 March 2014

Share certificates may not be dematerialised or rematerialised between Monday, 3 March 2014 and Friday, 7 March 2014, both days inclusive. The certificated register will be closed for this period.

In terms of the Listings Requirements of the JSE Limited regarding the new Dividends Tax effective 1 April 2012, the following additional information is disclosed:

- the dividend has been declared out of income reserves;
- the local dividend rate is 15%;
- Secondary Tax on Companies (STC) credits of 310 cents per share will be utilised;
- the gross local dividend amount is 310 cents per ordinary share for shareholders exempt from the Dividends Tax;
- the net local dividend amount is 310 cents per ordinary share for shareholders liable to pay the new Dividends Tax;
- Hudaco Industries Limited has 34 153 531 shares in issue (which includes 2 507 828 treasury shares); and
- Hudaco Industries Limited's income tax reference number is 9400/159/71/2.

Directorships

As reported on SENS, Mr PC Baloyi was appointed to the board with effect from 27 July 2013 and Mrs Dolly Mokgatle resigned with effect from 25 October 2013.

Results presentation and annual general meeting

Hudaco will host presentations on the financial results in Johannesburg and Cape Town on Friday, 31 January 2014 and Monday, 3 February 2014, respectively. Anyone wishing to attend should contact Janine Yon at +27 11 657 5007.

The slides which form part of the presentation will be available on the company's website from Tuesday, 4 February 2014.

The company's 29th annual general meeting will be held at Hudaco's corporate office situated at Building 9, Greenstone Hill Office Park, Emerald Boulevard, Greenstone Hill, Edenvale at 11:00 on Thursday, 27 March 2014. The notice and proxy form for the company's annual general meeting will be posted to the shareholders during the second week of February 2014 and will be included in the integrated report that will be published on Hudaco's website during February 2014.

Approval of financial statements

The financial statements have been approved by the board and abridged for purposes of this report. Grant Thornton has signed an unqualified audit opinion on the annual financial statements. Both the financial statements and the auditors' report are available for inspection at the company's registered office.

The auditors' report does not necessarily cover all of the information contained in this announcement. Shareholders are therefore advised that in order to obtain a full understanding of the nature of the auditors' work they should obtain a copy of the report together with the accompanying financial information from the registered office of the company.

For and on behalf of the board

RT Vice
Independent non-executive chairman

SJ Connelly
Chief executive

30 January 2014

Nedbank Capital
Sponsor

Group statement of **financial position**

R million	30 Nov 2013	30 Nov 2012
ASSETS		
Non-current assets	**922**	3 040
Property, plant and equipment	**214**	205
Investment in preference shares		2 181
Goodwill	**619**	594
Intangible assets	**39**	49
Taxation	**40**	
Deferred taxation	**10**	11
Current assets	**1 902**	1 679
Inventories	**1 104**	919
Trade and other receivables	**780**	684
Taxation	**2**	
Bank deposits and balances	**16**	76
TOTAL ASSETS	**2 824**	4 719
EQUITY AND LIABILITIES		
Equity	**1 835**	1 696
Interest of shareholders of the group	**1 816**	1 670
Non-controlling interest	**19**	26
Non-current liabilities	**30**	2 244
Subordinated debenture		2 181
Amounts due to vendors of businesses acquired	**30**	63
Current liabilities	**959**	779
Trade and other payables	**673**	592
Bank overdraft	**220**	93
Amounts due to vendors of businesses acquired	**61**	88
Taxation	**5**	6
TOTAL EQUITY AND LIABILITIES	**2 824**	4 719

Group statement of **comprehensive income**

R million	Year ended 30 Nov 2013	% change	Year ended 30 Nov 2012
Turnover	**3 942**	13	3 492
– Ongoing operations	**3 558**	6	3 360
– Acquired in 2012 and 2013	**384**		132
Cost of sales	**2 463**		2 137
Gross profit	**1 479**	9	1 355
Operating expenses	**1 010**		918
Operating profit	**469**	7	437
– Ongoing operations	**429**	2	418
– Acquired in 2012 and 2013	**40**		19
Reversal of impairment on property			1
Fair value adjustment to amounts due to vendors	**(23)**		8
Profit before interest	**446**		446
Dividends received on preference shares	**50**		202
Finance costs	**(71)**		(250)
Profit before taxation	**425**	7	398
Taxation	**120**		47
Profit for the year	**305**	(13)	351
Other comprehensive income			
Movement on fair value of cash flow hedges			2
Total comprehensive income for the year	**305**	(14)	353
Profit attributable to:			
– shareholders of the group	**294**		340
– non-controlling shareholders	**11**		11
	305		351
Total comprehensive income attributable to:			
– shareholders of the group	**294**		342
– non-controlling shareholders	**11**		11
	305		353
Headline earnings per share (cents)	**928**	(13)	1 071
Basic earnings per share (cents)	**930**	(13)	1 074
Comparable earnings per share (cents)	**983**	4	947
Diluted headline earnings per share (cents)	**917**		1 055
Diluted basic earnings per share (cents)	**918**		1 058
Diluted comparable earnings per share (cents)	**970**		933
Calculation of headline earnings			
Profit attributable to shareholders of the group	**294**	(13)	340
Adjusted for:			
Reversal of impairment and profit on disposal of property, plant and equipment	**(1)**		(1)
Tax effect	**1**		
Headline earnings	**294**	(13)	339
Calculation of comparable earnings			
Headline earnings	**294**	(13)	339
Adjusted for:			
Preference dividend received	**(50)**		(202)
Interest on debenture	**59**		234
Tax effect	**(16)**		(65)
STT on redemption of preference shares	**5**		
Fair value adjustments on amounts due to vendors	**23**		(7)
Non-controlling interest	**(4)**		1
Comparable earnings	**311**	4	300
Dividends			
– Per share (cents)	**465**		465
– Amount (Rm)	**147**		147
Shares in issue	**31 646**		31 646
– Total (000)	**34 154**		34 154
– Held by subsidiary (000)	**(2 508)**		(2 508)
Weighted average shares in issue			
– Basic (000)	**31 646**		31 646
– Diluted (000)	**32 054**		32 124

Segment **information**

	Turnover			Operating profit			Average net operating assets		
R million	Year ended 30 Nov 2013	% change	Year ended 30 Nov 2012	Year ended 30 Nov 2013	% change	Year ended 30 Nov 2012	Year ended 30 Nov 2013	% change	Year ended 30 Nov 2012
Engineering consumables	**2 478**	9	2 280	**292**	4	280	**1 394**	19	1 169
– Ongoing operations	**2 273**	3	2 216	**272**	1	268	**1 372**	22	1 127
– Acquired in 2012 and 2013	**205**		64	**20**		12	**22**		42
Consumer-related products	**1 470**	20	1 223	**199**	18	169	**601**	23	487
– Ongoing operations	**1 291**	12	1 155	**179**	10	162	**596**	27	469
– Acquired in 2012 and 2013	**179**		68	**20**		7	**5**		18
Total operating segments	**3 948**		3 503	**491**		449	**1 995**		1 656
Head office, shared services and eliminations	**(6)**		(11)	**(22)**		(12)	**124**		117
Total group	**3 942**	13	3 492	**469**	7	437	**2 119**	20	1 773

Group statement of **cash flows**

R million	Year ended 30 Nov 2013	Year ended 30 Nov 2012
Cash generated from trading	**513**	458
Increase in working capital	**(138)**	(121)
Cash generated from operations	**375**	337
Taxation paid	**(169)**	(54)
Net cash from operating activities	**206**	283
Net investment in new operations	**(181)**	(229)
Net investment in property, plant and equipment	**(32)**	(39)
Disposal of preference shares	**2 181**	
Dividends and interest received	**50**	202
Net cash from investing activities	**2 018**	(66)
Debenture repurchased	**(2 181)**	
Decrease in finance leases		(3)
Finance costs paid	**(66)**	(237)
Dividends paid	**(164)**	(163)
Net cash from financing activities	**(2 411)**	(403)
Net decrease in cash and cash equivalents	**(187)**	(186)

Group statement of **changes in equity**

R million	Year ended 30 Nov 2013	Year ended 30 Nov 2012
Equity at beginning of the year	**1 696**	1 525
Comprehensive income for the year	**305**	353
Decrease in equity compensation reserve	**(1)**	(19)
Non-controlling interest required	**(1)**	
Dividends	**(164)**	(163)
Equity at end of the year	**1 835**	1 696

Supplementary **information**

The consolidated financial statements have been prepared in accordance with IAS 34: Interim Financial Reporting, International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), SAICA Financial Reporting Guides as issued by the Accounting Practices Board, the requirements of the South African Companies Act and the JSE Listings Requirements. The same accounting policies, presentation and measurement principles have been followed in the preparation of the preliminary report for the year ended 30 November 2013 as were applied in the preparation of the group's annual financial statements for the year ended 30 November 2012, apart from the adoption of the amendment to IAS 1 – *Presentation of Financial Statements*. These results have been compiled under the supervision of the financial director, CV Amoils, CA (SA). The directors of Hudaco take full responsibility for the preparation of the preliminary report and ensuring that the financial information has been correctly extracted from the underlying annual financial statements.

	30 Nov 2013	30 Nov 2012
Average net operating assets (NOA) (Rm)	**2 119**	1 773
Operating profit margin (%)	**11,9**	12,5
Average NOA turn (times)	**1,9**	2,0
Return on average NOA (%)	**22,1**	24,6
Average net tangible operating assets (NTOA) (Rm)	**1 315**	1 172
PBITA margin (%)	**12,3**	13,0
Average NTOA turn (times)	**3,0**	3,0
Return on average NTOA (%)	**36,9**	38,7
Net asset value per share (cents)	**5 737**	5 277
Return on average equity (%)	**17,3**	21,8
Comparable return on average equity (%)	**18,4**	19,2
Operating profit has been determined after taking into account the following charges (Rm):		
– Depreciation	**29**	25
– Amortisation	**16**	16
Capital expenditure (Rm)		
– Incurred during the year	**38**	43
– Authorised but not contracted for	**59**	50

Contingent liability

The group has received and is strongly refuting tax assessments relating to the financing of the BEE transaction. The maximum exposure for tax, interest and penalties is considered to be R1,7 billion but the prospects of having to pay such an amount are considered remote.

Commitments

– Operating lease commitments on properties	**202**	168

– Tax payments in advance of legal process: R20 million per quarter until matter is resolved.
– Commitment to purchase businesses: Dosco, GPM and Joseph Grieveson, for a maximum consideration of R154 million.

Acquisition of businesses

The group acquired 100% of the businesses of Donsteel, Three-D Agencies and Specialised Battery Systems for total considerations based on future profits and which are estimated to be R78 million.

Plant and equipment of R5 million, inventories of R35 million, trade and other receivables of R42 million, trade and other payables of R14 million, borrowings of R15 million, taxation of R6 million, intangible assets of R6 million and goodwill of R25 million were recognised at date of acquisition. These values approximate the fair values as determined under IFRS 3.

The results since acquisition date included in consolidated results for the year are as follows:

– Turnover (Rm)	**96**
– Profit after tax (Rm)	**7**

If the acquisitions had been concluded at the beginning of the financial year, consolidated results for the group would have been as follows:

– Turnover (Rm)	**4 081**
– Profit after tax (Rm)	**315**

Events after reporting date

On 12 December 2013, Hudaco Trading acquired Dosco, GPM and Joseph Grieveson from a company controlled by Graham Dunford, a director of Hudaco, for a maximum consideration of R154 million.

Plant and equipment of R18 million, inventories of R32 million, trade and other receivables of R45 million, trade and other payables of R43 million, net borrowings of R8 million, taxation of R15 million, intangible assets of R17 million and goodwill of R108 million will be recognised at date of acquisition. These values approximate the fair values as provisionally determined under IFRS 3.

If the acquisitions had been concluded at the beginning of the financial year, consolidated results for the group would have included:

– Turnover (Rm)	**221**
– Profit after tax (Rm)	**28**

In December 2013 the group entered into a three year, R300 million revolving credit facility arrangement with ABSA Bank.

HUDACO INDUSTRIES LIMITED
Incorporated in the Republic of South Africa
Registration number: 1985/004617/06
JSE code: HDC ISIN: ZAE000003273

Transfer secretaries: Computershare Investor Services Pty Ltd, PO Box 61051, Marshalltown, 2107

Registered office: Building 9, Greenstone Hill Office Park, Emerald Boulevard, Greenstone Hill, Edenvale
Tel +27 11 657 5000 Email info@hudaco.co.za

Directors: RT Vice *(Chairman)**, SJ Connelly *(Chief executive)*, CV Amoils *(Financial director)*, PC Baloyi*
GR Dunford, SG Morris*, D Naidoo* * *Independent non-executive*

Group secretary: R Wolmarans

Sponsor: Nedbank Capital

ENGINEERING CONSUMABLES

AfroSales (A DIVISION OF HUDACO TRADING (PTY) LTD) — Distributor of engineering steels, solid, round, square, hexagonal and hollow bar steel.

Astore — Distributor of specialised thermoplastic pipes, fittings and Keymak PVC hose.

Bearings International — Distributor of bearings, chain, seals, geared motors, electric motors, transmission products and alternators.

Belting Supplies Services — Distributor of conveyor belting, process control products.

Bonwick — Manufacturer of conveyor drive pulleys, forgings and rollings.

DEUTZ DIESELPOWER — Distributor of Deutz diesel engines and Deutz spare parts and the provision of service support.

Dosco — Supply and repair of hydraulic gear pumps.

Ernest Lowe — Manufacturer of hydraulic and pneumatic equipment.

FHS — Supplier of filtration solutions, kits and accessories.

Joseph Grieveson — Manufacturer of ferrous and non-ferrous castings.

POWERMITE — Distributor of electrical cabling and accessories, plugs, sockets, electric feeder systems and crane materials.

VARISPEED — Distributor of controllers, monitors and regulators of the speed of standard AC motors.

CONSUMER-RELATED PRODUCTS

ABES — Distributor of automotive clutch kits and ignition leads, rotary oil and hydraulic seals.

Distributor of maintenance free batteries.

ELVEY — Distributor of intruder detection, access control and related CCTV equipment.

global — Distributor of professional mobile radio communication equipment and radio systems integrator.

PENTAGON — Distributor of CCTV equipment, including system design, integration into access control, intruder, fire detection systems and Video over IP.

Rebotec — Distributor of Makita power tools, Mercury marine engines and survey instrumentation.

SPECIALISED BATTERY SYSTEMS — Importers and distributors of standby and solar batteries.

"Value-added distribution – our core competency"

www.hudaco.co.za

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