AST Group Limited

Reviewed interim results

for the six months ended 31 December 2003

REGISTRATION NUMBER 1998/021790/06
Share code: AAA ISIN code: ZAE000049441

www.ast.co.za

Income statement

for the six months ended 31 December 2003

	Reviewed 31 Dec 2003 (6 months) R'000	Unaudited 31 Dec 2002 (6 months) R'000	Audited 30 Jun 2003 (12 months) R'000
Revenue	**886 036**	1 196 532	2 205 612
Earnings/(loss) before interest, tax, depreciation and amortisation (EBITDA)	**44 659**	(28 148)	385
Depreciation	**(28 175)**	(31 747)	(60 565)
Impairment of assets and investments	**(22 589)**	(5 262)	(23 435)
(Loss)/profit on sale of businesses	**(4 078)**	832	(1 372)
Operating loss before amortisation	**(10 183)**	(64 325)	(84 987)
Amortisation of intangible assets	**(862)**	(722)	(2 062)
Amortisation of goodwill	**(48 160)**	(79 669)	(145 434)
Operating loss	**(59 205)**	(144 716)	(232 483)
Net finance cost	**(18 473)**	(21 308)	(60 813)
Share of results of associates	**56**	53	323
Loss before tax	**(77 622)**	(165 971)	(292 973)
Tax	**(12 787)**	16 531	48 435
Loss from ordinary activities	**(90 409)**	(149 440)	(244 538)
Minority interest	**(4 671)**	15 156	17 057
Net loss for the period	**(95 080)**	(134 284)	(227 481)
Net finance cost	**(18 473)**	(21 308)	(60 813)
Interest received	**10 037**	10 408	20 161
Finance costs	**(28 510)**	(31 716)	(80 974)
Headline loss per ordinary share (cent)	**(13,23)**	(90,48)	(101,49)
Fully diluted headline loss per ordinary share (cent)	**(13,23)**	(90,48)	(101,49)
Basic loss per ordinary share (cent)	**(62,11)**	(234,24)	(370,95)
Fully diluted basic loss per ordinary share (cent)	**(62,11)**	(234,24)	(370,95)
Headline loss and basic loss per ordinary share for comparative periods have been restated as a result of the 1:10 share consolidation in October 2003			
Weighted average number of shares	**153 078**	57 329	61 323
Fully diluted number of shares	**161 812**	76 672	192 657
Number of shares in issue	**184 285**	57 505	67 311
Reconciliation of headline loss			
Net loss for the period	**(95 080)**	(134 284)	(227 481)
Amortisation of goodwill	**48 160**	79 669	145 434
Minority interest in amortisation of goodwill	**–**	(2 500)	(4 999)
Provision for restructuring costs	**–**	815	–
Loss on impairment of assets and investments	**22 589**	5 262	23 435
(Loss)/profit on sale of businesses	**4 078**	(832)	1 372
Headline loss	**(20 253)**	(51 870)	(62 239)

Balance sheet

as at 31 December 2003

	Reviewed 31 Dec 2003 R'000	Unaudited 31 Dec 2002 R'000	Audited 30 Jun 2003 R'000
ASSETS			
Non-current assets	**430 764**	635 426	506 867
Property, plant and equipment	**119 542**	158 110	158 634
Goodwill and intangible assets	**99 657**	232 879	147 802
Unlisted investments	**15 459**	70 868	19 115
Deferred tax asset	**196 106**	173 569	181 316
Current assets	**391 355**	588 934	537 279
Rental assets	**–**	42 376	–
Inventories	**44 946**	30 688	55 082
Trade debtors and other receivables	**270 868**	447 184	395 065
Tax asset	**–**	–	16 417
Cash and cash equivalents	**75 541**	68 686	70 715
Total assets	**822 119**	1 224 360	1 044 146
EQUITY AND LIABILITIES			
Capital and reserves	**95 942**	222 914	124 231
Minority interest	**11 571**	30 804	9 296
Non-current liabilities	**180 796**	169 009	182 298
Interest-bearing liabilities	**160 535**	144 111	159 208
Deferred tax liability	**20 261**	14 229	20 068
Amounts due to vendors	**–**	10 669	3 022
Current liabilities	**533 810**	801 633	728 321
Trade creditors	**181 408**	316 838	285 044
Provisions	**54 346**	67 139	67 607
Income received in advance	**51 721**	147 292	44 589
Short-term portion of interest bearing liabilities	**109 633**	79 744	238 174
Sundry payables (including payroll vendors and VAT)	**67 100**	112 545	44 240
Bank overdrafts	**55 525**	36 005	34 582
Amounts due to vendors	**6 258**	18 382	14 085
Tax liability	**7 819**	23 688	–
Total equity and liabilities	**822 119**	1 224 360	1 044 146
Net asset value per ordinary share (cents)	**52,06**	387,65	184,56

Cash flow statement

for the six months ended 31 December 2003

	Reviewed 31 Dec 2003 (6 months) R'000	Unaudited 31 Dec 2002 (6 months) R'000	Audited 30 Jun 2003 (12 months) R'000
OPERATING ACTIVITIES			
Cash generated from operations	**9 067**	70 288	50 849
Net finance cost	**(18 473)**	(21 308)	(69 019)
Normal tax paid	**(8 043)**	(23 695)	(34 131)
Cash (used by)/generated from operating activities	**(17 449)**	25 285	(52 301)
INVESTMENT ACTIVITIES			
Vendor payments for past acquisitions	**(2 381)**	(56 438)	(65 316)
Proceeds from the sale of businesses	**20 079**	–	21 301
Other investment activities	**(1 627)**	(33 648)	32 168
Cash from/(used in) investment activities	**16 071**	(90 086)	(11 847)
FINANCING ACTIVITIES			
Proceeds from the rights issue	**88 750**	–	–
Repayment of long-term borrowings	**(103 489)**	(14 249)	(11 450)
Cash used in financing activities	**(14 739)**	(14 249)	(11 450)
Net decrease in cash and cash equivalents	**(16 117)**	(79 050)	(75 598)
Cash and cash equivalents at the beginning of the period	**36 133**	111 731	111 731
Cash and cash equivalents at the end of the period	**20 016**	32 681	36 133

Statement of changes in equity

for the six months ended 31 December 2003

	Reviewed 31 Dec 2003 (6 months) R'000	Unaudited 31 Dec 2002 (6 months) R'000	Audited 30 Jun 2003 (12 months) R'000
Share capital	**184**	58	67
Balance at the beginning of the period	**67**	58	58
New shares issued during the period	**117**	–	9
Share premium	**350 175**	209 999	236 209
Balance at the beginning of the period	**236 209**	207 059	207 059
Premium on new shares issued during the period	**120 264**	–	23 969
Share issue expenses written off during the period	**(6 420)**	(61)	(1 553)
Utilisation of treasury shares during the period	**122**	3 001	6 734
Vendor claims	**8 298**	73 084	30 206
Balance at the beginning of the period	**30 206**	46 460	46 460
Changes in amounts due to vendors during the period	**(21 908)**	26 624	(16 254)
Distributable reserves	**(230 216)**	(66 327)	(135 136)
Balance at the beginning of the period	**(135 136)**	65 531	83 614
– as shown previously	**(135 136)**	78 278	78 278
– adjusted for AC 133	**–**	(12 747)	5 336
Net loss for the period	**(95 080)**	(134 284)	(227 481)
Currency translation differences for the period	**–**	2 426	–
Transfer to non-distributable reserves	**–**	–	8 731
Non-distributable reserves	**(32 499)**	6 100	(7 115)
Balance at the beginning of the period	**(7 115)**	4 409	4 409
Realised profits on cash flow hedges	**–**	4 852	5 951
Transfer from distributable reserves	**–**	–	(8 731)
Currency translation differences for the period	**(25 384)**	(3 161)	(8 744)
Balance at the end of the period	**95 942**	222 914	124 231

CEO's report

Introduction

During the period under review, we continued to focus on implementing the Business Improvement Programme. We are pleased to announce results that demonstrate that the benefits are starting to come through. This is evidenced by the improved operating margins and a significant reduction in our total liabilities. Maintaining our capability and competence has remained a high priority and we have implemented a number of refinements, making us Fit for Business.

Milestones

In the first half of fiscal 2004, we achieved a number of milestones towards returning our company to financial health in a tough environment:

- The rights offer was successfully implemented with 63% of our shareholders following their rights. The proceeds of R88,75 million were applied to debt. On completion of the rights offer, we undertook a 10:1 share consolidation. These actions have resulted in a stronger balance sheet.
- We completed the sale of the nine business units which were identified as non-core soon after commencing the Business Improvement Programme. We also concluded shared equity arrangements with two more businesses.
- The Business Improvement Programme did cause some initial uncertainty with our staff but our business environment has normalised, our relationships with our funders are good and our customer base has strongly supported us throughout the process.
- We have maintained the momentum of the Business Improvement Programme. The programme is well advanced and we are now anticipating sustainable annualised cost savings of at least R260 million compared to the historic cost base. The full effect of this will only be realised in our next fiscal year, as previously advised. We are currently seeing R15 million of cost savings per month on our run rate compared to July 2003, despite some pressure on revenue.
- AST achieved a profitable return at the EBITDA level, reflecting a margin of 5,0% compared to (2,4%) for the corresponding period.
- We focused on improving governance at all levels in the business and have formalised risk management, which is now independently audited.

Business update

AST is divided into three core divisions namely Solutions, Infrastructure Services and Products. The Products division focused on consolidating, defining and rebuilding the division and supplier relationships. This division experienced a slow start to the financial year but has a strong sales pipeline that will ensure increased revenue-generating activity for the second half of the year. It is expected that margins will also improve when this rebuilt products division gains momentum – we are increasingly seeing product sales leading future service opportunities, which should enhance the sales mix. The Infrastructure Services division also had lower than anticipated revenues mainly due to contracts that had been delayed. The division was part of the first wave of the Business Improvement Programme in August 2003 and the implemented ideas have already had a positive impact on the margins. The Solutions division performed well and delivered revenue in line with budgets for the first six months of 2003.

We continue to make progress within our sales environment, which was identified as a key element of the Business Improvement Programme. During 2003, we appointed highly skilled National Sales Managers to head up each of our core business units. Our sales processes ensure that we are selective in our participation in new business opportunities, so protecting the margins. We have simplified our sales process and automation of bid management is reducing the expense of pursuing new business. Sales support functions have been consolidated.

Our historic investment in specialist industry focus areas continues to be a competitive advantage in our market. As a result of our continued ability to deliver solutions in line with our customers' expectations, they have supported the recent improvements in AST. We have retained our major customers, but have experienced pressure to reduce their IT costs, which in turn put pressure on both revenue and margins. We have added several large new organisations to our client base and key clients awarded us contract extensions during the six months.

Business Improvement Programme update

The implementation of the Business Improvement Programme (BIP) continued to be the highest priority for our management team. The idea generation and planning phase of the programme will be completed by the end of March 2004 as planned. Full implementation is set for December 2004.

We are pleased with results to date and the progress suggests that sustainable annualised cost savings of R260 million are now achievable. In addition, the once-off costs associated with the BIP are well within budget.

We have successfully reduced total monthly base salaries by R10,3 million per month since December 2002. In addition, the in-depth analyses associated with the BIP has enabled us to reduce headcount from 3 662 to 3 061 over the same period, without significantly affecting delivery capability. In fact, our customer satisfaction has increased, as measured in recent surveys or service level agreements. We have been successful in retaining key personnel, although we realise that this will need to be carefully managed when demand for ICT skills turns.

The once-off costs associated with BIP implementation are expensed as incurred. Second half costs will be lower than first half. The operating margin will normalise in 2005 as these costs are eliminated and the programme is fully implemented. Further efficiencies rolled out as part of the BIP should also enhance profitability.

The BIP will evolve into a continuous improvement programme in order to ensure that the efficiencies that have been introduced during the implementation are enhanced into the future.

Financial update

Reported revenue of R886,0 million represents a 15,2% reduction on a comparable basis, excluding the contribution of non-core business units sold. The reasons for this reduction include difficult market conditions; rebuilding the sales force while implementing the BIP, and a more stringent approach to participation in new business opportunities. The disposal of non-core businesses resulted in R128,4 million lost revenue.

The improvement in operating margin, which was already starting to reflect in our 2003 annual results, has continued as the benefits of the BIP become more visible. EBITDA improved from (2,4%) in the first half of 2003 to 5,0% for the six months ended 31 December 2003. This reported EBITDA includes costs of R26,9 million associated with retrenchments and implementing the BIP. Excluding these once-off costs our normalised EBITDA margin was 8,1%.

The proceeds of the rights offer were applied to the repayment of debt, which, together with the lower interest rate environment, resulted in reduced finance costs of R18,5 million versus R21,3 million in the comparable period.

Reported headline loss of R20,3 million represents an improvement of 60% on the R51,9 million loss reported in the comparable period. This represents a headline loss per share of 13,23c compared to a loss of 90,48c (after adjusting the comparative figure for the 10:1 consolidation which occurred in October 2003).

The focus on improving the strength of our balance sheet is also paying off. Total liabilities decreased from 30 June 2003 by R196,0 million of which R106,3 million was the reduction of interest-bearing liabilities. Our stringent working capital strategy implemented during the first half of 2003 is working – as demonstrated by a 25,4% decrease in net current liabilities from 30 June 2003.

Cash generated from operations shows a decline from R70,3 million in December 2002 to R9,1 million in the six months ended December 2003. However, the figures are not directly comparable. Cash from operations in December 2002 included the sale of certain debtor invoices and pre-payments totalling R59,0 million. These funds were converted to interest-bearing debt as part of the funding agreement which became unconditional in August 2003 at the time of the rights issue.

We have impaired AST's remaining preference share investment of R22,6 million in AST Botswana following the sale of the business.

Capital expenditure

The capital expenditure for the Group during the period under review was R3,6 million, primarily in respect of purchases of income generating computer equipment. Commitments entered into over the same period to incur future expenditure amounted to R1,2 million.

Contingent liabilities

As disclosed in our annual financial statements to June 2003, the South African Revenue Service (SARS) issued a revised assessment in respect of the 1999 tax year of a subsidiary of AST Group Limited. In terms of the revised assessment, certain allowances claimed in terms of Section 11 (gA) of the Income Tax Act No. 58 of 1962, as amended, to the value of R503,5 million have been disallowed by SARS. The company lodged an objection in respect of the revised assessment and are waiting for a decision. The Group regards the potential impact of the revised assessment as a contingent liability.

Dividend policy

There will be no dividend payments for the 2004 financial year.

Prospects

AST is emerging from the Business Improvement Programme Fit for Business. Our competitive advantages are intact, with our capability and capacity to deliver cost-effective, flexible and dynamic solutions to our customers with the in depth industry knowledge supporting all offerings.

The corporate market is currently focused on custom-made solutions and personalised service. IT departments require cost-effective implementation. Our Business Improvement Programme will enable us to meet both the market's service and cost requirements.

The improving worldwide economy is giving rise to an expected recovery in global technology spend from the corporate market. However, we expect the challenging market conditions to persist – until our economic conditions improve.

During the second half of the financial year, which is traditionally stronger than the first half, our focus remains on strengthening the balance sheet through reduced gearing and completing the implementation of the Business Improvement Programme. Almost all of the costs associated with its implementation will be absorbed during the current financial year with the full financial benefit becoming evident in 2005.

Black Economic Empowerment (BEE) continues to gain importance in procurement decisions in the corporate market. We realise the importance of transformation in our Group but felt we needed to see significant progress on the BIP before giving attention to BEE. We are now seriously addressing the introduction of a meaningful BEE equity partner to AST.

Our offering is well positioned and we will continue to ensure that it is competitive going forward by taking into account changes in market conditions that result from technology advances.

Conclusion

We have made significant progress in ensuring the sustainability of AST during the past six months. We now have a solid platform on which to continue building our organisation, addressing BEE and transformation, and strengthening our balance sheet. For us to capitalise on the success of the BIP we now need to focus on increasing revenue at acceptable margins. We are well positioned to participate in new opportunities - and we have a solid value proposition.

We regrettably announce the resignation of non-executive director Sipho Ndlovu with effect 10 March 2004. We thank him for his contribution to the Group over the years and wish him well in his future endeavours.

I wish to thank our customers, employees, shareholders, suppliers and our bankers for their continued support and commitment.

And finally, sincere thanks to the board of directors for their support and assistance.

For and on behalf of the Board

John Miller

CEO AST Group

11 March 2004

Audit review report

PricewaterhouseCoopers Inc's unmodified review report on the condensed consolidated interim financial statements contained in this interim report is available for inspection at AST Group Limited's registered office.

Financial policy statements

- The financial statements of AST Group and its subsidiaries are prepared in accordance with and comply with the Statements of Generally Accepted Accounting Practice of South Africa.
- The accounting policies of the Group and its subsidiaries are consistent in all material respects with those applied in the previous financial year.
- Where necessary, comparative figures have been adjusted to conform to changes in presentation in the current period.

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