



# ANNUAL REPORT 2011

KLEIN KAROO INTERNATIONAL LIMITED



# KLEIN KAROO INTERNATIONAL LIMITED AND ITS SUBSIDIARIES

Registration Number: 1961/000721/06

## ABRIDGED ANNUAL REPORT FOR THE YEAR ENDED 30 JUNE 2011

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### NOTICE IN TERMS OF SECTION 29(3) OF THE COMPANIES ACT, 2008 (THE ACT):

- These abridged annual financial statements are a summary of the annual financial statements of the group for the year ended 30 June 2011.
- The annual financial statements of the group have been audited in compliance with the Act.
- The preparation of the annual financial statements has been supervised by TS Bruwer CA (SA).
- A copy of the annual financial statements is available at request from the registered offices of the group.



**MANAGING DIRECTOR’S REPORT FOR THE YEAR ENDED 30 JUNE 2011**

**THE 2011 FINANCIAL YEAR** has again been very challenging for Klein Karoo International Ltd (KKI) and its producers.

Leather prices remained under pressure – coupled with a rand, which performed very strongly against the currencies of KKI’s major trading partners, and the outbreak of H5N2 (Avian Influenza) during the last three months of the year – with the result that budgeted profit levels could not be achieved.

KKI, however, managed to record a profit for the year although the contribution of operating profit was considerably lower than in the previous year. The number of ostriches slaughtered in South Africa was 51 000 lower than in the previous year, while KKI’s market share for slaughtering remained consistent at 62%.

If one looks specifically at cash flow within the company, cash derived from operating activities was better than in the previous year. However, this can be largely attributed to changes in operating capital which are not sustainable in the long-term.

Payments made directly to producers dropped by R77 million due to the lower number of slaughterings. Cash payments made to producers per ostrich increased by 2%.

KKI’s turnover declined by R105 million, mainly because meat could not be exported during the last three months of the financial year. However, up to the time exports ceased, sales performance continued to be characterised by strong demand for all ostrich meat products.

Given relatively high producer prices, as well as a strong rand relative to the euro until February 2011, KKI Meat remained under pressure from a profitability perspective. As from January 2011, however, profitability levels started to improve until the outbreak of Avian Influenza which led to a ban on exports. Consequently, it was not possible to capitalise on the better trading conditions.

Demand for feathers was in balance with supply. KKI Feathers showed a good profit, recording sound stock levels at year-end.

KKI Leather again experienced a very difficult year with sales volumes approximately the same as in the previous year. Despite a considerable reduction in slaughtering compared to 2010, the total figure remained slightly higher than sales; thus the small increase in stock levels. Since April 2011, however, the Leather division has experienced an upswing in demand but with the dampening effect of Avian Influenza on slaughter figures lower stock levels are currently envisaged for the coming year.

**GOALS**

The Avian Influenza outbreak brought new challenges in terms of

achieving KKI’s goals. Although the targets as communicated in the prior two years, especially for the debt ratio and market development for leather sales, remain important, the shorter term goals will have to position the company correctly within an industry which could shrink significantly during the next two to three years.

KKI believes that the industry could shrink by up to 40%. This means that infrastructure and human resource structures will have to be adjusted to a smaller industry. However, this must be done in such a way that KKI can continue to strive for its value-adding objectives and without reverting to a commodity-based business model.

**RESULTS FOR 2011**

Acquisition of ostriches is KKI’s single biggest expense. It is also important for KKI to analyse producer payment trends to be able to understand the situation relating to the long-term welfare of producers. Producer payments for the year totalled a net amount of R307 million. Overall this was 20% less than in the previous year. The lower number of ostriches slaughtered, however, was the greatest contributing factor. Payment per ostrich was 2% higher than in the previous year, while slaughter figures dropped by slightly more than 20% compared to the previous year. Acquisition of ostriches as a percentage of total cash expenses was 2 percentage points lower than in the previous year.

KKI recorded a net profit attributable to shareholders of the group of R14.4 million for the financial year. Adjusted headline earnings amounted to R1.2 million. Adjusted headline earnings refer to the company’s earnings excluding the impact of items relating to its capital base; for example, the issue of shares to producers. This serves as a better indication of the earning capacity of the company.

If headline earnings is compared to the previous year, the figure is R20,1 million lower. The biggest contributing factor was the lower sales figure, which resulted in lower gross and operating profit. Gross margins, however, were lower at 17,6% vs. 18,2%, and operating profit margins were lower at 1,6% vs. 4,4%. The effect of lower sales is reduced with partial recognition of a deferred tax asset.

Overhead costs are largely fixed. Consequently, lower sales had a direct impact on operating profit margins. As mentioned, in the short-term KKI will have to adapt its overhead costs to a smaller industry to ensure that sustainable operating profit margins can be met. KKI has already implemented various steps in support of this objective and as the impact of Avian Influenza becomes clearer will take further steps to this regard.

Cash flow serves as a good barometer of actual performance of a company and in this respect KKI has had an acceptable year. Operating activities generated positive cash of R18,8 million, which is higher than in the previous year but was largely the result of a reduction in debtors



due to lower turnover. In the longer term, however, this is not a healthy situation as cash is not being generated by profitability but rather due to contraction of the business. Overall the company generated a positive cash flow of R10,9 million. This was the fourth consecutive year that KKI managed to generate positive cash.

KKI's balance sheet again reflects an improvement compared to the previous year. The interest-bearing debt ratio has improved to 1.1:1 compared to 1.3:1 in 2010 and is now almost at the minimum acceptable industry standard of 1:1. Operating capital improved by R24 million, which can be largely attributed to a reduction in debtors and creditors.

In general, KKI's shareholders can be satisfied with the company's performance during the past year. The company is having an extremely difficult time; therefore, it is important that the improvement, especially the company's balance sheet, be protected, given continued uncertainties in the future, which exacerbate the company's risk.

## CORPORATE REGULATION AND POLICY

### *Black Economic Empowerment (BEE)*

Klein Karoo International's focused BEE strategy was increasingly implemented during the year under review through co-operation with, among others, transformation agents. More representative appointments and continuous growth opportunities for deserving staff as well as training opportunities – within the framework of restrictions due to pressure on human resource structures – form part of this strategy. The development of training opportunities and SETA supported skills training will make a great difference in the industry and in the region.

Klein Karoo International Ltd, in consultation with various role players, is purposefully driving a comprehensive ostrich producer development project in the Eastern Cape. Amid the challenges facing the industry, good progress is being made to equip new entrants to the industry on a systematic and needs-driven basis.

KKI Leather's training centre on the premises of the KKI Boutique in Oudtshoorn contributes to growth opportunities for new technicians and entrepreneurs, and has already produced a range of high-quality leather products and skilled workers for some time now.

KKI has been accredited independently by an accredited BEE verification agent and received a Level 8 contribution recognition.

In general, Klein Karoo Limited's BEE strategy is constantly being tested against the company's over-arching objectives, and realistic and sustainable industry standards. It is then adapted and implemented accordingly.

### *King III*

Klein Karoo Limited endorses the principles of King III and aims to adhere to all prescriptions. However, from a cost perspective some of these aspects, in particular those relating to integrated reporting, may not be viable to implement.

### *Remuneration Policy*

The main goal of the human resources remuneration policy of Klein Karoo Limited is to ensure the long-term growth and sustainability of the group by employing and retaining efficient management staff and personnel. The standing members of Klein Karoo Limited's remuneration committee responsible for the above consists of three non-executive directors, the managing director and the human resources consultant.

The data contained in accredited remuneration surveys and publications are used to establish the extent to which the remuneration of the directors, management and personnel of the Klein Karoo group compares to that of comparable companies or institutions

in the national market.

The remuneration structure for management consists of two elements: a guaranteed element similar to that of other personnel and a flexible element which is purely performance-driven. The performance element includes individual performance (as compared to predetermined goals) and the financial results of the group.

During the past year the guaranteed remuneration earned by managing directors and other executive directors was on average equal to the 25th percentile of the national market for comparable companies. After calculating the company results and evaluating individual performance, the total of the flexible remuneration plus guaranteed remuneration equalled an amount varying between 60% and 85% of the 25th percentile of the market.

## FUTURE

The industry faces an uncertain future. There are major risks relating to the number of birds slaughtered as KKI and other processors in the industry rely on throughput to keep optimal infrastructure and human resource structures in place. Producers are cautious about investing in the industry, which could cause the industry to shrink. The extent to which this could take place is difficult to determine but in the shorter term KKI and other processors will have to try and adjust to lower throughput.

KKI's future will be largely determined by the degree to which it adapts to new circumstances. It will also depend on how fast producers reinvest in ostrich farming. This, in turn, will depend on the extent to which further large-scale outbreaks of Avian Influenza can be prevented as well as on the growth in earnings from ostrich products. KKI is working with the industry to address these risks at producer level. With regard to earnings from ostrich products the future looks somewhat more promising than a year ago.

As mentioned during the past two years, the two most important short-term factors for KKI and for the ostrich industry – from an earnings point of view – relate to the continued impact of the economic recession on consumers of products derived from ostrich, as well as the exchange rate of the rand against the US dollar and the euro. Consumer spending has started to grow moderately over the past 12 months but there are still fears that the recession could deepen – the so-called "double dip" – especially after the "new" credit crisis emerging in both Europe and the USA.

KKI is exposed to consumers' discretionary income – the portion of income not spent on necessities such as food, housing, education, etc. Recovery in demand for these products only started later in 2011. Leather sales currently show promising signs of recovery, and price increases could for the first time in three years be implemented in certain markets. The rand has also performed somewhat weaker since year-end, which will have a further positive effect on earnings.

## CONCLUSION

I wish to thank all KKI's stakeholders, starting with producers, for their ongoing support. Without product KKI has no future. Producers face the same challenges as KKI in the coming year and I wish to assure them that their interests remain a priority insofar as KKI's objectives and strategies are concerned. I wish to thank all KKI employees for their dedication to KKI and the producer. It is also appropriate to express my appreciation and respect for the KKI Board – not only do they fully support the KKI executive but they also perform their duties within an excellent corporate governance framework, aimed mainly at protecting the interests of the broad shareholder and producer base.



Johan Stumpf  
MANAGING DIRECTOR

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION AT 30 JUNE 2011**

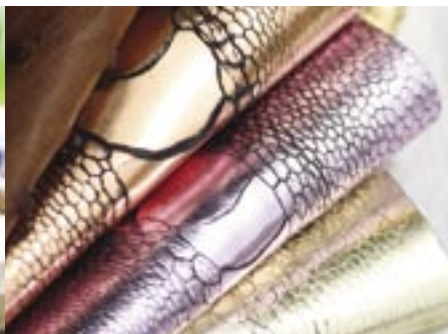
	Group		Company	
	2011 R'000	2010 R'000	2011 R'000	2010 R'000
<b>ASSETS</b>				
<b>Non-current assets</b>	88,357	72,075	64,204	75,826
Property, plant and equipment	60,907	62,153	40,050	40,555
Intangible assets	1,855	780	1,082	7
Interest in subsidiaries	-	-	17,327	34,309
Deferred taxation	21,854	4,096	5,745	955
Investment in associates	3,740	4,680	-	-
Investment and loans	1	366	-	-
<b>Current assets</b>	267,443	287,387	249,127	256,066
Inventory	199,944	188,532	191,978	177,971
Current income tax assets	788	1,654	788	1,595
Trade and other receivables	59,635	82,033	53,985	65,078
South African Revenue Service - VAT	1,636	8,590	1,361	7,160
Foreign exchange contract asset	76	34	76	-
Investments and loans	496	496	-	-
Cash and cash equivalents	4,868	6,048	939	4,262
<b>Total assets</b>	<b>355,800</b>	<b>359,462</b>	<b>313,331</b>	<b>331,892</b>
<b>EQUITY AND LIABILITIES</b>				
<b>Capital and reserves</b>	140,899	124,031	107,697	107,758
Share capital	92	88	92	88
Share premium	86,148	82,912	86,148	82,912
Fair value reserve	-	366	-	-
Foreign currency translation reserve	(74)	(117)	-	-
Treasury shares	(415)	-	-	-
Retained profit	55,148	40,782	21,457	24,758
<b>Non-controlling interest</b>	610	1,095	-	-
<b>Total equity</b>	<b>141,509</b>	<b>125,126</b>	<b>107,697</b>	<b>107,758</b>
<b>Non-current liabilities</b>	13,519	12,174	9,478	8,343
Retirement benefits	4,535	1,289	4,309	1,289
Long-term borrowings	3,399	5,371	2,894	4,552
Deferred taxation	575	115	-	-
Government grants	5,010	5,399	2,275	2,502
<b>Current liabilities</b>	200,772	222,162	196,156	215,791
Trade and other payables	46,470	54,659	42,664	49,851
Current income tax liabilities	3	-	-	-
South African Revenue Service - VAT	63	913	-	-
Short-term borrowings	154,053	166,286	153,492	165,644
Foreign exchange contract liability	1	296	-	296
Finance lease obligation	182	8	-	-
<b>Total equity and liabilities</b>	<b>355,800</b>	<b>359,462</b>	<b>313,331</b>	<b>331,892</b>

## CONSOLIDATED INCOME STATEMENT FOR THE YEAR ENDED 30 JUNE 2011

	Group		Company	
	2011 R'000	2010 R'000	2011 R'000	2010 R'000
Sales	573,222	678,272	546,323	620,933
Cost of sales	(472,269)	(554,592)	(469,708)	(527,974)
Gross profit	100,953	123,680	76,615	92,959
Other operating income	5,446	8,859	9,492	20,574
Distribution costs	(26,782)	(28,607)	(25,847)	(27,511)
Administrative expenses	(17,287)	(17,018)	(6,496)	(6,791)
Other operating expenses	(53,063)	(57,269)	(49,472)	(55,414)
Operating profit	9,267	29,645	4,292	23,817
Interest paid	(12,744)	(16,065)	(12,382)	(15,215)
Share in profit of associates	60	751	-	-
Net profit/(loss) before taxation	(3,417)	14,331	(8,090)	8,602
Taxation	17,294	3,918	4,789	4,230
Net profit/(loss) for the year	13,877	18,249	(3,301)	12,832
Attributable to:				
- Shareholders of the group	14,366	18,193	(3,301)	12,832
- Non-controlling interest	(489)	56	-	-
	13,877	18,249	(3,301)	12,832
Earnings per share (R)	159	209		
Diluted earnings per share (R)	146	184		

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 2011

	Group		Company	
	2011 R'000	2010 R'000	2011 R'000	2010 R'000
<b>Net profit/(loss) for the year</b>	13,877	18,249	(3,301)	12,832
Other comprehensive income:				
Fair value adjustments	(366)	-	-	-
Exchange differences on translating foreign operations	43	(856)	-	-
<b>Total comprehensive income for the year</b>	<b>13,554</b>	<b>17,393</b>	<b>(3,301)</b>	<b>12,832</b>
<b>Total comprehensive income attributable to:</b>				
- Shareholders of the group	14,039	17,337	(3,301)	12,832
- Non-controlling interest	(485)	56	-	-
<b>Total comprehensive income for the year</b>	<b>13,554</b>	<b>17,393</b>	<b>(3,301)</b>	<b>12,832</b>



**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY  
FOR THE YEAR ENDED 30 JUNE 2011**
**GROUP**

	Share capital	Share premium	Fair value reserve	Foreign currency translation reserve	Treasury Shares	Retained profit	Total
	R'000	R'000	R'000	R'000	R'000	R'000	R'000
Balance 30 June 2009	84	76,916	366	739	-	22,589	100,694
Shares issued	4	5,996	-	-	-	-	6,000
Total comprehensive income	-	-	-	(856)	-	18,193	17,337
Balance 30 June 2010	88	82,912	366	(117)	-	40,782	124,031
Shares issued	4	3,236	-	-	(415)	-	2,825
Total comprehensive income	-	-	(366)	43	-	14,366	14,043
Balance 30 June 2011	92	86,148	-	(74)	(415)	55,148	140,899

	Non-controlling interest	Total
	R'000	R'000
Balance 1 July 2009	1,039	1,039
Total comprehensive income	56	56
Balance 30 June 2010	1,095	1,095
Total comprehensive loss	(485)	(485)
Balance 30 June 2011	610	610

**COMPANY**

	Share capital	Share premium	Retained profit	Total
	R'000	R'000	R'000	R'000
Balance 30 June 2009	84	76,916	11,926	88,926
Shares issued	4	5,996	-	6,000
Total comprehensive income	-	-	12,832	12,832
Balance 30 June 2010	88	82,912	24,758	107,758
Shares issued	4	3,236	-	3,240
Total comprehensive income	-	-	(3,301)	(3,301)
Balance 30 June 2011	92	86,148	21,457	107,697



## CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 30 JUNE 2011

	Group		Company	
	2011 R'000	2010 R'000	2011 R'000	2010 R'000
<b>Cash flow from operating activities</b>				
Cash generated from/(utilised in) operations	30,687	27,346	5,035	(19,841)
Interest paid	(12,744)	(16,065)	(12,382)	(15,215)
Income tax received/(paid)	862	(2,047)	807	(1,988)
<i>Net cash flow from operating activities</i>	<u>18,805</u>	<u>9,234</u>	<u>(6,540)</u>	<u>(37,044)</u>
<b>Cash flow from investing activities</b>				
Property, plant and equipment acquired	(7,084)	(5,645)	(5,660)	(5,133)
Intangible assets acquired	(1,080)	(3)	(1,080)	(3)
Proceeds on disposals of property, plant and equipment	182	10,259	8	259
Interest received	1,029	1,421	644	1,223
Dividend received from associate	1,000	-	-	-
Increase in loans to subsidiaries and associates	-	-	(164)	(36)
Decrease in loans to subsidiaries and associates	-	-	23,279	35,491
<i>Net cash flow from investing activities</i>	<u>(5,953)</u>	<u>6,032</u>	<u>17,027</u>	<u>31,801</u>
<b>Cash flow from financing activities</b>				
Increase in long-term loans	174	32,680	-	27,408
Decrease in long-term loans	(2,114)	(22,210)	(1,768)	(500)
<i>Net cash flow from financing activities</i>	<u>(1,940)</u>	<u>10,470</u>	<u>(1,768)</u>	<u>26,908</u>
Net increase in cash and cash equivalents	10,912	25,736	8,719	21,665
Cash and cash equivalents at beginning of year	(157,934)	(183,670)	(159,472)	(181,137)
Cash and cash equivalents at end of year	<u>(147,022)</u>	<u>(157,934)</u>	<u>(150,753)</u>	<u>(159,472)</u>



**NOTES TO THE FINANCIAL STATEMENTS – 30 JUNE 2011**

**1. BASIS FOR PREPARATION AND ACCOUNTING POLICY**

The group’s abridged financial statements were derived from the complete set of financial statements which were prepared in accordance with International Financial Reporting Standards. The full set of financial statements is available on request at the registered office. The external auditors PricewaterhouseCoopers Inc. audited the group’s financial statements. A copy of their unqualified audit report is available at the registered office.

**2. HEADLINE EARNINGS**

Adjusted headline earnings is defined as headline earnings excluding the effect of equity-settled share-based payments. Headline earnings is calculated based on Circular 8/2007 issued by the South African Institute of Chartered Accountants.

	Group	
	2011 R'000	2010 R'000
Reconciliation between earnings and headline earnings		
Profit/(loss) attributable to shareholders of the company	14,366	18,193
Net profit on the sale of assets	(122)	(1,218)
Tax effect of net profit on the sale of assets	37	37
Headline earnings	14,281	17,012
Deferred tax asset not previously recognised in Karoo Cuisine (Pty) Ltd	(15,100)	-
Share-based payments	2,825	6,000
Tax effect of share-based payments	(791)	(1,680)
Adjusted headline earnings	1,215	21,332

**REGISTERED ADDRESS**

Koöperasie Street  
 OUDTSHOORN  
 6625

**REGISTRATION NUMBER:** 1961/000721/06

**AUDITORS**

PricewaterhouseCoopers Inc  
 PO Box 215  
 PAARL  
 7620

**BOARD OF DIRECTORS**

HR van der Merwe	Independent non-executive chairperson	
JH Delpont	Non-executive director	Appointed 12/11/2010
C du Plessis	Executive director	Appointed 11/05/2011
JRK du Preez	Independent non-executive director	Appointed 28/02/2011
JSN Fourie	Non-executive director	
JNDS Gomes	Executive director	Resigned 31/08/2011
PL Kleyn	Non-executive director	
JJ Klue	Non-executive director	Appointed 12/11/2010
GF Potgieter	Non-executive director	Resigned 12/11/2010
JJA Potgieter	Non-executive director	
JP Schoeman	Non-executive director	
PP Schoeman	Non-executive director	Resigned 12/11/2010
JE Stumpf	Executive managing director	
JH Terblanche	Non-executive director	
W van Rooyen	Executive director	Resigned 11/05/2011

Compiled and issued by KLEIN KAROO LIMITED.  
 Electronic version available on [www.kleinkaroo.com](http://www.kleinkaroo.com)



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