FINANCIAL REVIEW

The Group performed well for the year under review generating positive leverage of more than five times given a revenue growth of 9% and adjusted operating profit growth of 46%. The following salient features underpinned this performance:

- Beverage and cereal volume growth
- Normalisation of maize profitability
- Traction in bakeries across the value chain
- Power brands' share recovery and gains
- Robust Africa and international performance
- Significant benefits from cost and efficiency efforts
- Quantum Foods' turnaround and unbundling

The financial performance and reporting for the year has been impacted by the treatment of Quantum Foods as a discontinued operation and non-operational costs related to the Phase I (2006) B-BBEE transaction. Statutory results are therefore adjusted in the table below and throughout this report to provide clarity on comparable operational performance.

Unbundling of Quantum Foods and impairments

A comprehensive process was followed to ensure the successful unbundling and ultimate listing of Quantum Foods on the JSE on 6 October 2014. This was a key component of "shaping a winning corporate portfolio" given a core focus on building a branded business. As at 30 September 2014, and for the comparative period, Quantum Foods was treated as an "asset held for sale" and treated as a "discontinued operation" in the financial results.

In terms of IFRS 5, the net assets of Quantum Foods have to be valued at each reporting date and recognised at the lower of carrying amount and fair value less costs to sell. An independent valuation, which reflected the continued macro-challenges of the broiler industry, resulted in a further impairment for the year of R57 million after tax (2013: R208 million).

Due to sustained losses, the investment in the Pepsi business was impaired in the reporting period by an after-tax amount of R34 million.

The above impairments are included in items of a capital nature.

Group summary	2014	2013	Change
Total earnings (R'm)	**965**	499	93%
Earnings per share (cents)	***527***	*275*	*92%*
Plus: Items of a capital nature (after tax) (R'm)	**90**	208	
Headline earnings (R'm)	**1 055**	707	49%
Headline earnings per share (cents)	***576***	*390*	*48%*
Adjusted for after-tax effect of Phase I B-BBEE transaction	**187**	146	28%
Adjusted headline earnings (R'm)	**1 242**	853	46%
Adjusted HEPS (cents)	***678***	*470*	*44%*

Impact of non-operational costs related to the B-BBEE Phase 1 transaction

The 2006 Phase 1 B-BBEE transaction, benefiting more than 11 000 employees at the time, is a cash-settled scheme. The number of participants has declined to 3 218 as at 30 September 2014 as a result of beneficiaries leaving the Group's employment. The total pre-tax value paid to such beneficiaries amounts to R185 million since inception of the scheme. The outstanding obligation is remeasured to fair value taking into account the Pioneer Foods share price at each reporting date. For the year under review the share price increased by 35% from R87.50 to R118.00, resulting in a charge to profit or loss of R187.3 million. The charge in 2014 was exacerbated by the accelerated vesting of the Quantum Foods participants who left the Group's employment early in the new financial year.

In the 2013 reporting period the share price increased from R53.00 to R87.50, resulting in a charge to profit or loss in that year of R145.9 million.

Statement of comprehensive income

Due to the fact that Quantum Foods is being treated as a discontinued operation, its results are excluded from current and comparative numbers.

Group summary (Continuing operations)	2014	2013	Change
Revenue (R'm)	17 699	16 241	9%
Cost of goods sold (R'm)	(12 321)	(11 528)	7%
Gross profit (R'm)	5 378	4 713	14%
Gross profit margin (%)	*30.4*	*29.0*	
Operating profit (R'm)*	1 680	1 153	46%
*Operating profit margin (%)**	*9.5*	*7.1*	
Headline earnings (R'm)*	1 169	846	38%
Headline earnings per share (HEPS) (cents)*	637	467	36%
Diluted HEPS (cents)*	608	455	34%

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

Revenue from continuing operations increased by 9% to R17.7 billion for the period under review. This is largely attributable to increased selling prices, exports and sales mix. There was a strong recovery in both maize and bread volume and value market shares in the second half.

The operational reports from page 40 to page 55 provide detail on the volume and price performance of all main product categories.

Revenue analysis by region	2014 R'm	2013 R'm	Change
South Africa	15 461	14 558	6%
Africa	812	650	25%
Rest of World	1 426	1 033	38%
Continuing operations	17 699	16 241	9%
Discontinued operations: Quantum Foods	3 591	3 569	
Group revenue	21 290	19 811	8%

Cost of goods sold increased by 7% despite cost push and exchange rate pressures, resulting in gross margin expanding from 29.0% to 30.4%. The increase in direct conversion costs was contained at 5%, with raw material costs increasing by slightly more than 7%. Growth in cash operating expenses was well contained at less than 4%, yielding exceptional operating leverage.

Operating profit, before items of a capital nature, and adjusted as described above, increased by 46% to R1 680 million, with operating margin improving to 9.5% (2013: 7.1%).

Segmental performance

Revenue analysis by segment	2014 R'm	2013 R'm	Change
Essential Foods	10 928	10 314	6%
Groceries	7 069	6 169	15%
Bokomo Foods	3 728	3 148	18%
Ceres Beverages	3 341	3 021	11%
Less: Internal revenue	(298)	(242)	
Continuing operations	17 699	16 241	9%
Discontinued operations: Quantum Foods	3 591	3 570	1%
Group revenue	21 290	19 811	7.5%

Operating profit analysis by segment	2014 R'm	2013 R'm	Change
Essential Foods	1 075	784	37%
Groceries	736	543	36%
Bokomo Foods	407	279	46%
Ceres Beverages	329	264	25%
Other	(131)	(174)	
Continuing Operations*	1 680	1 153	46%

* Before items of a capital nature and adjusted for the charge in respect of the Phase I B-BBEE transaction

Operating margin by segment	2014	2013
Essential Foods	9.8%	7.6%
Groceries	10.4%	8.8%
Bokomo Foods	10.9%	8.9%
Ceres Beverages	9.8%	8.7%
Group continuing operations	9.5%	7.1%

The summarised segmental performance above demonstrates each segment's contribution to the overall results.

Essential Foods posted good results in a challenging, low-growth environment. Maize profitability improved to normalised levels through judicious price/volume management in a difficult procurement season. Wheat posted pleasing results while bakeries made exceptional progress on clear value drivers, resulting in significantly improved profitability. Rice benefited from reduced input costs and Pasta continued to contribute positively.

Bokomo Foods' performance was bolstered by a larger fruit crop and solid performance from the cereals business. Corn Flakes' volumes grew significantly given favourable consumer product acceptance. Biscuits achieved targeted volume growth, albeit at lower margins. The beverage business performed well as a result of strong volume growth, both locally and internationally, long-life juice market share gains and improved operational efficiencies.

The Groceries merger of Bokomo Foods and Ceres Beverages was successfully concluded and overall costs were particularly well managed throughout the year.

Quantum Foods returned to profitability after significant re-engineering efforts. A good performance from the feeds business, price recovery in the egg category, the downscaling of the Western Cape Broiler operations and pleasing performance from Mega Eggs (Zambia) were the main contributors to the business turnaround.

For more detailed commentary on the divisional performance, refer to the operational reports on pages 40 to 55.

Return on average net assets	2014 %	2013 %
Essential Foods	35	26
Groceries	21	15
Bokomo Foods	19	13
Ceres Beverages	23	19
Continued operations	26	18

Capital expenditure

R'm	2014	2013	Change
Expansion capital	270	1 143	(76%)
Replacement capital	216	235	(8%)
Total capital	486	1 378	(65%)

Dividend

A gross final dividend of 156 cents per ordinary share has been declared. With an interim dividend of 65 cents per ordinary share, the total dividend for the year amounts to 221 cents per ordinary share, a 67% increase on 2013 (132 cents per share).

In total the dividend declared for the year represents a 2.5 times dividend cover on an adjusted basis.

Statement of financial position

The good financial performance and capital expenditure limited to R486 million (2013: R1 378 million), resulted in much improved return ratios, as summarised below:

FINANCIAL REVIEW (CONTINUED)

The Malmesbury/Paarl mill consolidation project was the main beneficiary of the expansion capital. The balance of R216 million was spent on replacement of capital where needed to ensure prudent and efficient asset care.

Debt and financing facilities – continuing operations

R'm	2014	2013	Change
Third-party debt	501	482	4%
Own debt	1 273	1 357	(6%)
Total debt	1 774	1 839	(4%)
Less: Cash	1 108	379	192%
Net debt	666	1 460	(45%)
Net debt-to-equity ratio (%)	11	22	
EBITDA	2 006	1 499	36%
Net debt-to-EBITDA ratio (%)	33	97	

Statement of cash flows

Cash flow analysis	2014 R'm	2013 R'm	Change
Net cash profit from operating activities	2 134	1 556	37%
Competition Commission penalty	–	(217)	
Change in working capital	28	67	
Inventory	(19)	(276)	
Debtors	(334)	30	
Creditors	417	353	
Other	(36)	(40)	
Cash effect from commodity hedging	(8)	23	
Cash generated from operations	2 154	1 429	51%

Cash generated from operations increased by 51% to R2 154 million largely as a result of the growth in operating profit and a R28 million release from net working capital. Inventory increased by R19 million and debtors increased in line with increased trade and export sales in the latter two months of the financial year and a late non-trade related receipt. Improving the Group's cash flow from operations remains a key focus area.

Income tax of R386 million (2013: R233 million) was paid during the year. Income tax for the year amounted to R452 million at an effective tax rate of 32%.

Net debt for continuing operations decreased by R794 million to R666 million, yielding a net debt-to-equity ratio of 11% (2013: 22%). Net debt, excluding the third-party debt of R501 million relating to the 2012 Phase II B-BBEE transaction results in a net debt-to-equity ratio of 3% (2013: 15%). The Group's total net debt to EBITDA ratio of 33% is well within borrowing covenant limits.

The Group's total debt facilities amount to R3.5 billion, which is contracted with a syndicate of five financial institutions. This quantum caters sufficiently for the Group's long-term and working capital requirements.

The structure of the facility is as follows:

- R600 million bullet loan repayable in September 2018
- R400 million bullet loan repayable in September 2016
- R500 million revolving facility, currently undrawn
- R2 billion in general banking facilities, inclusive of specific raw material facilities to cost-effectively cater for the peak periods in working capital needs in the more active commodity trading months.

The Group is comfortable that the healthy cash flows generated from normal operating activities, and the above secured facilities, will be adequate to meet the working capital requirements and expansion plans of the foreseeable future.

The table below indicates that the excellent performance for 2014, achieved under challenging circumstances as the new business was embedded, has created a solid base for sustained performance in future.

Financial health indicators

Key ratios	2014	2013
Gross margin*	30.4%	29.0%
Operating profit margin*	9.5%	7.1%
Dividend cover	2.5	2.9
Return on average net assets*	26%	19%
Return on equity	20%	13%
Net debt to equity (excluding third-party debt)	3%	15%
EBITDA* interest cover	13 times	10 times

* Continuing operations adjusted for the Phase I B-BBEE charge