

# CHIEF EXECUTIVE'S REPORT

Johann Vorster



## Performance review

Clover is pleased with the results achieved during a year which included some substantial investments in new products and platforms as well as the continuing roll-out of Project Cielo Blu which is now nearing completion. Revenue increased by 10,7% to R7 997 million from R7 224 million, operating profit was up by 5,4% to R391,4 million from R371,2 million, whilst operating margin decreased slightly from 5,1% to 4,9%.

Clover's vision of reaching every customer on a daily basis with its most admired branded and trusted products whilst delivering improved and sustainable shareholder value by being a responsible corporate citizen and preferred employer, still remains relevant. It is against this background that Clover continues to deliver on its strategy of investing in, and focusing on, branded and value-added products.

Although the financial performance achieved during the first half of the financial year was weaker than expected, the recovery achieved in the last six months was very pleasing. Some of the factors which enabled the recovery can be ascribed to:

- Aggressive cost controls.
- Successful selling price increases to the trade.
- Lesser spend on new product launches during the last six months.
- Implementing only selected promotional activities following the selling price increases.

- Agility and robustness of Clover's new structures.
- Ability to convince Clover's consumers of its value proposition.

As mentioned earlier, a number of new production technology platforms were introduced during the first six months of the financial year and which will further differentiate, entrench and grow market share for the Group's products in the years to come. Most notable of these investments are:

- Extended shelf life (ESL) fresh milk with 18 days shelf life compared to the industry norm of 12 days
- Prisma packaging for UHT (long life) milk and Tropika fruit juice blend
- 30 days shelf life ultra-pasteurised milk (UP)
- Krush and Tropika brands in 2 litre carton packaging
- Newly formulated Danao in the Tetra Top packaging

The decision to launch these new products prior to the key high-trading festive season required substantial marketing and advertising costs in addition to promotional pricing

and other activities. In total, R27 million was spent on associated advertising and other point of sale activities. Aggressive price promotions on the same products also temporarily impacted profit margins, which partially recovered during the latter part of the year under review. In the second half only two new products were launched:

- New processed cheese platform (individually wrapped slices)
- Clover Amasi (Maas)

Overall sales volumes grew by 4,5% when compared to the prior corresponding period. Excluding the strategic exit from bulk mozzarella, as explained below, overall volume increased by 6,7%.

## Clover's vision is to reach every customer on a daily basis with its most admired branded and trusted products.

However growth in low margin ingredient volumes accounted for 2,2% of this 6,7%. The exit from the bulk of the mozzarella business, weaker UHT sales and the initial efficiency problems on the Prisma UHT lines caused Clover to convert substantially more milk into powder during the year which had to be sold as ingredients. Branded sales volumes grew by 7% while bulk products declined by 17,4%.

Whilst the widespread industrial action in the mining sector undoubtedly slowed consumption of the Group's products during the first part of the year, Clover also experienced seven days of industrial action at the start of its financial year with the national transport strike also indirectly impacting on the Group's supply chain. All these labour related events had an impact on sales volumes across all segments.

The market for drinking milk changed considerably during the calendar year to December 2012, with very competitive pricing on UHT resulting in an 8% growth in this market and a resulting 6,3% decline in the market for fresh milk, both indicators referring to top end retailers. Initial efficiency problems with the new Prisma pack platforms, delays in the importation of product to supplement own production during the relocation of equipment, fierce competition in this market and industrial action resulted in Clover's 3,1% growth in the UHT market not correlating with overall market growth.

Similar to the market Clover's fresh and ultra-pasteurised milk volumes also declined albeit at only 1,2% compared to the market decline of 6,3%.

The dairy fluids segment volume saw overall volume growth of 1,6% aided by Clover's launch of its Amasi product during January 2013.

Clover's strategy to focus on value-added branded products, and exit from commodity bulk products, had some impact on volumes, including a 3% decline in concentrated segment volumes. If the volume loss resulting from the bulk mozzarella exit are excluded, segment volumes actually increased by 14,5%. Pre-packed natural cheese volumes increased by 26,2%, feta cheese by 10,4% and condensed milk by 4,2%. Butter volumes decreased by 0,8% mostly due to a substantial buy-in from customers shortly before the start of the financial year in response to Clover's promotional activity at the time.

Beverage volumes again showed strong growth of 15,4% (7,7% excluding the effect of the Real Juice Co. Holdings ("RJC") acquisition) largely underpinned by Tropika growth of 6,6%, fruit juice growth of 34,1% (7,4% excluding the effect of the RJC acquisition), Danao growth of 26,5% and Aquartz water growth of 35,3%. Super M volumes declined by 9,2% in the face of a very aggressive performance by its major competitor whilst Manhattan Ice Tea volumes and Capri-Sun volumes declined by 10,4% and 40,8% respectively amidst fierce competition. Clover is considering the withdrawal of Capri-Sun from the market.

(All overall market statistics quoted from Aztec for the year ending June 2013, for Shoprite, Checkers, Pick n Pay and Spar).

Clover's short- to medium-term objectives remain unchanged with the completion of Project Cielo Blu now being imminent.

### The main strategic pillars underlining the investment case are as follows:

- Leveraging off strong sales and distribution network.
- Leveraging off strong heritage brand.
- Continuous brand extension.
- Aggressive product platform extension.
- Addressing supply chain cost inefficiencies.
- Capitalising on extensive route-to-market capability.
- Seeking consolidation opportunities in the FMCG market.
- Sensible Africa expansion.

### Other capital projects approved by the Board are:

Project	Status
Expansion of Ixopo Milk Procurement Depot	<ul style="list-style-type: none"> <li>● Extensive delays to obtain necessary governmental approvals</li> <li>● Expected completion date now end of 2013</li> </ul>
Expansion of Clayville chilled distribution capacity by 50%	<ul style="list-style-type: none"> <li>● Final designs approved</li> <li>● Tender process to commence shortly</li> </ul>
Expansion and rationalisation of Western Cape warehousing capacity	<ul style="list-style-type: none"> <li>● Exploring automated high density storing solution</li> <li>● Final designs to be presented to Executive Committee for approval</li> </ul>
Integration of RJC production facilities into Clover's Parrow site	<ul style="list-style-type: none"> <li>● Final designs approved and civil works underway</li> <li>● Expected completion date currently end February 2014</li> </ul>

## Brand strength and performance

### ● Fresh and Ultra Pasteurised milk

Market share increased by 2,3%, supported by the launch of Clover's Ultra Pasteurised (UP) milk variant and the marketing campaign for Clover's 18 days fresh milk. Both products were launched in the latter part of 2012 and aim to bridge the gap between fresh and long-life milk, with the UP milk featuring a shelf-life of 30 days – an industry first.

### ● UHT milk

As mentioned above Clover's UHT milk faced some major challenges including:

- Initial efficiency problems with the conversion of the machines to the new Prisma format.
- New market entrants.
- Imports delays meant to supplement Clover's production during machine relocations.

### ● Cream

Clover's market share declined 0.9% due to significant discounting by competitors during high milk flow periods in an effort to dispose of excess product.

### ● Feta Cheese

The category showed a pleasing market share increase of 3,7% supported by consistent pricing and a promotional strategy to gain market leadership, including marketing campaigns to increase consumption of Clover Feta over the typically lower volume winter months.

### ● Pure Fresh Juice

Following the acquisition of the RJC, Clover's combined market for Clover Krush and Quali juice increased to 46,2%.

### ● Manhattan ice tea

Clover lost 5,6% market share in the face of a very aggressive new market entrant. The new Clover Waters venture with Nestle, which will house the Manhattan brand, will focus on regaining this share.

### ● Dairy Fruit Mix

Tropika increased its market share by 4,3% and benefited from Clover's investment in trade and internal sales for the biggest Tropika Island of Treasure campaign to date. Danao increased market share by 0.9% after a successful re-launch in September 2012.

### ● Water

Aquartz water increased market share with 2,8% following the implementation of a competitive pricing strategy.

### ● Pre-packed cheese

A market share loss of 3.2% was attributable to certain "bulk" packs (800g to 900g) being measured together with smaller fixed weights packs (250g to 500g), a segment in which Clover is extremely competitive and that saw strong market growth during the year. Clover launched its 800g offering in 2012 to address this anomaly and a better performance is expected in the year ahead.

### ● Flavoured milk

Super M lost 1.7% market share as a result of the selling price increases to the market not being followed by competitors. This was mitigated by an improvement in profitability.

### ● Fruit Drink/Nectar

Combined market share for these products increased by 9,4%, reinforced by the successful re-launch of Clover Life in September 2012 and the acquisition of Quali nectar through the RJC transaction.

(All market statistics quoted from Aztec for the year ending June 2013, for Shoprite, Checkers, Pick n Pay and Spar).

PS: the Quali Juice acquisition contributed to the growth in pure juices and nectars for the year.

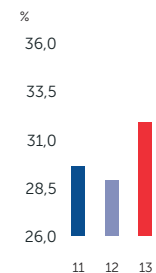
In recognition of positioning itself as a premium and trusted brand, Clover received a number of awards during the year.

- Apex Award – Bronze for Tropika – Sustainable Brand and marketing business
- Apex Award – Gold for Clover "Way Better" – Change Category Title
- Arrow Award – Diamond – Tropika – Best marketing campaign
- Arrow Award – Diamond – Clover Krush – Most successful product launch
- Arrow Award – Clover milk – 1st – Gold
- Arrow Award – Clover cheese – 1st – Gold
- Sunday Times Top Brands – Clover Krush – Winner
- Sunday Times Top Brands – Tropika – Top 3
- Sunday Times Youth Survey – Tropika – Top 10
- Product of the Year – Danao – Winner – Innovation
- Product of the Year – Clover UHT Prisma – Innovation
- Product of the Year – Clover 800g Cheese – Innovation
- Top Companies Reputation Index (TCRI) – No 1 – Confectionary and Dairy Sector.

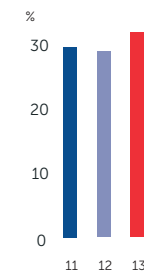
The overall TCRI ranking is based on the top 30 highest advertising spenders (measured using the Nielsen Ad Index data), in other words the businesses that should be the most visible and have the highest level of interaction with the public as a result. What is significant is that Clover's Reputation index of 87.89 would have placed it in the overall 3rd position if it was a Top 30 advertising spender.

## MARKET SHARE

### FRESH AND UP MILK

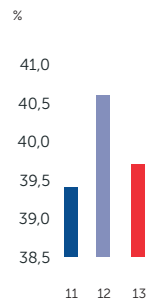


### UHT MILK

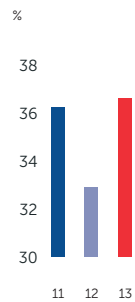


Clover has set itself ambitious targets which not only include volume and market share growth, but also to reduce supply chain costs, invest in market expansion into Africa, and in Human Capital.

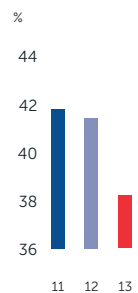
#### CREAM



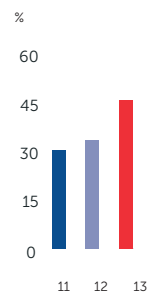
#### FETA CHEESE



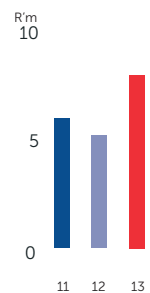
#### PRE-PACKED CHEESE



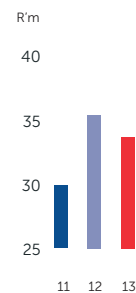
#### PURE FRESH JUICES



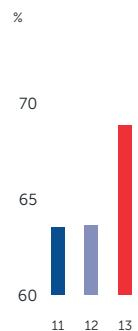
#### WATER BRAND



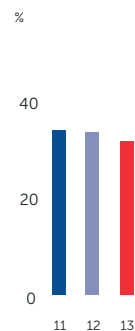
#### FLAVOURED MILK



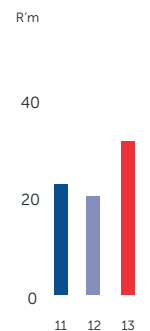
#### DAIRY FRUIT MIX



#### ICE TEA



#### FRUIT DRINK/NECTAR



- Qualité Awards 2013 – Clover IWS Cheddar – Quality award
- Reader's Digest Most Trusted Brands 2013 – Highly recommended – Clover Dairy
- 2013 Loerie Awards – Way Better campaign – for the Way Better advertising campaign

The most prized award received during the year was the TGI Icon Brands survey where Clover climbed one notch from 17th to 16th out of the 30 most loved and used brands in all South African households, by all South Africans.

#### Corporate activity

During the year under review Clover entered into a collaboration agreement with Nestlé SA which led to the formation of a new entity – Clover Waters (Pty) Ltd. Effective from 1 August 2013, Clover Waters will manage and develop the water and ice tea brands of the two respective companies; namely Nestlé Pure Life, Nestea, Clover Aquartz and Clover Manhattan Ice Tea. Clover owns 70% of Clover Waters and Nestlé the remaining 30%.

With effect from 1 November 2012, the Group acquired the 49,9% minority interest in Clover Manhattan for R24,7 million.

The acquisition of RJC was approved by the competition authorities and became effective on 1 October 2012. Potential synergies from this transaction are expected to be extracted over time although it has already made a positive contribution to profitability.

Clover has secured two new principals during the year under review which will further enable a reduction in our supply chain costs. These principals are Enterprise Foods (with effect from 1 June 2013) and Red Bull's top-end sales and merchandising services from 1 March 2013 (in addition to the forecourt channel's business also secured from 1 July 2012).

Clover's approach to obtaining new principals hinge around a number of important factors, for example:

- It must be a strategic fit to Clover's products/brands/operations.
- The aim must be to be a long-term relationship.
- It must compliment Clover's existing business.
- It must be "like-minded" partners (brand driven, value-added, etc.).
- It must be a principal who values Clover's entire supply chain offering.

Clover will continue to seek opportunities of expansion through mergers and acquisitions both locally and into the rest of Africa.

### Africa expansion

Clover's African expansion opportunities are starting to crystallise. In terms of Clover's fresh product range, limited opportunities exist in most African countries due to the lack of refrigeration and poor infrastructure. However, Clover has a number of ambient products which could service these markets well, and although the current "export distribution" model is gaining some momentum, the longer term model will entail larger infrastructure development and associate investments. To date Clover has identified Angola and Nigeria as countries of interest where such investments will be considered. Entry into these markets are challenging and Clover has adopted a prudent approach which will take longer to implement, but will have a better chance of succeeding in the long term. Own production facilities have been identified as a key driver for long-term sustainability.

### Sustainability

The Group's sustainability is based on the acknowledgement of its responsibility to all stakeholders in order to ensure its long-term viability.

In pursuing this strategy, the Group has to continuously identify and consider the impact of its business on all its stakeholders.

Clover also recognises its responsibility to reduce, and as far as practically possible eliminate the impact on the environment. This responsibility relates not only to operations within Clover's control but also to Clover's supply chain partners, who are acknowledged as having a significant environmental impact in supplying Clover.

(Refer to the Report on Sustainability and the Social and Ethics Committee report on the web or in the integrated annual report).

### Human Capital

Clover strongly believes in its people and the development of individual and group skills. It lives the phrase "People are our most important asset" and strives to be relevant today and tomorrow. With this in mind, Clover has launched a special project – Driven! – to ensure that Clover's Human Capital is developed as a long term competitive advantage.

(Refer to the Human Capital Development section of the Report on Sustainability, the Remuneration Policy and Remuneration Report).

### Dividends

The redemption of the CIL preference shares during June 2013 enabled the Board to reconsider the Group's dividend policy. Previously the rules regulating the preference shares prohibited the Company from paying dividends more than 25% of attributable earnings. In considering the dividend policy the Board took cognisance of the Group's growth ambitions and the potential need for capital to achieve this.

As a result the Board will, over the medium term, target a dividend cover, based on headline earnings per share, which is more comparable to the sector within which it operates.

A final dividend of 22 cents per share was declared by the Board on 11 September 2013 which brings the total dividend for the 2012/13 financial year to 32 cents per share. This represents a 12,7% increase and a dividend covered 3,75 times by headline earnings per share compared to the 4 times cover previously applied.

This once off liberalisation of the dividend cover is in pursuit of the Board's medium-term target. Going forward, a progressive dividend policy will be applied whereby dividends are maintained or grown at least by the same percentage as the growth in headline earnings per share until such time as a comparable dividend cover is achieved.

### Outlook

Clover has set itself ambitious targets which not only include volume and market share growth, but also to reduce supply chain costs, invest in market expansion into the rest of Africa, and in Human Capital. It has also launched an initiative to align itself with the different visions of its main customers. In this regard, Clover is working closely with its customers to develop integrated business platforms and procedures that will add long-term value for both Clover and its customers.

Consumer spending remains under pressure and coupled with continuous inflationary increases, it will be a challenge to balance short term profits with long term growth investments which are paramount to take Clover to the next level of growth.

Clover has many exciting opportunities which need to be explored to secure long term sustainability. The executive team is focused on maintaining an optimal equilibrium to grow its existing business while exploring new possibilities and territories, even if this approach puts some pressure on short-term profits and cash flows.

**Clover's main overall objectives for the current financial year are:**

- To recover cost increases in the market.
- To finalise Cielo Blu and other expansion projects.
- To increase capacity in the distribution network.
- To redesign its supply chain network.
- To develop new products.
- To enter new geographies.

Economic uncertainty has become the only constant and Clover will act responsibly and decisively in response to any challenges the economy presents. However, Clover remains confident that the investments made since listing will begin to pay off and lay a solid platform for the future.

### Welcome and appreciation

During the year in review, the Clover Industries Board appointed Werner Büchner as Chairman of the Board and we wish him a successful time at the helm.

I would again like to thank the previous Chairman, John Bredin, for the many years of dedicated service to Clover and the milk producers.

A special mention must go to Tom Wixley, who as Lead Independent Non-Executive Director plays a very important role on the Board. Tom Wixley also serves on a number of committees where his input is invaluable. None of his efforts go unnoticed.

As at the end of June 2013, one of our dearest and most committed Clover colleagues has decided to retire. Manie Roode has given 16 years of his life in the most unselfish manner imaginable to Clover, and his wisdom and direction will be sorely missed. As a director he was invaluable and as my Deputy Chief Executive for the last 8 years, irreplaceable.

I could not have focused on the enormous tasks during the restructuring and listing if it wasn't for Manie behind me. Thank you Manie from all of us at Clover.

Clover has a very competent and committed Board which is actively involved in setting the strategy and ensuring that Clover's reputation is safeguarded as a key pillar to long-term sustainability. We want to thank them for all their unselfish effort and support.

Without "Way Better" Cloverites, this company would not be what it is today. The daily commitment to the Clover Brand is commendable and I wish to sincerely thank every Cloverite for that!

The backbone of Clover has been and still is the Clover Milk Producers. In a year that was particularly difficult in terms of cost pressures, they again supported the company's operations by supplying the quality milk necessary to make all things happen. A great deal of appreciation goes to them.

And then, to my executive team, thank you for the tremendous support and hard work during this year. It was an equally challenging and exciting year in which many dreams came true. You were remarkable.

And lastly, it would be an omission not to give a special word of thanks to our supplier partners, who played an integral part in this year's results. Your efforts are much appreciated.



**Johann Vorster**  
Chief Executive

11 September 2013



## Product focus

### 18-day shelf life fresh milk project

- Implemented at two Clover plants, i.e. Queensburgh and Clayville.
- Installed a new pasteuriser in Queensburgh with heat energy regeneration of 94% makes it the most efficient pasteuriser in Clover, as well as the biggest in the country at 33 000 litres/hour.
- Installed 2 new Stork ESL filling lines capable of 60 000 litres/hour, capable of emptying two milk tankers every hour.
- Upgraded milk processing and implemented proprietary designs to enable the achievement of the required shelf life.
- 21 Companies were involved in implementing the project.
- The installation in Queensburgh was finished first and was supplying the entire country with 18 day ESL milk for 6 months before the Clayville installation came online.
- Created 30 additional jobs.