Chief executive report to stakeholders

Group chief executive, Brian Bruce

"We feel positive about our future prospects based on current economic prognosis for our selected markets."

This final year of Rebuilding Murray & Roberts has seen a fundamental reshaping of our Group in line with our strategic engagement of the global construction economy. The acquisition of Cementation and a strategic partnership with Clough has established a global engineering and contracting platform serving selected natural resource markets in Southern Africa, Middle East, Southeast Asia and North America.

Our domestic market leadership is enhanced through the acquisition of new business capacity in the construction economy and our preferred bidder status on both the Gautrain Rapid Rail Link and the PBMR Nuclear Power Programme.

Commercial fixed investment has improved in Middle East and new project awards such as Dubai International Airport offer Murray & Roberts a platform for sustainable expansion following two years of market realignment.

Finally, a major benefit of Rebuilding Murray & Roberts has materialised in the form of an empowerment strategy that will see broad-based community and staff participation in the equity of the Group into the future, combined with value-based empowerment partnerships in the Group's various operating markets.

Executive summary

I am pleased to report our financial and performance results for the year to 30 June 2005, providing stakeholders with insight into how Rebuilding Murray & Roberts has established a new platform for the future development of the Group.

This final year of Rebuilding Murray & Roberts has been characterised by further change and transformation as all the preparation throughout the five year process has been crystallised into a new performance platform for the future. While operating profits increased by 29% to R543 million off a 27% increase in revenues to R10,7 billion, a significant increase in taxation and reduced contribution from associates resulted in diluted headline earnings per share of 140 cents compared with 155 cents in the previous reporting period.

We included a *pro forma* summary income statement and balance sheet in last year's annual report highlighting the potential impact of the acquisition of 100% of Cementation and a 30% stake in Clough and disposal of our 45% shareholding in Unitrans. Had we adjusted for the normalisation of taxation, benchmark headline earnings per share would have reduced from 143 cents to 123 cents. This implies growth of 14% in the year.

Disposal of the Group's 45% shareholding in non-core investment Unitrans created the opportunity for acquisition of 100% of the Cementation business in South Africa and Canada and a control shareholding over time in Clough Limited in Australia. Both companies operate within our strategic focus and are expected to deliver attributable earnings from the 2007 financial year at least in line with what could have been expected had the Group remained invested in Unitrans.

The prospects statement included in the 2004 annual report was written at a time of significant corporate activity. Acquisition of the Cementation mining contracting assets in South Africa and Canada had been effected from 1 July 2004. Disposal of our 45% shareholding in Unitrans was in play and we had entered an agreement to acquire a strategic shareholding in Clough, an Australian oil & gas contractor.

Resolution of a number of problem contracts meant that approximately R750 million of revenues in the year would offer no contribution. It is therefore pleasing that we have performed ahead of the prospects update included in the 2004 annual report and the half-year report for the period to 31 December 2004.

We have maintained our operating margin at 5,1% (2004: 5,0%). This incorporates the substantial break-even order book carried through from the prior year and unbudgeted project losses, mainly in Middle East. The Group remains committed to a sustainable operating margin of between 5,0% and 7,5% which reflects both the opportunity and risk profile of our target market.

Our year-end net cash position improved to R1,74 billion from R1,0 billion at 30 June 2004. This includes capital expenditure of R303 million and a net acquisition inflow of R350 million. We experienced a peak in working capital demand during the year, fuelled primarily by delayed funding of losses booked in previous years and some intra-year stock build-up primarily in the steel business sector. R339 million in interest-bearing long-term liabilities relates primarily to a loan facility arranged to fund a portion of the Group's shares in Clough.

A 16,1% return on average shareholders' funds reflects the relative inefficiency of the Unitrans cash as an asset through the second half-year and the increase to normal taxation. While this is below the historic Group target of 20%, it is expected to improve in the future once surplus cash has been invested into productive capacity.

We have experienced a series of setbacks through the year that have impacted performance and represent primary areas of concern.

- We suffered a reversal of R40 million in the first half-year on the Khalifa Sports Hall project in Qatar. Whereas some financial recovery is still possible, it is our experience over recent years in Middle East that this will require significant corporate resolve and may take some considerable time to finalise. This reversal was partially compensated by the recovery of R26 million in respect of the Equatorial Guinea project for which no benefit was recognised in the previous year. We have used lessons from these projects to inform our new opportunity management system and so ensure that we do not repeat the tender and management errors that characterise international contracting risk.
- Our health & safety performance in the year has been disappointing, with 12 fatalities recorded in the period. The new year has started with a further three fatalities in the first month alone. This has highlighted the urgent need for greater awareness amongst all our employees and subcontractors of the inherent dangers associated with construction activity. We have revisited our fundamental strategies in this area and the Group has committed the necessary resources to ensure that all our operations are safe and that all people entering and working in our many work sites are appropriately prepared and protected against possible danger.
- The directors of Consani Engineering (Pty) Limited were required to place the company into liquidation following a decision by the Group to suspend further funding. It was evident that the company was not sustainable under projected economic circumstances. This was a major setback after the effort that went into transforming the company over the previous few years.

These incidents have challenged our delivery of sustainable earnings growth and value creation. But we have learned from the experiences and I have initiated the appropriate interventions into our risk procedures to limit the potential for similar problems in the future.

Market

For the first time in recent memory, all our target markets are showing signs of sustainable growth potential. This brings its challenges and our ability to extract increased value from future activities will depend on how clients, contractors, suppliers and labour adjust to the changed dynamics, and what we see as a temporary shortage of capacity.

South African gross fixed capital formation (GFCF) looks set for an extended period of sustainable growth over the next decade at least. This is in contrast to the steady decline in relative fixed investment we have experienced over the past 30 years. There are strong economic indications that we will experience average nominal investment growth of up to 15% per annum over this period, boosting real gross domestic product above 4% per annum.

We have experienced strong consumer-driven growth in the construction economy over the past two years, with increased private sector funding into the residential and retail asset base. We foresee continued growth in this sector, albeit at a slower rate, but predict that infrastructure spend by the public sector, including public private partnerships, will be the primary driver of growth over the decade ahead.

Fixed investment into essential economic infrastructure by key government agencies and the major parastatals will lead the process. A power deficit estimated at more than 20 000 MW by 2020 will require significant investment into new and upgraded facilities. Transport and logistics infrastructure in the country and region is inadequate for current economic growth projections. Road, rail, air and marine facilities require high levels of capital enhancement and efficiency upgrade. South Africa is also a water-stressed country with uneven distribution between source and consumption. The supply of water and sanitation to society remains an essential foundation for socio-economic development.

Natural resources are expected to offer increasing opportunity for growth as the production maturity of existing investments in the sector fails to meet new demand from China and the rest of Asia. The development opportunity for natural resources is inextricably linked to the provision of primary infrastructure, such as power, water and transport. Murray & Roberts has assembled the capacity in South Africa, Australia and Canada to play a lead design and installation role for the primary infrastructure to access and extract deep-level metal & mineral resources onshore and oil & gas reserves offshore.

Middle East countries are driven to diversify their regional economy. New investment is driven primarily by energy revenues, with increasing attention to the benefits of economic diversification in the region and eradication of its high levels of indigenous unemployment. At the recent World Economic Forum Summit in Jordan, it was stated that tourism would be the primary vehicle for the creation of an estimated 80 million jobs over the next 20 years.

We are well positioned to maintain our presence in the top end of this market, primarily in the United Arab Emirates and Bahrain, but with new opportunity under consideration in partnership with Clough serving the regional oil & gas market.

Globalisation has brought greater awareness of human development needs, highlighting a global deficit in the supply of power, energy and water as well as education and employment opportunity. Globalising Murray & Roberts recognises the influence of these trends on the fortunes of our Group.

More specifically, the competitive landscape for engineering and construction is increasingly influenced by those companies which have benchmarked global best practice for sustainable earnings growth and value creation. The Board of Murray & Roberts and its executive leadership have committed the Group to this level of achievement.

Order book

The Group's project order book has grown to R8,5 billion at 30 June 2005, significantly up on the R5,0 billion (including Cementation) at 30 June 2004 and steady compared with the level at the half-year. This is 130% of current revenues and represents an important cornerstone of performance best practice. R5,4 billion of the order book is for execution in the 2006 financial year with more than 67% repeat business with known clients. The most significant award in the year was Dubai International Airport where the Group's 40% share is worth R2,4 billion over three years.

Southern Africa accounts for 52% of the order book, with 40% in Middle East and 8% in the rest of the world, primarily Canada. From a market perspective, construction accounts for 53%, with 40% in mining contracting and 7% in engineering and fabrication.

Subsequent to year-end and not yet included as order book, is the selection of Bombela as preferred bidder for the Gautrain Rapid Rail Link. The Murray & Roberts share of this project will be disclosed on contract finalisation, and is significant. In addition, the Group is finalising its role as engineering contractor for the Pebble Bed Modular Reactor nuclear power programme, together with long-term partner SNC Lavalin. This project is planned for construction starting in 2007 and over a three year period will offer significant new opportunity to a number of companies in the Group. Thereafter and subject to licensing, the multi-unit rollout programme is expected to extend for up to 20 years.

New projects have been secured since year-end in the domestic mining and construction markets and in Middle East. We are further encouraged by the number of major prospects being pursued by the Group across all its principle domestic and international markets.

The long-term order book for foundry work is stable, although there is some volatility in off-take demand by customers, Ford in particular. We still await a final announcement on the Spoornet locomotive replacement programme in South Africa, where we are a key member of the preferred bidder for the Coalink upgrade project.

Acquisition and disposal

The Group's 45% shareholding in Unitrans was sold effective 31 December 2004 and its final contribution to associate earnings was R64 million for the year. An exceptional profit of R214 million was realised on the transaction which has been partially offset in the period against a provisional loss of R144 million on liquidation of Consani. An exceptional loss of R47 million on sale of Booker Tate relates primarily to its pension fund deficit.

Cementation Canada was acquired in July 2004 and under Roy Slack as president has integrated well into the international structure of the Group and delivered a good performance in the year. Although operating as a relatively independent 100% investment, there is a high level of technical interaction with Murray & Roberts Cementation in South Africa. The company is constructing the world's deepest mine shaft outside South Africa at Nickel Rim in Canada.

The Cementation Company (Africa) Limited was acquired with effect from 1 July 2004, delisted from the JSE Limited and all but 3,8% of minority shareholders bought-out. A series of transactions thereafter resulted in the merger of its main subsidiary with Murray & Roberts RUC.

Since his appointment in January 2005, managing director Henry Laas has led the integration process in the business.

We bade farewell to long-time Cementation managing director and mining personality Alastair Douglas in June 2005, when he retired after more than 30 years with the company. With effect from January 2005 and in terms of broad-based black economic empowerment criteria and the Mining Charter, AKA Capital acquired 26% of Murray & Roberts Cementation.

Our Australian mining operations have performed well in the year and following our decision not to acquire Cementation in Australia, we have reached agreement subject to due diligence, to pursue the acquisition of a specialist mining contracting company in this market. We believe that if successful, this acquisition enables us to improve our service in specialist raise drilling to our worldwide customer base.

Clough is a well established family controlled major engineering contractor that has been listed on the Australian Stock Exchange (ASX) since 1998. The company has a very similar development profile to Murray & Roberts, lagging between 10 and 20 years. It has established a leading position in the offshore oil & gas market over the past 25 years, following development of natural gas reserves from the Northwest Shelf off West Australia.

On 10 November 2004 minority shareholders in Clough based in Perth, Australia approved a transaction that allowed Murray & Roberts to increase its ownership in the company to 29,3% and in terms of a shareholder agreement with McRae Investments (representing the Clough Family), to move to control over time as allowed by the rules of the ASX. The Group has since acquired further shares in Clough through the ASX and its interest in the company stands at 30,3%.

Clough has recorded an attributable loss of AUD60 million (AUD = ZAR5,0) for the year to 30 June 2005. However, the majority of its problems relate to pre-acquisition matters identified by Murray & Roberts in due diligence.

These problems relate largely to an EPIC (engineer, procure, install and commission) oil & gas project off Melbourne in the Bass Straights valued at AUD400 million where the client has drawn-down two on-demand performance bonds to the value of AUD39,8 million against alleged damages. Clough has taken its disputes to arbitration in terms of the contract, but in the meantime suffers a cash flow deficit.

Our share of post-acquisition earnings from Clough is R16 million for the year, which derive largely from 83% listed subsidiary PT Petrosea in Indonesia, oil & gas services projects and some property development activity in Australia.

The initial investment by Murray & Roberts in Clough has been helpful in stabilising the company, allowing its operations to continue and mounting an appropriate legal response for Bassgas. However, the arbitration will not conclude within the new financial year at least, so to underpin the turnaround of the company and reinforce our original investment, we have reached agreement with McRae Investments and the board of Clough, subject to shareholder and regulatory approvals, to increase our shareholding in Clough through an issue and subscription for new shares and an equivalent sell-down by McRae Investments.

Murray & Roberts will thereafter hold the right to 49% of Clough and McRae will reduce to below 20%. In the meantime the strategic partnership with McRae as shareholder and the management of Clough under CEO David Singleton continues to develop. With our increased investment in Clough we have established the capacity to engage a more intense partnership across a broader market spectrum into the future.

Further details on Clough are available on www.clough.com.au

A number of new acquisition ventures have been pursued during the year under review, directed at increased penetration into the fragmented South African construction economy.

We have acquired an initial 80% shareholding in leading brick maker Oconbrick Manufacturing (Pty) Limited for a consideration of R96 million. The company is the third largest supplier in its market and together with Harvey Roofing will form the core of our strategy to serve the developing affordable housing market in South Africa.

There has been an extended process concerning the proposed disposal by international company Hochtief AG of its major shareholding in local contractor Concor Limited. Based on due diligence, Murray & Roberts reached agreement with Hochtief to acquire its 45% shareholding in Concor for 1 977 cents per share. Subsequently, the board of Concor agreed to recommend a cash offer of 2 230 cents per share to remaining shareholders, including the Concor Executive Share Trust holding of 15% of Concor shares, in terms of section 311 of the Companies Act.

Criterion Equipment has been sold to J&J Group effective 1 September 2005 in an empowerment transaction valued at R75 million, including an element of vendor financing. Managing director Graham Callanan and his team have served the Group with distinction over the past five years and the directors wish them well in the future.

The planned sale of Pefco Foundry could not be finalised due primarily to property related issues and the company has become an investment under the control of Murray & Roberts Foundries Group until a solution is found.

Acquisition and disposal activity has brought a new dimension to the demands on our corporate executive team. I feel confident that under the direction of Terry Rensen, we have developed leading capacity in due diligence processing. The knowledge we gather is often less about the commercial transaction than it is about the risks we face post-transaction and our option framework in dealing with them.

All these transactions are designed to establish a broader foundation for access to our chosen markets and enhanced delivery for improved performance into the future.

Empowerment

As a South African business enterprise, we are faced with the dual challenge of sustainable growth and broad-based empowerment in our economy. Whereas the former has been an illusive concept for the construction industry over the past two decades, the latter is essential for long-term market stability and requires careful consideration to ensure the correct formula for meeting our commitment to sustainable earnings growth and value creation.

In preparation for implementation of our broad-based empowerment strategy, we have refined the executive management and statutory structuring of our domestic and regional operations to facilitate an appropriate framework for introduction of partners in each business sector. We have established some key principles for our empowerment partnering strategy:

- Strategic and operational capacity focused on leadership, development and growth
- Capacity building through broad-based involvement and employment equity
- Risk and reward sharing through investment of financial and “sweat” equity
- More than 25% direct equity by 2010 in all relevant operations

Murray & Roberts is a diverse business enterprise, engaging the construction economy in South Africa from various market perspectives and with substantial regional and international business interests. However, we are South African and to embrace empowerment across the full spectrum of the Group, we have proposed that a minimum 10% of our equity be utilised to create a baseline and broad-based empowerment structure.

Within the framework of the Companies Act, the directors have approved a proposal for submission to shareholders at a special general meeting, to repurchase up to 10% of the Group’s shares using its own resources, with the specific intent to create broad-based black economic empowerment ownership in the equity of the Group, including qualifying staff.

Full details of this proposal are included in a separate circular to shareholders.

Risk management

Globalising Murray & Roberts will expose the Group to continuous and new risks, particularly through the acquisition of new business capacity and the engagement of new markets. Every aspect of business activity carries risk to a greater or lesser degree and the high levels of complexity that characterise Murray & Roberts compound the business risk environment.

The following are some of the key and material business risks for the Group that are found primarily in the contracting environment:

- The geo-political environment within which projects are engaged
- The legislative environment governing project implementation
- The commercial terms and conditions governing project fulfilment
- The choice of client and the issue of performance and other bonds and guarantees
- The creditworthiness and payment culture of project clients
- The competence of design, engineering and specification information
- The integration of design and build
- The appointment of executive and project leadership
- The choice of strategic and operations partners and subcontractors
- The availability and selection of construction materials and equipment
- The skills and availability of supervision and workforce resource

We have opted for a system of internal control that is designed to manage rather than eliminate the risk of failure to achieve the Group's business objectives. This system can provide reasonable, but not absolute assurance against material misstatement or loss. We believe that effective risk management requires executive leadership capable of overseeing the full impact of enterprise-wide risk. This includes oversight of group insurance and internal audit, the management of performance bonds and various forms of guarantee.

We have developed a comprehensive risk management framework that establishes the formal processes through which executives and staff must conduct themselves in the course of doing business. This is supported by internal audit, which monitors brand compliance, health, safety and environmental performance and other aspects of our risk framework.

We have made the important appointment of Bal Panicker as group projects director based in Dubai to ensure best practice in our major project implementation. Bal is involved with the Dubai International Airport project and the developing market engagement between Clough and Murray & Roberts.

Finally, we have introduced an internal online opportunity management system that tests the risk potential of all project opportunities against a matrix established in the context of the material business risks listed above. Linked to the guarantee management system at corporate office, the system establishes an authority framework for the full life of all projects that fall outside a predefined risk framework.

Capacity and capability

Looking to our future development, we appear to have greater capacity and capability compared to when we commenced our initial transformation process five years ago. We start our new journey Globalising Murray & Roberts with an executive and non-executive leadership team where almost 75% of the members (18) are new to Murray & Roberts, 75% of whom (14) have limited previous exposure to construction and engineering.

The transformation process in Rebuilding Murray & Roberts has placed our people under significant pressure. But the process has also liberated the performance potential of our organisation and we have witnessed significant growth in our younger executives. Various development programmes have been established to convert capacity into capability and prepare young and middle executives for the high standards of global performance.

We have continued to enhance our overall leadership capacity in the areas of human capital, strategy and marketing, legal and commercial, risk management, finance and administration and of course, operations.

Our capacity to engage specialist and new geo-political markets is through our choice of strategic partner. This is a key feature of our business model, although not all our partnerships have worked, with cultural differences or too little alignment sometimes causing tensions, single-party dominance or performance apathy.

We have benchmarked global best-in-class in the construction and engineering sector and recognise the increased levels of pressure this brings to our internal systems. We had already conducted a comprehensive review that defined a connectivity blueprint for shared services and project networks. The backbone for our connectivity plan is an enterprise resource planning (ERP) financial management and consolidation system, supported by standardised project management systems that will ensure consistent project delivery across the Group.

The ERP system will be operational during 2006 and promises improved risk management capacity across the Group.

The principal technologies in which we have a competitive competence are a function of the materials used in the majority of our business activities. These are concrete, steel and asphalt, mature technology materials that have formed the cornerstone of construction activity for the past 100 years. There have been many innovative developments in the fundamental chemistry and application technology of these materials. Murray & Roberts has played a pioneer role over many decades introducing these into the South African environment and is now using them to establish itself in new markets.

Restructuring of the Board is virtually complete for the moment. Our new board members and committee chairmen have revitalised governance leadership. New director appointments have replaced recent retirements and the five executive directors now more comprehensively represent the key strategic activities of the Group.

A number of executive appointments and changes have been made in the year. Malose Chaba and Edwin Hewitt were appointed executive directors of Murray & Roberts Limited. Together with Henry Laas (mining), Gordon Taylor (fabrication) and senior corporate executives Peter Young (systems), Frank Kruger (minerals) and Greg Ker-Fox (risk), we have established a formidable engineering leadership capacity in the Group.

The operations reports that follow will highlight more specific changes in structure and responsibility made during the year.

Prospects

The Group's primary leadership focus over the past year has been to stabilise and resource its existing operations

- in preparation for a period of sustainable market growth
- to build a quality major project order book across all business sectors, and
- to convert surplus balance sheet cash and gearing capacity into new areas of business potential within the core strategic focus of the Group

Improved investment and market sustainability in South Africa and elsewhere within the focus of the Group, combined with an improved balance sheet which is the direct result of Rebuilding Murray & Roberts, has reduced the group weighted average cost of capital to an historic low of 10,29%.

We continue to seek involvement in major project opportunities available in Middle East, Southeast Asia and South Africa. These include major construction projects, transport systems, power generation facilities, minerals processing investments and others.

We expect the demand for construction materials in South Africa to remain steady through the year ahead, with some growth as new major projects are started. It is encouraging that cement producers are well advanced with increased production planning.

We foresee further expansion for power generation capacity in South Africa and that our transport infrastructure is in need of significant upgrade to meet economic development targets. These developments will offer increased public private partnership opportunity.

International and natural resources markets of interest to the Group are expected to grow in line with continued economic activity in south and Southeast Asia and demand from China.

With a lower interest rate regime seemingly well established and inflation under control in spite of higher energy prices, we are positive that general market conditions will continue to improve during the year ahead. Growth will primarily be driven by government investment into infrastructure and domestic direct investment into industrial, commercial and residential assets.

In Rebuilding Murray & Roberts we have created a modern organisation for the future from the basic foundation and structure laid out by our founders. We have stripped surplus capacity from the organisation and have sought to take a lead in enhancing the image of our industry and to establish some level of differentiation in the minds of investors and clients.

We feel positive about our future prospects based on current economic prognosis for our selected markets. We are conscious that few executives in the South African construction industry have direct memory of the period of sustainable investment and growth experienced through the 1960's and 1970's. Nevertheless, we expect the years ahead to bring real growth in headline earnings off the sound and strategic platform established over the past five years.

Brian Bruce
Group chief executive