

Group chief executive report to shareholders



Brian Bruce, *group chief executive*

Murray & Roberts and its associates employ more than 30 000 people directly and a further 20 000 employees of our many business partners work daily on more than 150 active worksites throughout Southern Africa, Middle East, Australasia, Southeast Asia and North America. This collective capacity is focused on selected markets in the global construction economy and has been assembled through Rebuilding Murray & Roberts over the six years since July 2000.

Murray & Roberts 2010 is our short term strategy focused on the delivery of sustainable value from increased market activity in all the Group's regional and sectoral markets, including the impact of increased domestic activity associated with the 2010 Soccer World Cup, and the integration of our new business acquisitions into the Group's strategic value proposition.

Globalising Murray & Roberts is an ongoing strategic initiative that benchmarks the future performance potential of the Group against best-in-class characteristics drawn from the global engineering & construction sector.

Our commitment to sustainable earnings growth and value creation is non-negotiable.

We are experiencing a period of global socio-economic development that is defined increasingly by the will of society rather than just by decision of leadership. Two thirds of the global population live in the eastern hemisphere and we sense this to be the driver of growth for infrastructure development and resource extraction over the years ahead.

We have introduced a number of strategic initiatives through the past year that have focused attention on building better relationships between Murray & Roberts and its people and supporting the role they will play in shaping our future potential. This has been embodied in the concept of Letsema, which is the brand name for our broad based black economic empowerment (BBBEE) initiative.

Health, safety and environmental (HSE) issues have demanded increased attention over recent years and in South Africa we are faced with special challenges in this respect. Our Board has committed to a target of zero harm consequence from our activities on our company and clients, all people and the environment. We have benchmarked fatalities and permanent disablement at zero and set our lost time injury frequency rate (LTIFR) target below a benchmark of 3,0 with a long term objective of 1,0. Our performance this year was a LTIFR of 4,6 but regrettably at a price of 10 fatalities.

Stop.Think is a corporate intervention designed to stimulate a sustainable culture change in the organisation such that responsibility for personal health & safety is primarily devolved to the individual at the workplace. Accountability remains with management.

The Group has committed significant funding and resources to this important initiative.

We have established a number of communication forums in the Group that encourage interaction between the company and our stakeholders, including employees. The increasing success of these initiatives is testimony to the integrity of engagement. The Letsema BBBEE and Stop.Think initiatives are expected to increase the volume of internal interaction and engagement within the company.

We established ClientService initially as an interactive facility to improve the response quality of communication between Murray & Roberts and its external stakeholder community, who sought increased levels of information and management access. This facility is currently processing on average 2 000 calls a month and is now being extended to cater for an increase in activity expected from our internal communication initiatives.

Facilities such as Ask Brian on our internal website, CE discussion forum on the external website and Tip-Offs Anonymous through an independent service provider, offer additional and well utilised communication channels with our internal and external community.

Performance

I am pleased to report that our performance for the year to 30 June 2006 has exceeded expectations, as the markets we serve have started to deliver the increased opportunity predicted in previous years. I am also pleased with the performance platform serving these markets and established through Rebuilding Murray & Roberts over the past six years.

Operating profit increased 47% to R800 million off a 16% increase in revenue to R11,9 billion at a margin of 6,7%. This is the highest margin recorded by Murray & Roberts since its previous peak performance as an industrial holding group through the five years 1991 to 1995. Excluding an R87 million charge to the income statement relating to the granting of shares to almost 14 000 employees in terms of the Group's BBBEE transaction in the year, headline earnings increased 26% to 184 cents per share.

The prospects statement included in the 2005 annual report was written with some caution following the disposal of the Group's 44% interest in Unitrans in the previous year and the loss of its associate contribution to headline earnings. We were uncertain at that stage whether the Cementation businesses in South Africa and Canada and Clough in Australia would overcome this deficit, coupled with the turnaround risk in Construction Middle East.

At the half year we disclosed problems experienced on some projects in Construction SADC and an interim loss from associate Clough. We maintained our cautious outlook for the year although at that stage we were experiencing early signs of improved performance from our construction materials, industrial and remaining contracting operations.

While we are disappointed by the underperformance of Construction SADC and Clough in India, the remainder of the business has delivered ahead of expectation. We have taken decisive measures to resolve our problems, including the appointment of new leadership capacity that is geared for future performance.

We provide in some detail in the accompanying operational review, the performance characteristic of each business segment in Murray & Roberts.

Government investment into primary infrastructure is set to form the foundation for future growth, with power generation and transport logistics a primary focus, followed by water and sanitation.

Market

The year in review has been characterised by growing levels of activity in all the Group's regional and sectoral markets. Of particular note is that conditions in the South African construction market continued to improve through the second half year. This brought increased efficiency throughout the Group's operations resulting in improved utilisation of people and resources. Higher demand in the final quarter boosted all sectors of the Group's construction materials activities.

There is increasing evidence of shortages of capacity in some areas and in all sectors there is a reduction in the levels of price cutting that had become characteristic of the industry.

In South Africa, gross fixed capital formation (GFCF) has extended its growth trajectory, although increasing interest rates could dampen consumer related growth. Government investment into primary infrastructure is set to form the foundation for future growth, with power generation and transport logistics a primary focus, followed by water and sanitation.

Middle East countries forming the Gulf Cooperative Council (GCC) continue to benefit from strong oil revenues and have extended the diversification of their regional economy. The United Arab Emirates in particular offers ongoing business potential to the Group.

Global growth, particularly in and from the eastern hemisphere, continues to place heavy demand into the natural resources sector. Indications are that this will continue for at least the next five to seven years before reaching a new level of sustainable demand. This bodes well for further development of a global resources focus in the Group.

Our international markets have been positive overall, with improved performances coming from Cementation Canada and the turnaround of Construction Middle East. The construction market in the rest of Africa remains difficult and

patchy, challenged by governance concerns, a generally hostile business and working environment and poor human resource skills. The oil & gas sector is buoyant, but associate Clough has yet to overcome performance problems.

Murray & Roberts Construction

The Group's South African regional construction activities have experienced a difficult year resulting in a significant reversal in profitability and a comprehensive change in leadership. A contracting loss was identified in four projects in Tanzania, Botswana and South Africa and notified to shareholders in the Group's interim report.

These problem contracts have been addressed through the second half year and where contract terms have permitted, recovery has been pursued. In addition, claims have been lodged in terms of the Group's liability insurance policies where possible. Reporting of these contracts has been conservative as only committed recoveries are included in the results for the year under review, with further recoveries expected in the year ahead.

Over the past six to eight years, construction leadership in South Africa has become more building oriented as civil and industrial engineering opportunities waned in the market. At the same time, risk in the construction industry increased significantly for a variety of reasons, not least of which has been a reduced level of capacity and experience in client organisations and the built environment professional consultants on which they depend.

There has been an extended process in finalising award of the Gautrain Rapid Rail Link project to the Bombela Consortium, of which Murray & Roberts is a major participant. Bombela was selected preferred bidder on 2 July 2005 with an expectation that financial close and project award would occur in January 2006. The complexities involved in the process were clearly underestimated and an increasing number of key construction resources were allocated to the negotiating and early

preparation process. These resources have delivered no financial performance value to the Group in the year and the delay in award has resulted in additional operating cost plus a noticeable under-recovery of overhead.

There is a commitment by all the parties to commission the section between Johannesburg International Airport and Sandton Station in time for the 2010 World Cup. This is a project modification that has required extensive negotiation and is still subject to various regulatory clearances. We are confident that the conditions precedent for this phased approach will be cleared in time for a challenging but possible programme.

In recognition of this challenge and others that will arise from the infrastructure requirements for South Africa to effectively host the 2010 Soccer World Cup, we have created a more focused leadership structure over our SADC construction operations. Executive director Sean Flanagan has been appointed to lead the Group's implementation involvement in the above project, as well as other critical and time constrained projects associated with the 2010 Soccer World Cup.

Executive director Keith Smith will oversee the SADC construction businesses, with a new executive team in our South African construction operations comprising Gordon Taylor (managing director) and Charles Henwood (financial director) with operations directors Dave Monro (Civils), Dave Ashkar (Building North) and Andrew Fanton (Western Cape).

Keith also chairs new acquisition Concor Limited, led by managing director Cobus Bester, and our Botswana, Namibia and Zimbabwe construction operations, led by Piet Martins.

We are confident that Keith and Sean bring the highest level of experience and leadership to this important aspect of the Group's business platform.

Clough Limited

Murray & Roberts has recorded a break-even result from its 46,1% investment in Australian associate Clough Limited. This arises as a result of pre-acquisition accounting of a portion of the losses incurred and provisions raised on two EPC projects in India.

Clough recorded a loss of A\$15,1 million (2005: A\$57,6 million loss) in the year, enhanced by profitable performances from activities servicing the oil & gas sector, its Indonesian subsidiary and the property division. We are confident that the embedded value of the business remains intact and have agreed a number of strategic initiatives with the board of Clough that we believe are necessary to ensure its future value proposition.

Murray & Roberts will underwrite a further recapitalisation of Clough through a convertible note priced at the net asset value (NAV) of the balance sheet at 30 June 2006. This issue will be available for subscription by minority shareholders. As a result, the Group's investment in Clough will increase to approximately R1,0 billion, representing an effective shareholding just below 50% at a premium of 50% to NAV. This remains within the pre-acquisition mandate of management.

The shareholder agreement between Murray & Roberts and McRae Investments (representing the Clough family) will be terminated by agreement between the parties.

Murray & Roberts has appointed experienced Australian construction and engineering executive John Cooper as chief executive of its Australian activities and as a nominee to the board of Clough. He has been appointed by the directors of Clough as deputy chairman and will work closely with Clough management over the year ahead to review the company's strategy and ensure its return to sustainable profitability in the oil & gas market.

To accommodate the nomination of John Cooper to the board of Clough, Roger Rees resigned as a director with effect from 23 August 2006. Michael Harding, an experienced Australian oil & gas executive, joined the Clough board recently and will assume the role of independent chairman at the annual general meeting in November 2006.

Order book

During the year Murray & Roberts secured a leading partnership position in a number of major public sector programmes.

- VRESAP Pipeline for TCTA
- Pebble Bed Modular Reactor Demonstration Plant for PBMR
- CoalLink Locomotive Program for Spoornet
- Gautrain Rapid Rail Link for Gauteng Province
- Generation Expansion Engineering Services for ESKOM

This positions the Group at the forefront of the domestic engineering & construction market and complements its major project involvement in the Middle East. Whereas some of these projects have exposed the difficult processes involved between project approval and implementation, they clearly underpin a commitment to invest in primary infrastructure.

The Group's project order book stood at R10,0 billion at 30 June 2006, an 18% increase on the previous year. This amount includes R1,5 billion acquired through Concor Limited. The Group's involvement in the Gautrain project of approximately

R4,5 billion is not yet included. The order book indicates a significant swing towards the domestic economy, which will be enhanced by the inclusion of Gautrain.

Overall, the level of work on hand available to Murray & Roberts amounts to approximately R20 billion for execution primarily within the next three years. In this respect, Clough ended the year with an order book of A\$809 million (R4,0 billion) followed by a further A\$150 million (R800 million) secured since year end.

Committed long term orders in the Group's industrial fabrication & manufacturing businesses stand at an estimated R12 billion. This is a significant proportion of the workload requirement for these operations extending more than five years ahead, and includes both foundry engine programmes and the Spoornet locomotive recapitalisation programme.

Acquisition and disposal

The Group acquired 80% of Oconbrick Manufacturing effective 1 September 2005 for a consideration of R96 million. The company has quickly integrated into the Group and has delivered its expected performance for the year. We have approved an expansion to its production capability that will see its output increase by 30%.

In November 2005, the Group increased its shareholding in Clough Limited to 46,1% through a combination of new share issue and purchase from the Clough family. The cost of approximately R300 million included a convertible loan facility of A\$15 million which will result in a further 3,0% of the shares accruing to Murray & Roberts later in 2007.

The Group has indicated it will raise its shareholding above 50% once Clough is delivering acceptable financial performance, which is now expected by mid-2007.

Criterion Equipment was sold effective 1 October 2005 to Jay & Jayendra Group (J&J) in an empowerment transaction valued at R92,7 million, of which R45 million was supported through a vendor financing structure.

The Competition Tribunal approved the acquisition of 100% of Concor on 14 June 2006 and its delisting from the JSE Limited was effected on 3 July 2006. The cost of the transaction is R340 million including accrued interest to shareholders. This represents a premium of 13% on the NAV of the business which includes R220 million cash in hand.

Concor Limited

The acquisition of 100% of Concor Limited marks another important milestone in the creation of a new performance platform for the Group. Highly regarded in the domestic construction market for its ability to take on complex engineering projects, Concor has been through some difficult times at the tail-end of a long period of decline in the industry.

Concor closed the year with revenues of R1,8 billion (2005: R1,6 billion), delivering a net profit before tax of R46 million (2005: R43 million) at a margin of 2,6% (2005: 2,6%). We are confident that within Murray & Roberts and under the leadership of managing director Cobus Bester, the company will grow from strength to strength in its market.

Concor has negotiated the R150 million contract to refurbish our Murray & Roberts corporate office in Bedfordview, including the construction of a new multi-story car park. It has also secured preferred bidder status for the Department of Foreign Affairs precinct as a public private partnership.

Health safety & environment

A total of 10 people (2005: 12 people) were fatally injured on Murray & Roberts worksites in a year where 116 million hours were recorded as worked; 50% of the fatalities were employees of business partners. The declared objective of the directors is to achieve zero fatalities and disabling injuries in the work sites and facilities under control of the Group.

The Group is confident that the Stop.Think campaign initiated during the year will create the impetus needed to breach the inertia of health & safety consciousness. Many group operations already operate within the performance targets and significant management attention is being applied to the cultural challenges that influence the change in attitude needed for sustainable HSE success.

Prospects

A key focus in the year ahead will be to support the executive leadership teams appointed to deliver acceptable levels of performance in SADC Construction and Clough. We expect that our actions will lead to a significant financial turnaround in the fortunes of these businesses.

We expect that the Gautrain project should commence construction in September 2006 with a clear objective to commission the link between Johannesburg International Airport and Sandton Station in time for the 2010 Soccer World Cup. The many other major projects required for this global

event must also commence construction during the year ahead, and there will be little if no room for time extension. The minimum time required to build a specification stadium without a roof is 36 months.

New opportunities in Middle East have demanded increased resource allocations and new executive appointments in the region. We are well advanced towards finalising an agreement with a major regional client to manage a special purpose construction business established to implement its own property investment programme. This will be managed alongside our existing business in Middle East.

The Group's global mining contracting operations face increased opportunity and a higher level of international leadership coordination is being planned, linking these operations with the Group's increasing global oil & gas capability. Capital expenditure by mining houses in our largest market South Africa has firmed appreciably, but still without the expected growth.

Appreciation

Murray & Roberts is a complex group of companies bound by a common purpose serving the construction economies in selected regional and sectoral markets. Our federal structure offers high levels of responsibility and accountability to operations leadership, but within a performance framework and value system established by group leadership.

I wish to extend my appreciation firstly to all the people of Murray & Roberts who through the year have worked diligently to advance their personal and our group objectives. I am encouraged by the increased levels of interest and interaction within the Group and I sincerely believe that initiatives such as Letsema and Stop.Think will lead to a substantial improvement in our environment.

Murray & Roberts secures the majority of its revenues through our contracting activities across many project sites. We have launched a project web page that increases our disclosure in this respect and I extend my appreciation to our project managers, site agents and their teams who work so hard under often difficult and challenging circumstances to deliver value to our clients and shareholders. I spent almost twenty years of my early career in this environment.

The managing directors of our more than twenty operating companies and their executive teams in South Africa and around the world have worked diligently through the year to bring their operations to new levels of performance. We have

entered a period of relentless pressure for sustainable growth and performance and I extend my appreciation to these important executive teams for what has been done this year and their preparation for the years ahead.

My corporate colleagues and fellow directors under the board leadership of our chairman Roy Andersen engaged many strategic and challenging issues through the year and I thank them for their ongoing support and commitment to the strategic purpose of Murray & Roberts.

Finally, I would like to acknowledge the work of some of our younger executives who have taken significant responsibility through this year to drive important transformation initiatives throughout the Group. Carien Botha (enterprise resource planning), Andrew Skudder (Letsema), Tyron Botha (Stop.Think) and Greg Ker-Fox (opportunity management system) in particular have brought new dimensions of leadership into our group.



Brian Bruce
Group chief executive