

# MOODY'S

## INVESTORS SERVICE

### Credit Opinion: Imperial Group Ltd

Global Credit Research - 01 Jun 2015

Johannesburg, South Africa

#### Ratings

Category	Moody's Rating
Outlook	Stable
Bkd Issuer Rating	Baa3
Bkd Senior Unsecured -Dom Curr	Baa3
Bkd Subordinate MTN -Dom Curr	(P)Ba1
NSR BACKED Senior Unsecured	A2.za
NSR ST Issuer Rating	P-1.za

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#### Key Indicators

[1][2]Imperial Group Ltd	12/31/2014(L)	6/30/2014	6/30/2013	6/30/2012	6/30/2011
Revenue (USD Billion)	\$10.0	\$10.0	\$10.5	\$10.4	\$9.2
Operating Margin	5.6%	6.2%	7.1%	7.5%	7.4%
FFO / Debt	23.9%	26.5%	36.3%	40.9%	38.9%
EBITA / Avg. Assets	9.7%	10.5%	12.2%	12.8%	12.3%
Debt / EBITDA	2.9x	2.7x	2.2x	2.1x	1.8x
EBIT / Interest Expense	3.5x	3.9x	4.7x	5.3x	5.1x

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Source: Moody's Financial Metrics [2] Ratios relate to Imperial Holdings Ltd, the guarantor of Imperial Group Ltd

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

#### Opinion

##### Rating Drivers

- Strong brand and market presence in South Africa
- Diversified operations with concentration in South Africa and cyclical vehicle related businesses
- Operating margins exposed to foreign exchange volatility, cost pressures and productivity disruptions
- Credit metrics incorporate some financial flexibility to accommodate strategic initiatives including debt funded acquisitions

## **Corporate Profile**

Imperial Holdings Limited ("Imperial" or "Group") is the largest private sector transport and mobility group in South Africa. Established in 1948, Imperial operates in Africa, the UK, Europe, USA and Australia.

Imperial's core activities include services relating to transportation and mobility. In their broader context these activities include logistics, car rental, motor vehicle dealerships and distributorships, aftermarket parts as well as financial services. For the last twelve months (LTM) to 31 December 2014, Imperial reported revenues of ZAR108.4 billion (USD10 billion) and Moody's-adjusted EBITDA of ZAR10.2billion (USD0.94 billion).

## **Rating Rationale**

Imperial Group Ltd's Baa3/A2.za issuer rating continues to be based on Moody's perception of the Group's business risk profile, combined with its level of debt protection ratios, and its diversified business structure, which mitigates its complex organization structure. The ratings also recognise Imperial's high concentration to South Africa (Baa2 stable) contributing over 64% of revenues and 69.7% of operating profit during the LTM to 31 December 2014. Imperial's long history and solid reputation in South Africa, its track record of growth, its strong market position and quality of management also support its Baa3/A2.za rating. Furthermore, the rating factors Imperial's ongoing conservative financial policies and its inherent exposure to currency volatility.

## **DETAILED RATING CONSIDERATIONS**

### **STRONG BRAND AND MARKET POSITION COMBINED WITH DIVERSIFIED AND INTEGRATED MIX OF RELATED BUSINESSES SUPPORT THE RATINGS**

Imperial is the largest private sector transport and mobility group in South Africa. Imperial holds sole or joint market leadership positions in South Africa in all of its core businesses, with the exception of its financial services operations. Although Regent (Imperial's insurance company) is the leading motor-related, value-added insurance provider and it holds leading positions in Botswana (A2 stable) and Lesotho (not rated) for short-term and life insurance products. Imperial's two key business segments are logistics and vehicle distributions and retail, which together accounted for around two thirds of revenues and 58% operating profits in LTM to 31 December 2014.

Although over 64% of Imperial's revenues were derived from South Africa in the LTM to 31 December 2014, it has decreased from approximately 70% in FYE 2013, as Imperial has expanded its operations into Africa and the rest of the world. Contributions from Continental Europe have increased with the full consolidation of its Lehnkering Holdings GmbH acquisition and was the main driver behind the reduced revenues coming from South Africa. Africa (excluding South Africa) continues to grow both organically and through acquisitions contributing 9.1% of revenue and 11.3% of operating income for LTM to 31 December 2014 (6.1% and 6.5% respectively, for FYE 2013), while the rest of the world contributed 26.8% of revenue and 19.0% of operating profit for LTM to 31 December 2014 (24.2% and 14.2% respectively for FYE 2013). Imperial's commercial interests in Europe, the UK, Australia, the United States of America and Africa create a geographically diversified business. The diversification renders Imperial's combination of activities relatively resilient to external factors such as global economic downturns and currency volatility, although it remains highly exposed to the South African economy and its political, social and economic environment as well as the more cyclical motor vehicle market.

Imperial is structured around five operating divisions: (1) Logistics Africa; (2) Logistics International (all non-African countries); (3) Vehicle Import, Distribution and Dealerships; (4) Vehicle Retail, Rental and Aftermarket Parts and; (5) Financial Services. The business model comprises a mix of mostly related businesses operating in a common value chain around the transport and mobility sectors. Imperial's strategy is to extract the maximum value from identifying synergies and the cross-selling of different business solutions available across its value chain.

### **OPERATING MARGINS AFFECTED BY FOREIGN EXCHANGE DEPRECIATION, LABOUR DISRUPTIONS AND COST INFLATION IN SOUTH AFRICA**

The trading environment in South Africa continues to remain challenging given the weak South African economy, which has led to softer volume growth on new vehicle sales which is expected to continue over the next 12 months. The weaker demand is expected to intensify competition and limit pricing power on new vehicles. However, Imperial's exposure to the used vehicle market and autoparts (benefits from approximately 11 million vehicles on the road) is likely to help mitigate the weaker profit from new cars sales.

The risks to foreign exchange rate volatility, industrial action and above inflationary wage increases are key challenges facing the Group in South Africa. While future exchange rate movements are unpredictable we note

that the Rand depreciated against major currencies (approximately 16% to the US dollar over the past 18 months to 31 December 2014) which placed negative pressure on the Group's margins in 2014. In particular, it increased its costs of importing its major motor brands Kia and Hyundai which could not be fully passed on to the consumer. This was mitigated to some extent by hedging strategies employed but is unlikely to mitigate longer term Rand weakness without passing the cost increases onto the consumer, an element which will pressure Imperial's market share and value proposition. We note however that Imperial's foreign operational exposure does provide an element of protection against a weaker Rand as foreign cash flows benefit from translation gains.

The other key challenge facing Imperial is industrial action in South Africa and its negative ramifications being an ongoing challenge faced by many sectors in the country. Imperial's Logistics division was directly and indirectly negatively affected by industrial action during FYE 2014. We expect this risk to reduce given the two year wage agreement with its key unions at moderate above average inflation wage increases of 8% per annum. However, potential labour disruption could occur amongst its customer base which will have negative implications on its own businesses.

Over the next 12 months we anticipate Imperials performance and credit metrics to remain under pressure as the effects of the weaker Rand and softer South African economy continue to pressure South African margins. Thereafter, we expect trading to stabilize and improve as the higher margin non-vehicle businesses grow faster than the vehicle businesses contributing more to the consolidated group's cash flows.

#### **RATING INCORPORATES BOLT ON ACQUISITIONS AND MODERATE LEVERAGE GOING FORWARD AND RECOGNISES MANAGEMENT'S PRUDENT FINANCIAL POLICIES**

Imperial's stated growth plans include (1) organic growth through increased levels of capital expenditures as the Group invests in new capacity and replacement of its fleets; and (2) strategic acquisitions, similar to the Lehnkering logistics acquisition in Germany and logistics and health care service operations in Africa. Imperial's growth plans are focused in the logistics industry and product distribution reducing its exposure to the more cyclical vehicle operations in South Africa. Over the last 3 years non-vehicle business as a percentage of group revenue has increased to 45% (31 December 2014) from 37% (31 December 2011). Imperial's strategy of following its customers into new geographies is viewed favourably, as the Group is entering new countries with a known demand for its products already.

Imperial aims to grow its operations in Africa through acquiring large, well-run, established family-owned businesses, which we view favourably as it protects the Group from the risks associated with greenfield projects in Africa. Imperial has already developed a strong logistics presence in the fast moving consumer goods and pharmaceutical sectors within key African markets. We note that although there is good growth potential on the African continent fueled by favourable consumer demographics, it is a volatile and challenging market to operate in, which may pose certain risks to Imperial.

Moody's current rating has a degree of flexibility to accommodate further strategic acquisitions that might increase its current leverage or pressure its key financial metrics. However, each acquisition would be evaluated on a case-by-case basis in order to determine the strategic fit of the potential acquisition, its cash flow and margin contributions, as well as any integration risks the Group may face. To the extent that further acquisitions are considered, it is our expectation that management will continue to follow its prudent financial policies and maintain a solid focus on cash flow generation, capital management and liquidity management at all times. Shareholder remuneration is expected to also be approached in a prudent manner.

#### **Liquidity**

Imperial's liquidity position is sufficient to meet near term obligations, supported by the large availability under committed facilities of approximately ZAR6.3 billion (USD546 million), with sufficient covenant headroom, together with a substantial cash position of ZAR2.6 billion (USD226 million) as of 31 December 2014 and positive cash generation capabilities. The company's debt maturity profile comprises a well staggered tenor of repayments and continues to show good access to debt capital markets.

Imperial's funding profile is split 60% local currency (Rand) and 40% foreign currency (predominately Euro) as of FYE 2014. This compares to approximately 69.7% of operating income generated in South Africa and the balance from the rest of Africa and rest of the world. There is a small mismatch between foreign currency debt and cash flows which is not hedged exposing itself to foreign exchange risk should the Rand depreciate.

#### **Structural Considerations**

Imperial's euro-denominated senior unsecured banking facility is issued from Imperial Mobility Finance B.V. and guaranteed by both Imperial Mobility International B.V. (an offshore holding company - wholly owned by Imperial - established for its international operations) and Imperial Holdings Limited.

Compared to other existing debt at the Imperial Group Ltd level, the banking facility benefits from an additional upstream indemnity from Imperial Group Limited in favour of Imperial Holding Limited, which in our view is not deemed to be a strong enough difference in terms of guarantee package to consider any notching implications.

## Rating Outlook

The stable outlook on the ratings of Imperial Group Ltd reflects Moody's expectation that Imperial's credit profile will continue to be well positioned within the Baa3 rating category despite the group's growth plans.

## What Could Change the Rating - Up

Upward pressure could be exerted on the ratings or outlook of Imperial's subsidiaries if Imperial were able to (1) maintain an retained cash flow to net debt ratio above 25%, on a sustainable basis; (2) maintain stable and improving operating margins; and (3) achieve increased debt protection levels, such that Imperial's (funds from operations + interest expense)/interest expense were to exceed 4.0x on a sustainable basis. The credit metrics relative to guidance incorporates some flexibility to accommodate a range of strategic initiatives including debt funded acquisitions. Any debt funded acquisitions would nevertheless have to be assessed in terms of its impact on Imperial's business risk profile, overall capital structure and how it fits strategically in the group. All metrics are according to Moody's standard adjustments and definitions.

## What Could Change the Rating - Down

Negative pressure could be exerted on the ratings or outlook of Imperial's subsidiaries as a result of (1) weakness in Imperial's operating performance, resulting in lower debt protection measures, with (funds from operations + interest expense)/interest expense sustainably below 4.0x, or lower operating margins; (2) an average retained cash flow/net debt ratio that trends below 20% on a prospective basis, considering past and expected future performance; (3) debt protection measures weakening, and a failure to adjust financial policies and cost structure such that Imperial generates positive free cash flow on a sustained basis through conservative capital expenditure and adjusted shareholder remuneration policies.

## RATING METHODOLOGY

The principal methodology used in rating the company was Moody's Global Surface Transportation and Logistics Companies Rating Methodology (April 2013), which can be found at [www.moody.com](http://www.moody.com) in the Rating Methodologies sub-directory under the Research & Ratings tab. While Imperial has a broad product offering, its' operations are predominantly in the business of providing logistics services to corporations.

Based on the last twelve months to 31 December 2014 Imperial's overall performance measurements from the rating grid indicate a rating outcome equated to a Baa2, one notch higher than the assigned issuer rating of Baa3. The key reasons why the rating assigned is lower than the grid outcome is that the grid is based on historic financial information while the rating is based on our expectation for future performance which incorporates flexibility to accommodate future acquisitions that may result in weaker initial credit metrics.

## Rating Factors

### Imperial Group Ltd

Surface Transportation and Logistics Industry Grid [1][2][3]	Current LTM 12/31/2014		[4]Moody's 12-18 Month Forward ViewAs of 5/27/2015	
Factor 1 : Business Profile (15%)	Measure	Score	Measure	Score
a) Business Profile	Baa	Baa	Baa	Baa
Factor 2 : Scale (20%)				
a) Revenue (USD Billion)	\$10.0	A	\$9.5 - \$10.5	A
Factor 3 : Profitability, Cash Flow, and Returns (20%)				
a) Operating Margin	5.6%	Ba	5.2% - 5.5%	Ba

b) FFO / Debt	23.9%	Baa	23% - 28%	Baa
c) EBITA / Avg. Assets	9.7%	Ba	8% - 10%	Ba
<b>Factor 4 : Leverage and Coverage (30%)</b>				
a) Debt / EBITDA	2.9x	Baa	2.8x - 3.3x	Baa
b) EBIT / Interest Expense	3.5x	Baa	3x - 3.5x	Baa
<b>Factor 5 : Financial Policy (15%)</b>				
a) Financial Policy	Baa	Baa	Baa	Baa
<b>Rating:</b>				
a) Indicated Rating from Grid		Baa2		Baa2
b) Actual Rating Assigned		Baa3		

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 12/31/2014(L); Source: Moody's Financial Metrics [3] Ratios relate to Imperial Holdings Ltd, the guarantor of Imperial Group Ltd [4] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures.

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