Credit Opinion: Imperial Group Ltd

Global Credit Research - 31 Oct 2014

Johannesburg, South Africa

Ratings

<table>
<thead>
<tr>
<th>Category</th>
<th>Moody's Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outlook</td>
<td>Stable</td>
</tr>
<tr>
<td>Issuer Rating</td>
<td>Baa3</td>
</tr>
<tr>
<td>Bkd Senior Unsecured - Dom Curr</td>
<td>Baa3</td>
</tr>
<tr>
<td>Bkd Subordinate MTN - Dom Curr</td>
<td>(P)Ba1</td>
</tr>
<tr>
<td>NSR LT Issuer Rating - Dom Curr</td>
<td>A2.za</td>
</tr>
<tr>
<td>NSR BACKED Senior Unsecured - Dom Curr</td>
<td>A2.za</td>
</tr>
<tr>
<td>NSR ST Issuer Rating - Dom Curr</td>
<td>P-1.za</td>
</tr>
</tbody>
</table>

Contacts

Analyst                      | Phone          |
-----------------------------|----------------|
Carlos Winzer/Madrid         | 34.91.768.8200 |
Dion Bate/Johannesburg       | 27.11.217.5472 |
David G. Staples/DIFC - Dubai | 971.42.37.9536 |

Key Indicators

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue (USD Billion)</td>
<td>$10.0</td>
<td>$10.5</td>
<td>$10.4</td>
<td>$9.2</td>
<td>$7.0</td>
</tr>
<tr>
<td>Operating Margin</td>
<td>6.2%</td>
<td>7.1%</td>
<td>7.5%</td>
<td>7.4%</td>
<td>6.7%</td>
</tr>
<tr>
<td>FFO / Debt</td>
<td>27.4%</td>
<td>36.3%</td>
<td>40.9%</td>
<td>38.9%</td>
<td>28.1%</td>
</tr>
<tr>
<td>EBITA / Avg. Assets</td>
<td>10.5%</td>
<td>12.2%</td>
<td>12.8%</td>
<td>12.3%</td>
<td>9.4%</td>
</tr>
<tr>
<td>Debt / EBITDA</td>
<td>2.6x</td>
<td>2.2x</td>
<td>2.1x</td>
<td>1.8x</td>
<td>2.4x</td>
</tr>
<tr>
<td>EBIT / Interest Expense</td>
<td>3.9x</td>
<td>4.7x</td>
<td>5.3x</td>
<td>5.1x</td>
<td>3.3x</td>
</tr>
<tr>
<td>RCF / Net Debt</td>
<td>22.8%</td>
<td>30.9%</td>
<td>41.7%</td>
<td>43.3%</td>
<td>30.6%</td>
</tr>
<tr>
<td>(FFO + Interest Expense) / Interest Expense</td>
<td>5.4x</td>
<td>6.5x</td>
<td>7.4x</td>
<td>6.1x</td>
<td>4.5x</td>
</tr>
</tbody>
</table>


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
- Strong credit metrics incorporate 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 financial year end (FYE) 30 June 2014, Imperial reported revenues of ZAR103.6 billion (USD9.8 billion) and Moody's-adjusted EBITDA of ZAR10.2billion (USD0.96 billion).

**Rating Rationale**

Imperial'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 contributing over 65% of revenues and 74% of operating profit during FYE 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 and Lesotho for short-term and life insurance products. Imperial's two key business segments are logistics and vehicle distributions, which together accounted for around two thirds of revenues and operating profits in FYE 2014.

Although over 65% of Imperial's revenues were derived from South Africa in FYE 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 7.2% of revenue and 8.5% of operating income for FYE 2014 (6.1% and 6.5% respectively, for FYE 2013), while the rest of the world contributed 26.7% of revenue and 18.0% of operating profit for FYE 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 African 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 9.7 million vehicles on the road) is likely to 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 (6.5% to the US dollar and 10.7% to the Euro) which placed negative pressure on the Group's margins in FYE 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.

We note that Imperial has embarked on a number of efficiency and cost saving initiatives which should help reduce the above cost pressure facing the Group.

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

Imperial's stated growth plans include organic growth through increased levels of capital expenditures as the Group invests in new capacity and replacement of its fleets and strategic acquisitions, similar to the Lehnkering logistics acquisition in Germany and logistics and health care service operations in Africa. We view Imperial's investment in the German company as favourable with Germany (Aaa/ Negative) being a stable mature market, and less exposed to economic instability compared to many of its European neighbours, although still affected by the slowdown in the European economy, which has seen a slower than expected recovery rate. 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. 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 mover consumers goods and the 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 ZAR6.1 billion (USD 580 million), with sufficient covenant headroom, together with a substantial cash position of ZAR3.1 billion (USD123 million) as of 30 June 2014 and positive cash generation capabilities. The company also has over half of its ZAR13.5 billion domestic medium-term note programme available. 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 73.5% of operating income generated in South Africa and the balance from the rest of Africa and rest of the world. The mismatch between foreign currency debt and cash flows 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 all other existing debt at the Imperial Group, the banking facility benefits from an additional upstream guarantee from Imperial Mobility International B.V., 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 and Imperial Mobility Finance B.V. 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**

Given Imperial's broad product offering, there is no specific Moody's Rating Methodology that can be applied to Imperial. As a result, Imperial does not have any direct peers. The Bidvest Group is used as the closest national peer but it is not seen as a direct peer as its operations are not directly comparable to Imperial's.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [http://www.moodys.com](http://www.moodys.com) for the most updated credit rating action information and rating history.

© 2014 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.
CREDIT RATINGS ISSUED BY MOODY’S INVESTORS SERVICE, INC. ("MIS") AND ITS AFFILIATES ARE
MOODY’S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT
COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND CREDIT RATINGS AND RESEARCH
PUBLICATIONS PUBLISHED BY MOODY’S ("MOODY’S PUBLICATION") MAY INCLUDE MOODY’S
CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS,
OR DEBT OR DEBT-LIKE SECURITIES. MOODY’S DEFINES CREDIT RISK AS THE RISK THAT AN
ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY
ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY
OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE
VOLATILITY. CREDIT RATINGS AND MOODY’S OPINIONS INCLUDED IN MOODY’S PUBLICATIONS ARE
NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY’S PUBLICATIONS MAY ALSO
INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR
COMMENTARY PUBLISHED BY MOODY’S ANALYTICS, INC. CREDIT RATINGS AND MOODY’S
PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND
CREDIT RATINGS AND MOODY’S PUBLICATIONS ARE NOT AND DO NOT PROVIDE
RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT
RATINGS NOR MOODY’S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR
ANY PARTICULAR INVESTOR. MOODY’S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY’S
PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH
DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER
CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY’S CREDIT RATINGS AND MOODY’S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL
INVESTORS AND IT WOULD BE RECKLESS FOR RETAIL INVESTORS TO CONSIDER MOODY’S CREDIT
RATINGS OR MOODY’S PUBLICATIONS IN MAKING ANY INVESTMENT DECISION. IF IN DOUBT YOU
SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO,
COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE
REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED,
REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN
WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON
WITHOUT MOODY’S PRIOR WRITTEN CONSENT.

All information contained herein is obtained by MOODY’S from sources believed by it to be accurate and reliable.
Because of the possibility of human or mechanical error as well as other factors, however, all information contained
herein is provided "AS IS" without warranty of any kind. MOODY’S adopts all necessary measures so that the
information it uses in assigning a credit rating is of sufficient quality and from sources MOODY’S considers to be
reliable including, when appropriate, independent third-party sources. However, MOODY’S is not an auditor and
cannot in every instance independently verify or validate information received in the rating process or in preparing
the Moody’s Publications.