

**CREDIT OPINION**

5 July 2016

Update

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**RATINGS**
**Imperial Group Ltd**

Domicile	Johannesburg, South Africa
Long Term Rating	Baa3
Type	LT Issuer Rating - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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# Imperial Group Limited

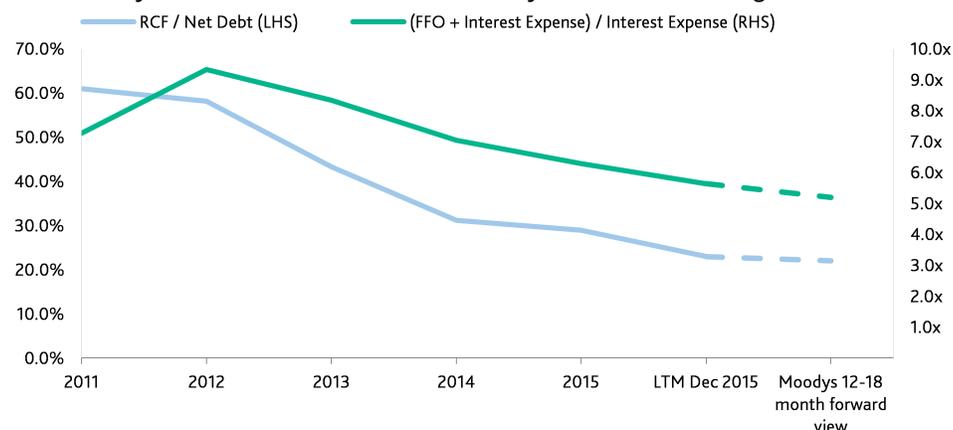
## Update to Discussion of Key Credit Factors

### Summary Rating Rationale

Imperial Group Limited's ("Imperial" or "Group") Baa3 global scale and Aa3.za national scale issuer ratings continue 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, which is rated Baa2 negative, contributing 60% of revenues and 65% of operating profit for the last 12 months (LTM) to 31 December 2015. 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 ratings. Furthermore, the rating factors Imperial's ongoing conservative financial policies and its inherent exposure to currency volatility. While credit metrics remain within rating guidance, the declining trend in metrics has eroded the headroom within Imperial's Baa3 rating category. We would expect management to respond and take measures to stabilise the decline in the credit metrics.

Exhibit 1

### Decline in key credit metrics limits financial flexibility within the Baa3 rating



Source: Imperial financials and Moody's Financial Metrics

### Credit Strengths

- » Strong brand and market presence in South Africa
- » Diversified operations by product offering and geography

## Credit Challenges

- » Concentration to South Africa and cyclical vehicle related businesses
- » Operating margins exposed to foreign exchange volatility, cost pressures and productivity disruptions
- » Declining financial flexibility to accommodate strategic initiatives including debt funded acquisitions

## Rating Outlook

The stable outlook on the ratings of Imperial 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.

## Factors that Could Lead to an Upgrade

Upward pressure could be exerted on the ratings or outlook of Imperial's subsidiaries if Imperial were able to (1) maintain a 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.

## Factors that Could Lead to a Downgrade

Negative pressure could be exerted on the ratings or outlook of Imperial 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.

## Key Indicators

Exhibit 2

### KEY INDICATORS [1][2]

#### Imperial Holdings Ltd

	12/31/2015(L)	6/30/2015	6/30/2014	6/30/2013	6/30/2012
Revenue (ZAR Billion)	110.9	107.5	100.7	92.4	80.8
Operating Margin	5.0%	5.2%	5.5%	6.7%	7.2%
FFO / Grossl Debt	27.1%	33.1%	35.5%	48.9%	53.1%
EBITA / Avg. Assets	8.4%	9.2%	10.1%	12.5%	13.0%
Gross Debt / EBITDA	2.8x	2.5x	2.3x	1.7x	1.7x
EBIT / Interest Expense	3.3x	3.6x	4.4x	5.6x	6.3x

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

(L) Last twelve months

Source: Moody's Financial Metrics™

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 [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

## 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. Imperial's two key business segments are (1) logistics and (2) vehicles (distribution and retail) which account for the majority of revenues and operating profit.

Although 60% of Imperial's revenues were derived from South Africa, it has decreased from approximately 70% in financial year ending (FYE) 30 June 2013, as Imperial has expanded its operations into Africa and the rest of the world. Contributions from Continental Europe have increased to 29% of revenue and 18% of operating profit (24.2% and 14.2% respectively for FYE 2014). Africa (excluding South Africa) continues to grow both organically and through acquisitions contributing 12% of revenue and 16% of operating income (6.1% and 6.5% respectively, for FYE 2014). 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.

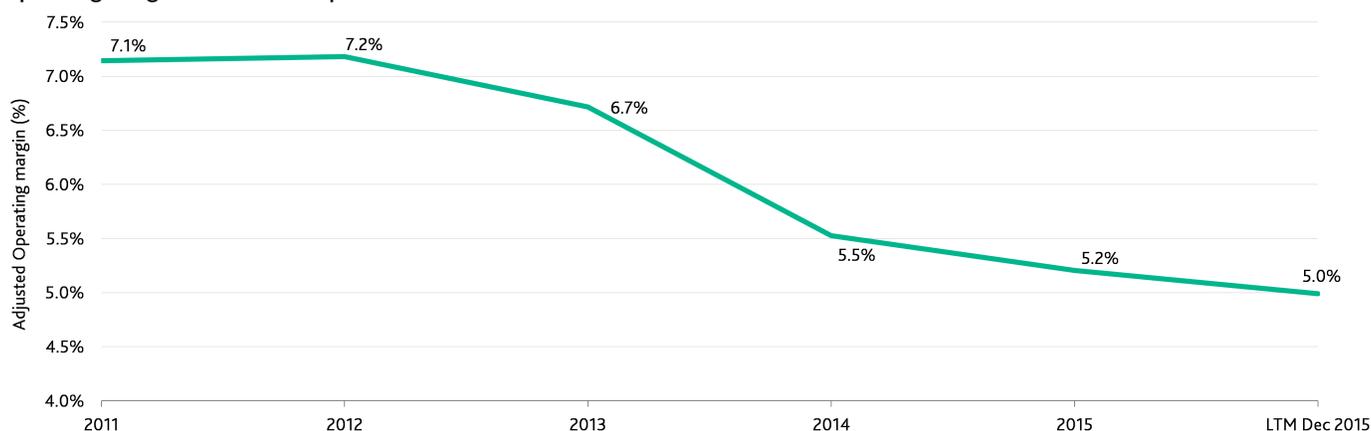
Imperial is structured around five operating divisions: (1) Logistics Africa; (2) Logistics International (all non-African countries); (3) Vehicle Import, Distribution and Dealerships; (4) Vehicle Retail, Rental and Aftermarket Parts and; (5) Financial Services. The business model comprises a mix of 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 AND WEAKENED OPERATING ENVIRONMENT 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) has and will continue mitigate the weaker profits 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 46% to the US dollar over the past 18 months to 31 December 2015) which placed negative pressure on the Group's margins in 2015. In particular, it increased its costs of importing its major motor brands Kia, Hyundai and Renault, which could not be fully passed on to the consumer. This was mitigated to some extent by hedging strategies employed and assistance by OEMs 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.

Exhibit 3

**Operating margins remain under pressure**

Source: Imperial's financials and Moody's Financial Metrics

Over the next 12-18 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. This will be tempered by stronger performance from non-vehicle businesses which are expected to growth faster than the vehicle businesses contributing more to the consolidated group's cash flows.

#### RATING INCORPORATES MODERATE LEVERAGE GOING FORWARD AND RECOGNISES MANAGEMENT'S BALANCED FINANCIAL POLICIES

Imperial's stated growth plans include (1) organic growth through capital expenditures as the Group invests in new capacity and replacement of its fleets; and (2) strategic acquisitions, as seen in the logistics in the United Kingdom 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 41% (31 December 2015) from 36% (31 December 2012). 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 distribution 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.

Given the anticipated weakening of credit metric Moody's Baa3 rating has limited flexibility to accommodate further strategic acquisitions that will increase its current leverage or pressure its key financial metrics. As of 31 December 2015 Imperial's net debt/equity was 76% at the upper end of its internal guideline of between 60% and 80%. We anticipate recent disposals, such as Regent, Mix Telematics and Goscor, will provide additional cash resources of approximately ZAR3 billion to either reduced debt or provide the financial flexibility to pursue acquisitions that are strategically aligned with its leadership positions across core operation in logistics and motor industries. Imperial is also looking at streamlining its ZAR8 billion property portfolio which could further release capital.

Imperial's long-term strategy of divesting operations in which it does not have long term prospects of having leadership market positions across logistics and motor related industries. It is our expectation that Imperial, given its leadership positions in South Africa, will pursue acquisitions in the rest of Africa (likely smaller targets) and in Europe where the company already has existing assets and business relationships, as evidenced by its acquisition of Palletways Group Limited in the United Kingdom (Aa1 negative). It is also our expectation that while considering potential acquisitions 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. Given the uncertainty around future M&A activity each potential acquisition would be evaluated on a case by case basis to determine how it impacts the

credit profile of Imperial, such as strategic fit, its cash flow and margin contributions, as well as any integration risks the Group may face.

### Liquidity Analysis

Imperial's liquidity position is sufficient to meet near term obligations, supported by the large availability under committed facilities of approximately ZAR4.4 billion (\$283 million), with sufficient covenant headroom, together with a substantial cash position of ZAR2.8 billion (\$180 million) as of 31 December 2015 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 2015. This compares to approximately 66% 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.

### Profile

Imperial Holdings Limited 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. Going forward Imperial will be restructuring its business into two groupings, Imperial Vehicles and Imperial Logistics.

For the last twelve months (LTM) to 31 December 2015, Imperial reported revenues of ZAR110.9 billion (USD8.7 billion) and Moody's adjusted EBITDA of ZAR10.4 billion (USD0.8 billion).

### Rating Methodology and Scorecard Factors

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.moodys.com](http://www.moodys.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 2015 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.

Exhibit 4

Rating Factors			Moody's 12-18 Month Forward View As of 4/7/2016 [4]	
Imperial Holdings Ltd				
Surface Transportation and Logistics Industry Grid [1][2][3]				
	Current LTM 12/31/2015		Measure	Score
<b>Factor 1 : Business Profile (15%)</b>				
a) Business Profile	Baa	Baa	Baa	Baa
<b>Factor 2 : Scale (20%)</b>				
a) Revenue (USD Billion)	\$8.7	Baa	\$7.5 - \$9	Baa
<b>Factor 3 : Profitability, Cash Flow, and Returns (20%)</b>				
a) Operating Margin	5.0%	B	4.5% - 5%	B
b) FFO / Gross Debt	27.1%	Baa	25% - 30%	Baa
c) EBITA / Avg. Assets	8.4%	Ba	7% - 10%	Ba
<b>Factor 4 : Leverage and Coverage (30%)</b>				
a) Gross Debt / EBITDA	2.8x	Baa	2.5x - 3x	Baa
b) EBIT / Interest Expense	3.3x	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 31/12/2015 (LTM); [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.

Source: Moody's Financial Metrics™

## Ratings

Exhibit 5

Category	Moody's Rating
<b>IMPERIAL GROUP LTD</b>	
Outlook	Stable
Bkd Issuer Rating	Baa3
Bkd Senior Unsecured -Dom Curr	Baa3
Bkd Subordinate MTN -Dom Curr	(P)Ba1
NSR BACKED Senior Unsecured	Aa3.za
NSR ST Issuer Rating	P-1.za

Source: Moody's Investors Service

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