38. FINANCIAL INSTRUMENTS

38.1 Financial risk factors

The Group's treasury activities are aligned to the company's decentralised business model and the asset and liability committee's (Alco) strategies. The Alco is a board subcommittee responsible for implementing best practice asset and liability risk management with its main objectives being the management of liquidity, interest rate, price and foreign exchange risk. The Alco meets every quarter and follows a comprehensive risk management process. The treasury implements the Alco risk management policies and directives and provides financial risk management services to the various divisional businesses, coordinates access to domestic and international financial markets for bank as well as debt capital markets funding. The treasury monitors and manages the financial risks relating to the operations of the Group through internal risk reports which analyse exposures by degree and magnitude of risks. These risks include market risk (including foreign exchange risk, interest rate risk, and price risk), credit risk and liquidity risk.

The day-to-day management of foreign exchange risk and credit risk is performed on a decentralised basis by the various business units within the Group's hedging policies and guidelines.

The Group's objectives, policies and processes for measuring and managing these risks are detailed below.

The Group seeks to minimise the effects of these risks by matching assets and liabilities as far as possible or by using derivative financial instruments to hedge these risk exposures.

The Group does not enter into or trade in financial instruments, including derivative financial instruments, for speculative purposes. The Group enters into financial instruments to manage and reduce the possible adverse impact on earnings from changes in interest rates and foreign exchange rates.

38.1.1 Market risk

This is the risk that changes in the general market conditions, such as foreign exchange rates, interest rates, commodity prices and equity prices may adversely impact on the Group's earnings, assets, liabilities and capital.

The objective of market risk management is to manage and control market risk exposures within acceptable parameters, whilst optimising the return on risk.

The Group's activities expose it primarily to the financial risks of changes in foreign currency exchange rates, interest rates and equity prices.

38.1.2 Currency risk

This is the risk of losses arising from the effects of adverse movements in exchange rates on net foreign currency asset or liability positions.

The Group undertakes certain transactions denominated in foreign currencies, hence exposures to exchange rate fluctuations arise. In order to manage these risks, the Group may enter into hedging transactions, which make use of derivatives. Derivative instruments are used by the Group for hedging purposes. Such instruments include forward exchange contracts, futures and certain currency options authorised by Alco.

The policy of the Group is to maintain a fully covered foreign exchange risk position in respect of foreign currency commitments with a few exceptions authorised by the Alco. Automotive spare parts may be settled in the spot markets and where specific South African Exchange Control authorisation has been obtained from authorised dealers in foreign exchange up to 75% of forecast annual sales can be covered. The day-to-day management of foreign exchange risk is performed on a decentralised basis by the various business units within the Group's hedging policies and guidelines. Trade-related import exposures are managed through the use of natural hedges arising from foreign assets as well as forward exchange contracts and the option structures authorised by Alco.

The average exchange rates shown include the cost of forward cover. The amounts represent the net rand equivalent of commitments to purchase and sell foreign currencies, and have all been recorded at fair value.

The Group has entered into certain forward exchange contracts and option structures authorised by Alco that relate to importation of inventories and interest-bearing borrowings at 30 June and specific foreign commitments not yet due. The details of these contracts are as follows:

Foreign currency	Foreign amount (million)	Average exchange rate	Contract value Rm	Marked to market Rm
2014				
Imports				
US dollar	**258**	**10,77**	**2 779**	**2 761**
Euro	**136**	**14,38**	**1 956**	**1 899**
Pound sterling	**12**	**17,63**	**204**	**200**
Japanese yen	**163**	**0,11**	**17**	**17**
Other	**1**		**6**	**6**
			4 962	**4 883**
Interest-bearing borrowings				
Japanese yen	**3 114**	**0,14**	**450**	**326**
			5 412	**5 209**
2013				
Imports				
US dollar	197	9,16	1 805	1 987
Euro	120	11,49	1 378	1 574
Pound sterling	12	15,13	189	194
Japanese yen	7 446	0,10	731	761
Other			5	5
			4 108	4 521
Interest-bearing borrowings				
Japanese yen	3 633	0,14	525	422
			4 633	4 943

Fair value is calculated as the difference between the contracted value and the value to maturity. The fair value adjustments are included in trade and other receivables and trade and other payables.

The impact from a 10% movement in the valuation of the Rand would approximately have a R8 million impact on group's equity. The 10% sensitivity rate is based on management's assessment of a reasonable possible change in foreign exchange rates over the foreseeable future.

The sensitivity of profits to changes in exchange rates is a result of foreign exchange gains or losses on remeasurement of foreign denominated financial assets and liabilities translated at spot rates are offset by equivalent gains or losses in currency derivatives.

Divisional currency risk

Logistics Africa

The risk in this division is limited with certain transactions in foreign currencies, which result in foreign currency denominated debtors and creditors. In order to mitigate the risks which arise from this exposure, these items are settled immediately or where foreign exchange contracts are available the risk is hedged within a 50% minimum group risk policy for African businesses.

Logistics International

Currency risk exposure arises from the conclusion of transactions in currencies other than the functional currencies of operations in the Netherlands, Belgium, France, Germany, Poland and Sweden. All material exposures arising from transactions external to the Group are covered by forward exchange contracts. Translation risk arises from the net investment in overseas businesses in the United Kingdom, Australia, United States of America, South America, Poland and Sweden. These translation exposures are recognised directly in equity through the translation reserve and only included in charged to profit or loss when the subsidiary is sold. No net investment hedges are in place.

38. FINANCIAL INSTRUMENTS continued

Vehicle import, distribution, and dealerships

The Group's major currency exposure exists in this division. Risk exposures result from vehicles, spare parts and equipment being imported, and invoiced in foreign currency. Forward exchange contracts, futures and certain currency options are used to hedge this exposure. Up to 75% of forecast annual sales can be covered should it be deemed necessary. In addition, investments in overseas businesses result in translation risk, which is recognised directly in equity through the translation reserve and only charged to profit or loss should the investment be sold. No net investment hedges are in place.

Vehicle retail, rental and aftermarket parts

Risk exposure is limited to translation risk for investments in dealerships in the United Kingdom, operational cash flows in these dealerships are in the functional currencies of those countries, and exposure to currency risk results from translation into our presentation currency (ZAR). This division is also exposed to certain small transactions in foreign currencies, which result in foreign currency denominated creditors. In order to mitigate the risks which arise from this exposure, forward exchange contracts are taken to hedge this exposure.

Insurance

Risk exposures result from foreign operations as well as the division holding investments in foreign equities, which are administered by portfolio managers and monitored by an investment committee.

38.1.3 Interest rate risk

This is the risk that fluctuations in interest rates may adversely impact on the Group's earnings, assets, liabilities and equity.

The Group is exposed to interest rate risk as it borrows and places funds at both fixed and floating rates. The risk is managed by matching fixed and floating rate assets and liabilities wherever possible and to achieve a repricing profile in line with Alco directives. Use is made of interest rate derivatives. The Group analyses the impact on profit or loss of defined interest rate shifts – taking into consideration refinancing, renewal of existing positions, alternative financing and hedging.

The Group's treasury follows a centralised cash management p`rocess including cash management systems across bank accounts in South Africa to minimise risk and interest costs. The Group's offshore cash management is managed by the treasuries in Germany, the United Kingdom and the Netherlands.

The interest rate profile of total borrowings is reflected in note 21.

The Group has entered into interest rate derivative contracts that entitle it to either receive or pay interest at floating rates on notional principal amounts and oblige it to pay or receive interest at fixed rates on the same amounts.

Details of the interest rate derivative instruments at 30 June 2014 were as follows:

	Notional amount Rm	Current year effective rate (variable)%	Derivative contract rate (fixed)%
Corporate bond – IPL 7 (swap from variable to fixed)	500	6,6 – 7,2	8,7
Revolving credit facility term loan (swap from variable to fixed)	1 500	7,3 – 7,4	8,8

The financial services division in addition to its short-term deposits, has fixed rate investments, such as negotiable certificate of deposits (NCDs), gilts and bonds. The risk is mitigated by the use of fund managers under the guidance of the investment committee, which has ultimate responsibility for the investment portfolio's risk profile and related decisions.

The 1% increase or decrease in interest rates represents management's assessment of the reasonably possible changes in interest risk. The impact of a 1% increase in interest rates will have an annualised R20 million (2013: R12 million) effect on group after tax profit and equity.

38.1.4 Equity price risk

The Group is exposed to equity price risk as it holds equity securities, which are classified as either available-for-sale or held for trading.

The sensitivity analysis has been determined based on the exposure to equity price risk at 30 June. The impact of a 10% increase in the equity index will have a R33 million (2013: R38 million) effect on group after tax profit and a R36 million (2013: R38 million) impact on equity. The sensitivity is based on management's assessment of a reasonable move in equity prices over the foreseeable future.

Divisional equity price risk

Insurance

The insurance division has limited its exposure to equities to minimise the volatility that the equity price risk brings to the Group's statement of profit or loss. The equity portfolio consists of high-quality securities. The risk is monitored by the investment committee reviewing performance of the portfolio taking into cognisance of the Group's risk appetite and cash requirements. The investment portfolios are well diversified and hedges are implemented when approved by the investment committee.

38.1.5 Credit risk

Credit risk, or the risk of counterparties defaulting, is controlled by the application of credit approvals, limits and monitoring procedures. Where needed, the Group obtains appropriate collateral to mitigate risk. Counterparty credit limits are in place and are reviewed and approved by the respective subsidiary boards.

The carrying amount of financial assets represents the maximum credit exposure on 30 June 2014. None of the financial assets below were given as collateral for any security provided.

The Group only enters into financial deposits with authorised financial institutions of high credit ratings assigned by international or recognised credit-rating agencies.

Cash resources

It is group policy to deposit short-term cash with reputable financial institutions with investment grade credit ratings assigned by international or recognised credit-rating agencies or counterparties authorised by the investment committee.

Trade accounts receivable

Trade accounts receivable consist of a large, widespread customer base. Group companies monitor the financial position of their customers on an ongoing basis. Creditworthiness of trade receivables is assessed when credit is first extended and is reviewed regularly thereafter. The granting of credit is controlled by the application of account limits. Where considered appropriate, use is made of credit guarantee insurance.

	2014 Rm	2013 Rm
Trade and other receivables that are neither past due nor impaired	**8 571**	7 460
Past due trade receivables	**2 117**	2 059
Less than 1 month	**1 440**	1 442
Between 1 – 3 months	**391**	384
More than 3 months	**189**	170
Past due more than 1 year	**97**	63
Total trade receivables	**10 688**	9 519

Based on past experience, the Group believes that no impairment is necessary in respect of trade receivables not past due as the amount relates to customers that have a good track record with the Group, and there has been no objective evidence to the contrary.

Included in trade receivables are receivables which are past the original expected collection date (past due) at the reporting date. There has not, however, been a significant change in credit quality and the amounts are still considered recoverable. Those which are not considered to be recoverable have been included in the provision for doubtful debts below. A summarised age analysis of past due trade receivables is set out above.

The overdue trade receivables ageing profile above is considered typical of the various industries in which certain of our businesses operate. Given this, existing insurance cover, and the nature of the related counterparties these amounts are considered recoverable.

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38. FINANCIAL INSTRUMENTS continued

Provision for doubtful debts for trade receivables

Before these financial instruments can be impaired, they are evaluated for the possibility of any recovery, which includes an examination of the length of time they have been outstanding. Provision is made for bad debts on trade accounts receivable. Management does not consider that there is any material credit risk exposure not already covered by a doubtful debt provision.

There is no significant concentration of risk in respect of any particular customer or industry segment. There is no single customer whose revenue streams exceed 10% of the Group's revenue.

Provision for doubtful debts for trade receivables	2014 Rm	2013 Rm
Set out below is a summary of the movement in the provision for doubtful debts for the year:		
Carrying value at the beginning of the year	**337**	345
Net acquisition of subsidiaries and businesses	**66**	10
Amounts reversed to profit or loss	**(3)**	(3)
Charged to profit or loss	**65**	3
Amounts utilised during the year	**(45)**	(36)
Currency adjustments	**9**	18
Carrying value at the end of the year	**429**	337

Divisional credit risk

Logistics

Risk exposures arise from the granting of credit to customers. The risk is managed by strict monitoring of credit terms. The risk is mitigated by stringent background checks on all new customers, as well as taking legal action against defaulting customers.

Vehicle import, distribution and dealerships

Risk exposures arise from the supply of vehicles and equipment to external dealerships and customers. Where vehicles are supplied to external dealerships these are generally covered by a dealer floorplan with a bank, and will usually settle within credit terms, and exposure to credit risk is therefore minimised. When dealing with external retail customers, the vehicle is required to be fully financed before delivery, thereby mitigating credit risk to the division.

Vehicle retail, rental and aftermarket parts

Risk exposures arise from the granting of credit to customers for parts, spares and vehicle rental. The risk is managed by monthly review of trade receivables ageing. The risk is mitigated by stringent background checks and credit limits being imposed on all new customers, continuous review of credit limits, as well as taking legal action against defaulting customers. Where our dealerships are transacting with external retail customers, the vehicles are required to be fully financed before delivery, thereby mitigating credit risk to the division.

Insurance

Risk exposures arise from commission being paid to brokers in advance. The risk arises as the client may lapse a policy at any point during the period. The risk is monitored by the credit committee and is mitigated by vetting all brokers, as well as retaining a percentage of the commission.

Guarantees

Guarantees issued to bankers and others, on behalf of subsidiaries, for facilities, as well as guarantees to investors in commercial paper and corporate bond issues, are disclosed in note 14 on page 94 to the company annual financial statements.

There were no guarantees provided by banks to secure financing during 2014 and 2013.

38.1.6 Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure that it will always have sufficient liquidity to meet its liabilities when due, under normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The responsibility for liquidity risk management rests with the Alco, which has developed an appropriate liquidity risk management framework for the management of the Group's short, medium and long-term funding requirements. The Group accesses the corporate bond market to ensure that there is sufficient long term funding within the funding mix together with long-term bank facilities.

The Group manages liquidity risk by monitoring forecast cash flows in compliance with loan covenants and ensuring that adequate unutilised committed borrowing facilities are maintained. Unutilised borrowing facilities are reflected in note 21.

To avoid incurring interest on late payments, financial risk management policies and procedures are entrenched to ensure the timeous matching of orders placed with goods received notes or services acceptances and invoices.

Contractual maturities (which includes interest) of financial liabilities are as follows:

2014	Carrying amount Rm	Contractual cash flows Rm	Less than one year Rm	One to five years Rm	More than five years Rm
Maturity profile of financial liabilities					
Interest-bearing borrowings*	**14 544**	**17 820**	**2 771**	**10 017**	**5 032**
Other financial liabilities	**1 711**	**2 006**	**377**	**712**	**917**
Trade payables and accruals	**15 869**	**15 869**	**15 869**		
Current derivative financial liabilities	**47**	**47**	**47**		
	32 171	**35 742**	**19 064**	**10 729**	**5 949**
Percentage profile – financial liabilities	**100%**	**100%**	**53%**	**30%**	**17%**

* *Excludes R441 million non-redeemable, non-participating preference shares (refer to note 19).*

38.2 Fair value measurement

38.2.1 Fair value hierarchy

The Group's financial instruments carried at fair value are classified into three categories defined as follows:

Level 1 financial instruments are those that are valued using unadjusted quoted prices in active markets for identical financial instruments. These instruments consists of listed equity securities.

Level 2 financial instruments are those valued using techniques based primarily on observable market data. Instruments in this category are valued using quoted prices for similar instruments or identical instruments in markets which are not considered to be active; or valuation techniques where all the inputs that have a significant effect on the valuation are directly or indirectly based on observable market data. Financial instruments classified as level 2 are mainly comprised of short-term deposits and over the counter (OTC) derivatives instruments.

Level 3 financial instruments are those valued using techniques that incorporate information other than observable market data. Instruments in this category have been valued using a valuation technique where at least one input, which could have a significant effect on the instrument's valuation, is not based on observable market data.

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38. FINANCIAL INSTRUMENTS continued

The following table shows which financial instruments on the statement of financial position are carried at amortised cost and which are carried at fair value. Financial instruments carried at fair value are further categorised into the appropriate fair value hierarchy.

2014 Financial instrument	Carrying value Rm	At fair value Level 1 Rm	 Level 2 Rm	 Level 3 Rm	At amortised cost Rm
Financial assets					
Investments and loans	2 468	1 883	309		276
Investments	2 192	1 883	309		
Loans	276				276
Other financial assets	267				267
Trade and other receivables	11 882		5		11 877
Trade receivables and prepayments	11 877				11 877
Derivative instruments	5		5		
Cash resources	3 103				3 103
	17 720	1 883	314		15 523
Financial liabilities					
Non-redeemable, non-participating preference shares	441				441
Interest-bearing borrowings	14 544				14 544
Other financial liabilities	1 711		209	1 072	430
Cross currency and interest-rate swap liabilities	199		199		
Contingent consideration liabilities	92		10	82	
Loans payable	430				430
Put option liability	990			990	
Trade and other payables	15 916		47		15 869
Trade payables and other accruals	15 869				15 869
Derivative instruments	47		47		
	32 612		256	1 072	31 284

38.2.2 Level 3 sensitivity information

The fair values of the level 3 financial liabilities of R1 072 million were estimated by applying an income approach valuation method including a present value discount technique. The fair value measurement is based on significant inputs that are not observable in the market. Key assumptions used in the valuations includes the assumed probability of achieving profits targets and the discount rates applied. The assumed profitability were based on historical performances but adjusted for expected growth.

The following table shows how the fair value of the level 3 financial liabilities as at 30 June 2014 would change if the key assumption was to be replaced by a reasonable possible alternative.

Financial instruments	Valuation technique	Main assumption	Carrying value Rm	Decrease in liability Rm
Put option liability	Income approach	Earnings growth	**990**	**(117)**
Contingent consideration liability	Income approach	Assumed profits	**82**	**(2)**

Movements in level 3 financial instruments carried at fair value

The following tables shows a reconciliation of the opening and closing balances of level 3 financial instruments carried at fair value at 30 June 2014:

Financial assets	Unlisted investments
Carrying value at beginning of year	**129**
Purchases	
Disposals	**(51)**
Fair valued to profit or loss	
Currency adjustments	**10**
Transfers to level 2	**(88)**
Carrying value at the end of the year	

Financial liabilities	Put option liability Rm	Contingent consideration Rm	Total Rm
Carrying value at beginning of year		**214**	**214**
Initial recognition direct in equity	**1 289**		**1 289**
Reversed in equity on buy-out of non-controlling interest	**(289)**		**(289)**
Fair valued through profit or loss	**16**	**(18)**	**(2)**
Settlements		**(39)**	**(39)**
Currency adjustments	**(26)**	**13**	**(13)**
Transfers to level 2		**(88)**	**(88)**
Carrying value at the end of the year	**990**	**82**	**1 072**

Transfers between hierarchy levels

A short-term fixed deposit, which was previously classified as level 3 has been reclassified to level 2, which is considered a more appropriate classification.

38.2.3 Fair value of financial instruments carried at amortised cost

The following table sets out instances where the carrying amount of financial liabilities, as recognised on the statement of financial position at 30 June 2014, differs from their fair values. In all other instances the carrying amounts of the Group's financial assets and liabilities approximate their fair values.

	Carrying value Rm	Fair value* Rm
Listed corporate bonds (included in interest-bearing borrowings)	**5 837**	**5 830**
Listed non-redeemable, non-participating preference shares	**441**	**377**

* *The fair values were determined with reference to unadjusted observable market data (level 1 in the fair value hierarchy).*

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38. FINANCIAL INSTRUMENTS continued

38.3 Capital management

The Group's objectives when managing capital are to safeguard its ability to continue as a going concern in order to provide returns and growth for shareholders and benefits for other stakeholders. The Group maintains an appropriate mix of equity and equity like instruments and debt in order to optimise the weighted average cost of capital (WACC) within an appropriate risk profile. Capital allocation is evaluated against the expected and forecast return on invested capital against the appropriate WACC for that division or business.

The Group has externally imposed capital requirements in terms of debt covenants on bank facilities. The covenant requires the Group to maintain a net debt to earnings before interest, taxation, depreciation and amortisation (EBITDA) of below 3.5:1. The ratio at 30 June 2014 is 1.55:1 (2013: 1.2:1). Our insurance businesses have externally imposed regulatory capital requirements as set out in Annexure A.

Consistent with others in the industry, the Group monitors capital on the basis of its gearing ratio. This ratio is calculated as net debt divided by total equity. Net debt is calculated as total borrowings less cash resources.

	2014 Rm	2013 Rm
Interest-bearing borrowings*	**14 985**	11 009
Less: Cash resources	**3 103**	1 844
Net debt	**11 882**	9 165
Total equity	**18 109**	17 536
Gearing ratio	**65,6%**	52,3%

* *Includes R441 million non-redeemable, non-participating preference shares.*

There were no defaults or breaches in terms of interest-bearing borrowings during either reporting periods.

There were no reclassifications of financial assets or financial liabilities that occurred during the year. There were no financial assets or liabilities settled or extinguished which did not meet the derecognition requirements.

39. INTEREST IN OTHER ENTITIES

39.1 Composition of the Group

Imperial is a diversified, international group of companies involved in mobility. The consolidated financial statements include the accounts of Imperial Holdings Limited (the Company) and all of its subsidiaries at 30 June 2014.

The Group holds a majority voting rights in all of its subsidiaries. Non-controlling shareholders have significant interests in three of the Group's subsidiaries. Material associates to the Group are MDS Logistics, MiX Telematics and Ukhamba Holdings. Details are provided below.

39.1.1 The principal operating subsidiaries of the Company and their activities are:

Subsidiary	Place of incorporation	Ownership interest (%)	Nature of business
Associated Motor Holdings (Pty) Limited*	South Africa	90	Associated Motor Holdings (Pty) Limited (AMH) imports and distributes passenger and light and heavy commercial vehicles, automotive products, motorcycles and industrial equipment in Southern Africa. It also sells maintenance and warranty products. Further details on the composition of the Associated Motor Holdings (Pty) Limited Group is provided in note 39.1.2.
Boundlesstrade 154 (Pty) Limited	South Africa	90	E-Z-GO, a distributor of golf carts is housed within Boundlesstrade. Its market includes golf courses and estates as well as healthcare and hospitality industries. This subsidiary also houses associates and joint ventures which distribute Chery and Foton motor vehicles.