

– Chairman’s letter to stakeholders –

“It is with great pleasure that I present my inaugural report as chairman of the Imperial board.”

INTRODUCTION

Against a backdrop of worldwide uncertainty and volatility, it is gratifying to lead the board of a group whose four past chairmen and their co-directors so successfully navigated periods of historic political, social and economic change in Southern Africa over 60 years, while developing the group into one of the largest companies listed on the JSE.

It is a privilege to be associated with board colleagues of such exceptional experience, wisdom and judgement and as a newcomer I am mindful of my obligation to marshal their collective capabilities with due care in pursuit of greater value for all Imperial stakeholders.

While there are many matters that are cause for deliberation in a group of Imperial’s size and scope, my exposure to date allows me to assure shareholders that the board’s attention and oversight will never waver far from strategy, risk, capital allocation, executive calibre and governance.

CONTEXT AND PERFORMANCE OVERVIEW

This past year was characterised by challenging and often turbulent conditions in the jurisdictions in which Imperial operates.

Global growth decreased to 3,2% in 2016 with a slight increase to 3,5% forecast in 2017. Towards the end of our financial year, the Brexit referendum and its outcome increased economic, political and institutional uncertainty in many markets.

The tough trading environment in South Africa intensified with GDP growth forecasts lowered to 0,1% for 2016 and to below 1% for 2017. Slowing growth, the rand weakening by 27%, policy uncertainty and a growing concern about corruption and so-called “state capture”, resulted in a sharp decline in business and consumer confidence. Finally, rising interest rates placed downward pressure on personal income, expenditure and durable consumer goods volumes.

The Rest of Africa experienced decreased economic growth due to falling commodity demand, lower oil prices and increased currency volatility and shortages, and the tentative recovery of the Eurozone



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continued through the year with the United Kingdom recording solid economic growth prior to the Brexit result.

Notwithstanding the specific impact of these conditions on Imperial (as described in the CEO's report) the group's revenue was up by a pleasing 8% to a record R118,8 billion, with operating profit up by 3% to R6,4 billion. Earnings per share remained flat and headline earnings per share declined by 3%. Although net working capital increased by 7% to R9,9 billion, the group generated solid cash flows from operations of R9 billion and a return on invested capital of 12,4%. A final dividend of 425 cents brought the full year dividend to 795 cents.

A NEW ERA

During the past year, your directors reached the conclusion that in essence the most valuable assets and capabilities of Imperial could be logically grouped within two value chains or sectors – logistics and vehicles. Imperial's genesis as a motor dealership in 1948 set the stage for its growth into a globally significant importer, distributor and dealer of motor vehicles and associated products and services. Concurrently, the group expanded into adjacent business areas associated – sometimes loosely – with the transport of people and goods.

The pedestrian growth over the past few years exposed two realities. The first was that we were involved in many businesses and assets that were non-core, strategically misaligned, underperforming or of a scale that produced a low return on effort. The second was that those businesses and assets with the most promising prospects of producing growth and returns, operated within the logistics and vehicles value chains. Although these value chains appear to overlap in different sectors of industry and commerce, their underlying strategic, financial, organisational and managerial determinants of success are far less similar and complementary than a superficial analysis would suggest.

Setting aside the impact of exogenous factors on the performance of Imperial, it was therefore decided to dispose of unwanted businesses and assets, and to consolidate the group's five operating divisions within two large increasingly self-sufficient divisions: **Imperial Logistics** and **Motus Holdings** will respectively house the group's worldwide interests in logistics and vehicles, to sharpen strategic, managerial and customer focus, and to reduce duplication, complexity and costs. This restructuring included numerous changes to the roles or reporting relationships of the group's most senior executives, some of which addressed imminent succession requirements. As if all this was not enough, a year of extraordinary managerial activity included acquisitions of R4.4 billion, some concluded shortly after the financial year end.

ETHICS AND SUSTAINABILITY

Imperial is committed to acting with uncompromising honesty and integrity. The board recognises that ethical leadership forms the cornerstone of good governance and we are confident that the correct "tone at the top" is set uncompromisingly by our chief executive leading an experienced and motivated management team.

As the group expands its international operating base, especially as new operations are acquired and integrated into the group, it becomes increasingly important to ensure that Imperial's reputation as an ethical, responsible corporate citizen is protected and enhanced. The board acknowledges that the consistent application of the values that inform our behaviour and that of our business partners is fundamental to the group's business practices. During the year, the code of conduct was reviewed to ensure that it was still relevant and upholds the highest ethical standards. A revised code of conduct and a new anti-bribery policy was thus introduced and compliance was formally confirmed by 1 387 managers worldwide. Ethics awareness campaigns were also undertaken in four African countries.

The board is mindful that the effect of our commercial activities on the broader society is significant and as fiduciaries we strive at all times to exercise due care in our dealings with our stakeholders. We believe that corporate sustainability is founded on accountability for decisions that impact on people, the planet and profits in the long term and thus the board regularly reviews the risks, opportunities and material issues that affect the group and their impact on broader society.

HUMAN CAPITAL

The far-reaching organisational restructuring of Imperial, aimed at positioning the group to capture growth, increase profitability and remain sustainable in an environment of profound structural and systemic change requires focused investment. Most prominent in this regard has been the accelerated investment in human capital management capabilities.

This has extended to ensure the relevance of the board's collective skills in providing oversight of the group's growth and value creation strategy. During the year, an independent board evaluation exercise was conducted by Woodburn Mann and the feedback was extremely positive. I am confident that the board, as a collective, has the optimum balance of relevant skills, expertise and experience to provide effective governance to create long-term value for all our stakeholders.

A highly developed workforce is critical to ensure stakeholder value. During the year, the organisation effectiveness function was established. The activities of this function range from leadership assessments to job profiling and the identification of strategically critical positions. By 30 June 2016, the group's investment in training amounted to R319 million – an 8% increase on the prior year with an average of 16 hours of training per employee.

Imperial promotes diversity across its business. With 74% of the group's employees located in South Africa, it is imperative that our workforce reflects the demographics of the talent pools from which we select our employees. Over the years, the group has made good progress up to middle management levels but our attention is currently focused on repeating this at top and senior management levels.

At 30 June 2016, black representation at top and senior management levels was 19,4% (2015: 17,5%) and 24,3% (2015: 21,2%) respectively. In Germany, where gender diversity at executive level is an imperative, female representation at senior level is 10%.

Diversity, transformation and employment equity plans for each business set out the targets and initiatives that need to be in place to ensure success. Performance against these targets is monitored at various levels in the organisation, including the social and ethics committee of the board. Growth in black representation at senior and middle management levels is linked to performance and remuneration for South African-based executives and senior managers. For our German business, gender diversity is linked to performance and remuneration incentives.

The basis and extent of executive remuneration is increasingly being scrutinised globally. Imperial is sensitive to this while recognising that the most pressing threat facing global organisations is a worldwide shortage of executive leadership skills. At Imperial's last annual general meeting, 95% of shareholders voted in favour of the group's remuneration policy, a significant improvement from the 70% in the previous year. Although a non-binding advisory vote, the board continues to acknowledge the views expressed by shareholders in its deliberations and remains deeply committed to ensuring responsible conduct, sound governance and transparency regarding executive compensation.

SOCIETY AND ENVIRONMENT

The group's social and environmental initiatives, which respond to critical social concerns, including road safety, education and access to primary healthcare, continue to receive attention as they are material to our group's home base in South Africa. In Logistics, road safety is of great concern and the group is focusing its attention on the safety of our drivers and raising public awareness of road safety in South Africa, which has one of the highest per capita road death rates in the world. In our South African operations, fatalities per million kilometres travelled have dropped from 0,106 in 2015 to 0,002 in 2016 and there were no fatalities in our international operations in 2016.

The group has a large number of operational sites in South Africa and internationally. These operations consume water, electricity and other natural resources and generate waste products. The social and ethics committee oversees the material environmental issues with a view to minimising the group's environmental footprint. Both Scope 1 and Scope 2 emissions, fuel usage and water and electricity consumption were reduced compared to the prior year. No fines or penalties were paid for environmental incidents.

The board takes its role seriously in ensuring compliance with relevant laws, codes and standards related to the environment.

CHANGES TO THE BOARD

On 1 September 2015, Raboijani Moses Kgosana was appointed to the board. Moses served as the chief executive officer of KPMG South Africa, chairman of the Accounting Practices Board and was a member of the IFRS Advisory Council. With his considerable experience in accounting and financial reporting he now chairs the audit committee, succeeding Mike Leeming who retired from the board on 31 August 2015. We thank Mike for his leadership on this committee and his contributions to the board.

In anticipation of a higher rate of acquisitive growth, the board constituted an investment sub-committee comprising directors and executives with corporate finance expertise, under the chairmanship of Peter Cooper.

PROSPECTS

Volatility and uncertainty are expected to continue in the markets in which we operate. In this context, the board fully endorses the group's strategic direction and the progress made over the year in continuing to position the group for stronger growth, profitability and sustainability.

Over half of Imperial's activities are in South Africa and, notwithstanding the smooth passage and results of the recent local government elections – clear evidence to the world that our country remains a well-functioning constitutional democracy – we remain deeply concerned about the political climate and the increasing evidence of corruption and interference in the major organs of state. We strongly urge the government and the African National Congress to be more considered in their policies and pronouncements, many of which will exacerbate rather than mitigate the unemployment, poverty and inequality which are of deepest concern to all patriots.

All things considered, the board believes the group is well placed to capitalise on growth opportunities as they arise and to enhance value creation for our stakeholders.

APPRECIATION

On behalf of the board, I extend my appreciation to our stakeholders for their continued loyalty and support during the past year. I am particularly indebted to my fellow board members for the clear direction they have provided in a challenging and ever-changing environment, to management for their sterling efforts in forging ahead with the board's vision for the group, and to every employee for their important contributions towards a pleasing set of results.

A heartfelt thank you to each of you!

SURESH P KANA