– Chief executive officer's report –

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INTRODUCTION

The year was a significant one in the evolution of Imperial. While dealing with the exigencies of everyday business in challenging environments, four additional streams of activity were directed at reallocating capital and fundamentally restructuring the organisation and its leadership for improved growth, returns and sustainability.

A major programme to dispose of non-strategic or low return businesses and properties reached an advanced stage. A number of sizable acquisitions, some concluded after year end, demonstrated our intent to invest in businesses whose growth is not reliant on further capital investment. The decision was taken to consolidate and integrate Imperial's five sub-divisions within two major divisions, focusing exclusively on Logistics and Vehicles. Finally, the most senior three levels of the Imperial management hierarchy were reconfigured, with new executives appointed to address structural and succession requirements over the next three years.

Collectively, these developments created a platform for Imperial to accelerate its transformation to a different entity: no longer a complex conglomerate, Imperial will comprise two increasingly self-sufficient large divisions, whose strategic, financial, managerial and market focus will unlock value for all stakeholders.

This report therefore comments on the past structures for the last time, while ushering in a new Imperial.

ENVIRONMENT

The impediments to GDP and personal consumption expenditure growth in most of the markets in which Imperial operates are well publicised. The following are additional factors that influenced Imperial's performance during the year.

South Africa

Imperial faced various external challenges in South Africa, which generated 58% and 64% respectively of the group's revenue and operating profit. As a provider of logistics services and retailer of vehicles, Imperial experienced falling or low demand from mining and industrial manufacturing clients, as well as declining private expenditure on consumer durables. As an importer and owner of foreign operations, Imperial experienced the effects of rand weakness and foreign currency volatility on the competitiveness of products and on financial reporting, both of which undermined the predictability of performance.

In addition, as the economy slowed and business and consumer confidence declined, competition and the demands of clients and counterparties intensified, exerting pressure on revenues, margins and working capital. Operating margins were depressed by inflationary increases in uncontrollable overheads.

HIGHLIGHTS

SOUND MANAGEMENT
OF CONTROLLABLE FACTORS UNDERPINNED PERFORMANCE

DISPOSED OF NON-STRATEGIC AND LOW RETURN ASSETS OF
R5,3 BILLION

ACQUIRED MINORITIES AND CAPITAL-LIGHT BUSINESSES FOR
R4,4 BILLION

COMMENCED FUNDAMENTAL ORGANISATIONAL AND
LEADERSHIP RESTRUCTURING

DEVISED AND ANNOUNCED
SUCCESSION PLAN
FOR 26 SENIOR EXECUTIVES

Rest of Africa

In sub-Saharan Africa, which generated 11% and 14% respectively of Imperial's revenue and operating profit, trade and fiscal deficits grew, currencies collapsed, foreign exchange became scarce or dried up in some countries, and GDP growth forecasts were sharply reduced.

These pressures were all felt by Imperial's businesses, more so in the second half when a scarcity of foreign exchange threatened the availability and competitiveness of dollar-based imports. Policy and regulatory uncertainty often heightened the operational and financial risks of doing business in some countries.

International

Imperial's operations beyond the African continent generated 31% and 22% respectively of Imperial's revenue and operating profit.

Our businesses in Germany were directly affected to various degrees by low water levels on the Rhine in the first half and full employment which hampered the attraction and retention of skills. With few exceptions our clients and counterparties operate very sophisticated, frequently global businesses, and we face continual pressure to deliver more for less.

In the United Kingdom uncertainty caused clients to delay purchases in the lead up to the Brexit referendum, the result of which had an impact on the value of the pound sterling earnings. There was little change in the economic or competitive pressures we face in Australia and South America where growth off a low base was primarily a function of management initiatives.

GROUP FINANCIAL HIGHLIGHTS

Despite difficult trading conditions, Imperial achieved record revenues and operating profits in 2016, with all divisions producing revenue growth in rand terms. Double-digit growth of revenue and operating profit from foreign operations, increased Imperial's share of revenue and operating profit from foreign operations to 42% and 36% respectively.

The impact of volatile currency movements on the group's profitability and invested capital was significant. Recent developments have shown that in addition to movements of the South African rand, foreign currency movements and our hedging strategies can result in sharp adjustments to reported income in rand. We are confident, however, that our hedging strategies are prudent and we will continue to highlight the impact of currency movements in our communication with stakeholders.

Detail and commentary on Imperial's financial position and performance is contained in the chief financial officer's report which follows, the divisional reviews on pages 54 to 69 and the summarised financial statements on pages 104 to 133.

OUR STRATEGY FOR VALUE CREATION

While always subject to refinement, the underlying precepts of our strategies to create value are unchanged.

The first is that as the listed parent of various business units that compete in the marketplace for goods and services, Imperial Holdings must achieve two objectives. It must add value to its business units in excess of the tangible or intangible costs of doing so, and it must add value to shareholders by diversifying in a manner they could not.

The second, which follows and is depicted on pages 12 and 13, is that the value-adding strategies of a holding company are supportive of, but distinctly different to the competitive strategies of its client-facing operating subsidiaries (pages 14 to 17). The following describes how we refined and implemented our strategies as a holding company that creates value as a "parent" and one that defines the parameters within which subsidiaries are empowered to achieve market leadership and thrive.

As the major determinant of all future performance we continued to **shape the group's portfolio to achieve focused growth**. The intent is to create a less complex, lower capital intense, higher return group of businesses, active only in the logistics and vehicles sectors.

To this end we disposed or are in the process of disposing of non-core, strategically misaligned, underperforming or low return assets amounting to R5,3 billion during the year. Excluding Regent (still subject to regulatory approval) we have disposed or are in the process of disposing of 29 businesses that generated revenues of R6 billion and utilised R2,8 billion of invested capital to produce operating profit of only R45 million – clear evidence that bigger is not better! And we invested R4,4 billion to acquire minorities and new businesses, the most significant of which was 95% of Palletways, acquired on 5 July 2016 at an enterprise value of R3,2 billion (£162,9 million).

As the custodian of equity, debt and assets, and as the funder or guarantor of subsidiaries, the holding company must **raise, allocate and control capital for value accretion**.

During the year, with due regard to cash flows arising from changes to the portfolio, the asset and liability committee and group treasury function ensured a prudent balance of short/long, fixed/variable and local/international debt within the group's self-imposed debt to equity range of 60% to 80%.

From a strategic perspective capital is allocated as per the principles of our investment thesis, shown on page 1. All capital allocation is made and evaluated over time with a view to achieving through the cycle returns on invested capital of between 3% and 4% above the weighted average cost of capital. Over the past year, the return on invested capital exceeded the weighted average cost of capital by 2,2% compared to 3% in 2015. Although uncontrollable external factors have been the major reason for this decline in recent years, we are determined to reverse this trend by reducing average working capital, restructuring or disposing of highly capital intensive businesses and avoiding acquisitions that are highly capital intensive businesses or require capital to grow.

Although divisions and subsidiaries define the bases on which they compete and grow in their chosen markets, their strategies are a basis for budgeting and capital allocation, and can influence the strategic positioning of Imperial as represented to stakeholders. A major responsibility of the holding company is therefore to **ensure strategic clarity at subsidiary level**. Over the past year the formality of this process enhanced competitiveness and created a framework for investment decisions within divisions.

With Imperial's success heavily reliant on the calibre of its leadership, the holding company has an obligation to **develop executive capability for performance and sustainability** throughout the group.

Over the past year, the talent management function established 18 months ago to focus on the most senior 200 managers in Imperial, has evolved. The deployment of leading-edge human capital practices is required not only to develop a leadership pipeline, but also to address issues of productivity, diversity, employment equity and compensation. The mandate of the renamed and restructured organisation effectiveness function is now to provide thought leadership and to institutionalise talent management, human resource architecture, core human resource data and technology, and enterprise architecture throughout Imperial's operations.

In a first for Imperial, the crafting and announcement of a multifaceted 18-month succession plan, involving changes to the roles or reporting lines of 26 senior executives for the next three years, was early evidence of the power of integrated talent management.

Fast developing information, communications and telecommunications technologies are both an opportunity and threat to Imperial's transactional efficiency and value propositions to counterparties. As the competitiveness, efficiency, returns, risks and ultimate value of Imperial can so easily be diminished by technology errors of omission or commission, the holding company must ensure that subsidiaries appropriately **deploy technology for control, efficiency and innovation**. Over the past year, progress in this regard included the appointment of chief information officers in all major business units and oversight by the board through a CIO forum, which reports to the group risk committee.

An insight fundamental to any decision on Imperial is that the group operates predominately in **two different sectors**. The strategic, financial, organisational and managerial determinants of success are very different in the logistics and vehicles sectors as broadly defined, and the synergies are few. Our disposal programme over the past few years has brought this into stark relief.

To give further expression to these differences we decided to sharpen strategic, managerial and customer focus and reduce duplication, complexity and costs, by consolidating and integrating Imperial's five sub-divisions within two large increasingly self-sufficient divisions, each focusing exclusively on Logistics and Vehicles, with effect from 1 July 2016.

Imperial's entire logistics interests (i.e. Imperial Logistics South Africa, Imperial Logistics Rest of Africa and Imperial Logistics International) will be managed as one division called **Imperial Logistics**, and Imperial's entire vehicle interests (i.e. Vehicle Import, Distribution and Dealerships; Vehicle Retail, Rental and Aftermarket Parts; and Motor-related Financial Services) will be managed as one division called **Motus Holdings**.

This restructuring will facilitate opportunities for intra-divisional efficiencies and collaboration, and deeper penetration of the supply chains in both sectors, through better coordinated and competitive value propositions to clients. The competitive strategies employed by and within the divisions will be driven by their leadership, but within the strategic and financial parameters defined by Imperial Holdings.

As both divisions have market-leading positions in South Africa, foreign growth will be preferred.

In the past year, 68% and 71% respectively of what is now Imperial Logistics' revenues and operating profits were foreign. The rapid growth in sub-Saharan Africa is planned to continue and, building on our proven international capabilities in logistics, major acquisitive growth is anticipated beyond the African continent.

With foreign revenues and operating profits of what is now Motus Holdings being 24% and 11% respectively in 2016, the division will pursue foreign growth in distribution and retail, but will remain a predominantly South African company for the medium term.

MATERIAL ISSUES

Notwithstanding significant external and internal developments during the year, five material issues continue to dominate the deliberations of the Imperial board, and the thoughts and actions of management. They are growth; capital management; leadership and human capital development; systems improvement and innovation; and legitimacy among stakeholders. These material issues take into account the key matters and concerns our stakeholders have raised in our engagement with them over the course of the year, and a comprehensive report on our progress appears on pages 26 to 33.

LOOKING FORWARD

Imperial's performance in the past financial year has been pleasing and reflects sound management of controllable factors under challenging circumstances.

Although the decisions have been taken and many of the plans formulated, the success of Imperial over the next few years will be highly dependent on the initial implementation processes in the current financial year.

There will be no help from the environment.

Globally tepid growth and uncertainty will persist. In all of the markets where Imperial operates, underlying economic growth will be slow and real organic revenue growth elusive, achieved only through continual innovation to improve value propositions and penetrate new markets. Locally, the structural obstacles to higher economic performance will remain and the socio-political climate will be unpredictable, fractious and disruptive in the lead up to the national elections in 2019.

We expect volume growth throughout our logistics operations to be subdued, and national new vehicle sales in South Africa to fall gradually in response to declining private consumption expenditure, rising interest rates and tightening credit. In addition, the volatility of the rand and the currencies in the countries in which we operate, together with the group's hedging policy to cover forward, will affect both our competitiveness and profitability. Low growth, the ubiquity and falling cost of data, and technological innovation, will each drive clients and counterparties to be more demanding, putting gross margins continually under pressure.

Aside from our primary obligation to deliver growth and returns, our agenda to unlock value is weighty. We are in the process of restructuring and altering the leadership, and will report differently on two very large multinational divisions in different sectors. Both would rank among the bigger companies in South Africa.

These factors make forecasting challenging but our current outlook for the financial year to June 2017 indicates single-digit revenue growth and a moderate decline in operating profit for Imperial's continuing operations.

APPRECIATION

My gratitude is due to each of the 51 256 people whose daily commitment contributed to these results and in particular to my co-directors and executive committee colleagues without whose counsel and support my task would be impossible.

MARK J LAMBERTI