



Chief executive officer's report

Mark J Lamberti

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Introduction

It was a very good year.

Despite a deteriorating **environment**, currency volatility and an ambitious restructuring programme, Imperial achieved all of the strategic, operational and **financial objectives** announced at the start of the financial year.

Concurrently, following three years of multi-faceted intervention to eliminate the dysfunctional attributes of conglomerate complexity and unfettered entrepreneurial zeal, we sharpened our vision of **strategic clarity, organisation simplicity** and **disciplined capital management**. With each of these now well established as a pillar of value creation, Imperial is well poised to produce **sustainable and improving returns for shareholders**.

Environment

Imperial's activities on the African continent produced 67% and 76% respectively of group revenues and operating profits in the financial year, with the balance generated mainly in Europe and the United Kingdom.

SOUTH AFRICA

Through the course of the year, there was a marked deterioration of the environment in South Africa, where R67,0 billion or 57% of group revenue and R3,8 billion or 63% of group operating profit was generated.

We can no longer euphemise about the socio-political and economic state of South Africa. With official unemployment now 27,7% – substantially higher among 15 to 34 year olds – there is no imperative greater than job creating inclusive growth. Instead, we have a ruling party more concerned with succession, survival and patronage than citizens' interests, and government delivery constrained by poor policy, incompetence and corruption.

More seriously, the capture of government institutions and political leaders by private criminal interests is threatening South Africa's democracy, sovereignty and credibility as an investment destination. Despite extensive revelation of its extent, "State Capture" is unchecked by law enforcement and prosecuting authorities, themselves tamed to protect the personal interests of a minority of flawed leaders and their allies who propagate racial, anti-business rhetoric to divert attention from their misappropriation of resources from the most needy.

With consumer and business confidence depressed by these developments, the South African economy entered technical recession in the first quarter of 2017 with GDP growth of -0,7%. The cabinet reshuffle on the 30 March triggered sovereign downgrades by S&P, Fitch and Moody's, thereby reducing the 2017 GDP growth forecasts of most analysts and the IMF to below 1%. Positive emerging market sentiment and a gradual weakening of the US Dollar resulted in the R/US\$ exchange rate strengthening by 11% during the year.

The impact of these uncontrollable factors on Imperial was lower revenues arising from a reduction in logistics volumes and a 7% decline in national vehicle sales, and pressure on margins amidst increased competition. The strengthening of the Rand by 11% against the US Dollar and by 9% against the Euro with intermittent short-term volatility, created high foreign exchange losses on various monetary items including working capital, intergroup loan funding and hedging instruments.

REST OF AFRICA

Our operations in sub-Saharan Africa generated R11,2 billion or 10% of group revenue and R792 million or 13% of group operating profit in generally subdued conditions.

Specific factors affecting Imperial in certain African countries during the 2017 financial year were slowing GDP growth rates; rising inflation and interest costs; lower consumer demand; and currency volatility, specifically the weakening of the Naira during the year which created foreign exchange losses on monetary items, including working capital and intergroup loan funding. The Naira parallel rate strengthened materially late in the second half of the 2017 financial year and access to foreign currency improved.

Financial highlights

The advanced stages of Imperial's groupwide restructuring required the restatement of certain 2016 financial metrics, on which the following highlights are based.



Detailed financial commentary is contained in the CFO's report.

RECORD REVENUE OF
R119,5 billion
UP 1%
(43% FOREIGN)

RECORD OPERATING
PROFIT OF
R6,5 billion
UP 2%
(37% FOREIGN)

HEPS DOWN 10% TO
**1 390 cents
per share**

EPS DOWN 14% TO
**1 339 cents
per share**

In addition to Africa's everyday operational challenges, these conditions demanded increased vigilance in the control and management of trading, treasury, currency and accounting, with a focus on reducing capital employed in all businesses.

EUROZONE

Our operations in the Eurozone generated R38,7 billion or 33% of group revenue and R1,4 billion or 24% of group operating profit.

Buoyed by a solid German economy and the results of the French presidential election, consumer confidence in the European Union rose to its highest level since before the GFC. The snap election in the United Kingdom produced the opposite result to that intended, weakening the Conservative Party, the Pound and the Prime Minister's hand in negotiating a "hard Brexit".

Specific factors affecting Imperial during the year were 80-year low water levels on the Rhine, and lower demand and pricing pressures in the steel, energy, commodities and construction sectors. The strengthening Rand depressed the translation value of our foreign operations.

Strategic clarity

Groups do not compete, only subsidiaries do.

Since late 2014, we have directed our efforts as a holding company to enhancing the sustainable competitive position of our subsidiaries. This entailed two major initiatives: an aggressive disposal and acquisition programme to agglomerate a portfolio of companies whose sectoral focus and common operating capabilities would ensure the creation of intragroup value for stakeholders; and simultaneously, the definition of the value proposition that each client facing company would require to compete and win in its chosen markets.

The first of these initiatives has to date resulted in the disposal of 42 businesses and 52 properties that were under performing, of low return on effort or strategically incompatible. These disposals generated revenues of R11,2 billion and operating profit of R982 million, and employed R4,2 billion of capital at the time of sale. The concurrent acquisition programme entailed the investment of R5,4 billion to acquire 15 companies that generated revenue of R13,7 billion and operating profit of R880 million in their first full year of operation.

The second initiative involved divisional and company leaders more accurately defining their market, product and customer focus, and thereafter configuring those capabilities necessary to render competitive advantage, growth and returns.

Although further portfolio and competitive strategy refinements are inevitable, the efforts of recent years have irrevocably altered the fundamental trajectory and future of the Imperial Group, which is now operating exclusively in two strategically unrelated sectors: **logistics** and **vehicles**.

LOGISTICS

In logistics, we are active mainly in Africa and Europe with established capabilities in transportation, warehousing and distribution management. Our expertise and experience in each of these enable us to provide integrated supply chain and route-to-market solutions to global and national market leaders. We focus across the value chains of consumer packaged goods, chemicals, healthcare and automotive as well as within specialised sectors of mining, manufacturing and agriculture.

In response to heightened customer expectations, new market entrants and disruptive business models, we are embracing relevant information, digital, positioning, and automation technologies across value chains and sectors, to increase transactional and operational efficiency, productivity and client value.

We will grow revenues, profits and returns by increasing principals, products and markets within and adjacent to our spheres of competence. We will acquire less capital-intensive higher return businesses with strong revenue growth potential. We will grow organically through a deep understanding and penetration of our chosen sectors, carefully staged integration and collaboration, and the development and deployment of executive talent. Our strong market presence in South Africa, although only 33% of our logistics business, favours foreign capital deployment and acquisitive growth.

VEHICLES

Our vehicle business, 76% of which is in South Africa, operates across the value chain importing, distributing, retailing and renting vehicles and aftermarket parts, supported and augmented by motor related financial services. In response to seminal changes in vehicle

CORE EPS DOWN 5%
TO **1 626 cents**
per share

CASH GENERATED BY
OPERATIONS UP 11%
TO **R9,1 billion**

FREE CASH
CONVERSION RATIO
OF **1,6 times**
(0,9 TIMES IN 2016)

NET DEBT TO EQUITY
RATIO IMPROVED
FROM
73% to 71%
(98% IN DECEMBER 2016)

RETURN ON EQUITY
12,7%

RETURN ON
INVESTED CAPITAL
12,4%

WEIGHTED AVERAGE
COST OF CAPITAL
9,0%

FULL YEAR DIVIDEND
DOWN 18% TO
650 cents
per share

technologies and in the way people and companies use, purchase and own vehicles, we see innovation, digitisation and collaboration across the supply chain as the foundations of efficiency, customer value and retention.

We will secure growth and returns through deep direct relationships with leading original equipment manufacturers, optimal distribution techniques, creative marketing, new dealership and client interface models, shared support facilities and loyalty engendering financial services. We will continually enhance our asset portfolio by disposing of or rationalising underperforming businesses dealerships and brands, and by acquiring and rapidly integrating like businesses and assets that can be enhanced by Motus's capabilities and resources. Resulting from our leading market shares in South Africa, and the largely unregulated pre-owned vehicle imports into sub-Saharan Africa, acquisitive growth will be beyond the continent. We will seek greater alignment with our customer base in South Africa by investing in the development of previously disadvantaged managers and entrepreneurs in our vehicle distribution, rental, retailing and aftermarket parts franchising businesses.

Organisation simplicity

The rationalisation of the portfolio and the clarification of strategy enabled the simplification of the structures and management of Imperial and the removal of complexity, duplication and cost.

This has now culminated in the assembly and consolidation of Imperial's entire logistics and vehicle operating companies and assets within two increasingly self-sufficient divisions each under one board, chief executive officer and executive committee. By year-end, **Imperial Logistics** (with sub-divisions South Africa, African Regions, and International) and **Motus** (with sub-divisions Import and Distribution, Retail and Rental, Aftermarket Parts, and Financial Services), were separately established and reported on as Imperial's only operating entities.

Numerous executive management changes were required to accommodate the new structure and the succession of retiring executives. During the course of the year, 23 of the 35 most senior executives in the group assumed new roles.

In order to strengthen further the independence and focus of the divisions, certain functions and services currently provided by the small Imperial Holdings office will devolve to divisional level. On 1 July 2017, the group executive committee was disbanded and its authorities devolved to the divisional boards.

Pursuant to more efficient capital and funding structures in each division, substantial progress was made with the divisionalisation of companies, the rationalisation of legal entities and the simplification, separation and alignment of Imperial's local and international financial structures.

Capital management

Neither external nor internal developments have caused us to review our comprehensive investment thesis (detailed elsewhere in this report) or our investment criteria. Having met its strategic objective, every investment in an acquisition, organic growth or asset renewal must produce a return on invested capital in excess of the weighted average cost of capital. Towards the end of the financial year, we refined our ROIC targets and WACC calculations per jurisdiction.

The new structures have facilitated a far more granular analysis of returns of our existing businesses by trading entity, facility, outlet, product or customer in both divisions, prompting numerous decisions to rectify or exit low return situations.

We have heightened our emphasis on working capital management as evidenced by the reduction of debt to equity from 98% at mid-year to 71%, well within our targeted 60% to 80% range.

The historic structure and management of Imperial relied on the high cash generation of the vehicle divisions to fund partially the acquisitive growth of what became over geared logistics sub-divisions. This situation was neither sustainable nor reflective of the performance of the businesses and we are committed to each division achieving appropriately geared independent and self-sustaining balance sheets by June 2018.

Unlocking value

Although continued evolution is inevitable, the efforts of recent years have irrevocably altered the fundamental trajectory and future of the Imperial group. The far-reaching changes to the portfolio, strategy, structure and management have enhanced executive focus, capital allocation, intra-divisional collaboration and the elimination of complexity, duplication and cost. These developments, as intended, will create value in the short term by increasing penetration and performance in our chosen supply chains, through better co-ordinated and competitive value propositions to clients.

Today Imperial Holdings is exclusively the owner of Imperial Logistics and Motus. Both of these function as large independent multinational operating divisions, each comparable in every way to the governance, executive, operating, control and reporting standards of major public companies.

Although there are no operational synergies between them, both are reliant on Imperial Holdings as the provider of debt and equity and the custodian of strategy, succession and governance. As the entry point for providers of capital, Imperial Holdings will strive to enhance understanding and insight through sensible communication and disclosure.

The obvious question is now whether the separate listing of Imperial Logistics and Motus will unlock value. Work is in process to determine the viability and benefit to Imperial shareholders of doing so and the board will make an announcement on this decision before the end of the current financial year.

Prospects

Against the backdrop of economic recovery in most developed and emerging economies, South Africa's socio-political and economic outlook is fragile. In the near term, politics will divert party leadership and the government from national priorities, and further sovereign downgrades are possible.

Internationally, geopolitics and central banks could dampen growth and influence capital flows. The impact of this unpredictable environment on sentiment, economic activity and the volatility of the Rand, is unlikely to assist the fortunes of Imperial.

Despite this, we anticipate solid operating and financial results in the year to June 2018, subject to stable currencies in the economies in which we operate and South Africa retaining its investment grade. We expect:

- > The self-sufficiency and effectiveness of both divisions to be further entrenched with balance sheet efficiency and independence a priority.
- > Logistics and Motus to grow revenues and operating profit from continuing operations.
- > Imperial Holdings' continuing operations to increase revenues and operating profit with a double-digit growth in headline earnings per share, stronger in the second half.

Appreciation

My gratitude is due to my 49 364 colleagues throughout Imperial whose resilience in dealing with difficult external circumstances has been tested by the unprecedented rate of internal change. The multifaceted restructuring of Imperial over the past three years was among the most complex and ambitious in South African business.

A particular thanks to my co-directors, executive committee colleagues and fellow managers at all levels of the organisation. These are not easy times in which to lead.

Finally, I thank our owners and funders for their support. We will continue to execute on our espoused strategies.