Chief financial officer's report

Mohammed Akoojee

Solid results, in line with expectations, reflect continued progress with Imperial's strategic, capital, operational, organisational and managerial restructuring, despite challenging trading conditions.

My appointment as Chief Financial Officer of Imperial was effective 1 March 2017. During the financial year, despite challenging trading conditions, particularly currency volatility, the group achieved results that were in line with its previous market guidance, with balance sheet management and cash generation ahead of expectations.

As the provider of debt and equity to its two divisions, Imperial Logistics and Motus, the group's key priority is optimal capital management. Recent strategic acquisitions and a delay in the receipt of proceeds from disposals resulted in Imperial's net debt to equity ratio spiking to 98% at December 2016. Following tighter capital management in the second half, receipt of proceeds from disposals, lower capital expenditure and excellent working capital management, debt levels had reduced by year-end. Our current net debt to equity ratio of 71% is well within our internal targeted range of 60% to 80%. The group's liquidity position is also strong with R12,4 billion of unutilised banking facilities, excluding asset backed finance facilities. Sixty nine percent of group debt is long-term in nature (longer than 12 months) and 55% of the debt is at variable rates. The group's international scale creditrating by Moody's is at Baa3, negative outlook (in response to SA's downgrade) and the national scale rating was upgraded recently to Aa1.za.

The group proactively monitors key debt, working capital and invested capital metrics through monthly divisional dashboards to meet internally and externally imposed benchmarks and optimise our returns and cost of capital. The divisional allocation of equity and debt is reviewed and the appropriate WACC determined to evaluate investments and measure performance on a risk-adjusted basis applicable to various businesses and jurisdictions. We are confident that we have well-functioning governance structures and clearly defined policies in place to ensure optimal capital management going forward, through sourcing of funding at competitive rates and allocating capital appropriately to fund divisional growth strategies, which deliver sustainable returns to shareholders.

Another priority is the effective management of foreign exchange volatility. Despite our efforts, the group recorded a foreign exchange loss of R619 million during the year. This related mainly to the unwinding of uneconomical and excessive forward cover in Motus (mainly Renault) and mark-to-market of monetary items in Logistics African Regions due to the significant devaluation of the Naira and Metical. The magnitude of the foreign exchange loss provoked a review of the group's foreign exchange controls and policies. Although the policies remain appropriate, oversight of their application has been strengthened and centralised.

During the year, the group restructured its external financial reporting of segmental information, which clearly outlines all the key metrics of financial performance for Imperial Logistics and Motus separately, and enables stakeholders to evaluate the performance of each division more accurately. The new disclosure format is fully reflected in the 2017 financial results.

Group financial highlights

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%**

ROE **12,7%**

ROIC **12,4%**

WACC **9,0%**

FULL YEAR DIVIDEND DOWN **18% to 650 cents per share**

Results overview

	Total 2017	Continuing 2017	Discontinued 2017	Restated[1] Total 2016	Restated[1] Continuing 2016	Restated[1] Discontinued 2016	Total % change	Continuing % change
Revenue (Rm)	119 517	116 839	2 678	118 849	115 800	3 049	1	1
Operating profit (Rm)	6 538	6 049	489	6 382	5 948	434	2	2
Operating margin (%)	5,5	5,2	18,3	5,4	5,1	14,2		
Net finance costs (Rm)	(1 680)	(1 680)		(1 440)	(1 440)		17	17
Income from associates (Rm)	103	103		138	138		(25)	(25)
Forex losses (Rm)	(619)	(619)		(72)	(72)			
Profit before tax (Rm)	3 625	3 187	438	4 402	3 984	418	(18)	(20)
Tax (Rm)	(1 060)	(901)	(159)	(1 221)	(1 054)	(167)	(13)	(14)
Net profit after tax (Rm)	2 565	2 286	279	3 181	2 930	251	(19)	(22)
Attributable to non-controlling interests (Rm)	36	87	(51)	(184)	(128)	(56)	(119)	(168)
Attributable to shareholders of Imperial (Rm)	2 601	2 373	228	2 997	2 802	195	(13)	(15)
Effective tax rate (%)	30,1	29,2		28,6	27,4			
ROIC (%)	12,4			12,8				
WACC* (%)	9,0			9,5*				

Note: ROIC is calculated based on taxed operating profit plus income from associates divided by the 12 month average invested capital (total equity and net interest bearing borrowings).

* *Restated to new calculation method. WACC for each sub-division of the group is calculated by making appropriate country/regional risk adjustments for the cost of equity and pricing for the cost of debt depending on jurisdiction. The group WACC calculation is a weighted average of the respective sub-divisional WACCs.*

1. *Restated 2016 to include Regent VAPS business.*

Total group revenue and operating profit grew by 1% to R119,5 billion and by 2% to R6,5 billion respectively. Excluding acquisitions and disposals in the current and prior year, revenue remained flat and operating profit declined by 1%.

The group profit before tax declined by 18% due to:

> Foreign exchange losses of R619 million compared to R72 million in the prior year, which resulted from:
  - The unwinding of uneconomical and excessive forward cover in Motus, mainly Renault, as referred to earlier, previously reported in the statement of comprehensive income at 31 December 2016; and
  - Mark-to-market valuation of monetary items in Logistics African Regions, mainly due to the devaluation of the Naira (41% devaluation on average for the period) and Metical (37% devaluation on average for the period). This was largely offset by price increases, which led to higher operating margins in Ecohealth in Nigeria.

> Increased finance costs from higher costs of funding and higher average debt levels during the year, which resulted from increased working capital (on average) during the year and acquisitions. This was exacerbated by delays in the receipt of proceeds from properties and businesses held for sale.
> Income from associates and joint ventures decreased by R35 million on the prior year mainly as a result of the sale of Mix Telematics.
> Loss on sale of subsidiaries amounting to R151 million compared to the prior year profit on sale of subsidiaries of R430 million.

The above factors were offset by:

> The profit on sale of properties (net of impairments) of R212 million (2016: R28 million).
> Impairment of goodwill, investment in associates and joint ventures and other assets amounting to R209 million (2016: R367 million).
> The non-recurring impairment of intangibles amounting to R151 million in 2016.

The effective tax rate for the group is 30,1%, up from 28,6% in the prior year as a result of the reversal of over provisions in 2016. No additional deferred tax asset was recognised on the losses incurred in Renault and this was largely offset by the deferred tax asset raised in Imperial Cold Logistics.

Losses recorded by underperforming subsidiaries, mainly Renault, contributed to a loss attributable to non-controlling shareholders. Furthermore, the profit share of the non-controlling shareholders reduced compared to the prior year due to the purchase of the non-controlling shareholders' interest in Associated Motor Holdings and AAAS (previously Midas), and the sale of the Goscor group in the second half of 2016 which had a 32,5% non-controlling shareholder.

RECONCILIATION FROM EARNINGS TO HEADLINE AND CORE EARNINGS:

R million	Notes	June 2017	Restated[1] June 2016	% change
Net profit attributable to Imperial shareholders (earnings)		2 601	2 997	(13)
Profit on disposal of assets		(320)	(98)	
Impairments of goodwill and other assets		185	437	
Loss/(profit) on sale of businesses		151	(431)	
Impairment and re-measurement of investment in associates and joint ventures		34	92	
Reclassification of gain on disposal of investment in associate		(8)		
Tax and non-controlling interests (NCI)		57	(3)	
Headline earnings		2 700	2 994	(10)
Amortisation of intangible assets arising from business combinations		521	437	
Foreign exchange gain on intergroup monetary items			(92)	
Re-measurement of contingent consideration, put option liabilities and business acquisition costs		109	117	
Tax and NCI		(171)	(139)	
Core earnings		3 159	3 317	(5)

EARNINGS, HEADLINE EARNINGS AND CORE EARNINGS PER SHARE

				Restated[1]					
	Group Total 2017	Continuing 2017	Dis-continued 2017	Group Total 2016	Continuing 2016	Dis-continued 2016	Group Total % change	Continuing % change	Dis-continued % change
Basic EPS (cents)	1 339	1 221	118	1 554	1 453	101	(14)	(16)	17
Basic HEPS (cents)	1 390	1 240	150	1 552	1 451	101	(10)	(14)	48
Basic Core EPS (cents)	1 626	1 480	146	1 720	1 617	103	(5)	(8)	42

Financial position overview

R million	June 2017	Restated[1] June 2016	% change
Goodwill and intangible assets	9 529	7 501	27
Property, plant and equipment	10 371	11 602	(11)
Investment in associates and joint ventures	1 002	993	1
Transport fleet	5 560	5 953	(7)
Vehicles for hire	3 963	3 469	14
Investments and loans	805	404	99
Net working capital	8 956	9 804	(9)
Other assets	1 839	1 871	(2)
Assets held for sale	979	6 287	(84)
Net debt	(14 647)	(16 075)	(9)
Non-redeemable, non-participating preference shares	(441)	(441)	
Other liabilities	(7 655)	(8 576)	(11)
Liabilities directly associated with assets held for sale		(3 017)	
Total shareholders' equity	20 261	19 775	2
Total assets	68 853	69 835	(1)
Total liabilities	(48 592)	(50 060)	(3)

1. Restated 2016 to include Regent VAPS business.

Cash generated by operations after working capital movements, interest charge and tax payments was R5,9 billion (2016: R4,8 billion), up 23%. Net working capital improved due to excellent working capital management in the second half.

Property, plant and equipment decreased by R1,2 billion to R10,4 billion primarily from the disposal of properties and the reclassification of properties to held for sale assets during the year.

The transport fleet decreased by 7% or R393 million as the net investment in trucks and barges of R366 million and net acquisitions of R249 million was reduced by currency adjustments of R334 million resulting from a stronger Rand and depreciation of R674 million.

Vehicles for hire increased by R494 million resulting from vehicle price increases, a higher fleet in the car rental business at year-end and increased sales to car rental companies by vehicle importers.

Net working capital improved to R9,0 billion from R9,8 billion in the prior year as a result of an increase in trade payables of R1,7 billion, partially offset by the increase in both trade receivables and inventory of R636 million and R236 million respectively. Net working capital turn improved from 12,5 to 12,7 times compared to the prior year.

Investment and loans increased by 99% due to the additional investments for the new cell captive arrangements with Regent for the VAPS business, and the loans receivable from the sale of Jurgens during the year.

Assets held for sale mainly includes non-strategic properties that have been identified for sale. The sale of Regent, non-strategic properties disposed in F 2017, Imperial Express, LTS Kenzam and Global Holdings, which were classified as held for sale in 2016, have been concluded.

Total assets decreased by 1% to R68,9 billion due mainly to the disposal of Regent, businesses held for sale, property disposals and currency adjustments, which were offset by acquisitions.

The net debt level is within the target gearing range of 60% to 80%. The net debt to total earnings before interest tax depreciation and amortisation (EBITDA) ratio of 1,7 times is in line with the prior year.

In addition to attributable profits, shareholders' equity was impacted by:

> The strengthening of the Rand, which resulted in a loss in the foreign currency translation reserve of R659 million.
> An increase in the hedging reserve of R159 million as a result of the favourable forward cover position of Motus relative to the Rand exchange rate at 30 June 2017.

MOVEMENT IN SHAREHOLDERS' EQUITY

R million	**2017**
Net profit attributable to Imperial shareholders	**2 601**
Net profit attributable to non-controlling interests	**(36)**
Decrease in the foreign currency translation reserve	**(659)**
Increase in the hedge accounting reserve	**159**
Remeasurement of defined benefit obligations	**116**
Movement in share based reserve	**(72)**
Dividends paid	**(1 688)**
Non-controlling interests:	
Palletways (share issue)	**147**
Midas (NCI buy out)	**(36)**
Imres (NCI buy out) (including remeasurement of put option)	**(52)**
Itumele (new acquisition)	**118**
Disposal of NCI share in Regent cell captives	**(122)**
Other movements	**10**
Total change	**486**

Cash flow overview

R million	June 2017	Restated June 2016
Cash generated by operations before movements in working capital	8 388	8 931
Movements in net working capital*	688	(788)
Cash generated after working capital movements	9 076	8 143
Interest paid	(1 670)	(1 461)
Tax paid	(1 520)	(1 910)
Cash generated by operations before capital expenditure on rental assets	5 886	4 772
Capital expenditure on rental assets	(1 709)	(1 611)
Cash flows from operating activities	4 177	3 1961
Net (acquisitions)/disposals of subsidiaries and businesses	(1 687)	760
Capital expenditure (non-rental assets)	(954)	(2 527)
Equities, investments and loans	702	179
Dividends paid	(1 688)	(1 909)
Other	(113)	(1 321)
Decrease/(increase) in net debt*	437	(1 657)
Free cash flow	4 296	2 536
Free cash flow to headline earnings (times)	1,59	0,85

* *Excludes currency movements and net acquisitions.*

Cash generated by operations after working capital movements, interest charge and tax payments was R5,9 billion (2016: R4,8 billion), up 23%. Net working capital improved due to excellent working capital management in the second half.

Capex reduced from R4,1 billion to R2,7 billion, down 36%. Capex in the prior year included the bulk of the contributions towards the chemical manufacturing plant and the additional convoys in South America. The current year capex was also reduced by the proceeds from the property disposals of R884 million.

The main contributors to the net outflow of R1,7 billion relating to acquisitions and disposals was the acquisition of Palletways (R1,7 billion) offset by R1,8 billion (less cash lost of R1,9 billion) proceeds from the sale of Regent.

Inflows from equities, investments and loans amounted to R702 million, resulting mainly from the sale of Mix Telematics.

Dividends amounting to R1,7 billion were paid during the year.

Other significant cash flow items included share buy backs amounting to R558 million, a higher outflow from a change in minorities and settlement of cross-currency swaps in the prior year which did not recur in F 2017.

Funding

R million	June 2017	June 2016
Gross debt (ex. preference shares)	19 146	18 396
Cash resources	(4 499)	(2 321)
Net debt before cash held for sale	14 647	16 075
Less: cash held for sale		(1 352)
Net debt	14 647	14 723
Net debt to equity (preference shares included as equity) (%)	71	73
Net debt to equity (preference shares included as debt) (%)	74	77

Despite the acquisition of Palletways (R3,0 billion including take-on debt on effective date), the net debt to equity ratio (including preference shares as equity) reduced to 71% from 73% (98% at December 2016) supported by proceeds from the sale of Regent and non-strategic properties, an improvement in working capital and a reduction in capital expenditure. Year-on-year currency effects reduced debt by R1 billion.

ROIC and WACC

Group	June 2017 %	June 2016 %
ROIC	12,4	12,8
WACC	9,0	9,5
Excess	3,4	3,3

ROIC and WACC by division	Logistics %	Motus %
ROIC	11,5	11,8
WACC	7,1	10,1
Excess	4,4	1,7

Imperial achieved a ROIC of 12,4% versus a WACC of 9,0% for the year to June 2017.

The group's role is to ensure that capital is allocated appropriately to the divisions in a manner that enables their competitiveness, and delivers sustainable returns over appropriate WACC levels. Our appropriate return target for our businesses, including acquisitions, is ROIC > regional WACC + an appropriate hurdle rate.

WACC for each sub-division of the group is calculated by making appropriate country or regional risk adjustments for the cost of equity and pricing for the cost of debt depending on jurisdiction. The group WACC calculation is a weighted average of the respective sub-divisional WACCs. ROIC is calculated based on taxed operating profit plus income from associates divided by the 12-month average invested capital (total equity and net interest bearing borrowings).

Final ordinary dividend

A final cash dividend of 330 cents per ordinary share (2016: 425 cents per share) has been declared, bringing the full-year dividend to 650 cents per ordinary share (2016: 795 cents per share). The 18% decline in the dividend exceeds the 10% decline in HEPS as a result of a stepped reduction in the pay-out ratio (previously based on core HEPS) towards a targeted 45% of HEPS, subject to circumstances.

Conclusion

The 2017 financial year has ended pleasingly with the key financial objectives met and an appropriate capital structure and balance sheet largely in place. This was achieved notwithstanding extensive corporate activity. We disposed of 33 properties that realised R900 million and 11 businesses that generated total annual revenue of R4,9 billion and operating profit of R634 million. Acquisitions to the value of R1,8 billion were concluded.

While analysis of the strategic and financial performance of businesses will result in continual refinements to the portfolio of Imperial Logistics and Motus in future, the bulk of identified disposals have been concluded, with planned disposals now mainly for non-strategic properties.

A key financial objective of the current financial year is to eliminate the financial interdependence of Imperial Logistics and Motus by introducing sustainable capital and balance sheet structures. An equally important objective is to maintain an investment grade credit rating (international scale) to facilitate access to debt capital at the lowest cost as a foundation of appropriate risk-adjusted returns to shareholders.

We expect improved performance in all key financial metrics in the next financial year.