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ALLAN GRAY STEWARDSHIP REPORT – CALENDAR YEAR 2017

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Environmental, social and governance considerations and our investment process

We aim to earn superior long-term returns through investment decisions that are founded on diligent fundamental research and a disciplined investment process. A key part of this is incorporating environmental, social and governance (ESG) considerations into all stages of our investment process - we believe that this can improve investment returns over the long term and assist our clients to act as responsible owners. We take this responsibility seriously, and use our best efforts to ensure that the boards and management teams of companies in which we invest on our clients' behalf are held accountable and conduct their business sustainably. We publish this Stewardship Report annually to update our clients on important ESG matters that have arisen.

Improvements to investment process

We made two relevant improvements to our investment process during 2017. Firstly, we introduced a process enhancement allowing the chief investment officer (CIO) to veto investments by other portfolio managers in cases where he determines that the company's business practices are unethical. While we continue to use the multiple portfolio manager system and view it as key to our success, we believed it was necessary to have an additional level of oversight through the CIO's ethical veto. This veto has been used once to date. The Allan Gray board holds the CIO to account, including for his use of (or decisions not to use) this veto.

Secondly, we now employ an analyst to perform dedicated research on the environmental and social impact of companies, as well as their mitigation efforts. This is in addition to our existing dedicated governance research function (which we have written about in past Stewardship Reports) and the ESG research performed by the investment analysts themselves, as material ESG factors are likely to impact the investment case for companies they cover.

Dedicated ESG research provides additional oversight through: (i) news monitoring for any potential environmental/social issues relevant to the company; (ii) dedicated research into concerns identified during monitoring and how the company is responding; (iii) monitoring companies' sustainability reporting and (iv) performing detailed environmental and social "due diligences" of all of our significant shareholdings with material ESG considerations.

We try to form a pragmatic and balanced view of ESG issues. For environmental issues in particular, we consider the company's efforts to reduce its impact, management's acknowledgement of the issues and whether management strives to be best in class. We also ensure that we are well-informed of the company's impact within the local and global context and meet readily with interested third parties.

Public discourse is one method of holding management to account. We prefer to engage with management in private as we believe this is more constructive and has a higher probability of producing good outcomes for our clients and society at large. However, we also understand the importance of being transparent about our interactions, particularly where the societal impact and interest is significant. Our Stewardship Report is part of our effort to be more transparent. In 2017 three of our clients' investments were the subject of extensive media coverage – these being Group Five, Net1 and SA Taxi (a division of Transaction Capital).

Group Five

Constructive engagements with companies are not always successful and sometimes we have to consider other options. Group Five, in which Allan Gray clients have a 25% shareholding, is an example. We became concerned by the number of resignations by key individuals in early 2017. After extensive correspondence and meetings with board members we were unable to gain a clear understanding of the underlying issues and became increasingly concerned.

We concluded that a fresh start was required, including new leadership and skills in the non-executive team. We called for an extraordinary general meeting (EGM) of shareholders in an attempt to change the board. The EGM took place on 24 July 2017 and our efforts were successful, resulting in the election of eight individuals to serve as the new non-executive directors. We believe that the reconstituted non-executive board's independence and skillset will assist in turning around Group Five.

Net1

We invested in Net1 in 2012 and by the end of 2016 our clients had a 17% shareholding in the company, making up 0.3% of our clients' portfolios. Allan Gray's investment in Net1 was not based on the renewal of the South African Social Security Agency (SASSA) contract, but rather on the company's track record in delivering payment technologies and solutions. As the SASSA crisis unfolded, we became very concerned about Net1 in light of some excellent investigative journalism and concerns being raised by various civil society organisations.

These concerns included the immediate need to ensure that 17 million grant beneficiaries received their grants on time and allegations that grant beneficiary data was being used illegally, unauthorised deductions were being made on their accounts, and credit was being extended to them recklessly. These issues were very concerning for us, especially given their human impact on some of the poorest and most vulnerable in our society.

Since investing in Net1 we have met with the board and management on several occasions specifically to discuss governance issues, their business practices and several external investigations, which to date have not found the company guilty of wrongdoing. Naturally, we did not take their responses at face value. Our own research is key to our investment process and we use our judgement to evaluate the risks of legal and regulatory non-compliance at companies in which we invest. Still, our assessment of Net1 relied partially on assurances made by the company and third-party investigations. With the benefit of hindsight we should have been far more on top of many of the issues that came to light during the SASSA crisis – for this we apologise unreservedly and we have taken several steps (including some of the improvements discussed earlier) to ensure that it does not happen again.

As the SASSA crisis was unfolding, we considered the option of divesting immediately from Net1 – this certainly would have been the easier road to take. Our clients are significant shareholders but do not control Net1. Due to Net1 being incorporated in Florida, with a primary listing on NASDAQ, it is practically impossible to change the board (as we had done with Group Five). We decided it would be more effective to hold Net1 to account as shareholder representatives and undertook a number of initiatives. These included putting pressure on Net1 to improve their business practices (with specific suggestions on how to do this) and oversight functions.

In addition we hired two external parties to help us investigate Net1, met with several civil society organisations to better understand their concerns and met with grant beneficiaries to get a first-hand account of their grievances. We met with Net1's internal auditors who assist with their compliance, other Net1 shareholders and had several meetings with Net1's executive and non-executive directors. We also urged Net1 to publish a comprehensive statement that clearly explains their response to the allegations of illegal and improper behaviour.

Net1 has made a number of changes to their business over the past year. The board decided to change the chief executive officer (CEO) and recruited an external chief financial officer (CFO) (the previous CFO was promoted to the CEO role), a new independent non-executive director was appointed and Net1 has appointed a respected former banking ombudsman as its independent adjudicator to assist with resolving grant beneficiary complaints.

Despite this progress and the agreement signed between SASSA and the South African Post Office in December 2017, we are concerned that the SASSA crisis may repeat itself in March 2018. The Net1 leadership seems to be attuned to the issues and assures us they are cooperating fully and trying to assist SASSA in ensuring a smooth transition to a new service provider before 31 March 2018.

As a concerned and responsible shareholder, we continue to monitor the situation closely and hold Net1 to account.

SA Taxi, a division of Transaction Capital

During 2017 there were several protests by minibus taxi operators in Gauteng and KwaZulu-Natal. Their grievances were directed at more than 30 industry participants, including government for a lack of financial support, banks and insurers for not financing and insuring taxi owners, original equipment manufacturers (Toyota) for high vehicle prices and SA Taxi for financing vehicles at high rates.

Allan Gray's clients hold 9% of Transaction Capital (TCP). TCP derives more than half its earnings from SA Taxi, which is a vertically integrated business that provides credit and ancillary services to South Africa's minibus taxi industry. Given the grievances raised and the minibus taxi industry's importance to our society (taxis are responsible for more than 15 million commuter trips daily), we undertook a detailed review of SA Taxi's business practices to gain a better understanding of whether their services and pricing were fair and sustainable.

Firstly we looked at the interest rates SA Taxi charges. The average SA Taxi loan recipient pays an interest rate of 24.4%. Previously SA Taxi's maximum rate was 28.5%; since the protests they have reduced the maximum rate to 26.5% on new loans. We understand that this average interest rate appears very high. However, it is arguably warranted by two factors: SA Taxi's high funding costs and credit loss ratio. In 2017 SA Taxi's borrowing cost was 11.4%, compared to 4.8% for the big 4 South African banks and Capitec. Its credit loss ratio was also high at 3.2%. The big 4 banks' credit loss ratio averaged 0.9%. Capitec's ratio was 11.9% but its loan book is unsecured and one would expect it to be highest.

SA Taxi's risk-adjusted net interest margin (NIM), a measure of the profits SA Taxi makes after adjusting for borrowing costs and bad debts, was 8.2% in 2017. The big 4 banks' most recent risk-adjusted NIMs range from 3.1% to 4.6% and Capitec's NIM is 14.6%. SA Taxi's risk-adjusted NIM is high but does not seem excessive for a niche business. After careful analysis we concluded that SA Taxi simply manages credit better than their competitors, which allows the company to achieve these superior margins while still offering a better-than-average deal to their customers.

The NIM does not capture the higher costs involved in lending money to a relatively informal industry. Other companies, including the big 4 banks, have tried to compete with SA Taxi but have been unable to turn a profit. The taxi operators are not forced to use SA Taxi but do so out of choice as SA Taxi provides the cheapest available credit. It is in SA Taxi's long-term interest to ensure the borrower can run a profitable business.

SA Taxi requires loan recipients to install tracking devices in their vehicles, which provide extensive data on route and operator profitability. SA Taxi uses this data to perform accurate credit assessments based on the applicant's approved route, therefore credit scoring the micro-enterprise rather than the individual. It is estimated that 90% of SA Taxi's clients have personal credit scores that would have precluded them from bank financing. SA Taxi has 29 000 taxi loans on its book out of an estimated 70 000 – 80 000 financed taxis, and more than 200 000 taxis in South Africa. Since 2008, SA Taxi has extended R18.6 billion to taxi operators, a significant contribution to inclusion. This has supported the creation of approximately 65 000 small and medium enterprises, all of which are black-owned.

We also assessed SA Taxi's insurance products, which are provided to 85% of their loan book and over 4 000 external clients. The average monthly insurance premium charged on SA Taxi-financed vehicles is comparable to competitors and fair, given the increased risk associated with the high mileage and time on the road. The insurance coverage is comprehensive and SA Taxi provides owners with options to recover some of this cost. SA Taxi rejects less than 1% of claims and their claims' ratio is high, at about 70%.

This means that R70 of every R100 in premium income is paid out to claimants, which leaves R30 for costs and profit. For context, Outsurance has a claims ratio of only 51%. SA Taxi has in-house refurbishment facilities in Gauteng, which facilitates lower cost repairs. Getting taxis back on the road quickly after accidents is critical for the taxi owner's cash flow and SA Taxi attempts a turnaround of less than 7 days (damage dependant) at their Taximart.

Lastly, we enquired about their debt collection and vehicle repossessions. Management sent us a detailed due diligence of their collections process, which seems well managed and fair.

SA Taxi's management has responded proactively to all the complaints raised. They are working with the South African National Taxi Association to raise cheaper financing from government, specifically the PIC. Cheaper debt would enable them to charge lower rates on loans. They are also engaging with original equipment manufacturers to contain vehicle price increases and with Toyota to increase the monthly allocation of Toyota Ses'fikile taxis to the SA Taxi retail dealership.

TCP's integrated reporting is comprehensive and transparent, SA Taxi management engages openly on matters and they have a good balance between seeking profits and acting in the best interests of their clients. Because we rely on publicly available information it is impossible for us to know for sure whether everything is above board at SA Taxi, or any company in which we invest, and there will always be a risk that we come to the wrong conclusion. However, based on our assessment we believe that SA Taxi's business practices are fair and that they fulfil an important role by increasing financial inclusion, developing SMEs and making the minibus taxi industry safer.

Monitoring of and reporting on ESG issues

We monitor ESG and sustainability issues throughout all phases of our investment process and on an ongoing basis once our clients are shareholders in a company. Please refer to our Policy on ownership responsibilities, Policy on incorporation of sustainability considerations, Policy on conflicts of interest and Statement on Responsible Investing on the Allan Gray website for more information on our approach to ESG and sustainability. Details regarding company engagements in the 12 months to 31 December 2017 follow.

Company engagements and voting recommendations

Company engagements

During 2017, our analysts and portfolio managers engaged with company representatives on 617 occasions. These are usually meetings with executives and non-executives, site visits to companies' operations or formal written correspondence. During these meetings ESG and sustainability issues were specifically discussed on 305 occasions. Table 1 provides a quantitative summary of our engagements during the 12 months to 31 December 2017.

Table 1: Summary of our engagements with companies

		Occasions when ESG issues were discussed		
Type of engagement	**Total number of engagements**	**Environmental**	**Social**	**Governance**
Meetings	385	10	73	122
Written correspondence	18	0	1	15
Site visits	50	2	11	9
Other forms of engagement	164	11	25	26
Total	**617**	**23**	**110**	**172**

Proxy voting

We provide voting recommendations for general meetings of companies which have a material weight in your portfolio and for smaller companies in which our clients collectively have significant holdings. We publish our voting recommendations, together with the outcome of the shareholders' vote on each relevant resolution, quarterly on our website. Over the 12 months to 31 December 2017, we made voting recommendations on 2 231 resolutions tabled at shareholder meetings, as shown in Table 2.

Table 2: Voting recommendations

Quarter	Number of meetings	Resolutions 'For'	Resolutions 'Against'	Resolutions 'Abstained'	Total resolutions
Q4 2017	53	589	71	17	677
Q3 2017	37	391	60	17	468
Q2 2017	61	722	54	16	792
Q1 2017	29	262	25	7	294
Total	**180**	**1 964**	**210**	**57**	**2 231**

One of the most topical matters on which we make voting recommendations is the annual non-binding resolution on a company's executive remuneration. These are important resolutions to consider as they provide shareholders with a direct say on executive remuneration and act as a path to align executives' incentives with the best interests of shareholders. Table 3 sets out our voting recommendations on resolutions relating to executive remuneration policies over the past year.

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Table 3: Voting recommendations related to executive remuneration policies

Quarter	Resolutions 'For'	Resolutions 'Against'	Resolutions 'Abstained'
Q4 2017	African Rainbow Minerals BHP Billiton Bidvest Namibia Clover Comair Firstrand FNB Namibia Group Five Hospitality Property Fund KAP OneLogix Group Pan African Resources Putprop Remgro Sasol Super Group Tower Property Fund Tsogo Sun Unicorn Capital Partners Wilson Bayly Holmes-Ovcon Woolworths	Aveng Caxton Emira Property Fund Impala Platinum MMI Murray & Roberts Net1 RMI Spur	Capricorn Investment Group Ellies
Q3 2017	Adcorp African Phoenix Investments Argent Industrial Holdsport Mr Price Novus Holdings The Foschini Group	Alexander Forbes Naspers Peregrine Stefanutti Stocks Tongaat Hulett	Trencor Vukile
Q2 2017	AECI Anglo American Bell Equipment British American Tobacco Calgro M3 Capital & Counties Properties Capitec Bank Glencore Gold Fields Liberty Holdings Mondi Mpact Nedbank Randgold & Exploration Royal Bafokeng Platinum Sanlam SEPLAT Standard Bank Tullow Oil Zeder Investments	Barclays Africa Group Basil Read Merafe Resources MTN Old Mutual Santam	OCI N.V.
Q1 2017	Astral Foods Coronation Fund Managers Hudaco Industries Life Healthcare Namibian Asset Management Nampak Netcare Quantum Foods RDI REIT Reunert Sappi Transaction Capital		