LEADERSHIP REVIEWS

JOINT CHAIRMAN'S AND CEO'S REPORT

Improved trading environment for Sephaku Cement but increased competitive forces for Métier.

Brent Williams
Chairman

Dr Lelau Mohuba
Chief executive officer

Dear stakeholders,

The year saw a positive turn in Sephaku Cement's performance, while Métier's performance declined. We hope to provide you with insight into our performance and how we navigated the year. We continue to structure our report around investors' frequently asked questions.

HOW WOULD YOU DESCRIBE THE MACROECONOMIC OPERATIONAL CONTEXT?

The macroeconomic environment remained challenging for a large portion of the year, and improved slightly during the fourth quarter of 2017 which had a 3,1%[1] annualised and seasonally adjusted GDP growth rate. The construction industry declined by 0,3% during that quarter, characterising the operating environment for the cyclical building and construction materials industry. The estimated total cement demand was approximately 13 million tonnes against an industry production capacity of 17 million tonnes. This supply/demand imbalance has caused intense pricing competition among cement manufacturers since Sephaku Cement entered the market in 2015.

Mixed concrete sector

The mixed concrete manufacturing sector has low barriers to entry, and producers can move fairly easily between markets to secure volumes. Independent producers migrated from low-demand areas to regional markets with relatively high construction activity such as Gauteng.

Cement sector

Prices were more stable than during the 2016 calendar year. Manufacturers used segmentation pricing strategies to reach their targeted sales volumes which reduced price increases in the highly competitive regions. Some competitors attempted to merge and capitalise on the consolidation opportunities in the overcapacity context but were unsuccessful. However, we observed a sharpened focus by all manufacturers on improving operational efficiencies to enhance margins.

HOW DID THE GROUP RESPOND TO THE OPERATING ENVIRONMENT?

The group mainly focused on supporting margins by reducing debt to strengthen the balance sheet, improving cost efficiencies and maintaining sustainable sales volumes.

[1] *Statistics South Africa, Gross Domestic Product, Q4 2017.*

The mixed concrete competitive arena saw marginal price increases per cubic meter for Métier. Pricing was significantly below cost inflation with Gauteng remaining the most contested regional market.

Sephaku Cement's performance improved significantly as a result of:

- its management's excellent competence and deal making abilities;
- a more stable cement industry which allowed it to effectively increase prices in all of its markets; and
- persistent technical plant challenges for a competitor.

WHAT MATERIAL MATTERS IMPACTED THE GROUP'S VALUE CREATION?

The material matters are detailed on pages 16 to 21, and the top four are summarised below.

Loan covenant pressure	Sephaku Cement's reduced margins pressured its ability to meet its project loan debt covenants. The board prioritised the matter, and we are pleased to report that the debt was reshaped in September 2017. We no longer consider the management of this debt as material going forward.
Price competition	Métier's prices increased marginally amid intense competition in the mixed concrete industry, which inadvertently lowered margins. SepHold and the subsidiary are implementing several interventions to alleviate the continued pressure on the operations.
Managing local communities' expectations	Since Sephaku Cement's inception, it has been challenging to engage with the communities surrounding its plants. At Aganang, there were isolated disruptions to operational activities during the year. The lack of substantive community leadership structures hampered the quality of our engagements. To address the issue, Sephaku Cement developed a memorandum of understanding with local government representatives and communities to establish the terms of engagement.
Industry-concentrated investment portfolio	Cement and concrete are cyclical – the group is exposed and directly impacted by macroeconomic performance. Although bagged cement has persevered despite declining demand, it is essential for the group to improve the composition of assets to minimise the volatility of earnings. The group is pursuing the investment into aggregates that are less cyclical to diversify the concentration while simultaneously securing raw materials for Métier.

WHAT FACTORS HAVE ENABLED THE GROUP TO REMAIN COMPETITIVE?

Our management teams' competence and deep industry knowledge steer the group through the competitive landscape. Operational management's understanding of the trading environment was instrumental in maintaining market share. Sephaku Cement has established itself as a major producer in the country with solid relationships in the retail distribution network. Both Métier and Sephaku Cement have distinguished their offering to customers through consistent quality, timely deliveries and after-sales service.

HOW IS THE GROUP LIVING UP TO ITS RESPONSIBILITY AS A CORPORATE CITIZEN?

We have been responsive to our stakeholders to give their legitimate matters adequate attention. The group holds combined board social and ethics committee meetings for Métier and Sephaku Cement. The group responds to key issues timeously thanks to SepHold's and operational executive management's participation. We have a third party-managed whistle-blowing number for stakeholders to communicate matters freely. Furthermore, we are proud of the Sephaku Cement EDP that has developed local entrepreneurs, thereby contributing to the provincial GDP.

We have added sustainability to our value creation pillars, and we will emphasise responsible manufacturing and environmental stewardship in the new financial year. To this end, Sephaku Cement has set targets to reduce its coal consumption. Refer to page 59.

JOINT CHAIRMAN'S AND CEO'S REPORT (continued)

WHAT IS THE OUTLOOK FOR THE GROUP IN THE 2019 FINANCIAL YEAR AND BEYOND?

We will strengthen our strategic action plans to improve returns on shareholders' investment. Our operational companies are formidable competitors in the building and construction materials industry. We will ensure that they sustain their competitiveness to achieve superior returns.

We will implement the recommendations from our King IV gap analysis to propagate governance best practice in all group entities.

The economy is likely to remain under pressure for the next 12 to 18 months as the pro-business monetary and fiscal policies are implemented. The anticipated improvement in business confidence and investment should grow demand and improve earnings.

APPRECIATION

We extend our gratitude to all the employees and management teams who have remained committed to the group in an extremely challenging time. The board's and the executive committee's supervision and resourcefulness steered the group forward. They showed unwavering commitment to the group's strategic objectives. We appreciate the contribution of Ms. B Maluleke who resigned from the board on 30 October 2017 to fulfil her executive responsibilities at African Bank. Although Ms. Maluleke's tenure was short, her contribution was invaluable.

Finally, we acknowledge the ongoing support, loyalty and investment of our other stakeholders: our customers, shareholders, suppliers and contractors, the government bodies, and communities in which we operate. The group is dedicated to creating mutual value and to continue delivering on your material expectations.

Brent Williams
Chairman

Dr Lelau Mohuba
Chief executive officer