AllanGray

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Dear Client

ALLAN GRAY STEWARDSHIP REPORT – CALENDAR YEAR 2016

We aim to earn superior long-term returns for your portfolios through investment decisions that are founded on diligent research and a disciplined process. Although this is the most important aspect of the service we provide to you, it is not the only one. We recognise that many of our clients feel far removed from their underlying investments and that they look to us to help them act as responsible owners. We do so gladly – it is part of the service we provide, and we believe that it can improve investment returns. In this Stewardship Report we aim to inform you of our actions as stewards of your hard-earned savings over the past calendar year.

KING IV AND THE IMPORTANCE OF GOVERNANCE

We integrate Environmental, Social, Governance (ESG) and sustainability issues into all stages of our investment process. However, governance is the primary mechanism through which we can exert pressure on executives to act in the long-term best interests of shareholders, and to refrain from making unwise long-term sacrifices for unsustainable short-term gains. We believe that governance is at the heart of sustainability and a company is unlikely to generate free cash flow over the long term unless it manages its environmental and social risks, and its relationships with its stakeholders, in a sustainable manner. In addition, a company that succeeds in creating value for shareholders is also more likely to create value for other stakeholders, such as its employees and the communities in which it operates. As long-term investors we think very carefully about the sustainability of the business models of companies before investing in them and work hard to improve the governance of companies once we are invested.

The governance landscape underwent a major change in 2016 with the launch of the King IV Report on Corporate Governance in South Africa (King IV), which is set to be incorporated into the JSE Listings Requirements. We submitted detailed comments on both King IV and its incorporation into the JSE Listings Requirements and some of our suggestions made their way into the final regulations. We expect the implementation of King IV to be broadly positive for shareholders. We consider King IV to be a significant improvement over King III as it emphasises governance as a substantive tool for adding value to a company, rather than an exercise in box ticking that often distracts the board from its job of actually running the business. King IV also emphasises the need for a board to have the necessary skills and experience to be able to effectively lead the company, whereas King III appeared to value the independence of non-executives as an aim in and of itself. While it is appropriate for boards to have some independent directors, we usually prefer non-executive directors to be skilled and experienced professionals who own shares in the companies they lead as this aligns their interests with shareholders.

Another improvement in King IV is that it enhances the disclosure that companies are required to make of the remuneration paid to executives and how the quantum of this remuneration is determined. King IV also prescribes a mandatory annual shareholder vote on the company's executive remuneration policy and a separate vote on the implementation of this policy during the past year. While we are disappointed that King IV does not afford shareholders a binding vote on the remuneration policy, these developments are nevertheless beneficial to shareholders as executive remuneration is an important mechanism through which we can hold executives to account. This is particularly important given the principal-agent problem that arises as the executives, who manage a company on behalf of its shareholders, may have incentives that are materially misaligned with shareholders' interests. We think the simplest way to align these interests is for executives to own shares in the companies they manage: this incentivises them to think like owners and focus on the long term. We encourage this practice for companies in which we invest.

A sceptic may ask whether our work on the governance and executive remuneration of companies makes any practical difference to the fortunes of shareholders. We believe that it can directly impact the value of a company. Below we provide three examples to illustrate how we use engagements and proxy voting to act as responsible stewards of our clients' savings. These examples also showcase our approach to governance, which is thoroughly integrated into our investment process and comprises of rigorous fundamental analysis and a dose of common sense. We believe this approach is more effective at creating value for shareholders than outsourcing this responsibility to a compliance department and making proxy voting recommendations that are mechanically based on arbitrary technical rules (i.e. box ticking).

Directors: M Cooper BBusSc FIA FASSA, R W Dower BSc (Eng) MBA, W B Gray BCom MBA CFA (Irish)*, A R Lapping BSc (Eng) BCom CFA, I S Liddle BBusSc (Hons) CFA*+, T J Mahuma BA (Hons) MPhil*, T Mhlambiso AB MBA JD, K C Morolo BSc (Eng) MEng*, N M Nene BCom (Hons)*, *Non-Executive* + *Chairman* **Company Secretary:** C E Solomon BBusSc (Hons) CA (SA) **Allan Gray Proprietary Limited:** Registration Number 2005/002576/07
1 Silo Square V&A Waterfront Cape Town 8001, P O Box 51318 V&A Waterfront Cape Town 8002 South Africa Tel +27 (0)21 415 2300, Fax +27 (0)21 415 2400 Email info@allangray.co.za www.allangray.co.za
Allan Gray Proprietary Limited is an authorised financial services provider.

OLD MUTUAL

Old Mutual (OML) is at a pivotal moment in its history. In Quarterly Commentary 2, 2016 we set out the investment case for why the group's restructuring, through a managed separation, could unlock significant value for shareholders by eliminating the discount to the combined value of its underlying businesses at which the OML share price is currently trading. However, the managed separation is a complicated affair and the way OML's executives are being incentivised presents an additional challenge: they would effectively be working themselves out of a job if they succeed in restructuring the group. Furthermore, until the restructuring is completed they also have to keep up the performance of the underlying businesses, many of which operate in very competitive markets. OML's remuneration committee therefore had the very difficult task of coming up with an incentive package for OML's executives that overcomes these complexities to align the long-term interests of executives with those of shareholders.

We have often seen restructurings of this kind result in poor outcomes, where executives receive handsome bonuses simply for disposing of assets, while shareholders suffer when it subsequently emerges that the assets were sold too cheaply or that the underlying businesses have deteriorated while executives were focused on the restructuring. It is usually difficult to tell immediately after a restructuring whether or not executives have actually done good job. It is therefore essential that the remuneration committee has a very clear, pre-determined and objectively measurable idea of what a good or bad execution would look like. We engaged extensively with OML's remuneration committee on these issues. This included a formal letter to OML's board setting out our recommendations for how executives' incentives should be structured.

The outcome of this process was the managed separation incentive plan (MSIP) awarded to OML's executives. The MSIP attracted a lot of negative press coverage, but we believe that it will effectively incentivise executives to act in shareholders' long-term best interests. The MSIP awards are performance shares, meaning that they are tied in value to the OML share price and only vest to executives if pre-determined performance targets are met based on a sensible blend of performance factors. Forty percent of the MSIP vests based on the execution of the managed separation. Although this will necessarily entail some discretion and subjectivity, the remuneration committee has committed to making the process and performance measurement as objective and transparent as possible and getting input from shareholders before making its final assessment on the quality of the execution. Twenty-five percent of the MSIP vests based on the sustained financial performance of the underlying businesses and the unlisted business carry a greater weighting, meaning that executives will be incentivised to keep their eye on the ball in this regard. The remaining 35% vests based on OML's total shareholder return (TSR) versus a group of appropriate peer companies, with no incentive pay-outs for performance below the median of this peer group and the maximum vesting only if OML's TSR significantly exceeds the median of the peer group. Executives will therefore only receive material bonuses if they truly do an excellent job for shareholders.

The MSIP has three additional safeguards in place that we believe are beneficial to shareholders. Firstly, 50% of the MSIP will be subject to a holding period of one year after completion of the managed separation and during this period executives will not be able to cash out their incentives that are tied in value to the OML share price. If issues emerge subsequent to the restructuring, executives' remuneration pay-outs would be significantly reduced. However, we would have preferred all of the MSIP awards be subject to a holding period and for the holding period to be even longer. Secondly, executives will receive neither accelerated nor automatic vesting on their legacy long-term incentives (LTIs) when the restructuring is complete. This is contrary to what tends to happen with many other restructurings: executives often receive full and accelerated vesting on their legacy LTIs. By retaining the original vesting schedule and performance conditions for the legacy LTIs, executives are incentivised to make sure that the underlying businesses are in a sustainable position after the restructuring. Lastly, the remuneration committee has asymmetric discretion: it can make downward but not upward adjustments to the level of pay-outs based on its assessment of the risks executives took to deliver on the managed separation.

While at this stage we cannot know for certain whether the managed separation will be a success, we do know that OML's executives are strongly incentivised to do the right thing for shareholders as they will only be rewarded if the managed separation results in the material creation of value for shareholders over the long term.

CLOVER

Our clients have a 19% interest in Clover, a household name in South Africa known for its dairy products. The investment case for Clover is based on the company shifting its business strategy away from lower margin commoditised dairy products towards higher margin fast-moving consumer goods (FMCGs) like yoghurt, custard and fruit juices. However, there were weaknesses in Clover's executive remuneration policy that were an impediment to this change in strategy. Historically the quantum of total remuneration paid to executives was high considering Clover's size and performance. Seventy-five percent of executives' LTIs were based on Clover's headline earnings per share (HEPS) growth versus easy targets: executives received the maximum vesting on their LTIs for HEPS growth equal to CPI + 2% per annum, an outcome which would have been very disappointing for shareholders and executives would have been able to hit this target without delivering on the change in strategy to higher margin FMCGs. Using HEPS growth as the primary performance metric was also problematic in that it incentivised growth, but did not give sufficient regard to capital allocation – something which is very important to shareholders considering that Clover reinvests 65% of its earnings back into the business. Due to these weaknesses we recommended that our clients vote against the

remuneration policy in 2013, 2014 and 2015. During this period we had several robust engagements with Clover's remuneration committee and also wrote a letter detailing our suggestions for how the executive remuneration policy could be improved.

In 2016, our efforts finally started bearing fruit as the remuneration committee made several important improvements to the remuneration policy. Thirty-five percent of executives' LTIs are now tied to increasing Clover's return on equity (ROE) and executives will only be able to reach these targets (and be rewarded accordingly) if they successfully deliver on the change in strategy to higher margin FMCGs. The ROE performance targets also ratchet up each year, meaning that sustained and continuous improvement will be necessary for executives to receive high LTI pay-outs. Thirty-five percent of the LTIs are still based on HEPS growth, but the performance targets have been made significantly more stretching, with executives only receiving full vesting for growing HEPS at CPI + 8% per annum over a long time period, an outcome which should be pleasing to shareholders if attained. Executives also received a 0% increase on their base pay. These improvements went a long way towards addressing the concerns that we had raised with the executive remuneration policy. Clover's remuneration policy is now much better aligned with both its business strategy and the interests of its shareholders, and we therefore recommended that our clients vote in favour of the policy at the 2016 AGM. Other shareholders seemed to agree: only 58% of shareholders supported the remuneration policy at the 2015 AGM (a very low percentage for this type of resolution). This increased to 99.9% of shareholders at the 2016 AGM after the remuneration committee made the necessary improvements.

GOLD FIELDS

The shares of the gold mining companies listed on the JSE have delivered disappointing investment returns over the last few years, with most underperforming the FTSE/JSE All Share Index (ALSI) and the rand price of gold by a sizeable margin. Some of the underperformance is attributable to circumstances largely outside of these companies' control: a deteriorating and ageing asset base resulting in higher costs of mining, policy uncertainty, electricity price increases ahead of inflation and an inflexible labour regime combined with increasingly confrontational labour relations and declining labour productivity. However, many of the gold mining companies are also guilty of scoring own goals by investing in marginal projects, instead of retaining cash to tide them over during lean years or returning the cash to shareholders as dividends. We believe that many of these self-inflicted problems are attributable to executive remuneration policies that have little regard for aligning executives' incentives with shareholders' long-term interests.

Our clients have a substantial position in Gold Fields and most of the company's intrinsic value is tied to delivery on its South Deep mine, in which it has invested R36 billion to date (approximately the company's current market capitalisation). However, Gold Fields' executive remuneration policy was problematic and posed a significant risk to the investment case. A large portion of executives' remuneration was delivered through uncapped cash-settled LTIs that vested after three years. This provided very weak alignment with shareholders and was one of the reasons why executives hardly owned shares in the company. In addition, the performance factors for the LTIs were heavily geared towards the gold price, something over which Gold Fields' executives essentially has no control, and very limited exposure to the aspects of performance that was within the control of executives. Due to these weaknesses executives received a high level of vesting on their performance pay, resulting in total remuneration being paid to executives that was high relative to similarly sized gold mining and JSE-listed companies. This occurred despite Gold Fields failing to deliver on South Deep and often underperforming its peers in a struggling industry.

As a result of these concerns we recommended that our clients vote their shares against the Gold Fields executive remuneration policy at the 2013 and 2014 AGMs. After our initial engagements with Gold Fields about the remuneration policy failed to yield results, we began to take a more forceful approach: at the 2015 AGM we recommended that our clients vote against the remuneration policy and also against the re-election of directors serving on the remuneration committee, including the chair of the remuneration committee and chair of the board. We also sent a formal letter to the board detailing our suggestions for how the policy's alignment with shareholders could be improved.

This had the desired impact as the remuneration committee subsequently made incisive and material improvements to the remuneration policy. The LTIs are now delivered through equity-settled performance shares – these instruments are tied in value to the Gold Fields share price and make it the default outcome that executives build a shareholding in the company over time without having to take any active steps to acquire shares. This may seem like a minor point, but several studies have proven that executives who receive equity-settled LTIs tend to have much higher levels of share ownership. Formal shareholding requirements have also been put in place, meaning that executives will now be required to build material shareholdings in Gold Fields, aligning their interests with shareholders.

The remuneration committee made further improvements to the scheme by increasing the weighting of delivery on South Deep in determining executives' short-term incentives and by introducing TSR versus peers as the performance factor for 33% of the LTIs. We think TSR versus peers is a very sensible performance factor for gold mining companies, as it focuses executives on prudent capital allocation over the long term. Seeing that the peer group is impacted by the same industry pressures as Gold Fields, it also better rewards executives for performance which is under their control: executives are rewarded if Gold Fields outperforms its peers when the industry is struggling, but will receive little remuneration for underperforming peers during a cyclical upswing or when the price of gold spikes. Some areas remain where we think the remuneration policy can be further improved, such as using a five-year performance period for the LTIs and further increasing the weighting of TSR versus peers as a performance factor. Nevertheless, these improvements to the executive remuneration policy have strengthened the investment case for Gold Fields.

We have also worked with Gold Fields to improve the strength of its board. A number of non-executives were close to retirement age and there was also a shortage of technical mining and financial expertise on the board. This is particularly important for a mining company's board given the technical nature of its operations and the large capital allocation decisions they have to undertake. The decision on whether to invest in and develop a new mine is fraught with uncertainty and has the potential to either create or destroy billions of rands in shareholder value, so it is crucial that the board makes high-quality decisions. Over the last 12 months Gold Fields has appointed five new non-executives directors with extensive experience and technical expertise in mining and corporate finance in the countries in which Gold Fields operates. This should enable the board to do a better job of critically analysing capital allocation decisions and assessing how executives have performed for shareholders. Although there are risks to the investment case and it remains to be seen whether Gold Fields will deliver on South Deep, we believe the company is in a much better position now that its board has been strengthened and its executives incentivised to act in the long-term interests of shareholders.

COMPANY ENGAGEMENTS

During 2016, our analysts and portfolio managers formally engaged with company representatives on 565 occasions. These engagements typically took the form of meetings with executives and non-executives, site visits to companies' operations, formal written correspondence and other forms of engagement such as conferences, road shows and analyst days. During these engagements ESG and sustainability issues were specifically discussed on 205 occasions. The table below provides a quantitative summary of our engagements during the 12 months to 31 December 2016:

		OCCASSIONS WHEN ESG ISSUES WERE DISCUSSED		
Type of engagement	**Total number of engagements**	**Environmental**	**Social**	**Governance**
Meetings	292	16	40	89
Written correspondence	27	0	2	22
Site visits	26	6	5	2
Other forms of engagement	188	3	7	11
Total	**525**	**25**	**54**	**124**

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 2016, we made voting recommendations on 1 689 resolutions tabled at shareholder meetings of South African listed companies:

QUARTER	NUMBER OF MEETINGS	RESOLUTIONS 'FOR'	RESOLUTIONS 'AGAINST'	RESOLUTIONS 'ABSTAINED'	TOTAL RESOLUTIONS
Q1 2016	16	183	10	3	196
Q2 2016	27	417	37	6	460
Q3 2016	35	366	62	10	438
Q4 2016	47	544	45	6	595
Total	**125**	**1 510**	**154**	**25**	**1 689**

As alluded to above, one of the most topical matters on which we make voting recommendations relates to the annual non-binding resolution on a company's executive remuneration scheme. 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. While these resolutions are non-binding and lack legal enforceability (an issue which we have raised with the JSE), they nevertheless represent an important way for shareholders to keep executives in check. The table below sets out our voting recommendations on resolutions relating to executive remuneration schemes over the past year.

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QUARTER	'FOR'	'AGAINST'	'ABSTAIN'
Q1 2016	Aquarius Platinum	Quantum Foods	Life Healthcare
	Nampak		Transaction Capital
	Sappi		Spar
	Reunert		
	Redefine International		
	Netcare		
	Astral Foods		
	Namibian Asset Management		
Q2 2016	Royal Bafokeng Platinum	Anglo American	Bell Equipment
	Tullow Oil	Barclays Africa Group	OCI N.V.
	Capital & Counties Properties	Standard Bank	Basil Read
	Mondi	Merafe Resources	
	Randgold & Exploration	Sibanye Gold	
	Liberty Holdings		
	AECI		
	Mpact		
	Old Mutual		
	British American Tobacco		
	Nedbank		
	Mondi		
	Gold Fields		
	Glencore		
	Capitec		
	SEPLAT		
	Sanlam		
Q3 2016	SABMiller	Alexander Forbes	Pick n Pay Holdings
	Investec	Wilderness	Trencor
	Vukile	Novus	Tongaat Hulett
	Raubex Group	Naspers	Adcorp
	Peregrine	Datatec	
	Equites Property Fund		
	Holdsport		
	Investec		
	Mr Price Group		
	Stefanutti Stocks Holdings		

QUARTER	'FOR'	'AGAINST'	'ABSTAIN'
Q4 2016	Tsogo Sun	Shoprite	Impala Platinum
	Aveng	Putprop	Murray & Roberts
	Group Five	Sun International	Capricorn Investment Group
	Northam Platinum	Eqstra Holdings	Tower Property Fund
	Sentula Mining	Spur Corporation	
	Super Group	Lewis Group	
	OneLogix Group	Hosken Consolidated Investments	
	South32	U.E.P.S.	
	Pan African Resources	MMI	
	Clover	RMI	
	KAP		
	African Rainbow Minerals		
	Blue Label Telecoms		
	BHP Billiton		
	FNB Namibia		
	PPC		
	Comair		
	Wilson Bayly Holmes-Ovcon		
	Bidvest Namibia		
	RMH		
	Harmony		
	Sasol		
	FirstRand		
	Woolworths		
	Caxton		

CONCLUSION

We monitor ESG and sustainability issues throughout all phases of our investment process and on an ongoing basis once we are shareholders on behalf of our clients. 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.

We hope that you have found this report interesting and informative. We welcome your feedback and suggestions for improving next year's edition.

Yours sincerely

Andrew Lapping

Pieter Koornhof