ALLANGRAY

26 February 2016

Dear Client

ALLAN GRAY STEWARDSHIP REPORT – CALENDAR YEAR 2015

We aim to make wise investment decisions, founded on diligent research and a disciplined process, in order to earn superior long-term returns for your portfolios. 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 inaugural Stewardship Report we aim to inform you of our actions as stewards of your hard-earned savings. While the format of this report may be new, our efforts to act as responsible managers of your capital date back to our founding in 1973. We prefer to engage company directors privately, as our experience suggests that this approach has a good chance of success. Only rarely will our disagreements with company directors reach the media. This has understandably made it difficult for you to assess our stewardship activities in the past. Hopefully this new report, which we intend to update annually, sets that right.

Our approach to stewardship is not motivated by a 'tick-box' mentality. We integrate Environmental, Social, Governance (ESG) and sustainability issues into all stages of our investment process, and all members of our investment team are responsible for properly considering ESG and sustainability factors. We do not outsource this responsibility to either an internal or external bureaucrat, as we believe that it is an integral component of our investment process.

COMPANY ENGAGEMENTS

During 2015, our analysts and portfolio managers formally engaged with company representatives on 464 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 208 occasions. The table below provides a quantitative summary of our engagements during the 12 months to 31 December 2015.

		OCCASIONS WHEN ESG ISSUES WERE DISCUSSED		
TYPE OF ENGAGEMENT	**TOTAL NUMBER OF ENGAGEMENTS**	**ENVIRONMENTAL**	**SOCIAL**	**GOVERNANCE**
Meetings with executives	250	18	45	46
Meetings with non-executives	41	0	1	41
Written correspondence	15	0	0	15
Site visits	26	4	5	5
Other forms of engagement	132	4	9	15
Total	**464**	**26**	**60**	**122**

It is clear from the table above that governance issues were raised at many meetings (either by us or by the company concerned). Governance is the primary mechanism through which we can put pressure on executives to act in the long-term best interests of their 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. The board has ultimate responsibility for overseeing a company's activities and this includes addressing the environmental and social issues that the company may face. Accordingly, we focus on helping companies to improve their governance structures and practices. A company without a strong board of directors and a proper governance framework is unlikely to make sustainable progress on environmental and social issues.

To provide insight into how our engagements on ESG and sustainability work in practice and how they are incorporated into our investment process, below are five examples of stewardship activities that we undertook in 2015.

Governance

Executive remuneration at Sasol

We acquired a significant position in Sasol for our clients over the course of 2010 and 2011. While we considered Sasol to be an attractive investment opportunity at the time (and still do today), we thought that Sasol's executive remuneration scheme was very poor and accordingly recommended that our clients vote their shares against the scheme at the 2011 annual general meeting. We had a number of concerns with the scheme at the time: the disclosure was minimal, many of the performance targets were low, the majority of the long-term incentives (LTIs) were not subject to performance conditions and simply vested over time, executives did not own shares in the company and most of the LTIs were delivered through share appreciation rights. These instruments do not provide suitable alignment with shareholders as they result in executives not sharing in downside risks if performance is disappointing and, as they are delivered in cash, it is the default outcome that executives do not own shares in the company. This lack of alignment with shareholders was especially concerning in light of the large capital projects that the company was undertaking.

We subsequently started working with Sasol's Remuneration Committee (Remco) to improve the scheme. This included detailed analysis and benchmarking of the remuneration scheme, meeting with the Remco in person on a number of occasions and further formal correspondence through letters to Sasol's board. While the scheme was still short of best practice, we recommended to our clients that they vote their shares in favour of Sasol's remuneration scheme in 2012, 2013 and 2014. We did so to recognise the progress that was being made and to give the Remco a clear mandate to make further improvements to the scheme. Though it took some time for our efforts to bear fruit, the scheme has transformed dramatically over the last four years and is now close to being best in class: disclosure has been enhanced; performance targets required for incentives to vest have been made more challenging; all the LTIs are subject to stringent performance conditions and executives are formally required to build substantial shareholdings in the company. These changes go a long way towards ensuring that executives act in the long-term best interests of shareholders.

Despite the progress, we believe there is still some room left for improvement and we continue to engage with Sasol's Remco on a regular basis to ensure that the scheme keeps evolving to the benefit of shareholders. In particular, even higher shareholding requirements for executives and the use of equity-settled incentives would further improve alignment with shareholders. We also consider changes to the macro environment, such as the collapse of oil prices over the last 15 months, when thinking about the appropriateness of the performance factors and targets that are used to incentivise executives.

Africa: Governance at Econet Wireless

Zimbabwean telecommunications group Econet is one of the biggest positions in our Africa funds. While we think that the share is an attractive investment, we do harbour material concerns over the company's corporate governance and believe that resolution of these issues would unlock significant value for shareholders. Our concerns relate to two interconnected issues: Econet has undertaken a number of related party transactions that do not appear to be at arm's length and its board does not have a sufficient number of independent non-executive directors. Its founder, Mr S Masiyiwa, still controls a significant shareholding and he remains an influential executive. We believe that it is of paramount importance that the board is appropriately structured to ensure that related party transactions do not prejudice minority investors.

We voiced these concerns in a formal letter to the board and subsequently met with Econet's chairman. During the meeting we discussed the strength and independence of board members, the efficacy of the respective governance and board structures, and the extent of oversight with regards to related party transactions. While an ongoing dialogue with the board is a good start, Econet is still a work-in-progress.

Executive remuneration at Aveng

South African construction companies have had a torrid few years and investors in these companies even more so. While external economic forces and the cyclical nature of the industry have undoubtedly contributed to these woes, some of the problems arose due to executive remuneration schemes that incentivised executives to grow the businesses they manage without much regard for prudent capital allocation and shareholders' interests. In this vein, we had concerns about Aveng's executive remuneration scheme as we believed that executives were not being incentivised to create value for shareholders over the long term: executives hardly owned any shares in the company and their long-term incentives were delivered through share appreciation rights, instruments whose short-comings are discussed above. The disclosure of performance targets was also limited, making it difficult to assess whether the performance targets set for executives' annual bonuses were sufficiently demanding. This resulted in a remuneration scheme that was not aligned with shareholders.

In order to address these concerns, we met in person with the respective chairpersons of Aveng's Remco and board. During the engagement we set out our thoughts on how the scheme could be improved and pointed out the risks of benchmarking the remuneration scheme to those of other construction companies, as most of those schemes are poorly aligned with shareholders. After our engagement a number of improvements were made to the scheme: a portion of annual bonuses are now deferred in Aveng shares over three years, executives are formally required to build a meaningful shareholding in the business and the share appreciation rights have been replaced by performance shares – these are equity-settled shares that only vest if certain performance conditions are met. Changes were also made to the incentives at a project level to improve alignment with shareholders.

We recognised these positive developments in a formal letter to Aveng's board, but also highlighted areas where there remains room for improvement, specifically with regards to higher shareholding requirements for executives and more demanding performance targets. Aveng is still trading below our assessment of its intrinsic value, although these improvements to the executive remuneration scheme may over time contribute to the company's successful turnaround. We believe that it may also be a competitive advantage for a construction company like Aveng to have an executive remuneration scheme that is geared to capital allocation and long-term value creation for shareholders.

Social

Sustainable labour relations at The Foschini Group

South African manufacturing has been in structural decline over the past 25 years. Despite facing infrastructure bottlenecks, an inflexible labour regime, rapid increases in electricity prices and several additional challenges, a number of firms still manage to manufacture goods in South Africa on a competitive basis. Foschini is one of them. We visited Foschini's apparel design centre in Parow and manufacturing facility in Maitland to gain a better understanding of how the company is able to do so. The apparel manufacturing facility is a significant employer in the local community. The social benefit of this growing source of employment is striking, as it is occurring in an industry that has suffered massive job losses over the past decade as local clothing retailers accelerated sourcing in lower-cost clothing and textile markets. Engagement with the facility's management and personnel confirmed awareness of social responsibility and a commitment to providing a mutually beneficial, safe and rewarding work environment. Management reported that instances of organised labour unrest or strike action are uncommon. Competitive wages, a respectful work environment and attempts made at improving the lives of workers (by providing employees with interest-free loans to purchase needed household furniture and appliances, for example) are seen as contributing factors to goodwill. We believe that sustainable labour practices can be a competitive advantage and contribute to Foschini's investment case.

Environment

Emissions and environmental sustainability at Sasol

Sasol, one of the largest holdings across our funds, is an important contributor to the social and economic priorities of South Africa. It does so through job creation, investment in infrastructure, supporting enterprise development, paying taxes and investing in skills development. Despite these positives, being in a carbon intensive industry, it also has a material impact on South Africa's environment and has come under increasing pressure from environmental regulations that pose a threat to the company's future if it does not reduce this impact.

One of these regulations is the Air Quality Act, which sets certain Minimum Emissions Standards (MES) for companies that operate in South Africa, including Sasol. When a revised set of MES was promulgated in 2013, Sasol had at that time already made significant progress in reducing atmospheric emissions from its various facilities and complied with many of the principles outlined in the MES. Despite this, some of its facilities would not have been able to comply within the allotted timeframe, whilst parts of its Secunda facility may never be able to achieve compliance for technological reasons. In order to achieve full compliance for Secunda, Sasol estimates that it would have to spend billions of rands and close the facility for an extended period of time, making it economically unfeasible. If Sasol is forced to close its Secunda facility permanently due to non-compliance with the MES, the impact on the South African economy would be severe: Sasol is one of the largest corporate tax payers in South Africa and the Secunda facility accounts for the majority of Sasol's profits in the country. Sasol also directly employs 26 374 people in South Africa and, despite the diversified nature of its operations, invested R53 billion in its South African operations during 2014 and 2015.

Sasol engaged with the Department of Environmental Affairs to resolve this issue by requesting a postponement for compliance with the MES for those facilities that will be unable to comply in the prescribed timeframe and an exemption for parts of its Secunda facility on the understanding that any future expansion or replacement would have to be compliant. Sasol also launched a legal objection as a matter of last resort, seeking to prevent the possible current or future closure of the facility. The Minister of Environmental Affairs subsequently announced rolling postponements to some of the areas where Sasol could not comply with the MES. However, postponement does not entirely resolve the issue for Sasol, since the postponement for compliance may be revoked on short notice. Should Sasol fail to secure a subsequent postponement, the company may need to close the facility down in its entirety, given the integrated nature of its operations.

Over the course of the dispute, we engaged with Sasol's board on a number of occasions to discuss how they were dealing with the issue. We also consulted with an external environmental rights group to gain a different perspective on the Air Quality Act and MES. While this matter does give rise to uncertainty regarding the future performance of the company, we have continuously incorporated these concerns into our fundamental research and adjusted our assessment of Sasol's intrinsic value accordingly. We believe that Sasol currently trades at a discount to our assessment of intrinsic value and provides a sufficient margin of safety to compensate for the associated downside risks.

PROXY VOTING

Why do company directors listen to us when we engage with them? Hopefully it is because we have good ideas to contribute, and we make our points in a constructive manner. But it is also because they know that we advise you on how to vote your shares at company general meetings. These votes are important, and they include votes on the appointment and re-election of directors.

Before general meetings we write a letter to you or your appointed representative with recommendations on how we think your shares should be voted. To facilitate the administrative process, we instruct your custodian to issue proxy votes for your shares as per our recommendation. You are welcome to disagree with our recommendation. Some clients occasionally do, and if their shares are held directly in a segregated mandate they then simply instruct their custodian to vote their shares as they see fit. If your shares are held indirectly via a pooled investment vehicle, our voting recommendations are made to the independent trustee for unit trust holdings and the board for life company pooled portfolio holdings. 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 hold a significant percent of the company.

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 2015, we made voting recommendations on 1 476 resolutions tabled at shareholder meetings of South African listed companies:

QUARTER	NUMBER OF MEETINGS	RESOLUTIONS 'FOR'	RESOLUTIONS 'AGAINST'	RESOLUTIONS 'ABSTAINED'	TOTAL RESOLUTIONS
Q4 2015	41	518	31	8	557
Q3 2015	24	292	20	6	318
Q2 2015	31	363	30	4	397
Q1 2015	14	197	5	2	204
Total	**110**	**1 370**	**86**	**20**	**1 476**

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 particularly 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.

QUARTER	'FOR'	'AGAINST'	'ABSTAIN'
Q4 2015	Tsogo Sun Holdings	Peregrine	Impala Platinum
	Aveng	Sentula Mining	Net1 UEPS Technologies
	Group Five	Hosken Consolidated Investments	Tower Property Fund
	Fortress Income Fund – A	Eqstra Holdings	
	Northam Platinum	Clover Industries	
	KAP Industrial Holdings	Shoprite Holdings	
	Rand Merchant Investment Holdings	FNB Namibia Holdings	
	Sun International	Growthpoint Properties	
	Blue Label Telecoms	Assore	
	Comair	Spur Corporation	
	Sasol		
	Caxton CTP Publishers & Printers		
	Raubex Group		
	BHP Billiton		
	Bank Windhoek Holdings		
	Putprop		
	Murray & Roberts Holdings		
	Wilson Bayly Holmes-Ovcon		
	MMI Holdings		
	Harmony Gold Mining Company		
	Super Group		
	Pan African Resources		
	African Rainbow Minerals		
	Aspen Pharmacare Holdings		

Continues...

QUARTER	'FOR'	'AGAINST'	'ABSTAIN'
Q3 2015	Illovo Sugar	Naspers	Equites Property Fund
	Tongaat Hulett		Alexander Forbes Group Holdings
	Investec		Pick n Pay Holdings
	Holdsport		
	Adcorp Holdings		
	SABMiller		
	Novus Holdings		
	Vukile Property - Namibia		
	Datatec		
Q2 2015	British American Tobacco	Gold Fields	Basil Read Holdings
	Metair Investments	Sibanye Gold	Trencor
	Mondi	Grindrod	
	Old Mutual	Merafe Resources	
	Standard Bank Group	Barclays Africa Group	
	Mpact		
	Capital & Counties Properties		
	Sabvest		
	Liberty Holdings		
	AECI		
	G4S (Botswana)		
Q1 2015	Redefine International		The Spar Group
	Netcare		Business Connexion Group
	Astral Foods		
	Quantum Foods Holdings		
	Nampak		
	Sappi		
	Reunert		
	Transaction Capital		

CONCLUSION

Recent events, such as the emissions scandal at Volkswagen and MTN's record fine in Nigeria, have again highlighted the massive impact that ESG and sustainability issues can have on shareholder value if they are not actively managed and addressed in a robust manner. We monitor ESG and sustainability issues throughout all phases of our investment process. 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 responsible investing.

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

Yours sincerely

Ian Liddle & Pieter Koornhof