ALLANGRAY

ALLAN GRAY STEWARDSHIP REPORT – CALENDAR YEAR 2018

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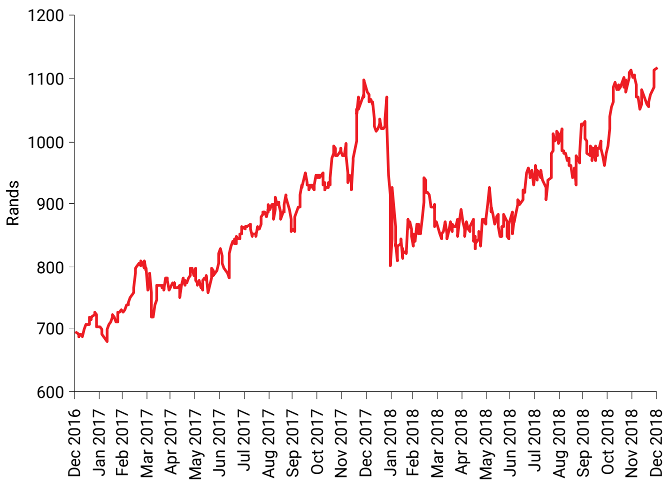
We aim to earn superior long-term returns through investment decisions that are founded on diligent fundamental research and a disciplined investment process. A key part of this is incorporating environmental, social and governance ('ESG') considerations into all stages of our investment process. We 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 the 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.

For more information on our approach to incorporating ESG considerations into our investment research, please see our 'Policy on the incorporation of sustainability considerations' and our 'Policy on ownership responsibilities', available on our website. We are also a signatory of the United Nations endorsed Principles for Responsible Investing.

Viceroy and Capitec

On 30 January 2018 Viceroy Research, a US-based short-seller[1], released a report on Capitec Bank accusing the company of dubious accounting and various unethical and unsustainable business practices, such as reckless lending. Viceroy had a lot of credibility at the time as it had released an influential report on Steinhoff in December 2017, just as that company had announced its chief executive officer's resignation and possible accounting irregularities. As a result, Capitec's share price plunged by over 20% in the days following the report's release, as shown in **Graph 1.**

Graph 1: Capitec share price



Source: IRESS

Before the Viceroy report was released we had done thorough research and analysis on Capitec as a regular part of our investment process, including detailed analysis of Capitec's accounting policies and business practices. We had also performed additional ESG research due to the high ESG risks associated with micro-lending, from which Capitec makes a substantial portion of its profits. This included engaging with various third parties such as Debt Busters and Summit Financial Partners, two organisations that help low-income consumers with debt problems and know the South African micro-lending market very well. We had also looked in detail at the various reckless lending court cases that Capitec had been involved in over the years.

Thorough analysis pays off

Even with thorough research and analysis, it is never possible to know with 100% certainty that everything is above board at a company. However, what is important from an investment perspective is whether there is wrong-doing that is pervasive or material. Because we had already done thorough research into Capitec, we were able to make a rapid assessment of Viceroy's allegations and could conclude that most were untrue. Many other investors were not in a similar position and hastily exited their positions, providing us with a unique opportunity to buy a bigger stake in Capitec at around a 20% discount to what it was trading at a few days earlier.

With the benefit of hindsight, this was a very profitable investment for our clients. Capitec's share price subsequently recovered to over R1 100 per share as investors did their homework and realised that Viceroy's allegations were more fiction than fact, and the company continued to perform well.

Various market commentators have come out strongly against short-selling in general, and Viceroy in particular. It is illegal to publish knowingly false claims with the intent to manipulate a share price. However, short-sellers that publish accurate information are a critical part of price discovery and ensuring that markets operate efficiently. They also highlight financial and ESG risks of listed companies. Conversely, as the Viceroy report on Capitec illustrates, poorly researched short-seller reports will not cause a decline in a company's share price over the long term and actually present astute investors with unique buying opportunities.

Environmental risks at Sasol

Over the past year we have spent a lot of time deepening our understanding of Sasol's environmental impact and engaging more with management on the steps they are taking to reduce it. Sasol's air quality impacts and greenhouse gas ('GHG') emissions are two key

1. Short-selling essentially entails betting that a company's share price will decline.

concerns and have been our focus areas to date. Given the growing importance of and attention being paid to human-induced climate change, we have limited our discussion in this report to Sasol's GHG emissions, although we have also done extensive work on Sasol's management of its other pollutants.

Sasol generates over 95% of its GHG emissions in South Africa. At a group level it has reduced GHG emissions by over 10 million tons between 2004 and 2018, roughly a 13% absolute decrease. On facilities of this size and nature (and when compared to other large emitters), this is a substantial achievement. The reductions have primarily come from switching Sasolburg from coal to gas feedstock in 2005 and by increasing its self-generation of electricity (using gas from Mozambique rather than coal-fired power from Eskom) at Secunda and Sasolburg since 2010/11.

Sasol has been one of the largest contributors to South Africa's reduction from our business-as-usual GHG emissions trajectory over this period. It has spent approximately R25bn on GHG and other pollutant emission abatement projects over the past 12 years. This amounts to a significant portion of its net profit over the period.

Secunda is a petrochemical facility that gasifies coal to make liquid fuel and other derivatives. By its nature it will always be a large emitter and management is forced to work within this constraint. Going forward Sasol has fewer levers to pull to substantially reduce its GHG emissions, but incremental reductions are possible through energy efficiency projects. Targets have been set and management is incentivised on this. Management should look to (and is already considering) alternatives such as carbon offset projects to reduce their overall impact, which we continue to monitor. Globally, experts believe that carbon capture and utilisation or storage is essential to reducing climate change. While research continues, this does not appear to be a technically viable option for South Africa at this stage.

Comparing SA emissions to those of other countries

South Africa is responsible for roughly 1.3% of the world's GHG emissions, of which just less than half is from Eskom, while Sasol contributes roughly a tenth. In comparison, China, the US and India together contribute over 50% of global emissions and are the key players to watch. While South Africa is in the top 20 emitters globally, and therefore has a role to play, our emissions reduction path has to balance environmental and social imperatives. This is how we will ensure a 'just transition', which you will often hear discussed in the media. Sasol employs 27 000 South Africans and the indirect benefit of that job creation is multiples higher. Sasol is also South Africa's largest corporate tax payer and vitally important to our economy, supplying approximately 30% of our liquid fuels, amongst other products. If Secunda was to shut down, this fuel requirement would be fulfilled by imports in the short to medium term, meaning that South Africa would lose all the economic and social benefits, while the environmental impact (i.e. petrochemical emissions plus transport emissions) may not be drastically reduced and may simply be emitted in another country into the same atmosphere.

It is easy to criticise companies and allege that they are not doing enough, but significantly harder to find solutions to these complex issues, particularly when trying to balance environmental, social and economic imperatives. We strive to maintain a balanced view on ESG impacts and focus on management's efforts to reduce the adverse impacts, rather than simply not invest at all. This would be extremely limiting on our investment universe given that, depending on one's personal value set, one could criticise the business activities of most listed companies for one reason or another.

Our role in ensuring Sasol reduces its environmental footprint

That said, we do recognise that, as a large shareholder in Sasol on behalf of our clients, we have a role to play in ensuring that the company strives to reduce its substantial environmental footprint. Below we list some of what we have done in 2018 to act as a responsible shareholder:

- We held a teleconference with Sasol's sustainability team to query and better understand their constraints to implementing technology retrofits to reduce their various emissions.
- As an investment team, we held a policy group meeting (where we discuss company buy or sell recommendations) entirely on Sasol's environmental impacts.
- We sent a letter to Sasol's joint-CEOs on environmental concerns and provided sustainability disclosure recommendations. We were pleased to see that a number were incorporated into their 2018 Sustainability Report and we hope to continue this engagement.
- We held a follow-up meeting with Sasol in which we discussed the need for greater disclosure and communications on sustainability issues. Sasol openly addressed the issues we raised.
- We have increased our attendance at environmental conferences, working groups and regulatory meetings. We also engage with Sasol informally at these events.

There is no doubt that large GHG emitters will be subject to an increasing regulatory burden, as well as greater civil society, consumer and shareholder scrutiny, going forward. In South Africa, carbon tax has long been discussed and at this stage will be implemented in mid-2019. For many years we have closely monitored developments and considered the impact that this tax will have on Sasol's earnings. The Department of Environmental Affairs ('DEA') will also be implementing mandatory carbon budgets for large emitters, including Sasol, from 2021. Sasol is already participating in the voluntary pilot phase from

2016 – 2020 and again, we are watching this closely. We factor environmental and associated regulatory risks into the earnings multiple we use to determine Sasol's intrinsic value. We similarly factor in changing consumer demands for products such as oil and plastics when modelling Sasol's long-term earnings potential.

What about offering a fossil fuel-free fund?

We have received requests to offer fossil fuel-free or low carbon funds. In practice, no fund can be 100% fossil fuel-free. If we take solar energy as an example, it is undeniably a cleaner energy option than a coal or gas power plant, but manufacturing solar photovoltaic (PV) panels is extremely energy-intensive and currently much of that energy is supplied by fossil fuels. Is investment into a solar PV manufacturer therefore fossil fuel-free and suitable for inclusion in a clean energy fund?

Similarly, if we look to electric vehicles their batteries currently require lithium, nickel and cobalt mining, all of which have a myriad of negative environmental impacts. Due to the nature of mining, all these companies would also have a high carbon footprint and risk being excluded from a low carbon fund. Is that meaningful when they could also be supplying the raw materials to assist us with switching to electric vehicles, which would lower overall carbon emissions?

What about a petrochemical facility producing plastic? One of the lowest cost options we have globally to reduce GHG emissions is to make internal combustion engine vehicles more efficient. This is in part achieved by reducing the vehicle's weight through greater use of lighter materials, such as plastic. How does one weigh up these two contradictory considerations? Lastly, is it fair to remain invested in a company that benefits from the mining company but not the miner itself? For example, a telecoms provider makes use of cell phone technology, for which many of the raw materials were mined.

The above examples also demonstrate why we do not believe in a blanket divestment from fossil fuel companies or large GHG emitters. A further consideration is that if fossil fuel companies were not able to access capital in the public markets, they would remain private. A public, listed company is required to produce far more disclosures, which improves transparency and better enables shareholders and the public to hold them to account. Therefore the ultimate objective of fossil fuel divestment – to deny these companies access to public capital – would not necessarily achieve the desired goal of addressing climate change.

These are all questions to consider when trying to form a balanced view on companies and their ESG impacts. We will not always get it right, but we try to ensure that our stance is well considered and that directors think carefully and critically about the long-term viability and sustainability of the companies they lead.

Glencore

In May 2018 Glencore's share price fell significantly after reports that the UK's Serious Fraud Office ('SFO') was launching a bribery investigation into Glencore's Democratic Republic of Congo ('DRC') copper and cobalt operations. This investigation is yet to be confirmed by the SFO. In July 2018, Glencore received a subpoena from the US Department of Justice ('DOJ') to provide documents related to compliance with the Foreign Corrupt Practices Act ('FCPA') and US money laundering statutes. The request relates to Glencore's business in the DRC, Nigeria and Venezuela from 2007 to present. When the DOJ news broke, Glencore's market capitalisation fell by roughly US$12.5bn. To put this into perspective, Glencore's market capitalisation was US$73bn at the start of 2018 and the largest FCPA fine in history has been US$1.8bn, which was issued against Petrobras in September 2018 (and some of which was offset against other claims).

While the quantum of any potential fine relative to the movement in the share price is an important consideration, there are two additional critical issues that need to be taken into account: 1) How do we evaluate the ethics of a company facing a potential corruption investigation? and 2) What are the associated risks to the long-term investment case?

Our analysis centred on Glencore's DRC operations where its 86%-owned subsidiary, Katanga Mining, owns large copper and cobalt mines that currently account for about 5% of Glencore's profitability and will contribute in the low double digits once fully ramped up. Nigeria and Venezuela are on the marketing side of Glencore's business and while not immaterial, are much smaller in scale.

How do we evaluate the ethics of a company facing a potential corruption investigation?

In 2007, Glencore entered into a long-term working relationship with Dan Gertler, a close personal friend of the DRC's President Kabila. In December 2017 Gertler was one of several international persons sanctioned by the US for involvement in corruption or human rights abuses. It is clear that Gertler was extremely influential in the DRC mining sector in the late 2000s and even today. In early 2018 Glencore bought Gertler out of his shares in its DRC subsidiaries and ended their relationship. Despite this, it is still contractually bound to pay Gertler royalties. Glencore faces questions on the due diligence conducted on Gertler when first entering into a relationship with him, and whether it was aware of, or partook in, any corrupt schemes in the DRC.

The reality is that Glencore manages to operate successfully in difficult countries with a high corruption risk, where many of its peers have failed to do so. It would be remiss of us not to question how Glencore achieves this. Prior to the DOJ announcement, we had raised governance queries at all management meetings held with Glencore during the preceding year. After rumours about the SFO investigation emerged we held a call with Glencore's chairman, Tony Hayward, in which we addressed a number of DRC-related governance queries specifically. Finally, after the DOJ announcement, we held a call with Glencore's General Counsel to gain more insight into compliance procedures and how these have been strengthened over time. An important takeaway was that Glencore has significantly tightened its controls around middlemen. The business is no longer permitted to use intermediaries unless a meaningful business justification is submitted as to why their services are essential. We believe this is a positive step, although it obviously does not mitigate the company's alleged past misdeeds.

Questions have also been raised around Glencore's business dealings in Russia, Brazil and to a lesser extent, South Africa. The number of allegations is concerning but we also bear in mind that Glencore's global footprint is extensive. It has offices in more than 50 countries and produces and markets over 90 commodities. While some of their activities are a cause for concern, at this stage we are comfortable investing but we are monitoring the situation closely, and as new information comes to light we may change our position. The ability of our CIO to veto investments, which we wrote about in the 2017 Stewardship Report, is used to prohibit investments into companies that are unethical in nature; in other words, where the unethical behaviour is intrinsic and that business would not be able to operate 'successfully' without that unethical behaviour. While views on ethics are subjective and differ even within our team, we do not think Glencore is an example of such a company. Two-thirds of Glencore's through-the-cycle earnings comes from more stable jurisdictions where the risk of corruption is significantly lower.

What are the associated risks to the long-term investment case?

So how do we incorporate this analysis into the investment case for Glencore, specifically the risk that the DOJ investigation reveals that Glencore has in fact been extensively involved in corruption? We have spent a lot of time researching and discussing past DOJ investigations, FCPA fines and associated costs (some of which are more substantial than the fine itself) and investigating the allegations against Glencore in each country. We believe that at the current discount to intrinsic value, the share offers an appropriate margin of safety for regulatory risk and an attractive investment into a company that is diversified across a mix of commodities and should generate decent cash flow from its portfolio of well-capitalised assets through the cycle. Despite this, given its risk profile, we closely scrutinise the size of our clients' position in the company and the risk it builds into their portfolios.

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', available 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 2018 follow.

Company engagements and voting recommendations

During 2018, our analysts and portfolio managers engaged with company representatives on 636 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 352 occasions. Table 1 provides a quantitative summary of our engagements during the 12 months to 31 December 2018.

Table 1: Summary of our engagement with companies

		Occasions when ESG issues were discussed		
Type of engagement	Total number of engagements	Environmental	Social	Governance
Meetings	370	23	78	130
Written correspondence	33	4	5	21
Site visits	37	8	10	3
Other forms of engagement	196	10	24	36
Total	636	45	117	190

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 2018, we made voting recommendations on 2 305 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 2018	55	684	68	23	775
Q3 2018	39	446	29	15	490
Q2 2018	59	704	40	18	762
Q1 2018	23	255	18	5	278
Total	176	2 089	155	61	2 305

The most topical matters on which we make voting recommendations are the annual non-binding resolutions on a company's executive remuneration policy and the implementation thereof. 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.

Table 3: Voting recommendations related to executive remuneration

Quarter	'For'	'Against'	'Abstained'
Q4 2018	African Rainbow Minerals Aspen BHP Billiton Capricorn Clover Comair Emira Property Fund Fortress REIT – A Impala Platinum KAP Northam Platinum OneLogix Group Putprop Rand Merchant Investment Remgro Sandown Capital Super Group Tower Property Fund Unicorn Capital Partners Wilson Bayly Holmes-Ovcon Woolworths	Blue Label Telecoms Caxton CTP Publishers & Printers Growthpoint Hosken Consolidated Investments Hospitality Property Fund – B MMI Pan African Resources Sasol Spur Tsogo Sun	Aveng Bidvest Namibia Namibia Breweries
Q3 2018	Equites Property Fund Famous Brands Investec Mr Price Naspers Novus Pick n Pay Raubex Sephaku Stefanutti Stocks Wilderness	Alexander Forbes Long4Life Peregrine Tongaat Hulett	Adcorp Trencor
Q2 2018	A E C I Bell Equipment British American Tobacco Calgro M3 Capital & Counties Properties Capitec Bank Glencore Gold Fields Hudaco Industries Merafe Resources Metair Investments Mondi Mpact Nedbank Randgold & Exploration Company Royal Bafokeng Platinum SA Corporate Real Estate Fund Standard Bank Tullow Oil SEPLAT Sun International Stanbic Zeder Investments	Absa JSE Old Mutual	Basil Read
Q1 2018	Astral Foods Blue Label Telecoms Coronation Life Healthcare Nampak Quantum Foods RDI REIT Reunert Transaction Capital	Netcare	Namibia Asset Management Pepkor