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Leadership reviews

Chairperson's review

Sue Graham Johnston
Chairperson

Afrox operated with unrelenting focus and our 2016 results bear witness to the skill and determination of everyone in Afrox to deliver a motivated, competitive business, regardless of economic challenges.

We are at a pivotal time for Afrox. As head of The Linde Group's Region Africa, the UK and Ireland, I have been working closely with the Afrox management team since June 2015. In September 2016, I succeeded Bernd Eulitz as Chairperson of the Afrox Board and have strived to support the business to fully realise and sustain the benefits of the 2015 turnaround plan's restructure process.

The Company delivered positive financial results which reflect the benefits of our 2015 restructure. Reduced selling, general and administrative overheads, improved efficiency and an enhanced competitive position were evident in this performance and Afrox is in an advantageous position going into 2017.

The last year was a bedding-down period for the Company's new structures and operating model. Afrox now seeks to align its commercial practices, procurement processes, governance and compliance guidelines with the best practices of The Linde Group, our parent company.

Refer to the Managing Director's review on page 36 and Financial Director's review on page 40 for further detail.

Economic review

Afrox's leaner, more customer-focused approach, and benefits realised from the 2015 restructure (refer to the Turnaround Plan on page 19), have somewhat cushioned the economic shocks of low gross domestic product (GDP) and industrial demand in South Africa.

The outlook for 2017 is another year of subdued growth for South Africa, with a likelihood of further political uncertainty as an additional risk factor. This will be a real test of Afrox's abilities to deliver on the promise to shareholders of sustainable growth and results.

What growth occurs in Africa during 2017 is not expected to come from our traditional sectors. While we will continue to efficiently serve those sectors, we will be looking for new revenue streams to compensate for the changing business dynamics.

Strategic overview

Our cost-base has reduced substantially and firm controls are in place to ensure this remains the case.

As a strong proponent of technologies to drive efficiencies and to deliver innovative products, I am pleased to confirm our commitment to e-commerce, our Tag 'n Trace Individual Cylinder programme and the transfer of knowledge, best practices and latest product offers from The Linde Group to Afrox.

Our sales force, and in turn our customers, will benefit from global Linde support in rolling out a major training and sales development programme in 2017, supported by a new customer relationship management system. This will equip our sales teams with cutting-edge knowledge and the latest tools and technology available to serve our markets and deliver tailored solutions that add value to our customers.

Our focus on renewable energy, healthcare, hospitality, food and beverage and speciality gases as growth markets will continue, as will our drive to grow our share of the LPG sector and helium market through improved security of supply.

Our four strategic objectives remain unchanged this year, namely:

- Maintain and grow profitability and operating performance
- Ensure sustainable growth while enhancing competitiveness
- Embed advanced performance in areas of safety, health, environment and quality (SHEQ)
- Build a performance culture

1. Generating sustained financial returns by:

- identifying opportunities for growth;
- achieving growth in headline earnings; and
- delivering superior returns to shareholders.

2. Driving transformation by:

- achieving a positive shift in our BBBEE rating in South Africa in 2017; and
- promoting the ongoing transformation of Afrox's equity profile.

3. Optimising operations by:

- actively evaluating and mitigating risk, and maintaining effective governance systems;
- driving effectiveness and efficiency throughout our value chain; and
- attracting, developing and retaining the best available talent.

4. Build and maintain relationships by:

- delivering value to customers; and
- adhering to strict product quality standards.

Refer to page 19 for further details on our strategy.

Afrox continues to improve in all areas of its strategic objectives and tangible progress has been made in achieving a step change in profitability and operating performance. Our leaner, more focused organisation post-restructure adds a layer of confidence to our continued positive performance. It is now imperative to preserve the benefits achieved, build a performance culture, and endeavour to improve on the operating margins achieved during 2016.

Governance

We continued with in-house training across all divisions on ethics, anti-corruption, and business partner compliance. Good governance will always be at the heart of what we stand for as a business, an employer and as a socially responsible corporate citizen.

Afrox's Social, Ethics and Transformation Committee is in its fourth year of operation, achieving steady progress on our non-financial agenda, under the committee chairperson and lead independent director, Dr Khotso Mokhele.

BBBEE

A company's BBBEE rating is fast becoming the differentiating and deciding factor in the awarding of many South African government and government-linked contracts. As expected under the new BBBEE codes promulgated in 2016, Afrox fell from a level 3 status to a level 8. We are committed to achieving the highest possible rating in balance with business viability and the newly introduced BBBEE Codes in the short to medium term. Refer to page 60 for our BBBEE strategy.

Board

In September 2016, Bernd Eulitz stepped down as Afrox Chairman after serving in this position since 1 June 2015. We thank him for his dedication and commitment to Afrox and wish him well in the future. We also welcome Nolitha Fakude who joined us in February 2017 and brings a wealth of petrochemical and business acumen to our team. Refer to page 66 for our governance structure.

Outlook

In South Africa, our decision to reorganise and refocus our operations has produced positive results. However, the continued turbulence experienced in our traditional markets indicates that we must continue to be agile and resilient in these times of economic uncertainty.

With wages in South Africa growing at 8% a year, inflation quickening to 6.8% in December 2016 and GDP at 0.4% for 2016, there is no shortage of risk going into 2017. While economists forecast GDP growth of between 0.9 % to 1.5% for 2017, they also predict government debt to GDP rising to over 51%. This highlights the short-term risk to the economy of a sovereign downgrade by rating agencies. In the worst-case scenario a downgrade could precipitate a recession.

In the short term, we will have to leverage the solid progress in our restructure of the Company, management structure and our geographic footprint, channels to market, our distribution network as well as our business and product portfolios, to achieve our profit targets.

It remains incumbent on Afrox to drive continuous improvements and maximise efficiencies to ensure the Company profile mirrors customer needs and that our products are competitive, relevant and cost-effectively delivered.

Gratitude

I wish to thank my fellow Board members for their support and guidance. I would also like to thank our management team, employees and our suppliers for their dedication and commitment. Most importantly, I thank our customers, without whom we would not exist.

Sue Graham Johnston
Chairperson


AFROX
A Member of The Linde Group
The Professional's Choice
Premium Product Range
HANDIGAS

Managing Director's review

Schalk Venter
Managing Director

Sustained focus on cost efficiencies, right-sizing operations, improved logistics, market channels and leveraging the business with the help of committed and determined people brought benefits that will manifest in 2017.

Highlights

- Afrox successfully completed its 'get healthy' activities in the context of the Turnaround Plan
- Benefits from the Turnaround Plan were as expected, with EBITDA increasing by 23.2% to R1 237 million (2015: R1 004 million)
- Improvement in ROCE by 790bps from 16.7% to 24.6%
- Bulk industrial gases volumes improved in the second half of 2016
- Strong LPG performance in the second half of 2016 driven by improved supply chain, cost recovery, and volume growth
- Major, long-running legal claim settled

Challenges

- A sluggish first quarter including shortages of CO_2 and LPG, and an uncertain economic environment
- On-site business were negatively impacted by a fixed cost base, supplier shutdowns and reliability challenges at certain plants
- Hard Goods and industrial compressed gases attained lower volumes but bottomed out towards the fourth quarter due to slightly improved economic activity and higher commodity prices
- Currency exchange rate impacts, especially in Africa, as well as the challenges of a relatively high inflationary environment, made cost recovery through price increases to market challenging

Overall performance

Financial synopsis

Revenue increased to
R5.537 billion
(2015: R5.473 billion)

The EBITDA margin before restructuring costs incurred in 2015, increased by
400bps to 22.3%
(2015: 18.3%)

Headline earnings per share of
189.4 cents
(2015: 139.2 cents)

Basic earnings per share of
193.3 cents
(2015: 134.2 cents)

Overall, our performance was again positive. Low levels of capital expenditure, focused trade working capital management, optimisation of fixed assets and underlying EBITDA growth resulted in Afrox remaining strongly cash generative. Cash reserves increased by R301 million to R153 million from a net debt position of R148 million in 2015. ROCE improved 790bps to 24.6%, reflecting improved profitability and asset utilisation.

Refer to the Financial Director's review on page 40 for further details.

Performance and developments in the context of our environment

The first quarter of 2016 got off to very slow start and was further hampered by the early Easter period which curtailed business momentum. Afrox's high level of exposure to the weak South African manufacturing, mining and engineering sectors remains a key challenge. We will continue to robustly manage the balance between sales, gross margin and expenses, as well as position the Company to supply products and services to more robust, high-growth consumer-led markets like hospitality, food and beverage, LPG supply, healthcare, as well as Emerging Africa.

The underlying economy remains a difficult place to do business with price cost recovery a challenge. In general our markets continue to face commodity price pressure, an uncertain labour climate and increased competition. This, coupled with slowed infrastructure construction amid electricity shortages continues to hamper production and investments in sub-Saharan Africa.

We continue to drive the new customer-centric go-to-market model (refer to page 27 for further detail), increase effectiveness of traditional channels, drive best commercial practice on price cost recovery and target growth in the key markets mentioned.

In South Africa, we opened our latest state-of-the-art facility in Riverhorse Valley, KwaZulu-Natal. The filling and engineering services hub represents an investment of more than R60 million and is a sign of confidence in the KwaZulu-Natal economy. Our Afrox eShop continues to help reduce the cost to serve and to drive e-commerce sales, with online orders values up by 203% compared to last year.

We completed the Cornubia land disposal for R119.4 million and concluded a significant settlement agreement, receiving R165 million from ArcelorMittal South Africa Limited (AMSA) in settlement of an ongoing dispute. Afrox also signed an agreement with TETRA 4 and The Linde Group to exclusively market and supply helium from the Free State natural gas field from 2018. Refer to page 47 for further detail.

Business segment performance

LPG

LPG revenue decreased by **1.26%** mainly due to negative price movements

Two strategic LPG import deals in KwaZulu-Natal and the Western Cape mitigated customer run-outs during refinery shutdowns and peak winter demand. This improved security of supply will place us well ahead of competition going into 2017.

These initiatives also resulted in additional bulk sales to industrial customers, but, volumes were down compared to 2015 due to severe product shortages from local refineries in the first four months of the year.

Afrox continues to actively manage the illegal filling threat and we await the outcome of the Competition Commission LPG market inquiry, now expected in early 2017. Growing Afrox's LPG footprint into Emerging Africa is being actively pursued as part of our strategy.

Refer to page 100 for the segmental report.

Atmospheric Gases

Revenue from Atmospheric Gases was up **9.99%** at **R2.319 billion** (2015: R2.110 billion)

Difficult market conditions impacted demand in the steel, mining, and manufacturing sectors in South Africa. A two-month shutdown of a key CO_2 supplier severely constrained the market in the first half of 2016. Afrox is actively seeking new sources to supplement current supplies and grow market share. Over-capacity in the atmospheric gases market due to steel plant closures, a general market downturn, rising inflation and electricity costs, impacted sales.

Refer to page 100 for the segmental report that includes the contributions and performance of various sub-segments.

Hard Goods

Hard Goods revenue down **15.5%** (2015: 9.1%)

Hard Goods revenue continued to decline for the second consecutive year. Underlying performance was impacted by declines in the mining sector, export markets, and a slowdown of infrastructure projects in South Africa, all leading to increased price pressure.

Going forward Afrox will leverage Hard Goods as an integrated offer with gases, further reduce inventory, and seek options to right-size fixed costs to throughput. Growth opportunities in the light industry market exist today and Afrox has tailored offers to capitalise on these.

Refer to page 100 for the segmental report.

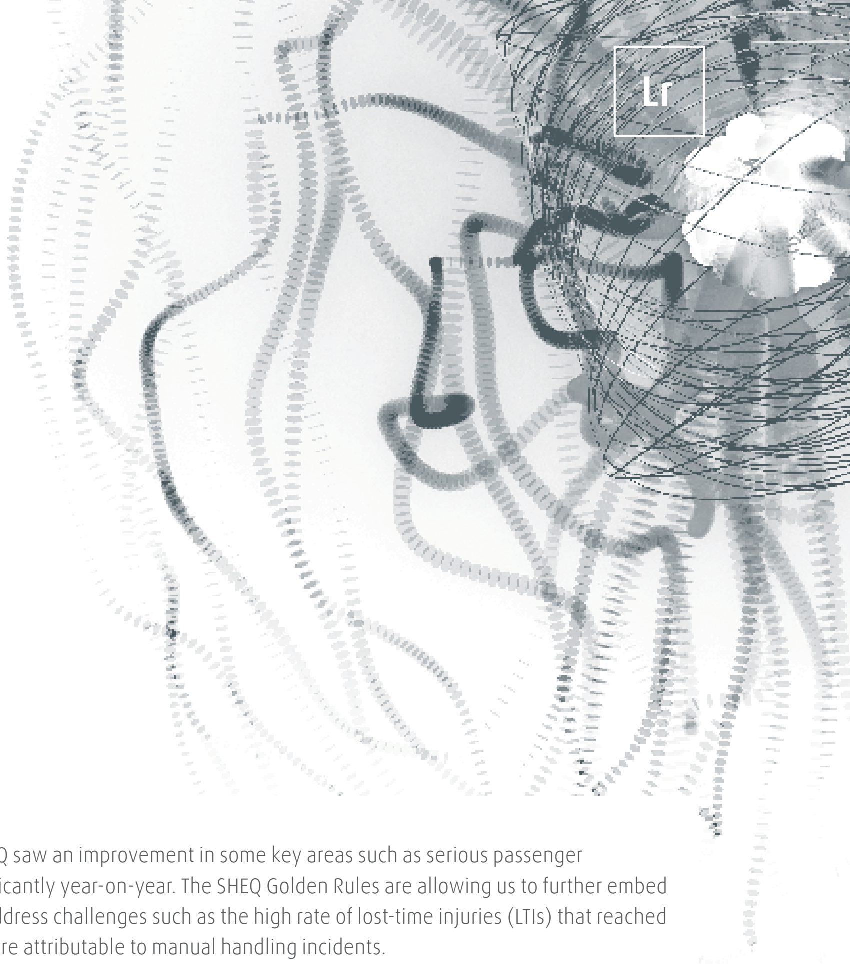
Emerging Africa

Revenue remained flat at **R755 million** (2015: R755 million)

Operations in Emerging Africa continue to face challenges and economic shocks stemming from global oil and commodity prices, currency fluctuations, rising national debt of certain countries and inflationary pressures.

Emerging Africa contributes 17.2% (2015: 19.6%) of the Group's GPADE. Afrox maintains a pragmatic approach to investment in Emerging Africa, but remains determined to participate in the African growth agenda over the coming years.

Refer to page 100 for the segmental report.



SHEQ

MIRs increased marginally to **9** (2015: 8)

From a safety perspective, SHEQ saw an improvement in some key areas such as serious passenger incidents that decreased significantly year-on-year. The SHEQ Golden Rules are allowing us to further embed a safety-focused culture and address challenges such as the high rate of lost-time injuries (LTIs) that reached 15 (2015: 9), of which 40% were attributable to manual handling incidents.

Afrox is moving towards further integrating our occupational health programme with our management system to reduce and prevent the contraction of occupational illnesses and diseases.

On the environmental front, improvements occurred in areas such as water consumption, however, CO_2 emissions increased marginally. Quality remains a focus area for continuous development, reflected in maintained and newly awarded accreditations such as the ISO 14001:2015 presented to the new Port Elizabeth ASU.

Dividends

The Company retains its policy whereby headline earnings cover the dividend twice. In compliance with this policy a final dividend for 2016 of 56 cents was declared, bringing the total dividend for 2016 to 94 cents.

Outlook

Afrox remains a profitable, robust and strongly cash-generative company. Our focus in 2017/18 remains our key business areas, aligning strategies in healthcare, special and bulk gases to retain and win profitable market share at sustainable margins. We will continue to seek and exploit new profitable opportunities and continue to drive greater operational efficiencies and customer service levels to higher standards. We expect 2017 to be another year of challenges and will require continued fiscal, operational, compliance and behavioural discipline. In the coming year we will strive to:

- at least maintain core Hard Goods and industrial gases business at current levels of activity;
- focus on price cost recovery;
- improve asset utilisation;
- grow Special Gases, CO_2 Healthcare, LPG and Emerging Africa; and
- maintain current ROCE levels of 20% or more.

Gratitude

I extend my sincere thanks to our customers, members of the Board and my colleagues for their unwavering commitment and support. It is only through this support that Afrox is able to achieve sustainable long-term growth and returns.

Schalk Venter
Managing Director

Financial Director's review

Dorian Devers
Financial Director

We reflect on another positive financial year supported by the effectiveness of our Turnaround Plan, which leaves us well positioned going forward.

Financial performance at a glance

Revenue
R5.537 billion
(2015: R5.473 billion)
1.2% increase

EBITDA
R1.237 billion
(2015: 1.004 billion)
23.2% increase

EBITDA margin
22.3%
(2015: 18.3%)
400bps increase

Operating cash flow
R573 million
(2015: R676 million)
15.2% decrease

EBIT
R848 million
(2015: R508 million)
66.9% increase

Earnings per share
193.3 cents
(2015: 134.2 cents)
44% increase

Headline earnings per share
189.4 cents
(2015: 139.2 cents)
36.1% increase

Cash generated from operations
R1.099 billion
(2015: R926 million)
18.7% increase

ROCE
24.6%
(2015: 16.7%)
790bps increase

Income statement analysis

Income statement comparison for the year ended 31 December

R'million	2016	2015	Variance %
Revenue	5 537	5 473	1.2
Operating expenses (excluding restructuring costs)	(4 300)	(4 469)	(3.8)
Earnings before interest, taxation, depreciation, amortisation and impairments (EBITDA)	1 237	1 004	23.2
Earnings before interest and taxation (EBIT) before restructuring costs	848	587	
Restructuring costs	–	(79)	
EBIT	848	508	66.9
Net finance income/(expense)	14	(9)	(256.0)
Income from associate	2	1	
Profit before taxation	864	500	72.9
Taxation	(264)	(75)	251.4
Non-controlling interests	(3)	(11)	
Attributable earnings	597	414	44.0
Adjustments	(12)	15	
Headline earnings	585	429	36.1
Number of shares in issue (millions)	309	309	
Basic and diluted earnings per share – cents	193.3	134.2	44.0
Headline earnings per share – cents	189.4	139.2	36.1

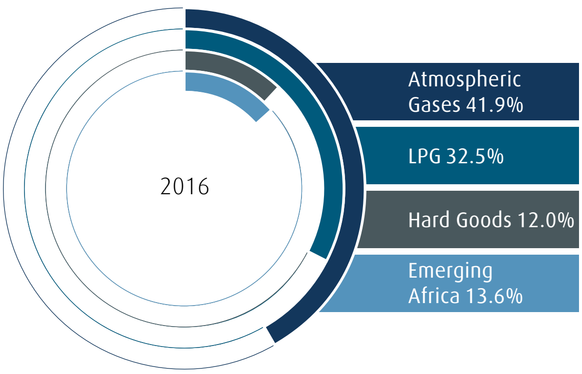
Financial Director’s review continued

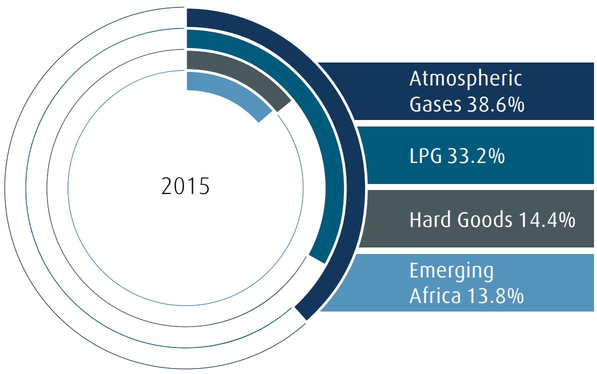
Trading performance

The benefits from the successful restructuring and litigation settlement (R165 million) with AMSA, a prominent steel supplier, resulted in revenue increasing by 1.2% and EBITDA increasing by 23.2%. This growth was achieved despite the weakness of the South African economy and supply constraints seen in CO_2 and LPG.

Year-on year increase in revenue was achieved in the Atmospheric Gases segment as a result of the litigation settlement and growth in some sectors, however, volumes remained under pressure during the first half of the year with a moderate recovery in the second half. LPG revenue was lower due to LPG market price developments. Supply constraints due to reduced volumes from local refineries during the first quarter were addressed by debottlenecking our import storage facility, and a new import supply agreement that will ensure security of supply in the future. A difficult trading environment with a marked decline in production at key customers resulted in reduced revenue in the Hard Goods segment. Despite a weak trading environment, largely as a result of depressed commodity prices, revenue in Emerging Africa remained stable.

Total revenue contribution by segment





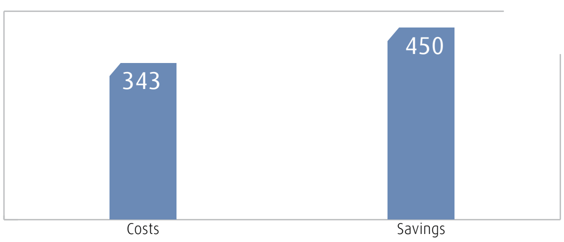
Operating expenses

Operating expenses reduced by 3.8% as a result of the successful restructuring activities. The reduction was achieved despite the impact of inflationary pressures on costs as well as negative currency impacts. Various savings initiatives as a result of the culmination of the restructuring activities contributed positively to the overall reduction in operating expenses.

EBITDA

The improvement in EBITDA is due to operational efficiencies and was further supported by the litigation settlement. There was no expenditure provided for in respect of restructuring activities, as these were fully provided for in prior years.

Restructure costs vs benefit

Costs		Benefit
Full costs posted and final for ‘get healthy’ phase of Turnaround Plan	Restructuring costs and total programme benefits impact from 2014 to 2016 Cost R343 million (includes restructuring and impairments) Savings R450 million	
Costs reflective of 2014 and 2015 restructuring expenses	R’million	
Restructuring costs covering: • redundancy • outsourcing • closure of operations • stock-keeping unit reduction • consultant support		 Delivered

Net finance income

The net finance income of R14 million (2015: net finance cost R9 million) was largely as a result of the interest earned on the significant cash balances on hand during 2016 as well as an increase in the net interest income from the retirement benefit asset.

Taxation

The effective tax rate is 30.5% (2015:15%). The increase is due to the impact of the additional tax allowances received in 2015 in respect of the Port Elizabeth ASU. Foreign taxes on dividends received from subsidiaries further increased the effective rate.

Non-controlling interest

Non-controlling interest of R3 million reduced mainly as a result of the reduction in the reported profit in Zambia due to the impairment of assets in the DRC.

Headline earnings

Group adjusted earnings increased by 36.1% to R585 million. The adjustments include the after-tax and non-controlling interest impact of the profit on sale of assets held for sale and the impairment of assets in the DRC.

The weighted average number of shares remained constant at 308 567 602 during the year.

This resulted in an increase in headline earnings per share of 36.1% at 189.4 cents (2015: 139.2 cents).

Cash flow analysis

Cash flow statement comparison for the year ended 31 December

R'million	2016	2015	Variance %
Cash generated from operations	1 099	926	18.7
Net finance expenses	(66)	(74)	(11.4)
Taxation paid	(177)	(116)	52.0
Dividends received	1	1	
Cash available from operating activities	857	737	
Dividends paid to owners of the parent	(275)	(56)	394.4
Dividends to non-controlling interest	(9)	(5)	
Operating cash flow	573	676	(15.2)
Additions to property, plant and equipment and intangibles	(389)	(377)	3.2
Proceeds from disposal of property, plant and equipment and intangibles	84	34	144.5
Other investing activities	33	22	
Net cash outflow from investing activities	(272)	(321)	(15.5)
Free cash flow	301	355	(15.2)
Cash and cash equivalents at the beginning of the year	852	497	
Cash and cash equivalents at the end of the year	1 153	852	

Cash generated from operations of R1 099 million increased by 18.7% as a result of the positive impact of the restructuring activities, a reduction in restructuring costs paid and the settlement received. Net finance expenses decreased due to the impact of increased interest earned on cash balances.

The cash taxation payments returned to normal levels after the reduced payments in the prior year as a result of the tax allowance received. Interim and final dividend payments resumed after the restructuring in 2015. This resulted in operating cash flow reducing by 15.2% to R573 million (2015: 676 million).

Cash utilised in investing activities reduced mainly due to inflows from the disposal of assets held for sale (R84 million) and a marginal increase in capital expenditure. Free cash flow of R301 million reduced by 15.2% and cash and cash equivalents increased by 35.3% to R1 153 million (2015: R852 million).

Dividends

A final gross cash dividend of 56 cents per share in respect of the Group's 2016 year-end was declared and the dividend will be paid on 10 April 2017. The dividend will be subject to a local dividend tax rate of 20% resulting in a net dividend of 44.8 cents per share to shareholders not exempt from dividend tax.

Refer to page 89 for our summarised audited consolidated financial statements and page 17 for our Valued Added Statement.

Looking ahead

The economic environment in South Africa is expected to remain subdued, however, Afrox will continue to focus on productivity improvements and opportunities to grow market share to enable growth.

Gratitude

I extend our gratitude to our shareholders, who continued to show confidence in our abilities, as well as our employees and leadership who continue to steer us on a path of positive operation and profitability in testing times.

Dorian Devers

Financial Director