Strategic review

Johan van Zyl
Group Chief Executive

2014 presented us with one of the more challenging operating environments since the financial crisis.

Operating conditions during 2014 are covered in detail in the Economic and Operating Environment Review, but I would like to single out the following events, which had substantial impacts on the Group and its businesses.

- **Economic growth:** The pressure on economic growth, both in South Africa and in the other major regions where Sanlam operates, put a damper on the Group's growth potential.
- **Industrial action in South Africa:** Around 10% of Sanlam Sky Solutions' new business originates from the platinum belt. In addition Sanlam Employee Benefits administers a large portion of the employee benefits for the platinum mining companies. The five month platinum mining strike in the first half of 2014 therefore had a significant impact on these businesses. More details can be found in the Operational Cluster Review.
- **Currency exchange rates:** Although the weak average rand exchange rate worked in our favour in some instances, investing offshore with a volatile currency is difficult. In addition, weak currencies in some of the regions where we operate depressed the translated rand results of these operations. The biggest impact came from the significant depreciation of the Ghanaian cedi.
- **Regulatory change:** The raft of regulatory changes imposed on the savings and investment industry in South Africa as well as in a number of other countries in which we operate, most notably, India and the UK, has placed cost pressures on all of the Group's businesses. The uncertainty created by some of these reforms has resulted in significant opportunity costs. A great deal of capacity has been invested in preparing for the implementation of these reforms at the expense of product development and other important projects.

Given the difficult operating environment of 2014, I am particularly pleased to be able to report that the Group achieved solid overall operating results in 2014.

The diversified nature of the Group's operations, together with the strength of the Sanlam brand and the brands of our international partners, contributed to our total new business volumes that grew by 18%, the combination of 24% growth in new insurance business and 15% growth in new investment mandates received. Net result from financial services (net operating profit) grew by 27% (26% on a per share basis). We consider this a very satisfactory achievement in an environment where the South African economy is growing by less than 2%. In 2014 all the major businesses contributed to this growth.

The following are some of our other salient results:
- Net value of new covered business up 21%
- Net VNB margin of 2,92% compared to 3,06% in 2013
- Dividend per share increased by 13% to 225 cents

Sanlam Personal Finance, our South African business cluster operating in the retail space, performed exceptionally well within an environment where particularly the retail consumer is under increasing financial pressure. Our general insurance business, Santam, also performed substantially better in 2014 with underwriting margins that exceeded the high end of the target range. Our financial performance is covered in more detail in the Financial Review.

I believe it is the Sanlam Group's proven ability to deliver consistently on long-term promises that qualifies us to refer to ourselves as "Wealthsmiths™". We introduced the "Wealthsmiths™" brand positioning in 2014, together with our refreshed brand identity, because it encapsulates best how the Group does business: making the most of our clients' money in a straightforward, honest and hardworking way.

Sanlam is one of South Africa's 50 Most Valuable Brands as measured by independent brand valuation company, Brand Africa, and we intend keeping it that way. One of the characteristics of truly iconic brands is the ability to adapt and remain relevant while always staying authentic and true to its core. We therefore opted to refresh, rather than change, our brand identity in 2014 to better align our brand with our strategic drive to grow a more diversified client base.

This Integrated Report provides a holistic and transparent overview of Sanlam's performance in 2014, both from a financial point of view as well as in terms of our consideration of environmental, social and governance (ESG) issues.

Delivering sustainable value

The Group continued to deliver in line with its strategic objectives in 2014 as outlined in our five-pillar strategy, which has remained firmly in place for the past 11 years. Our strong commitment to this strategy has made it possible for the Group to transform into the profitable and well-diversified world-class business that Sanlam is today.

Towards the end of 2014 the Sanlam Board confirmed that the same five strategic pillars will continue to underpin the Sanlam Group business model for 2015. The five pillars are:
- Improving performance through **earnings growth**;
- Improved **operational efficiencies**, including costs and quality;
- Improving returns through **optimal capital utilisation**;
- **Diversification** of the base (including geographical presence, products, market segments and distribution platforms); and
- Embracing and accelerating **transformation** of the Group.

Focusing on these strategic pillars alone will yield results over the short term, but will not in isolation create sustainable value for our shareholders over the long term. For this reason the following strategic enablers are embedded together with the five strategic pillars in the overall Sanlam strategy for long-term sustainable value creation:

- Managing all our activities within a framework of **sound governance** and risk management;
- Placing continuous focus on human capital, our key resource, through our **people development**;
- Providing **responsible products and services** to our clients. Only by providing clients with relevant products and services at a fair price will we be able to balance the value proposition of our clients and shareholders sustainably over the long term within a TCF framework;
- Ensuring a sustainable client base by investing in a more just and **prosperous society**; and
- Contributing to a sustainable environment to operate in by managing our **environmental footprint**.

In 2014 we made substantial progress in implementing the strategy. The results achieved show the positive effects of both the diversification and internationalisation drives coming through on the bottom line.

Our primary performance target for measuring shareholder value creation is Return on Group Equity Value (RoGEV). Given the nature of the Group's diversified business we consider this measure of performance the most appropriate since it incorporates the result of all the major value drivers in the business.

The RoGEV per share for 2014 of 18,5% exceeded the target of 12,2% by a healthy margin. The adjusted RoGEV per share, which excludes the impact of investment market return deviations from long-term assumptions, tax changes and other factors outside of management's control during the period, amounted to 18,0%, also well in excess of the target.

Below is a brief overview of our achievements for 2014 against our five strategic pillars.

Earnings growth

Given the tough conditions that plagued 2014, we consider the Group's operating earnings growth of 27% an exceptional achievement.

Our established core operations performed very well and delivered the required organic growth. We are particularly pleased with Santam's contribution, which more than doubled in 2014.

Operational efficiencies

Maintaining cost efficiency across the Group remains a key focus. All businesses are experiencing cost pressures, which is aggravated by additional costs associated with regulatory changes and new compliance requirements as well as relatively low growth rates in certain key areas, in part due to already significant existing market shares. The areas experiencing most of the cost pressures are our more mature businesses – Sanlam Investments (SI), Sanlam Personal Finance (SPF) and Santam.

These businesses are therefore continuously exploring ways to increase cost-efficiencies. Santam introduced a project in 2014 aimed at reducing management costs, while SPF focused on driving down acquisition costs. SI implemented a new distribution structure in 2014 that should reduce client acquisition costs through an improvement in client retention.

In addition, the two long-term Group-wide initiatives introduced in recent years to foster efficiency remain firmly in place.

The *Sanlam for Sanlam* programme, which has been in place for four years, encourages effective collaboration between clusters with the goal of achieving greater growth and profitability.

The *Blueprint for Success* initiative, launched in 2012, is aimed at enhancing the *Sanlam for Sanlam* programme by helping employees embrace the critical enabling factors that will help Sanlam achieve accelerated growth. The success of this initiative is measured annually and the 2014 results show that in the two years since launch the engagement levels of our employees have improved from 45% to 75%, which is bordering on a world-class score.

These two initiatives are certainly achieving the desired results for the Group.

Managing an efficient business also requires stringent risk, compliance and corporate governance systems. In 2014 we spent more than R150 million on various initiatives aimed at ensuring that we remain a responsible corporate citizen, including internal and external audits, reporting of results and Board activities.

Diversification

Our successful strategy of diversification across geographies, market segments and products once again enabled the Group to deliver overall solid growth and value to our stakeholders in a more sustainable manner. In just 10 years this strategy has helped us transform the profile of the Group from a traditional insurer to a well-diversified financial services provider with a direct footprint on four continents and able to offer extensive solutions across all market segments in South Africa.

In 2014 we continued to aggressively pursue this strategy with the aim of further diversifying revenue streams. We concluded several transactions in 2014, including some 10 acquisitions and the disposal of our stake in Intrinsic in the UK. These transactions utilised a net R1,9 billion of surplus capital. As a result, we now have a direct footprint in 10 African countries, as well as Europe, India and Malaysia. The Financial Review includes more information on these transactions.

In addition to the above transactions, SPF identified a need for a credible investment in a medical scheme administrator and entered into a deal of some R700 million with Afrocentric Healthcare Assets. The transaction is still subject to conditions precedent. If concluded, it will result in the Group holding a 28,7% stake in Medscheme, South Africa's largest health risk management services provider and the country's third largest medical scheme administrator. Not only will this transaction enable SPF to further diversify its product offering to include medical aid solutions for retail clients, but it also provides the cluster with an opportunity to offer other products and services to the broader Medscheme client base.

In addition to diversifying our reach and product offering, we have also taken a long hard look at how we reach our clients. While we remain a predominantly intermediated business, we are also focusing on developing viable alternative distribution models enabled by innovative technology. Our investment in MicroEnsure, for example, will enable us to sell insurance products via mobile phones. This presents a potentially significant growth opportunity across all our markets, but especially in the Rest of Africa. SPF will also launch one of its three new Tax Free Savings products, to be introduced early in 2015, via intermediaries as well as online. Life insurance products will also be added to MiWay's direct distribution platform.

Currently South Africa still contributes around 74% of the Group's profits and our international businesses around 26%. We are confident that the international contribution will increase over time as our emerging market investments continue to grow.

Optimal capital utilisation

The Group's strategic approach is to use surplus capital for further diversification and the internationalisation of our business.

Over the past seven years we redeployed R30 billion of surplus capital. With R13 billion we bought back our own shares when they were still significantly undervalued and we used R1 billion for a special dividend in 2013. A total of R16 billion was used to give effect to our diversification strategy. This substantial investment fundamentally changed the structure of the Group.

Only 10 years ago this business mainly consisted of a large capital base and a relatively small life business. Through the efficient use of capital, we have succeeded in largely de-risking the business and transforming it into a profitable world-class business that is far less capital intensive. This has significantly increased the return on capital.

Strategic review continued

In combination with our relentless focus on quality business and client retention, our strategy has created significant value for our shareholders. It is not surprising therefore that the Sanlam share has rerated over the past few years.

The Group started the year with discretionary capital of R4 billion. An additional R1,2 billion was added to this war chest during the year, generated from investment returns, capital releases and excess dividend cover. This provided us with capital of R5,2 billion available for strategic deployment in 2014.

Investment opportunities of significant scale are generally scarce in financial services. Our focus has therefore been on smaller bolt-on deals across the spectrum of financial services in partnership with established businesses in a number of countries in the emerging markets. As outlined earlier under the diversification section, we were able to apply a total of R1,9 billion of the available surplus capital in respect of a number of growth opportunities in 2014, leaving available discretionary capital of some R3,3 billion at 31 December 2014. All of this is earmarked for further expansion and diversification of the Group.

Transformation

At the end of 2013, the 10-year term of what has been described as one of the most successful black economic empowerment transactions in South Africa with Ubuntu-Botho Investments came to an end. The Group's continued alignment with Ubuntu-Botho post the original 10-year deal is a key part of our sustainability and future strategy. Both parties agreed in 2014 to continue with the partnership and to develop a new strategic relationship.

The Group is therefore exceptionally pleased that a new formal relationship was concluded with Ubuntu-Botho Investments. In terms of this agreement:

- Ubuntu-Botho Investments has agreed to retain a core shareholding in Sanlam for a further 10 years, thereby ensuring a sustained empowerment shareholding for the Group. Sanlam will also continue to benefit from the valued involvement of the Ubuntu-Botho representatives on the Sanlam Board.
- Both parties will jointly explore and pursue opportunities of common interest while Sanlam will assist Ubuntu-Botho in its strategy to establish an independent financial services business.
- The Sanlam Ubuntu-Botho Community Development Trust that benefited from the value created in the transaction over the past 10 years will now actively contribute to the initiatives of both Sanlam and Ubuntu-Botho Investments aimed at supporting poor and disadvantaged communities.

With the Ubuntu-Botho transaction we transformed our ownership in the most meaningful way possible, namely by involving a representative spectrum of South African community groups in Sanlam's future.

In 2014 the focus of our transformation goals in South Africa shifted from ownership towards employment equity as well as training and development. At the end of 2014, our black staff percentage stood at 67%. It must be pointed out that 10 years ago only 30% of our employees were black.

While we have made significant progress in some areas in terms of improving our employment equity scorecard, we acknowledge that more must be done. The empowerment targets at the middle and senior management levels are particularly tough to meet. To accelerate our progress we are in the process of implementing a number of innovative projects.

The Group requires all businesses in South Africa to measure their employment equity achievements and submit these statistics on a quarterly basis. A complete report is then submitted to the Sanlam Board's Human Resources committee four times a year. This ongoing measuring of our progress is critically important to help us achieve our targets.

At the end of 2014 we completed two full years of working within a clear framework of how the empowerment efforts of the financial sector are measured in terms of the South African Financial Sector Code (FSC) for Black Economic Empowerment.

The Group again achieved a level 2 BEE status in 2014 when measured against the FSC. This is in line with our target and an achievement that we are very proud of.

Responsible corporate citizenship

Underpinning our growth strategy is a commitment by the Group to invest in long-term sustainable development and not just where profits are to be made.

This starts with the investments in our own staff, as covered elsewhere in this Integrated Report and the Sustainability Report. Through growing our operations and businesses and those of our agents and distributors, we actively participate in job creation in all the regions where we operate.

Sanlam also remains committed to the 10 principles of the United Nations Global Compact (UNGC), which have been integrated into Sanlam's sustainability framework. The UNGC is a strategic policy initiative aimed at encouraging businesses around the world to ensure that markets, commerce, technology and finance advance in ways that benefit economies and societies everywhere.

The Sanlam enterprise development (ED) programme, launched in 2013 and managed by the Association for Savings and Investment SA (ASISA), is one example of our commitment to contribute to the economic transformation of South Africa and its people. It recognises that some of the critical hurdles to sustainable growth for many entrepreneurs is access to quality business development support, mentorship and markets. The focus of the programme is therefore on incubating and developing small and medium businesses that show potential for future growth, rather than simply supplying grant money and expecting business owners to achieve growth on their own.

The Sanlam ED programme successfully completed the first phase of this enterprise and supplier development project in 2014, resulting in the following achievements:

- Five small and medium enterprises (SMEs) were handpicked from Sanlam's supply chain and provided with more than 1 500 hours of focused business development support. The aim is to double the number of participating enterprises in 2015.
- The creation of 37 new jobs for these businesses and an average growth in revenue of 20%.
- Procurement spend of around R2,1 million was channelled to these SMEs in 2014.

Following the success of the first phase the second phase was launched towards the end of 2014.

This important flagship programme added greatly to Sanlam's overall enterprise development initiatives, which in 2014:

- Supported 107 businesses with 7 600 hours of enterprise development and mentorship, thereby creating 137 new jobs; and
- Helped these enterprises achieve a 22% growth in turnover.

Equally important for sustainable economic development is helping consumers better understand the long-term implications of their financial decisions as well as the products available from the savings and investment industry. In 2014 Sanlam was able to influence the financial futures and attitudes of more than 20 000 South Africans across the country at LSM 1 – 8 levels through the Group's consumer financial education interventions.

While a comprehensive overview of all our efforts as a responsible corporate citizen is contained in the Sustainability Report published on our website, I would like to also highlight the following:

- Sanlam was included in the JSE's Socially Responsible Investment (SRI) Index for the ninth consecutive year.
- In 2014 Sanlam participated in the Carbon Disclosure Project for the first time and was included in the top performance list of the Carbon Disclosure Leadership Index (CDLI). This makes Sanlam one of nine South African listed companies to qualify for the index, and one of four financial sector companies.
- Sanlam's biggest resource use in South Africa is that of purchased electricity, which makes up 73% of the Group's total carbon footprint. In 2014 the Group managed to reduce electricity consumption by 15% (per m^2), on top of 11% in 2013.

- Although Sanlam is not a water-intensive business, as one of South Africa's leading financial services groups we recognise our responsibility as a corporate citizen to address the challenges of water scarcity. In 2014 we therefore participated in the Global Water Disclosure Project, enabling society to interrogate how its corporate citizens use this scarce resource. The Group aims to become water neutral in 2015 by investing in the Water Balance programme of the World Wide Fund for Nature South Africa (WWF-SA).
- Sanlam's responsible investment policy commits the Group to undertake research into investment-related environmental risks and opportunities. In 2014 Sanlam developed a model that includes an environmental element to company valuations, allowing us to deliver on our commitment to monitor companies on their material environmental issues. We will develop thresholds, procedures and channels for engaging with companies.

Key risks for 2015

The South African financial services industry continues to face substantial regulatory changes, which come with unintended consequences and uncertainty. We consider this a major threat to a sustainable environment conducive to doing business. A sustainable environment is one where appropriate policies and regulations enable the financial services sector to continue to operate, compete, innovate and deliver solutions for the country and its citizens.

The decision by government, for example, to delay the implementation of the retirement tax reforms, which were meant to come into effect on 1 March 2015, has had a major impact on SPF as well as Sanlam Employee Benefits (SEB).

Furthermore, the Retail Distribution Review (RDR) proposals released for discussion by the Financial Services Board (FSB) late in 2014 come with far-reaching consequences for intermediated businesses such as SPF.

As mentioned earlier all our businesses are experiencing cost pressures, mainly due to regulatory changes and new compliance requirements.

In the UK, the RDR and other reforms also impacted substantially on the financial services industry. However, we still believe that businesses like Nucleus and Sanlam UK are well positioned to take advantage of regulatory change in the UK. Furthermore, there has been valuable learning from the regulatory reform process in the UK, which can be applied across the Group as South Africa moves towards its own RDR.

In India, Shriram's credit businesses are also exposed to potential regulatory changes as non-bank institutions are increasingly being regulated as if they were banks. Finally, the life insurance operations in India are still struggling to achieve past growth numbers due to the regulatory reforms making it difficult to sell Unit Linked Insurance Plans (ULIPs).

A second major risk for the Group is the sluggish economy and the absence of strong growth in the foreseeable future. Overall, South Africa's GDP growth is expected to continue to be under pressure for some time. While the growth rates in sub-Saharan Africa, India and Malaysia are expected to be at least double that of South Africa, these economies are also performing at sub-optimal levels.

Priorities for the Sanlam Group in 2015

The Group as a whole has identified four key focus areas in 2015. The underlying priorities of the individual businesses are outlined in detail in the Operational Cluster Review section.

Driving diversification and efficiencies

The key focus in 2015 will be on driving diversification and efficiencies in the more mature South African market, while simultaneously bolstering our expansion efforts in the emerging markets (Africa, India and South-East Asia) and the developed markets so that the international component forms a meaningful and growing proportion of our total business.

Client centricity

Key to the success of Sanlam has been our unwavering commitment to putting the needs of our clients first. Our client-centric approach forms an integral part of our business philosophy and will continue to constitute the foundation of our business model.

I am pleased to report that the Treating Customers Fairly (TCF) implementation across the SPF and SI clusters is complete, in line with the current principles and guidelines as provided by the Financial Services Board. In September 2014 SPF and SI started providing the Sanlam Customer Interest committee with a TCF management information dashboard, which provides insight into the clusters' progress and measurement against the proposed fairness outcomes.

Transformation

Transformation in the South African context refers to a company's willingness to adapt the composition of its staff complement and its shareholding to more accurately reflect the demographics of the country. We demonstrated Sanlam's commitment to transforming into a truly South African business 10 years ago when we announced the Ubuntu-Botho Investments black economic empowerment (BEE) transaction. We remain as committed to transformation today as we were then and will continue to work with Ubuntu-Botho as our strategic partners.

As outlined earlier, employment equity and training and development at middle and senior management levels will be our focus for 2015.

Achieving a smooth transition

Consistency and predictability are two of the Group's main characteristics. In keeping with these character traits, which have served the Group well over the past 96 years, the Sanlam leadership succession planning was announced more than a year in advance. We understand that there is enough change in the external environment, which our business needs to absorb. Therefore, to facilitate a smooth transition in the Group's leadership, Ian Kirk was appointed as Deputy Group Chief Executive of the Sanlam Group with effect from 1 January 2015. The position of Deputy Group Chief Executive is part of Sanlam's succession planning strategy and implementation of a smooth leadership transition in 2015.

In closing

Although 2014 was a tough year, the Group once again delivered on its promises to all stakeholders and this is something I am exceptionally proud of. In 2013, I said that we had raised the bar, but in 2014 we managed to deliver against that bar despite strong headwinds.

I believe strongly that our promises are only as good as the people who make them, namely the Sanlam staff. I would therefore like to thank each and every Sanlam employee who faced adversity in 2014 and helped us break records. It is this culture that has made Sanlam the successful and sustainable financial services group that it is today.

I would also like to express my gratitude to our clients and shareholders for choosing us as your "Wealthsmiths™". A very big thank you also goes to my management team for their unwavering support and to the members of the Sanlam Board for their expert guidance and long-term vision.

I am looking forward to the energy that the new leadership will bring to the Sanlam Executive structure in 2015 and am excited about the prospects that the transition will unlock for the Sanlam Group and its stakeholders.