

## 4. Internal controls and risk management systems

The Board of Directors performs its control duties by (i) ensuring that D'leteren's entities correctly perform their own control duties and that committees entrusted with special survey and control tasks (such as the Audit Committee and Remuneration Committee) are put in place and function properly and (ii) ensuring that reporting procedures are implemented to allow the Board to follow up the entities' businesses at regular intervals, notably regarding the risks they face.

The Board of Directors is assisted by the Audit Committee in the exercise of its control responsibilities for the Company's entities, in particular with respect to the financial information distributed to shareholders and to third parties and the monitoring of the different risk management and internal control mechanisms.

Against this background, the effectiveness of D'leteren's system of controls, including operational and compliance controls, risk management and the Company's internal control arrangements, has been maintained. Such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives, and can only provide reasonable, and not absolute, assurance against material misstatement or loss.

Reviews have included an assessment of both financial and operational internal controls by the internal audit of each entity and reports from the external auditor on matters identified in the course of its statutory audit work.

### 4.1. INTERNAL CONTROL ENVIRONMENT

#### 4.1.1. The system of internal control includes but is not limited to:

- clear definition of the organizational structure and the appropriate delegation of authorities to management;
- maintenance of appropriate separation of duties together with other procedural controls;
- strategic planning and the related annual budgeting and regular review process;
- monthly reporting and review of financial results and key performance statistics;
- adoption of accounting procedures to help ensure the consistency, integrity and accuracy of the company's financial records;
- specific treasury policies and the regular reporting and review of all significant treasury transactions and financing activities;
- procedures for the authorisation of capital expenditure;
- internal audit reviews;
- implementation of action plans and audit recommendations on an annual basis;
- policies and business standards;
- country visits and discussions with local management;
- quarterly reporting to D'leteren's Audit Committee.

#### 4.1.2. The effectiveness of the system of internal control is assured by the following:

- independence of the head of internal audit is ensured by direct reporting to the Audit Committee;
- strengthening of the Corporate team;
- review of internal and external audit plans (including IT audit missions and fraud risks);
- review of any significant reported unsatisfactory control matters;
- review of any control issues that arise from internal and external audits together with any additional matters brought to the attention of the Audit Committee;
- mapping of any significant risks identified by the company's risk management process;
- annual and multi-annual audit plans that are submitted and reviewed annually by the Audit Committee;
- discussions with management on any significant new risk areas identified by management and the internal and external audit processes;
- prioritization of the control missions based on the risk profile.

D'leteren's Audit Committee receives regular reports on the work carried out by the Audit Committee of each activity before itself reporting to the Board.

## 4.2. ASSESSMENT OF BUSINESS RISK

**4.2.1.** D'leteren ensures that business risks, whether strategic, operational, reputational, financial, legal or environmental, are both understood and visible as far as practicable. D'leteren's policy is to ensure that risk is taken on an informed rather than an unintentional basis.

**4.2.2.** Each entity conducts an annual risk review and updates its risk register with each risk's impact and mitigation measures. This approach forms the cornerstone of D'leteren's risk management activities, the aim of which is to ensure that the major risks the Company faces have been identified and assessed, and that there are controls either in place or planned to manage these risks.

The main risks the company faces are summarised hereafter.

## 4.3. INTERNAL AUDIT

**4.3.1.** Each entity has its own internal audit function, which is independent of its external auditors and which may work in partnership with an outsourced provider, where specialist skills are required. A periodic review ensures that these functions are appropriately staffed, that their scope of work is adequate in the light of the key identified risks the entity faces and that the annual internal audit plan is properly approved.

**4.3.2.** The Audit Committee of each entity ratifies the appointment and dismissal of its internal audit manager and assesses her/his independence and objectivity and helps ensure that she/he has unfettered access to management and to the Audit Committee.

**4.3.3.** The role of internal audit of each entity is to:

- assess the design and effectiveness of control systems governing key operational processes and risks;
- provide an assessment, independent of management, of the adequacy of the entity's internal operating and financial controls, systems and practices;
- provide advisory services to management in order to enhance the control environment and improve business performance;
- provide a mapping of any significant risks identified by the company's risk management process.

## 4.4. KEY RISKS

### 4.4.1. Business risks

#### 4.4.1.1. Industry risk

The automobile distribution business may be impacted by several factors relating to the car industry and the volume of cars sold on the Belgian market. Overall demand and mix may be affected by factors including general economic conditions, changes in the fiscal regime, the rising success of car sharing and the availability of credit to potential buyers. Specific demand for the distributed brands (VW, Audi, SEAT, Škoda, Porsche, Lamborghini, Bugatti, Bentley and Yamaha) depends on the success of the models developed by their automotive suppliers (the VW Group and Yamaha) and their adequate pricing on the Belgian market. Demand for less polluting vehicles drives changes in the composition of the overall vehicle fleet, with an increasing number of vehicles equipped with petrol engines or new engines (hybrid, plug-in hybrid, electric, natural gas, etc). The improved quality of cars in general and the rising share of electric vehicles drives down their maintenance frequency, which in turn has a negative impact on the sale of spare parts and revenues from after-sales activities. The rising share of electric vehicles will exacerbate this negative trend. Note that the rising penetration of electric vehicles will create new opportunities for D'leteren (e.g. offering of integrated systems, including solar panels and home batteries). Market volumes are set to decline in the bodywork sector as new technologies result in a lower accident rate. The price per bodywork job is however set to rise due to increasing technological complexity (e.g. advanced driver assistance system (ADAS) sensors and cameras). Volatility of used car prices and a shift in demand for specific engines (e.g. shift from diesel to petrol) may affect residual values of leasing cars.

In the vehicle glass repair and replacement business, several unfavourable factors tend to reduce the frequency of glass breakage. These include: mild weather conditions, a reduction in the number of miles driven, improved road conditions, a reduction of average speed on roads as a result of speed limit enforcements and new technologies such as adaptive cruise control. Changes in insurance policies regarding glass breakage, such as an increase of deductibles, may reduce demand or increase price pressure. There have been no changes in the competitive environment recently, with Saint Gobain continuing to build its franchise network in Europe and national competitors remaining aggressive on price. In some countries there is an external price-setting mechanism or benchmark (e.g. NAGS in US, Audatex in Germany) on which Belron is dependent.

Moleskine faces diverse and fragmented competition from other players in the stationary sector and there are numerous competing products that are similar to Moleskine's notebooks. Economic downturns could have a negative impact on demand for discretionary consumer goods. Increasing digital penetration could also negatively impact demand for Moleskine's analogue products. The wholesale channel of Moleskine deals with "bricks and mortar" retailers who are under pressure from online retailers and changing consumer behaviour. Moleskine tries to mitigate this risk by helping the "bricks and mortar" retailers to improve the in-store experience. The risk is also tempered by Moleskine's multi-channel (including e-commerce) approach. Moreover, new product categories are being developed including the digital products and smart writing sets (with Moleskine+) and travel accessory (with bags). Moleskine has also strengthened its local presence by going direct in 12 countries, including the US and Germany.

Developments are actively monitored by each entity and fed in to a planning process including strategic planning, long-term financial planning, budgets and monthly reporting. This process allows early anticipation of these trends or swift reactions to sudden events and provides management with a base for making decisions regarding the range of products and services offered, their pricing and the optimum size of the organisation.

Where business is by essence subject to rapid changes in demand, structures have been adapted to provide the maximum flexibility. D'Ieteren Auto's Market Area project is a good illustration of this, as are the restructuring measures in the UK, Netherlands and Italy for Belron.

#### *4.4.1.2. Strategy execution risk*

Project implementation entails the investments and financial and operational risks that can impact the results. Project management governance ensures the best transition possible and prevents any negative effect on the activities and results.

D'Ieteren Auto's three strategic projects (Market Area, Pole Position, Powered by You), which were launched in 2014, are reaching completion. This strategy, aimed at strengthening the Company's leadership and profitability, is based on three pillars. The first is the reorganization of the D'Ieteren Car Centers (the company's corporately-owned dealerships in the Brussels region), in order to improve their financial and commercial performance. The number of sites was reduced from 12 in 2003 to 5 at the end of 2017. The second pillar is the optimization of the independent dealer network by dividing the territory into 25 homogeneous market areas that are each fully-owned and run by a single investor, the Market Area Leader, in order to improve their competitive positioning and leverage synergies. The third, and last, pillar is the overhaul of D'Ieteren Auto's internal structure in order to align it with the Market Area structure and to improve customer-centricity. This includes, for example, the roll-out of a CRM (customer relationship management) system and digital marketing, which should enhance the customer experience. Mobility is set to change fundamentally in the long term, with a growing share of connected, shared and electric vehicles and the arrival of autonomous vehicles. This will not only entail risks, but also opportunities. D'Ieteren Auto aims to become the natural choice for mobility in Belgium, evolving from being the market leader in new car sales to the market leader in the number of kilometres travelled. To realize this ambition, D'Ieteren Auto will need to be able to offer new services such as online sales or an electric vehicles ecosystem. This will require investments and new partnerships. A recent example of these new initiatives is Lab Box, a fully-owned subsidiary of D'Ieteren Auto established in 2017 to develop innovative mobility services and which launched Poppy, a car sharing service, in January 2018 in Antwerp.

Belron increased its investment in marketing and technology by upgrading its IT systems and gradually integrating digital customer tools. In addition to the above, the business continues to implement its service extension strategy including vehicle bodywork and home assistance/repair services. Such a potential diversification entails acquisition, financial and operational risks and deviates from vehicle glass repair and replacement, Belron's historic activity.

In its effort to maintain the growth of its activities at a high level, Moleskine relies on the strength of its brand to launch different initiatives, like the Moleskine Café and the bags product range. The Retail channel continued to be loss-making in 2017. Initiatives (e.g. improved logistics and service levels, introduction of the new store concept-Retail 2.0) are being implemented to make this channel profitable.

#### *4.4.1.3. Brand reputation*

The success of D'Ieteren's entities is closely connected with the brand image, so it is potentially exposed to certain events that may prejudice it. Any event that could have adverse effects on the brand image, whether internal (for example inability to adequately communicate the underlying values of the brands and their distinctive features) or external (for example, the dissemination by third parties of untrue or misleading information) could have a material adverse effect on the business, results and financial health. These reputational risks are mitigated through community engagement, sound ethical, environmental, labour and safety standards and respect for laws and regulations.

#### *4.4.1.4. Trademark and intellectual property protection*

D'Ieteren's businesses aim to protect their trademarks and intellectual property. The value of the D'Ieteren businesses could be compromised however if the protection of the brand or of any other intellectual property rights associated with the products and services becomes impracticable or particularly difficult or onerous.

#### *4.4.1.5. Business seasonality*

D'Ieteren's activities may be subject to seasonal fluctuations. For example, Moleskine's sales through the B2B, e-Commerce and Retail channels peak in the fourth quarter of each financial year. Belron's sales benefit from frosty winters and D'Ieteren Auto's sales tend to be stronger during the first quarter of the year when the Brussels Car Show takes place.

As a result of these quarterly fluctuations, comparisons of revenues and results of operations between different quarters within a single financial year are not meaningful and such comparisons cannot be relied upon as an indication of future revenues or results of operations of a full year.

#### *4.4.1.6. Sourcing risk*

D'Ieteren Auto imports and distributes new cars and spare parts of the brands and models of the Volkswagen Group. The relationship with Volkswagen has been built over 70 years and is formalized in wholesale agreements with each of the brands with no specified end dates. Any adverse changes to the terms of the agreements, any deterioration in the relationship with the Volkswagen Group or any significant change in policy towards independent importers is likely to have an adverse effect on the financial condition and the results of the entity. The key defence against this risk resides in the company's ability to demonstrate to the Volkswagen Group its added value through state-of-the-art logistics, the professionalization of the Belgian dealer network and in-depth knowledge of the Belgian market. The company is strictly aligned to the commercial, marketing and services policies of the Volkswagen Group.

The vehicle glass repair and replacement business is critically dependent on the supply of vehicle glass, polyurethane and repair resin. To ensure that the loss of a key supplier in any of these areas does not significantly disrupt its operations, purchasing teams have developed a strategy to diversify sourcing and actively allocate volumes.

Moleskine's production is entirely subcontracted to producers in China, Vietnam and Europe. If Moleskine replaces one or more of its principal suppliers of raw materials, semi-finished or finished products, it may have to bear higher supply costs and charges or delays in delivery times and it may experience greater difficulty in maintaining its quality standards and possibly in meeting contractual obligations or retaining its relationships with distributors and/or customers. To manage this risk the company avoids extreme concentration in terms of number of factories/suppliers.

Failure by suppliers to comply with standards of ethical conduct could tarnish D'Ieteren's reputation.

#### *4.4.1.7. Input price risk*

Profitability can be impacted by rising input prices. It is not always possible to fully pass on price hikes to customers or to offset higher input prices through hedging and efficiency measures.

#### *4.4.1.8. Key account risk*

A significant part of D'Ieteren Auto and Belron's activity concerns large key accounts such as businesses, leasing companies or insurers. Any loss of one or several major key account(s) could have an adverse effect on financial health and the results.

The implementation of D'Ieteren Auto's Market Area Strategy, whereby the Belgian market will be subdivided into 25 Market Areas that will each be led by a Market Area Leader will result in a sharp reduction in the number of counterparts and a significant increase in their size. The concentration risk is however mitigated by the fact that the network consolidation has led to the professionalization of the dealerships. Moreover, D'Ieteren Auto is providing the dealers with support and tools (e.g. digitization).

As Moleskine's business model is transitioning from a predominantly wholesale business to a direct-to-consumer model, risks related to customer concentration are diminishing.

Each entity of the D'Ieteren Group undertakes actions to ensure that its relationship with key accounts remains strong while focusing on customer satisfaction. Every major account has a dedicated manager who develops a key account plan with clear objectives on how to develop the relationship further. Each entity ensures that its customer portfolio remains sufficiently balanced.

#### *4.4.1.9. Product/service failure risk and non-compliance with standards and regulations*

Vehicles or spare parts distributed by D'Ieteren Auto may be subject to a major defect. In this case, the technical response to such a failure is organised by the Volkswagen Group. Such situations may however have a negative impact on D'Ieteren Auto's reputation as importer and distributor. In order to reduce this risk, D'Ieteren Auto has a transparent, proactive communication policy towards its customers and dealers, and organises any necessary recalls to ensure that vehicles are compliant with regulations. D'Ieteren Auto's response to "Emissiongate" showed that its crisis management procedures are effective. It acted in a fully transparent, open and honest manner while dealing with both customers and the authorities. Increasingly stringent emission regulations could affect D'Ieteren Auto's activities. This risk will be mitigated however by the Volkswagen Group's ambitious plans to develop electric cars.

The technological complexity of vehicle windshields is on the rise as Advanced Driver Assistance Systems (ADAS) such as autonomous braking, lane departure warnings, cross traffic alerts, park assist and surround view are more widely adopted. This trend should intensify with the development of autonomous vehicles. ADAS uses radar, sensors and cameras that are mounted on the windshield and need to be re-calibrated when the windshield is replaced. A failure to do so could adversely impact the safety of the vehicle and as a result expose Belron (or insurers) to a legal, financial and/or reputational risk. In order to minimise this risk, Belron develops clear fitting and calibration standards, rolls them out throughout the organisation, and regularly monitors compliance through technical teams in every business unit. In addition, events such as the "Best of Belron", a worldwide competition to elect the Group's best fitter based on compliance with standards and quality of execution, reinforce the importance of the highest fitting standards. ADAS penetration is expected to rise to 40-60% of new vehicles in the next 5 years. Note that this offers opportunities for Belron given its technological leadership in the field of re-calibration.

Moleskine closely monitors the quality of the products that are manufactured by third parties. Its products are made of paper and/or other materials, the production of which may impact the environment. Moleskine is actively engaged in taking every action to comply with the highest environmental standards:

- All Moleskine notebooks are made with acid-free paper, making them environmentally friendly products;
- Moleskine creates and sells FSC-certified products;
- Moleskine designs its packaging to keep waste to a minimum.

In terms of respect for universal human rights, Moleskine, Belron and D'Ieteren Auto have a deep-seated commitment to meeting the highest standards of legal and ethical conduct in their commercial dealings and employee management.

#### 4.4.1.10. Talent recruiting and retention

Recruiting and talent management are crucial as new competences are needed to ensure the Company is well positioned for the future.

Business continuity may be impaired by the loss of personnel responsible for key business processes. Personnel retention is managed through the offer of a competitive compensation package that is regularly benchmarked against market practices, good career prospects, regular feedback and employee satisfaction surveys. Succession planning related to key personnel is regularly reviewed by the top management of each entity.

D'Ieteren Auto recently launched the CaReer Model, which increases transparency in terms of expectations, skills and results, while offering career opportunities across the business.

The management incentive programs of the activities and D'Ieteren's Corporate team are aligned with shareholder value creation.

### 4.4.2. IT and financial risks

#### 4.4.2.1. Catastrophic loss risk

D'Ieteren's entities are heavily dependent on key resources such as IT systems, call centres and distribution centres. A major disaster may result in the inability of the entity to provide essential products or services either locally or globally. Absent mitigating actions, operating costs resulting from the occurrence of a disaster could be significant.

Management regularly reviews the underlying potential causes of loss and implements protective measures. In addition, Business Continuity Plans are designed to ensure continuity of the entities should a disaster occur. More specifically for IT systems, duplication of key data and systems and penetration testing for web applications mitigate the impact of a potential major system failure. Residual risk may be covered by appropriate insurance policies.

#### 4.4.2.2. Risks related to IT projects

There are risks related to new IT and digitization initiatives. For example, Belron is introducing a new ERP system in several countries, Moleskine has implemented a new SAP system and a new e-commerce website and both Moleskine and D'Ieteren Auto are developing new CRM and BI tools. Risks associated with these projects are mitigated thanks to clear governance and support from professional service providers.

#### 4.4.2.3. Information protection and cyber security

Information protection and cyber risk includes theft of data, manipulation or destruction of information, and reputational damage. D'Ieteren's activities have been taking appropriate steps to protect data and be compliant with the new European General Data Protection Regulation (GDPR), which will be effective as of 25 May 2018.

#### 4.4.2.4. Liquidity risk

The activities of D'Ieteren Group are financed independently (ring-fenced). Moreover, structural financial leverage is avoided at the level of D'Ieteren S.A.

Each entity of D'Ieteren Group:

- pursues its own financing strategy under the supervision of D'Ieteren's Corporate team;
- ensures that it has a core level of committed long-term funding in place with maturities spread over several years and diversified sources;
- maintains a regular dialogue with debt providers and keeps them updated on the general situation of the company.

D'Ieteren S.A.'s net cash position increased from EUR 71.7 million at the end of 2016 to EUR 549.5 million at the end of 2017. This level increased further following the sale of a 40% stake in Belron to CD&R on 7 February 2018. The Treasury Committee (composed of D'Ieteren Group's CFO, D'Ieteren Auto's CFO and the Head of Treasury) ensures that the guidelines of the Investment Policy are abided by. The goal is to protect the capital, assure liquidity and optimize returns. Risks are mitigated through counterparty and investment diversification (e.g. term deposits, commercial paper, money market funds) and by choosing counterparties with a high credit rating.

D'Ieteren Auto has a stake of 50% minus one share in Volkswagen D'Ieteren Finance s.a. (VDFin), a joint-venture with Volkswagen Financial Services, a subsidiary of the Volkswagen Group. VDFin is financed by Volkswagen Financial Services.

Belron issued 7-year Term Loans B for an amount of EUR 1.3 billion (of which USD 1.0 billion) in October 2017. It aligns the financial structure of Belron with the profile of its activities and future financial needs while extending the duration of Belron's debt profile. It also provides more flexibility compared to the US Private Placement which was reimbursed. For example, Belron has the possibility to start reimbursing early without penalty.

The acquisition of Moleskine was financed through available cash and draw-downs on existing credit facilities at the level of D'Ieteren S.A. and through a new credit facility at the level of DM Invest S.r.l., which merged with Moleskine S.p.A. in 2017.

#### 4.4.2.5. Interest rate and currency risk

Borrowings issued at variable rates expose the Company to cash flow interest rate risk whereas borrowings issued at fixed rates expose the company to fair value interest rate risk. To manage these risks, D'Ieteren is financed through a combination of fixed and floating rate facilities, possibly combined with derivatives-based hedges (see note 17 of the Consolidated Financial Statements 2017 concerning the financial instruments that were used). The renegotiation of credit spreads and conditions when credit facilities come up for renewal might result in less favourable terms. Belron has hedges in place to fix the interest rates of its Terms Loans B at just below 4% for a period of 5 years.

Belron's international operations are exposed to foreign exchange rate risks. The majority of the sales are denominated in US dollars, euros and pounds. In each country where Belron has a subsidiary, revenue generated and costs incurred are primarily denominated in the relevant local currency, thereby providing a natural currency hedge. Whenever possible, the policy is to hedge the value of foreign currency denominated investment with an equivalent amount of debt in the same currency to protect its value in euros.

Moleskine's exposure to exchange rate fluctuations arises from its trading activities, which may be conducted in currencies other than the euro. Revenues and costs denominated in a foreign currency may be influenced by fluctuations in the exchange rate, resulting in an impact on margins (economic risk), just as trade and financial payables and receivables and liquidities denominated in a foreign currency may be affected by foreign exchange fluctuations, impacting the statement of comprehensive income (transaction risk). Finally, exchange rate fluctuations are also reflected in consolidated net profit and equity, given that the financial statements of several subsidiaries are prepared in a currency other than the euro and then translated (translation risk).

#### 4.4.2.6. Impairment loss on investments

Due to the evolution of economic and trading environments, and the uncertainties affecting them, D'Ieteren faces the risk of a decrease in the value of its investments. This could lead to the recognition of non-cash write-downs on shares and impairment losses in the income statement. D'Ieteren mitigates this risk by regular business review meetings with the management of each business unit, periodic review of financial performance and key performance measures and regular active reviews of the long-term financial planning and budgeting process with local management.

### 4.4.3. Other risks

#### 4.4.3.1. Compliance risk

In geographies where D'Ieteren's businesses have significant market shares and/or are governed by vertical agreements that fall within the scope of Block Exemption regulations, the key legislative risk relates to Competition Law. Any breach of Competition Law can result in significant fines. There have also recently been significant changes to Data Protection legislation, with substantial fines introduced for violations.

In order to mitigate these risks, clear policies and legal monitoring have been put in place and widely communicated. Their application is audited on a regular basis.

#### 4.4.3.2. Integrity risk

D'Ieteren's reputation or assets may be affected if employees, customers, suppliers or agents commit unethical or fraudulent acts against D'Ieteren for personal gain, or if D'Ieteren is considered jointly responsible for such acts perpetrated by third parties.

The company has implemented a series of measures aimed at avoiding these risks to the maximum extent possible, including established policies and procedures, an ethics policy or code of conduct applicable to all staff, appropriate staff training, the delegation of authority with separation of duties, management information, internal audit and financial controls.