Finance Director's Report

REVENUE	EXPENSES	NPAT	HEPS	TOTAL DIVIDEND
R6,8 billion	R1,226 billion	R272,1 million	270 cents	45 cents
+12,7%	-13,5%	+604%	+463%	+200%
(2016: R6,0 billion)	(2016: R1,418 billion)	(2016: R38,6 million)	(2016: 48 cents)	(2016: 15 cents)

Financial performance

2017 marked a significant improvement in the financial performance of the Bell group compared with recent years. The group reported a profit after tax for the year of R272,1 million for 2017, compared with R38,6 million for 2016, and headline earnings per share of 270 cents (2016: 48 cents). The operating profit margin increased from 2,5% in 2016 to 6,4% in 2017.

The profit attributable to the new BBBEE partner in BESSA for the period since the transaction was concluded in May 2017 was R11,8 million.

Although sales in most mining dependent markets remained constrained, increased ADT sales volumes in North America and Australasia, higher production volumes through the factory facilities and a reduction in expenses, particularly relating to the group's operation in the DRC where significant losses were incurred in 2016, contributed to 2017 being a more profitable year for the group. The second half of 2017 reflected an improvement on the first half of the year as the effects of further right-sizing steps taken in the DRC and ramped up production volumes yielded positive results. The Rand was also weaker, on average, against the Euro in the second half of the year than in the first half of 2017 and this had a favourable impact on the second half result.

Although the Rest of Africa operating segment reported a substantially lower loss in 2017, especially in the second half of 2017, than in 2016, this segment is still not generating an acceptable financial return and further steps will be taken during 2018 to address this. The group's operation in the DRC is still experiencing low sales, partly due to subdued mining activity but also due to the group's tighter credit management in this market. The group's operation in Mozambique was taken over by an independent dealer during 2017.

Revenue

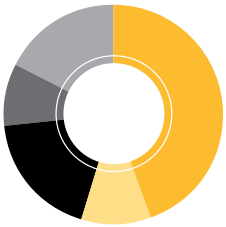
Total group revenue in Rand terms increased by 13% compared with 2016 from R6 billion in 2016 to R6,8 billion in 2017. ADT sales volumes were relatively flat in all markets in 2017 other than in North America and Australasia which showed good volume increases.

Revenue from sales in South Africa increased by a modest 9,6% compared with 2016 and contributed 44,5% of group sales in 2017, slightly down on 45,8% in 2016. Sales in Africa outside South Africa contracted by a further 23,1% in 2017 and contributed 9,1% of group sales in 2017.

Total group sales in Europe increased by 7,8%, with the contribution by the European market to total group sales decreasing from 22,7% in 2016 to 18,6% in 2017. Sales in the increasingly important North American market increased by a pleasing 73,5% and contributed 17,5% to group sales, compared with 11,4% in the prior year. Sales to dealers in Africa, South America and Australasia increased by 71,1%, due to increased sales to the group's independent dealer in Australasia, and these sales comprised 10,3% of group sales.

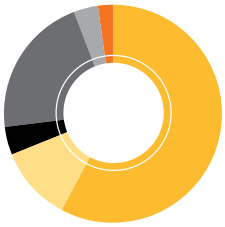
Revenue analysis

Geographic



- South Africa **44,5%**
- Europe **18,6%**
- North America **17,5%**
- African, South American and Australasian Dealers **10,3%**
- Rest of Africa **9,1%**

Product



- Manufactured machines **57,9%**
- Parts **20,9%**
- Alliance partner machines **11,1%**
- Used machines **4,3%**
- Service **3,6%**
- Rental **2,2%**

Gross margin

The gross margin is dependent on the product and geographic mix of sales, market conditions and exchange rates. The average gross margin reduced to 21,3% for 2017 compared with 23,3% for 2016. The Rand was stronger on average against the Euro and the US Dollar during 2017 than in 2016 and this was not favourable for Bell for sales in any of the group's markets. Weak economic conditions and strong competition also added pressure on margins.

Other operating income

Other operating income increased by 31% in 2017 due to higher sales of extended warranty products and due to increased production based incentives in the form of import duty rebates on higher production volumes in 2017.

Deferred revenue on extended warranty contracts sold reflected in the statement of financial position and which will be recognised in other operating income in future periods amounts to R141 million.

Expenses

Group overheads reduced by 13,5% in 2017. Excluding foreign currency losses, overheads decreased by 11,2% compared with 2016. The reduction resulted mainly from higher production volumes and greater capitalisation of operating costs to inventory, lower cost structures in the Rest of Africa region, especially in the DRC, and effective cost management across the group. Overheads also included the once off impact of the recovery of a customer account of approximately R19 million which had been written off in a prior period.

The group has continued its investment in research and development and development costs totalling R38 million were capitalised during 2017. These costs are amortised over the life of new machines once projects have been completed. The total cumulative carrying value of capitalised development costs at year end amounted to R201 million and total amortisation of development costs for the year amounted to R30 million.

Interest paid

Net interest paid was similar in 2017 compared to 2016 due to similar average borrowings levels, which remained at stable, low levels throughout 2017.

Taxation

The effective tax rate reduced to 32,6% in 2017 from the exceptionally high level of 66,6% in 2016, when significant losses were incurred in group operations, especially in the DRC, on which deferred tax assets were not raised. The rate of 32,6% is still too high and with further improvement in the results of the Rest of Africa region, this rate is expected to reduce further.

Financial position

The improved profitability in 2017 meant that the net asset value per share increased by 8,4% from 2 894 cents in 2016 to 3 136 cents in 2017.

Return on net assets

The group made progress towards its objective of delivering sustainable financial returns to shareholders through the business cycle during 2017, but did not fully meet its targets in this regard. Return on total assets increased from 3,4% to 8,5% year-on-year. The effect of the higher operating profit on the return on assets ratio was partially offset by an increase in total assets, mainly inventory, in 2017.

Working capital

Inventory days increased from 193 days at the end of 2016 to 209 days at the end of 2017. This followed a strategic decision to increase production and inventory levels to position the group to respond more swiftly to sales opportunities in key markets. The group commenced 2018 with more complete machines in inventory than usual and this should give the sales operations a head start for the new year.

The working capital cycle for the group is long due to long lead times into the factory in South Africa and a number of owned distribution operations. Optimisation of inventory levels remains a focus area for the group and systems are in place to monitor levels and respond on a timely basis when necessary.

Receivables days improved further in 2017 to 42 days from 46 days at the end of 2016. We are very pleased with the improvement in the ageing of receivables, as detailed in note 35.3 of the annual financial statements. This was largely the result of tighter credit management and a lower appetite for credit risk in the Rest of Africa segment.

Borrowings

The increase in inventory consumed cash and there was a net cash inflow for the year of only R7 million. Borrowings remain at acceptable levels at the date of this report and there is adequate headroom on banking facilities.

Exchange rates

Continuing the trend from 2016, the Rand strengthened further against major currencies during 2017. This increased pressure on both local and export sales margins.

The group's approach to managing foreign currency exposures remains the same as in past years. A substantial portion of the group's purchases and sales transactions are in foreign currency and as such the group has a strong natural currency hedge. Forward cover contracts are utilised to manage the residual trade exposure to the Rand.

The group is further exposed to currency fluctuations with respect to the translation of profits into Rand, as a substantial portion of the group's operating profit is derived from operations outside South Africa.

Looking ahead

The positive impact of higher production and sales volumes on the financial results of the group in 2017 was significant and we will seek to build on this growth in 2018. LTRS sales, which did not fully meet targets in 2017, is a key focus area in 2018. The stronger Rand at the start of 2018 presents a challenge and we will have to work even more diligently, especially on product and operating costs, to counter the impact of this on the bottom line.

It was reported last year that the losses in the African operations would continue into the first half of 2017 while costs were further reduced to align them with market conditions and low sales levels. Progress was made during 2017 and losses were substantially lower in the second half of 2017, but further attention to these operations is required during 2018 as this region is still not delivering sustainable financial results. This region will again be a key focus area in 2018.

The group is well placed to take on the challenges of 2018 and we look forward to the year ahead.