Finance director's report

SALIENT FEATURES

REVENUE	EXPENSES	NPAT	HEPS	TOTAL DIVIDEND
R7,5 billion	R1,226 billion	R276,4 million	278 cents	45 cents
+9,6%	+13,5%	+1,6%	+3%	unchanged
(2017: R6,9 billion)	(2017: R1,081billion)	(2017: R272,1 million)	(2017: 270 cents)	(2017: 45 cents)

In 2018 the group implemented *IFRS15, Revenue from Contracts with Customers,* and consequently certain prior year figures have been restated. Where applicable, prior year figures referred to in this report have been restated.

FINANCIAL PERFORMANCE

Revenue increased by 9,6% in 2018 to R7,5 billion. The group reported a stable profit after tax for the year of R276,4 million, compared with R272,1 million for 2017, but the result for 2018 was after a significant once off currency loss in Zimbabwe of R87,4 million. Without this currency loss, the result for 2018 would have been a significant improvement on 2017, especially in the second half when a weaker Rand increased margins on both export and local sales and higher production volumes at the Richards Bay facility led to greater overhead absorption. Headline earnings per share was 278 cents (2017: 270 cents). Total dividends of 45 cents per share were paid for the year, 20 cents per share at interim and a final dividend of 25 cents per share, the same as paid for the 2017 financial year.

Sales in the Rest of Africa segment increased by 8,6% and contributed 8,9% of group sales in 2018 compared with 9,0% in 2017. This segment's result was negatively impacted by a currency loss in Zimbabwe following the introduction of the RTGS dollar and the separation of bank accounts between RTGS dollar accounts and USD accounts. All monetary assets and liabilities were revalued at year end using the Old Mutual Implied Rate. The majority of the foreign currency loss relates to the devaluation of significant RTGS dollar bank balances trapped in that country. This followed low currency allocations throughout 2018 and the investment of some cash in listed shares in Zimbabwe to try and protect the group from the currency devaluation. The group continues to service customers who own Bell machines in Zimbabwe, but under current circumstances will only be in a position to deliver parts and machines to that country after receipt of payment in advance in South Africa for the goods. Elsewhere in the Rest of Africa segment, there was some recovery in sales in the group's operation in Zambia although management is concerned about the current economic and political conditions in Zambia. In 2018, the group's operation in the DRC was sold to an independent dealer. This followed the sale of the group's operation in Mozambique to an independent dealer in 2017.

Revenue from sales in South Africa increased by 10,2% compared with 2017 and contributed 43,4% of group sales in 2018, almost the same as 43,3% in 2017. 2018 was a very difficult year for the SA construction market with very few projects and low activity and this impacted on sales into this market and the profitability of this segment. Coal related demand however remains strong in South Africa.

Total group sales in Europe increased by 23,2%, with the contribution by the European market to total group sales increasing from 18,6% in 2017 to 20,9% in 2018. The contribution to operating profit from this segment reduced slightly in 2018 mainly due to below plan assembly volumes at the assembly plant in Germany, affected by supplier delivery constraints and a challenging SAP implementation in Germany. The SAP challenges have since been resolved.

Sales in the north American market decreased by 17,3% in 2018 following an increase of 80,0% in 2017 and contributed 13,2% to group sales, compared with 17,4% in 2017. Sales were affected by delivery constraints from the assembly plant in Germany, but it also needs to be understood that the group sells to an independent distributor in this region rather than directly to dealers, and as both the distributor and dealers carry inventory, the trend in the group's sales into this region over time needs to be measured rather than the sales in any one financial year. The opening of the new ALC in 2018 with the aim of enhancing the supply of parts and after sales support to customers in this segment will have a positive impact on LTRS growth in this market, especially in time as machines in the field age.

Sales to independent dealers in Africa, South America and Australasia comprised 13,6% of group sales compared with 11,7% in 2017.

Finance director's report continued

GROSS MARGIN

The gross margin is dependent on the product and geographic mix of sales, market conditions and exchange rates. Gross profit held up well in 2018 and increased by 10,2% in Rand terms in 2018 in line with the increase in sales, despite difficult market conditions in certain markets. The average gross margin for the year was 19,7% compared with 19,6% in the prior year. Although the Rand started off 2018 stronger against the Euro and the USD than it had been in 2017, the Rand weakened in the second half of the year and overall was weaker on average in 2018 than in 2017. This was favourable for Bell.

OTHER OPERATING INCOME

The introduction of IFRS15 in 2018 resulted in income from the sale of extended warranty products being reclassified as revenue whereas this had previously been included in other operating income. Prior year numbers were also restated.

Other operating income increased by 42,2% in 2018 due to an increase in production incentives in the form of import duty rebates. This increase was due to higher production volumes in 2018.

EXPENSES

Group overheads increased by 13,5% in 2018. Excluding the foreign currency loss in Zimbabwe, overheads increased by just 5% and we are pleased with the control of costs throughout the group.

The group has continued its investment in research and development and development costs totalling R37,5 million were capitalised during 2018. 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 R215,6 million and total amortisation of development costs for the year amounted to R23 million.

Net foreign currency losses increased to R127,4 million for the year, but this includes the R87,4 million currency loss in Zimbabwe referred to earlier in this report. The balance relates to the impact of the weaker Rand on import payments and the revaluation of foreign payables at the Richards Bay facility.

INTEREST PAID

Interest costs rose in 2018 due to higher average borrowings, mostly funding higher working capital, especially inventory. The group has also extended longer credit terms to certain customers to fund the purchase of machines from the group. Especially in the SA market, customers increasingly seek a financing solution together with the purchase of machines and there has been an increase in long term receivables relating to this financing. Higher interest costs meant that profit before tax for the year was up only 0,5% on 2017, despite profit from operating activities being up 12,5%. Interest cover reduced from 9,3 to 5,1 times.

TAXATION

The effective tax rate of 31,8% was very similar to the 2017 rate of 32,6%. The foreign currency loss in Zimbabwe was not tax deductible and this had a negative impact of 6% on the effective tax rate of the group.

FINANCIAL POSITION

The profit for the year and the impact of the weaker Rand on the foreign currency translation reserve resulted in the net asset value per share increasing by 12,4% from 3 136 cents in 2017 to 3 526 cents in 2018.

RETURN ON EQUITY

The group still has some way to go to deliver on its objective of providing meaningful financial returns to shareholders through the business cycle. Return on equity for the year was 8,7%.

PROPERTY, PLANT AND EQUIPMENT

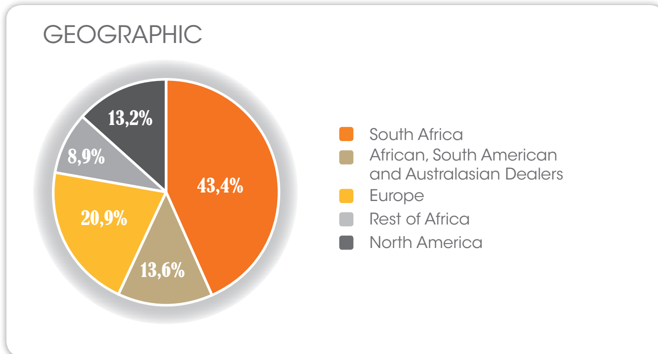
The completion of construction of the manufacturing plant on the recently purchased German assembly site, on which the group has assembled ADTs for the last decade or so, and the commencement of manufacturing in Germany is an exciting development which the group looks forward to in 2019. Approximately R200 million was invested in this capex in 2018 and a further R35 million has been committed to complete the construction in the first half of 2019.

WORKING CAPITAL

Inventory is up R858 million or 28% and days increased from 203 days at the end of 2017 to 236 days at the end of 2018. There were a number of drivers of the increased inventory. Firstly, the addition of the Kobelco and Kamaz products to the distribution range meant that the group has added machines and parts inventory of these brands to the group's inventory holding. In addition, the construction sector in South Africa was harder hit than expected and this meant that sales targets into this sector were not met and that the group ended 2018 with higher inventory levels in South Africa than planned. These levels will be worked down in 2019. The new parts logistics centre in the US, the ALC, started operations in 2018 and parts inventory is now being carried at that facility. Strategic stockholdings of certain key, long lead time components were also added at both the Richards Bay and German facilities in order to improve manufacturing and assembly response times and flexibility.

The working capital cycle for the group is high due to long lead times into the factory in South Africa from northern hemisphere suppliers and a number of owned distribution operations. However, with the transition of more sales operations from owned operations to independent dealers, the working capital investment and cycle will reduce. 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.

2018 REVENUE ANALYSIS



Trade receivables days are within targeted levels and bad debts remain low. Interest bearing receivables have increased with an increase in finance leases and instalment sale agreements with customers to assist them with funding the purchase of machines from the group. The group retains ownership of machines until they are fully paid for and the protection of the value of the financed machines is a key consideration in the extension and management of credit risk. The investment in the rental fleet was also increased from R78,7 million in 2017 to R106,9 million in 2018.

BORROWINGS

The group invested cash in inventory and to a lesser extent, receivables. Borrowings also increased as a result of the Euro mortgage loan secured to finance the property development in Germany. Borrowings are at the upper end of the targeted gearing range of between 30% and 40%. Borrowings remain at an acceptable level at the date of this report and there is adequate headroom on banking facilities.

EXCHANGE RATES

The Rand weakened in the second half of 2018 and this has extended into 2019. This is favourable for the group.

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 Bell group strives to create value for all its stakeholders and to manage its financial capital to support the group's growth and diversification objectives in a sustainable and profitable manner. We remain committed to moving closer towards delivering meaningful financial returns to shareholders.