Finance director's report

REVENUE	EXPENSES	NPAT	HEPS	TOTAL DIVIDEND
R7,8 billion	R1,418 billion	R61,0 million	80 cents	20 cents
+3,8%	+15,7%	-78,0%	-71,2%	-55,6%
(2018: R7,5 billion)	(2018: R1,226 billion)	(2018: R276,4 million)	(2018: 278 cents)	(2018: 45 cents)

At the time of writing this report in May 2020, the 2019 financial year seems like a very long time ago. So much has changed globally since 31 December 2019. The spread of the COVID-19 pandemic and measures taken to control the spread of the disease have had a significant impact on the global economy and changed the outlook for many companies, including the Bell group.

The JSE announced on 3 April 2020 that the outbreak of the COVID-19 pandemic and subsequent national lockdown in South Africa had caused significant challenges for issuers and that the Financial Sector Conduct Authority ('FSCA') would grant issuers with year-ends of 31 December 2019, 31 January 2020, 29 February 2020 and 31 March 2020 temporary relief of two additional months within which to complete their year-end financial reporting process should this be required by the issuers. The group has utilised this two-month extension in order to finalise its 2019 year-end financial results. Disclosures relating to the COVID-19 non-adjusting subsequent event has been included in the directors' report and note 17 of the summarised consolidated financial statements.

Financial Performance

Revenue of R7,8 billion for 2019 fell significantly short of expectations, ending the year with a very modest increase of 3,8% on 2018. Profit after tax for the year of R61,0 million was significantly down on R276,4 million reported for 2018. The once-off, non-cash and non-tax deductible IFRS 2 share-based payment charges of R82,3 million relating to the BBBEE empowerment deal concluded in the group's South African operations, BECSA and BESSA, in December 2019 had a significant impact on the 2019 financial results of the group. The further deterioration in the South African market which resulted in lower demand and tighter sales margins in this market than in 2018 was also a key driver of the reduction in profit in 2019, especially in the second half of the year. Interest costs were also higher in 2019 due to higher borrowings than in the prior year. Headline earnings per share was 80 cents (2018: 278 cents). In light of the difficult market conditions and in order to preserve cash, no final dividend will be paid for the 2019 year. An interim dividend of 20 cents per share was paid. In the prior year, total dividends of 45 cents per share were paid.

The group conducts two main business operations. The first is the OEM operations comprising manufacturing, assembly and sales of equipment and aftermarket products to independent and group owned distributors and dealers. These OEM operations are conducted from South Africa and Europe. The second business is the direct sales business which comprises owned distribution operations in South Africa and Rest of Africa that are engaged in direct sales of own OE products, other third-party products and the supply of aftermarket support and products to the market. The South Africa direct sales business comprises customer service centres in South Africa, Namibia and Swaziland. Rest of Africa comprises customer service centres in Zambia and Zimbabwe. In the current year the group's segment information has been restated to align with these two main business operations and the geographical areas they operate in.

As is evident from the segment results in note 9 of this report, the decline in group profitability in 2019 related mainly to the group's South African operations.

The profit from operating activities of the OEM business in South Africa deteriorated in 2019 compared with 2018 as a result of a reduction in production volumes of certain product lines and unrecovered overheads at the Richards Bay facility. Total sales, including both external and inter-segment sales, increased by 5,5% in 2019. External revenue contributed 18,4% of group sales in 2019 compared with 15,1% in 2018. Due to pressure on sales margins globally, the OEM had to provide pricing assistance to support sales deals in all its markets. Higher than expected warranty costs were incurred on the E-series large truck. In addition, the majority of the once-off IFRS 2 share-based payment charges relating to the BBBEE transaction was in respect of the empowerment of the Richards Bay factory operation and was carried by this segment. This operation will be right-sized given the low volumes and poor profitability.

External sales by the OEM business in Europe increased by 16,2% in 2019 with the contribution to total group sales increasing from 32,5% in 2018 to 36,4% in 2019. The contribution to operating profit from this segment improved by 13,1% compared with 2018.

External revenue from direct sales operations in South Africa decreased by 3,8% compared with 2018 and contributed 40,3% of group sales in 2019, compared with 43,5% in 2018. 2019 was a very difficult year for the South African construction and mining markets and as a consequence of this the group's South African sales operation earned lower sales in 2019 than in 2018 and incurred a loss for the financial year. In addition to low sales volumes, significant margin pressure was experienced. Interest costs were also higher than anticipated due to higher than planned inventory levels. The loss attributable to the BBBEE partner in BESSA for 2019 was R14,5 million. BESSA will be right-sized in 2020, not only in respect of operating expenses but also in respect of its inventory investment, to match the decline in the mining and construction sectors in South Africa, to reduce borrowings and interest costs, to halt losses in that operation and to ensure sustainability of the South African sales operation into the future.

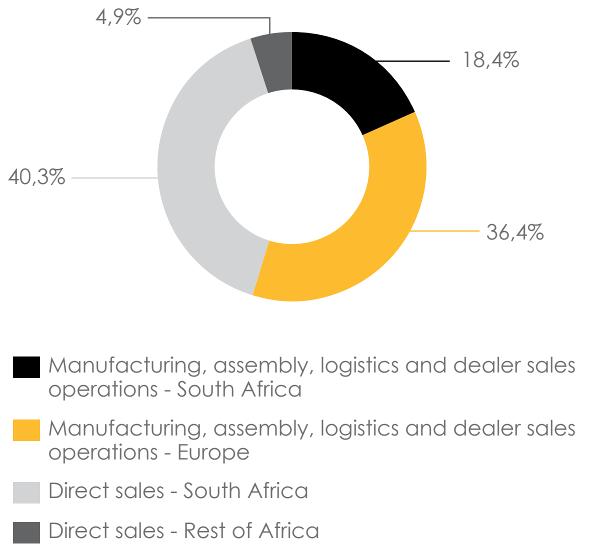
The external sales of the direct sales operations in Rest of Africa, being owned customer service centres in Zambia and Zimbabwe, decreased by 43,2% in 2019 and contributed 4,9% to group sales in 2019 compared with 8,9% in 2018. The main reason for the reduction in revenue in 2019 is that the group's operation in the DRC was sold to an independent dealer in the last quarter of 2018. Sales to this dealer are now reported under the OEM business in South Africa. This segment's operating result in 2018 was negatively impacted by a R87,4 million currency loss in Zimbabwe following the introduction of the RTGS dollar and the separation of bank accounts between RTGS dollar accounts and USD accounts in that country in the prior year. The group continues to support customers in Zimbabwe on the basis of payment in advance in South Africa for parts and machines supplied.

From 1 January 2019, the group implemented IFRS 16, Leases. The modified approach as permitted in the standard was applied and this resulted in no retrospective effect on retained earnings and prior year figures have not been restated. In lease arrangements where the group is the lessee, lease charges are no longer reflected in lease expenses in the statement of profit or loss. From 2019, the group recognises right-of-use assets and lease liabilities in the statement of financial position for these leases. The impact on the statement of profit and loss is an increase in depreciation and interest expenses and a reduction in operating lease expenses.

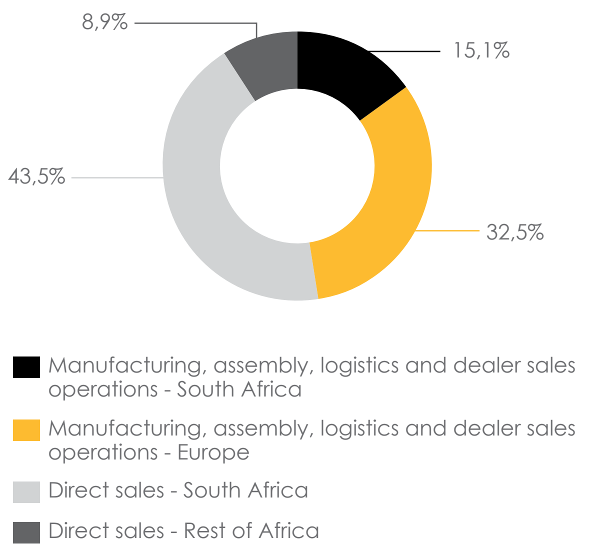
Gross Margin

The gross margin is dependent on the product and geographic mix of sales, market conditions and exchange rates. Margins were under pressure in 2019, especially in the tough South African market. The average gross margin for the year was 18,7% compared with 19,7% in the prior year.

2019 External Revenue Analysis - Geographic



2018 External Revenue Analysis - Geographic



Finance director's report *continued*

Other operating income

Other operating income relates mainly to production incentives in the form of import duty rebates earned on the South African government's Automotive Production Development Programme. This benefit decreased by 2,7% to R117,2 million in 2019 due to a marginal decrease in production volumes of qualifying products in 2019.

Expenses

Group overheads increased by 15,7% in 2019. Excluding the foreign currency loss in Zimbabwe from the 2018 base, group overheads increased by 24,5%. The main factors contributing to this increase in expenditure in 2019 were the following:

- The once-off, non-cash and non-tax deductible R82,3 million IFRS 2 share-based payment charges relating to the BBBEE deal concluded in December 2019. Substantial consulting fees were also incurred on the transaction, relating to transaction advisory, legal, taxation and accounting advice on the transaction which entailed restructuring of the group's South African operations. Most of this cost relates to the empowerment of the Richards Bay factory operation and is reflected in factory operating expenses in the consolidated statement of profit or loss.

- An under-recovery of overheads at both production facilities, in Richards Bay and in Germany. At Richards Bay, production volumes of certain machines reduced in 2019 and this impacted on recovered overheads. In Germany, manufacturing commenced for the first time in the Eisenach-Kindel facility and costs incurred on the once-off set up of the bin fabrication line that did not directly relate to the production of machines and which therefore could not be capitalised, also resulted in an increase in unrecovered overheads.

- An increase in warranty costs relating to challenges experienced with the E-series large truck.

- A general increase in overheads, including increases in expenses relating to IT, electricity including the cost of generators during periods of load-shedding in South Africa and an increase in amounts written off as credit impaired in BESSA.

Salaries, excluding the IFRS 2 charges which are accounted for in salary costs in the statement of profit or loss, increased by 7,6% on 2018.

The group has continued its investment in research and development and development costs totalling R54 million were capitalised during 2019. 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 R245 million and total amortisation of development costs for the year amounted to R25 million.

Interest paid

Interest costs rose by 131% in 2019 due to higher average borrowings. Borrowings increased due to higher levels of working capital, especially inventory, but also higher levels of receivables particularly in South Africa where the group is increasingly required to assist customers with funding for the purchase of equipment. New mortgage loans in respect of the Eisenach-Kindel expansion which was completed in 2019 also resulted in an increase in interest charges. Interest charges also includes an amount of R22 million in 2019 in respect of the changes relating to the adoption of IFRS 16, on capitalised leases.

Taxation

The effective group tax rate of 48,6% is exceptionally high due to the IFRS 2 share-based payment charges not being tax deductible. Without these charges, the effective group tax rate would have been 28,7%.

Financial position

The low profit for the year and the impact of the stronger Rand at year end compared with the 2018 year end on the foreign currency translation reserve resulted in the net asset value per share increasing by only 2,0% from 3 526 cents in 2018 to 3 595 cents in 2019.

Property, plant and equipment

The expansion of the manufacturing plant in Eisenach-Kindel was commissioned in 2019. Manufacturing of components commenced in that facility in the second half of 2019.

As a consequence of the difficult market conditions and in order to preserve cash, all capital expenditure is currently halted and only capital expenditure critical to the continuation of operations will be considered on a case by case basis.

Working capital

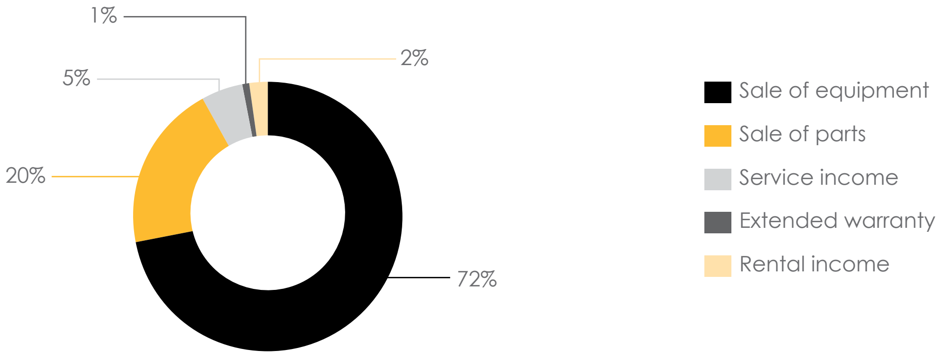
Due to lower than expected sales, inventory remained at higher than planned levels at 242 days at the end of 2019 compared with 236 days at the end of 2018. The area hardest hit with excess inventory was BESSA, where the construction and mining sectors in South Africa performed at an even lower level than the modest level forecast. This meant that sales targets were not met and that the group ended 2019 with far higher inventory levels in South Africa than planned.

The working capital cycle for the group is high due to long lead times into the factory in South Africa 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. Management of inventory levels remains a critical area for the group, especially during the current market conditions.

Trade receivables days ended 2019 at 42 days, the same as at the end of 2018. Total allowances for expected credit losses amounted to R59,1 million at year-end, of which R19,5 million related to customers in the South African market and the balance related mainly to prior year debts in the DRC and Zambia which the group continues to work on recovering. 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 security in the value of the underlying financed equipment is a key consideration in the extension and management of credit risk. Customers in the tough construction and mining industries in South Africa are operating in very difficult circumstances and many are experiencing cash flow challenges. This has impacted on the timely collection of receivables. Despite this, bad debts remain low and amounts due to the group may take longer to collect, but receivables are usually recovered in full.

2019 Revenue Analysis - By Product

(the contribution to total sales was unchanged from 2018)



Borrowings

The reduction in sales outlook which was identified in the last quarter of 2019 led to a significant cut in the production plan for 2020 and consequently inventory levels and liquidity were just starting to improve when the lockdown in South Africa was announced. The lockdown and the less severe restrictions imposed in other countries in which the group trades, had a significant impact on trading in the month of April 2020 and the extent of the impact on trading in the coming months is uncertain. We have seen a gradual re-start of sales in May 2020. An inability to trade impacts cash flows and borrowings levels. The group's cash forecasts to April 2021 allow for significant disruption for a further three months. This refers to disruption of such significance that all production and sales are prevented by further prolonged lockdowns or other severe restrictions such as the closure of major trading borders or ports for a three month period, resulting in severely diminished income during the period.

Exchange rates

The Rand fluctuated extensively in 2019 and ended the year stronger against both the Euro and the USD compared with both the end of 2018 and the average for 2019. On average, however, the Rand was weaker in 2019 than in 2018. The group earned net foreign currency gains of R12,6 million for the year.

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.

The Rand has depreciated sharply in 2020 and this is favourable for Bell, both as far as exports are concerned and in the South African market where Bell competes against fully imported products. This should assist the group with its objective of liquidating excess inventory in 2020.

IAS 36 Impairment of Assets assessment

The market capitalisation is substantially below the net asset value of the group and in terms of the accounting standard, IAS36 Impairment of Assets, an assessment was performed to test the assets for impairment based on the expected future cash flows of the group's cash generating units and discounted cash flow valuation principles.

No impairment losses were identified from this assessment.

Looking ahead

As South Africa and the group's other major markets gradually phase out the lockdowns imposed to control the spread of the pandemic, there is still widespread uncertainty associated with how long the impact is likely to last and the shape of the economy recovery curve. We are mindful of the present potential for and risks of over-optimism and are focusing on liquidity and working capital management and planning the group's operations at a leaner and modest level for the foreseeable future, until there is greater certainty regarding the timing of a meaningful recovery in global markets.