Finance director's report

The pandemic affected all aspects of the business in 2020. The initial hard lockdowns in the first half of the year led to the closure of the factory in South Africa for a month and in high levels of uncertainty and subdued sales in all markets. These sudden challenging conditions focused the business on cash preservation and working capital management.

Financial performance

Revenue of R6,7 billion for 2020 was 14% down on 2019, which was an improvement on half year end when sales to 30 June 2020 were down 24% on the comparative period. Sales for the first half of 2020 were severely impacted by hard lockdowns and other measures taken by authorities globally to control the spread of the pandemic. Weak market conditions, low activity levels in the sectors that the group operates in and uncertainty relating to the duration and severity of the pandemic meant that there was reduced demand for Bell's products across all key markets. Sales in the second half of 2020 were 17% up on the first half and signs of some recovery were evident. The Rand was approximately 17% and 15% weaker against the Euro and USD respectively in 2020 compared with 2019 and this helped offset some of the impact of the volume pressure on revenue. Sales volumes were down approximately 25% on 2019.

The group incurred a loss after tax of R57,2 million for the year, after reporting a loss after tax for the half year to 30 June 2020 of R52,3 million. Apart from the impact of weak economic conditions and low sales on the bottom line, the result for the year was further negatively affected by low production volumes, due to the group having started 2020 with record high inventory levels which meant that planned production levels were low while inventory was being sold off and right sized, as well as by certain once off costs. Low production levels resulted in low recovery of a largely fixed cost base, especially at the Richards Bay factory. This is evident in the operating losses reported for the group's manufacturing operations in South Africa and Germany in the segmental report. The once off costs incurred in 2020 related to provisions totalling R82 million for residual value losses on guarantees provided to a financial institution on equipment rentals financed in the USA, the impairment of R32 million on the group's owned facility in Kitwe, Zambia and the impairment of certain research and development projects totalling R23 million. These matters are detailed in notes 24 and 41 of the annual financial statements. Headline loss per share was 31 cents (2019: restated HEPS of 71 cents) for the year. In light of the continued difficult market conditions, no interim or final dividend was paid for the 2020 year. In the prior year, an interim dividend of 20 cents per share was paid.

The share price of the company is trading at a significant discount to net asset value per share and as this is an indicator of possible impairment in terms of IAS 36: Impairment of Assets, valuations and assessments were performed to determine the recoverable amount of the group's main cash generating unit and certain other key assets in the group. No impairments resulted from this review. Refer to note 41 in the annual financial statements for further details of this assessment.

The group also assessed the potential impact of the weak economic conditions brought about by the pandemic and changed economic circumstances in certain countries, specifically Zambia, on the judgements and estimates exercised in determining the carrying values of assets and made additional provisions where necessary. Additional provisions were made on certain categories of inventory. The owned customer service centre in Kitwe, Zambia and certain non core development projects were impaired. Note 41 of the annual financial statements provides further details of these assessments.

During the second half of 2020, our internal processes identified an error relating to the accounting for the group's standard warranty provision on manufactured equipment sales. A firm of accounting specialists was engaged to assist with determining the correct accounting treatment for this complex area. This was remediated by management prior to the finalisation of the year end results and led to the restatement of prior year audited results as detailed in note 5 of the annual financial statements. The change in accounting treatment has no impact on the expected cash flows relating to the group's warranty obligations.

Segmental performance

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 manufactured 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 and Swaziland. Rest of Africa comprises customer service centres in Zambia and Zimbabwe.

The OEM business in South Africa reported an operating loss in 2020 as a result of low production volumes due to over stocking and weak demand. Low production volumes meant

unrecovered overheads at the Richards Bay facility. Total sales, including both external and inter segment sales, reduced by 23,4% in 2020. External revenue contributed 16,0% of group sales in 2020 compared with 18,4% in 2019.

External sales by the OEM business in Europe decreased by 18,4% in 2020 with the contribution to total group sales decreasing from 36,4% in 2019 to 34,7% in 2020. This segment was hard hit by low assembly volumes at the Kindel factory and weak conditions and low demand from the USA, as well as the provision for residual value losses relating to guarantees provided to a financial institution for equipment rentals funded in the USA, resulting in an operating loss for the year.

External revenue from direct sales operations in South Africa decreased by 5,7% compared with 2019 and contributed 44,5% of group sales in 2020, compared with 40,3% in 2019. The South African sales operation performed remarkably well considering the difficult year experienced by the South African construction and mining sectors. Sales volumes recovered well in the second half of the year following extremely low activity in the first half of 2020 in this market during the period of complete lockdown in South Africa. The release of unutilised maintenance provisions at the expiry of a number of rental contracts in 2020 contributed to the better than expected result for the year.

The external sales of the direct sales operations in Rest of Africa, being owned customer service centres in Zambia and Zimbabwe, decreased by 16,0% in 2020 and contributed 4,8% to group sales in 2020 compared with 4,9% in 2019. This segment also reported an operating loss for the year because of the adverse effect of the impairment of the group's owned customer service centre facility in Kitwe, Zambia. An independent valuation was performed during 2020 and the carrying value of the property was written down to the market valuation and this resulted in a R32 million charge to profit or loss. The group continues to support customers in difficult conditions in Zimbabwe on the basis of payment in advance in South Africa for parts and machines supplied.

Gross margin

The gross margin is dependent on the product and geographic mix of sales, market conditions and exchange rates. Market conditions and demand during 2020 were weak, competition was strong and margins were under pressure. In addition, substantial foreign currency losses were incurred and accounted for in cost of sales on the revaluation and settlement of foreign currency suppliers due to the weakening of the Rand during 2020. Although selling prices are adjusted to counter the impact of currency changes on costs, a time lag applies. The refund liabilities relating to the residual value guarantees also contributed to a lower margin as the charge was to revenue in line with IFRS 15. The average gross margin for the year was 18,4% compared with 18,5% in the prior year.

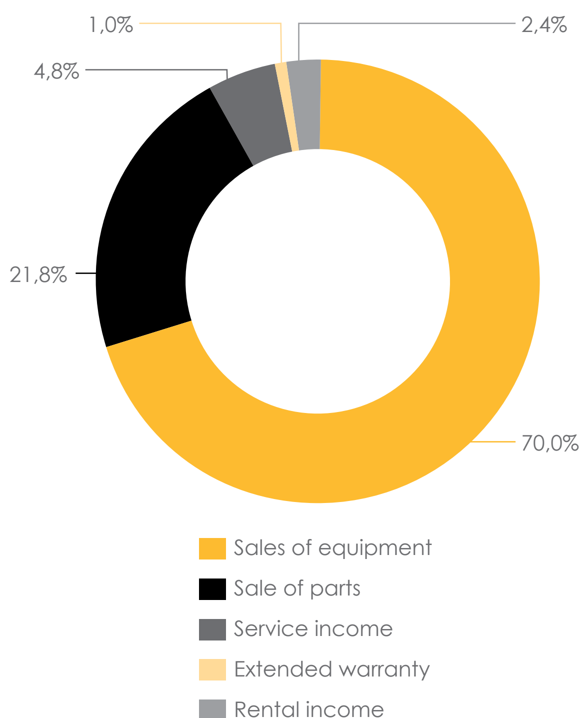
Other operating income

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 very significantly by 47% to R62,6 million in 2020 from R117,2 million in 2019, due to a decrease in production volumes of qualifying products in 2020.

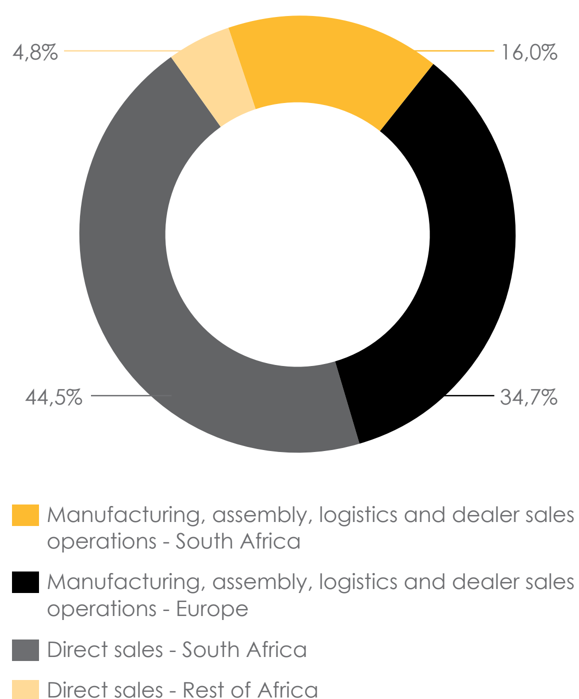
Expenses

In response to the pandemic, immediate action was taken to reduce costs through employee short time and the halting of all non essential expenditure. The group has a predominantly fixed cost base and therefore, although the curtailment of expenses reduced the negative impact of the pandemic on the bottom line, this was not sufficient to adequately address the full effect thereof.

2020 External Revenue Analysis - by product



2020 External Revenue Analysis - geographic



Finance director's report *continued*

Group overheads decreased by 7,6% in 2020. The main factors contributing to this decrease in expenditure in 2020 were the following:

- A reduction in variable costs relating to the lower production volumes in 2020, including contract labour and overtime costs.
- Cost reductions in many areas affected by the pandemic related restrictions, such as marketing and travel.
- Savings from the staff short time implemented from May to July 2020.
- In the prior year, IFRS 2 share based payment charges of R82,3 million relating to the BBBEE deal concluded in December 2019 were incurred. Substantial consulting fees were also incurred in 2019 on that transaction, relating to transaction advisory, legal, taxation and accounting advice.
- The above cost reductions were offset by the impact of a significantly increased under recovery of overheads at both production facilities, in Richards Bay and in Germany, in 2020 and by the once off costs incurred in 2020 as detailed above.

The group has continued its investment in research and development and development costs totalling R38,9 million were capitalised during 2020. 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 R233,6 million and total amortisation of development costs for the year amounted to R27,0 million.

Interest paid

Borrowings were very high at the start of 2020, as a result of high inventory levels, but reduced by half year end and have remained stable since then. Interest costs were R90,0 million for the first half of 2020 and R64,1 million for the second half of the year.

Taxation

The effective group tax rate (credit) of 15% is low due to the impact on a low pre tax result of small prior year charges and withholding taxes.

Financial position

Despite the loss for the year, the net asset value per share increased by 3,4% from 3542 cents in 2019 to 3664 cents in 2020. This was due to the impact of the weaker Rand at year end compared with the 2019 year end on the net assets and foreign currency translation reserve.

Property, plant and equipment

The group halted all non essential capital expenditure during 2020 and only capex critical to the continuation of operations was considered. Additions to capex of R45 million in 2020 comprised mainly factory plant and equipment of R42,6 million.

Right of use assets

The renewal of the group's rental of the Jet Park premises in Johannesburg for a 12 year period resulted in an increase of R164,3 million in right of use assets in 2020. Lease liabilities has consequently also increased.

Deferred tax assets

The group has substantial deferred tax assets of R221,2 million. The main reason for the increase in this asset in 2020 is an amount of R57,2 million relating to the estimated tax loss in BEGS of R204,3 million. This tax loss is mainly as a result of the abnormally low factory production volumes in 2020 and the once off costs carried by this entity. Management is satisfied that this deferred tax asset is recoverable, based on forecasts which indicate that BEGS is expected to utilise this tax loss from 2022.

Working capital

The factory in South Africa was forced to close for a month during the South African lockdown and disruptions to the supply chain were experienced. Consequently, the excess inventory holdings in the group at the start of the lockdowns proved to be beneficial during that period. Inventory ended 2020 at 240 days compared with 238 days at the end of 2019. The days inventory at year end is impacted by low sales in 2020. The inventory value in Rand terms is down 13% compared with the end of 2019 and taking the weakening of the Rand in 2020 into account, has reduced by substantially more than that in real terms. This is evident in the significant reduction in the level of borrowings in the group in 2020.

Trade receivables days ended 2020 at 48 days, up from 42 days at the end of 2019. Total allowances for expected credit losses amounted to R34,5 million at year end, of which R20,6 million related to customers in the South African market. Considering the circumstances in 2020, we are pleased with collections and credit management and bad debts remain low. Although certain customers experienced cash flow challenges during 2020 and this impacted on the timely collection of receivables in some cases, receivables are generally recovered in full.

Cash generated and borrowings

The reduction in inventory levels released cash and resulted in a reduction in group borrowings. Cash generated from operations amounted to R996,2 million in 2020. Subsequent to year end the IDC working capital facility was reduced from R750 million to R550 million. Cash flow forecasts indicate that the group has sufficient borrowing facilities to meet its plans and cash flow requirements.

Exchange rates

The Rand depreciated in 2020, resulting in the group reporting net currency losses of R46,7 million for the year, mainly at the Richards Bay factory on import payments and on the revaluation of foreign payables, which exceeded the gains earned on foreign currency receivables. Not evident in this reported net foreign currency loss is the favourable impact of a weaker Rand on revenue in Rand terms.

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 group was able to withstand extremely challenging circumstances in 2020 and despite the pandemic, borrowings and inventory levels have improved significantly compared with this time last year. We expect conditions to remain challenging in the short term. We will continue the focus on working capital, cash and cost management.