Finance director's report

'Strong revenue growth delivered the highest operating profit and headline earnings in the group's history'

An overview of 2023

The group delivered a strong financial performance on the back of record market demand and successfully managed working capital levels, despite challenges in the operating environment.

The group earned profit after tax of R793,6 million for the year, 66% up on R478,9 million earned for the 2022 financial year. Earnings per share and headline earnings per share were 799 cents and 798 cents respectively (2022: earnings per share of 478 cents and headline earnings per share of 473 cents per share) for the year.

The high demand from mining and construction industries in the group's major markets exceeded the group's ability to supply product and fully capitalise on the favourable market conditions. In the southern hemisphere markets, strong mining demand was driven by high commodity prices. In North America and Europe, infrastructure projects drove construction demand.

We are particularly pleased that we delivered on our strategy to grow machine sales volumes to our key target market, North America, the largest ADT market in the world. We look forward to building on this progress in the coming years.

With the growth came an increased demand for working capital funding. The allocation of capital to the sales volume strategy was a priority in 2023, as was the allocation of capital to projects that drive progress on re-positioning ADT manufacturing in the northern hemisphere and on growing BHI.

The positive market conditions came with significant challenges - strain on the global supply chain, port delays in SA and Europe which impacted both inbound and outbound shipments, labour shortages in Germany, higher levels of inflation and interest and currency volatility, not only in respect of a depreciating Rand but also from the perspective of the Euro to USD fluctuations experienced by the group's German operation. The supply chain and port constraints meant that we had to carry more inventory to buffer component and material shortages and logistics delays, which was in conflict with our efforts to reduce the group's substantial investment in inventory.

Strategic delivery	
ROIC growth	✓
Re-position ADT manufacturing in northern hemisphere and grow contract manufacturing in SA	•
Ongoing development of our existing and new World Class Products	✓
Machine sales volume growth	✓
LTRS growth	-
Dealer network growth	✓

Operating environment	
Global market conditions and demand	✓
ADT manufacturing location	✗
Supply chain constraints	✗
Port inefficiencies and delays	✗
Labour shortages in Eisenach	✗
Currency impacts	✗
Inflation	✗
Interest rates	✗
Electricity supply	✗

✓ Positive ✗ Negative
- No material impact • In progress

Our most material financial matters

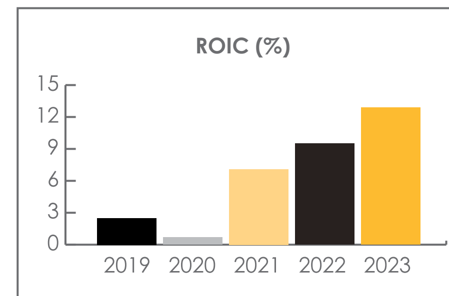
ROIC - Progress was made on improving the ROIC to 12,9%. Although this is not yet within the targeted ROIC range of 15% to 24%, this is heading in the right direction and we look forward to further improvement as we execute on the group's strategy to relocate more of the ADT manufacturing closer to suppliers and customers, and to grow BHI, which are aimed at reducing the working capital cycle and delivering a step change in ROIC and sustainability.

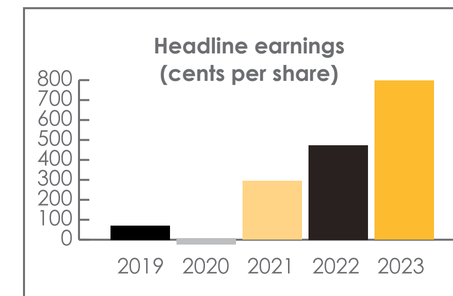
Sales growth - Global ADT sales volume growth is a strategic imperative for the business because the factories require throughput to support a large, fixed cost base and a substantial investment in ADT research and development. Growth in the aftermarket contribution to total sales is also a key objective. These drive a higher ROIC.

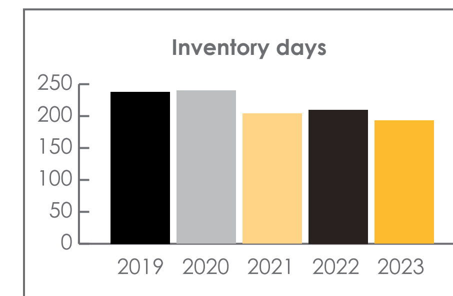
HEPS - To be sustainable, the business must be profitable. HEPS increased by 69% to 798 cents per share in 2023.

Inventory days - Reducing inventory days is challenging for us given the location of the main factory at Richards Bay, and aggravated by the inventory buffers that are having to be carried to try and offset the impact of port delays and other supply chain obstacles. Optimising inventory days is important because this is a key driver of the group's ROIC and liquidity.

Liquidity - The group targets a net debt to equity ratio of around 30%, and not more than 40%, and we ended the year with an acceptable gearing level of 29%. This is monitored on an ongoing basis and where necessary, the group will make adjustments to the sales and production plans to bring the business back to this targeted gearing range.



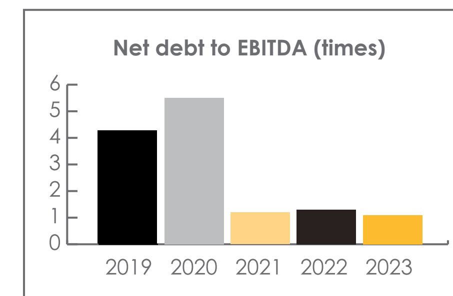




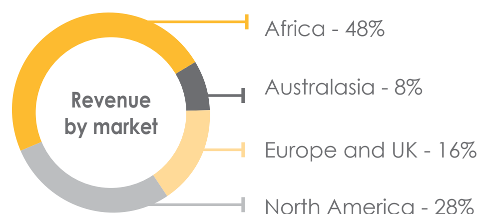
Annual Financial Statements key points

Operating profit and headline earnings increased by 69%, mainly driven by:

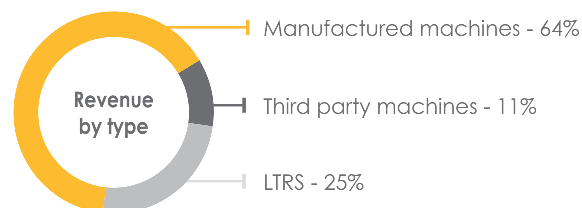
- Revenue that increased by 32% to R13,5 billion from R10,3 billion in 2022.
- Expenses that increased by 16%, contained despite the weaker Rand by the higher production volumes which meant higher recovery of labour and overheads for the year.
- Offset by net interest paid, which increased by 91% to R113,6 million from R59,5 million in 2022, due to higher borrowings levels funding higher working capital.

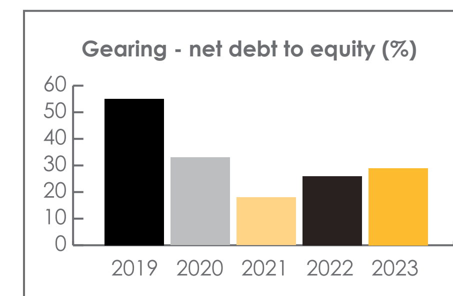


1. Revenue by market



2. Revenue by type





Segmental performance

OEM, manufacturing, assembly and dealer sales operations in SA

The most notable increase in profitability in 2023 was in the OEM and manufacturing operations in South Africa and this is mainly due to higher production and sales volumes of complete machines and kits at the Richards Bay facility, and higher recovery of labour costs and overheads, compared with the prior year. This OEM business in South Africa reported a significantly improved operating profit of R834,0 million in 2023, up from R369,2 million in 2022. Total external sales increased by 26,5% in 2023. External revenue contributed 19,1% of group sales in 2023 compared with 19,8% in 2022.

OEM, manufacturing, assembly and dealer sales operations in Europe

External sales by the OEM business in Europe increased by 51,5% with the contribution to total group sales increasing to 41,9% from 36,4% in 2022. Sales to North America are reflected in this segment. Operating profit increased to R158,3 million from R141,8 million in 2022. Most of the demand was driven by infrastructure projects in the construction industry. The Russian business remains on pause due to the war in Ukraine.

Direct sales - South Africa

External revenue from direct sales operations in South Africa increased by 11,7% compared with 2022 and the contribution to group sales reduced to 32,5% in 2023, compared with 38,2% in 2022. Sales in this operation were limited by the allocation of machines from the factory and we were not able to capitalise fully on the strong demand for ADT's from the mining sector. The segment reported operating profit of R220,4 million, up from R174,9 million in 2022.

Direct sales - Rest of Africa

The external sales of the Zambian customer service centre in the group's Rest of Africa operations experienced strong growth in 2023. Revenue for the segment increased by 54,1% on 2022. This however remains a small part of the business, contributing 6,6% to group sales in 2023. Trading conditions in Zimbabwe are challenging and the group is considering alternatives for servicing this market in future.

Gross Margin

The gross margin is dependent on the product and geographic mix of sales, market conditions and exchange rates. The depreciation of the Rand against major currencies in 2023 increased the cost of imports and put pressure on gross margins, but the strong market conditions generally supported favourable margins on sales deals. The average gross margin for the year was 20,0% compared with 19,8% 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 increased by 65,6% to R239,0 million in 2023 from R144,4 million in 2022, due to the increase in production volumes of qualifying products in 2023.

Expenses

The increased production volumes and higher recovery of labour and overhead costs offset some of the impact of the depreciation in the Rand and inflation, and expenses increased by 16% compared with 2022.

The group has continued its investment in research and development, and development costs totalling R42,3 million were capitalised during 2023. These costs are amortised over the life of new products once projects have been completed. The total cumulative carrying value of capitalised development costs at year end amounted to R238,6 million and the total amortisation of development costs for the year amounted to R28,8 million.

Balance Sheet

During 2023, total assets increased by 22% to R10,5 billion, mainly due to the increased investment in working capital that was required to support the sales growth and due to the impact of the weaker Rand.

Inventory

Inventory increased by 21% in 2023. All categories of inventory increased in Rand terms compared with the end of 2022. Revenue increased by 32% and that growth required an increased investment in inventory. Significant effort was given to managing inventory levels and those efforts paid off, with the group achieving 193 days inventory at year end, despite the supply chain and port challenges experienced. This is the lowest inventory days level reached in a number of years.

Of all the categories of inventory, finished manufactured machine inventory increased by the greatest percentage compared with the prior year. This was mainly due to port and shipping delays. These machines were invoiced and shipped to customers, primarily in North America and Australasia, in early 2024.

The increase in components and WIP at the factories reflects the high production levels going into 2024 and the component and material buffers in place to try and manage supply chain and port delays.

Inventory of R468,8 million in the group's operation in Germany was provided as security for that operation's borrowings base facility.

Receivables

Trade and other receivables increased by 56% and ended 2023 at 54 days compared with 45 days at the end of 2022. The main reason for the increase in receivables days was an extension of credit to the North American distributor. A large volume of ADT's were invoiced and shipped to North America later in 2023 than planned, in the Winter season in North America. We partnered with our North American distributor, provided extended payment terms for this concentrated batch of machines and have used the opportunity to get the machines on the ground in North America for the start of the sales season in 2024.

The general health of trade receivables is good. The group has experienced low bad debts in the past and even if certain customer accounts take time to collect, they are generally recovered in full.

Trade receivables of R605,1 million in the group's operation in Germany was provided as security for that operation's borrowings base facility.

Debt and Liquidity
Bank borrowings are up 87% on 2022, mainly due to the funding of the sales growth and the increase in working capital. Gearing increased to 29,0% from 26,3% at the end of 2022.

Interest cover and net debt to EBITDA improved due to higher earnings in 2023.

The group's funding lines were reviewed during 2023 and a new ABSA supply chain finance arrangement was implemented to replace a portion of the IDC revolving working capital facility. We aim to make further changes to the funding arrangements in 2024, to improve the tenure and pricing of the group's funding. All covenants in funding arrangements were met in 2023.

Cash flow statement
When the group ramps up for stronger market conditions this requires a cash investment in inventory. The increased investment in working capital, in both inventory and receivables, were the most substantial cash outflows during the year.

Interest payments increased due to the higher average borrowings during the year, relating to the funding of the increase in working capital.

Tax payments also increased substantially in 2023 due to the increased profitability in many of the operations.

Exchange rates
The group has a strong natural Rand hedge and foreign currency proceeds, mainly US Dollars, are utilised to settle import commitments in Euros, US Dollars, British Pounds and Japanese Yen. However, different payment terms, the timing of cash flows and the impact of accounting treatment, result in substantial foreign currency gains and losses in the reported numbers. The group's approach to managing foreign currency exposures remains the same as in past years. We aim to match currency inflows and outflows as far as possible, with the group's strong natural currency hedge, and forward cover contracts are used to assist in managing the residual currency exposures.

Realised and unrealised net foreign currency losses totalling R76,9 million were incurred on cash flows during the year, and on the revaluation of monetary balances at year end. The Rand weakened against major currencies in 2023, resulting in an increase in the cost to the Richards Bay factory of imported components and equipment. Machine sales to North America are in US Dollars, and the strengthening of the Euro to the US Dollar meant that the Eisenach factory also incurred foreign currency losses on these sales during the year.

The weaker Rand drove an increase in net assets and the foreign currency translation reserve on translation of the foreign operations increased by R249,3 million.

	31 December 2023	31 December 2022	Average 2023
USD/ZAR	**18,53**	16,95	**18,49**
Euro/ZAR	**20,47**	18,09	**20,03**

Share price
The share price increased by 51%, having started the year at R15,25 per share and closing at R23 per share. The net asset value increased by 21,1% to R55,27 per share. The company's share price is therefore still 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 these valuations. By focusing on delivering strong ROIC results and growing a more resilient business, the share price should increase and the gap to net asset value should reduce.

Dividends
We have taken a conservative approach and preserved cash rather than paying a dividend. This will allow us time to gain a clearer understanding of the changing market conditions, which is especially important because of the 6 to 7 month pipeline of incoming components and materials that we are managing for the manufacturing plant in SA. This will be reviewed again in September, at the time of release of the group's interim results.

CEO and CFO financial controls attestation
Bell Equipment strives to maintain a strong financial controls environment to support the integrity and reliability of the financial statements. We have implemented adequate and effective internal financial controls, and a comprehensive controls framework and self-assessment tool which we continue to develop and enhance. Ashley Bell and I were therefore able to make the attestation required by the JSE.

External auditors
In anticipation of the introduction of mandatory audit firm rotation, the group followed a comprehensive request for proposals process and PWC was selected as the incoming audit firm to replace Deloitte & Touche, subject to shareholder approval at the upcoming AGM in May 2024. Whilst the anticipated mandatory audit firm rotation rules have since been set aside, we are committed to the principles of audit firm independence and Deloitte & Touche will rotate off the external audit of the group on conclusion of their duties for the year ended 31 December 2023. I extend the group's thanks to Deloitte & Touche for their service to the Bell group over many years.

Acknowledgement and looking ahead
My sincere appreciation to the dedicated finance team across the group for their support and for their commitment to Bell during 2023. The people at Bell set this company apart.

Markets are not expected to remain at the same high levels as in 2023, and this will bring new challenges in 2024. Due to signs of markets cooling off, we have tempered the planned production volumes for 2024 since year end and we will continue to monitor market conditions and will make further adjustments to the plan if required.

We look forward to another exciting year in the history of this great company.

KJ van Haght CA(SA)
Group finance director
28 March 2024