Results transcript

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INTERIM RESULTS

Nwabisa Piki

Good morning. A warm welcome to Barloworld's interim results for the six months ended 31 March 2023. Today we will present starting with our group CEO, Mr Dominic Sewela, with the group highlights and overview. We'll then move to Ms Lila, our FD, for the financial overview. After that she'll be followed by the business unit heads, starting with Mr Emma Leeka from Equipment Southern Africa, Mr Quinton McGeer, Equipment Eurasia, followed by Chris for our Consumer Industries vertical, presenting Ingrain's results. There after we will have our CEO take you through our statutory update and outlook. And thereafter we will take questions from you online, over the telephone, on LinkedIn for those watching on LinkedIn, and we'll close off after that. I'll now hand you over to our CEO, Mr Dominic Sewela.

Dominic Sewela

Good morning, ladies and gentlemen. As Nwabisa said, you're welcome to Barloworld’s interim results. As per usual, it's always important that we start with ESG. We at Barloworld have been in the habit of ensuring that we can integrate ESG as part of our business. And some of our key focus areas in ESG is financial inclusion because we operate in emerging markets. And in these markets, there are societies that are impacted negatively. So, one of our main tasks is to ensure that our communities are included, and we have Mbewu and Siyakhula that is used as a vehicle to do so. It is known that we're leading in the areas of diversity and inclusion. And to that extent, we've also issued bonds that speaks to inclusion and gender as well as sustainability.

But of importance as well is that our board focuses on governance, and it is important that we continue to have a balanced board that has got a keen interest and attention to what shareholders require. Also importantly is that from a people point of view, we look at people and the planet that we live in, because in many ways it is our behaviour as human beings to impact the planet. Therefore, from Barloworld point of view, we ensure that our employees are aligned in ensuring that we can reduce our footprint onto the planet. And when you look at what we do as a business, we try and focus and say, whatever we focus on, it's going to be part of the business. When you look at the gender bond, when you look at the targets that we've set, it is already what we're doing, but trying to entrench that and saying, let's set targets that are in line with what we're doing.

Therefore, diversity and inclusion are what we do well. And there are many other instances where I can show you, but I think what's notable is that we've been recognised and given an award on that ESG gender linked bond. And prior to that, we had issued a sustainability linked bond. And key focus area in that was to reduce our footprint on the environment. And we're using it to roll out solar PVs to reduce our reliance on coal-fired power stations or drawing electricity. But more importantly, it's actually making sure that our employees are able to go home safely to their families as they come to work. So, that is the focus. And I think come the year end, we will be able to give you even more numbers in terms of our targets and how we are progressing there.

I think another highlight for us, notwithstanding the challenges we have in our various jurisdictions – it doesn't matter where we are, we've got even here in South Africa a lot of challenges – but notwithstanding that, our strategies that we embarked on five years ago, which was focused on saying we need to fix, optimise our business, and then get into growth has really been a strategy in action. It has delivered the results that you're seeing here. I mean, we've been able to exit businesses that were dragging us down in terms of returns, in terms of earnings. And now that we have simplified the portfolio and, in the meantime, also made acquisitions that are very accretive, whether you look at Mongolia and Ingrain, those are very accretive to our business at all levels.

You can see that we basically generated a revenue about 12.9% increase on our continuing operations, notwithstanding the challenges we have in a jurisdiction like Russia. If you were to exclude it, just for demonstration purposes, the revenue is still strong at 34.5%, very strong, right up to operating profit. I think you can see R2.1 billion compared to R1.8 billion of operating profit. Similarly, when you look at the HEPs, 29% HEPs growth for continuing operations is very strong in this environment that we operate in. Operating margins, I'm very pleased that we are now in the double digits operating margin at the group. And as you will see from the divisions, they will be able to demonstrate where it is all coming from.

I'm also pleased that from a capital allocation framework that the board uses, what was declared, a dividend of 200 cents, which is about 21.2% up on last year. And so, we are actually living up to and making sure that we remain very accretive to our stakeholders. And this for me is a major step towards that. And I think we continue to focus on cash conversion. I think when you look at EBITDA in the first half, it's significantly up to R2.7 billion compared to R2.4 billion, even having taken Avis off, which is very good. Let me hand you over to Ms Lila to take us through the numbers in detail. Thanks, Ms Lila.

Nopasika Lila
Thank you, Mr Sewela, and welcome all to Barloworld's 2023 interim results. My task is pleasant today as I present exceptional strong results for the group. And thank you to Team Barloworld. As Mr Sewela has mentioned, we have successfully exited our automotive pillar. Avis was unbundled on the 13th of December 2022, logistics disposed of on the 31st of March 2023. So, what remains within the group now is our two core businesses, being the pillar consumer industries, as well as service industrial equipment and services.

I'm delighted to present the financial highlights. Stellar performance coming through our revenue, EBITDA, operating profit and core trading activities, as well as headline earnings per share. Our gearing has remained within our targets. And as expected with a net asset value per share, the number would have decreased because we did unbundle Zeda during this period. I move on to the income statement, and there you can see the strong performance coming through in the revenue where we've delivered R20.8 billion in revenue, which is a significant 12.9% up compared to the prior financial period. Also on the operating profit side, reporting a R2.1 billion is 16.5% ahead of the previous year.

The finance costs have increased, and we all know and have experienced the increase in interest rates. So, we were also impacted by that, as well as increasing our investment in working capital. When we look at discontinued operations, as I've indicated, we've seen great delivery coming through from discontinued operations which gave us R243 million in terms of performance. On this slide we show the performance of Barloworld excluding the Russian operation. And what is outstanding for me to note is the remarkable resilience of the group, displaying the power of geographic diversification.

I move on to segment numbers and I start with equipment in Southern Africa, which performed exceptionally well with a 38.4% increase compared to the previous financial year. And this increase was as a result of the increase in machine sales, as well as the increase in the sale of parts. The mining also saw increase in activities, which the business did certainly benefit from. The opening of the Chinese borders has certainly contributed favourably to the performance of Mongolia, and it's clear with the increase in performance of 73.2%. And also, contributing to that good performance was the prime product sales in the business. Also, with Ingrain at 15.3% was an improvement compared to the previous year, and this one was as a result of the commodity price increase as well as the increase in volumes from export sales.

A lot of the unpacking of these numbers, the CEOs will talk to them as they deliver their presentations. Mongolia has delivered exceptional operating profit at 164.3%. And this improvement is also driven by the margin improvement. This year they delivered a 16.1% margin compared to the 10.6% in the previous year. Equipment Southern Africa has delivered a 31.5% operating profit. And this is really as a result of the change in product mix. And they had increased on the machine sales side. And the machine sales side would generally attract a lower margin than other categories. But the positive of this is we expect an improvement in the after sales in the future years. Ingrain is behind marginally there, and this is as a result of the increase in maintenance costs as well as the overhead costs.

Taxation as a percentage of operating profit before tax is impacted by the devaluation of the Rouble as well as the Zambian Kwacha against the US Dollar functional currency. In the prior period, you will note that we did report an impairment, and that was as a result of the impairment of our Russian business at that point in time. Great performance coming through from our joint ventures and associates, Bartrac delivering a very dignified 48.5% performance. On the NMI side, its profit was impacted by the increase in interest rates, which has also equally impacted their margins. But what is important to note when one looks at the numbers delivered by NMI is that the revenue top line has improved by 14.1% compared to the previous financial period.

We delivered sustainable earnings from core business reflected there through the increase in our HEPs at 578 from 447 cents per share in the previous financial period. Our income statement shows a reduction in total assets as well as equity, and this is expected considering the fact that we have unbundled Zeda during the period. You will also observe the reduction in cash, and this is as a result of the dividend that we did declare last year, and you may recall that, as well as increase in working capital. Also, on the trade and other receivables, there we also reflect the loan that we had given to Zeda. It was initially R1.5 billion when we unbundled in December, but they have paid off a substantial amount of the debt. And what remains now in our accounts is R825 million.

The free cash outflow of R3.3 billion demonstrates the increasing working capital, which I had spoken about earlier, but what is comforting with this number is that it is expected to unwind in the second half of the financial year. Our net debt has reduced. It's currently at R1.1 billion from R1.3 billion in the previous financial year. And this number includes the R825 million that I spoke about earlier to Zeda. And if one excludes that R825 million, being the amount owed by Zeda, the true debt of Barloworld at this point in time is R6.3 billion.

When one looks forward into the next few months, as I've indicated, we expect the unwinding of the working capital coming through in the second half. Therefore, one would expect a lower net debt at the end of the financial year end. The group remains well below its covenants, affirming the strong financial health of Barloworld as a group. Impressive performance of the group resulted in both ROE as well as ROIC being ahead of prior year and also ahead of our targets.

In conclusion, as our Chief, Mr Dominic Malentsha Sewela, had mentioned, the board has declared a dividend of 200 cents per share. And this is achieving a 2.9x cover, which is very much in line with our policy and also capital allocation framework. I must also indicate and mention that these 200 cents per share is 21.2% higher than what we declared in the previous year. It is quite an outstanding growth from year to year. You may recall we had declared 165 prior year. So, for me, this demonstrates the commitment that we have in delivering value for our shareholders, and we will continue to do our best in ensuring that we declare dividends. With that, I'd like to hand over to Mr Emmy Leeka.

Emmy Leeka

Thank you, Nopasika. Good morning, ladies and gentlemen. The division delivered strong results with revenue up 38.4%, headlined by a 60% growth in the prime product and a 28.4% growth in our part sales, also with 11.3% growth in our rental business. Operating profit was up 31.5%, but also pleasing, as indicated by Nopasika, is the positive results that we are getting from our joint venture in the Democratic Republic of Congo, and I will unpack that later. Overall returns at 19.7%.

Turning to the new equipment sales by segment, significant growth in new equipment sales across all customer segments, up at about 65%, mainly driven by our mining houses. If you look at the bottom left graph, the mining contribution in terms of new equipment sales were up 203%. If you combine both contract mining as well as mining, the overall contribution to the new equipment sales, we saw an improvement of about 67% and that contribution overall, despite the fact that we've seen a significant growth compared to prior year, remains at 70% overall contribution.

Now turning to commodity mix. Just to mention prior year, as we delivered machines to the greenfield project in Botswana, we've seen significant contribution then. But it's pleasing to see that that continued in terms of the mining sector, in terms of the machine replacement, mostly brownfields, contribution for iron ore, copper, as well as the PGMs and coal maintaining their contribution. Nopasika did highlight the impact of the sales mix. If you look at the first half, given the fact that we had a very strong aftermarket and as well as equipment sales, the product support or the aftermarket contribution compared to prior year moved from 56% to 51%. Given that growth as well, with the sales mix changes, as well as the dilution in terms of our parts margin, but continuous focus in terms of delivering on our digital transformation resulted in our margin moving from a 10.3% to that 9%.

Positive results indeed from the joint venture in the DRC where the share of profits moved from R52 million to R77 million, which is a 49% uplift, on the back of improved trading activity, as we've mentioned the turnaround plans that we're focusing on as well in terms of the cost-based restructuring and the diversification strategy. For the second half, we have a positive outlook with activity levels expected to be sustained.

We have achieved great strides in executing our divisional strategy with a laser focus in making sure that we focus on the growth agenda, services growth, double-digit growth, population growth in seeding machines, but also making sure that we improve our turnaround time, as well as, as you've seen, that we've increased our inventory so that we can improve our customer experience. On the digital transformation front, we have increased e-commerce penetration for our retail customers and also focusing on digitising our processes. We continue to embed the execution culture through BBS. That will help us to drive operational excellence.

In conclusion, we remain cautiously optimistic for the remainder of the year. A strong order book at R5.7 billion, but also with a growth trajectory expected on the aftermarket for the second half. We'll continue to focus on unwinding the prime product inventory to continue to optimise our profit margins as we generate positive cash. With that, I would like to thank you and hand over to Mr McGeer, who will share the equipment Eurasia.

Quinton McGeer

Thank you, Emmy, and good morning, ladies and gentlemen. I'm very pleased to announce the Eurasia division's results for the half year 2023 on the back of a strong trading result that has been supported by a good turnaround in Mongolia. Mongolia contributed 34% of the revenue of the Eurasia division, up from 14% prior year. Margin realisation was good in both countries, in both segments, both in aftermarket as well as in prime product. This supported the operating profit growth of 2.3% in Rand terms, and it was bit down, 10.5% in USD. The division continues to generate excellent ROIC, and from a division perspective, a ROIC of 30.4% was generated in Dollar terms. And if one were to reverse the impairment that was booked last year, the ROIC would still have been 22.6%, well above the group threshold of 14%.

If we analyse the new equipment sales, it's still dominated by mining, with 52% of prime products sold to this segment, significantly down from a 70% compared to the prior year. Aftermarket remains the backbone from the profitability perspective and 57% of the revenue we generated from this segment. When we look at the commodity exposure from the division, one can see the impact of the Chinese borders opening in Mongolia with 60% of sales to the coal segment. 92% of this coal that was exported was coking coal, the good coal that was exported to China.

From a Russian perspective, a very similar picture compared to prior year diversified mining mix, albeit in a lot smaller numbers from a real-term perspective. In terms of the outlook, I think the firm order book is self-explanatory in terms of what's happened in Russia. But what is very pleasing to see is the recovery of Mongolia, and we do expect this strong recovery to continue in the second half. Also pleasing is that the results that we've delivered in the first half already is ahead of expectations against the business case that was tabled to the board in 2020.

From a Russian perspective, the environment remains fluid, and we will continue to align our business on a constant basis based on the opportunities that is in front of us. I think our focus areas remains our employees first and foremost, the safety as well as the well-being of all our employees. Compliance is an important factor in our division and that gets a very high priority. And then we will continue to focus on what we can control, our cost containment, looking after our customers, cost preservation, working capital management and focusing on continuing the Mongolia recovery. And with that, I would like to say thank you and hand over to Chris Wierenga from Ingrain. Thank you.

Chris Wierenga

Thank you, Quinton. Good morning, ladies and gentlemen. It gives me great pleasure to announce the results for Ingrain for the six months. I think despite some of the operating challenges we've had, the business remains really well positioned and performing well ahead of our investment thesis into the business. If we unpack those results a little bit, our top line has grown nicely, 15% in the period. That has been supported by strong commodity prices last year and those contracts running through into this year. We expect that to continue for the remainder of this particular year and into next.

We've improved cash generation in the business during the six months and are very pleased with the 65% increase in cash flow six months on six months in the division. As I indicated, we did have some operating challenges and efficiency losses, and some lower volumes delivered out of our Germiston mill have impacted both EBITDA and operating profits slightly, but we're seeing some recovery in that post the half-year results.

If we quickly look through the revenue for the business, our domestic sales have been supported by stable volumes across most of the sectors. We've seen good growth in the export market where the weaker Rand has certainly supported demand for the product. And that's also in line with our overall strategy to utilise some of that excess capacity to take advantage of a favoured position that we're in in the business at the moment. On the agri side, our products remain in high demand, with more demand than what we've got capacity in the plant at the moment, which bodes well. But we have seen the lower grind rates coming through impacting the revenue potential in that particular segment.

If we turn our attention then to the sales, which are the biggest driver for this business, the domestic market was relatively flat six months on six months. We've done well in the confectionery sector where we've actively gone out to try and displace imports coming into this particular segment. And we have seen some strong growth in the alcoholic beverages sector in real terms. Coffee creamers continue to come off slightly and we're continuing to see that decline post-COVID come through and requiring us to divert that capacity into some of the other channels available to us. But I think overall, the business is well positioned with a diverse customer base and also a diverse offtake into various segments. If we look overall, we're very pleased about the export sales growth that I spoke about earlier, 7.9% growth in that segment in the six months is certainly very welcome across the business.

If we look at the operations, I think very, very pleasing is we've continued to unlock plant capacity through BBS. You can see Kliprivier, Meyerton and Bellville have all seen volume growth in the sector that has been supported by the capital replacement that we've put into the business and the ongoing commitment that we've got as a business to reinvest into these facilities. Germiston was plagued by some outages and some end-of-life plants which was replaced just after the half year and we're seeing that improve with Germiston back on stream now in the month of May and performing at its historic levels. So, we're quite pleased with the progress that we've made across the operations generally.

If we look at the focus for the division, I mean we need to do a lot more work on safety and we're implementing some safety initiatives and some technology to support our safety journey in the business. We're seeing BBS really deliver efficiencies in our operations and also driving the culture change that is much needed in the business.

And then overall, our product portfolio, we're looking at how we optimise that, looking at products that make sense for us to make, and the streamlining of our operations to meet demand and also yield the capacity that we've got for better margin realisation, and then using our supply chain efficiencies through our new central DC to better serve customers and also import certain products which we think would be more attractive for us to import than to manufacture in low volumes locally. So, a range of issues underway to try and strengthen the division and then also support our overall capital investment programme in the business.

If we look at the outlook for the business, I think things remain quite positive despite the challenging macros that we sit with in South Africa. I think the week around will continue to support our export drive and we see good volume growth coming through in that sector. In the domestic market, we should see a recovery now that we're back up to the right level of production across the business and our investment in capital projects will continue to accelerate over the remaining months in line with our standard capital allocation approach for the business.

On the growth side, I've spoken about the opportunities to leverage our DC and our supply chain capabilities to find new growth markets for us and see what we can do to expand our presence in the food and ingredient market. We think that that growth will certainly offset some of the higher commodity prices, or let's call it the higher utility cost that we're going to be seeing coming through in the business. And then with softening maize prices coming through, I think we'll be able to hold prices and that will bode well for domestic demand as well. So, I think all in all we're looking forward to a better six months than the first six months this year. Thank you very much. I'd like to hand back to Dominic, please.

Dominic Sewela
Thanks Chris. I think I'd like to start with a slide, because when you think about strategy, strategy is easy to articulate, you can articulate a great strategy, but if you don't execute on your strategy and ensure that you're able to measure that in quantifiable terms, you're not going to be able to get anywhere. And I think six years ago when I started with the process of being transparent in terms of where we are, the metrics that we have decided, I said I will continually be able to flag this for us to be able to reflect the journey that we have travelled thus far in terms of rolling out the strategy.

I think if you think about what is fixing, I said in the beginning we basically exited those businesses that we said we could not fix, starting with Iberia, and lastly with logistics that we have just sold out. But when you look at optimise, I think the deployment of the Barloworld Business System in the equipment division, it has definitely yielded the results that we intended. You can actually see albeit interim, albeit rolling 12, but to achieve a 19.7% after having had 18.1% return on invested capital, that's sustainable. And I think like Quentin just demonstrated, even if you took out impairment of this business – remember we impaired in 2020 this business – still it will achieve returns above our hurdle rate of 14%, which we have since adjusted from about 13% to 14%.

I think Quinton spoke largely to Eurasia. And you can actually see that our Russian business has delivered. We've been in Russia for 25 years. And under Quinton's leadership, there's been clear focus on making sure that the things that you can control, you are able to continue to focus on them. But what's pleasing is that when we bought Mongolia, we deployed BBS, we've used the leverage of contiguous territory, and if you look on Rand terms, because I think Quinton spoke about Dollar terms, Mongolia achieved about 16% return on invested capital. That's a credible result for a business that we bought, which is ahead of what we estimated at acquisition.

Similarly, when you look at Ingrain, which is one of those businesses that we bought in 2020, which we said it's going to be defensive and relatively asset light and cash generative. And as you saw with Chris's results, at 9.8%, it is better than last year this time. I think when you look at 11.3% of the previous year of 2020, it was because of once off tax benefits. But I think I am very comfortable that we are still ahead in terms of our estimates when we acquired this business. From a group point of view, you should be seeing the group number being closer to about the equipment business, but I guess when you look at some of non-productive debt that still sits on our books because we have basically capitalised Avis pre-unbundling, we have also funded the losses of logistics. But relatively speaking, as we allocate capital, you will see that return come through from an invested capital point of view.

So, if you then look at return on equity, a similar trend line. And this is where you see the benefit of allocating capital in a disciplined way. When the market gives you a gift of mispricing the valuation of the business, it is always best to deploy that capital in buying back your shares. And we've been consistently buying back the shares. You can actually see that benefit that comes through in terms of returns and as well as our HEPS. But a 19.3% return on equity is a very convincing, credible result. And similarly, if you look at it on a yearly basis, I gave you the numbers in 2022, this is a historic achievement for Barloworld. And that is also show that our strategy didn't focus on bigger, but really saying you can have a small business that gives you quality earnings and return.

And this is what the Barloworld business is, having pivoted out of those business. We are now having a very simple business that is easy to evaluate and see how accretive it is. And these number speak for themselves. And just to put that history in perspective, as you look at our review from 2017, when we exited Iberia, we took the capital, allocated it to acquire Mongolia. We also took some of the capital to de-risk the pension fund, because where we are currently sitting, it would have been a very volatile environment. But I'm pleased to say we've now since de-risked the capital fund. We've also acquired a business, like I said, being consumer industries. And basically, the pivoting out of the business has been punctuated by the unbundling and separate listing of Zeda and the disposal of our logistics business.

But what lies ahead obviously, we operate in very tough jurisdictions and notwithstanding, we operate within the context of inflationary pressures that are driving higher interest rates. And as we see the Fed and even our own Reserve Bank trying to wrestle the scourge of inflation, from a business point of view, we see that persist over a couple of years. In South Africa, I think we will see the MPC meet this week, and one is expecting that there will be a move upward given the events over the last two weeks in South where you saw the Rand depreciate very steeply against other currencies. And therefore, from a capital allocation, because we as leaders in business, we say we need to control what we can control. We can't really determine what politicians do or what reserve bank governors do.

So, from a capital allocation point of view, we'll be prioritising making sure that we keep our debt in check. We'll make sure that from an efficiency point of view, that our costs continue to give us flexibility to be able to move fast if we need to move fast should the things change quickly. But we also have a growth agenda. And the growth agenda is around organic growth, first and foremost. And as you can see in Equipment Southern Africa, that organic growth has been very strong. But it requires working capital to be able to finance that working growth.

So, as Ms Lila said, the second half you will see the unwind of that capital utilisation in the first half as per usual. But also, given the two platforms of business in industrial services as well as equipment distribution, where opportunities present themselves, we will look at programmatic action in allocating capital that way because we are mindful of the fact that we've got this discipline going of ensuring that we allocate capital where it is accretive. And we shy away from just doing things by pure instinct if it's going to detract us from our objective of delivering value to all our key stakeholders.

On that note, I'd like to pause here. But before I take questions, this is the right time to acknowledge the good work that Quinton has been doing over the last 31 years. And Quentin, I salute you. I mean, you're retiring 31 years later. Quinton started in our business in automotive, did about a decade in that automotive business, and then he saw the light, and he came into equipment. And so, his blood is infused in yellow. And Quinton, you could really be proud of your track record. Your track record speaks for itself.

And you were in a tough environment in Russia. And then I deployed you in Spain. You had to deal with the Spanish. At no point you complained. You just kept on it. And we acquired Mongolia in a very difficult time. Literally, we bought a business during COVID that it took me two years to go and see what I bought. But I was very pleasantly surprised when I got to Mongolia to look at the quality of the business. I really wish you well. And I hope you have more time to play golf. But don't be surprised when I call you and ask you a question on what you did in some of those territories. But thanks, Quinton, for that. We really, really appreciate it.

And I also would like to acknowledge Emmy. He was wearing similar shoes, but I don't know whether it was Timberland or a Cat. But I think it's Cat boots that you're wearing. And I don't know what size Quinton was wearing, but I wish you well, Emmy, as you take over Eurasia in this interesting time. But I think you've shown the mettle of running Southern Africa over the years, so I wish you all the best as you do so. But I'd also like to acknowledge and congratulate Andronicca Masemola, who was the FD of Equipment Southern Africa, who's earned the stripes to be able to now lead this division, Equipment Southern Africa. And Emmy has passed on a baton in a business that's solid. So, I don't want to forecast what type of returns you need to achieve, but I wish you the best of luck. And this, ladies and gentlemen, speaks to the strength of our intellectual capital review that we focus on in making sure that, from a succession point of view, it's seamless. And I'm pleased that we're able to also replace people internally. So, I'm going to pause here and start taking questions online.

Nwabisa Piki
Thank you, Dominic. I start with the questions on the webcast. We've got a question from Paul Steegers, and he wants us to talk to the average cost of debt in the first half and what we think it will be for 2023 financial year. Thank you.

Nopasika Lila
Thanks, Paul, for the question. So yes, our interest financing cost is sitting at about R583 million. But just to mention with the make-up of the finance cost and what has contributed, so over and above what you would have seen as an interest rate, we have the floor plans, interest on the floor plans which have increased as a result of our increase in working capital, as I had indicated earlier. And this is going to reduce in the second half. And just by way of a number, that number is R85 million being the floor plan contribution towards interest. We also have an amount of R25 million which is a pure exchange rate number, which relates also to the interest. So, if you had to compare ongoing and into the long term, I would say the number for interest would have been around R470 million. But in terms of percentage themselves, we had projected… or in fact, let me start by saying last year the interest rate was 5.86%, but with the increase in interest rates we are sitting at about 7.19% for the half year. And that would be a good number to use and to measure the Barloworld interest rates for the first half year.

Dominic Sewela
You are talking about basis points, 700 basis points?

Nopasika Lila
Well, 700 basis points or 7.19%.

Dominic Sewela
Okay, thank you.

Nwabisa Piki
Thank you very much. Can I stay with you, FD? Assuming an average gross debt position of around R10 billion for the period, the average interest expense was 14.5% for the six months. Please explain or could you guide us to second half finance costs?

Nopasika Lila
Yes. So, I think it's very much similar to what I said, but to clarify, the difference is the floor plan, which you don't see in the debt, but you will see in our accounts payable, because that's where then the actual debt on the floor plan will be.

Nwabisa Piki
Thank you.

Dominic Sewela
But I think it's also important to point out that largely because of the order book of equipment, for the first half, if you exclude Avis and all those, you look at the movement in cash flow, about R4 billion of that has been working capital in that. So, when you reverse that or you claw back on it, your gross debt is going to be significantly lower. So, I think that guidance is very important that we highlight.

Nwabisa Piki
Thanks Dominic. Can I just ask one more question from Etienne, which is, please could you elaborate on the impact to group profits from the current Rand weakness? Will we see operational leverage in Southern Africa Equipment and Ingrain as in higher margins in the second half?

Dominic Sewela
Yeah, I guess, Emmy.

Emmy Leeka
If I look at the South Africa in terms of the weakening of the Rand to the top line, that contributed about 10% in terms of the uplift.

Dominic Sewela
Okay. Andronicca, you wanted to add something?

Andronicca Masemola
Yes.

Dominic Sewela
There's a mic.

Andronicca Masemola
Thanks. Yeah, top line impact 10%, but we also have costs that are Dollar-denominated, so that will have an impact on our cost base. But to the question around the margin improvement, we have always been open about what our definition is of winning on margins, being minimum 10%. And in the second half, we continue to work towards achieving that.

Nwabisa Piki
Thanks. Please keep the mic, Andronicca, because I’ve got another question from Vilash Maharaj at Standard Bank. Congrats on the good performance overall. What is the long-term view of Congo Equipment and the tough operating environment it faces, and the impact its cash flow constraints have or will have on Bartrac?

Andronicca Masemola

Yeah, thanks for that question. We have a 50-year JV agreement with Tractafric, and at this moment we're not planning to exit Congo Equipment. Our focus is really on optimising performance and improving profitability. And the question around cash outflow in the DRC, similar to Southern Africa, they had to bulk up on the inventory to respond to longer lead times. And the second element that impacted the cash position there is that one of the very key customers stopped exporting commodities. And that had a ripple effect in that some of the equipment that was ordered for contract miners on that site, the conversion had to be delayed. The issue has been resolved. The stoppage was as a result of an issue that they needed to address with the government. That has been resolved and we expect the delivery of the equipment to start taking effect. Thanks.

Nwabisa Piki
Thank you very much. Can we move to the Eurasia division? And I'll read two questions for you Quinton. One is please elaborate on the Mongolian margin at 16%. Why so high, and how sustainable is this?

Quinton McGeer
Okay. Thanks, Nwabisa. I think maybe just starting at the margin, a good operating margin one will find for a Cat dealer is anything between 10% to 12%. That's an excellent result. From a Mongolian perspective, quite a few things impacted the operating margin in the first quarter. One is the fact that we had inventory, which we managed to dispose of during the first quarter. Secondly, the impact of the borders opening up meant that product came in and customers were looking to buy product. And we were able to capitalise on a higher margin realisation.

Another factor was the fact that Caterpillar announced quite a big price increase last year, which with the stock in country already, we also were able to capitalise on a higher operating gross margin from a parts perspective. So, that all supported quite a very good operating margin for the first half. In terms of going forward, I think definitely it's going to be repeated in the second half, without a doubt. And I think long term, medium to long term, we would be ecstatic if we can be in the region of 12% on operating margin level. Thank you.

Nwabisa Piki
Thank you. And then just from Tinashe, while you are on Mongolia, he was worried about the small or low order book in Mongolia specifically, stating that at $15 million, he sees it as low. Would you just like to give us some...?

Quinton McGeer
Yes. So, the Mongolian business environment is slightly different to our Russian business environment. The mining industry is a lot smaller. And with the long lead times to Mongolia, we tend to order the smaller mining equipment without having necessarily the signed contracts. And then we’ve got about nine months to sign the contracts with the customers. So, I think Mongolia will always operate with a smaller firm order book with the small mining equipment being sold as they arrive in Mongolia, as what we've seen in the first half.

Nwabisa Piki
Okay, thank you. And just staying with you a little bit, Quinton, Malusi is just wanting to know, the reduced order book in the Russian business as well. What is your outlook for the Russian order book? And are we likely to see break-even problems, as he states?

Quinton McGeer
I think from a firm order book, obviously with the mining industry no longer in play, there's going to be a significant… there is already a significant reduction, as one can see. We still do have access to the SEM product, but that product we also basically sell from inventory. So, I think going forward, the Russian business for the foreseeable future will not really operate on a firm order book. But aftermarket remains very robust, and we are still able to support our customers, which at this point in time taking the current conditions into account is contributing significantly to the profitability of the business. So, based on the current situation, the second half should mirror the first half.

Nwabisa Piki
Thank you very much. Mr Wierenga, can I move over to you? As it relates to the Ingrain business, what is driving the efficiency losses for the business? That's from Axolile Majola at Ashburton.

Chris Wierenga
Okay. So, I think as we've guided in the trading update at the end of March, we had some unplanned plant breakdowns at the Germiston mill. I think that impacted our ability to deliver product. Now, if you have a look at what we experience, as we typically go out and we cost to a standard costing, when the plants are not running efficiently, we do have production losses. And I think in the period that we spoke to now we had about a R50 million loss in efficiencies across the period. So, I think that impacted us in this particular period. I just want to stress again that we've addressed that through the capital that we've put into the business. We're returning that to a more normalised operating environment in that plant, and I think those issues are largely behind us at Germiston as we sit here today.

Nwabisa Piki
Thank you, Chris. And there's a lot of questions on load shedding, and I'll just maybe summarise them in general by saying the impact of load shedding on manufacturing operations. Have you secured any sufficient amount of diesel given the likely increasing strain on diesel supply chain through winter? And then what is the cost of diesel impact on EBITDA?

Chris Wierenga
So, thanks, Nwabisa. And I think to all on the line, we've said this consistently. Ingrain is part of the large energy user group at this point, so we are not subjected to load shedding on our reef mills. At our mill down in Bellville, we do get load curtailed from time to time. In our previous three days rolling average of demand and have about a 30% reduction in available capacity to us. So, currently we are not reliant on diesel to operate our plants. And I think I also just want to stress that we do not have any diesel costs baked into our operating costs of any significance.

It would also not be possible for us to run our plants on diesel gen sets for an extended period of time. And we would have some capacity to finish up certain runs, etc., but certainly nothing longer than a 12-hour run on the plants. I think the power demands are too large. So, I think as things stand, we're not necessarily directly impacted. Some of our customers are impacted and we are seeing variations in off-take coming through, but largely that demand remains intact.

I think one of the issues that we have highlighted as well is some of the water supply issues that have come up from time to time because of extended periods of load shedding, particularly in that East Rand manufacturing base where we've seen some of our customers have some short-term impact because of that. But I think overall our results are largely unaffected by load shedding.

Nwabisa Piki
Thank you very much, Chris. Very clear. Can I move on to Mr Leeka? There are a few questions on the growing prime sales in South Africa. Are those just replacement fleets or are market share gains being seen?

Emmy Leeka
We have slightly seen a level of market gain, because when you look at some of the mines, when they're doing pushbacks, they need additional equipment. But other areas it was just pure replacement cycle.

Nwabisa Piki
Thank you. And then an indication of how the lead times have changed with Caterpillar over the years, over the year?

Emmy Leeka
Yeah. Yeah, we've seen a significant improvement if I compare it to three years ago to where we are sitting now in terms of the lead times. And if you look at some product groups, they've actually improved significantly. But there are still others that are still battling and also overall logistic challenges depending on where you source your equipment. But overall, we can say we try to mitigate that as well by making sure that we have inventory on the ground.

Nwabisa Piki
Yeah, and on that, just to follow up on higher working capital use, particularly the inventory holding cost. Maybe it's an overall finance one as well. Please explain the expected seasonality.

Emmy Leeka
Yeah, look, we normally bulk up first half with anticipation to reduce our working capital in the second half as indicated before. So, we will see it actually coming down by the end of this financial year.

Nwabisa Piki
Thank you very much. And then for you, Dominic, there are some questions on M&A opportunities. Are you seeing increased M&A opportunities as a result of the tough economy locally?

Dominic Sewela
Yeah, I guess we get approached from time to time by people who are either experiencing financial stress that presents what they would regard as opportunities. But fortunately, we are very disciplined in our approach.

Because we've confined our strategy to the two verticals, we're not seeing a lot of things that interest us in the local market. And hence I emphasise that, in that vein, it will be focussing on organic growth in consumer industries as well as industrial equipment and services. So, my view is that as the interest rates continue to bite, you are likely to see private equity that would have taken advantage of low capital, letting go of assets that could interest us, and where the valuations could also be interesting for us to start looking in the horizon. But I can't be specific because we continue to see a deal flow. It goes through our guardrails. Our guardrails are quite rigid in terms of how we look at things. And I said it's really about cash generation, the profit pool, the size of the profit pools. So, we look at those things. And also, it's got to be within what we operate in. I wish I can buy more Caterpillar dealerships, if they could come my way. But those are closely held. And what adjacent businesses could there be to actually improve our services and our equipment business is going to be really the key issue.

For me, I want Chris to really focus on actually making sure that the thesis that we brought this business could be unlocked. But to an extent that we find something interesting in that area at an attractive value, for me it is key that I talk about value because when you look at the share price of Barloworld, it's very attractive at this level. It’s trading way below intrinsic. So, I should be focusing on saying between paying debt and buying back shares, for me it's a no-brainer.

Nwabisa Piki
Thank you very much. We've reached 12:00 noon and that is the last of our questions.

Dominic Sewela
Thank you.

Nwabisa Piki
Over to you for closing.

Dominic Sewela
Thanks, everybody.

END OF TRANSCRIPT