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Conference Call transcript

28 September 2021

TRADING UPDATE

Operator
Good day ladies and gentlemen and welcome to the Barloworld trading update conference call. All participants will be in listen-only mode. There will be an opportunity to ask questions later during the conference. If you should need assistance during the call, please signal an operator by pressing * then 0. Please note that this call is being recorded. For participants who would be interested in the playback details, you may get this by emailing bawir@barloworld.com. I would now like to hand the conference over to Dominic Sewela. Please go ahead.

Dominic Sewela
Thank you. Good afternoon ladies and gentlemen. Welcome to Barloworld's pre-close trading update for the 11 months to 31st August 2021. I hope most of you have had an opportunity to read. I'm just going to go through high level elements of the update. I think we believe that we've achieved resilient numbers if you think about the conditions under which we are trading in all our territories. We still are operating under COVID in all our regions. And it has been very difficult in areas like Mongolia where we've not been able to actually travel into Mongolia. And in Southern Africa I guess most of you would be aware that particularly towards the end of June and July it has been very difficult with respect to lockdowns as well as the unrest that we've seen.

So from a socio-political point of view it has been a very difficult trading environment. notwithstanding that we have had a lot of things in our favour in terms of the actions taken last year are yielding good results if you look at Equipment in Southern Africa in particular, whilst revenue in terms of machine sales is somewhat down largely due to supply constraints in the main. I guess on the back of the commodity prices that business has been very resilient. We have seen a double digit increase in parts revenue in Equipment Southern Africa which is pretty good.

And I think to that extent the cost containment that Emmy is driving is yielding good results as you can see from the operating profit. I think the DRC Emmy can delve in that a bit later. We are still in a loss-making situation, albeit improving with every month because we did take some special charges in this region. But what's also pleasing with Equipment Southern Africa number is that we've seen the order book actually increase over the last two to three years. We have seen it at around R2.4 billion. Now we've actually see it go to about R3.6 billion, which is very good. I think we've got new orders coming out of Botswana. And Emmy can comment about that later on. Eurasia I think has been a great story both VT itself as well as the newly acquired Mongolia. We've seen revenue increases in that particular region. But a very strong order book once again, I think $248 million order book, $177 million being VT and the balance being Mongolia. And I think if you look at those results whether you're talking operating margins or returns for these 11 months it has been very good.

I think when you move to Ingrain I think the biggest challenge there has been the alcohol over the month of July. But I must say we're still trading better than expected in this business if we look at what our forecast was. But the month of July was very difficult, but notwithstanding we continue to see a recovery. And I think we saw a better August, and we're hoping that we will be able to have even a better September in Ingrain.

And the automotive sector, being mainly car rental and Avis fleet, there once again in a very challenging environment of COVID one business that was badly impacted by COVID was car rental. But I think if you look at the fact that we've basically had six months of last year of trading under COVID because the first half was really pre-COVID in this business, so if you look at these results for these 11 months the business has done very well because it's still trading under COVID. So you will see that probably once you have a year on year comparable. But notwithstanding that we're seeing fleet utilisation up to 77% compared to last year.

And I think in terms of operating profit because we've taken such a huge impairment last year and the business has recovered in terms of being repositioned out of the airports. That business is holding well. The fleet notwithstanding the fact that we've lost some of the fleet where certain fleets have not be renewed, particularly in some municipalities, the business revenue has declined slightly in that business. But overall the operating profit of that business remains well ahead of last year. And this is really attributable to the cost savings and restructuring that we took last year. And I think SMD is performing well. It's a small business that we chose to retain after we sold motor retail. I'm happy with where SMD is currently.

On the logistics front I think we had a bit of a setback because I think we would have liked to sell this business as a whole. We've had offers where people wanted to buy the whole business and some wanted to buy parts of the business. And I think what happened in July is we had one buyer who was far advanced who pulled out. And basically now we are selling this business in parts. I think there are various potential buyers. And what it's going to do is basically shift the date that we have said we would like to have been out of this business probably by a month or two, but certainly hard at work in trying to sell the logistics business.

I think overall when you look at the trading businesses they have done very well in generating cash. And this has translated in what you see in the balance sheet where our net debt level on a comparative basis, whilst it is high compared to September of R2.6 billion you have to take into account that we've paid R5.3 billion for Ingrain. And with the exceptional cash generation you can actually see that we are up R1.1 billion net debt. And I think we will see where we end in September. The gearing in terms of the covenants we are well below the target set in terms of our covenants. And our view in terms of progress on the strategy is that we're focussing and prioritising really on the disposal side and really on capital allocation more than anything else. I will pause here and see if there are other questions that people could be having specifically that we can answer. I do have with me on the line the FD, Nopasika. I do have some of the operational CEOs on the line. Let me pause because I can't see if there are any questions.

Operator

Thank you. Ladies and gentlemen, if anyone would like to ask a question you are welcome to press * and then 1 on your touchtone phone or on the keypad on your screen. If you however wish to withdraw the question, you may press * and then 2. Once again, if anyone would like to ask a question, you are welcome to press * and then 1. Our first question is from Paul Steegers of Bank of America.

Paul Steegers
Hello everyone. I hope you can hear me, and thanks for the opportunity to ask questions. I had a question on your automotive car rental business. When you say profits improved by 290% can you elaborate on the base of that number because I believe that business was loss-making last year? And as you say, Dominic, there was also an impairment. So I'm just wondering what the actual swing in profitability is for that business in Rands millions from a loss to there roughly, that would be helpful. Thank you.

Dominic Sewela
Okay. Let me check if Ramasela is on the line. I can't see.

Ramasela Ganda
I am, Dominic.

Dominic Sewela
Okay. Go ahead.

Ramasela Ganda
Thank you very much. Good afternoon all. Yes, it is a swing of just under R200 million loss in the 11 months of 2020 financial year to a profit of just over R300 million. You know if you think about the first six months or the second six months we still had a lot of cost in the business, especially costs like employee cost that we couldn't take out until we complete our Section 189. This is the first year where we are really seeing the benefit of our cost restructuring from facilities all the rental expenditures that are out. But on the top line it also relates to since we resized the fleet and we really did an adjustment on the rate. Those really came out [unclear] for us.

And we still have a robust used car market mainly because of the semiconductor issues that are affecting new car sales. So you've got a number of factors that were either based on our plans and our restructuring that we've done last year as well as the change in the structures that we did. The rate per day has increased. We've seen the replacement market, which is the insurance market, currently we're trading at 86% of the 2019 level. And we've managed to gain new accounts during this COVID period on the replacement market. So there are a number of the top line impacts as well as costs that really helped convert the numbers. I'm talking about close to R500 million turnaround between last year 11 months and this year. Thank you Dominic.

Paul Steegers
Thank you. That's very helpful. May I have the opportunity for one more question, if I can be as bold? Maybe just in ingrain, you helpfully gave some margin guidance there. Can you maybe give a little bit more quantitative colour on revenue and volume momentum year to date for that business? Thank you.

Dominic Sewela
Garth, are you on the line?

Garth Macpherson
Yes I'm here. Thanks Dominic. Everyone can hear me. I think just in terms of revenue growth we've had quite extensive revenue growth during the current year in the order of probably 20% from a revenue perspective. And from a volume perspective we've seen around about 10% in terms of the volume growth up to the end of August from that perspective. And that's driven largely be recoveries in the alcoholic beverage sector and reasonably strong ongoing performance in coffee creamers and paper converting and a little bit of negative play in the paper making sector, confectionary and the canning sector to some extent. From an overall margin perspective obviously that flows through to the margins.

We've seen an improvement in overall margins. As we signalled in our guidance, not quite at the same levels as the first half, and a number of reasons for that. The second half is slightly lower from a volume perspective. We've obviously seen a bigger impact of lockdowns in the second half and also the civil unrest in July. And then from a winter tariffs point of view it's slightly higher during the second half of the year. So I think that's really where we're sitting at the moment. And probably the last point I'd guide at this stage as well is that it's really important as we present our results from an Ingrain perspective to focus on the EBITDA numbers when looking at the comparatives against the prior year because of the big impact of what the purchase price allocation will be against the comparatives.

Paul Steegers
Thank you.

Operator
Thank you. Our next question is from Marc Ter Mors of SBG Securities.

Marc Ter Mors
Good afternoon everyone, and thanks, Dominic and team, for the presentation. Just a question on Southern African equipment. It looks like the second half profitability has been really exceptional despite the fact that the top line was still quite constrained. Can you perhaps talk about the mix of business that impacted the margin? And some of the supply chain constraints and port hindrances. Are they clearing up going into the next financial year?

Dominic Sewela
Let me see if Emmy is on the line.

Emmy Leeka
Yes I am on the line.

Dominic Sewela
Okay. Go ahead.

Emmy Leeka

Just to give you a view in terms of the top line, as we've indicated about a 2% growth. The second half has been quite strong, particularly both from the machine sales but also, as we've indicated, in terms of the focus on the aftermarket particularly on the parts side, a double digit growth. And we've seen it actually coming through in the second half. And given the fact that we indicated a strong mix in terms of the aftermarket which actually helped us as well with regards to the operating profit margin. And the guidance still based on what we've achieved in terms of the mix for the interim period, we foresee a similar type of mix.

And talking of the logistics constraint, not necessarily from a South Africa point of view, we've indicated that overall we have seen some challenges in terms of the overall global supply chain. But we are starting to see the clearing at the ports and also good deliveries in terms of most of the machines as well as the parts that plan for the period going forward. We are not where we're supposed to be with all the bunching that we have seen at the ports, but tin terms of what we are seeing in terms of the estimated delivery times there has been some level of improvement. I hope I've answered your question. Thank you.

Marc Ter Mors
Thank you.

Operator
Our next question is from Cobus Cilliers of All Weather Capital.

Cobus Cilliers
Hi. Thank you for taking the question. I just want to find out, in the trading statement you specifically mention congestion at the ports and the difficulty in getting the goods cleared. I just want to find out [break in audio] currently and are you finding it difficult to get stock in for the equipment sales? Thanks.

Dominic Sewela
Emmy, you can still take them.

Emmy Leeka
As we've indicated with the riots that we've had earlier on, but also that had an impact. But as I've indicated now, we are starting to see significant improvement in terms of clearing at the port. I've also indicated that we have been dealing with a lot of demurrage and delays in terms of some of the machines. But most of them have been cleared. Most of the machines have been delivered. So I'm quite comfortable in terms of where we are in terms of the clearing at the ports.

Cobus Cilliers
Thank you.

Operator
Our next question is from Rowan Goeller of Chronux Research

Rowan Goeller

Thank you very much for your time, Dominic and team. I've got two questions. The first one is return on equity. Dominic, you have been working quite hard on this. I think now that the way you measure it and the good work that's been done on working capital in particular, return on equity should start to improve possibly by the end of this year, but as we flow into 2022 we should see a nice improvement. Could you comment on the progress on there please? I've got a second question but I'll ask it afterwards.

Dominic Sewela
Hi Rowan. I think there is progress. One of the major constraining issues on return on equity is basically that we do sit with a lot of cash in our operations currently and less debt. One of the key issues for us is to see how we can ensure that we continue to distribute the capital back to the shareholders. As I did indicate at the first half, that is going to be the focus. And as we basically sell some of the businesses like the automotive legs of it – we did mention that the core businesses are going to be very cash generative – I think then we will begin to see ROE improve. My sense obviously – you're going to have to hold me to this – is that by 2023 we should be way above the hurdles that we are setting ourselves of about 15%. But it will take several actions because we would have disposed of some of the operations. We have to address things like the pension fund in the UK, and there are various options that we are looking at there, and whether one does special dividends or buybacks. It will be something of that nature that we will have to look at to address in the element on the equity side.

Rowan Goeller
Okay. Thank you. And my next question is on the disposals process. It has been a little bit stop start. I would like to know if you have any specific criteria for potential purchasers of your businesses. Is it the highest bidder wins, or are you applying for example black empowerment credentials or requirements on companies looking to purchase some of your businesses? Which leads into if you can't sell logistics as a whole but you're selling it piecemeal that may be one explanation why you're struggling to sell your businesses in a large bit as opposed having to break it up and sell in pieces.

Dominic Sewela
You have to understand buying and selling businesses you go through the same process in a way where once you start the process you open up to potential buyers. People want to open up the hood. And some of them may not necessarily be genuine. So you've got to go through various gates in determining whether people are serious. They make you a non-binding offer. It goes to the next stage where they make a binding offer. Like I said, we had one offer, but what happened to them in terms of their business in July with the unrest they pulled out of the transaction. So these other buyers that are looking at piecemeal we are just progressing things with them. And we're not using BEE criteria at all. Here we're purely looking at somebody who would offer us something that makes sense to us commercially. And basically the person who is able to actually execute in terms of being able to raise capital, we don't think there are going to be statutory hurdles, that person is the person who is going to emerge as a winner in this process.

Rowan Goeller
Thank you.

Operator

Our next question is from Ross Krige of JP Morgan.

Ross Krige
Good afternoon. Thanks for the call guys. I just wanted to check if you have any comments on the contribution from NMI-DSM in the second half, whether that's profit or trading momentum. And then just on automotive can you just clarify? Did you say around R300 million operating profit in that segment for the 11 months? That's quite a big sequential improvement in H2.

Dominic Sewela
Ramasela, do you just want to clarify that point? I presume you're talking at an operating level in terms of your swing. Do you just want to clarify? Maybe just give people a base. Just remind people where we were probably not even 11 months in September so that they can work out that, Ramasela. Then I'll come back to the other question.

Ramasela Ganda
Thank you very much. So the operating profit line, so the trading line, that's what we're referring to when we spoke about the swing of 289%. That's really coming from activities that we had. As I've indicated, that was sitting at R166 million loss 11 months to August 2020. Then that has now swung by almost R500 million, to be exact about R481 million. That's where we are now currently sitting. And really the driver into that is not just one line. The biggest driver is our cost saving through the restructuring process. So that restructuring process both on facility and network people as you know to comply with the legislation we needed to do a longer consultation process to make sure that we comply. So you really took out most of the cost towards the end of this financial year and we started the new financial year on a proper base for the company from the fleet as well as network and people. And that really worked in our favour with regard to the cost containment. Even when we started seeing some pick up, we didn't increase the cost. Our network structure is still the same from a facility point of view, similar to employee level.

But then from a top line point of view there are a number of things that we did. during our interim we did indicate that we really went aggressive on our subscription product, which in the second half of this financial year, meaning the five months from April till now, we really stabilised from a pricing point of view, from benefit point of view. So our subscription product then had a good take-up. I think when we talked in the first six months people were still not understanding the subscription product. We saw a lot of stabilisation. We did a number of strategic partnerships in that product. Similar with the insurance. Our top line improved because of our partnership with the insurance product. And we're seeing more and more cars on the road that really see a pick up in the insurance industry, and by virtue of it then it means more accidents, it means more courtesy cars from a replacement standpoint. So we saw a real improvement in that.

But we can't discount the fact that used cars have been very robust as well. We remain very strong on margins, still double digit at over 20% compared to previous years where it was still strong but not as strong as this. The cut of production from the OEMs really contributes as well. It is hurting us on the number of vehicles that we're getting, but it still keeps the used car market to be robust. So that's where we still continue to see the biggest improvement in our business. As much as we had two lockdowns that really hurt us in this financial year, the

December which dragged till February as well as the June/July and the riot that Dominic spoke about. We didn't operate at least for a week in that period in KZN and part of Gauteng.

Those lockdowns did impact us, but I think where we've been sitting with just reduced costs we were able to really protect ourselves from a lot of challenges that may come with lockdowns. I think after the third lockdown we know how to then operate with this lockdown and the third wave that we continuously prepare ourselves and do forecasts of when the next wave is and how we're going to react to make sure that we do not suffer as we did with the first and the second. So it's a continuous improvement of selling when you need to sell. So it' all about acting right at the right time. You dispose when you need to dispose. You acquire when you need to acquire. And you put the price right. I think if you look at the industry as a whole the rate per day that is on the market now has not been seen ever. I can't even compare to 2016. It has just not been seen. And we believe that is a sustainable rate of the industry going forward. Thanks Dominic.

Dominic Sewela
Thanks Ramasela. I think in terms of the NMI, NMI has done very well for the 11 months. But just to break it out, we would have sold motor retail into NMI. So those numbers reflect three months including motor retail. And the other thing that I'd like to highlight is the fact that in buying the business NMI had to go and raise debt to finance this business. So the interest charges to NMI have risen. But notwithstanding that, the numbers were still very positive compared to March. So it's a good set of results. And I think if I look at the impact of the strike, out of all Barloworld businesses NMI-DSM, the joint venture, was heavily impacted particularly in Pietermaritzburg both on the truck side as well as motor dealerships where there have been some damages to the property. That is one business that has been impacted by that, but notwithstanding still the guys have been able to deliver a decent result.

Ross Krige
Thanks Dominic. Thanks Ramasela.

Operator
Thank you. Our next question is from Nhlakanipho Mncwabe of 361 Asset Management.

Nhlakanipho Mncwabe
Hello. I hope you can hear me. Thanks for the call. I just have a quick question on supply chain. Emmy has spoken much about it but if you could just give a general comment and also include the Eurasia business. Just given the shortages of containers and the backlog etc. how are you guys experiencing the access to parts and equipment in all your equipment businesses?

Dominic Sewela
I guess I'm going to get Quinton to comment on Mongolia. Emmy has already covered. One of the issues is having a CAT warehouse here has helped quite a bit because most of the supply into Africa goes into a CAT environment and then they supply to us. Where Emmy was talking about was mainly on whole goods, things like for instance [unclear] which is a product manufactured out of India and other products that are manufactured from other

areas. Whole goods we've seen an impact in southern Africa. But let's hear from Quinton to hear from his side whether he has been experiencing similar things from Mongolia and VT. Quinton.

Quinton McGeer

Thank you, Dom, and good afternoon everyone. I think from a Russian perspective we haven't experienced a negative impact largely due to the reason Dom has just mentioned from a parts perspective as the warehouse is within the Russian boundaries. So not a big impact from that perspective. From a product perspective we haven't experienced any problems in terms of importing, but what we have experienced is just a supply chain with lead times getting a little bit longer as demand has ramped up throughout the CAT dealer network. I think the situation is slightly different from a Mongolian perspective where it's a landlocked country and some of the containers got stuck on the Chinese border. And that has impacted deliveries in this financial year. And we will see it in the results as well. But with saying that, it is still exceeding our expectations, the Mongolian results. But they did face a lot of challenges from COVID and also the supply chain specifically on the Chinese border. I hope that answers the question.

Nhlakanipho Mncwabe

Yes. Thank you very much.

Operator

Our next question is from James Twyman of Prescient Securities.

James Twyman

Hi .Thank you very much. I've got two questions. The first one is on the logistics business. There seems to be invested capital of R1.9 billion there. What sort of proportion of that do you think is feasible to get back out of that business just in terms of how much of that is a real asset that can be liberated given that the business itself is loss-making? And then secondly on the other loss-maker, Bartrac, could you just talk about excluding all these one-offs are we back to breakeven on a monthly basis now or how close are we to that would you say? Also relating to that, are you seeing improving orders on that side of the business? Thank you.

Dominic Sewela

Okay. Thanks James. James, you would appreciate I'm in the middle of the sales process. I'm not going to comment on numbers of the logistics. Safe to say we are selling the entire business, but in piecemeal. I'm going to ask Emmy to just respond to Bartrac.

Emmy Leeka

Thanks Dom. With regards to the Bartrac, as we've indicated we had quite a number of once-offs. And particularly also looking at some of the provisions that we've included. But what is positive though is to look at what is happening on the ground particularly with regards to our turnaround strategy. We have seen Bartrac as of July/August being profitable. However, the losses have been so significant towards the end of this year, but we are looking forward to 2022 whereby Bartrac will start being profitable.

James Twyman

Great. Thanks very much.

Operator
Ladies and gentlemen, one final reminder, if anyone else would like to ask a question you are welcome to press * and then 1 on your touchtone phone or on the keypad on your screen. If anyone would like to ask a question you're welcome to press * and then 1. We have another question from Hayden Smith of Investec Bank. Hayden, we cannot hear you. Please make sure your line is not muted.

Hayden Smith
Sorry about that. My line was muted. I joined a little late, so apologies if the question has been asked. But I'd just like to get some input cost pressures that you are starting to see on the yellow metal side given what steel prices have done and so forth. And secondly, if you are seeing substantial pressures on that front do you feel that your various geographies are strong enough in terms of order books to fully pass that through? Thank you.

Dominic Sewela
Thanks. Quinton, you have pricing increases on a yearly basis with Caterpillar. Do you want to comment specifically on what Hayden was asking in terms of steel prices?

Quinton McGeer
Yes. Thanks Dom. I will answer it. Yes, we have definitely seen price increases. Caterpillar in fact has announced price increases now and they are also considering price increases in 2022. However, in saying that they have given us price protection in terms of our order book and there are various mechanisms which we will be using to make use of this price protection. So I don't see a big risk on the order book. So all other manufacturers are sitting in the same boat, which brings us back on a level footing. And then commodity prices, our product is going to miners, most of our product. So commodity prices remain strong and stable and the miners are capitalising on these prices as well. So yes, the price increases are coming through, but we do have some protection and we've also built in protection on our contracts. And then our customers are also benefitting from the higher commodity prices. So at this point in time we haven't experienced any undue pressures from a pricing perspective.

Dominic Sewela
Thanks Hayden. I hope you're answered.

Hayden Smith
Thanks gentlemen.

Operator
Thank you. Ladies and gentlemen, one final reminder, if anyone else would like to ask a question you are welcome to press * and then 1. It seems we have no further questions on the lines. I would like to hand back to Dominic for closing comments.

Dominic Sewela

Thank you very much. And thanks everybody for attending. I know that some of you we'll be seeing tomorrow on one-on-ones. But as you could see we are towards the tail end. We will try and ensure that we answer your questions pre-close. If you have any more questions, just send them to Nwabisa and we will try and have a quick turnaround. But thanks all for attending. Have a lovely afternoon. Cheers.

Operator

Thank you. Ladies and gentlemen, once again if you would like to get the information for the playback you are welcome to email bawir@barloworld.com for any information. That concludes this conference. Thank you for joining us. You may now disconnect your lines.

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